

# SPORTS AND ENTERTAINMENT LAW JOURNAL

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SANDRA DAY O'CONNOR COLLEGE OF LAW  
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The *Arizona State Sports and Entertainment Law Journal* is edited by law students of the Sandra Day O'Connor College of Law at Arizona State University. As one of the leading sports and entertainment law journals in the United States, the Journal infuses legal scholarship and practice with new ideas to address today's most complex sports and entertainment legal challenges. The Journal is dedicated to providing the academic community, the sports and entertainment industries, and the legal profession with scholarly analysis, research, and debate concerning the developing fields of sports and entertainment law. The Journal also seeks to strengthen the legal writing skills and expertise of its members. The Journal is supported by the Sandra Day O'Connor College of Law and the Sports Law and Business Program at Arizona State University.

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Stephen F. Ross, James Gorman III & Ryan Mentzer\*

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## INTRODUCTION

Americans love sports. Sporting events provide millions of Americans a brief reprieve from the difficulties of life. Sporting events also provide millions of Americans the opportunity to watch their heroes live out the dreams that nearly all Americans shared while growing up in backyards and parks with their family and friends. And for many Americans, wagering related to sports competition is an important part of the experience.

Gambling has long been viewed as a major problem in our society.<sup>1</sup> Betting is perceived as a form of corruption affecting the integrity of American sports. The ill-effects of sports gambling dates back, at least, to the infamous Black Sox scandal during the 1919 World Series between the Chicago White Sox and the Cincinnati Reds. Following the series, several White Sox players were accused of intentionally losing games in exchange for money.<sup>2</sup> And in the 1950s, college basketball was rocked by point-shaving scandals.<sup>3</sup> Congress enacted anti-gambling legislation to combat these problems, including, perhaps most notably, the Professional and Amateur Sports Protection Act (PASPA).<sup>4</sup> This act makes it illegal to

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<sup>1</sup> NCAA v. Governor of N.J., 730 F.3d 208, 215 (3d Cir. 2013); Erica N. Reib, Comment, *Ante Up or Fold: What Should Be Done About Gambling in College Sports?*, 21 MARQ. SPORTS L. REV. 621, 621 (2011).

<sup>2</sup> NCAA, 730 F.3d at 215; *see generally* ELIOT ASINOF, EIGHT MEN OUT: THE BLACK SOX AND THE 1919 WORLD SERIES (1963); DAVID PIETRUSZA, ROTHSTEIN, THE LIFE, TIMES, AND MURDER OF THE CRIMINAL GENIUS WHO FIXED THE 1919 WORLD SERIES (2003).

<sup>3</sup> *See* Joe Goldstein, *Explosion II: The Molinas Period*, ESPN (Nov. 19, 2003), [http://espn.go.com/classic/s/basketball\\_scandals\\_molinas.html](http://espn.go.com/classic/s/basketball_scandals_molinas.html).

<sup>4</sup> Professional and Amateur Sports Protection Act, 28 U.S.C. §§ 3701-3704 (1992).

run or operate a sports book on any amateur or professional athletic event.

In recent years, some states softened their stances against sports gambling and enacted gambling regulations. In 2012 and 2014, the New Jersey legislature enacted laws aimed at legalizing sports gambling.<sup>5</sup> However, the NCAA and professional sports leagues staunchly opposed and successfully challenged the New Jersey legislature's efforts. In both instances, Federal judges found that the state laws were impermissible under PASPA.<sup>6</sup>

Unlike in the United States, not all countries have responded to the integrity concerns of sports betting by banning it outright. For instance, "[i]n many countries, sports wagering is legal and regulated, with scandals more readily exposed and violators punished. Sports in two such countries, the United Kingdom and Australia, are generally seen as fair and clean."<sup>7</sup> In contrast, the two nations with the largest population of sports consumers, China and India, outlaw all forms of sports gambling. In those markets, gambling thrives unregulated and corruption flourishes.<sup>8</sup> The Singaporean and Malaysian soccer leagues folded in the 1990s and the Chinese football league disbanded after sponsors Pirelli and China Central TV pulled out due to endemic match fixing.<sup>9</sup> Ongoing match fixing scandals has also affected one of the fastest growing leagues in world sports—the Indian Premier League in cricket.<sup>10</sup>

In the Australian state of Victoria, sports betting is legal

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<sup>5</sup> N.J. STAT. ANN. §§ 5:12A-1-4, 5-6 (2012) invalidated by *NCAA v. Christie*, 926 F. Supp. 2d 551 (D.N.J. 2013); S. 2460, 216th Leg., Reg. Sess. (N.J. 2014) invalidated by *NCAA v. Christie*, 61 F. Supp. 3d 488 (D.N.J. 2014).

<sup>6</sup> *NCAA v. Christie*, 61 F. Supp. 3d 488, 499 (D.N.J. 2014); *NCAA v. Christie*, 926 F. Supp. 2d 551, 554 (D.N.J. 2013).

<sup>7</sup> See Stephen F. Ross & Arthur Anderson, *Strong Regulation Could Inject Integrity into Sports Regulation*, SPORTS BUS. J., 25 (2015), <http://www.sportsbusinessdaily.com/Journal/Issues/2015/02/16/Opinion/Ross-Anderson.aspx> (last visited Nov. 2, 2015).

<sup>8</sup> Adrian Anderson, *Match-fixing, not drugs, is sport's biggest threat*, HERALD SUN (Melbourne) (Sept. 16, 2013), <http://www.heraldsun.com.au/news/opinion/matchfixing-not-drugs-is-sport8217s-biggest-threat/story-fni0ffsx-1226719582273>.

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

<sup>10</sup> *Id.*



and regulated.<sup>11</sup> Australians maintain that it is better to bring betting out of the dark shadows of back alleys and smoky bars, and into the hands of regulators and corporations.<sup>12</sup>

American sports leaders are re-evaluating their predecessors' implacable hostility to sports gambling. As recently as a May 2014 sports lawyers' convention, a senior counsel to Major League Baseball — perhaps reflecting the views of his then-boss, Commissioner Bud Selig — expressed skepticism over renewed efforts to consider expanding legalized betting on major sports beyond Nevada sports books. Alluding to the Black Sox scandal, he suggested that MLB was not interested in experimenting with changes in its unalterable opposition to any connection with sports wagering, given the damage to the national pastime's integrity from that unfortunate event. Later that fall, the new NBA Commissioner, Adam Silver, wrote a *New York Times* op-ed calling for legislative reforms that would couple modification of current federal prohibition on sports gambling with tighter regulation.<sup>13</sup> Even the MLB's new commissioner, Rob Manfred, acknowledged the movement toward legalized gambling: "I think it's important for there to be a conversation between me and the owners about what our institutional position will be."<sup>14</sup>

Commissioner Silver called for some basic regulatory standards, including licensing of sports bookmakers and monitoring of unusual betting-line movements.<sup>15</sup> The latter is one of the key benefits of sports gambling, allowing potential scandals to be nipped in the bud. In this article, we go further and propose that, in addition to fine bottles of shiraz, marsupials, and wool, the United States should import a model for sports

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<sup>11</sup> See generally NATIONAL GAMBLING IMPACT STUDY COMMISSION REPORT 15 (1999) [hereinafter COMM'N REPORT], <http://govinfo.library.unt.edu/ngisc/reports/fullrpt.html> (last visited Nov. 2, 2015).

<sup>12</sup> See Ross & Anderson, *supra* note 7, at 2.

<sup>13</sup> Adam Silver, *Legalize and Regulate Sports Betting*, N.Y. TIMES (Nov. 13, 2014), [http://www.nytimes.com/2014/11/14/opinion/nba-commissioner-adam-silver-legalize-sports-betting.html?\\_r=0](http://www.nytimes.com/2014/11/14/opinion/nba-commissioner-adam-silver-legalize-sports-betting.html?_r=0).

<sup>14</sup> *Outside The Lines: Rob Manfred* (ESPN television broadcast Feb. 5, 2015), ESPN, <http://espn.go.com/video/clip?id=12286112> (last visited Nov. 2, 2015).

<sup>15</sup> See Silver, *supra* note 13.

gambling regulation as implemented in the Australian State of Victoria.

This article demonstrates the value in using Victorian legislation as a model for legalizing American sports betting. Part I reviews the scope of illegal gambling in the United States, the need for policy changes, and the fiscal benefits of legalized gambling. Part II provides an overview of relevant American law and demonstrates the need for federal legislative reform. Part III casts its gaze Down Under, providing an overview of Australian sports gambling regulation and detailing how Australian law responds to American concerns about legalized sports gambling. Part IV analyzes the ways in which current American law would need to be changed in order to successfully implement the Victorian model, and builds upon reforms publicly advocated by Adam Silver.

## **I. THE PROBLEM WITH ILLEGAL SPORTS GAMBLING IN THE UNITED STATES**

### **A. THE SCOPE OF ILLEGAL GAMBLING**

Illegal sports gambling is a major problem in the modern United States. Each year, an estimated \$400 billion is illegally wagered,<sup>16</sup> dwarfing the amount that is legally gambled in Nevada's sports books.<sup>17</sup> For the 2014 Super Bowl, "300,000 Americans traveled to Nevada for Super Bowl weekend to wager a record \$119 million, yielding a \$19.7 million recorded profit for Las Vegas sports books."<sup>18</sup> The illegal gambling on this

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<sup>16</sup> See Silver, *supra* note 13; see also COMM'N REPORT, *supra* note 11, at 2-14; Matthew T. Mierswa, Note, *Poor Man Wanna Be Rich, Rich Man Wanna Be King: The Battle to Legalize Sports Betting in the Garden State*, 38 SETON HALL LEGIS. J. 447, 449 (2014).

<sup>17</sup> See COMM'N REPORT, *supra* note 11, at 2-14; Will Hobson, *Sports Gambling in the U.S.: Too Prevalent to Remain Illegal*, WASH. POST (Feb. 27, 2015), [http://www.washingtonpost.com/sports/sports-gambling-in-us-too-prevalent-to-remain-illegal/2015/02/27/f1088e4c-b7d3-11e4-9423-f3d0a1ec335c\\_story.html](http://www.washingtonpost.com/sports/sports-gambling-in-us-too-prevalent-to-remain-illegal/2015/02/27/f1088e4c-b7d3-11e4-9423-f3d0a1ec335c_story.html); Mierswa, *supra* note 16, at 449.

<sup>18</sup> Michael Welsh, *Betting on State Equality: How the Expanded Equal Sovereignty Doctrine Applies to the Commerce Clause and Signals of the Demise of the Professional and Amateur Sports Protection Act*, 55 B.C. L. REV. 1009, 1009 (2014); see also Associated Press, *Fans Bet Record \$119M on Super Bowl*, ESPN (Feb. 4, 2014), [http://espn.go.com/nfl/playoffs/2013/story/\\_/id/10399019/super-bowl-xlvi-fans-bet-record-119m-game-nevada-casinos](http://espn.go.com/nfl/playoffs/2013/story/_/id/10399019/super-bowl-xlvi-fans-bet-record-119m-game-nevada-casinos).

event was exponentially more, as indicated by an American Gambling Association (AGA) study of the 2015 Super Bowl, which estimated that Americans wagered \$3.8 billion illegally on that single sporting event.<sup>19</sup> All of the money was untaxed, unregulated, and a fair portion of it was related to organized crime.<sup>20</sup>

The scope of illegal gambling and the problems associated with it were further magnified by the NBA's game fixing scandal in 2007.<sup>21</sup> NBA referee Tim Donaghy bet on "probably over 100 games" that he refereed over the course of four years. The FBI took notice and determined that Donaghy won between seventy and eighty percent of the bets on games he officiated, which was an obvious indicator of game fixing. He was federally charged and convicted as having been part of an illegal gambling operation.<sup>22</sup> This scandal was a huge black eye for the NBA and shed light on the ugly world of illegal sports gambling that exists without taxation and without regulation.

Compulsive gambling adds another layer to the problems associated with illegal sports gambling.<sup>23</sup> The number of compulsive gamblers has steadily increased over the past few

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<sup>19</sup> Chris Moyer, *Illegal Super Bowl Bets to Total \$3.8 Billion This Year*, Am. Gaming Ass'n. (Jan. 22, 2015), <https://www.americangaming.org/newsroom/press-releases/illegal-super-bowl-bets-total-38-billion-year>.

<sup>20</sup> See COMM'N REPORT, *supra* note 11, at 2-15.

<sup>21</sup> David Purdum, "I'm Not Pro Sports Gambling. I'm just A Realist.", ESPN MAGAZINE (Feb. 16, 2015), <http://abcnews.go.com/Sports/im-pro-sports-gambling-realist/story?id=28773595> (last visited Nov. 2, 2015).

<sup>22</sup> CBSNews, *Ex-NBA Ref Tim Donaghy's Personal Foul*, CBS (Dec. 3, 2009), <http://www.cbsnews.com/news/ex-nba-ref-tim-donaghys-personal-foul/>.

<sup>23</sup> See National Council on Problem Gambling, *College Gambling Facts and Statistics*, NCPG.ORG, <http://www.ncpgambling.org/files/NPGAWcollegefactsheet.pdf> (last visited Nov. 2, 2015) (illustrating that about 67% of all college students bet on sports); see also Bill Bradley & Serene Murphy, *The Professional and Amateur Sports Protection Act – Policy Concerns behind Senate Bill 474 (proposed legislation to prohibit sports gambling)*, 2 SETON HALL J. SPORT L. 1 (1992); Ante Z. Udovicic, *Special Report: Sports and Gambling a Good Mix? I Wouldn't Bet On It*, 8 MARQ. SPORTS L.J. 401, 404 (1998).

decades, primarily among adolescents.<sup>24</sup> One reason why the number of compulsive gamblers are on the rise is that gambling may no longer be considered morally wrong. Gambling is now a perfectly normal aspect of American culture. As Rodger Svendsen, former director of the Minnesota Compulsive Gambling Hotline characterizes it, "[w]e're working with the first generation that has been raised when gambling has been seen as a positive thing."<sup>25</sup>

## B. THE NEED FOR POLICY CHANGES

The current prohibition on legalized gambling in most states results in a major social problem. To the extent the laws reveal a policy preference to outlaw sports gambling, the laws have failed because the vast underground market for illegal sports gambling is free from effective regulation and taxation. Furthermore, the laws are also preventing visibility of the compulsive gambling problem in our society. The problems with the current landscape of sports gambling in the United States are threefold: (1) heavy involvement with organized crime, (2) lack of transparency leading to loss of sporting integrity, and (3) foregone financial opportunities.

Because the massive market for sports gambling is illegal, it has become—like illegal consumption of alcohol during Prohibition—a ready target for organized crime. Organized crime exhibits a considerable amount of influence over the illegal market, although the precise share of the estimated \$400 billion of illegal gambling that can be attributed to organized crime is uncertain. New Jersey Senator Raymond J. Lesniak outlined the reach of organized crime families, such as the Genovese family, on the illegal market. Senator Lesniak lamented that federal

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<sup>24</sup> Mary K. Wilber & Marc N. Potenza, *Adolescent Gambling Research and Clinical Implications*, 3 PSYCHIATRY 10, 10 (2006).

<sup>25</sup> Tim Layden, *Bettor Education Gambling is The Dirty Little Secret on College Campuses, Where it's Rampant and Prospering*, SPORTS ILLUSTRATED (Apr. 3, 1995), <http://www.si.com/vault/1995/04/03/8093095/bettor-education-gambling-is-the-dirty-little-secret-on-college-campuses-where-its-rampant-and-prospering-this-si-special-report-reveals-how-easy-it-is-for-students-to-bet-with-a-bookie-become-consumed-with-wagering-and-get-over-their-heads-in-debt> (illustrating the seriousness of the problem with the case of Keith Tubin: after having lost tens of thousands of dollars gambling, Tubin robbed eight Las Vegas banks for over \$89,000 to pay off his gambling debts).

laws “essentially give organized crime and overseas interests a virtual monopoly on sports wagering in the 46 states that are prohibited from setting up legal sports wagering.”<sup>26</sup> The National Gambling Impact Study Commission Report, which was issued sixteen years prior to Senator Lesniak’s comments, showed that the organized crime issue is longstanding when it indicated that in 1999, there was an “increase in the involvement of organized crime groups on sports wagering.”<sup>27</sup>

In many cases, violence accompanies the operation of illegal gambling rings. One well-documented example comes from the illegal gambling in South Philadelphia during the late 1980s and early 1990s. In an effort to remove competition from other bookmakers, the Scarfo crime family used force to put a stop to their competitors’ businesses. In one instance, associates of the Scarfo family broke into the home of a competing bookmaker, bound him to a chair, and beat him repeatedly with a handgun in an effort to scare him out of their illegal gambling market.<sup>28</sup>

In addition to organized crime, a lack of transparency results in an unacceptable risk to the integrity of American sports. Underground gambling increases the risk that sporting events may be fixed. Although there is no statutory basis directly mandating the lack of transparency, under the current legal framework, the fact that federal statutes drive gambling to the illegal market is what creates the opacity.<sup>29</sup> This is illustrated by the widely reported NBA officiating scandal involving Tim Donaghy. Donaghy bet on “probably over 100 games” and won

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<sup>26</sup> See Raymond J. Lesniak, *If You Outlaw Sports Betting, Only Outlaws Will Have Profits*, U.S. NEWS (June 15, 2012), <http://www.usnews.com/debate-club/should-sports-betting-be-legal/if-you-outlaw-sports-betting-only-outlaws-will-have-profits> (outlining a case in New Jersey where 13 members of the Genovese organized crime family were charged in a scheme to use an overseas betting website to run an illegal online sports gambling operation); see also Brett Wolf, *U.S. Treasury Warns Casinos on Illegal Sports Betting*, REUTERS (Jan 16, 2015), <http://www.reuters.com/article/2015/01/16/us-gambling-sports-casinos-idUSKBN0KP2I020150116>.

<sup>27</sup> COMM’N REPORT, *supra* note 11, at 2-15.

<sup>28</sup> See SEAN PATRICK GRIFFIN, *GAMING THE GAME: THE STORY BEHIND THE NBA BETTING SCANDAL AND THE GAMBLER WHO MADE IT HAPPEN*, 42-43 (Barricade Books Inc., 2011).

<sup>29</sup> See Moyer, *supra* note 19.

at a nearly 80 percent rate in the illegal gambling market.<sup>30</sup> Had there been a system in place that promoted transparency, Donaghy would have likely been caught much sooner and the NBA could have avoided the huge black eye it suffered in the scandal.

In order to fix this transparency problem, avoid game fixing scandals like Tim Donaghy's, and protect sporting integrity, a new legal framework that legalizes sports gambling with authorized bookmakers is required. Bringing visibility and legality to sports gambling would allow for government oversight, which would deter attempts at match fixing, and allow for quicker action against corruption.

### C. FISCAL BENEFITS OF LEGALIZED GAMBLING

Legalized gambling will generate tax revenue, create jobs, and keep money from leaving the country. First, legalized gambling will generate large tax revenues for the United States. The Australian state of Victoria (with a population of less than six million people) realized \$57.6 million in tax revenue related to sports betting in 2013 to 2014.<sup>31</sup> Australia taxes only sports betting providers, meaning that bettors' winnings are not taxed.<sup>32</sup> The United States would likely tax both the profits made by the sports betting industry and the winnings from ordinary sports bettors,<sup>33</sup> resulting in significant additional tax revenues for the federal treasury.<sup>34</sup> Nevada was able to tax an estimated \$19.7

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<sup>30</sup> CBSNews, *supra* note 22.

<sup>31</sup> VICTORIAN COMM'N FOR GAMBLING AND LIQUOR REGULATION, ANNUAL REPORT 2013-2014, at 56 tbl.7 (2014) [*hereinafter* VICTORIAN COMM'N REPORT], <http://www.vcglr.vic.gov.au/utility/about+us/about+the+vcglr/annual+reports>.

<sup>32</sup> *Australia's Future Tax System: Final Report, Part 2: Detailed analysis, Chapter E: social and market outcomes, E7-2, Existing Gambling Taxes*, [http://taxreview.treasury.gov.au/content/FinalReport.aspx?doc=html/publications/Papers/Final\\_Report\\_Part\\_2/chapter\\_e7-2.htm](http://taxreview.treasury.gov.au/content/FinalReport.aspx?doc=html/publications/Papers/Final_Report_Part_2/chapter_e7-2.htm) (last visited Sept. 27, 2015).

<sup>33</sup> See IRS, *Topic 419 - Gambling Income and Losses* (last updated Aug. 31, 2015), <http://www.irs.gov/taxtopics/tc419.html> (last visited Nov. 2, 2015) (reflecting current U.S. tax treatment of gambling income).

<sup>34</sup> See Robert Ferris, *These 13 States Raked in 34B in Gaming Revenue*, USA TODAY (April 27, 2014),

million in recorded profit by Las Vegas casinos on the 2014 Super Bowl alone. Additionally, due to the draw of this major sports gambling event, Las Vegas visitors spent an estimated \$106.2 million in non-gaming activities and accommodations.<sup>35</sup> In contrast, other states did not benefit from these and other major sporting events because federal law outlaws sports gambling outside of Nevada. There was, no doubt, a large amount of sports gambling throughout the U.S. for the Super Bowl and other events, yet all of it was untaxable and on the illegal market.

Another fiscal benefit would include an influx of new jobs for regulators and sports betting providers. These include key “licensed” bookmaking employees,<sup>36</sup> officials within sports leagues who assist with information sharing with sports betting providers, and more government employees to help regulate and enforce any new regulatory legislation. Indeed, New Jersey has sought to overcome federal legislation precisely on the perception that sports gambling could be an important source of jobs and maintenance for Atlantic City’s struggling casinos.<sup>37</sup>

The United States will also benefit by keeping illegal gambling money inside the country. Currently, it is estimated that billions of dollars are wagered yearly on offshore websites.<sup>38</sup> If sports betting were legalized, the billions that are lost to foreign websites would remain in the United States. This would keep the money in the economy while increasing tax revenue at the same time.

## II. SUMMARY OF U.S. LAW AND THE NEED FOR FEDERAL

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<http://www.USAtoday.com/story/money/business/2014/04/27/top-gambling-states/8168681/>.

<sup>35</sup> See Welsh, *supra* note 18, at 1010; *Sports Wagering*, AMERICAN GAMING ASSOCIATION (Jan. 22, 2015), <https://perma.cc/B3V7-QRTP?type=source>.

<sup>36</sup> In the relatively small state of Victoria, there are 208 such employees. See VICTORIAN COMM’N REPORT, *supra* note 31, at 55 tbl.6.

<sup>37</sup> Seth McLaughlin, *Chris Christie Bets Legalized Sports Gambling Will Boost Atlantic City, 2016 Hopes*, WASH. POST (Jan. 29, 2015), <http://www.washingtontimes.com/news/2015/jan/29/chris-christie-backs-legalized-sports-betting-in-b/?page=all> (outlining Christie’s hopes that sports gambling jobs would bring relief to the 11.5 percent unemployment rate in Atlantic City).

<sup>38</sup> See Ross & Anderson, *supra* note 7, at 2.

### LEGISLATIVE REFORM

Two federal statutes have driven sports gambling underground: the Wire Fraud Act and the Professional and Amateur Sports Protection Act (PASPA). In this section, we summarize the key provisions of these statutes, analyze a critical loophole that permits the widespread participation in fantasy sports, and review recent legal challenges. The current legal framework demonstrates that Congress will need to amend these statutes in order to implement an effective scheme of legalization, regulation, and taxation of sports wagers.

#### A. THE FEDERAL WIRE FRAUD ACT

For practical purposes, the Federal Wire Fraud Act (the “Wire Act”)<sup>39</sup> makes sports wagering illegal. Enacted in 1961, the Wire Act was part of a crime bill that recognized the need for independent federal action to combat interstate gambling operations.<sup>40</sup> The Wire Act was the federal government’s first initiative aimed at eliminating gambling operations. The Wire Act states:

Whoever being engaged in the business of betting or wagering knowingly uses a wire communication facility for the transmission in interstate or foreign commerce of bets or wagers or information assisting in the placing of bets or wagers on any sporting event or contest, or for the transmission of a wire communication which entitles the recipient to receive money or credit as a result of bets or wagers, or for information assisting in the placing of bets or wagers, shall be fined under this title or imprisoned not more than two years, or both.<sup>41</sup>

The Wire Act contains two essential elements: “(1) the information transmitted by wire must have assisted in the placing of bets or wagers, and (2) the defendant must have been engaged in the business of wagering or betting during the time of transmission.”<sup>42</sup> The language of the Wire Act suggests that all

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<sup>39</sup> 18 U.S.C. § 1084 (1961).

<sup>40</sup> See e.g., *Martin v. United States*, 389 F.2d 895, 898 (5th Cir. 1968).

<sup>41</sup> 18 U.S.C. § 1084 (1961).

<sup>42</sup> *Truchinski v. United States*, 393 F.2d 627, 630 (8th Cir. 1968); Megan E. Frese, Note, *Rolling the Dice: Are Online Gambling*



forms of gambling are covered; however, recent judicial trends indicate the Wire Act has specifically targeted sports gambling.<sup>43</sup>

#### B. THE PROFESSIONAL AND AMATEUR SPORTS PROTECTION ACT (PASPA)

PASPA makes it unlawful for a governmental entity or person to sponsor, operate, advertise, promote, license, or authorize a lottery, sweepstakes, or other gambling scheme based on amateur or professional athletic events.<sup>44</sup> The goal of PASPA is to ban gambling that "threatens the integrity and character of, and public confidence in, professional and amateur sports, and instills inappropriate values in our Nation's youth."<sup>45</sup> Congress included a grandfather clause that would allow states, such as Nevada, to keep their sports gambling while also allowing other states that wanted to enact sports gambling laws to do so within a year's grace period.<sup>46</sup>

#### C. THE FANTASY SPORTS EXCEPTION

While these provisions seem to outlaw all forms of sports wagering and reflect the view that any sports wagering threatens sporting integrity, participation in fantasy sports leagues, in most cases, is completely legal under federal law

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*Advertisers "Aiding and Abetting" Criminal Activity or Exercising First Amendment-Protected Commercial Speech?*, 15 FORDHAM INTELL. PROP. MEDIA & ENT. L.J. 547, 560-61 (2005).

<sup>43</sup> *In re Mastercard Int'l Internet Gambling Litig.*, 313 F.3d 257, 263 (5th Cir. 2012) (ruling that the Wire Act applies only to sports betting and not to other kinds of gambling).

<sup>44</sup> 28 U.S.C. §§ 3701-3704 (1992).

<sup>45</sup> 137 Cong. Rec. S2,256-04 (daily ed. Feb. 22, 1991) (statement of Sen. DeConcini).

<sup>46</sup> 28 U.S.C. § 3704 (1992). Ironically, New Jersey considered pursuing its own law under the grace period, but ultimately never acted, causing them to fall under the rigors of PASPA. New Jersey Senators Frank Lautenberg and Bill Bradley intensely debated the issue during the federal grace period. The state ultimately sided with Senator Bradley's opposition to sports gambling. *See* 138 CONG. REC. S7, 300-01 (daily ed. June 2, 1992) (statement of Sen. Lautenberg); Joseph F. Sullivan, *Gambling Debate Rages Anew Over Sports*, N.Y. TIMES (Nov. 20, 1991),

<http://www.nytimes.com/1991/11/20/nyregion/gambling-debate-rages-anew-over-sports.html?pagewanted=all&src=pm>; *see generally*

Bradley & Murphy, *supra* note 23.

even if the leagues provide monetary compensation for the winners.<sup>47</sup> An express fantasy sports exception in the Unlawful Internet Gambling Enforcement Act of 2006 deems this conduct to be legal when it meets the following three criteria: “(1) the value of the prizes is not determined by the number of participants or the amount of fees paid; (2) all winning outcomes reflect the relative knowledge and skill of the participants; and (3) the fantasy game’s result is not based on the final scores of any real-world games.”<sup>48</sup> Most traditional versions of fantasy football seem to comply with this federal law.<sup>49</sup>

There are some issues that arise when evaluating the legality of fantasy sports under state laws. Fantasy leagues are deemed illegal under most state laws if there is consideration to play, a reward, and chance.<sup>50</sup> The exact definition of “chance” varies from state to state. Some states use the “predominant purpose test,” which allows for fantasy sports if the games involve more skill than chance.<sup>51</sup> Others use the “any chance test,” which is much more stringent because it states that the presence of any chance at all renders fantasy sports illegal.<sup>52</sup> Ultimately, with the exception of those states adopting the “any chance test,” the vast majority of fantasy sports are completely legal.

The legality of fantasy sports stands in stark contrast to the illegality of sports gambling. In particular, there seems to be little expressed concern about the risks of corruption as prize

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<sup>47</sup> Marc Edelman, *A Short Treatise on Fantasy Sports and the Law: How America Regulates its New National Pastime*, 3 HARV. J. SPORTS & ENT. L. 34, 37-38 (2012) [hereafter Edelman, *Short Treatise*] (discussing the “fantasy sports games” carve-out provision found in the Uniform Internet Gambling Enforcement Act of 2006).

<sup>48</sup> 31 U.S.C. § 5362 (2006).

<sup>49</sup> Marc Edelman, *Is it Legal to Play Fantasy Football for Money?*, FORBES (Sept. 3, 2013), <http://www.forbes.com/sites/marcedelman/2013/09/03/is-it-legal-to-play-fantasy-football-for-money/>.

<sup>50</sup> See *Geis v. Cont’l Oil Co.*, 511 P.2d 725, 727 (1973) (Utah 1973) (stating that “the statutory elements of a lottery are: (1) prize; (2) chance; and (3) any valuable consideration”); see also *Valentin v. La Prensa*, 427 N.Y.S.2d 185, 186 (N.Y. Civ. Ct. 1980) (stating that three elements are needed to constitute an illegal lottery: (1) consideration, (2) chance, and (3) a prize).

<sup>51</sup> Edelman, *Short Treatise supra* note 49, at 29.

<sup>52</sup> *Id.* at 31.

money increases, despite the lack of regulatory safeguards that characterize regulated sports gambling in other countries.

#### D. UNSUCCESSFUL EFFORTS TO IMPLEMENT LEGAL SPORTS GAMBLING UNDER CURRENT FEDERAL LAW

New Jersey is the most prominent state that has sought to secure the benefits of legalized gambling in spite of the aforementioned federal statutes. In 2012, New Jersey's Governor Chris Christie signed state legislation allowing sports gambling at casinos.<sup>53</sup> This was the first instance of a state directly attempting to circumvent PASPA. This legislation would have allowed casinos and other gambling proprietors to "operate a sports pool" and apply for "a license to operate a sports pool."<sup>54</sup> The legislation was immediately challenged by all of the professional sports leagues and the NCAA. They claimed that this law would damage their reputation and goodwill due to "the fact that the proliferation of sports gambling will adversely affect the way that the public views amateur and professional sports."<sup>55</sup>

New Jersey's legal response to the claim of inconsistency between PASPA and its new regulatory regime was that PASPA exceeded Congress' authorized powers under the Constitution's Commerce Clause.<sup>56</sup> The district court rejected New Jersey's argument, granted the plaintiffs' request to declare the state law illegal, and enjoined the state from sponsoring, operating, promoting, licensing, or authorizing any betting on competitive sports events.<sup>57</sup> The court reasoned that Congress enacted PASPA to prevent the spread of state-sponsored sports gambling and to protect the integrity of professional and amateur sport.<sup>58</sup> This concern provided Congress with the constitutionally required rational basis to conclude that legalized sports gambling would affect interstate

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<sup>53</sup> N.J. STAT. ANN. §§ 5:12A-1-4, 5-6 (2012) invalidated by *NCAA v. Christie*, 926 F. Supp. 2d 551 (D.N.J. 2013).

<sup>54</sup> *Id.* at § 5:12A-2(a).

<sup>55</sup> Complaint for Declaratory and Injunctive Relief, *NCAA v. Christie*, No. CV124947, 2012 WL 3171566, at \*1 (D.N.J. Aug. 7, 2012).

<sup>56</sup> *See NCAA v. Christie*, 926 F. Supp. 2d 551, 558 (D.N.J. 2013).

<sup>57</sup> *Id.* at 576.

<sup>58</sup> *Id.* at 576.

commerce.<sup>59</sup> The decision was affirmed on appeal.<sup>60</sup>

In response to this ruling, Governor Christie and the New Jersey legislature amended the statute in an effort to maneuver around the *Christie I* decision. Similar to the invalidated statute, the goal of the 2014 statute was to allow casinos and other proprietors in New Jersey to operate sports gambling pools; the 2014 law sought to avoid PASPA's specific prohibition on state operation, licensing, or authorization of sports gambling by partially repealing state laws and regulations prohibiting sports wagering in certain circumstances.<sup>61</sup>

When the 2014 statute was challenged, counsel for Governor Christie and the New Jersey legislature argued that the 2014 law was in line with the Third Circuit's reasoning in *Christie I*. That court, after rejecting claims that PASPA had unconstitutionally "commandeered" state enforcement of federal policy,<sup>62</sup> had stated that it did "not read PASPA to prohibit New Jersey from repealing its ban on sports wagering," and "it is left up to each state to decide how much of a law enforcement priority it wants to make of sports gambling, or what the exact contours of the prohibition will be."<sup>63</sup> However, the district court in *Christie II* held that, despite the new language, the 2014 law remained inconsistent with PASPA and invalid under the Supremacy Clause;<sup>64</sup> the Third Circuit affirmed.<sup>65</sup> Although the court in *Christie II* reasoned that PASPA does not prevent states from completely repealing any state law constraints on sports gambling, the federal judicial interpretation of these statutes make it clear that any regulatory regime designed to legalize, regulate, and tax sports gambling will be struck down. The only realistic option is federal legislative reform. In determining

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<sup>59</sup> *Id.* at 560.

<sup>60</sup> *NCAA v. Governor of N.J.*, 730 F.3d 208, 241 (3d Cir. 2013), *cert. denied sub nom. Christie v. NCAA*, 134 S. Ct. 2866 (2014).

<sup>61</sup> S. 2460, 216th Leg. Reg. Sess. (N.J. 2014) invalidated by *NCAA v. Christie*, 61 F. Supp. 3d 488 (D.N.J. 2014). Additionally, this statute contains a broad severability clause and repealed provisions of New Jersey law governing criminal and civil penalties for gambling.

<sup>62</sup> *New York v. United States*, 505 U.S. 144, 166, 180 (1992) (holding that Congress "lacks the power directly to compel the States to require or prohibit" acts which Congress itself may require or prohibit).

<sup>63</sup> *NCAA v. Governor of N.J.*, 730 F.3d at 233.

<sup>64</sup> *NCAA v. Christie*, 61 F. Supp. 3d 488, 508 (D.N.J. 2014).

<sup>65</sup> *NCAA v. Governor of N.J.*, Nos. 14-4546, 14-4568, and 14-4569, 2015 U.S. App. LEXIS 14955 (3d Cir. Aug. 25, 2015).

whether and how to reform current law, American legislators would do well to look Down Under.

### III. HOW AUSTRALIAN LAW REGULATES SPORTS GAMBLING IN A MANNER THAT ADDRESSES AMERICAN CONCERNS

Americans' passion for sports and their concerns about the dark shadows and perceived risks to sporting integrity associated with sports betting inhibit the widespread legalization of sports betting in this country. Lessons from Australia suggest that this view is near-sighted. The model implemented by the state of Victoria emphasizes information sharing and cooperation amongst sports betting providers, sports controlling bodies, and law enforcement. Australian observers believe this promotes, rather than endangers, sporting integrity.

#### A. OVERVIEW OF AUSTRALIAN FEDERAL AND VICTORIAN STATUTORY REGULATION

Like the United States, Australia is a federal country where states enjoy plenary regulatory power. However, in Australia, the federal (Commonwealth) government's constitutional authority to regulate interstate commerce<sup>66</sup> has been interpreted by the High Court of Australia more narrowly than in the United States.<sup>67</sup> Commonwealth legislation is limited to restrictions on Internet gambling.<sup>68</sup> The Interactive Gambling Bill of 2001 (IGB) makes it lawful to wage on sporting events or a series of sporting events,<sup>69</sup> although it bars betting on sporting events after they have commenced.<sup>70</sup> For example, a bettor cannot place a bet on a tennis match after the first set is completed, a bettor can only bet on the outcome of the entire match before the match begins. The IGB also bars betting on contingencies that may or may not occur after the start of a sporting event.<sup>71</sup> For example, the IGB would ban Super Bowl

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<sup>66</sup> AUSTL. CONST, s 51(i).

<sup>67</sup> See e.g., *Airlines of NSW Pty. Ltd. v State of New So. Wales (No. 2)* (1965) 113 CLR 54 (Austl.) (rejecting the American interpretation allowing federal legislation of intra-state activity that substantially affects interstate commerce).

<sup>68</sup> This legislation is based on the Commonwealth power over "postal, telegraphic, telephonic, and other like services." AUSTL. CONST, s 51(v).

<sup>69</sup> *Interactive Gambling Bill 2001* (Cth) pt 1 s 8A(1).

<sup>70</sup> *Id.* s 8A(2)(a).

<sup>71</sup> *Id.* s 8A(2)(b).

prop bets placed after the game's kick-off, such as bets on a second quarter score, who will score the next touchdown, or whether or not there will be a safety. Outside of the preceding stipulations, sports betting regulation is left to the states for regulation.

Victorian Sports betting is governed by the Gambling and Racing Legislation Amendment (Sports Betting) Act of 2007.<sup>72</sup> The statute delegates to the Victorian Commission for Gambling and Liquor Regulation (the Commission) the authority to grant sporting events, sports controlling bodies, and sports betting agencies the right of sports betting. Under the Sports Betting Act, the Commission may approve a particular event or class of events for betting purposes, and approve a betting competition on that event or class.<sup>73</sup> The Commission may also approve events that are held "wholly or partly within or outside Victoria."<sup>74</sup> The Commission considers such factors as: (1) whether the event is an unmanageable integrity risk; (2) whether the event is administered by an organization capable of enforcing rules regarding integrity; (3) whether betting on the event is offensive or against the public interest; (4) whether the event is an unreasonable expansion of the scope of gambling in Victoria; and (5) any other matter the Commission deems relevant.<sup>75</sup> The Commission also reserves the right to revoke approval at any time for reasonable cause, as determined by the Commission.<sup>76</sup> By way of illustration, the Commission recently approved betting on badminton.<sup>77</sup> In its decision, the Commission

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<sup>72</sup> See Gambling and Racing Legislation Amendment (Sports Betting) Act 2007, (Vict.), [http://www.legislation.vic.gov.au/Domino/Web\\_Notes/LDMS/PubStatbook.nsf/f932b66241ecf1b7ca256e92000e23be/7F87494B9F48C351CA2572EA0020E114/\\$FILE/07-018a.pdf](http://www.legislation.vic.gov.au/Domino/Web_Notes/LDMS/PubStatbook.nsf/f932b66241ecf1b7ca256e92000e23be/7F87494B9F48C351CA2572EA0020E114/$FILE/07-018a.pdf) (last visited Nov. 2, 2015).

<sup>73</sup> *Id.* div 3 s 4.5.6(1).

<sup>74</sup> *Id.* div 3 s 4.5.7(1).

<sup>75</sup> *Id.* div 3 s 4.5.8. Once the Commission approves an event the approval takes effect on the day notice is published, or under a date specified in the notice. *Id.* div 3 s 4.5.6(4). The Commission is required to publish notice of approval in the Government Gazette. *Id.* div 3 s 4.5.10. Additionally, the Commission must maintain a list of all approved betting events on its website. *Id.* div 3 s 4.5.10(3).

<sup>76</sup> *Id.* div 3 s 4.5.11.

<sup>77</sup> See Victorian Comm'n for Gambling and Liquor Regulation, *Approval of Betting Event Sport of Badminton*, <http://assets.justice.vic.gov.au/vcglr/resources/1192de02-066a-4676->

mentioned that it considered the integrity risks under section 4.5.8(1)(a) of the Sports Betting Act, the capability of the organization holding the event to ensure integrity under section 4.5.8(1)(b), and whether allowing betting on badminton would be offensive to the public under section 4.5.8(1)(c).<sup>78</sup>

An organization may apply to the Commission for approval to be a sports controlling body, thereby forgoing the need to obtain approval for each individual sporting event.<sup>79</sup> The Commission considers such factors as: (1) whether the applicant has control of the event or administers the event; (2) whether the applicant has adequate rules in place to ensure integrity; (3) whether the applicant complies with international codes relating to integrity in sport; (4) whether the applicant has resources and authority to monitor integrity systems; (5) “whether the applicant has clear policies on the provision of information that may be relevant to the betting market;” (6) whether the applicant has a clear process for reporting the results of the event and hearing appeals relating to the results; (7) whether the applicant has a clear policy of sharing information with sports betting providers in order to investigate suspicious betting activity; (8) whether the applicant is the most appropriate body to be approved as the controlling body for the event; (9) whether approval supports the public interest; and (10) any other objections filed and any other relevant matter the Commission deems appropriate.<sup>80</sup> The Commission’s website lists those sports controlling bodies approved by the Commission. Currently, this list includes the Australian Football League, the Australian Rugby Union, Basketball Australia, Cricket Australia, Football Federation Australia Limited, National Rugby League, Netball Australia,

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9011-fa1946d35046/gamingdecisionbadminton.pdf (last visited Nov. 2, 2015).

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

<sup>79</sup> Sports Betting Act 2007, (Vict.) div 4 s 4.5.12. Upon filing the application with the Commission, the sports controlling body must publish notice in a newspaper “circulating generally throughout Australia.” *Id.* div 4 s 4.5.12(3). This notice must also contain a notice stating that objections must be made within 28 days of publication to the Commission. *Id.* div 4 s 4.5.12(3)(a).

<sup>80</sup> *Id.* div 4 s 4.5.14. As with the previous procedure, the Commission decision is required to be published in the Government Gazette. *Id.* div 4 s 4.5.16. The Commission can revoke approval at any time. *Id.* div 4 ss 4.5.16(1), 4.5.17(1).

Professional Golfers Association of Australia, and Tennis Australia.<sup>81</sup>

The Sports Betting Act also places requirements on sports betting providers, otherwise known as bookmakers. The Sports Betting Act defines a sports betting provider as one who accepts, offers to accept, or invites a person to place a bet or facilitates the placing of a bet.<sup>82</sup> To be considered a sports betting provider, a company must meet three prerequisites. First, the sports betting provider must have an agreement with the sports controlling body in charge of the sporting event, unless the event is wholly outside of Victoria.<sup>83</sup> Second, the agreement must promote integrity by providing for information sharing.<sup>84</sup> And third, the agreement must also stipulate whether the sports betting agency will pay a fee to the sports controlling body and specify the amount of the fee.<sup>85</sup>

If the sports betting provider is unable to reach an agreement with a sports controlling body, the provider may apply to the Commission for the right to service bets.<sup>86</sup> The Commission may authorize wagering, with a number of conditions. Most prominent is that the bookmaker's proposal must "provide for the sharing of information between the [bookmaker] and the [sports league] for the purposes of protecting and supporting integrity in sports and sports betting."<sup>87</sup> Although the statute does not detail precisely how information sharing promotes integrity, we can readily infer that close cooperation between all parties permits the monitoring of who is betting (precluding betting by participants or close family members) and suspicious betting movements. The Commission may consider other factors such as: (1) any integrity-related costs that might face the sports controlling body relating to betting; (2) the integrity of the betting event; (3) the financial benefits to the betting provider; (4) existing legislative rights and liabilities of

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<sup>81</sup> *Sports Controlling Bodies*, VICTORIAN COMM'N FOR GAMBLING AND LIQUOR REG.,

<http://www.vcglr.vic.gov.au/home/gambling/new+applicants/sports+betting/sports+controlling+bodies> (last visited Nov. 2, 2015).

<sup>82</sup> Sports Betting Act 2007, (Vict.) div 5 s 4.5.21.

<sup>83</sup> *Id.* div 5 s 4.5.22.

<sup>84</sup> *Id.* div 5 s 4.5.23(2)(a).

<sup>85</sup> *Id.* div 5 s 4.5.23(b).

<sup>86</sup> *Id.* div 5 s 4.5.24.

<sup>87</sup> *Id.* div 5 s 4.5.26(2).



both the betting provider and the sports controlling body regarding the use and dissemination of information; and (5) any other matters that the Commission deems relevant.<sup>88</sup>

It is clear that a key aspect of sports betting in Victoria is due to information sharing: the sharing of information between the sports betting providers and the sports controlling bodies. For instance, bookmakers and leagues share information regarding suspicious betting trends, participants barred from placing bets, suspicious inquiries, and attempts to fix matches.

The statutory considerations that the Commission undertakes when determining approval for sports betting events, sports controlling bodies, and sports betting providers appear to leave considerable room for discretion and debate. There are no landmark court cases that shed light on the statutory considerations. The fact that such little litigation exists likely signifies a mutual cooperation between the sports controlling bodies, the sports betting agencies, and the Commission. All of the aforementioned stakeholders are aware that sports betting is mutually beneficial for both monetary and integrity reasons. As such, the stakeholders are willing to be flexible with the legislation currently in place, and are happily meeting the statutory requirements because it is good for business. If the United States adopted similar legislation to the Victorian law, it could find similar cooperation between the sports leagues, sports betting providers, and sports regulators.

#### B. HOW THE VICTORIAN MODEL RESPONDS TO AMERICAN CONCERNS REGARDING SPORTING INTEGRITY

The Australian perspective reflects the famous phrase that “sunlight is said to be the best of disinfectants.”<sup>89</sup> A leading Australia sports executive observed that a few years ago, “an unusual change in strategy by a prominent Australian Rules Football club was improperly disclosed to gamblers; authorities were able to follow the money trail regarding the family of one of the corrupted players, whilst another one was photographed making a wager at a licensed bookmaker.”<sup>90</sup>

Information sharing will provide professional sports

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<sup>88</sup> *Id.* div 5 s 4.5.26(3).

<sup>89</sup> LOUIS D. BRANDEIS, OTHER PEOPLE’S MONEY AND HOW THE BANKERS USE IT 92 (1914 ED.)

<sup>90</sup> See Ross & Anderson, *supra* note 7, at 2.

leagues, the NCAA, and sports betting providers with the opportunity to monitor who is placing bets, how much is being bet, and any other suspicious betting movements. Further, information sharing will flag any improprieties that could affect the outcome of a sporting event and it allows the leagues to take proper action, whether internally or by enlisting the help of law enforcement. By taking betting out of the dark shadows and into the sunlight, the illegal betting industry will cease to exist as it operates today, thereby inhibiting unsavory characters from exerting influence over the outcome of sporting events and diminishing a recurrence of notorious cases of sport betting impropriety. This section discusses how an Australian regulated gambling model may prevent unscrupulous match-fixers and participants from jeopardizing the integrity of American sports contests. The model considers how some notorious prior incidents could have been avoided through transparent, legally regulated sports wagering.

### *1. The Donaghy Scandal*

In 2007, a scandal rocked the NBA when it was discovered that a referee with thirteen years' experience bet on NBA games, including games that he refereed. Tim Donaghy admitted to betting on "probably over 100 games," over a four-year span.<sup>91</sup> Donaghy claimed to have won between seventy and eighty percent of the bets he placed on NBA basketball games during that span.<sup>92</sup> Eventually as more people began to rely on Donaghy's betting advice, word of Donaghy's success reached the mob, which ultimately led to his downfall. One night, two men from the Gambino crime family picked up Donaghy outside of a Philadelphia hotel.<sup>93</sup> The men required Donaghy to provide them with picks for NBA games or else the mob would visit his family in Florida.<sup>94</sup> According to Donaghy, he supplied picks to the mob through a high school friend, using code language in case the phone calls were tapped.<sup>95</sup> Eventually the FBI learned via wiretaps on mob phone calls that Donaghy was relaying inside information on sports gambling.<sup>96</sup> The FBI estimated that

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<sup>91</sup> CBSNews, *supra* note 22.

<sup>92</sup> *Id.*

<sup>93</sup> *Id.* at 4.

<sup>94</sup> *Id.*

<sup>95</sup> *Id.*

<sup>96</sup> *Id.* at 5.

the mob made several millions of dollars through Donaghy's picks.<sup>97</sup> Donaghy ultimately cooperated with the FBI for a lesser sentence, but he still lives in fear of mob retribution.<sup>98</sup> Donaghy partly blames the NBA, alleging that the NBA does everything it can to help large market teams advance in the playoffs, while also trying to make each playoff series go as long as possible.<sup>99</sup>

The Donaghy scandal caused substantial harm to the NBA. Commissioner David Stern ran a massive campaign to restore the public's faith in the integrity of the NBA's games.<sup>100</sup> The NBA was concerned that the scandal would cause fans to believe that games were being fixed, and if one referee could do it, others could as well.<sup>101</sup> Additionally, Donaghy's further accusations regarding alleged league efforts to extend the playoff series and to get large market teams to advance in the playoffs were also troubling assaults on the integrity of the game.<sup>102</sup> The public scrutinized the integrity of the NBA after the Donaghy scandal broke and it was the main headline on the sports news network, ESPN, for weeks. ESPN consistently asked experts on their shows if they thought that NBA games were being fixed. Although the answers were nearly always a resounding no, the question was always asked.<sup>103</sup> In response to the negative publicity, David Stern sought to distance the league from Donaghy and to discredit him. Stern and the NBA claimed that Donaghy was not credible because he was a convicted felon who was only trying to save his own skin by making wild

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<sup>97</sup> *Id.* at 4.

<sup>98</sup> *Id.* at 5.

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

<sup>100</sup> Howard Beck, *Lawyer Will Examine N.B.A. Gambling Rules*, N.Y. TIMES (Aug. 22, 2007), [http://www.nytimes.com/2007/08/22/sports/basketball/22refs.html?\\_r=0](http://www.nytimes.com/2007/08/22/sports/basketball/22refs.html?_r=0).

<sup>101</sup> Paul M. Anderson, *Gambling on Sports*, in HANDBOOK ON INTERNATIONAL SPORTS LAW 169 (James A.R. Nafziger & Stephen F. Ross eds., 2011).

<sup>102</sup> CBSNews, *supra* note 22, at 5.

<sup>103</sup> See Marc Stein, *NBA Has No Quick Fix for Donaghy's Fixing Charges*, ESPN (June 19, 2008), [http://sports.espn.go.com/nba/playoffs2008/columns/story?columnist=stein\\_marc&page=DonaghyStern-080611](http://sports.espn.go.com/nba/playoffs2008/columns/story?columnist=stein_marc&page=DonaghyStern-080611) (outlining former-NBA Commissioner David Stern's repeated assertions that Tim Donaghy was the only party guilty of criminal activity in this scandal).

accusations.<sup>104</sup> Stern's campaign to save the public's faith in the integrity of the game seemed to work because the NBA is still widely watched and the dominant basketball league in the United States. Since the Donaghy scandal, the NBA has not had to defend its integrity.

A Victorian sports betting regime would inhibit scandals like Donaghy's. Where gamblers may lawfully wager with betting corporations rather than illegal businesses, the mob would have difficulty finding a person like Donaghy with inside information. The people taking bets would be legitimate businessmen, not criminals operating illegal sports books with ties to other criminal organizations. Further, information sharing would allow authorized bookmakers to inform sports leagues about people placing bets, such as Donaghy, or people close to Donaghy, thereby allowing the league to respond quickly.

## 2. *The Pete Rose Scandal*

Pete Rose is Major League Baseball's career leader in hits, yet he is barred from the Hall of Fame and remains suspended from any official role with Major League Baseball due to unlawfully betting on baseball during his time as the manager of the Cincinnati Reds. MLB Rule 21(d) provides for the permanent ban of anyone that bets on a game in which he is participating.<sup>105</sup> In 1989, MLB released a report by John M. Dowd, who had been appointed as a special counsel to the Commissioner of Baseball, which concluded that Rose had bet on Reds games between 1985 and 1987, including \$2,000 per game between May and July 1987.<sup>106</sup> Rose would even go as far as using hand signals to communicate with his friends in the stands to see how he was doing with his bets during games he was managing. During the investigation Rose was adamant that he never bet on baseball; however, the investigation uncovered that Pete Rose used friends to place bets with bookies illegally,

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<sup>104</sup> Henry Abbot, *Justin Wolfers on the Quality of an NBA Denial*, ESPN (Oct. 20, 2009), [http://espn.go.com/blog/truehoop/post/\\_/id/4970/justin-wolfers-on-the-quality-of-an-nba-denial](http://espn.go.com/blog/truehoop/post/_/id/4970/justin-wolfers-on-the-quality-of-an-nba-denial).

<sup>105</sup> Major League Rule 21(d), *reprinted in* PAUL C. WEILER ET AL., DOCUMENTARY SUPPLEMENT TO SPORTS AND THE LAW 67-68 (4th ed. 2011).

<sup>106</sup> JOHN M. DOWD, PETE EDWARD ROSE, MANAGER CINCINNATI REDS BASEBALL CLUB REPORT TO THE COMMISSIONER 3-5 (1989), <http://www.thedowdreport.com/part1.pdf> (last visited Nov. 2, 2015).

amassing gambling debts with loan sharks with ties to New York crime families that totaled in the hundreds of thousands of dollars. To support his gambling habits and get out of his debts, Rose at one point resorted to financing cocaine purchases for his friends to sell, hoping for a good return on his “investment.” As a result of the Dowd investigation, Rose was permanently banned from baseball. Rose was also found guilty of tax evasion for the money he received from gambling, spending five months in prison.<sup>107</sup> The Pete Rose scandal casted a dark shadow on the sport of baseball. Rose is currently in the process of trying to be reinstated by Major League Baseball.<sup>108</sup>

The Pete Rose saga illustrates the problems with illegal gambling. Rose had ready access to a network of illegal gambling run by loan sharks with ties to New York crime families. Legalizing sports betting under a Victorian model would remove people such as Rose from the sports betting industry. When ordinary bettors are able to wager with legitimate businessmen rather than criminals, unsavory bookmakers will not find it profitable to accept wages solely from the few high-risk gamblers who are unable to place lawful bets. Further, the Victorian model would also inhibit these types of scandals by making it more difficult to hide gambling profits from legitimate operations. By regulating and taxing the business of sports betting, the government will be able to track money made and lost by gamblers and bookmakers more effectively than when gambling is conducted in secret by unsavory characters. As such, the government would be able to identify gambling income, acting as a further deterrence for people like Pete Rose who think about gambling on their own sport. Transparency and information sharing would also inhibit the ability of players and coaches to hide bets, as Rose did, by using friends to place the bets for him. Known associates of Rose placing bets could be tracked, allowing the MLB to take

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<sup>107</sup> James Pitcher, *Pete Rose’s Investigator: Never Let Him Back in Baseball*, CINCINNATI.COM, <http://www.cincinnati.com/story/news/2015/03/21/rose-investigator-pete-belong-game/25112355/> (last visited Nov. 2, 2015).

<sup>108</sup> Matt Snyder, *MLB met with Pete Rose, will decide on possible reinstatement in 2015*, CBS Sports, <http://www.cbssports.com/mlb/eye-on-baseball/25316151/mlb-met-with-pete-rose-will-decide-on-possible-reinstatement-in-2015> (Sept. 25, 2015).

swift action before a scandal could get out of control.

### 3. *The Black Sox Scandal*

Perhaps the most infamous attack on baseball's integrity was the 1919 Black Sox Scandal. In an era featuring underpaid players who often searched for additional income from bettors, baseball was littered with gambling corruption. Many baseball historians believe that many teams had at least one player who would influence the outcome of a game for the chance of earning a little extra cash. Starting with White Sox first baseman, Chick Gandil, eight members of the Chicago White Sox came together with a plan to throw the 1919 World Series against the Cincinnati Reds.<sup>109</sup> The fix initially involved Gandil's acquaintance, professional gambler "Sport" Sullivan, as the financier for the fix. As word of a potential fix grew, other players entered into the fold for a piece of the action. Among the men involved in the fix beyond Sullivan was Arnold Rothstein, a well-known sports gambler in the United States. Rothstein's associate and Sullivan met with the players, who agreed to fix the series for \$80,000. Rothstein's associate gave Sullivan half of the money the players requested, but Sullivan decided to place \$30,000 on the Reds instead of giving the players the full \$40,000. As the series started, the players managed to throw games one and two, but after becoming frustrated with the lack of money coming to them, they did not fix game three, which they won. The players demanded \$20,000 before game four, or the fix was over; they received the money and promptly threw game four. They threw game five as well, but after failing to receive their promised money, the players decided the fix was over; the White Sox then won games six and seven, before losing the nine game series in game eight.<sup>110</sup>

The Black Sox Scandal exemplifies the problem with illegal betting: it is a cloud of complete and utter darkness. No one knows for sure which games were actually thrown, or who actually received money for throwing the games. The entire series is a puzzle for historians, with money changing hands rapidly and men like Arnold Rothstein making large profits.

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<sup>109</sup> See generally Douglas O. Linder: *The Black Sox Trial: An Account*, (2010), <http://law2.umkc.edu/faculty/projects/ftrials/blacksox/blacksoxaccount.html> (last visited Nov. 2, 2015).

<sup>110</sup> See *id.*

Further, it is difficult for historians to make an accurate analysis of whether the allegations of complicity by the named eight players were actually true. Historians believe that there are strong arguments for the assumption that two of the alleged match fixing players—Joe Jackson and Buck Weaver—were not involved in the fix. Joe Jackson statistically outperformed his career numbers in the series, but admittedly took money from the gamblers. Weaver on the other hand never received money, but was present at some of the meetings and failed to report the fix. In the following months, all eight players and several of the gamblers were indicted by a federal grand jury. Ultimately, they were found innocent, but newly designated Commissioner K. M. Landis took action the following day to permanently ban all eight players from the sport.<sup>111</sup>

A regulatory regime modeled on the Victorian statute would result in legitimate businessmen, who must report their financial statements to the government, replacing the Arnold Rothsteins of the sports betting world. Criminals would no longer be involved in the inner workings of sports betting, thereby removing their ability to fix sporting events. Information sharing, again, would play a key role by allowing the sports betting providers to identify large bets and convey this information to the league and authorities for proper investigation and monitoring. Monitoring of the betting market by the bookmakers would allow MLB to put a stop to the series before a fix could be completed. Even if a modern day Arnold Rothstein was somehow able to place enough illegal bets to make it worth his while to try and fix the series, the information regarding the fix would undoubtedly leak into the public realm. Once widespread speculation hit the public, legal bets would be placed based on the knowledge of the fix, causing a highly suspicious shift in the betting lines. The unusual lines would be shared with the FBI and MLB, who would likely prohibit the series from continuing. This model could have solved the problem of the 1919 World Series. Legalized sports betting would create a paper trail and hard evidence, which could uncover facts, unlike the situation in 1919. A paper trail would help reveal who placed bets and who received money from the bets, and allow bookmakers, law enforcement, and the MLB to

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<sup>111</sup> *See id.*

investigate and report on what was actually occurring.

#### 4. *The College Basketball Point Shaving Scandal of the 1950s*

The college basketball point shaving scandal of the 1950s provides a final example of how illegal sports betting has corrupted American sports. The scandal demonstrates how corruption can be minimized through transparency-enhancing regulation. When the scandal was uncovered in 1961, thirty-seven NCAA basketball players from twenty-two different schools, including prominent institutions such as Columbia University, St. John's University, New York University, North Carolina State University, and The University of Connecticut, were arrested for conspiring with Jack Molinas and mobster Thomas Eboli to fix games.<sup>112</sup> Later, it was discovered that from 1957 to 1961, Molinas and his partner, Joe Hacken, controlled 476 players from twenty-seven schools for over forty-three games. Together, Molinas and Hacken bribed collegiate basketball players with money to attempt to influence the outcome of the games. Molinas was arrested in January 1962 and convicted of bribing the players to fix games. Molinas spent five years in prison and was later murdered in what was likely a mob hit.<sup>113</sup>

Information sharing between leagues, betting providers, and law enforcement agencies would likely have led to a quick uncovering of the Molinas scandal. The Molinas scandal involved a lot of players. The fear of crossing the mob kept most players silent for fear of retribution, but under a Victorian model, the mob would not have had the power over and access to bookmakers, because the bookmakers would have been legitimate businessmen, not criminals. Without the fear produced by criminal organizations, there would be much more conversation amongst teammates and more dialogue from players and coaches. Additionally, bookmakers would be able to spot suspicious bets on minor college basketball games because small-scale college basketball games are unlikely to have much betting action. The bookmakers could flag the games and inform the NCAA or law enforcement, which would then investigate certain games for a possible fix. The scandal would be

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<sup>112</sup> See Joe Goldstein, *Explosion II: The Molinas Period*, ESPN (Nov. 19, 2003), [http://espn.go.com/classic/s/basketball\\_scandals\\_molinas.html](http://espn.go.com/classic/s/basketball_scandals_molinas.html).

<sup>113</sup> See *id.*



uncovered much more quickly than the Molinas scandal.

With information sharing and cooperation between sports leagues and sports betting providers, illegal-betting rings like the preceding scandals could be uncovered sooner. Additionally, the uncovering of these schemes could act as a deterrent to placing improper bets on sporting events. Legalized sports betting provides another means to provide integrity in sports: profits are no longer in the hands of unsavory characters and criminals, but instead in the hands of legitimate businessmen. As such, most of the temptation to fix matches is removed because the money could be monitored by government agencies and the bookmakers would have the economic incentives to promote, rather than interfere with, an honest competition. Information sharing and the removal of influence from unsavory characters under the Victorian model of sports betting would ease American concerns regarding sports betting and the integrity of sports.

#### **IV. NECESSARY MODIFICATIONS OF AMERICAN LAW TO SUCCESSFULLY IMPORT THE VICTORIAN REGIME OF REGULATED SPORTS BETTING**

The foregoing analysis suggests that sporting integrity, government tax revenues, and modest job opportunities in the sports wagering industry would be enhanced if the United States legalized and regulated sports gambling. This section considers legislation necessary to accomplish this objective. Certain federal laws will need to be repealed or substantially amended to remove prohibitions on sports gambling. PASPA must be modified to include three critical requirements: (1) remote gaming must be regulated and permitted; (2) information sharing between law enforcement, regulated bookmakers, and sporting organizations must be encouraged and obstacles to this effect must be removed; and (3) leagues must be given legal and economic incentives to cooperate fully. State implementation is also essential because federal legislators are likely to prefer that sports gambling build on the current model of state regulated gambling. To facilitate information sharing critical to sporting integrity, Congress may also need to adopt modest exceptions to privacy law. Finally, we compare the ideas offered here to those previously articulated in a path breaking op-ed column by NBA Commissioner Adam Silver.

##### **A. NEEDED CHANGES IN CURRENT FEDERAL LEGISLATION**

Federal law prohibits sports betting in the United States.

There are three existing federal laws that would require amendment to successfully implement a regulatory scheme based on the Victorian model. First, Congress would need to repeal the specific section of the Wire Act criminalizing betting on sporting events in which the bettor receives money or credit through wire communications in interstate or foreign commerce.<sup>114</sup> Sports gambling necessarily involves both interstate commerce and the transfer of money. To function meaningfully, individuals located in one state must be able to place a bet with a bookmaker located in another state. This requires repeal of the current Wire Act provision barring the exchange of money or credit for sports gambling purposes. Second, Congress would need to substantially modify PASPA,<sup>115</sup> which courts have interpreted to outlaw sports betting in all states except Nevada, Montana, Oregon, and Delaware.<sup>116</sup> Third, Congress would need to reconsider the Unlawful Internet Gambling and Enforcement Act of 2006 (UIGEA).<sup>117</sup> UIGEA currently prohibits gambling over the Internet, but it has provisions exempting fantasy sports as well as online gambling where permitted under state law.<sup>118</sup> The UIGEA needs to be amended to permit online gambling to be consistent with federal and state law, and to subject fantasy sports to the same integrity-protecting regulations that apply to other sports wagering industries.

Congress has three options to regulate interstate commerce. First, it can adopt a uniform rule, which preempts all state law under the Supremacy Clause.<sup>119</sup> Second, it can take no action, allowing states to regulate as they please (subject to relatively narrow judicially-imposed restraints on protectionist state legislation). And third, it can adopt a mixed approach to permit and ban certain conduct and activities, and authorize state

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<sup>114</sup> 18 U.S.C. § 1084.

<sup>115</sup> 28 U.S.C. §§ 3701-3704.

<sup>116</sup> *NCAA v. Christie*, 926 F. Supp. 2d 551, 556 (D.N.J. 2013).

<sup>117</sup> 31 U.S.C. Ch. 53, §§ 5361-5367.

<sup>118</sup> 31 U.S.C. §§ 5362(1)(e)(ix), 5363.

<sup>119</sup> JOHN E. NOWAK & RONALD D. ROTUNDA, *CONSTITUTIONAL LAW* 393 (8<sup>th</sup> ed. 2010) (“When Congress exercises a granted power, federal legislation may ‘preempt’ or override concurrent state legislation. The supremacy clause [U.S. Const. Art. VI, cl. 2] mandates that federal law overrides, i.e., preempts, any state regulation where there is an actual conflict between the two sets of legislation.”)

regulation under general standards.

In our view, sports gambling raises special concerns that make the second option of simple repeal and complete delegation to the states an inappropriate policy choice. The foundational argument for legalization is that it imposes transparency and removes the criminal element from sports gambling. For legalization to succeed, virtually all adults, other than proven violators, those with demonstrable compulsive gambling issues, and critical participants in the sports industry, need to be able to make lawful wagers. Allowing most adults to wager lawfully would dry up the minimum core of business for illegal bookmaking.

For practical and political reasons, a uniform federal regime under the auspices of a federal regulator also seems unwarranted. It would make legislative reform more difficult by incurring the wrath of turf-conscious and politically powerful state regulators. It also would require duplication of a wide variety of administrative tasks already performed by state regulators. Many, if not most of the authorized sports bookmakers, would be companies that are already involved and authorized to offer non-sports gambling.

For these reasons, the most effective way to implement the Victorian model would be through federal legislation that amends PASPA. Amending PASPA would permit sports gambling where authorized by state law. However, Congress should set certain specific standards and limit state regulation where necessary to ensure that legalization has the integrity-promoting properties discussed herein.

## B. REPLACING PASPA WITH FEDERAL STANDARDS

PASPA will need to be amended to establish a minimum standard for states to meet in order to regulate sports betting. These amendments should include three specific provisions to ultimately create a successful sports betting regime. First, the statute should permit remote online betting from states that do not support sports betting. Second, the statute should require information exchange among law enforcement, gambling regulators, authorized bookmakers, and sports leagues. Third, the statute should facilitate league cooperation.

### *1. Online Sports Betting*

Online sports betting is the future of sports betting; it will facilitate betting from the comfort of one's own home and

give bettors the option to watch their sporting events in private. The Australian Wagering Council has noted “[a]n ongoing shift of wagering spend from traditional offline betting channels (i.e. retail or TAB outlets, on-course bookmakers and with bookmakers over the phone) to online channels (internet, mobile, tablet). This trend is in line with consumer spending patterns in other retail sectors such as books, clothing and electronic goods, which have also seen a very high level of online growth.”<sup>120</sup>

Online sports betting also provides fiscal benefits, because it could provide increased revenue for bookmakers and the federal government. The benefits of online sports betting are also practical. Bettors in states where sports gambling remains illegal will likely, if permitted, place lawful wagers online with regulated bookmakers in other states. This demonstrates a need for a federal law to permit online sports betting, including wagers between bettors in states that disallow sports betting and bookmakers in states that allow sports betting. This would likely preclude an illegal gambling market of any size to flourish in states barring sports gambling.

## 2. *Information Sharing*

The new statute also needs to emphasize information sharing policies among sports controlling bodies, sports betting providers, state regulators, and law enforcement. There is a critical need of an effective system for sports bookmakers, leagues, gambling regulators, and law enforcement to share information seamlessly. As demonstrated by the Victorian model, information sharing is a key aspect to ensure the integrity of sporting events. American expert observers have also echoed this view. Geoff Freeman, President of the American Gaming Association, stated “while casinos routinely look for suspicious bets at sports books and have worked with law enforcement to identify illegal activity—in some cases leading to criminal convictions—no such oversight exists for the illegal sports betting market.”<sup>121</sup> Currently, outside of Nevada, states without the

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<sup>120</sup> Austl. Wagering Council, *Key Industry Facts & Statistics*, <http://australianwageringcouncil.com/policy-representation/industry-statistics> (last visited Nov. 2, 2015).

<sup>121</sup> Press Release, American Gaming Association, *American Gaming Association Welcomes FinCEN Guidance on Sports Books, Urges Further Scrutiny of Illegal Sports Betting* (Jan. 16, 2015),

power to regulate legal gambling lack infrastructure that would allow them to effectively regulate and monitor sports gambling. Developing this ability should be a federal prerequisite to state authorization of sports gambling. Relatedly, all bettors should be required to provide information about their identity to better enforce integrity in the betting marketplace and in sporting events. This would allow sports controlling bodies and law enforcement to better monitor who is placing bets, and ensure that suspicious betting activity is monitored.

### 3. *League Cooperation*

Politically and practically, widespread regulated sports gambling cannot exist without the support and cooperation of sports leagues; strong opposition from sports leagues would doom federal legislative reform. On the other hand, enthusiastic support would facilitate implementing legislation at both the federal and state levels. More importantly, sports league cooperation is critical to the success of the Victorian scheme. Sports executives are best able to identify “spot bets” that have little effect on the outcome of a contest and are also most likely to compromise sporting integrity (players are more likely to act corruptly regarding conduct that will not affect the outcome of the contest).<sup>122</sup> League cooperation is essential to identify those who may be involved in a corrupt money trail, and to provide critical information to bookmakers and law enforcement.

## C. STATE IMPLEMENTATION

Once Congress makes the necessary changes to federal

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<https://www.americangaming.org/newsroom/press-releases/american-gaming-association-welcomes-fincen-guidance-sports-books-urges>.

<sup>122</sup> E-mail from Adrian Anderson, former General Manager for Football Operations, Australian Football League (Nov. 18, 2015) (on file with author). To illustrate, three Pakistani cricketers were found guilty of spot betting during a 2010 international 5-day match against England. The plot involved an agreement to bowl a number of “no balls” (the equivalent of a foot fault in tennis, which gives the other team a single run – in a contest where winning teams will score over 500 runs) at a particular time during the match. *See also* Ali Martin, *Former Pakistan Captain Salman Butt Admits Role in Spot-Fixing Scandal*, THE GUARDIAN (Feb. 18, 2015), <http://www.theguardian.com/sport/2015/feb/18/salman-butt-pakistan-spot-fixing-role>.

laws governing sports betting, the states will need to enact implementation statutes. The regulatory regime adopted by the State of Victoria should be implemented in the United States with appropriate modifications to suit local needs. As previously discussed, a foundational goal of legalized sports betting is to deprive illegal betting markets of enough bettors so that corruption can no longer flourish. A national policy that accomplishes this goal can be implemented within the traditional scheme of state gaming regulation, but only if online gambling is also permitted. That is, states that choose to prohibit sports bookmaking within their boundaries will not frustrate the federal scheme by creating a new market for underground illegal sports gambling, as long as their citizens remain free to engage in online sports gambling with regulated bookmakers in other states.

A potential federalism issue may arise if states not only seek to preclude “brick and mortar” sports books within their borders, but also seek to prohibit their citizens from engaging in online sports betting. The best way to effectuate a national policy precluding the market for underground illegal sports gambling is for federal legislation to preempt any state laws from prohibiting online betting with regulated bookmakers in other states, where the other states’ regulation meets minimum federal standards.

Congress has the undisputed authority to regulate such activity because online gambling with bookmakers in other states is clearly interstate commerce. Congressional regulation under the Commerce Clause includes the power to preempt contrary state laws.<sup>123</sup> Absent such legislation, most states<sup>124</sup> would retain

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<sup>123</sup> This principle dates back to *Gibbons v. Ogden*, 22 U.S. 1 (1824), the first commerce clause case, where a New York state statute that granted a steamship monopoly to inventors Robert Livingston and Robert Fulton was struck down as being inconsistent with a federal statute that authorized Thomas Gibbons to operate a ferry in interstate commerce between Elizabethtown, New Jersey and New York City.

<sup>124</sup> States that permit gambling (either sports or other) within their borders might be subject to challenge if they sought to preclude their residents from online gambling with out-of-state establishments. The Supreme Court has repeatedly held that state laws violate the “dormant” Commerce Clause when they mandate “differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter,” and that states “may not enact laws that burden out-of-state producers or shippers simply to give a

the power to ban online sports gambling within its borders, thereby creating an unacceptable opportunity for organized crime and others to evade the transparency and information sharing of regulated gaming by taking advantage of a rich market for would-be legal sports bettors.<sup>125</sup>

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competitive advantage to in-state businesses.” *Granholm v. Heald*, 544 U.S. 460, 472 (2005) (quoting *Or. Waste Sys., Inc. v. Dep’t of Env’t Quality of Or.*, 511 U.S. 93, 99 (1994)) (striking down Michigan law allowing in-state wineries to sell directly to consumers while prohibiting out-of-state wineries from doing the same). The scenario in *Granholm* is similar to a potential Nevada online sports betting ban. Nevada offers in-state in-person sports betting at numerous casinos. Nevada may want to ban online sports betting out of a fear that it could cannibalize the current in-person sports betting market. Challengers could argue that Nevada would be barring out-of-state online bookmakers in order to compel their citizens to continue to patronize Nevada’s in-person casinos. A court would ultimately decide whether Nevada’s ban on online sports betting burdens out-of-state businesses in order to create a competitive advantage for its in-state businesses.

Courts are not always sympathetic to claims that state bans on online sports gambling are motivated by unconstitutional protectionist objectives. For example, in *Churchill Downs, Inc. v. Trout*, 979 F. Supp. 2d 746 (W.D. Tex. 2013), the court held that a Texas ban on out-of-state online horse race betting was not a violation of the Commerce Clause. *Churchill Downs, Inc.*, operates an online horse racing wagering platform that accepts bets on races at Churchill Downs in Kentucky. The races are simulcast to Texas racetracks, where patrons can wager on the races. However, the Texas Racing Act mandated that all wagering on horse racing by Texas residents must be done in-person, thus cutting out Churchill Downs from the Texas market. The court reasoned that in-person gambling is different from online gambling because there are numerous in-person gambling regulations that cannot be effectively transferred to online gambling. *Id.* at 751. The court also considered whether the Texas legislature passed the act for protectionist reasons. Applying a four-factor text articulated in *Allstate Ins. Co. v. Abbott*, 495 F.3d 151, 160 (5th Cir. 2007), the court determined that there was no history of discrimination, and the only evidence of discrimination against Churchill Downs stemmed from the debate regarding the passage of the act in the Texas legislature, which was insufficient to prove a history of discrimination. *Churchill Downs*, 979 F. Supp. 2d at 753.

<sup>125</sup> In *Rouso v. State*, 170 Wash. 2d 70 (2010), the Supreme Court of Washington rejected a Dormant Commerce Clause challenge to a state ban on Internet gambling. The court found that the ban on online

As the Supreme Court recognizes, federal legislation legalizing regulated online gambling is within Congress' powers under the Commerce Clause. The placing of an online bet from a state where sports gambling is prohibited to a sports bookmaker operating lawfully in a state where sports gambling is regulated fits both the recognized federal power to regulate persons and things in interstate commerce, as well as activities that substantially affect interstate commerce.<sup>126</sup>

Congress can easily find that if individual states were to prohibit all forms of sports betting, both in-person and online, this would create a black market in those states for people to place bets illegally, just as there are black markets for sports betting under the current federal legislation banning sports betting. This is precisely what the Victorian model would prevent. State prohibitions take its citizens out of a national market for online sports betting, which Congress has the power to regulate. Indeed, the government does not have to prove that

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gambling in Washington was not discriminatory towards out-of-state business, because *all* online gambling was prohibited in Washington, regardless of its origin. The Court observed that the U.S. Supreme Court had upheld state corporate takeover legislation that applied equally to in-state and out-of-state entities, even though "a majority of entities seeking to effectuate a hostile takeover of an Indiana corporation were out-of-state [entities]." *Id.* at 80, (citing *CTS Corp. v. Dynamics Corp. of America*, 481 U.S. 69, 87-88 (1987)). The court reasoned that online gambling and in-person gambling are two different activities, with different risks and concerns. Finally, the court applied the balancing test articulated by the U.S. Supreme Court in *Pike v. Bruce Church*, 397 U.S. 137, 142 (1970), to determine if the burden on interstate commerce caused by Washington's ban on online gambling was excessive compared to the state interests. The court concluded that state regulation of online gambling might not be sufficient to protect the state's interests, because regulation would be very difficult, and the ban addresses legitimate concerns, such as "reducing underage gambling, compulsive gambling, and Washingtonians' unintentional support of organized crime and money laundering operations." *Rouso*, 170 Wash. 2d at 89. Likewise, in *Churchill Downs*, the court relied on *Rouso* in holding the Texas ban on online gambling did not violate the *Pike* test. The court reasoned that although the ban places a "meaningful burden" on interstate commerce, the state's interest in protecting gambling addicts and preventing underage gambling is sufficient to overcome the burden. *Churchill Downs*, 979 F. Supp. 2d at 754.

<sup>126</sup> *Gonzales v. Raich*, 545 U.S. 1, 16-17 (2005).



a black market in these states actually has substantial effects on interstate commerce for online sports betting (although it likely would); rather, the Supreme Court has stated that it will uphold federal legislation as long as there is a “rational basis” for believing that it has such an impact.<sup>127</sup> Illegal wagers in states where sports gambling is outlawed come in lieu of the interstate market, because these bettors would otherwise make online wagers with regulated bookmakers in other states.<sup>128</sup>

#### D. MODEST PRIVACY LAW EXCEPTIONS TO FACILITATE ESSENTIAL INFORMATION SHARING

As previously noted, an essential element of the Victorian regulatory model is the active and unimpeded exchange of information among law enforcement agencies, state gaming regulators, sports leagues, and authorized sports bookmakers.<sup>129</sup> Although current United States federal law permits some of this sharing, some modifications in federal and equivalent state law may be necessary.

Consider the importance of ensuring that authorized bookmakers do not employ criminals, or that certain criminals are prohibited from legally gambling. To ensure that persons barred from bookmaking employment or from wagering do not participate in the sports wagering industry, bookmakers should be able to consult government databases. Taking Pennsylvania’s limited information sharing system for example, there are two differing databases that come into play, the U.S. Department of Justice’s NCIC database<sup>130</sup> and the Pennsylvania database under the Pennsylvania Criminal History Record Information Act

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<sup>127</sup> *Id.* at 22.

<sup>128</sup> While one person who acts in this manner is not making a large dent in the national market for online sports betting, an entire state of people acting in this way, or multiple entire states acting this way will severely hurt the market for online sports betting. This is sufficient to justify federal Commerce Clause regulation. *Wickard v. Filburn*, 317 U.S. 111, 127-28 (1942).

<sup>129</sup> See Ross & Anderson, *supra* note 7.

<sup>130</sup> See generally *National Crime Information Center (NCIC)*, FAS.ORG, <http://www.fas.org/irp/agency/doj/fbi/is/ncic.htm> (last visited Nov. 2, 2015).

(CHRIA).<sup>131</sup> An agency like the Pennsylvania Gaming Control Board (PGCB) can undoubtedly use these databases to obtain access to information concerning criminal arrests and convictions.<sup>132</sup>

The difficulties, however, come into play when obtaining access to “protected information,” which includes intelligence, investigative, and treatment information.<sup>133</sup> Only a “criminal justice agency” may gain access to protected information.<sup>134</sup> This is problematic because typically the type of information a state regulator or authorized bookmaker needs in order to determine an individual’s suitability to gamble is privileged information. An administrative licensing agency generally will not be considered a criminal justice agency and hence will not be able to obtain direct access to the protected information,<sup>135</sup> and private bodies, such as sports leagues or sports bookmakers, are certainly unable to obtain this information. In order for states to effectively regulate a sports gambling market, federal and state law needs to provide state gaming regulators greater oversight and investigatory capabilities.

There are several examples of useful information exchange systems that newly authorized sports gambling regulators may emulate. These include the anti-money laundering system used by the Financial Industry Regulatory Authority,<sup>136</sup> the Las Vegas’ joint information sharing system with the Federal Bureau of Investigation (FBI),<sup>137</sup> and the

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<sup>131</sup> 18 PA. CONS. STAT. §§ 9101-9106 (1979) (Supp. 1994); *see generally* COMMONWEALTH OF PA., CRIMINAL HISTORY RECORD INFORMATION ACT HANDBOOK (6th ed. 2012),

<sup>132</sup> *See generally* Michael Adams, *White Paper #7: Benchmarking the Background Check Industry Criminal and Civil Records*, COMMERCIAL BUSINESS INTELLIGENCE, INC. (Aug. 2005) (paper on file with author).

<sup>133</sup> *See* COMMONWEALTH OF PA., *supra* note 131, at 2.

<sup>134</sup> *Id.* at 4-6; *see also* 18 PA. CONS. STAT. §§ 9102, 9106.

<sup>135</sup> *See* COMMONWEALTH OF PA., *supra* note 131, at 4-5.

<sup>136</sup> *See e.g.*, Jamal El-Hindi, *AML Compliance Program Requirements*, U.S. DEP’T OF THE TREASURY FIN. CRIMES ENFORCEMENT NETWORK (Dec. 24, 2014), [http://www.fincen.gov/statutes\\_regs/guidance/pdf/01162015.pdf](http://www.fincen.gov/statutes_regs/guidance/pdf/01162015.pdf) (last visited Nov. 2, 2015).

<sup>137</sup> *See generally* *Twenty-Five Individuals Indicted in Multi-Million-Dollar Illegal Nationwide Sports Gambling Ring*, FBI.GOV

Australian system.

Currently, casinos are required to develop and implement a compliance program reasonably designed to manage the risk of illicit activity and ensure compliance with applicable regulations. The agreement requires casinos to file reports, properly identify customers conducting transactions, and maintain appropriate records of transaction. These reports are then used to track everything from money laundering and illegal gambling to counter terrorism.<sup>138</sup>

Established FBI practices used to combat an illegal gambling ring based in Las Vegas could also be emulated. The FBI worked together with many different agencies, including the New York Police Department, the Nevada Gaming Control Board, the New Jersey State Commission of Investigation, the Monmouth County Prosecutor's Office, the Pennsylvania State Police, and the Los Angeles Police Department, in a concerted effort to bring down a multi-million dollar, nationalized illegal gambling ring. The FBI orchestrated the exchange of information amongst all of these agencies and this effort led to several indictments.<sup>139</sup> Even though this example involves one of the previously discussed "criminal justice agencies," it illustrates how sharing can work, especially if legislation expanded access to critical information.

In Australia, Victorian laws promote information sharing among the betting agencies, the sports leagues, and the government.<sup>140</sup> The mechanics of the Australian system are fairly straightforward. To accept sports wagers, bookmakers must enter into agreements with sports leagues whose competitions are the subject of the wager, and the agreements must provide for information sharing between the betting

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(Oct. 25, 2012), <http://www.fbi.gov/newyork/press-releases/2012/twenty-five-individuals-indicted-in-multi-million-dollar-illegal-nationwide-sports-betting-ring> (describing the system in operation) [hereinafter *Sports Gambling Ring*].

<sup>138</sup> See El-Hindi, *supra* note 136, at 2-3.

<sup>139</sup> *Sports Gambling Ring*, *supra* note 137.

<sup>140</sup> Sports Betting Act 2007, (Vict.) div 3 s 4.5.23, [http://www.legislation.vic.gov.au/Domino/Web\\_Notes/LDMS/PubStatbook.nsf/f932b66241ecf1b7ca256e92000e23be/7F87494B9F48C351CA2572EA0020E114/\\$FILE/07-018a.pdf](http://www.legislation.vic.gov.au/Domino/Web_Notes/LDMS/PubStatbook.nsf/f932b66241ecf1b7ca256e92000e23be/7F87494B9F48C351CA2572EA0020E114/$FILE/07-018a.pdf) (last visited Nov. 2, 2015).

providers and the leagues.<sup>141</sup>

Federal privacy laws are closely linked with the feasibility of a robust information sharing system. In particular, the Privacy Act of 1974<sup>142</sup> could limit the information sharing capacity of private bookmakers, sports leagues, and the government. The Privacy Act “establishes a code of fair information practices that governs the collection, maintenance, use, and dissemination of information about individuals that is maintained in systems of records by federal agencies.”<sup>143</sup> The Privacy Act mandates that a federal agency cannot disclose a record about an individual from a system of records<sup>144</sup> absent the written consent of the individual, unless the disclosure is pursuant to one of twelve statutory exceptions. The twelve exceptions are as follows: (1) the “need to know” within an agency; (2) required disclosures under the Freedom of Information Act; (3) routine uses; (4) Bureau of Census; (5) statistical research; (6) national archives; (7) law enforcement request; (8) health or safety of an individual; (9) congressional; (10) general accounting office; (11) court order; and (12) debt collection act.<sup>145</sup>

Conflicts between the Privacy Act and a legalized sports gambling framework could arise because the information exchange required for effective sports gambling regulation might not fall under any of the twelve exceptions, thus making the framework illegal under the Act. When evaluating these exceptions, the law enforcement request exception could very well apply for records exchanged among some parties involved in the regulation of sports gambling. Government guidelines state that, “in addition to providing for disclosures to federal law enforcement agencies, [the Act] also allows an agency, ‘upon receipt of a written request, [to] disclose a record to another agency or unit of State or local government for a civil or criminal

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<sup>141</sup> *Id.*

<sup>142</sup> 5 U.S.C. § 552a (1974).

<sup>143</sup> Office of Privacy and Civil Liberties, *Privacy Act of 1974*, THE U.S. DEP’T OF JUSTICE (last updated July 15, 2015), <http://www.justice.gov/opcl/privacy-act-1974> (last visited Nov. 2, 2015).

<sup>144</sup> “A system of records is a group of records under the control of an agency from which information is retrieved by the name of the individual or by some identifier assigned to the individual.” *Id.*

<sup>145</sup> 5 U.S.C. § 552a(b)(1)-(b)(12) (1974).

law enforcement activity.”<sup>146</sup> The administrative agencies that would handle a large amount of the regulatory responsibility in a legalized sports gambling framework, such as state gaming control board, could very well qualify under the “another agency or . . . civil . . . law enforcement activity.” Information sharing between private bookmakers and sports leagues would require appropriate modifications to the Privacy Act, parallel legislation, and equivalent state level legislation.

#### E. BUILDING ON COMMISSIONER SILVER’S PROPOSAL

NBA Commissioner Adam Silver recently stated that “the laws on sports betting should be changed. Congress should adopt a federal framework that allows states to authorize betting on professional sports, subject to strict regulatory requirements and technological safeguards.”<sup>147</sup> Silver acknowledged the hypocrisy associated with the professional sports leagues’ opposition to sports gambling by pointing to league collaborations with fantasy sports, and pointed to the NBA’s own very lucrative deal with the fantasy sports operator Fan Duel that gave the NBA an equity stake in the company. Silver noted, “while I wouldn’t categorize [fantasy sports] as sports betting, on the continuum of no betting at all and legalized betting, it is certainly on the spectrum.”<sup>148</sup>

Although NBA’s Silver may be the most vocal about the need to change the thinking on legalized sports gambling, other leagues are taking notice as well. Most notably, MLB Commissioner Rob Manfred has stated that it is time to give fresh consideration to the issue of sports gambling, thus distancing himself from MLB’s historical stance that sports gambling should continue to be banned.<sup>149</sup> Additionally, in 2012, the NFL convened a forum in collaboration with other pro leagues, the IOC, and the NCAA to discuss the feasibility of sports gambling. This forum, as well as private meetings among

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<sup>146</sup> OMB Guidelines, 40 Fed. Reg. 28,948, 28,955 (July 9, 1975).

<sup>147</sup> Silver, *supra* note 13.

<sup>148</sup> Purdum, *supra* note 21.

<sup>149</sup> Adam Kilgore, *MLB’s Deal with DraftKings Should Signal Baseball’s Changing Stance on Gambling*, WASH. POST (Apr. 7, 2015), <http://www.washingtonpost.com/news/sports/wp/2015/04/07/mlbs-deal-with-draftkings-should-signal-baseballs-changing-stance-on-gambling/>.

professional sports leagues' leaders, indicates that the leagues are aware that change is on the horizon regarding legalized sports gambling.<sup>150</sup>

Commissioner Silver has proposed a persuasive framework to establish a robust system of checks and monitoring that would promote the integrity of the sporting events and rid the events of corruption previously left undetected. The framework consists of six specific regulatory features that would best inhibit sports corruption, including "mandatory monitoring and reporting of unusual betting-line movements; a licensing protocol to ensure betting operators are legitimate; minimum-age verification measures; geo-blocking technology to ensure betting is available only where it is legal; mechanisms to identify and exclude people with gambling problems; and education about responsible gaming."<sup>151</sup>

We quibble with Commissioner Silver's proposal only in a few respects. First, as previously noted, geo-blocking technology could preclude lawful and regulated sports gambling in states where sports bookmaking is illegal. Such regulation could create an undue risk of facilitating an underground illegal sports gambling market. Second (and perhaps Silver was simply being politic in leaving this out), league cooperation and consent should be essential, and, as in Victoria, mandated by statute as a prerequisite for legalized sports betting. This not only avoids some potentially cumbersome issues of trademark and related intellectual property law,<sup>152</sup> but it also facilitates strong league

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<sup>150</sup> Purdum, *supra* note 21.

<sup>151</sup> Silver, *supra* note 13.

<sup>152</sup> In order to facilitate legalized sports gambling, sports books and casinos would be required to use league names, team names, logos, and player likenesses to promote their new sports gambling businesses. This use would raise trademark implications, because without appropriate licensing, the leagues and their players would assert that unlicensed use of this information would constitute trademark infringement. Unlike copyrighted material, or inventions that are patented, leagues and clubs do not "own" trademarked logos "outright." For example, federal law allows for non-commercial trademark use by third parties. 15 U.S.C. § 1115(b)(4) (1946). Leagues and club trademark holders can, however, enjoin others from using a trademark when the use is likely to cause "consumer confusion." ROBERT W. GOMULKIEWICZ, *LICENSING INTELLECTUAL PROPERTY* 119 (Edwin Chemerinsky et. al. eds., 3d ed. 2014). In *Boston Prof'l Hockey Ass'n*

support and cooperation. As previously noted, league cooperation is essential for three reasons: First, legislative reform is politically infeasible without league cooperation; second, leagues are critical to effective information exchanges; and third, league input is necessary to bar particular kinds of wagers (such as “spot betting”) that pose undue risks to sporting integrity.

League support is critical in order to break congressional gridlock on major legislation. Although some leading legislators, including Senator John McCain, feel that the sports

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v. *Dallas Cap & Emblem Mfg., Inc.*, 510 F.2d 1004, 1009-10 (5th Cir. 1975), the court held that trademark infringement occurs when

[A] person uses (1) any reproduction . . . of a mark; (2) without the registrant's consent; (3) in commerce;(4) in connection with the sale, offering for sale, distribution or advertising of any goods; (5) where such use is likely to cause confusion, or to cause mistake or to deceive.

However, in *Boston Hockey*, the court found that even without consumer confusion, trademark law prevents third parties from capitalizing on the goodwill of a sports entity's trademark. *Id.* at 1012-13. The use of team and league logos by sports bookmakers would, under the reasoning of *Boston Hockey*, constitute trademark infringement. Moreover, the fair use doctrine would not be applicable to commercial operations like sports books. *See* 15 U.S.C.S. § 1115(b)(4) (1946) (outlining the fair use exception); *ACLU v. Miller*, 977 F. Supp. 1228, 1233 n. 6 (N.D. Ga. 1997) (“Congress acknowledged the first amendment problems with banning non-commercial use of trademarks by limiting the scope of the new Federal Trademark Dilution Act to apply to commercial use only”); 4 CALLMANN ON UNFAIR COMPETITION, TRADEMARKS & MONOPOLIES § 22.59 (4th ed. 2011).

Some sports books would like to offer wagers on individual sporting performances. In this regard, the case law is somewhat less favorable to intellectual property rights of the sports industry. In *C.B.C. Distrib. & Mktg, Inc. v. Major League Baseball Advanced Media, LP*, 505 F.3d 818 (8th Cir. 2007), the Eighth Circuit held that combinations of player names and statistics for commercial purposes were deemed protected for public use under the First Amendment. The court reasoned that “the information used in CBC’s fantasy baseball games are all readily available in the public domain, and it would be strange law that a person would not have a [F]irst [A]mendment right to use information that is available to everyone.” *Id.* at 823.

gambling issue needs to be reevaluated,<sup>153</sup> others, such as Representative Glenn Thompson, do not agree that “expanding gambling is a good thing.”<sup>154</sup> Even if a consensus could be developed among sports leagues and regulators, Nevada’s legislators may oppose federal reform because of its current advantage as one of the few states that has legalized sports gambling.<sup>155</sup>

In addition to the benefits of league cooperation to promote legal reform and implementation of an integrity-enhancing regulatory regime, league cooperation also promotes an economically beneficial licensing scheme. With league approval, there could be a previously planned licensing scheme that would give each respective league their fair share of licensing fees. Data sharing between leagues and sports books could also be facilitated through licensing.<sup>156</sup> In a previously planned licensing scheme, prior to the induction of a legalized sports gambling framework, the sports leagues, government, and gambling proprietors would institute a licensing system that promulgates all the licensing provisions so that difficulties do not arise once legalized gambling is officially enacted. The leagues could also charge sports books and casinos licensing fees to use the leagues’ data.

### CONCLUSION

Outside of Nevada, the current United States prohibition on sports gambling is flawed. As a result of the prohibition,

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<sup>153</sup> Matt Bonesteel, *Sen. John McCain Says Congress Needs to Re-Examine U.S. Ban on Sports Gambling*, WASH. POST (Feb. 2, 2015), <http://www.washingtonpost.com/blogs/early-lead/wp/2015/02/02/sen-john-mccain-says-congress-needs-to-re-examine-u-s-ban-on-sports-gambling/> (quoting Sen. McCain, “[w]e need a debate in Congress . . . [w]e need to have a talk with the American people, and we need to probably have hearings in Congress on the whole issue so we can build consensus”).

<sup>154</sup> Tim Davaney, *NBA Push to Legalize Sports Betting No Slam-Dunk in Congress*, THE HILL (Nov. 15, 2014), <http://thehill.com/regulation/224278-nba-push-to-legalize-sports-betting-no-slam-dunk-in-congress>.

<sup>155</sup> McLaughlin, *supra* note 37 (stating how Nevada Senator Harry Reid, the Democrats’ floor leader, would use his powerful position to protect Nevada’s near-monopoly on sports gambling).

<sup>156</sup> See Purdum, *supra* note 21 (stating Dallas Mavericks owner Mark Cuban’s suggestion that the leagues could charge sportsbooks and casinos licensing fees to use the league’s data).



problems include organized crime, a lack of transparency, and foregone financial opportunities. Judicial interpretation of the Professional and Amateur Sports Protection Act makes it clear that federal law precludes all state efforts to implement regulated sports gambling.

The best solution is to legalize sports gambling through federal legislative reform, coupled with league agreement and approval. This would allow states to tax and regulate sports gambling, thereby removing the presence of organized crime and allowing transparency between the bettors, bookmakers, regulators, and sports leagues. Bringing sports gambling into the light would also provide increased visibility to the problems of compulsive gamblers and facilitate the identification, treatment, and other appropriate remedies for problem gamblers.

The Victorian sports betting model has proved to be successful in maintaining integrity in sports, while also boosting the Victorian economy. By removing sports betting from the dark shadows and smoky back rooms of bars and into the hands of legitimate businessmen, the United States can ensure sporting integrity while simultaneously boosting the economy and substantially increasing federal and state tax revenues. Additionally, with league approval, there would be no need to engage in costly and difficult intellectual property licensing disputes between the leagues and the gambling proprietors. While there are many legal hurdles to overcome on the path to legalized sports betting in the United States, with carefully crafted statutes, it is possible.

Ultimately, the legalization of sports betting would be a positive move for the United States. It would ensure sporting integrity while also boosting the economy. Such reform is in the public interest.

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### COLLEGIATE ATHLETICS AND THE UNRELATED BUSINESS INCOME TAX: OLD ASSUMPTIONS AND NEW DIRECTIONS FOR AN ISSUE OF CHARITABLE TAX EXEMPTIONS

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### INTRODUCTION

College sports are popular and valuable commercial products, which generate revenue through the sale of tickets, broadcast rights, and licensed merchandise. At the center of this commercial product is the concept of the “student athlete,” a young person who pursues extracurricular athletic competitions while attending college. To a great extent, college sports are popular and valuable because spectators enjoy watching athletes who are presumably motivated by the love of their university and the love of the game—and not by any financial or commercial motives.

The ideal concept of the student athlete is becoming increasingly difficult to maintain. College sports generate an ever-increasing amount of revenue every year. In 2010, the National Collegiate Athletic Association (“NCAA”), the major entity that regulates and organizes college sports, signed a 14-year contract for the broadcast rights to its annual men’s basketball tournament that will produce a total of \$10.8 billion in revenue for its member colleges and universities.<sup>1</sup> Two years later, the entity that administers college football’s postseason playoff system signed a 12-year contract for broadcast rights to a few postseason games each year for \$5.64 billion.<sup>2</sup> Meanwhile,

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<sup>1</sup> Brad Wolverton, *NCAA Agrees to \$10.8-Billion Deal to Broadcast its Men’s Basketball Tournament*, CHRONICLE OF HIGHER EDUCATION (Apr. 22, 2010), <http://chronicle.com/article/NCAA-Signs-108-Billion-De/65219/>.

<sup>2</sup> Jerry Hinnen, *ESPN Reaches 12-Year Deal to Air College Football Playoffs*, CBS SPORTS (Nov. 21, 2012), <http://www.cbssports.com/collegefootball/eye-on-college-football/21083689/espn-reaches-12year-deal-to-air-college-football-playoffs>.

stories about academic fraud<sup>3</sup> and other rule-breaking violations<sup>4</sup> have undermined the presumption that collegiate athletics are merely an avocation for student athletes. An ever-increasing number of observers see collegiate athletics as nothing more than a big business that is in tension with the educational purposes of universities.

The tension between the ideal and the reality of collegiate athletics has been heightened by recent litigation, which challenges the legality of the “amateur ideal” that animates collegiate athletics.<sup>5</sup> This litigation threatens to change the structure and conception of college athletics and will perhaps eliminate the current ideal of the student athlete. There are many consequences of this litigation for the operations of collegiate athletic departments and even for the structure of university operations. However, one potential consequence has not drawn immediate attention: the effect of these fundamental changes on the taxation of the enormous income derived from collegiate athletic programs, especially football and men’s basketball.

Currently, under the broad tax exemption provided by IRC Section 501(c)(3), such income is exempt from taxation because it is treated as “substantially related” to a university’s educational mission.<sup>6</sup> This exemption is premised on certain ideas that are bound up with the idealized model of collegiate athletics. The most important of these presumptions is the idea that athletics are an aspect of a university’s educational mission.

The recent and pending litigation about college athletics threatens the viability of this idea and therefore threatens one of the crucial foundations of the tax exemption for income from collegiate athletics. At the core of the legal challenges to the university’s athletic model is the contention that collegiate

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<sup>3</sup> See generally Jack Stripling, *Widespread Nature of Chapel Hill’s Academic Fraud Is Laid Bare*, CHRONICLE OF HIGHER EDUCATION (Oct. 23, 2014), <http://chronicle.com/article/Widespread-Nature-of-Chapel/149603/>.

<sup>4</sup> See generally Lynn Zinser, *U.S.C. Sports Receive Harsh Penalties*, N.Y. TIMES (June 10, 2010), [http://www.nytimes.com/2010/06/11/sports/ncaafootball/11usc.html?\\_r=0](http://www.nytimes.com/2010/06/11/sports/ncaafootball/11usc.html?_r=0).

<sup>5</sup> Patrick Vint, *Ranking the NCAA’s 5 Biggest Legal Battles, from Least to Most Threatening*, SB NATION (Mar. 20, 2014), <http://www.sbnation.com/college-football/2014/3/20/5528032/ncaa-lawsuits-obannon-kessler-union>.

<sup>6</sup> I.R.C. § 501(c)(3).

athletics are a business and that the relationship between the “student athlete” and the university is primarily a commercial one, which should be governed by the ordinary legal rules applying to any other commercial relationship. Interestingly, in defending against these challenges, entities associated with collegiate athletics, especially the NCAA, have essentially conceded this point.<sup>7</sup> Consequently, regardless of how the challenges to the established model are resolved, the litigation process has provided a substantial basis for challenging the premises behind the tax exemption.

This article examines how the emerging changes in the structure and concept of collegiate athletics may affect the tax-exempt status of the income generated by “big time” college sports. Part I of this article reviews the business of college sports and how that business fits into the educational missions of colleges and universities, both in theory and in practice. Part II reviews the law governing taxation of the business activities of tax-exempt charitable and educational institutions, such as colleges and universities; this part also includes a brief background of the tax law that could be affected by changes to the concept of collegiate athletics. Part III discusses the application of these taxation rules to universities and their business operations that are collateral to their educational mission. Part IV discusses how these taxation rules have traditionally been applied to income generated by collegiate athletics; it reviews important, recent developments in the current litigation challenging the collegiate athletics model and how those developments affect the established approaches to taxing income from collegiate athletics. This article concludes by considering ways in which the law governing taxation of income from collegiate athletics may develop in the future.

### **I. THE BUSINESS OF COLLEGE SPORTS**

College sponsorship of student athletic competition did

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<sup>7</sup> Gary T. Brown, *Is College Sports a Big Business?*, NCAA NEWS ARCHIVE (Aug. 29, 2005), <http://fs.ncaa.org/Docs/NCAANewsArchive/2005/Association-wide/is%2Bcollege%2Bsports%2Bbig%2Bbusiness%2B-%2B8-29-05%2Bncaa%2Bnews.html>.

not begin until the twentieth century. Collegiate athletics began in the middle of the nineteenth century as an informal social activity for students. The first collegiate athletic competition occurred in 1852, when Yale and Harvard competed in rowing.<sup>8</sup> After the Civil War, universities began to encourage their students to play the new sport of football.<sup>9</sup> Football was seen as a means to develop the moral character of students because its combative nature, acting as a salutary substitute for the discipline and rigor of military service.<sup>10</sup> Thus, in the beginning, collegiate athletics were intended to be an element of the educational process for a thoroughly well-rounded student.

The popularity of collegiate athletics among students and spectators alike fueled its rapid growth and prompted efforts towards national organization and standardization of practices and policies governing collegiate athletic competition. In 1905, the presidents of 62 colleges and universities founded the NCAA for the principal purpose of creating a uniform set of rules to regulate intercollegiate football.<sup>11</sup> As a voluntary membership organization, the NCAA has rapidly grown; today, the NCAA includes approximately 1,100 schools and regulates intercollegiate athletic competitions in approximately two dozen different sports.<sup>12</sup> Despite this growth, the NCAA remains founded on the principle that inspired the creation of intercollegiate athletics in the nineteenth century. Specifically, that participation in athletic competition is a crucial aspect of the education of young men and women.<sup>13</sup> According to its current

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<sup>8</sup> *Great Moments in Yale Sports*, YALE ALUMNI MAGAZINE (Mar. 2001), [http://web.archive.org/web/20121114113135/http://yalealumnimagazine.com/issues/01\\_03/sports.html](http://web.archive.org/web/20121114113135/http://yalealumnimagazine.com/issues/01_03/sports.html) (last visited Nov. 4, 2015).

<sup>9</sup> GEORGE M. FREDRICKSON, *THE INNER CIVIL WAR: NORTHERN INTELLECTUALS AND THE CRISIS OF UNION* 222-24 (1993).

<sup>10</sup> *Id.*

<sup>11</sup> *O'Bannon v. Nat'l Collegiate Athletic Ass'n*, 7 F. Supp. 3d. 955, 963 (N.D. Cal 2014) (finding basic factual matters regarding the history and structure of the NCAA and college athletics stipulated by the parties), *aff'd in part, vacated in part* 2015 WL 5712106 (9th Cir. 2015).

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

<sup>13</sup> Myles Brand, President, NCAA, *State of the Association Speech at the NCAA Convention in Indianapolis: The Principles of Intercollegiate Athletics* (Jan. 7, 2006), <http://fs.ncaa.org/Docs/NCAANewsArchive/2006/Association->

constitution, the NCAA seeks to "initiate, stimulate and improve intercollegiate athletics programs for student athletes and to promote and develop educational leadership, physical fitness, athletics excellence and athletics participation as a recreational pursuit."<sup>14</sup>

The NCAA establishes rules governing athletic competition among its member schools.<sup>15</sup> These rules apply to almost every conceivable aspect of the life of student athletes, from the rules of the competition on the playing field to the smallest detail of their lives on campus.<sup>16</sup> As outlined in the NCAA constitution and bylaws, these rules set forth guidelines and restrictions for recruiting high school athletes, establish academic eligibility requirements for student athletes, and impose limits on the number and size of athletic scholarships that each school may provide.<sup>17</sup> The rules even prescribe the kind and amount of food that can be given to athletes as a part of the meal plans included in their athletic scholarships.<sup>18</sup>

The NCAA is subdivided into three primary divisions – Divisions I, II, & III. A school is placed in a division based on the number of sports they sponsor, the amount of money they offer in athletic scholarships and financial aid, and the competitiveness of the programs in those sports.<sup>19</sup> In football, Division I is further divided into two subdivisions, the "Football Championship Subdivision," for smaller football programs, and

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wide/brand+charts+course+for+collegiate+model\_s+next+century+-+1-16-06+ncaa+news.html (last visited Nov. 4, 2015).

<sup>14</sup> NCAA 2015-2016 DIVISION I MANUAL art. 1, § 1.2(a) (Aug. 1, 2015), <http://www.ncaapublications.com/productdownloads/D1116.pdf> (last visited Nov. 4, 2015).

<sup>15</sup> *O'Bannon*, 7 F. Supp. 3d at 963.

<sup>16</sup> *See id.* at 963-64, 971-72.

<sup>17</sup> *See* NCAA 2015-2016 DIVISION I MANUAL art. 2, *supra* note 14.

<sup>18</sup> Michelle Brutlag Hosick, *Council Approves Meals, Other Student-Athlete Well-Being Rules: New Model Provides Unlimited Student-Athlete Meals and Snacks*, (Apr. 15, 2014), <http://www.ncaa.org/about/resources/media-center/news/council-approves-meals-other-student-athlete-well-being-rules>.

<sup>19</sup> *O'Bannon*, 7 F. Supp. 3d at 963-64.

the Football Bowl Subdivision, for the most well-known and competitive programs, such as the University of Michigan, the University of Southern California, and Ohio State University.<sup>20</sup>

At the core of all NCAA division and subdivision rules is the principle of amateurism. NCAA rules strictly prohibit athletes in member schools from receiving any compensation in connection with their participation in collegiate athletics.<sup>21</sup> NCAA athletes cannot endorse commercial products or sell autographs, they cannot accept payments from fans or alumni or other “outside sources,” and they certainly cannot be paid for their services by the schools for which they perform.<sup>22</sup> In the view of the NCAA (and, presumably, in the view of its member institutions), amateurism is the key to making sure that athletic competition is an aspect of the educational experience and that it does not become the primary or absolute reason for the student athlete’s association with a college or university. In other words, a commitment to amateurism in athletic competition is what assures that collegiate athletics have an educational purpose. As the NCAA includes on its website:

Amateur competition is a bedrock principle of college athletics and the NCAA. Maintaining amateurism is crucial to preserving an academic environment in which acquiring a quality education is the first priority. In the collegiate model of sports, the young men and women competing on the field or court are students first, athletes second.<sup>23</sup>

To assure that the provision of athletic scholarships does not compromise principles of amateurism, the NCAA imposes strict rules to define the amount and nature of the benefits that can be awarded through athletic scholarships. Most fundamentally, these rules prohibit member institutions from giving student athletes financial aid based on athletic ability that exceeds the cost of tuition, room and board, and course-related books.<sup>24</sup>

Thus, the foundational concept of collegiate athletics and

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<sup>20</sup> *See id.* at 964.

<sup>21</sup> *Id.* at 971.

<sup>22</sup> *Id.* at 971-72.

<sup>23</sup> NCAA, *Amateurism*, <http://www.ncaa.org/amateurism> (last visited Nov. 4, 2015).

<sup>24</sup> *O'Bannon*, 7 F. Supp. 3d at 971.



the NCAA rules are premised on the idea that athletic competition is merely an extracurricular activity for full-time students. However, the financial realities of collegiate athletics suggest that it is far more than a pastime for students-- it is a big business, generating billions of dollars in revenue for colleges and universities. The most prominent collegiate athletic programs generate well over \$100 million dollars in annual revenues.<sup>25</sup> In the most recent year for which data is available, the University of Oregon generated over \$196 million in annual income from its athletic programs, including income from ticket sales, trademark licensing for souvenirs, and the sale of broadcast rights.<sup>26</sup> Nineteen other schools earned over \$100 million dollars annually.<sup>27</sup>

Notwithstanding the enormous revenue generated by collegiate athletics, the NCAA and its member schools steadfastly insist that collegiate athletics are not a business but rather just another aspect of the process of educating students. According to an NCAA publication:

[Former] NCAA President Myles Brand said intercollegiate athletics, and higher education in general, have business elements that must be adroitly addressed. Bills must be paid, salaries have to be provided and difficult personnel decisions must be made, Brand said, but similar decisions face other nonprofit enterprises that rely on major revenue streams. 'College sports may be a business with respect to the revenue side of the equation,' he said, 'but it is a nonprofit focused on the values of higher education with regard to expenditures.'<sup>28</sup>

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<sup>25</sup> *NCAA Finances*, USA TODAY, <http://sports.usatoday.com/ncaa/finances/> (last visited Nov. 4, 2015).

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

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

<sup>28</sup> Gary T. Brown, *Is College Sports a Big Business?*, NCAA NEWS ARCHIVE (Aug. 29, 2005), <http://fs.ncaa.org/Docs/NCAANewsArchive/2005/Association->

In Brand's view, which persists today, the revenue generated by football and men's basketball is sought only as a means of funding other educational projects, chiefly the so-called "non-revenue" sports, such as lacrosse or field hockey.<sup>29</sup> Indeed many, if not most, collegiate athletic departments do no better than break even or operate at a loss.<sup>30</sup> Thus, the income generated from collegiate athletics are just the way that schools are able to pay for the educational experience of collegiate athletics for all of the student athletes in a school. This understanding of how collegiate athletics departments work is designed to preserve the idea that collegiate athletics are integrated into the overall educational mission of the university.

In a wide variety of recent cases, current and former student athletes have sued the NCAA, its member institutions, or both, challenging the legality of the NCAA model, especially its strict requirements of amateurism and its prohibitions on any compensation for student athletes beyond their athletic scholarships.<sup>31</sup> In these cases, the plaintiffs have alleged violations of antitrust law by the NCAA and its members. According to the plaintiff's theory, the NCAA's amateurism rules are an unlawful restraint of trade that prevents student athletes from deriving full market value for their services and intangible property rights associated with their athletic performance.<sup>32</sup>

In the most well known of these cases, *O'Bannon v. National Collegiate Athletic Association*, the plaintiffs were a group of current and former college student athletes. These athletes challenged "the set of rules that bar student athletes from receiving a share of the revenue that the NCAA and its member schools earn from the sale of licenses to use the student athletes' names, images, and likenesses in videogames, live game telecasts, and other footage."<sup>33</sup> In response to this challenge, the NCAA maintained, "that its restrictions on student athlete compensation are necessary to uphold its educational mission

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[wide/is%2Bcollege%2Bsports%2Bbig%2Bbusiness%2B-%2B8-29-05%2Bncaa%2Bnews.html](http://www.is%2Bcollege%2Bsports%2Bbig%2Bbusiness%2B-%2B8-29-05%2Bncaa%2Bnews.html).

<sup>29</sup> See *id.*

<sup>30</sup> *Id.*; see also *NCAA Finances*, *supra* note 25.

<sup>31</sup> Vint, *supra* note 5.

<sup>32</sup> See *id.*

<sup>33</sup> *O'Bannon*, 7 F. Supp. 3d at 963.

and to protect the popularity of collegiate sports.”<sup>34</sup>

Thus, these legal challenges threaten the fundamental premise behind the idea that college athletics are an aspect of the educational process and not an independent business operation. As this idea is essential to the justifications for the tax exemptions for revenue generated by collegiate athletics, this litigation has the potential to change understanding of the relationship between college athletics and the educational mission of the university. A change in this relationship could alter the entire analysis as to whether, and to what extent, income from collegiate athletics are exempt from taxation. In order to more fully understand how this change in analysis could occur, it is necessary to examine the background and nature of that exemption.

## **II. EXISTING LAW GOVERNING THE UBIT OF 501(C)(3) ORGANIZATIONS**

Section 501 of the Internal Revenue Code (the “Code”) provides an exemption from income tax for certain organizations, including corporations organized by an act of Congress as an instrumentality of the United States, charitable trusts, and a variety of organizations that serve charitable and public purposes.<sup>35</sup> Section 501(c)(3) specifically includes educational institutions and amateur sports organizations in its list of organizations that serve charitable purposes, public purposes, or both:

Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment) . . . .<sup>36</sup>

This tax exemption does not extend to “unrelated

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

<sup>35</sup> I.R.C. § 501 (2010).

<sup>36</sup> *Id.* § 501(c)(3).

business income.”<sup>37</sup> Sections 511-513 of the Code provide for the imposition of tax at standard corporate tax rates on the “unrelated business income” of an organization that is otherwise exempt from taxation under Section 501.<sup>38</sup> This tax is known as the “unrelated business income tax” or “UBIT.” The UBIT applies to income earned by a tax exempt organization that: (1) comes from a “trade or business” as that term is used in Section 162 of the Code,<sup>39</sup> (2) is “regularly carried on,”<sup>40</sup> and (3) is not “substantially related” to the accomplishment of the organization’s exempt purpose.<sup>41</sup>

As with any legislation, the statutes establishing the UBIT were enacted for a variety of reasons. A couple of those reasons are important to understanding how the UBIT has developed and, in particular, are important to understanding how it will develop to apply to the changing dynamics of college athletics. These reasons relate to the concerns prompted by the commercial activity of tax-exempt organizations.

One such concern was the risk of unfair competition. In the legislative history associated with the UBIT in 1950, there is extensive discussion of how tax law could be applied to prevent charitable organizations from competing unfairly with for-profit enterprises.<sup>42</sup> Such unfair competition could occur if exempt organizations were able to use the economic advantages associated with their tax exemptions to undercut their commercial rivals on prices.

Another significant concern at the time of UBIT inception was how to permit the tax exemption for charitable organizations without eroding the tax base-- specifically the tax

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<sup>37</sup> *Id.* § 501(b).

<sup>38</sup> *Id.* §§ 511-13.

<sup>39</sup> *Id.* § 513(a); Treas. Reg. § 1.513-1(b).

<sup>40</sup> I.R.C. § 512(a); Treas. Reg. § 1.513-1(c).

<sup>41</sup> I.R.C. § 513(a); Treas. Reg. § 1.513-1(d).

<sup>42</sup> *See, e.g.,* H.R. REP. No. 2319, 81st Cong., 2d Sess. 36 (1950); S. REP. No. 2375, 81st Cong., 2d Sess., 28 (1950); Henry Hansmann, *Unfair Competition and the Unrelated Business Income Tax*, 75 VA. L. REV. 605, 613 (1989); Donald L. Sharpe, *Unfair Business Competition and the Tax on Income Destined for Charity: Forty-Six Years Later*, 3 FLA. TAX REV. 367, 385-86 (1996); Ethan G. Stone, *Adhering to the Old Line: Uncovering the History and Political Function of the Unrelated Business Income Tax*, 54 EMORY L.J. 1475, 1488-90 (2005).

base of commercial activity by profit-making organizations.<sup>43</sup> One aspect of this concern arises from the possibility that charities could earn an unwarranted premium on their investments by purchasing and running a business directly, rather than by purchasing stock as a passive investor. Thus, a nonprofit organization could “capture” a financial return premium if it could conduct a business directly and avoid the corporate tax that otherwise would be paid.<sup>44</sup> This was not merely a hypothetical concern. There is evidence that precisely this kind of activity was occurring before the enactment of the UBIT. In a famous example, New York University operated the Mueller Macaroni Company,<sup>45</sup> along with “a piston ring factory, and a chinaware manufacturing operation. Other colleges and universities owned enterprises manufacturing automobile parts, cotton gins, and food products, and operated an airport, a street railway, a hydroelectric plant, and a radio station.”<sup>46</sup>

Yet another reason for adopting the UBIT was to prevent the use of charitable organizations as accommodation partners in tax-shelter transactions, especially leasebacks and bootstrap acquisitions.<sup>47</sup> At the time of the UBIT legislation, there was substantial anecdotal evidence that charities were being used in these kinds of transactions.<sup>48</sup> One concern with these activities was that they would cause a diversion of managerial resources away from serving the charity’s exempt purpose. Such a diversion would damage both the charity’s ability to accomplish the purpose that justified its exemption, and it could harm economic efficiency overall because non-experts would be managing business enterprises that could be managed more

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<sup>43</sup> H.R. REP. No. 2319, 81st Cong., 2d Sess. 39 (1950); *See* Stone, *supra* note 42 at 1491, n.55; Sharpe, *supra* note 42, at 393.

<sup>44</sup> Hansmann, *supra* note 42, at 610.

<sup>45</sup> C.F. Mueller Co. v. Comm’r of Internal Revenue, 190 F.2d 120 (3d Cir. 1951).

<sup>46</sup> Susan Rose- Ackerman, *Unfair Competition and Corporate Income Taxation*, 34 STAN. L. REV. 1017, 1017 n.2 (1982).

<sup>47</sup> Stone, *supra* note 42, at 513-18.

<sup>48</sup> *Id.* at 1519.

effectively by others.<sup>49</sup>

As noted above, the UBIT applies to income earned by a tax exempt organization that: (1) comes from a "trade or business" as that term is used in Section 162 of the Code,<sup>50</sup> (2) is "regularly carried on,"<sup>51</sup> and (3) is not "substantially related" to the accomplishment of the organization's exempt purpose.<sup>52</sup> There is little controversy or question about how to apply the first condition for application of the UBIT. An income-generating activity constitutes a "trade or business" for UBIT purposes when it is a profit-making activity that involves the sale of goods or services.<sup>53</sup> In meeting this first condition, "profit-making" is the crucial concept; the activity cannot be taxed unless it was undertaken for the primary purpose of generating income or profit.<sup>54</sup> The Internal Revenue Service ("IRS") has recently relied more heavily on the "profit motive" factor to disqualify money-losing ventures from UBIT analysis.<sup>55</sup> Most important is whether the organization is engaging in the activity for the purpose of making a profit and with a reasonable expectation of eventually making a profit, even if the activity does not generate a profit in the short-term.<sup>56</sup>

The second condition in applying the UBIT is similarly

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<sup>49</sup> See Hansmann, *supra* note 42.

<sup>50</sup> *Id.* § 513(a); Treas. Reg. § 1.513-1(b).

<sup>51</sup> I.R.C. § 512(a); Treas. Reg. § 1.513-1(c).

<sup>52</sup> I.R.C. § 513(a); Treas. Reg. § 1.513-1(d).

<sup>53</sup> Treas. Reg. § 1.513-1(b).

<sup>54</sup> See, e.g., *United States v. Am. Bar Endowment*, 477 U.S. 105, 110 n.1 (1986) (holding that the "taxpayer's primary purpose for engaging in the activity must be for income or profit" in order for the UBIT to apply); *Prof'l Ins. Agents v. Comm'r of Internal Revenue*, 726 F.2d 1097, 1102 (6th Cir. 1984) (finding that the "existence of a genuine profit motive is the most important criterion for . . . a trade or business.").

<sup>55</sup> See FRANCES R. HILL & DOUGLAS M. MANCINO, *TAXATION OF EXEMPT ORGANIZATIONS* ¶22.03 at 22-8 (2002, supp. 2013); BRUCE R. HOPKINS, *THE LAW OF TAX-EXEMPT ORGANIZATIONS* 638- 40 (10th ed. 2011).

<sup>56</sup> For the purposes of the UBIT, an activity can show losses for many years and still be "for-profit." For example, a charitable organization might undertake a real estate development project, which loses money in the short term but which leads to an eventual net profit upon sale of the land and buildings in the future. See Treas. Reg. § 1.183-2(a).

straightforward. “Regularly carried on” means that the business is conducted with the same “frequency and continuity” as an analogous for-profit business.<sup>57</sup> For example, if a charity operated a restaurant on a year-round basis, it would be considered as an activity that was “regularly carried on” because restaurants operated by for-profit entities are open year-round. But, if a charity operated a food booth for two weeks per year at a local fair, that activity would not be characterized as “regularly carried on.”<sup>58</sup> Applying these principles, a court ruled that the NCAA did not engage in a “regularly carried on” business when it sold advertising in game programs during its annual basketball tournament.<sup>59</sup> This was because the for-profit business of selling advertising in sports publications is a year-round enterprise.<sup>60</sup> However, by the same token, even an activity carried on for a very short period can be characterized as “regularly carried on.” If a charity operated a Christmas tree lot in November and December, that business likely would be “regularly carried on” because commercial Christmas tree lots operate for the same period of time.

Determining whether an activity is “substantially related” to an organization’s exempt purpose is far more problematic. According to the applicable regulations, a trade or business is substantially related to an organization’s exempt purpose when it bears a “causal relationship” and “contribute[s] importantly” to the accomplishment of that purpose.<sup>61</sup> IRS rulings and cases stand for the proposition that the business activity must be tied directly to how the charity executes its exempt purpose; it is not enough that the activity be related to that purpose in some abstract or indirect way. For example, with respect to art museums, which are exempt as “educational” organizations, the IRS has held that the sale of art and art-related materials at a museum gift shop are “related” but that the sale of

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<sup>57</sup> Treas. Reg. § 1.513-1(c)(1).

<sup>58</sup> *Id.* § 1.513-1(c)(2).

<sup>59</sup> *See* NCAA v. Comm’r of Internal Revenue, 914 F.2d 1417, 1421-22 (10th Cir. 1990).

<sup>60</sup> *See id.*

<sup>61</sup> Treas. Reg. § 1.513-1(d)(2). □ □

science books is an unrelated trade or business.<sup>62</sup> Thus, for an art museum, a sales activity is not unrelated trade or business if it involves the promotion of knowledge and appreciation of art, but is unrelated if it involves education about non-art matters.

Courts have agreed with this approach. In *Carle Foundation v. United States*,<sup>63</sup> the Seventh Circuit held that pharmacy sales by an exempt hospital were “related” when the sales were made to patients, but not when the sales were made to the general public. This is because selling medications to hospital patients has a “causal relationship” and “contribute[s] importantly” to the exempt purpose of treating the hospital’s own patients, but selling medication to non-patients lacks the same close connection.<sup>64</sup>

The application of these three requirements is complicated by the “fragmentation rule,” which is codified in Section 513(c).<sup>65</sup> This rule generally permits the IRS to subdivide income-producing activities in various ways for the purpose of determining whether they involve unrelated business income that should be subject to taxation. According to the regulations, the fragmentation rule provides:

Activities of producing or distributing goods or performing services from which a particular amount of gross income is derived do not lose identity as trade or business merely because they are carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which may, or may not, be related to the exempt purposes of the organization.<sup>66</sup>

This rule has been applied in a number of contexts. As noted above, it was applied to analyze the business of an art museum gift shop<sup>67</sup> and the business of pharmaceutical sales by a hospital.<sup>68</sup> It has also been applied to the business of

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<sup>62</sup> Rev. Rul. 73-105, 1973-1 C.B. 264.

<sup>63</sup> *Carle Found. v. United States*, 611 F.2d 1192 (7th Cir. 1979).

<sup>64</sup> *See id.*

<sup>65</sup> I.R.C. § 513(c) (2011).

<sup>66</sup> Treas. Reg. § 1.513-1(b); *see generally* HILL & MANCINO, *supra* note 55, at ¶22.02; HOPKINS, *supra* note 55, at 643.

<sup>67</sup> Rev. Rul. 73- 104, 1973-1 C.B. 263; Rev. Rul. 73-105, 1973-1 C.B. 264.

<sup>68</sup> Treas. Reg. § 1.513-1(b).



publishing a periodical so that the income from the sale of advertising in the publication is analyzed separately from the income of selling the publication itself.<sup>69</sup> This varied application demonstrates the flexibility of the rule. Activities can be fragmented by product (an art museum's sale of books about art is separated from the sale of science books<sup>70</sup>) or by customer (a hospital's sale of medication to the general public is separated from its sale of medications to its patients<sup>71</sup>).

### III. APPLICATION OF EXISTING UBIT RULES TO UNIVERSITY ACTIVITIES

There is an established body of law outlining the analysis of when and how the UBIT can be applied to various businesses operated by universities. These cases demonstrate that the analysis of university-sponsored business activities can be quite variable and can lead to apparently divergent results. To a great extent, this diversity of decision-making may be a product of the fact that the established law permits great flexibility in how an income-producing activity can be defined and how it can be related to the university's exempt purpose of providing education.

One prominent university-related case addressed the "regularly carried on" requirement. In *NCAA v. Commissioner*, the Tenth Circuit held that the UBIT did not apply to income derived from the sales of advertising in a souvenir program sold at a NCAA men's basketball tournament.<sup>72</sup> According to the Tenth Circuit, neither the tournament itself, nor the sale of program advertising were "regularly carried on" because the

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<sup>69</sup> *United States v. Am. Coll. of Physicians*, 475 U.S. 834 (1986) (holding that the advertising sales were subject to the UBIT because commercial advertisement sales in a medical journal could be separately tested under UBIT due to the fragmentation rule).

<sup>70</sup> Rev. Rul. 73-105, 1973-1 C.B. 264.

<sup>71</sup> Treas. Reg. § 1.513-1(b); *see also* I.R.S. Tech. Adv. Mem. 96-45-004 (Nov. 8, 1996) (finding that the use of university-owned golf course by students and staff is a related business but that use by alumni and guests is not related).

<sup>72</sup> *NCAA v. Comm'r of Internal Revenue*, 914 F.2d 1417 (10th Cir. 1990).

tournament was conducted for only a three-week period, once a year.<sup>73</sup> In reaching its conclusion, the NCAA Court found the relevant commercial analogue to be monthly or weekly sports magazines, such as *Sports Illustrated*, which also sold advertising aimed at sports fans.<sup>74</sup>

Other rulings involving college and university activities have focused on the “substantially related” requirement. In its regulations, the IRS uses an example concerning income from a student performance as an illustration of when an activity is substantially related.<sup>75</sup> In its example, the IRS takes the position that the sale of tickets for a public performance should be characterized as a related activity because teaching students how to perform in front of an audience is a necessary component of performing arts training and it is at the core of a university’s educational purpose.<sup>76</sup> A similar theory is applied to the business of selling tickets to the public for athletic events.<sup>77</sup>

The IRS has concluded that a business activity is not “substantially related” if it does not have a direct connection to a formal educational program. For example, many colleges and universities offer travel tour programs offered to alumni through their alumni associations.<sup>78</sup> These programs will generally fail to meet the “substantially related” requirement unless they are part of a substantial formal educational program.<sup>79</sup> In 2000, the IRS finalized regulations on tour activities and indicated that a test focusing on all of the facts and circumstances surrounding such programs will be used to determine whether individual tours are in compliance with the “educational content” standard.<sup>80</sup> For example, if a university offers a “summer camp” to the general

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<sup>73</sup> *Id.* at 1424-26.

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

<sup>75</sup> Treas. Reg. § 1.513-1(d)(4)(i) ex. 1.

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

<sup>77</sup> See, e.g., Rev. Rul. 80-296, 1980-2 C.B. 195. There are, of course, good reasons to question this conclusion. While students in a performing arts program are receiving training specifically designed to prepare them for a professional career in the performing arts, the same is not true for participation in sports programs. By all accounts, college sports are extracurricular activities that has a role to play in education, but it is not considered to be part of a “pre-football” or “pre-basketball” course of study.

<sup>78</sup> See Rev. Rul. 78-43, 1978-1 C.B. 164.

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

<sup>80</sup> Treas. Reg. § 1.513-7(a).

public in an area of educational instruction, then the summer camp is generally considered “substantially related.”<sup>81</sup>

The IRS has also ruled on the question whether the UBIT applies to income earned from the use of university facilities. Apparently following the same analysis as applied to hospital pharmacies, the IRS has held that use of university facilities, such as recreational facilities by students, faculty, and staff is “substantially related” to the university’s exempt purpose; but use by the general public, including alumni, is not.<sup>82</sup> With respect to events held in university facilities, there must be a close connection between the event and the university’s educational mission. Thus, a professional symphony orchestra performance in a university’s performing arts center could be characterized as an integrated part of the university’s purpose to provide a performing arts education.<sup>83</sup> However, the same conclusion cannot be said of a popular music concert held in a basketball arena, or a professional soccer game held in a football stadium, and especially not when those events are commercially indistinguishable from similar events in non-university facilities.<sup>84</sup>

There are numerous exceptions to the general rules governing the application of the UBIT. Listing all of them would be unproductive for the purposes of this article. However, there are some specific exceptions that apply to university

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<sup>81</sup> Rev. Rul. 77-365, 1977-2 C.B. 192.

<sup>82</sup> *See, e.g.*, Treas. Reg. 1.513-1(d)(4)(iii) (applying analysis to dual-use facilities in general); Rev. Rul. 78-98, 1978-1 C.B. 167 (finding that income from general public’s use of ski facilities owned by exempt school and otherwise used for physical education classes was UBIT); I.R.S. Tech. Adv. Mem. 96-45-004 (Nov. 8, 1996) (finding that the use of a university golf course by students and staff is a related business but that the use by alumni and guests is not related).

<sup>83</sup> *See, e.g.*, I.R.S. Gen. Couns. Mem. 39,862 (Jun. 3, 1991) (ruling that income generated by the use of a multipurpose facility for rock concerts, professional basketball games and similar events aimed at general public audience is not “substantially related”); *see also* I.R.S. Tech. Adv. Mem. 91-47-008 (Nov. 22, 1991).

<sup>84</sup> I.R.S. Tech. Adv. Mem. 91-47-008 (Nov. 22, 1991).

operations. These exemptions may shed some light on how to analyze changes in college athletics programs, which could subsequently change the application of the UBIT to the income derived from those programs.

I.R.C. Section 513(a)(2) provides an exception from the UBIT for an activity carried on “primarily for the convenience of members, students, patients, officers or employees.”<sup>85</sup> The test for applying this exception is factually oriented, and the IRS has not provided any meaningful guidance on how to draw the line between an activity that qualifies for this exception and one that does not.<sup>86</sup> The convenience exception has broad application in the university context, having been applied to activities as diverse as the sale of toothpaste to students by a university bookstore as well as income from parking garages on university property.<sup>87</sup>

The complexity of the interaction between the fragmentation rule, the “substantially related” rule, and the convenience exception is nicely illustrated in the context of the university bookstore. The IRS stated in 1994 published guidelines:

The sale to students, officers and employees of books, supplies, and other items that are necessary for courses at the institution is an activity substantially related to the institution's educational purposes. Thus, the sale of books that are required or recommended for courses at the institution and general school supplies such

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<sup>85</sup> I.R.C. § 513(a)(2) (2012). The exception is limited to 501(c)(3) organizations and public universities which are subject to the UBIT by virtue of I.R.C. § 511.

<sup>86</sup> See HILL & MANCINO, *supra* note 55, at ¶22.03[2] (asserting there is “little guidance exists as to what constitutes a convenience-type activity.”); HOPKINS, *supra* note 55, at 707.

<sup>87</sup> As a general rule, however, regardless of what kinds of activities are covered by the convenience exception, the fragmentation rule suggests that the exception applies only to income derived from students, faculty, and staff who are involved in the activity, not from income derived from the general public. See Rev. Rul. 78-98, 1978-1 C.B. 167 (income from general public’s use of ski facilities owned by exempt school and otherwise used for physical education classes was UBIT); I.R.S. Tech. Adv. Mem. 96-45-004 (Nov. 08, 1996) (holding that the use of a university golf course by students and staff is related but that the use by alumni and guests is not related).

as notebooks, paper, pencils, typewriters, and athletic wear necessary for participation in the institution's athletic and physical education programs, does not constitute unrelated trade or business. Similarly, educational purposes are served by the availability of other materials that further the intellectual life of the campus community. In general, the sale to students, officers, and employees of an institution of books, tapes, records, compact discs, and computer hardware and software (whether or not required for courses) is considered an activity substantially related to educational purposes.<sup>88</sup>

In this guideline, the fragmentation rule is applied in various ways that demonstrate how the convenience exception will work. First, the analysis uses the rule to distinguish sales of “related activity” items, such as books and educational supplies, from the sale of other items, such as toothpaste, toiletry articles, or apparel. Under this approach, “[e]xcepted merchandise may include toiletry articles, wearing apparel or novelty items bearing the institution's insignia, and other items such as candy, cigarettes, newspapers and magazines, greeting cards, photographic film, cameras, radios, and television sets or other appliances.”<sup>89</sup> At the same time, the guidelines also invoke the fragmentation rule to reach the conclusion that sales to alumni do not qualify for the convenience exception and “the sale of multiple computers, in a single year, to a single student or the sale of a computer to someone who is not a student, officer or employee of the institution may result in unrelated business

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<sup>88</sup> I.R.S. COLLEGE AND UNIVERSITY EXAMINATION GUIDELINES, ANNOUNCEMENT 94-112; 1994-37 I.R.B. 36 at 342.(13)(2) (1994), <http://www.federaltaxissues.com/docs/IRS-announce-94-112.pdf> (last visited Nov. 3, 2015).

<sup>89</sup> *Compare id.* (finding that the sale of a wide range of items to students, officers and employees of an institution are substantially related) *with* Rev. Rul. 81-62, 1981-1 C.B. 355 (finding that sales of heavy appliances by exempt senior citizens center was unrelated).

income.”<sup>90</sup>

The flexibility afforded by the combined application of both the fragmentation rule and the convenience exception is evident in the analysis of income derived from other university operations. Thus, the IRS has ruled that revenue from vending machines on campus property generally would be excluded per the convenience exception<sup>91</sup> as would revenue generated by on-campus parking for students, faculty, and staff.<sup>92</sup> Apparently relying on similar logic, the IRS has ruled that concession sales at university athletic events should also be exempt as analogous to a museum operating a cafeteria for the convenience of staff and visitors.<sup>93</sup> Interestingly, this ruling does not make a distinction between sales to university students, staff, and faculty in attendance and sales to members of the general public.

Universities also generate substantial income through the sale of advertising and the solicitation of corporate sponsorships for various university activities. Through the fragmentation rule, the IRS has long taken the position that any activity could be broken up into different components for the purpose of UBIT analysis; this is particularly true with respect to advertising that is sold in connection with an exempt activity. Even so, according to the Supreme Court’s holding in the *American College of Physicians* case, the application of the fragmentation rule to advertising does not create a *per se* rule that advertising income was subject to the UBIT.<sup>94</sup> As with any other source of income, the question whether advertising or sponsorship income

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<sup>90</sup> GUIDELINES, *supra* note 90, at 342.(13)(5).

<sup>91</sup> See Rev. Rul. 81-19, 1981-1 C.B. 353 (finding that “[t]he goods and services dispensed by the vending machines are necessary for the day-to-day living on the campus of students, faculty, and staff. If the university operated the vending facilities, the income would not be subject to the tax on unrelated business income because the activity would be carried on for the convenience of its students and employees within the meaning of section 513(a)(2) of the Code.”).

<sup>92</sup> See Rev. Rul. 69-269, 1969-1 C.B. 160 (ruling that parking revenue generated by patients and visitors “substantially related” to mission of exempt hospital).

<sup>93</sup> See, e.g., I.R.S. Priv. Ltr. Rul. 86-23-081 (Mar. 17, 1986) (finding that concession sales at related event not subject to UBIT); Rev. Rul. 74-399, 1974-2 C.B. 172 (finding that sales at a museum cafeteria are exempt).

<sup>94</sup> *United States v. Am. Coll. of Physicians*, 475 U.S. 834 (1986) (holding that the advertising in question was not substantially related).

was taxable would be resolved according to the “substantially related” rule.<sup>95</sup>

In 1991, the IRS applied these rules to corporate sponsorships of college football games. In Technical Advice Memorandum 9147007, the IRS ruled that the UBIT applied to income received from corporations who paid to be “sponsors” of college football bowl games.<sup>96</sup> The Service reasoned that the “sponsorship” arrangement was not simply a way to provide a benefit to an exempt organization associated with education and amateur sports.<sup>97</sup> In the Service’s view, the corporation received reciprocal benefits that went well beyond simple “donor recognition.”<sup>98</sup> These benefits included the prominent display of the corporate name and logo on the playing field and the scoreboard, on patches placed on the players’ uniforms, and in related print materials distributed at the game.<sup>99</sup> The IRS concluded that the “sponsorship” was more like a payment for advertising.<sup>100</sup> When fragmented from the overall trade or business of conducting a football game, the income from these sponsor payments would be subject to the UBIT.<sup>101</sup>

The implications of this ruling for the economic viability of college athletics was significant, prompting concerns about whether and to what extent other revenue associated with the commercialization of college sports would be subject to the UBIT. In 1997, Congress responded to this ruling by enacting Section 513(i), which provided a specific exemption from the

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<sup>95</sup> *Id.*

<sup>96</sup> I.R.S. Tech. Adv. Mem. 91-47-007 (Nov. 22, 1991); *see generally* JAMES J. FISHMAN & STEVEN SCHWARZ, *TAXATION OF NONPROFIT ORGANIZATIONS* 397 (3d ed. 2010); *see also* Richard L. Kaplan, *Intercollegiate Athletics and the Unrelated Business Income Tax*, 80 COLUM. L. REV. 1430 (1980).

<sup>97</sup> I.R.S. Tech. Adv. Mem. 91-47-007 (Nov. 22, 1991).

<sup>98</sup> *Id.*

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

<sup>100</sup> *Id.*

<sup>101</sup> *Id.*

UBIT for “qualified sponsorship” payments.<sup>102</sup> These can include payments from corporations and other business entities.<sup>103</sup> The IRS finalized regulations for the new statute in 2002 as Treasury Regulation 1.513-4.<sup>104</sup> The statute and the attendant regulations attempt to distinguish between income from sponsorships, which is not taxable, and income from advertising, which could be taxable, depending upon the facts and circumstances.<sup>105</sup> In general, when a corporate sponsorship provides a corporation with nothing more than the right to display the corporation’s name, logo, or product lines, the payments will qualify as “sponsorship” payments and not advertising because, at least in theory, the mere display of a logo is not seen as providing a substantial return benefit to the sponsor.<sup>106</sup>

Another source of income for universities that could be subject to the UBIT is royalty income. In general, “royalties” are defined as payments for the use of intangible property, such as a trademark, logo, copyright or patent, or for the exploitation of minerals or natural resources like oil, gas, or minerals.<sup>107</sup> In some situations, royalty payments can be difficult to distinguish from payments for services. The business of college athletics implicates this difficulty in an important way because many of the payments received by colleges for various media rights could be characterized as royalties for the use of intellectual property, including the names and likenesses of the athletes themselves.

The problematic nature of the distinction between service and royalty payments was famously at issue in *Sierra Club v. Commissioner*,<sup>108</sup> a Ninth Circuit case. There, the Ninth Circuit considered whether payments received by the Sierra Club for the use of its mailing list and for an “affinity card” arrangement with a bank credit card issuer constituted

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<sup>102</sup> See generally HILL & MANCINO, *supra* note 55, at ¶22.11[7] (discussing additional details on the workings of Section 513(i)); HOPKINS, *supra* note 55, at 714-18.

<sup>103</sup> HILL & MANCINO, *supra* note 55, at ¶22.11[7].

<sup>104</sup> *Id.*

<sup>105</sup> *Id.*

<sup>106</sup> Treas. Reg. § 1.513-4(c)(2)(iv).

<sup>107</sup> See generally HILL & MANCINO, *supra* note 55, at ¶23.03; HOPKINS, *supra* note 55, at 697-98; *Sierra Club, Inc. v. Comm’r of Internal Revenue*, 86 F.3d 1526, 1531 (9th Cir. 1996).

<sup>108</sup> *Sierra Club, Inc.*, 86 F.3d 1526.



royalties.<sup>109</sup> The IRS's position was premised on the idea that royalty income is "passive," meaning the recipient pays royalties without any requirement of affirmative conduct.<sup>110</sup> According to the IRS, the payments for use of the mailing list and for the "affinity" credit card required some active conduct by the Sierra Club and therefore did not qualify as royalties.<sup>111</sup> The Ninth Circuit declined to adopt this analytical approach, however, and ruled that the key issue was whether the payments were for the use of property, even intangible property, such as member lists, or for the services that the Sierra Club provided in keeping the mailing list updated and in promoting the affinity card to its members.<sup>112</sup> With respect to the member lists, the Ninth Circuit concluded that the payments the Sierra Club received for use of those lists were royalties because they were solely intended for the exploitation of the Sierra Club's property rights in the lists.<sup>113</sup> The Ninth Circuit found the lower court record inadequate to decide the affinity card issue and, on remand, the Tax Court found in favor of the Sierra Club, noting that it was the bank, not the Sierra Club, that performed the marketing and solicitation services.<sup>114</sup>

As a result of the ruling in *Sierra Club* and subsequent similar cases that followed its reasoning, the "royalty" exception has been expanded so that it applies to almost any payment intended to exploit an underlying property right. In a university context, this means that revenue derived from mailing lists and affinity card arrangements should be exempt. In addition, the *Sierra Club* reasoning demonstrates that income derived from licensing marks for sports-related souvenirs should also be exempt.

#### IV. THE UBIT AND THE PRESUMPTIVE PURPOSES OF COLLEGIATE ATHLETICS

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<sup>109</sup> *Id.*

<sup>110</sup> *Id.* at 1532.

<sup>111</sup> *Id.* at 1536.

<sup>112</sup> *Sierra Club, Inc.*, 86 F.3d 1526.

<sup>113</sup> *Id.* at 1536.

<sup>114</sup> *Sierra Club, Inc. v. Comm'r of Internal Revenue*, 77 T.C.M. (CCH) 1569 (1999).

Since the enactment of the UBIT, it has always been presumed that the UBIT would not apply to income from collegiate athletics because athletic competitions were “substantially related” to a university’s educational mission. However, recent developments surrounding the litigation challenging the legality of the NCAA’s amateurism rules make this presumption more difficult to sustain. In particular, the NCAA’s own understanding of the nature of collegiate athletics seems to be contradicting the presumption that has long protected collegiate athletics from the UBIT

At the time of the legislation establishing the UBIT, Congress did not seem to regard collegiate athletics as the sort of thing that could be considered an unrelated business. In this respect, the legislation seems to have been drafted with the same presumption that underlies the understanding of collegiate athletics held by the NCAA and its member schools. Neither the House Ways and Means Committee nor the Senate Finance Committee heard any testimony on the issue, but reports of both committees nevertheless asserted, without much reflection or support, that “[a]thletic activities of schools are substantially related to their educational functions.”<sup>115</sup> Thus, the committees reflexively concluded that “[o]f course, income of an educational organization from charges for admissions to football games would not be deemed to be income from an unrelated business, since its athletic activities are substantially related to its educational program.”<sup>116</sup>

Subsequently, rulings by the IRS confirmed that the legislation and regulations associated with the UBIT were designed with the idea that collegiate athletics were unquestionably an aspect of a university’s educational mission. In 1977, the Service attempted to make the income from broadcasting college sports events taxable, but this attempt was short-lived.<sup>117</sup> After extensive public protest and political

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<sup>115</sup> H.R. REP. No. 2319, 81st Cong., 2d Sess. (1950), *reprinted in* 1950-2 C.B. 380, 409; S. REP. No. 2375, 81st Cong., 2d Sess. (1950), *reprinted in* 1950-2 C.B. 483, 505.

<sup>116</sup> *Id.*

<sup>117</sup> *See* I.R.S. Tech. Adv. Mem. 78-51-002 (Jan. 1, 1978). The Service tried to take advantage of this gap in the legislative history and notified several universities and the Cotton Bowl Athletic Association, a tax-exempt entity that presents the annual Cotton Bowl football game,

pressure, the Service issued a series of unpublished Technical Advice Memoranda, which ruled that “there is no meaningful distinction between exhibiting the game in person to 100,000 people and exhibiting the game on television to a much larger audience where both groups of people may be made up not only of students.”<sup>118</sup> Indeed, the Service even provided a rationalization for its conclusions that had been missing in the legislative history:

[A]n audience for a game may contribute importantly to the education of the student-athlete in the development of his/her physical and inner strength and to the education of the student body and the community-at-large in heightening interests in and knowledge about the participating schools. In regard to the student-athlete, the knowledge that an event is being observed heightens its significance, which raises the levels of both competitive effort and enjoyment. Attending the game enhances student interest in education generally and in the institution because such interest is whetted by exposure to a school's athletic activities. Moreover, the games (and the opportunity to observe them) foster those feelings of identification, loyalty, and participation typical of a well-rounded educational experience.<sup>119</sup>

The presumptions that have justified exempting college athletics from the UBIT are at risk due to developments in recent litigation challenging the legality of the NCAA's model for college athletics. This risk arises, of course, from the possibility

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that revenue from the broadcasting rights to the game would constitute unrelated business income.

<sup>118</sup> *Id.* (finding that unrelated business income was not created by university sales of broadcast rights to football and basketball games); see also 78-51-005 (Jan. 1, 1978); see also 78-51-006 (Jan. 1, 1978).

<sup>119</sup> I.R.S. Tech. Adv. Mem. 78-51-002 (Jan. 1, 1978); see also 78-51-004 (Aug. 21, 1978); see also 78-51-005 (Jan. 1, 1978); see also 78-51-006 (Jan. 1, 1978).

that a court may rule that NCAA sports are not truly a part of the educational mission of a university. But, perhaps even more importantly, the risk arises from arguments that the NCAA has made in its own defense. These arguments include some ideas that are in tension with the existing justifications for not taxing college athletic income.

In the *O'Bannon* case, the district court certainly seemed dubious about the idea that the NCAA's model of collegiate athletics and, in particular, its amateurism rules, were really part of a consistent program and policy for accomplishing educational objectives. When the NCAA provided testimony from its current president, Mark Emmert, that it had always made sure that the only resources provided to student athletes were those that were necessary for helping them receive an education, the district court rejected that position.<sup>120</sup> Instead, the district court concluded that a historical review of the NCAA's rules and bylaws demonstrated that the professed relationship between amateurism and education was a relatively recent one and that the NCAA had, over time, taken varying and inconsistent positions on whether athletic scholarships were consistent with a university's educational objectives.<sup>121</sup> Indeed, for many years, the NCAA had taken the position that any kind of scholarship given strictly for athletic purposes was entirely inconsistent with the educational mission of universities.<sup>122</sup> Not surprisingly, then, the district court concluded that the amateurism rules did not significantly advance educational objectives:

The only evidence that the NCAA has presented that suggests that its challenged rules might be necessary to promote the integration of academics and the testimony of university administrators, who asserted that paying student-athletes large sums of money would potentially "create a wedge" between student-athletes and others on campus . . . . These administrators noted that, depending on how much compensation was ultimately awarded, some student-athletes might receive more money from the school than their professors. Student-athletes

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<sup>120</sup> *O'Bannon*, 7 F. Supp. 3d at 973-75.

<sup>121</sup> *Id.*

<sup>122</sup> *Id.*

might also be inclined to separate themselves from the broader campus community by living and socializing off campus.

It is not clear that any of the potential problems identified by the NCAA's witnesses would be unique to student-athletes. In fact, when the Court asked Dr. Emmert whether other wealthy students — such as those who come from rich families or start successful businesses during school — raise all of the same problems for campus relations, he replied that they did. . . . It is also not clear why paying student-athletes would be any more problematic for campus relations than paying other students who provide services to the university, such as members of the student government or school newspaper.<sup>123</sup>

Despite its skepticism about the educational value of the amateurism rules, the district court concluded that there could be some limited educational value in the attempt to restrict student athlete earnings.<sup>124</sup> Nevertheless, the court ultimately rejected the NCAA's contention that the amateurism rules were essential to preserving the university's educational mission with respect to student athletes; and it ruled that student athletes were entitled to payments for the use of their names and likenesses by their schools, although the extent of those payments would be limited so that they would, in effect, constitute modest supplements to the traditional athletic scholarship.<sup>125</sup> The district court's conclusions, buttressed by the NCAA's own arguments, make it difficult for anyone to take the position that the traditional model of collegiate athletics are necessary to accomplish a university's educational objectives or that collegiate athletics are not a commercial enterprise driven for profit.

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<sup>123</sup> *Id.* at 980 (citations omitted).

<sup>124</sup> *Id.* (finding that "certain limited restrictions on student-athlete compensation may help to integrate student-athletes into the academic communities of their schools, which may in turn improve the schools' college education product").

<sup>125</sup> *Id.* at 1007.

### CONCLUSION

Recent litigation suggests that collegiate athletics may not be “substantially related” to the educational mission of a university. There are several reasons for this assumption. First, any finding of a substantial relationship is hard to maintain in light of the NCAA’s own description of collegiate athletics as a commercial product, and in light of findings by the *O’Bannon* court concerning the interplay between the amateurism ideal, the business of collegiate athletics, and the realities of day-to-day lives of student athletes.

Second, a new or revised understanding of the nature of collegiate athletics could make it much easier to fragment the income derived from football and men’s basketball from the rest of an athletic program. To the extent that football and men’s basketball appear to be different kinds of activities than the rest of an athletic program, the IRS could conclude that these activities constitute an unrelated business that is not substantially related to a university’s educational mission, even if other sports are considered substantially related. Of course, colleges and universities could respond to such a conclusion by contending that their athletic programs should be viewed as a unified whole, with the gains created by football and men’s basketball offset by the losses resulting from the operation of all other sports programs. This would be a fairly compelling argument, given the fact that most athletic programs break even or lose money as a whole. Nevertheless, the power of the fragmentation rule has been demonstrated again and again. Additionally, if the IRS can fragment income from the sale of science books at an art museum gift shop from income derived from the sale of other art-related materials, then there is a very strong possibility that the IRS can fragment a couple of enormously lucrative sports programs from the rest of a collegiate athletic program.

Third, if the current litigation results in payments to student athletes for the use of their names and likenesses, then the fundamental nature of the relationship between student athletes and their universities would change. The relationship could look more commercial than educational because the student athletes would be receiving royalty payments for their intangible property. Although case law has established that the passive receipt of royalty payments does not necessarily create UBIT liability for an exempt organization, it is another thing entirely if an exempt organization is *making* royalty payments so that it can receive a business benefit. In other words, if colleges and universities are paying royalties to some student athletes in

return for the profit-making use of a student athlete's intangible property, then the relationships involved in collegiate athletics could start to look even more commercial.

For all of these reasons, it seems clear that recent developments in collegiate athletics could make it much more difficult for colleges to sustain the long-standing presumption that the revenue derived from their athletic programs should be entirely exempt from taxation. However, there is a great deal of inertia behind the current tax treatment of such revenue and there are powerful political forces that could promote legislation that would preserve the status quo. Things are changing fast and dramatically in collegiate athletics, and it would not be surprising if some of those changes included a substantial revision to the way in which the UBIT was applied to income derived from collegiate athletic programs.

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### COMMENT

#### AMATEUR AMBITION: HOW ATHLETIC PROGRAMS SHAPE UNIVERSITY POLICY

Andrew Weigel\*

*Increasing university dependence on sports program income has widespread implications for education, and the lack of legal guidelines allows corporatization to continue unchecked.*

Many people debate whether student athletes are entitled to the profits that universities hoard, tax-free, under the pretext of amateur sports exemptions. The capitalization of amateur athletics has heavily contributed to the rapid, unchecked corporatization of universities, the inflation of tuition, and the devaluation of student labor in general.

Football remains the most profitable collegiate sport in the United States, with an estimated annual revenue of \$3.4 billion, an amount which is set to increase in the future,<sup>1</sup> surpassing the \$1 billion generated annually by men's collegiate basketball.<sup>2</sup> Indeed, football has been a frontrunner of national intercollegiate league development and in the treatment of student athletes since the sport amassed popularity in the late nineteenth century.<sup>3</sup> The NCAA was founded in 1906 at the

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<sup>1</sup> Cork Gaines, *College Football Reaches Record \$3.4 Billion in Revenue*, BUS. INSIDER (Dec. 17, 2014), <http://www.businessinsider.com/college-football-revenue-2014-12>.

<sup>2</sup> Steve Berkowitz, *NCAA Nearly Topped \$1 Billion in Revenue*, USA TODAY (Mar. 11, 2015), <http://www.usatoday.com/story/sports/college/2015/03/11/ncaa-financial-statement-2014-1-billion-revenue/70161386/>.

<sup>3</sup> Jordan R. Bass, et al., *The "Front Porch"*, 141 ASHE HIGHER EDUC. REPORTER 1, 4.



request of President Theodore Roosevelt, and it expressly classified college athletes as amateur sportsmen.<sup>4</sup> This idea of amateurism was directly challenged the same year when the Big Ten required coaches be full-time employees,<sup>5</sup> thereby cementing college football's dual status as a nonprofit hobby and an entertainment cash cow.

The invention of the term "student athlete" can be attributed to Walter Bryers, who became the NCAA's first director in 1951.<sup>6</sup> Bryers consciously promoted this term to avoid classifying players as university employees entitled to payment.<sup>7</sup> In recent years, publicity has been generated surrounding NCAA student-athletes by the use of rhetoric likening them to slaves.<sup>8</sup> Such arguments hinge on the assertion that unpaid athletes must be considered workers, and are therefore entitled to protection under workers' rights laws.<sup>9</sup> The public auctions by which the NBA and NFL draft their teams certainly invite feelings of being treated like property.<sup>10</sup> This appears to be a direct consequence of the overexpansion of the professional sports industry. College football not only acts as a development league for the NFL, but it also provides free publicity.<sup>11</sup>

The rise of commercial NCAA sports can mostly be attributed to the decision, in 1973, to separate schools into divisions based on profitability, and subsequently increase public

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<sup>4</sup> *Id.* at 4-5.

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

<sup>6</sup> *Id.* at 7, 8.

<sup>7</sup> *Id.* at 8.

<sup>8</sup> Maria L. Ontivarios, *NCAA Athletes, Unpaid Interns and the S-Word: Exploring the Rhetorical Impact of the Language of Slavery*, MICH. ST. L. REV. (forthcoming), <http://ssrn.com/abstract=2631183> (last visited Dec. 12, 2015).

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

<sup>10</sup> *Id.*

<sup>11</sup> Steve Almond, *College Football is Ruining Education*, NEW REPUBLIC (Aug. 23, 2014), <https://newrepublic.com/article/119012/nfl-profits-college-football-ruining-education-universities>.

exposure through television broadcasts.<sup>12</sup> Television companies found college broadcasting rights especially appealing because the production costs were low,<sup>13</sup> presumably due to the absence of paid athletes. It wasn't until the removal of NCAA control over football telecasting, in 1984, that conferences and universities were given the freedom to negotiate television deals.<sup>14</sup> The Supreme Court ruled in *NCAA v. Board of Regents of the University of Oklahoma*, that the NCAA violated the Sherman and Clayton Antitrust Acts by leveraging its television plan to raise prices and reduce output.<sup>15</sup> This restraint upon the free market was found to fall squarely within the sort of monopolistic and anticompetitive behavior the Antitrust Acts were designed to protect against.<sup>16</sup> However, this has not yet been found to extend to other sports, and so most of the NCAA's revenue is generated from basketball television rights. In 2010, CBS and Turner Broadcasting paid the NCAA \$10.8 billion for a fourteen-year exclusive broadcast monopoly on March Madness games.<sup>17</sup> Division I schools profited similarly from football; ESPN paid \$7.3 billion for rights to broadcast six major bowl games and the national championships for twelve years.<sup>18</sup> Ironically, although the intent behind *Board of Regents* was to prevent television from detracting from ticket sales, Power Five conferences have been deriving most of their revenue from television contracts for years.<sup>19</sup>

Thanks in part to television; athletic departments have become the "front porches" of universities, serving as a major

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<sup>12</sup> Bass et al., *supra* note 3, at 8-10.

<sup>13</sup> *Id.* at 21.

<sup>14</sup> Marc Tracy & Tim Rohan, *What Made College Football More Like the Pros? \$7.3 Billion, for a Start*, N.Y. TIMES (Dec. 30, 2014), [http://www.nytimes.com/2014/12/31/sports/ncaafootball/what-made-college-ball-more-like-the-pros-73-billion-for-a-start.html?\\_r=0](http://www.nytimes.com/2014/12/31/sports/ncaafootball/what-made-college-ball-more-like-the-pros-73-billion-for-a-start.html?_r=0); Bass et al., *supra* note 3, at 22.

<sup>15</sup> *NCAA v. Board of Regents*, 468 U.S. 85, 113 (1984).

<sup>16</sup> *Id.* at 112-113.

<sup>17</sup> Jonah Walters, *Against the NCAA*, JACOBIN MAG. (Apr. 4, 2015), <https://www.jacobinmag.com/2015/04/march-madness-ncaa-student-athletes/>.

<sup>18</sup> Chris Isodore, *Wildly Profitable College Football*, CNN MONEY (Jan. 13, 2015), <http://money.cnn.com/2015/01/12/news/companies/college-football-profits/>; Tracy & Rohan, *supra* note 14.

<sup>19</sup> Bass et al., *supra* note 3, at 22.

interface between academics and society.<sup>20</sup> By pushing athletics programs, universities increase their brand and consequently their enrollment and tuition rates.<sup>21</sup> Most big football programs see over half—and in some cases over 70 percent of their budget from tuition and fees.<sup>22</sup> These budgets are often equivalent to those granted to professional schools, such as law or medicine programs, and receive university subsidies even if they do not meet operating expenses.<sup>23</sup> An elite football program could cost over \$42 million.<sup>24</sup> This money primarily goes into forging multimillion-dollar contracts for coaching, media coverage, and outsourcing to management and marketing groups.<sup>25</sup> In 2014, more than twenty basketball college-level coaches had annual salaries exceeding \$2 million,<sup>26</sup> as did fifty-five football coaches.<sup>27</sup> The highest paid college football coach is former NFL coach Nick Saban, who makes \$7 million a year at Alabama.<sup>28</sup> Contrast this with the fact that only five professors in the United States have salaries exceeding even \$1 million.<sup>29</sup> Since 1984, average compensation for college professors

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<sup>20</sup> *Id.* at 1.

<sup>21</sup> *Id.* at 2.

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

<sup>23</sup> *Id.* at 23.

<sup>24</sup> Adrienne Green, *'College' Football Has Almost Nothing to Do with College*, THE ATLANTIC (Sep. 19, 2015), <http://www.theatlantic.com/business/archive/2015/09/billion-dollar-ball-college-football-business/406249/>.

<sup>25</sup> *Id.*; Bass et al., *supra* note 3, at 58.

<sup>26</sup> Steve Berkowitz et al., *2015 NCAA Basketball Coaches' Pay*, USA TODAY (last updated Mar. 31, 2015), <http://sports.usatoday.com/ncaa/salaries/mens-basketball/coach> (last visited Dec. 12, 2015).

<sup>27</sup> Steve Berkowitz et al., *2015 NCAA Football Coaches Salaries*, USA TODAY (last updated Oct. 8, 2015), <http://sports.usatoday.com/ncaa/salaries/football/coach> (last visited Dec. 12, 2015).

<sup>28</sup> *Id.*; Tracy & Rohan, *supra* note 14.

<sup>29</sup> *10 Highest-Paid Professors in the U.S.*, THE BEST SCHOOLS, <http://www.thebestschools.org/blog/2013/11/25/10-highest-paid-college-professors-u-s/> (last visited Dec. 12, 2015).

increased by 32 percent, in contrast to head football coaches at 750 percent.<sup>30</sup>

Athletic department investments have proven to be so profitable, that they have completely dominated university agendas. What Professor Murray Sperber coined as, the “Flutie Factor,” or the positive correlation between a college’s reputation and its athletic performance, has consumed university marketing. The term is named after a Hail Mary play by Doug Flutie in a televised 1984 Thanksgiving weekend game, which caused Boston College applications to rise 25 percent the next year.<sup>31</sup> Between 2008 and 2015, average annual tuition increased 29 percent,<sup>32</sup> but most noticeably, states with strong college football traditions and programs saw increases averaging 55 percent, thereby in direct correlation with the fees that go into the athletic departments.<sup>33</sup> Athletic departments have exploded in their employment—sometimes fourfold—just to keep players eligible and playing.<sup>34</sup> Even poor and unprofitable programs compete in an accelerating “arms race” with Division I teams, resorting to subsidies, tuition reallocations, and athletics fees—all of which are footed by their student bodies—to stem the “hemorrhaging” of funds.<sup>35</sup> Economists have noted that the few football programs that are in the black simply put the revenue back into the programs;<sup>36</sup> very little goes toward “academic programming,” and even most of that can be earmarked for athletic scholarships and other athletic expenses.<sup>37</sup>

Yet despite how profitable universities would like sports programs to appear, state legislatures continue to cut public

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<sup>30</sup> Bass et al., *supra* note 3, at 34.

<sup>31</sup> *Id.* at 39.

<sup>32</sup> Emily Jane Fox, *Where Public University Tuition Has Skyrocketed*, CNN MONEY (May 13, 2015), <http://money.cnn.com/2015/05/13/pf/college/public-university-tuition-increase/>.

<sup>33</sup> Robert Greenwald, *College Football is Stealing Your Education*, HUFFINGTON POST (Oct. 13, 2015), [http://www.huffingtonpost.com/robert-greenwald/college-football-is-steal\\_b\\_8282690.html](http://www.huffingtonpost.com/robert-greenwald/college-football-is-steal_b_8282690.html).

<sup>34</sup> Green, *supra* note 24.

<sup>35</sup> Bass et al., *supra* note 3, at 31-34.

<sup>36</sup> Ben Mangrum, *Is College Football Profitable for Universities?* ETHOS (27 Mar. 2014), <http://www.ethosreview.org/intellectual-spaces/is-college-football-profitable/>; Almond, *supra* note 11

<sup>37</sup> Mangrum, *supra* note 36.

funding,<sup>38</sup> encouraging universities to adopt a “corporatization” model as they privatize revenue generators.<sup>39</sup> Rising tuition costs, and the administrative erosion of the tenure system with adjunct labor, serve to subsidize college football.<sup>40</sup> Average university tuition has increased by 1,120 percent from 1978 to 2012, four times faster than the consumer price index.<sup>41</sup> In the past 40 years, universities have experienced a sharp increase in the proportion of administrators to faculty and students, in an attempt to operate as big businesses.<sup>42</sup> Just as corporations are courting college sports programs to build arenas and license apparel,<sup>43</sup> universities are investing income they don’t have on highly specialized facilities to attract star faculty, or leisure structures to attract larger student bodies—all in the interest of boosting rankings.<sup>44</sup>

Corporate ambition is redefining university roles. Presidents spend more time raising money than leading their institutions, and professors are expected to act as “academic entrepreneurs,” where their ability to generate revenue through prestige and research grants is prioritized over educating the students.<sup>45</sup> Oftentimes, they are simply replaced with adjunct faculty, who can be paid less and excluded from decision-

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<sup>38</sup> Fox, *supra* note 32 (stating that average state spending decreased 20% from 2008 to 2015).

<sup>39</sup> Bass et al., *supra* note 3, at 40-41.

<sup>40</sup> Mangrum, *supra* note 36.

<sup>41</sup> Michelle Jamrisko & Ilan Kolet, *Cost of College Degree in U.S. Soars 12 Fold*, BLOOMBERG BUS. (Aug. 15, 2012), <http://www.bloomberg.com/news/articles/2012-08-15/cost-of-college-degree-in-u-s-soars-12-fold-chart-of-the-day>.

<sup>42</sup> See Noam Chomsky, *How America’s Great University System is Being Destroyed*, JACOBIN MAG. (Mar. 3, 2014), <http://www.alternet.org/corporate-accountability-and-workplace/chomsky-how-americas-great-university-system-getting>.

<sup>43</sup> Bass et al., *supra* note 3, at 43-45.

<sup>44</sup> Andrew Rossi, *How American Universities Turned into Corporations*, TIME MAG. (May 22, 2014), <http://time.com/108311/how-american-universities-are-ripping-off-your-education/>.

<sup>45</sup> Bass et al., *supra* note 3, at 41, 42.

making,<sup>46</sup> while administrators take advantage of this manufactured job insecurity.<sup>47</sup> Without any cost to the university, graduate students are expected to perform instruction, conduct research, and accept internships all in precarious unemployment.<sup>48</sup> If this doesn't qualify as slave labor, whatever menial grading and research tasks that commonly spill over to undergraduates surely must. Ultimately, it is this offloading of inconveniences that allow universities to keep their true operating costs invisible, reinforcing artificially high valuations on what is essentially a growing snowball of middle men, and forcing laborers to bargain their wages to zero just to participate.

The corporatization of universities holds particularly ominous implications for scientific research. The Bayh-Doyle Act of 1980, which allowed institutions to claim patent and trademark rights to federally funded discoveries, largely enabled this shift in ideology.<sup>49</sup> The attempt to stimulate the American economy effectively privatized publicly funded research and increased the interaction between academia and industry.<sup>50</sup> Corporate funding followed on the footsteps of multi-million, multi-year "strategic corporate alliances."<sup>51</sup> Undoubtedly, the increased emphasis on production has also exacerbated the pressure for academics to "publish or perish," calling the integrity of research into question, and producing a "landfill" of published articles that range anywhere from unoriginal, to useless, to downright misleading.<sup>52</sup> Most recently, it was discovered that of 100 experiments published in three top psychology journals, only 39 could be replicated with a fair

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<sup>46</sup> Chomsky, *supra* note 42.

<sup>47</sup> Risa L. Lieberwitz, *The Corporatization of the University: Distance Learning at the Cost of Academic Freedom?*, 12 B.U. PUB. INT. L.J. 73, 98 (2002).

<sup>48</sup> See Chomsky, *supra* note 42.

<sup>49</sup> 35 U.S.C. § 200 (2006).

<sup>50</sup> Risa L. Lieberwitz, *Education Law: The Corporatization of Academic Research: Whose Interests Are Served?*, 38 AKRON L. REV. 759, 764-65 (2005).

<sup>51</sup> *Id.* at 766.

<sup>52</sup> See Wes Alwan, *Please Stop Contributing to the Publish-or-Perish Landfill*, PARTIALLYEXAMINEDLIFE.COM (Apr. 9, 2014), <https://www.partiallyexaminedlife.com/2014/04/09/please-stop-contributing-to-the-publish-or-perish-landfill/>.

degree of leniency.<sup>53</sup> Proposals have been made to protect objective and disinterested reporting of research, such as the disclosure of potential conflicts, where financial or personal considerations may compromise professional judgment,<sup>54</sup> but solutions like this fail to adequately address the systemic devaluation of truth in the pursuit of prestige and profit. Similar developments can be observed in other college programs as they attempt to keep up with and support athletics programs.

In conclusion, the likelihood of student athletes gaining more than nominal living stipends is ridiculously impractical because the housing of university sports programs are mostly done at the expense of academics.<sup>55</sup> The present model barely allows for professors to be paid, let alone students. The average student-athlete, despite restrictions on scholarships and income, receives academic scholarship and training worth about \$125,000.<sup>56</sup> The only available income to student-athletes would either have to come from athletics programs themselves, or tuition hikes. Most athletics programs cannot even turn a profit, and those that do are reliant upon reinvesting that profit to continue generating any significant revenue.

Increasing tuition, then, seems to be the only option. Already tuition rates are pushing the limits of sustainability. Total student loan debt in the United States surpassed \$1 trillion in 2012.<sup>57</sup> Paying athletes would cause tuition to inflate even faster and attendance could plummet. Universities would lose all incentive to accept anyone who couldn't generate the necessary income to fund student-athletes, and universities could likely abandon major academic initiatives altogether.

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<sup>53</sup> John Bohannon, *Many Psychology Papers Fail Replication Test*, SCI. MAG., Aug. 28 2015, at 910.

<sup>54</sup> Risa L. Lieberwitz, *The Marketing of Higher Education: The Price of the University's Soul*, 89 CORNELL L. REV. 763, 772 (2004) (reviewing DEREK BOK, *UNIVERSITIES IN THE MARKETPLACE* (2003)).

<sup>55</sup> Mangrum, *supra* note 36.

<sup>56</sup> Jeffrey Dorfman, *Pay College Athletes?*, FORBES (Aug. 29, 2013), <http://www.forbes.com/sites/jeffreydorfman/2013/08/29/pay-college-athletes-theyre-already-paid-up-to-125000year/>.

<sup>57</sup> Bass et al., *supra* note 3, at 34.

The problem, it seems, is not that student-athletes are underpaid, but instead their craft has been overvalued at their expense. Unlike graduate students, athletes' roles in universities are more charismatic than productive; they don't directly further the educational goals of an institution, or serve as anything more than a distraction—albeit an inspiring one—to society. While a case could be made for student-athletes to have more influence over how athletic programs are run, to claim anything that places more university income into non-educational pursuits is to doom secondary education as a whole.

As of now, there have been no legal efforts to reign in the rampant growth of the cancer that collegiate sports represent to higher education. There have been isolated pushbacks at several universities by students and faculty, but these efforts seem to be drowned out by the increasing widespread popularity of college athletics.<sup>58</sup> Although most universities are state or privately funded, past measures suggest federal action is necessary to effectively moderate the NCAA. Given how pervasive college sports have become to American pastimes, and the level of social mobility they provide, such a measure would likely be extremely polarizing. Yet all the money that this nonprofit generates, and how much it squanders on hype and paraphernalia, flies in the face of the universities that support it, and the original spirit of intercollegiate sports.

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<sup>58</sup> See generally *id.* at 34-36.



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### ***McNair v. NCAA: WHAT IT MEANS FOR THE NCAA ENFORCEMENT PROCESS AND HOW TO FIX THE PROBLEM IT CREATES***

John Carlson\*

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#### **INTRODUCTION**

To a casual observer, the *McNair v. National Collegiate Athletic Association* decision does not appear overtly controversial or troublesome. However, the *McNair* decision

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created a significant barrier to the efficient and effective disposition of internal National Collegiate Athletic Association (“NCAA”) enforcement matters. In *McNair*, the California Court of Appeals refused the NCAA’s motion to seal certain confidential enforcement documents that it desired to use in its defense against Plaintiff Todd McNair’s claims.<sup>1</sup> The Court relied on “the public’s First Amendment right of access to documents used at trial or as a basis of adjudication.”<sup>2</sup> The NCAA unsuccessfully argued that “the interest in confidentiality of its enforcement proceedings [should] override [this] public right of access to documents used as a basis for adjudication.”<sup>3</sup>

If the *McNair* decision is not overturned, and if other courts throughout the United States subsequently adopt it, the NCAA will be required to conduct an evidentiary balancing act in every future case it defends in court. The NCAA will find it necessary to balance the interests of proving its case in court using confidential enforcement documents, against the interests in maintaining the confidentiality of those same documents. This overarching problem creates two major underlying problems related to confidentiality. First, the NCAA will have more difficulty convincing witnesses outside the purview of the NCAA bylaws to cooperate due to the diminished guarantee of confidentiality. Second, members of the NCAA enforcement staff, Committee on Infractions (“COI”), and the Infractions Appeals Committee (“IAC”) will be less likely to express their candid opinions in internal communications, memoranda, and other notes due to the fear of possible future disclosure in a court proceeding.

Part I of this article provides an overview of previous and current NCAA enforcement procedures; part II summarizes *McNair* and how the case creates a problem for the NCAA’s future enforcement process; part III examines the solutions currently adopted by the NCAA; and part IV offers the NCAA a new solution to the *McNair* problem.

## **I. NCAA ENFORCEMENT PROCESS**

### **A. HISTORY OF NCAA ENFORCEMENT**

Until the early 20<sup>th</sup> century, intercollegiate sports were

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<sup>1</sup> *McNair v. NCAA*, 183 Cal. Rptr. 3d 490 (Ct. App. 2015).

<sup>2</sup> *Id.* at 492.

<sup>3</sup> *Id.* at 496.

largely unregulated.<sup>4</sup> The need to regulate and reform intercollegiate rules prompted the formation of the Intercollegiate Athletic Association in 1906.<sup>5</sup> In 1910, the Intercollegiate Athletic Association changed its name to the NCAA.<sup>6</sup> In its early years, the NCAA predominately focused on standardizing the rules of play and creating national championships for the various intercollegiate sports.<sup>7</sup> During this initial period, the NCAA was highly ineffectual in its enforcement and governance functions.<sup>8</sup>

The NCAA enacted the “Sanity Code” in 1948 to bolster its enforcement powers and to combat the illegal payment of players.<sup>9</sup> The Sanity Code stated that if an athlete met the ordinary admission requirements, he or she could only receive financial aid based on need.<sup>10</sup> To investigate institutions and enforce the Sanity Code, the NCAA created the Constitutional Compliance Commission.<sup>11</sup> The Sanity Code, however, was highly ineffectual because the only sanction for a violation was expulsion of the member institution.<sup>12</sup> In 1951, both the Sanity Code and the Constitutional Compliance Committee were replaced with the Committee on Infractions, “which was given broader sanctioning authority.”<sup>13</sup>

The enforcement powers were strengthened in the 1950s, primarily due to the efforts of Walter Byers,<sup>14</sup> the new NCAA

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<sup>4</sup> Rodney K. Smith, *A Brief History of the National Collegiate Athletic Association's Role in Regulating Intercollegiate Athletics*, 11 MARQ. SPORTS L. REV. 9, 10 (2000) [hereinafter Smith, *Brief History*].

<sup>5</sup> Louis Hakim, *The Student-Athlete vs. The Athlete Student: Has the Time Arrived for an Extended-Term Scholarship Contract?*, 2 VA. J. SPORTS & L. 145, 155 (2000); Smith, *supra* note 4.

<sup>6</sup> Smith, *Brief History*, *supra* note 4, at 12.

<sup>7</sup> *Id.* at 12-13

<sup>8</sup> *Id.* at 13.

<sup>9</sup> *Id.* at 14.

<sup>10</sup> Hakim, *supra* note 5, at 157.

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

<sup>12</sup> Smith, *Brief History*, *supra* note 4, at 15.

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

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

Executive Director, who established the NCAA's enforcement division.<sup>15</sup> Byers formed the enforcement division to work with the Committee on Infractions in the enforcement process.<sup>16</sup> The NCAA's enforcement powers steadily increased until the early 1970s, when it was "criticized for alleged unfairness in the exercise of its enhanced enforcement authority."<sup>17</sup> Partially in response to these criticisms, the NCAA enforcement process was modified in 1973 by splitting the Committee on Infractions' prosecutorial and investigative roles.<sup>18</sup> However, the criticism remained, and it further increased in 1978 "when the NCAA was given additional authority to enforce the rules by penalizing schools directly, and, as a result, athletes, coaches, and administrators indirectly."<sup>19</sup> The United States House of Representatives Committee on Oversight and Investigation became involved in 1978, and "held hearings to investigate the alleged unfairness of the NCAA's enforcement processes."<sup>20</sup> Although the NCAA made changes in response to these investigations, the NCAA's enforcement processes would be subject to further criticism over the next two decades.<sup>21</sup>

Faced with the fact that college athletics were becoming a primary driver of students' higher education related decisions, many university presidents were determined to take on a larger role concerning NCAA governance.<sup>22</sup> In 1984, university presidents collaborated and formed the Presidents Commission,<sup>23</sup> which was initially formed to change a number of NCAA enforcement rules.<sup>24</sup> However, a decade after it formed, the Presidents Commission implemented an Executive Committee, and Board of Directors comprised predominately of university presidents,<sup>25</sup> and attempted to change the very governance

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<sup>15</sup> Rodney K. Smith, *The National Collegiate Athletic Association's Death Penalty: How Educators Punish Themselves and Others*, 62 IND. L.J. 985, 993 (1987) [hereinafter Smith, *Death Penalty*].

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

<sup>17</sup> Smith, *Brief History*, *supra* note 4, at 15.

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

<sup>19</sup> *Id.* at 16.

<sup>20</sup> *Id.*

<sup>21</sup> *Id.*

<sup>22</sup> *Id.* at 16-17.

<sup>23</sup> *Id.* at 17.

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

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

structure of the NCAA.<sup>26</sup>

In 1988, as a result of the Presidents Commission's attempt, the Supreme Court decided *NCAA v. Tarkanian* in a 5-4 decision.<sup>27</sup> The Court held that the NCAA was not a state actor; and therefore, the NCAA was protected from constitutional due process claims.<sup>28</sup> Despite *Tarkanian* protecting the NCAA's enforcement process, the presidents still believed the NCAA needed enforcement reform.<sup>29</sup> They subsequently formed a special committee to review the NCAA enforcement and infractions process, chaired by Brigham Young University President Rex E. Lee.<sup>30</sup> In 1991, the special committee released a report with several recommendations:

- (1) 'Enhance the adequacy of the initial notice of an impending investigation and assure a personal visit by the enforcement staff with the institution's chief executive officer;'
- (2) 'Establish a 'summary disposition' procedure for treating major violations at a reasonably early stage in the investigation;'
- (3) 'Liberalize the use of tape recordings and the availability of such recordings to involved parties;'
- (4) 'Use former judges or other eminent legal authorities as hearing officers in cases involving major violations and not resolved in the 'summary disposition' process;'
- (5) 'Hearings should be open to the greatest extent possible;'
- (6) 'Provide transcripts of all infractions hearings to appropriate involved parties;'
- (7) 'Refine and enhance the role of the Committee on Infractions and establish a limited appellate process beyond that committee;'
- (8) 'Adopt a formal conflict-of-interest policy;'
- (9) 'Expand the public reporting of infractions cases;'
- (10) 'Make available a

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

<sup>27</sup> *See id.*

<sup>28</sup> Smith, *Brief History*, *supra* note 4, at 17.

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

<sup>30</sup> *Id.* at 17-18.

compilation of previous committee decisions;’  
and (11) ‘Study the structure and procedures of  
the enforcement staff.’<sup>31</sup>

These recommendations influenced the current enforcement and  
infractions process.<sup>32</sup>

## B. CURRENT ENFORCEMENT AND INFRACTIONS PROCESS

The NCAA enforcement staff initially handles NCAA  
enforcement matters.<sup>33</sup> The enforcement staff consists of  
approximately 57 staff members who are responsible for  
enforcing 5,800 rules across 1,084 member colleges and  
universities.<sup>34</sup> They conduct an estimated 450 interviews each  
year, investigating potential rules violations.<sup>35</sup> The enforcement  
process begins when the NCAA enforcement staff receives  
information about a potential violation.<sup>36</sup> This initial information  
can come from various sources, including confidential or  
anonymous tips, or self-reports from a member or conference.<sup>37</sup>  
The enforcement staff then researches the claims to determine  
whether the information is credible and if a possible violation  
actually exists.<sup>38</sup> The type of research at this stage varies  
depending on the nature of the alleged violations.<sup>39</sup> If the  
enforcement staff determines that the facts warrant a full

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<sup>31</sup> Smith, *Brief History*, *supra* note 4, at 18-19 (citing NATIONAL COLLEGIATE ATHLETIC ASSOCIATION, REPORT AND RECOMMENDATIONS OF THE SPECIAL COMMITTEE TO REVIEW THE NCAA ENFORCEMENT AND INFRACTIONS PROCESS, Oct. 28, 1991, at 1).

<sup>32</sup> Smith, *Brief History*, *supra* note 4, at 19

<sup>33</sup> See *National Office Enforcement Staff*, NCAA DIV. I INFRACTIONS PROCESS, NCAA.ORG [http://www.ncaa.org/sites/default/files/Enforcement%20Handouts\\_Combined.pdf](http://www.ncaa.org/sites/default/files/Enforcement%20Handouts_Combined.pdf). (last visited Dec. 1, 2015); *Enforcement by the Numbers*, NCAA DIV. I INFRACTIONS PROCESS, NCAA.ORG [http://www.ncaa.org/sites/default/files/Enforcement%20Handouts\\_Combined.pdf](http://www.ncaa.org/sites/default/files/Enforcement%20Handouts_Combined.pdf). (last visited Dec. 1, 2015).

<sup>34</sup> *Enforcement by the Numbers*, *supra* note 35.

<sup>35</sup> *Id.*

<sup>36</sup> *Overview of a Division I Investigation*, NCAA DIV. I INFRACTIONS PROCESS, NCAA.ORG [http://www.ncaa.org/sites/default/files/Enforcement%20Handouts\\_Combined.pdf](http://www.ncaa.org/sites/default/files/Enforcement%20Handouts_Combined.pdf). (last visited Dec. 1, 2015).

<sup>37</sup> *Id.*

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

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

investigation, it will issue a Notice of Inquiry to the institution and begin the investigation.<sup>40</sup> During the investigation, the enforcement staff works closely with the involved individuals, including the institution's employees and student athletes.<sup>41</sup>

The majority of interviews take place during this portion of the enforcement process.<sup>42</sup> The institutions' current employees and student athletes are required, under the bylaws, to cooperate and provide information during this process.<sup>43</sup> However, individuals that do not fall into these categories are outside the sphere of NCAA control, and are not required to cooperate or provide any requested information to the enforcement staff.<sup>44</sup> Furthermore, the NCAA does not have subpoena power to obtain this information.<sup>45</sup> Thus, the enforcement staff members generally rely on the guarantee of confidentiality to convince outside individuals to provide information.<sup>46</sup> Without these guarantees of confidentiality, it can be difficult to persuade witnesses to cooperate.<sup>47</sup>

If the enforcement staff finds that sufficient information exists to conclude that a violation has occurred, they will issue a Notice of Allegations.<sup>48</sup> The staff then prepares a written report

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

<sup>41</sup> *Infractions Phases and Parties*, NCAA DIV. I INFRACTIONS PROCESS, NCAA.ORG [http://www.ncaa.org/sites/default/files/Enforcement%20Handouts\\_Combined.pdf](http://www.ncaa.org/sites/default/files/Enforcement%20Handouts_Combined.pdf). (last visited Dec. 1, 2015).

<sup>42</sup> *See Id.*

<sup>43</sup> *F.A.C.T. Investigations*, NCAA DIV. I INFRACTIONS PROCESS, NCAA.ORG [http://www.ncaa.org/sites/default/files/Enforcement%20Handouts\\_Combined.pdf](http://www.ncaa.org/sites/default/files/Enforcement%20Handouts_Combined.pdf). (last visited Dec. 1, 2015).

<sup>44</sup> *See id.*; *see also* *McNair v. NCAA*, 183 Cal. Rptr. 3d 490, 493 (Ct. App. 2015).

<sup>45</sup> *McNair*, 183 Cal. Rptr. 3d at 493.

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

<sup>47</sup> *See id.*

<sup>48</sup> *Resolving Alleged Bylaw Violations*, NCAA DIV. I INFRACTIONS PROCESS, NCAA.ORG [http://www.ncaa.org/sites/default/files/Enforcement%20Handouts\\_Combined.pdf](http://www.ncaa.org/sites/default/files/Enforcement%20Handouts_Combined.pdf). (last visited Dec. 1, 2015).

outlining their investigation's findings of fact.<sup>49</sup> At this point, the matter is turned over to the Committee on Infractions ("COI").<sup>50</sup> The COI is ultimately responsible for deciding whether violations occurred and, if so, which penalties are appropriate.<sup>51</sup> COI members are not NCAA staff members, but instead are individuals from member schools, conferences, and the public.<sup>52</sup> The COI reviews the evidence from the enforcement staff and any written submissions prepared by the institution or involved individuals.<sup>53</sup> If all the parties agree on the facts, then the COI may decide the case through summary disposition.<sup>54</sup> If there are factual disputes, the COI will hold a hearing where the parties will have the opportunity to present their respective cases, and the COI will have the opportunity to ask questions.<sup>55</sup> The COI will then deliberate privately until it reaches a decision.<sup>56</sup> It will release a written decision with its conclusion, stating whether violations occurred and, if so, which penalties shall be imposed.<sup>57</sup>

If either the institution or any involved individual disagrees with the COI's decision, they may appeal to the Infractions Appeals Committee ("IAC").<sup>58</sup> Like the COI, the IAC is made up of qualified individuals from the NCAA schools

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

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

<sup>51</sup> *Committee on Infractions*, NCAA DIV. I INFRINGEMENTS PROCESS, NCAA.ORG

[http://www.ncaa.org/sites/default/files/Enforcement%20Handouts\\_Combined.pdf](http://www.ncaa.org/sites/default/files/Enforcement%20Handouts_Combined.pdf). (last visited Dec. 1, 2015).

<sup>52</sup> *Id.*; NCAA DIV. I MANUAL 2014-2015, art. 19.3 (2015), <http://www.ncaapublications.com/productdownloads/D115JAN.pdf> (last visited Dec. 1, 2015) [hereinafter 2015 NCAA MANUAL] The COI is made up of two university presidents, two conference commissioners, three senior athletic administrators, two university administrators, three professors and/or faculty athletic representatives, two former NCAA coaches, and four public individuals with formal legal training). See *Committee on Infractions*, NCAA.ORG, <http://www.ncaa.org/about/resources/media-center/news/committee-infractions> (last visited Dec. 1, 2015).

<sup>53</sup> 2015 NCAA DIV. I MANUAL, *supra* note 54, at Fig. 19.2; DIV. I ENFORCEMENT HANDOUTS, *supra* note 35.

<sup>54</sup> *Resolving Alleged Bylaw Violations*, *supra* note 50.

<sup>55</sup> *Id.*

<sup>56</sup> *Id.*

<sup>57</sup> *Id.*

<sup>58</sup> *Id.*



and public.<sup>59</sup> The IAC hears arguments from the schools, involved individuals, and the COI, and then deliberates privately until it decides whether the COI decision should be affirmed or reversed.<sup>60</sup> Their decision is final, barring a lawsuit and judicial intervention.<sup>61</sup>

## II. MCNAIR V. NCAA

### A. SUMMARY

In 2010, the NCAA penalized former University of Southern California assistant football coach, Todd McNair, with a one-year show cause penalty as a result of the NCAA's investigation into former USC running back Reggie Bush.<sup>62</sup> The *McNair* case arose from a complaint filed by Todd McNair against the NCAA for damages due to breach of contract, defamation, and other torts stemming from the investigation and penalty.<sup>63</sup> The NCAA quickly filed a special motion to strike, in which it argued that the plaintiff's lawsuit was a "strategic lawsuit against public participation."<sup>64</sup> This special motion imposed an automatic stay on discovery.<sup>65</sup> McNair applied to lift this automatic stay of discovery so that he could take the depositions of the lead investigator, Committee on Infractions (COI) chairman, and COI director.<sup>66</sup> McNair also sought to obtain

transcripts from the COI and Appeals Committee hearings, the entire investigative file, and drafts of the COI Report, including all notes, and other writings discussing or referring to the drafts, and e-mails within the custody and

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<sup>59</sup> *Infractions Phases and Parties*, *supra* note 43.

<sup>60</sup> *Resolving Alleged Bylaw Violations*, *supra* note 50.

<sup>61</sup> *Id.*

<sup>62</sup> *NCAA Delivers Postseason Football Ban*, ESPN.COM (June 11, 2010), <http://sports.espn.go.com/los-angeles/ncf/news/story?id=5272615>.

<sup>63</sup> *McNair v. NCAA*, 183 Cal. Rptr. 3d 490, 493 (Ct. App. 2015).

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

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

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

control of the NCAA, by or to members of the COI or Appeals Committee staff that mentioned or related to plaintiff.<sup>67</sup>

The trial court determined that McNair had shown good cause and granted the motion, subject to a protective order and the court's supervision.<sup>68</sup> The parties signed a protective order and the NCAA produced the requested documents.<sup>69</sup> The NCAA then moved to seal certain portions of the record, including many of the exhibits that were disclosed as part of the court's order.<sup>70</sup> In its motion, "[t]he NCAA argued that its bylaws require it to keep its investigations strictly confidential."<sup>71</sup> The NCAA routinely promises confidentiality to witnesses to obtain much of its needed information.<sup>72</sup> The NCAA claimed that if the trial court were to deny its request to seal the documents, "its enforcement proceedings would be made public, thereby prejudicing its enforcement abilities and embarrassing witnesses who had relied on confidentiality."<sup>73</sup> The relevant documents were lodged conditionally under seal.<sup>74</sup>

The trial court denied the NCAA's motion to seal, stating that they "failed to make a sufficient factual showing to seal the documents."<sup>75</sup> However, the court stayed enforcement

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

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

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

<sup>70</sup> *Id.* The NCAA sought

"[t]o seal unredacted versions of plaintiff's opposition to the NCAA's special motion to strike, his memorandum of points and authorities in support thereof, the declarations of plaintiff and his counsel, and specified exhibits attached thereto, including (1) the COI Report, (2) the NCAA case summary provided to the COI, (3) memoranda drafted by members of the COI concerning the allegations, (4) excerpts of witness interviews, (5) telephone records, (6) the notice of allegations, (7) excerpts of the deposition testimony of NCAA officials describing the NCAA's investigative and adjudicative process, (8) e-mails between the COI members while adjudicating the allegations, (9) excerpts of the COI hearing transcripts, (10) plaintiff's response to the notice of allegations, and (11) his appeal to the NCAA's Appeals Committee."

<sup>71</sup> *Id.*

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

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

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

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

and ordered the documents “to remain conditionally lodged under seal pending appellate review.”<sup>76</sup> The NCAA then filed a notice of appeal from the denial of the special motion to strike, and subsequently moved the appellate court to seal the “appellate record that had been conditionally sealed in the trial court.”<sup>77</sup> The documents in the record on appeal were conditionally sealed pending the resolution of the motion.<sup>78</sup>

The appellate court began its analysis by stating that the public has a general First Amendment right of access to civil litigation documents that are used at trial or are a basis for adjudication.<sup>79</sup> It maintained, “the public has an interest, in *all* civil cases, in observing and assessing the performance of its judicial system.”<sup>80</sup> Public court records help “expose corruption, incompetence, inefficiency, prejudice, and favoritism.”<sup>81</sup> However, the openness of court records is a presumption that is not absolute.<sup>82</sup> California courts follow a rule established in *NBC Subsidiary* to determine whether a presumption of openness has been overcome.<sup>83</sup> The trial court must find that

- (1) there is an overriding interest supporting sealing of the records;
- (2) there is a substantial probability that the interest will be prejudiced absent sealing;
- (3) the sealing order is narrowly tailored to serve the overriding interest; and
- (4) there is no less restrictive means of meeting that interest.<sup>84</sup>

These requirements are explicitly embodied in the California

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

<sup>77</sup> *Id.* at 493-94.

<sup>78</sup> *Id.* at 494.

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

<sup>80</sup> *Id.* (citing *NBC Subsidiary, (KNBC-TV), Inc. v. Superior Court*, 980 P.2d 337 (1999) (emphasis in original)).

<sup>81</sup> *McNair*, 183 Cal. Rptr. 3d at 494.

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

<sup>83</sup> *Id.*; see *NBC Subsidiary*, 980 P.2d at 337.

<sup>84</sup> *McNair*, 183 Cal. Rptr. 3d at 494 (citing *NBC Subsidiary*, 980 P.2d at 337).

Rules of Court, Rule 2.550.<sup>85</sup> Furthermore, an appellate court must order a record to be sealed if the record was not initially filed in the trial court; a seal is not permitted solely by stipulation of the parties.<sup>86</sup> Because this was not an appeal of the trial court's order denying the motion to seal, the appellate court must make its own findings in accordance with *NBC Subsidiary* and Rule 2.550 requirements.<sup>87</sup> Finally, "the NCAA has the burden to 'justify the sealing.'"<sup>88</sup>

The appellate court first addressed whether there was an overriding interest justifying a sealing order.<sup>89</sup> The NCAA argued that its interest in confidentiality, as outlined in its bylaws and contractual agreements, is an overriding interest.<sup>90</sup> It contended that enforcement is necessary to uphold the basic NCAA principle of amateurism and to protect student athletes from exploitation.<sup>91</sup> Confidentiality, in turn, is an essential enforcement tool because the NCAA lacks the power to subpoena.<sup>92</sup>

The court dismissed the NCAA's claim that its bylaws created an overriding interest, stating "the NCAA cannot make the showing of an overriding interest to justify sealing merely because its internal bylaws say so by designating certain

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<sup>85</sup> *Id.*; Cal. Rules of Court, Rule 2.550.

<sup>86</sup> *McNair*, 183 Cal. Rptr. 3d at 495; Cal. Rules of Court, Rule 8.46(d)(1).

<sup>87</sup> *McNair*, 183 Cal. Rptr. 3d at 495;

<sup>88</sup> *Id.* (citing Cal. Rules of Court, Rule 8.46(d)(2)).

<sup>89</sup> *Id.* The court lists examples from *NBC Subsidiary* of an assortment of interests that potentially constitute an overriding interest to justify a sealing order. These include: "an accused's interest in a fair trial; a civil litigant's right to a fair trial; protection of minor victims of sex crimes from further trauma and embarrassment; privacy interests of a prospective juror during individual voir dire; protection of witnesses from embarrassment or intimidation so extreme that it would traumatize them or render them unable to testify; protection of trade secrets; protection of information within the attorney-client privilege; enforcement of binding contractual obligations not to disclose; safeguarding national security; ensuring the anonymity of juvenile offenders in juvenile court; ensuring the fair administration of justice; and preservation of confidential investigative information." *Id.*

<sup>90</sup> *Id.* at 496.

<sup>91</sup> *Id.*

<sup>92</sup> *Id.*

documents as confidential.”<sup>93</sup> The court determined that the two NCAA bylaws, which stated that certain information and documents related to investigations are confidential, did not create an all-encompassing, overriding interest to justify the sealing of a public record.<sup>94</sup>

The court also dismissed the NCAA’s argument that the contractual confidentiality agreements signed by the parties should be considered an overriding interest.<sup>95</sup> The court stated that “[m]ore than a mere agreement of the parties to seal documents filed in a public courtroom’ is needed” to show an overriding interest to justify sealing;<sup>96</sup> “[t]here must be a specific showing of serious injury.”<sup>97</sup> Broad allegations of harm are not sufficient to meet this standard.<sup>98</sup> Further, California Rules of Court Rule 8.46(d)(1) confirms that a record will not be sealed solely by agreement of the parties.<sup>99</sup> The court concluded that the NCAA had not made a specific showing of serious injury, therefore the agreements themselves were not sufficient to constitute an overriding interest to justify sealing the documents.<sup>100</sup> Overall, the court concluded, “the bylaws and contractual agreement of confidentiality of a private, voluntary organization . . . do not overcome the presumption of, and the courts’ obligation to protect the constitutional interest in, the openness of court records in ordinary court proceedings.”<sup>101</sup>

The court next considered the second required finding of *NBC Subsidiary*, whether there exists a substantial probability of

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<sup>93</sup> *Id.* at 497.

<sup>94</sup> *Id.* at 496-97. (The NCAA cites bylaw 32.1.1, which treats case information in a confidential manner until it has been announced, and bylaw 32.3.9, which designates the interview records of interviewees and their institutional representatives confidential). *Id.*

<sup>95</sup> *Id.* at 498.

<sup>96</sup> *Id.* at 497 (citing *Universal City Studios, Inc. v. Superior Court*, 110 Cal. App. 4th 1273, 2 Cal. Rptr. 3d 484 (2003)).

<sup>97</sup> *McNair*, 183 Cal. Rptr. 3d at 497.

<sup>98</sup> *Id.*

<sup>99</sup> *Id.* at 498.

<sup>100</sup> *Id.*

<sup>101</sup> *Id.*

prejudice if the documents are not sealed.<sup>102</sup> The NCAA argued that its enforcement ability would be crippled if its records were not kept confidential.<sup>103</sup> The NCAA was afraid that “witnesses who might otherwise cooperate will be unwilling to talk or may temper their statements or candor for fear of repercussions.”<sup>104</sup> In addition, the NCAA asserted that volunteer investigators and committee members may now “forego detailed notes of their thoughts and impressions” due to “concern over disclosure of internal emails and communications.”<sup>105</sup>

The court was not convinced by the NCAA’s arguments.<sup>106</sup> The court noted that “member institutions, their employees, students, and alumni already agree to submit to NCAA enforcement” and thus are required to give testimony, whether it is confidential or not.<sup>107</sup> Additionally, the court believed that the risk of disclosure would likely force COI members and investigators to “ground their evaluations in specific examples and illustrations in order to deflect potential claims of bias or unfairness.”<sup>108</sup> The court further pointed out the fact that the NCAA’s investigative and adjudicative documents have been subject to public scrutiny in other courts throughout the United States, and that “[t]he NCAA has not demonstrated that such disclosure chilled future investigations.”<sup>109</sup>

The Court also reaffirmed the point that the NCAA is a private, voluntary organization that “is more akin to a private employer who investigates misconduct of its employees” than it is to judiciary and administrative agencies acting in an adjudicative capacity, both of which enjoy confidentiality of their deliberations under the law.<sup>110</sup> The court was also not persuaded by the NCAA’s complaint that if the records were not sealed, it must decide between two opposing evils.<sup>111</sup> Namely

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

<sup>103</sup> *Id.*

<sup>104</sup> *Id.* (The NCAA cites a fact that it took “months and months and months” to convince one non-party witness to cooperate). *Id.*

<sup>105</sup> *Id.*

<sup>106</sup> *Id.*

<sup>107</sup> *Id.*

<sup>108</sup> *Id.* at 499 (citing *Univ. of Penn. v. EEOC*, 493 U.S. 182, 200-201 (1990)).

<sup>109</sup> *McNair*, 183 Cal. Rptr. 3d at 499-500.

<sup>110</sup> *Id.*

<sup>111</sup> *Id.*

the decision to either “publicly reveal the contents of the conditionally lodged documents to pursue its appeal or . . . to have those records returned to it.”<sup>112</sup> The NCAA did not believe it could present a complete defense without using the documents.<sup>113</sup> The court held that this did not create substantial prejudice, as it is a decision that all litigants must face.<sup>114</sup>

The court did not address the final two requirements of *NBC Subsidiary* because the NCAA failed to make the necessary showing for the first two.<sup>115</sup> Thus, the court denied the motion to seal and directed the clerk to return the conditionally sealed documents to the NCAA so that it may determine which documents it wants to submit to the public record, and which documents it will withhold.<sup>116</sup>

#### B. PROBLEMS STEMMING FROM THE *McNAIR V. NCAA* RULING

In its argument to the California Appellate Court, the NCAA summarized the problem that the *McNair* decision creates. In any action against the NCAA in California, the NCAA will be required to balance two competing interests regarding the use of its evidence. The first interest is in presenting a full defense using any and all documents in its possession. The second interest is that of confidentiality in those documents that the NCAA wishes to use. If the court had granted the motion to seal, these interests would not conflict. Because the court made it clear that the NCAA will not be able to file these documents under seal unless it comes up with a persuasive argument, the NCAA must balance the competing interests.

As noted, this overarching problem creates two underlying problems for the NCAA. The NCAA routinely relies on confidentiality guarantees to obtain information from witnesses who are not subject to NCAA governance.<sup>117</sup> The

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<sup>112</sup> *Id.* at 500.

<sup>113</sup> *Id.*

<sup>114</sup> *Id.*

<sup>115</sup> *Id.* at 501.

<sup>116</sup> *Id.*

<sup>117</sup> *Id.* at 493.

*McNair* decision limits the extent of confidentiality that the NCAA can guarantee to these individuals. A second underlying problem concerns the communications between individuals involved in the enforcement and infractions process, including members of the enforcement staff, COI, and IAC. The NCAA argued that without a standard in place that allows the NCAA to file confidential enforcement documents under seal, the individuals involved in the enforcement process would be hesitant to fully disclose their impressions in internal communications and notes. It is possible that these individuals would be concerned that their impressions could someday be subject to public record as evidence in a potential NCAA lawsuit. This could disrupt the effectiveness and efficiency of the enforcement process.

### III. SOLUTIONS CURRENTLY ADOPTED BY THE NCAA

There have been no direct solutions to the *McNair* problem offered from any outside sources since the February 2015 decision.<sup>118</sup> However, there is at least one current strategy that the NCAA may employ to cope with the *McNair* problem. This section presents this strategy and addresses two other practices that the NCAA should not employ. The most direct solution to the *McNair* problem would have been to appeal to the California Supreme Court; however, this is no longer an option available to the NCAA. The NCAA has employed an initial, workable practice following *McNair*: the NCAA continues to rely on its current confidentiality standards and engages in the evidentiary balancing test. The final portion of this section examines the NFL's personal conduct policy, and addresses why the enforcement procedures of professional sports organizations present little assistance to the NCAA.

#### A. APPEAL

The NCAA's first and most straightforward solution was to appeal the decision to the California Supreme Court. The NCAA quickly sought a rehearing before California's 2<sup>nd</sup> Court of Appeals, but the court denied this request.<sup>119</sup> If the NCAA had appealed to the California Supreme Court, it could have

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<sup>118</sup> As of March 25, 2015.

<sup>119</sup> Nathan Fenno, *Court Denies NCAA Request to Reconsider Todd McNair Ruling*, LA TIMES (Feb. 24, 2015), <http://www.latimes.com/sports/sportsnow/la-sp-sn-ncaa-todd-mcnair-lawsuit-documents-20150224-story.html>.



eliminated the *McNair* problem with a reversal. However, the California court docket indicates that the NCAA did not file a petition of review with the California Supreme Court within the deadline.<sup>120</sup> In fact, the NCAA filed many of the documents that were conditionally sealed into the public record.<sup>121</sup> Therefore, an appeal of the *McNair* decision is no longer a viable solution. One reason for its lack of appeal is perhaps that the NCAA believed it was beat on this issue, and did not want to expend resources on appeal.

#### B. NCAA CONFIDENTIALITY BYLAWS AND BALANCING TEST

It is unquestionable that NCAA employees, Board of Directors, or COI members have had internal conversations regarding how they should address *McNair*. However, the NCAA has not publicly indicated how, if at all, it will alter its enforcement practices. Therefore, the NCAA's current solution to the problem is to continue to rely on its established confidentiality bylaws, and then engage in the evidentiary balancing test of confidentiality in the face of a lawsuit.

As part of its recent enforcement modification process, the NCAA has removed and modified several of its relevant confidentiality bylaws. Bylaw 32.1.1, titled "Confidentiality," which was cited by the NCAA in *McNair*, has been retitled and moved to bylaw 19.01.3. It is now titled "Public Disclosure."<sup>122</sup> This bylaw previously stated that the members of the enforcement staff, COI, and IAC were to treat all cases as confidential until they had been announced.<sup>123</sup> The modified bylaw states that the enforcement staff, COI, and IAC "shall not make public disclosures about a pending case until the case has

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<sup>120</sup> Cal. 2d Appellate District Docket for *McNair v. NCAA*, CAL. APP. CT. CASE INFO. (Dec. 1, 2015, 2:13 PM), [http://appellatecases.courtinfo.ca.gov/search/case/dockets.cfm?dist=2&doc\\_id=2031960&div=3&doc\\_no=B245475](http://appellatecases.courtinfo.ca.gov/search/case/dockets.cfm?dist=2&doc_id=2031960&div=3&doc_no=B245475) (last visited Dec. 1, 2015).

<sup>121</sup> *Id.*

<sup>122</sup> 2015 NCAA DIV. I MANUAL, *supra* note 54, at art. 19.01.3.

<sup>123</sup> 2011-2012 NCAA DIV. I MANUAL, ART. 32.1.1 (2011), <http://www.ncaapublications.com/productdownloads/D112.pdf> (last visited Dec. 1, 2015) [hereinafter 2011 NCAA MANUAL].

been announced.”<sup>124</sup> The new bylaw functions in the same manner as the old bylaw, but it uses different phrasing. Thus, this change would likely have little effect on changing the court’s mind in *McNair*. But this bylaw does have continued effect in ensuring that certain confidential documents will not be disclosed to the public, absent their use in court.

The second relevant bylaw cited in *McNair* was bylaw 32.3.9.1.4, titled “Statement of Confidentiality.”<sup>125</sup> This bylaw has since been relocated to bylaw 19.5.8.<sup>126</sup> This bylaw states that individuals and institutional representatives who are interviewed as part of the enforcement process must sign a confidentiality agreement that precludes them from releasing any recordings or interview transcripts to a third party.<sup>127</sup> The *McNair* decision noted that this provision does not cover many of the documents that the NCAA wished to seal, including communications between COI members and enforcement staff, memoranda drafted by the COI, and other investigative documents.<sup>128</sup> The court in *McNair* conceded that although this bylaw provides confidentiality protection to the NCAA and its interviewees, it indicated that these extrajudicial agreements do not bind the court.<sup>129</sup> Thus, this bylaw remains effective in guaranteeing confidentiality for certain documents, but only outside of a court proceeding.

The final bylaw relevant to the confidentiality of enforcement proceedings is bylaw 19.7.7.3.1, titled “Information from Confidential Sources.”<sup>130</sup> The bylaw states:

At a hearing, the parties, including the enforcement staff, shall present only information that can be attributed to individuals who are willing to be identified. Information obtained from individuals not wishing to be identified shall not be relied on by the hearing panel in concluding whether a violation occurred. Such confidential sources shall not be identified to the hearing panel, the institution or an involved

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<sup>124</sup> 2015 NCAA MANUAL, *supra* note 54, at art 19.01.3.

<sup>125</sup> 2011 NCAA MANUAL, *supra* note 125, at art. 32.3.9.1.4.

<sup>126</sup> 2015 NCAA MANUAL, *supra* note 54, at art. 19.5.8.

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

<sup>128</sup> *McNair v. NCAA*, 183 Cal. Rptr. 3d 490, 497 (Ct. App. 2015).

<sup>129</sup> *Id.*

<sup>130</sup> 2015 NCAA MANUAL, *supra* note 54, at art. 19.7.7.3.1.

individual.<sup>131</sup>

Curiously, the NCAA in *McNair* did not cite this bylaw, even though it tends to strengthen the argument that the NCAA values the confidentiality of its sources. However, citing this provision would likely not have affected the *McNair* decision. The court would likely critique it in the same manner as bylaw 19.5.8, by stating that it only applies to the identity of the confidential witness and the information obtained from that witness. It does not cover the remaining documents the NCAA sought to seal. In addition, the court is not obligated to cooperate with a NCAA confidentiality requirement. In sum, this bylaw still operates functionally the same way post-*McNair*, but again, there is little protection of confidentiality afforded to individuals in court proceedings.

The NCAA may determine that it will continue to conduct all of its enforcement proceedings and investigations in the same manner as before *McNair*, without any alterations to its procedures. However, the primary fallout from *McNair* concerns how individuals within the NCAA, and any potential witnesses outside the NCAA, will behave in the future, which in turn could harm the overall NCAA enforcement process. In other words, even if the NCAA as an organization states that it will not modify its procedures in the wake of *McNair*, it is likely that the individuals affected the most by *McNair* (the enforcement staff, COI and IAC members, and witnesses outside the scope of the NCAA's bylaws) will independently alter their behavior. This behavior modification will likely come in two forms, as outlined above: (1) refusing to cooperate in an investigation because confidentiality is no longer actually guaranteed if the case goes to court; and (2) a decrease in the candidness of internal enforcement communications. In post-*McNair* cases, the NCAA will be forced to decide between keeping the information confidential, or disclosing it in its defense. The threat of disclosing confidential documents could scare away potential witnesses, which would harm the overall NCAA enforcement process. Thus, the NCAA's decision to maintain its current

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<sup>131</sup> 2015 NCAA MANUAL, *supra* note 54, at art. 19.7.7.3.1.

confidentiality bylaws, with no formal change, will not lead to optimal outcomes.

#### C. NFL CONFIDENTIALITY OF WITNESSES

The NCAA is a highly specific organization. The size of the membership, its public nature, and the types of violations it investigates differ greatly from most other organizations. For this reason, it is difficult to compare its enforcement process with any other private organizations. The only other organizations that are comparable in size and purpose are American professional sports leagues. These leagues differ in several key areas, but are similar enough to warrant examining how their policies might deal with *McNair*.

In December 2014, the NFL revised its personal conduct policy.<sup>132</sup> The new policy states that promises of confidentiality will be given to witnesses if reasonable: “In conducting investigations, the league office will make reasonable efforts to safeguard requests for confidentiality from witnesses and others with information.”<sup>133</sup> The NFL’s “reasonable efforts” to keep confidentiality are not at the same level as the NCAA’s commitment to confidentiality, which *requires* confidentiality in several situations. Furthermore, the NFL does not indicate in any supporting documents that confidentiality is a key concern in its overall investigatory process. More importantly, the NFL and other professional sports leagues would be subject to the same standard outlined in *McNair* if they ever sought to seal enforcement and investigatory documents. Having less interest in confidentiality than the NCAA, it is highly unlikely that the NFL would be able to overcome the burden of openness of court records in order to seal its records. Because of this, the policies and procedures of the professional sports leagues provide little assistance in examining the best practices currently available to the NCAA.

#### IV. PROPOSED SOLUTION TO THE *MCNAIR* PROBLEM

This section presents a new, unique solution to the *McNair* problem, and involves the implementation of several new NCAA bylaws. The proposed bylaws intend to ensure confidentiality to the greatest extent possible for potential

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<sup>132</sup> *Personal Conduct Policy*, NFL.COM (Dec. 2014), <http://static.nfl.com/static/content/public/photo/2014/12/10/0ap3000000441637.pdf> (last visited Dec. 1, 2015).

<sup>133</sup> *Id.*

confidential witnesses and members of the NCAA enforcement staff, COI, and IAC.

**A. PROPOSED BYLAWS**

**19.14 CONFIDENTIALITY OF NON-DISCLOSED ENFORCEMENT DOCUMENTS.**

**19.14.1 GENERAL STANDARD OF CONFIDENTIALITY.**

All Confidential Documents (as defined in 19.14.2) shall remain confidential, subject to the exceptions contained in bylaw 19.14.3.

**19.14.2 CONFIDENTIAL DOCUMENTS DEFINED.**

Under this bylaw, Confidential Documents shall include all internal communications (including emails), memoranda, reports, interview transcripts and recordings, hearing transcripts and recordings, notices, personal notes and other documents prepared by or for any member of the NCAA enforcement staff, Committee on Infractions, or Infractions Appeals Committee in connection with any NCAA enforcement proceedings, which have not been previously disclosed in a 19.8.1 Infractions Decision or a 19.10.6 Decision of the Infractions Appeals Committee.

**19.14.3 EXCEPTIONS TO THE GENERAL STANDARD OF CONFIDENTIALITY**

**19.14.3.1 CONFIDENTIAL DOCUMENTS NEEDED BY NCAA IN CONNECTION WITH COURT PROCEEDINGS.**

The NCAA reserves the right to use any Confidential Documents in a court proceeding connected to the enforcement proceeding in which the Confidential Documents were used, but only if the relevant court grants an order sealing the Confidential Documents. If the court does not grant the sealing of the confidential documents, the NCAA may use the Confidential Documents in the court proceeding only after obtaining the express written consent of those individuals who created, drafted, or were

transcribed within, each particular Confidential Document that the NCAA desires to use.

#### **19.14.3.2 WHEN DISCLOSURE ORDERED BY THE COURT.**

If a party in a court proceeding seeks to compel disclosure of Confidential Documents or the court has ordered the disclosure of Confidential Documents, the NCAA will take all reasonable efforts to ensure any requested Confidential Documents remain confidential, while still complying with any court orders. This includes, but is not limited to, objecting to the relevance of requested documents, objecting to overbroad requests, seeking an in-camera review of the requested documents, and/or redacting sensitive and/or confidential information from the requested documents when appropriate.

#### **B. ANALYSIS OF THE PROPOSED BYLAWS**

The proposed bylaws do not completely eliminate the *McNair* problems, but they do alleviate many of the pressure points. The post-*McNair* world does not guarantee complete confidentiality to any witnesses or members of the COI, IAC, or enforcement staff, and there is little the NCAA can do to escape this reality. However, the proposed bylaws help adapt the NCAA's enforcement confidentiality provisions to the post-*McNair* world, to ensure the greatest degree of confidentiality possible.

##### *1. Confidential Documents*

It is important that any adopted bylaws clearly outline which documents are covered. Proposed bylaw 19.14.2 broadly defines what is included in the definition of Confidential Documents. Confidential Documents do not include any documents that have been disclosed as part of a final written decision publicly disclosed by either the COI or IAC. As drafted, the bylaw covers all documents that the NCAA was seeking to have filed under seal in *McNair*. It includes documents and recordings related to any interviews conducted, and internal communications and notes of the members of the COI, IAC, and enforcement staff, which were created in connection with an NCAA enforcement proceeding. These two areas of confidentiality were the NCAA's primary concerns when arguing for the sealing of documents in *McNair*. Additionally, the definition is modifiable, so if after review of

the bylaw, and before adoption, the NCAA deems that one or more of the categories may be routinely important in future court proceedings, the NCAA can simply remove the bylaw from the list.

## 2. *General Standard*

The general standard of the proposed bylaws is stated in bylaw 19.14.1. The function of this bylaw is straightforward: all Confidential Documents shall remain confidential, unless there is an applicable exception. Neither the NCAA nor the individuals who have access to the Confidential Documents may publicly disclose any Confidential Documents. It is important that the restriction extends to both the NCAA and the individuals. Any individual who is under the purview of the NCAA will be obligated to comply with this confidentiality requirement. And any individuals outside the NCAA's power will sign confidentiality agreements according to bylaw 19.5.8.

Together, proposed bylaws 19.14.1 and 19.14.2 provide a basic groundwork for maintaining confidentiality in NCAA enforcement proceedings. The *McNair* court rejected the NCAA's argument that the bylaws were not "[a] one-size-fits-all cloak of confidentiality."<sup>134</sup> The proposed bylaws address this aspect of the NCAA's argument. The proposed bylaws are much more akin to the so-called "one-size-fits-all cloak of confidentiality."<sup>135</sup> The proposed bylaws provide more broad and explicit protection to involved parties, which were absent from the original NCAA bylaws in *McNair*. If the proposed bylaws are adopted, a court ruling on a motion to seal could issue a different conclusion than the conclusion reached in *McNair*. However, the *McNair* court implied that even if a "one-size-fits-all cloak of confidentiality" provision had been present, the court would still not be obligated to honor the confidentiality agreements and rules of a private organization.<sup>136</sup> Therefore, a reversal based on the proposed bylaws, although not impossible, is unlikely.

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<sup>134</sup> *McNair*, 183 Cal. Rptr. 3d at 497.

<sup>135</sup> *Id.*

<sup>136</sup> *Id.*

### 3. *Exceptions*

Because the court is not likely to honor the general standard of the proposed bylaws, and because the NCAA may be required to disclose confidential documents in the future, exceptions to the general rule are necessary. Proposed bylaw 19.14.3 outlines the exceptions. Both 19.14.3.1 and 19.14.3.2 exceptions relate to the use of confidential documents in court proceedings. Bylaw 19.14.3.1 covers situations in which the NCAA desires to use confidential documents in a court proceeding, but has not been ordered to disclose the documents by the court. The first sentence of the bylaw allows the NCAA to use any confidential documents in a court proceeding if it obtains a sealing order. This provision is consistent with the general standard of confidentiality, and functions as a clarifying statement. Granted, even without this language, the NCAA would still be able to use the sealed, confidential documents in a court proceeding. However, the sentence is necessary because it explicitly permits this behavior and it frames the remainder of the exception.

The second provision of bylaw 19.14.3.1 outlines how the NCAA may use confidential documents if the court declines to seal the documents. The NCAA must obtain written consent from the individuals who were involved in the creation of the confidential documents. This provision serves several purposes. First, it provides the NCAA the ability, although limited, to use confidential documents in a court proceeding if the NCAA deems them to be relevant or useful. The permission requirement may preclude the NCAA from using certain documents, but in most situations, the NCAA should not have much difficulty obtaining this permission. Enforcement staff, COI, and IAC members are all directly involved with the NCAA in some way; thus, they presumably have the NCAA's best interests in mind. Therefore, it should not be too difficult to obtain permission to use certain confidential documents drafted by these individuals, if necessary.

Bylaw 19.14.3.1 creates a greater guarantee of confidentiality for confidential witnesses. The NCAA would likely have difficulty obtaining permission from these individuals. This reality provides greater confidentiality protection to witnesses because witnesses are permanently guaranteed to remain confidential unless the witness consents to disclosure (or the court orders the disclosure, which is addressed below). This partially alleviates the *McNair* problem of



potentially discouraging confidential witnesses to come forward with information.

Finally, proposed bylaw 19.14.3.2 addresses court ordered disclosure of confidential documents. The courts may overcome any confidential bylaw guarantees and may order the NCAA to produce certain confidential documents if an opposing party has moved to compel document disclosure. In these situations, the NCAA will use all reasonable efforts to oppose the motion. However, if the motion is granted and the court orders the disclosure, the NCAA must take further reasonable steps to ensure the confidential documents remain as confidential as possible. This may include seeking an in-camera review to ensure the parties and judge may locate the relevant documents, thereby reducing the total number of confidential documents disclosed to the public record. It may also include redacting any non-relevant confidential information contained in a confidential document.

#### C. BENEFITS OF THE PROPOSED BYLAWS

There are several benefits to the proposed bylaws, some of which have been briefly mentioned in the preceding sections. The benefits are framed with respect to the problems that the proposed bylaws were designed to address. One of the problems created by *McNair* was the possible issue that individuals, who are not required to participate in NCAA investigations, may be reluctant to cooperate if they are not guaranteed confidentiality. The proposed bylaws do not eliminate this risk completely, but they do greatly reduce it. The proposed bylaws create an additional layer of protection for individuals who wish to share information with the NCAA. These individuals, under proposed bylaw 19.14.3.1, have the final say whether the NCAA may use their interview documents in the NCAA's defense. This provision grants individuals greater authority over the future use of confidential documents.

Additionally, proposed bylaw 19.14.3.2 requires the NCAA to take all reasonable steps to protect the confidential information in the event the court orders the disclosure of confidential documents. This provision creates an added layer of protection for outside individuals. Overall, the proposed bylaws

increase the level of confidentiality afforded to individuals outside the governance of the NCAA, which should alleviate some of the *McNair* confidentiality problems.

The second fundamental problem created by *McNair* includes the possibility that members of the NCAA enforcement staff, COI, and IAC might be less candid or forthright in their internal communications, and that these individuals “may forego detailed notes of their thoughts and impressions” due to fear of disclosure.<sup>137</sup> Confidential deliberation processes prevent influence from outside forces. Therefore, for the enforcement process to function effectively and efficiently, the individuals in these groups must be able to communicate and take notes with minimal fear of future disclosure. A confidential deliberation process allows individuals to focus on the issues and allegations at hand, instead of how internal communications may be perceived by the public.

The proposed bylaws ensure deliberations remain confidential to the greatest extent possible. The proposed bylaws also provide final authority over the use of confidential documents to the involved individuals. Therefore, if a member of the enforcement process does not authorize disclosure of a confidential document that she worked on, it will not be disclosed absent a court order. Granted, it is possible the NCAA could exercise influence over enforcement staff members, who are NCAA employees, to gain their permission to use their confidential documents. On the other hand, members of the COI and IAC are volunteers and are not employees of the NCAA, and therefore the NCAA may have a more difficult time forcing permission from these individuals. As noted above, the proposed bylaws do not completely shield confidential documents from disclosure, but an ultimate veto over the use of confidential documents should alleviate further *McNair* confidentiality fears.

Finally, the proposed solution would benefit the NCAA because implementation would be relatively inexpensive. The proposed solution could be implemented in the normal course of business and therefore costs would be negligible. Granted, extra costs could possibly arise once a lawsuit is brought against the NCAA, or when the NCAA desires or is required to use confidential documents. However, as *McNair* demonstrated, the NCAA is already prepared to pay legal fees associated with a

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<sup>137</sup> *Id.* at 498-99.

motion to seal, thus litigation costs should not be considered an additional cost. On the other hand, document review costs would likely increase as the NCAA carefully determines which confidential documents are necessary, and in addition, costs may also be required to obtain permission from required parties. Nevertheless, these costs should not pose a substantial burden on the NCAA.

Overall, the benefits of the proposed bylaws alleviate the regulatory enforcement concerns that arose from *McNair*. Increasing confidentiality protections to various individuals under the proposed bylaws will lead to more effective and efficient enforcement proceedings. The NCAA enforcement staff will more easily be able to obtain the cooperation of witnesses who wish to remain confidential. Further, members of the COI and IAC will be able to express their full opinions and impressions nearly completely free from the fear of disclosure.

#### D. DISADVANTAGES OF THE PROPOSED BYLAWS

The proposed bylaws present several distinct disadvantages. First, the proposed bylaws limit the NCAA's ability to effectively defend itself in court. The proposed bylaws give more power over confidentiality to the individuals who create the confidential documents, and essentially grant these individuals the ability to veto the NCAA's use of the documents in a court case that gave rise to the production of the same documents. The NCAA's lack of ultimate authority over the documents restricts the NCAA's ability to unilaterally decide which documents are important enough to be disclosed despite their confidential nature.

Second, the proposed bylaws could potentially damage the NCAA's reputation. The proposed bylaws decrease the possibility that certain enforcement documents will be disclosed to the public. The general public will not likely react warmly to the NCAA's perceived unwillingness to disclose certain information. The proposed bylaws may be perceived as an attempt by the NCAA to hide incriminating documents. Granted, this would not be a fair reading of the bylaws. If implemented, the NCAA must frame the adoption of the proposed bylaws in a manner that avoids these reputational

setbacks. As it relates to confidential witnesses, the NCAA must make it clear that the COI and IAC members do not rely on the information obtained from these witnesses in making their final decisions. These witnesses are used for other purposes.

Finally, the NCAA should analogize the confidential documents created by the COI and IAC, to the internal notes kept by judges and other administrative bodies. Judges' notes and memoranda are not disclosed publicly, only their final decision is released. This structure should also apply to private organizations such as the NCAA, because it promotes freer discussion among the members of the respective committees.

#### E. IMPLEMENTATION

The logistics of implementing the proposed bylaws do not present significant hurdles. The proposed bylaws should be implemented into the NCAA Division I bylaws, in Article 19, which covers the infractions process. The NCAA Division I Board of Directors overhauled the enforcement process in 2012 and could again vote to add the proposed bylaws with relative ease.<sup>138</sup> The primary barrier to successful implementation would be garnering a majority of votes in favor of the proposed bylaws. The voting directors must weigh the advantages and disadvantages to decide whether to ultimately implement the proposed bylaws.

Any difficulty in implementation will arise during the initial rollout of the new bylaws. As previously noted, the general public may view the new bylaws as a method to hide potentially incriminating documents. This was apparent after the release of the disputed documents in *McNair*; however, it was also apparent that some individuals involved in *McNair* were biased against McNair, USC, or both.<sup>139</sup> The NCAA should distance itself from individuals who portrayed such bias, or indicate that it has already distanced itself from these

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<sup>138</sup> Casey C. Kannenberg, *The New NCAA Enforcement Model*, AMERICANBAR.ORG, [www.americanbar.org/groups/young\\_lawyers/publications/the\\_101\\_201\\_practice\\_series/the\\_new\\_ncaa\\_enforcement\\_model.html](http://www.americanbar.org/groups/young_lawyers/publications/the_101_201_practice_series/the_new_ncaa_enforcement_model.html) (last visited Dec. 1, 2015).

<sup>139</sup> Dennis Dodd, *NCAA Overstepped in USC Case, Unsealed Documents Seem to Show*, CBS SPORTS (Mar. 24, 2015), <http://www.cbssports.com/collegefootball/writer/dennis-dodd/25121727/ncaa-overstepped-in-usc-case-unsealed-documents-seem-to-show>.

individuals. Next, the NCAA should communicate that it is committed to conducting fair investigations and reviews. It is important the NCAA emphasizes that its commitment to confidentiality does not hamper the integrity of the enforcement process. One possible way to accomplish this task would be to introduce a bylaw that makes all enforcement communications reviewable by internal NCAA staff. This would help ensure the integrity of the process, while also maintaining overall confidentiality.

Finally, the NCAA must also effectively demonstrate why there is a need for confidentiality. The general public most likely does not understand the importance of confidentiality. A carefully worded statement regarding why confidentiality is important should accompany the press release that announces the proposed bylaws. There should also be an area on the NCAA website dedicated to the explanation of confidentiality in the enforcement process. These clarifying statements may not alter everyone's perception, but they will help clarify the NCAA's position on confidentiality in the enforcement process.

#### CONCLUSION

The NCAA needs an effective and complete enforcement structure. The *McNair* decision negatively impacted the current enforcement structure by eliminating the confidentiality of certain NCAA enforcement documents. The NCAA must alter its enforcement structure in response to *McNair* if the NCAA wishes to continue to conduct effective enforcement and infractions cases. The proposed bylaws provide a framework that the NCAA should implement to achieve continued confidentiality.

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### FASHION NIGHTMARE! THE FUTURE OF CONSUMER 3-D PRINTING AND ONLINE COUNTERFEITING IN THE FASHION INDUSTRY

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*A designer's greatest asset is his or her creativity. The satisfaction of purchasing and wearing a designer brand comes from the knowledge of the investment of human capital into the product, the creative mind that imagined it, and the steps to bring the product to the consumer. Taking that creativity from the designer compromises their business.<sup>1</sup>*

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<sup>1</sup> COUNCIL OF FASHION DESIGNER OF AMERICA, <http://cfda.com/programs/protecting-intellectual-property> (last visited Oct. 26, 2015).

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### INTRODUCTION

Fashion designers do not necessarily use a pencil, paper, needle, and thread anymore. In fact, some do not use any of these materials at all. In March of 2013, designer Michael Schmidt partnered with architect Francis Bitonti and 3-D printing company, Shapeways, to design the “world’s first fully articulated 3-D printed dress.”<sup>2</sup> According to the designer, the dress was designed entirely on an iPad, refined via Skype,<sup>3</sup> rendered digital, and printed in seventeen parts on an EOS P350 3-D printer.<sup>4</sup> The dress, worn by American celebrity Dita Von Teese at a private event in New York, received much attention from the international high-end fashion community.<sup>5</sup> At Paris Fashion Week, Dutch designer Iris Van Herpen became the first to incorporate 3-D printed pieces into her Haute Couture runway collection.<sup>6</sup>

Industrial grade 3-D printers have existed since the 1980s and were traditionally used to print plastic, metal, glass,

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<sup>2</sup> MICHAEL SCHMIDT STUDIOS,  
<http://www.michaelschmidtstudios.com/dita-von-teese.html> (last visited Nov. 29, 2015).

<sup>3</sup> Nathan Hurst, *Dita Von Teese Flaunts Fibonacci-Inspired, 3-D Printed Gown*, WIRED (Mar. 5, 2013, 4:52 PM),  
<http://www.wired.com/2013/03/dita-von-teese-3-d-printed-gown/>.

<sup>4</sup> Damir Brodjanac, *3D Printers in the Fashion World*, DECRYPTED TECH (Mar. 10, 2013), <http://www.decryptedtech.com/news/3d-printers-in-the-fashion-world>.

<sup>5</sup> Rachel Hennessey, *3D Printing Hits the Fashion World*, FORBES (Aug. 7, 2013),  
<http://www.forbes.com/sites/rachelhennessey/2013/08/07/3-d-printed-clothes-could-be-the-next-big-thing-to-hit-fashion/>.

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

and ceramic.<sup>7</sup> However, 3-D printing, or additive manufacturing,<sup>8</sup> has evolved to include a greater range of materials from titanium to human cartilage, and even nylons.<sup>9</sup> Materialise, a 3-D printing company, recently created TPU-92A-1, the first 3-D printable material durable enough to be worn and withstand a washing machine.<sup>10</sup> “It’s cushioning, elastic, and lightweight, designed specifically for use in the fashion industry.”<sup>11</sup> This creation has leading manufacturers taking note of the rapidly expanding capabilities that 3-D printing presents. A McKinsey Global Institute study suggests that 3-D printing could have a global impact of up to \$550 billion per year by 2025.<sup>12</sup> The study also predicts that by 2025, up to ten percent of all consumer products could be 3-D printable.<sup>13</sup> McKinsey & Company attribute these numbers to the advancements in 3-D technology, stating “these advances have brought the technology to a tipping point – it appears ready to emerge from its niche status and become a viable alternative to conventional manufacturing processes in an increasing number of applications.”<sup>14</sup>

Advancements in 3-D printing technology has increased its applicability on the fashion industry. To date, most 3-D printable fashion is designed by Haute Couture fashion designers and can be seen on the runway. However, this is quickly

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<sup>7</sup> See Richard D’Aveni, *The 3-D Printing Revolution*, HARV. BUS. REV. (May, 2015), <https://hbr.org/2015/05/the-3-d-printing-revolution> (last visited Nov. 29, 2015).

<sup>8</sup> Daniel Cohen, et al., *3-D Printing Takes Shape*, MCKINSEY QUARTERLY, (Jan. 2014), [http://www.mckinsey.com/insights/manufacturing/3-d\\_printing\\_takes\\_shape](http://www.mckinsey.com/insights/manufacturing/3-d_printing_takes_shape) (last visited Nov. 29, 2015).

<sup>9</sup> *Id.*; Fira Rietveld, *3D Printing: The Face of Future Fashion?*, TEDXAMSTERDAM, <http://www.tedxamsterdam.com/3d-printing-the-face-of-future-fashion/> (last visited Nov. 29, 2015).

<sup>10</sup> Rietveld, *supra* note 9.

<sup>11</sup> Hennessey, *supra* note 5.

<sup>12</sup> James Manyika et al., *Disruptive Technologies: Advances that will Transform Life, Business, and the Global Economy*, MCKINSEY QUARTERLY (May, 2013), [http://www.mckinsey.com/insights/business\\_technology/disruptive\\_technologies](http://www.mckinsey.com/insights/business_technology/disruptive_technologies) (last visited Nov. 29, 2015).

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

<sup>14</sup> Cohen, *supra* note 8.



changing as numerous fashion companies have begun experimenting with 3-D printing.

For example, New Balance is currently customizing running shoes for athletes using 3-D printing technology.<sup>15</sup> New Balance's manager of studio innovations, Katherine Petrecca, states, "printing will allow us to be incredibly efficient by making products on-demand and eliminating large chunks of a traditional supply chain . . . [W]e will see significant opportunities to expand our usage and the scale of production."<sup>16</sup> Nike has followed suit and is experimenting with 3-D printed sportswear, including football boots with integral 3-D printed elements and a Rebento Duffle Bag.<sup>17</sup> Continuum, a San Francisco-based clothing company, is among the first to design 3-D printed wearable pieces in their new bikini line.<sup>18</sup> Customers can now go on Continuum's website, design their own bikini, input their body shapes and measurements, and the company will print each unique design using nylon material.<sup>19</sup> Outside of the U.S., consumer involvement in the 3-D printing process also exists in Russia, Ukraine, and Kazakhstan, where 3-D printing stores were launched to create an upscale shopping experience.<sup>20</sup>

Soon, everyday household consumers may also experiment with 3-D printers and 3-D printable fashion. According to Google's Head of Engineering and world renowned futurist Ray Kurzweil, at this year's Google I/O Conference, soon consumers will be able to print 3-D printable

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<sup>15</sup> Chris Reidy, *New Balance Uses 3D Printing Technique to Customize Track Shoes*, BOSTON.COM (Mar. 8, 2013), <http://www.boston.com/businessupdates/2013/03/08/new-balance-uses-printing-technique-customize-track-shoes/v0GgY5NN9efZpCWrfq0pTN/story.html>.

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

<sup>17</sup> Shane Taylor, *Ray Kurzweil's Predictions for 3D Printing at the 2014 Google I/O Conference*, 3DPRINTINGINDUSTRY.COM (June 27, 2014), <http://3dprintingindustry.com/2014/06/27/ray-kurzweils-predictions-3d-printing-2014-google-io-conference/>.

<sup>18</sup> Hennessey, *supra* note 5.

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

<sup>20</sup> Brian Heater, *Solidoodle 3D Printing Stores Set to Bring 'Upscale Fashion Shopping' to Russia, Ukraine and Kazakhstan*, ENGADGET (Feb. 28, 2013), <http://www.engadget.com/2013/02/28/solidoodle/>.

clothing at home.<sup>21</sup> Kurzweil believes that “additive manufacturing technologies are currently in their ‘hype phase,’ and that it will be around five years before the tech set is where it needs to be to enable a major paradigm shift.”<sup>22</sup> According to Kurzweil, this paradigm shift will cause 3-D printable fashion designs to be commonplace by the 2020s.

Despite consumer 3-D printing’s positive impact on the fashion industry, it also presents worrisome intellectual property implications for the fashion industry, especially in online counterfeiting. There is immense potential for online counterfeiting when consumers are able to print fashion designs from the convenience of their own homes. Kenneth Mullen, an intellectual property law specialist at Withers Worldwide, states “[i]ncreased access to inexpensive 3-D printing potentially presents a significant challenge to designers, as well as brand owners, a great degree of whose power resides in their control of manufacturing and distribution channels.”<sup>23</sup> As the cost of 3-D printers decreases, household consumers’ experimentation with 3-D printers increases.<sup>24</sup> This repositioning of control over the distribution channel into the hands of the consumer generates greater potential for counterfeiting. “Hack the code for a Chanel bangle, get your hands on a MakerBot (3-D Printer) and you’ve engaged a brand new version of fashion piracy.”<sup>25</sup>

The current state of intellectual property law for fashion leaves this industry particularly vulnerable. “As with fashion items that struggle to gain protection under existing intellectual property laws, 3-D printed fashion and fashion accessories will have to navigate copyright, design patent and other potential intellectual property requirements to gain full protection.”<sup>26</sup> It is

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<sup>21</sup> Taylor, *supra* note 17.

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

<sup>23</sup> Navaz Batliwalla, *3D Printing, Copyright Nightmare or DIY Heaven?*, BUSINESS OF FASHION (Oct. 23, 2012), <http://www.businessoffashion.com/2012/10/3d-printing-copyright-nightmare-or-diy-heaven.html>.

<sup>24</sup> Taylor, *supra* note 17.

<sup>25</sup> Rebecca Hiscott, *Will 3D Printing Upend Fashion Like Napster Crippled the Music Industry?*, MASHABLE (Mar. 3, 2014), <http://mashable.com/2014/03/03/3d-printing-fashion/>.

<sup>26</sup> Bryan J. Vogel, *IP: Five 3D Printing Headlines and the Law Issues They Raise*, INSIDE COUNSEL, (Nov. 12, 2013),

likely the fashion industry will follow its own precedent and lobby for more comprehensive copyright protections similar to the protections that the music and film industries enjoy.<sup>27</sup>

This article will discuss: (1) the current state of U.S. intellectual property law for fashion design; (2) the background of 3-D printing; (3) how 3-D printable fashion will lead to widespread online file sharing and counterfeiting; and (4) proposes intellectual property reform by expanding copyright law to include fashion design, and by extending the Digital Millennium Copyright Act (“DMCA”) safe harbor provisions to trademark law.

### **I. THE CURRENT STATE OF U.S. INTELLECTUAL PROPERTY PROTECTION FOR FASHION DESIGN**

Intellectual property is perhaps the most valuable asset a fashion designer can own.<sup>28</sup> However, intellectual property law in the United States is insufficient in meeting the needs of most fashion designers because, absent a few exceptions, fashion design is not protected under U.S. intellectual property law.<sup>29</sup> “[F]ashion design . . . [is] the way a specific garment is cut and assembled.”<sup>30</sup> Therefore, it is typically legal in the United States for one fashion designer to copy the identical construction of a garment from another designer.<sup>31</sup> Fashion design lacks comprehensive protection; accordingly, fashion designers have attempted to rely on the different forms of intellectual property protection with varying degrees of success.<sup>32</sup> These forms of intellectual property law include: copyright, trademark, trade dress, and design patents.

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<http://www.insidecounsel.com/2013/11/12/ip-five-3d-printing-headlines-and-the-law-issues-t>.

<sup>27</sup> Hiscott, *supra* note 25.

<sup>28</sup> Charles E. Colman, *An Overview of Intellectual Property Issues Relevant to the Fashion Industry*, in NAVIGATING FASHION LAW: LEADING LAWYERS ON EXPLORING THE TRENDS, CASES, AND STRATEGIES OF FASHION LAW 114 (2012).

<sup>29</sup> Marc Misthal, *Trademarks and Trade Dress*, in FASHION LAW: A GUIDE FOR DESIGNERS, FASHION EXECUTIVES, & ATTORNEYS 26 (Guillermo C. Jimenez & Barbara Kolsun eds., 2d ed. 2014).

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

<sup>31</sup> *Id.* at 28.

<sup>32</sup> Alexandra Manfredi, *Haute Copyright: Tailoring Copyright Protection to High-Profile Fashion Designs*, 21 CARDOZO J. INT’L & COMP. L. 111, 126 (2012).

## A. COPYRIGHT

Copyright law is often described as a “bundle of rights granted to the creator of an original work of authorship that is fixed in a tangible form.”<sup>33</sup> In order to be “original,” it must be “independently created by the author as opposed to copied from other works . . . and possess at least some minimal degree of creativity.”<sup>34</sup> The work is not required to be entirely novel.<sup>35</sup> In fact, the Second Circuit has described the level of originality as “minimal, only an unmistakable dash of originality need be demonstrated, [and] high standards of uniqueness in creativity are dispensed with.”<sup>36</sup>

In the United States, these “bundle of rights” are protected under the US Copyright Act, which grants the copyright owner the exclusive right to reproduce, distribute, perform, display, and create derivative works from the protected work.<sup>37</sup> Copyright infringement occurs when a protected work is reproduced, distributed, performed, publicly displayed, or made into a derivative work without the permission of the owner of the copyright.<sup>38</sup> In order to successfully claim copyright infringement, a plaintiff must first establish the validity of the copyright, and then show that “substantial similarity” exists between the protected work and the defendant’s work.<sup>39</sup> “Substantial similarity” exists when a non-trivial amount of the protected work is used<sup>40</sup> and when “the ordinary observer, unless he set out to detect the disparities, would be disposed to overlook them, and regard their aesthetic appeal as the same.”<sup>41</sup>

As a general rule, copyright law does not protect fashion

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<sup>33</sup> Colman, *supra* note 28, at 115 (citing *Feist Pubs. v. Rural Telephone Service Co.*, 499 U.S. 340, 355 (1991)).

<sup>34</sup> *Feist Pubs.*, 499 U.S. at 345.

<sup>35</sup> Colman, *supra* note 28, at 115.

<sup>36</sup> *Folio Impressions Inc. v. Byer Cal.*, 937 F.2d 759, 764-65 (2d Cir. 1991).

<sup>37</sup> 17 U.S.C. § 106 (2002).

<sup>38</sup> U.S. Copyright Office, Definitions, COPYRIGHT.GOV, <http://www.copyright.gov/help/faq/faq-definitions.html> (last visited Nov. 11, 2014).

<sup>39</sup> Colman, *supra* note 28, at 116.

<sup>40</sup> *Ringgold v. Black Entm’t TV*, 126 F.3d 70 (2d Cir. 1997).

<sup>41</sup> *Peter Pan Fabrics Inc. v. Martin Weiner Corp.*, 274 F.2d 487, 489 (2d Cir. 1960).

design.<sup>42</sup> U.S. federal courts hold that fashion design, or the construction of garments, fall within the Copyright Act's exclusion of "useful articles."<sup>43</sup> As defined by the Copyright Act, a useful article is "an article having an intrinsic utilitarian function that is not merely to portray the appearance of the article or to convey information."<sup>44</sup> The utilitarian function derives from the view that fashion is meant to cover the body for purposes of warmth or social norms.<sup>45</sup> This "functional aspect of fashion design is the primary reason why there is no copyright protection for such designs in the United States."<sup>46</sup>

However, some elements of fashion are protectable by copyright.<sup>47</sup> As an exception to the general rule, certain garments may be eligible for copyright protection if they "incorporate pictorial, graphic, or sculptural features that can be identified separately from, and are capable of existing independently of, the utilitarian aspects of the article."<sup>48</sup> This is known as the "separability" exception.<sup>49</sup> Essentially, copyright protection is granted when the design components can be separated from the functional components of the design.<sup>50</sup>

U.S. federal courts have applied a two-pronged, disjunctive test to evaluate the separability exception: "[I]f a useful article incorporates a design element that is *physically* or

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<sup>42</sup> Charles Colman, *Copyright, in FASHION LAW: A GUIDE FOR DESIGNERS, FASHION EXECUTIVES, & ATTORNEYS* 45 (2014) (Guillermo C. Jimenez & Barbara Kolsun eds., 2d ed. 2014).

<sup>43</sup> "It is well settled that articles of clothing are 'useful articles' not protected by the Copyright Act." *Jovani Fashion, Ltd. v. Fiesta Fashions*, No. 12-598-CV, 2012 U.S. App. LEXIS 21245, at \*2 (2d Cir. 2012).

<sup>44</sup> 17 U.S.C. § 101 (2010).

<sup>45</sup> Colman, *supra* note 28, at 118.

<sup>46</sup> Meaghan McGurrin Ehrhard, *Protecting the Seasonal Arts: Fashion Design, Copyright Law, and the Viability of the Innovative Design Protection & Piracy Prevention Act*, 45 CONN. L. REV. 285 (2012).

<sup>47</sup> Colman, *supra* note 42, at 45.

<sup>48</sup> 17 U.S.C. § 101 (2010).

<sup>49</sup> Colman, *supra* note 28, at 119.

<sup>50</sup> See 17 U.S.C. § 101 (2010); Sara R. Ellis, *Copyrighting Couture: An Examination of Fashion Design Protection and Why the Dppa and Idpppa Are a Step Towards the Solution to Counterfeit Chic*, 78 TENN. L. REV. 163, 171 (2010).

*conceptually separable* from the underlying product, the element is eligible for copyright protection.”<sup>51</sup> A summary of fashion design categories that have passed this test and received copyright protection include: sufficiently original images affixed to garments, sufficiently original fabric patterns, sufficiently original jewelry, certain sculptural components of fashion, certain embroidery, beading and lace, as well as certain components of “fanciful costumes.”<sup>52</sup>

Unfortunately, the vast majority of fashion design remains unprotected by the U.S. federal court’s present interpretation of the Copyright Act. Accordingly, there have been over eighty proposed amendments to the U.S Copyright Act since 1910 which purport to include fashion design.<sup>53</sup> Proponents of protection, including the Council of Fashion Designers of America (“CDFA”), the American Apparel and Footwear Association (“AAFA”), Harvard Law Professor Jeannie Suk, and fashion law scholar Professor Susan Scafidi, have argued that “fashion designs are creative works meriting copyright-style protection.”<sup>54</sup> The demand for more comprehensive copyright protection increased traction in Congress for recently introduced legislation, and may “[reignite] the debate over copyrighting fashion designs.”<sup>55</sup> Most notably, H.R. 2511, the Innovative Design Protection and Piracy Act (“IDPPPA”), and S. 3523, the Innovative Design Protection Act of 2012 (“IDPA”), were congressional bills aimed to amend the U.S. Copyright Act to include fashion design protection.<sup>56</sup> Both bills sought to revise the definition of “useful article” to include

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<sup>51</sup> *Chosun Int’l v. Chrisha Creations, Ltd.*, 413 F.3d 324, 328 (2d Cir. 2005) (emphasis added).

<sup>52</sup> Colman, *supra* note 28, at 120.

<sup>53</sup> Manfredi, *supra* note 32, at 130 (citing Arina Shulga, *Intellectual Property for Fashion Designs*, BUS. LAW POST (Aug. 3, 2011), <http://www.businesslawpost.com/2011/08/intellectual-property-protection-for.html>; Ellis, *supra* note 50, at 171).

<sup>54</sup> Guillermo C. Jimenez et al., *Design Piracy Legislation: Should the United States Protect Fashion Design?*, in *FASHION LAW: A GUIDE FOR DESIGNERS, FASHION EXECUTIVES, AND ATTORNEYS* 66 (Guillermo C. Jimenez & Barbara Kolsun eds., 2d ed. 2014).

<sup>55</sup> Manfredi, *supra* note 32, at 130.

<sup>56</sup> Jimenez et al., *supra* note 54, at 67.

an article of apparel,<sup>57</sup> and effectively would provide a three-year window of protection from infringement for fashion designs.<sup>58</sup> However, neither proposed bill passed the committee nor received a floor vote.<sup>59</sup>

## B. TRADEMARK & TRADE DRESS

Trademark law is quite feasibly the most important form of intellectual property protection for fashion designers.<sup>60</sup> The fashion industry utilizes trademarks to fill the voids left unprotected by copyright law.<sup>61</sup> A trademark is “any work, name, symbol, or device, or any combination thereof” intended to be utilized in commerce.<sup>62</sup> Trademarks are protected under federal law under The Lanham Act.<sup>63</sup> Section 1125 reads:

Any person who, on or in connection with any goods or services, or any container for goods, uses in commerce any word, term, name, symbol, or device, or any combination thereof, or any false designation of origin, false or misleading description of fact, or false or misleading representation of fact, which is likely to cause confusion, or to cause mistake, or to

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**<sup>57</sup> ARTICLES OF APPAREL INCLUDE AN ARTICLE OF MEN’S, WOMEN’S, OR CHILDREN’S UNDERGARMENTS, OUTERWEAR, GLOVES, FOOTWEAR, HEADGEAR, HANDBAGS, PURSES, WALLET, TOTE BAGS, BELTS, AND EYEGLASS FRAMES. S. 3523, 112TH CONG. § 2(A)(10) (2012).**

<sup>58</sup> See S. 3523, 112th Cong. § 2(d)(2)(2012); H.R. 2511, 112<sup>th</sup> Cong. § 2(a)(2)(2011).

<sup>59</sup> Jimenez et al., *supra* note 54, at 69.

<sup>60</sup> Richard Reinis, a leading attorney in the area of fashion law, has described trademark protection as, “The most important form of protection for fashions and accessories . . . [and] the most commercially oriented one . . . a trademark identifies the source of goods. For many companies in the business, however, especially those in the luxury sector, their trademarks are the most effective communication devices for the most enduring property that the brand has, which is its story.” Richard Reinis, *An Exploration into the Practice of Fashion Law*, in NAVIGATING FASHION LAW: LEADING LAWYERS ON EXPLORING THE TRENDS, CASES, AND STRATEGIES OF FASHION LAW 95 (2012).

<sup>61</sup> Colman, *supra* note 28, at 150.

<sup>62</sup> 15 U.S.C. § 1127 (2006).

<sup>63</sup> 15 U.S.C. §§ 1051 et. seq.

deceive as to the affiliation, connection, or association of such person with another person, or as to the origin, sponsorship, or approval of his or her goods, services, or commercial activities by another person, or in commercial advertising or promotion, misrepresents the nature, characteristic, qualities, or geographic origin of his or her or another person's goods, services, or commercial activities, shall be liable in a civil action by any person who believes that he or she is or is likely to be damaged by such act.<sup>64</sup>

Two purposes are served by this statute, and by trademark law more generally: (1) to make certain that the owner of the trademark, or the brand owner, will enjoy the benefits of any investment he or she made in the brand, and (2) to prevent confusion among consumers.<sup>65</sup> Federal courts tend to focus most of their attention on trademark law's purpose of preventing consumer confusion.<sup>66</sup>

To establish a violation of the Lanham Act, a plaintiff must show that (1) they have a legally protected mark under the statute, (2) they own the mark, and (3) the defendant's unauthorized use of the mark to identify a good or service causes a likelihood of confusion.<sup>67</sup> Each federal circuit has adopted a version of the "likelihood of confusion" test, which queries whether a considerable number of ordinarily prudent purchasers are "likely to be confused" about the source, sponsorship, or affiliation of the good or service they are observing.<sup>68</sup> The courts apply the "Polaroid" factors, or some equivalent, and determine *how close is too close*?<sup>69</sup>

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<sup>64</sup> 15 U.S.C. § 1125 (2012).

<sup>65</sup> Colman, *supra* note 28, at 150.

<sup>66</sup> *See id.* at 151.

<sup>67</sup> A&H Sportswear, Inc. v. Victoria's Secret Stores, Inc., 237 F.3d 198, 210 (3d Cir. 2000).

<sup>68</sup> Colman, *supra* note 28, at 151-52 (citing Western Pub. Co. v. Rose Art Indus., 910 F.2d 57, 59 (2d Cir. 1990)).

<sup>69</sup> Colman, *supra* note 28, at 151-52. The "Polaroid" factors are as follows: (1) the strength of his mark; (2) the degree of similarity between the two marks; (3) the proximity of the products/services; (4) the likelihood that the prior owner will bridge the gap; (5) actual



The fashion industry utilizes various kinds of trademarks. Personal name marks are of particular importance to trademark protection in the fashion industry.<sup>70</sup> A person, typically the designer, can choose to use his or her own personal name as a company's trademark.<sup>71</sup> Countless fashion designers have used personal name marks, including Ralph Lauren, Marc Jacobs, Chanel, Gucci, Versace, and others. However, the right to use one's own surname as a trademark is a qualified right.<sup>72</sup> In order to receive trademark protection, the rights holder must demonstrate that the use of the surname is both descriptive and has acquired secondary meaning.<sup>73</sup> Secondary meaning requires a determination of whether the average American perceives the word as a surname only, or with other significance.<sup>74</sup> If it is viewed as a surname only, it will fail to gain protection under the secondary meaning test.<sup>75</sup>

Design marks, such as the Nike swoosh and the Lacoste alligator, are also important in the fashion industry.<sup>76</sup> Design marks do not require a secondary meaning, so long as (1) the image is not merely ornamental, and (2) the image creates a commercial impression, which is not related to the claimed mark's aesthetic impact.<sup>77</sup> Thus, a design mark may not receive protection if it serves an aesthetic function.<sup>78</sup> The purpose of this functionality bar is to prohibit producers from controlling a "useful product feature," so that trademark law does not create

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confusion; (6) the defendant's good faith in adopting its own mark; (7) the quality of the defendant's product; (8) the sophistication of the buyers. *See* Polaroid Corp. v. Polarad Elec. Corp., 287 F.2d 492, 495 (2d Cir. 1961).

<sup>70</sup> Colman, *supra* note 28, at 163.

<sup>71</sup> Francesca M. Montalvo, *Refashioning the Right of Publicity: Protecting the Right to Use Your Name After Selling a Personal Name Trademark*, 31 CARDOZO ARTS & ENT. L.J. 893, 898 (2013).

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

<sup>73</sup> J. THOMAS MCCARTHY, MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION § 13:2 (4th ed. 2013).

<sup>74</sup> Colman, *supra* note 28, at 163.

<sup>75</sup> *See In re Cazes*, 21 U.S.P.Q.2d 1796 (T.T.A.B. 1991).

<sup>76</sup> Colman, *supra* note 28, at 169.

<sup>77</sup> *See In re Paramount Pictures Corp.*, 213 U.S.P.Q. 1111, 1113 (T.T.A.B. 1982); *In re E.J. Brach & Sons*, 256 F.2d 325, 327 (C.C.P.A. 1958).

<sup>78</sup> Colman, *supra* note 28, at 169-70.

limitless monopolies over utilitarian product features.<sup>79</sup>

Lastly, color trademarks, a contentious area, are important in the fashion industry.<sup>80</sup> According to the U.S. Supreme Court in *Qualitex Co. v. Jacobson Prods. Co.*, 514 U.S. 159 (1995), a company can feasibly own a color for trademark purposes so long as the color is non-functional and has accrued secondary meaning.<sup>81</sup> Since *Qualitex*, courts have struggled to determine whether or not a particular color is functional. The landmark case, *Christian Louboutin S.A. v. Yves Saint Laurent America Inc.*, is illustrative of this problem.<sup>82</sup>

Fashion designer Christian Louboutin sells more than five hundred thousand pairs of shoes every year and “virtually all Louboutin shoes” sold since 1992 have exhibited his signature lacquered red sole.<sup>83</sup> In *Louboutin v. Yves Saint Laurent*, Louboutin sought a preliminary injunction to enjoin the luxury fashion house Yves Saint Laurent (“YSL”) from selling shoes with bright-red soles.<sup>84</sup> YSL counterclaimed for cancellation of Louboutin’s registration, arguing that the single color was aesthetically functional and therefore not eligible for protection.<sup>85</sup> The Southern District Court held that single colors in the fashion industry are “per se aesthetically functional,” and it would therefore cancel the mark’s registration.<sup>86</sup> However, on appeal to the Second Circuit, Judge Cabranes reversed insofar as

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<sup>79</sup> *Id.* at 173 (quoting *Qualitex Co. v. Jacobson Prods. Co. Inc.*, 514 U.S. 159, 164 (1995)).

<sup>80</sup> Colman, *supra* note 28, at 175.

<sup>81</sup> The Court found that “over time, customers may come to treat a particular color on a product . . . as signifying a brand.” *Qualitex Co. v. Jacobson Prods. Co.*, 514 U.S. 159, 163 (1995).

<sup>82</sup> *Christian Louboutin S.A. v. Yves Saint Laurent Am., Inc.*, 778 F. Supp. 2d 445 (S.D.N.Y. 2011) *aff’d in part, rev’d in part and remanded sub nom.* *Christian Louboutin S.A. v. Yves Saint Laurent Am. Holdings, Inc.*, 696 F.3d 206 (2d Cir. 2012).

<sup>83</sup> Danielle E. Gorman, *Protecting Single Color Trademarks in Fashion After Louboutin*, 30 CARDOZO ARTS & ENT. L.J. 369, 370 (2012) (citing Brief of Appellant at 9, *Louboutin S.A. v. Yves Saint Laurent Am., Inc.*, No. 11-cv-3303 (2d Cir. Oct. 17, 2011), No. 45).

<sup>84</sup> *Christian Louboutin*, 778 F. Supp. at 445.

<sup>85</sup> *See Christian Louboutin*, 778 F. Supp. at 445.

<sup>86</sup> CHARLES E. COLMAN, *A Red-Leather Year for Aesthetic Functionality*, 4 No. 2 LANDSLIDE: A PUBLICATION OF THE ABA SECTION OF INTELLECTUAL PROPERTY LAW 26, 28 (Nov./ Dec. 2011).

the district court held that a color can never receive trademark protection in the fashion industry.<sup>87</sup> Thus, it seems that in some circumstances a single color in the realm of fashion can qualify for trademark protection.

As a result of the Lanham Act's expansive language,<sup>88</sup> fashion companies often seek to protect the overall image of a product through trade dress protection. Trade dress is "the total image of a product and may include features such as size, shape, color, color combinations, texture, graphics, or even particular sales techniques."<sup>89</sup> Trade dress has been extended to protect certain noteworthy fashion items, such as the blue Tiffany box and the Hermès' Birkin bag.<sup>90</sup>

Fashion designers argue that trade dress should be extended to protect fashion design.<sup>91</sup> Unfortunately, the U.S. Supreme Court addressed this issue and denied general protection to fashion design under trade dress.<sup>92</sup> Instead, the Court held that fashion design only indicates source, and is thus eligible for protection when a "secondary meaning" exists in the minds of consumers.<sup>93</sup> This is a relatively high standard and thus, it is difficult for most designers to secure protection unless they are well-known by consumers. Accordingly, while designers repeatedly attempt to secure protection under trademark and trade dress to fill the gap left unprotected by copyright, this too has proven fairly insufficient to protect fashion design.

### C. DESIGN PATENTS

Design patents occasionally fill the void copyright and

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<sup>87</sup> *Christian Louboutin*, 696 F.3d at 229.

<sup>88</sup> The aforementioned language being referred to here is as such: "[A]ny word, term, name, symbol, or device, or any combination thereof . . . which . . . is likely to cause confusion[.]" 15 U.S.C. § 1125(a)(1)(A) (2012).

<sup>89</sup> *Two Pesos, Inc. v. Taco Cabana, Inc.*, 505 U.S. 763, 764 (1992).

<sup>90</sup> *See Coach Leatherware Co. v. Ann Taylor, Inc.*, 933 F.2d 162, 168 (2d Cir. 1991).

<sup>91</sup> ANNE GILSON LALONDE, *GILSON ON TRADEMARKS*, § 2A.12 (LexisNexis 2012).

<sup>92</sup> *Wal-Mart Stores, Inc. v. Samara Bros., Inc.*, 529 U.S. 205, 216 (2000).

<sup>93</sup> *Id.*

trademark leave unprotected in the fashion industry.<sup>94</sup> Generally, a fashion design is eligible for design patent protection if it is a “new, original and ornamental design for an article of manufacture.”<sup>95</sup> However, design patent protection is only available where the article is “ornamental, a product of aesthetic skill, and artistic conception”;<sup>96</sup> therefore, protection does not extend when “functional features dominate the design.”<sup>97</sup> Furthermore, because of the time-consuming nature of patent registration with the U.S. Patent and Trademark Office, many designs become outdated by the time the patent is issued due to the rapid evolvement of the fashion industry.<sup>98</sup>

## II. BACKGROUND ON 3-D PRINTING

To understand the intellectual property issues surrounding consumer 3-D printing, one must first understand the basics of 3-D printing functions. The 3-D printers build 3-D objects by printing tiny layers upon layers of plastic, metal, ceramic, or other materials.<sup>99</sup> This “additive” process of building layer upon layer allows the production of intricate structures, and its application has been extended to, among other things, machine parts, architectural models, human tissue,<sup>100</sup> and of course, fashion.

Additionally, 3-D printers can turn a computer model into a 3-D physical object.<sup>101</sup> The virtual 3-D models that 3-D printers use to operate are called computer-aided design

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<sup>94</sup> See Colman, *supra* note 28, at 144.

<sup>95</sup> 35 U.S.C. § 171 (2006).

<sup>96</sup> Warbern Packaging Indus. Inc. v. Cut Rate Plastics Hangers Inc., 652 F.2d 987, 988 n.1 (2d Cir. 1981).

<sup>97</sup> Tough Traveler v. Outbound Prods., 60 F.3d 964, 971 (2d Cir. 1995).

<sup>98</sup> See Colman, *supra* note 28, at 145 (2012).

<sup>99</sup> See HOD LIPSON & MELBA KURMAN, *FABRICATED: THE NEW WORLD OF 3D PRINTING* 39 (2013).

<sup>100</sup> Kyle Dolinsky, *Cad's Cradle: Untangling Copyrightability, Derivative Works, and Fair Use in 3d Printing*, 71 WASH. & LEE L. REV. 591, 599 (2014).

<sup>101</sup> Brian Rideout, *Printing the Impossible Triangle: The Copyright Implications of Three-Dimensional Printing*, 5 J. BUS. ENTREPRENEURSHIP & L. 161, 163 (2011).

(“CAD”) files.<sup>102</sup> CAD files, mostly saved in .amf format,<sup>103</sup> have been described as “the object equivalent of a .pdf file — they are more or less universally printable by 3-D printers and allow objects to be transferred digitally around the world.”<sup>104</sup> Designers utilize these CAD files to create digital “blueprints” for 3-D products.<sup>105</sup> When the objects are printed, the CAD files “deconstruct the image into a series of 2-D cross-sectioned slices” and these slices are then deposited layer-by-layer with the material used by the particular printer.<sup>106</sup> With each pass of the printing heads, the object gradually begins to take shape.<sup>107</sup>

The present 3-D printing online community emphasizes an “open source” system,<sup>108</sup> meaning users are typically free to “upload, improve upon, and distribute virtually any design.”<sup>109</sup> Under this system, control and ownership over designs can virtually spread to all the individuals who take part in the

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<sup>102</sup> See E. Sachs et al., *Three-Dimensional Printing: Rapid Tooling and Prototypes Directly from a CAD Model*, 39 CIRP ANNALS - MFG. TECH. 1, 201-04 (1990).

<sup>103</sup> See Lipson & Kurman, *supra* note 100.

<sup>104</sup> See Michael Weinberg, *What's the Deal with Copyright and 3D Printing?*, PUB. KNOWLEDGE 8 (Jan. 2013), [https://www.publicknowledge.org/files/What's%20the%20Deal%20with%20Copyright\\_%20Final%20version2.pdf](https://www.publicknowledge.org/files/What's%20the%20Deal%20with%20Copyright_%20Final%20version2.pdf) (last visited Nov. 29, 2015).

<sup>105</sup> Charles W. Finocchiaro, *Personal Factory or Catalyst for Piracy? The Hype, Hysteria, and Hard Realities of Consumer 3-D Printing*, 31 CARDOZO ARTS & ENT. L.J. 473, 477 (2013); see also Michael Weinberg, *It Will Be Awesome if They Don't Screw it Up: 3D Printing, Intellectual Property, and the Fight over the Next Great Disruptive Technology*, PUB. KNOWLEDGE (Nov. 2010), <http://publicknowledge.org/it-will-be-awesome-if-they-dont-screw-it-up> (last visited Nov. 29, 2015) (“Much as a word processor is superior to a typewriter because it allows a writer to add, delete, and edit text freely, a CAD program allows a designer to manipulate a design as she sees fit.”).

<sup>106</sup> Dolinsky, *supra* note 101, at 601.

<sup>107</sup> Rideout, *supra* note 102, at 163.

<sup>108</sup> *Id.*

<sup>109</sup> See Peter Hanna, *The Next Napster? Copyright Questions as 3D Printing Comes of Age*, ARS TECHNICA (Apr. 6, 2011), <http://arstechnica.com/tech-policy/2011/04/the-next-napster-copyright-questions-as-3d-printing-comes-of-age/>.

creation and editing of the designs.<sup>110</sup> A number of websites have emerged supporting this open source system.

Currently, the most popular 3-D design file website, Thingiverse, encourages users to share designs and emphasizes community collaboration.<sup>111</sup> Thingiverse serves as an online platform where users are free to upload designs, improve upon them, and virtually distribute these design files, which can then be printed by anyone with access to a 3-D printer.<sup>112</sup> Another leading website, Shapeways, has begun to commercialize 3-D printing by allowing consumers to order custom designs and have them shipped to their homes, allowing those without a 3-D printer to print their own custom designs.<sup>113</sup>

### **III. INTELLECTUAL PROPERTY SHORTCOMINGS: CONSUMER 3-D PRINTING IN THE FASHION INDUSTRY**

Innovative designers are now using 3-D printers for the expanded capabilities that allow complex and creative designs.<sup>114</sup> Guillermo C. Jimenez, fashion law professor at the Fashion Institute of Technology, has predicted that “[c]ontinuing advances in the materials available for 3-D printing are expected by many to lead to 3-D printers taking their place alongside the sewing machine in apparel manufacturing so that 3-D printed clothing becomes commonplace.”<sup>115</sup> Yet, 3-D printing has still

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<sup>110</sup> Rideout, *supra* note 102, at 163.

<sup>111</sup> See *What is Thingiverse?*, THINGIVERSE, <http://www.thingiverse.com/> (last visited Nov. 29, 2015) (“MakerBot’s Thingiverse is a thriving design community for discovering, making, and sharing 3D printable things. As the world’s largest 3D printing community, we believe that everyone should be encouraged to create and remix 3D things, no matter their technical expertise or previous experience. In the spirit of maintaining an open platform, all designs are encouraged to be licensed under a Creative Commons license, meaning that anyone can use or alter any design.”).

<sup>112</sup> Rideout, *supra* note 102, at 164-65.

<sup>113</sup> See *About Us*, SHAPEWAYS.COM, <http://www.shapeways.com/about/> (last visited Nov. 29, 2015).

<sup>114</sup> Rose Auslander, *Time for Fashion Designers to Buckle up for 3-D Printing*, LAW360.COM (Oct. 17, 2013), <http://www.law360.com/articles/478826/time-for-fashion-designers-to-buckle-up-for-3-d-printing>.

<sup>115</sup> GUILLERMO C. JIMENEZ, *A Survey of Fashion Law: Key Issues and Trends*, in FASHION LAW: A GUIDE FOR DESIGNERS, FASHION

not reached the mainstream public.<sup>116</sup> However, prices of at-home 3-D printers are rapidly falling; Staples recently began selling a 3-D printer for \$1,299.99 and other companies, such as Assembled Printrbot Simple, have sold 3-D printers for as low as \$399.<sup>117</sup> With commentators forecasting that “[e]ventually every household could have its own 3D printer, placing the production of garments firmly in the hands of the consumer,”<sup>118</sup> it is evident that fashion designers must prepare for the implications that will come along with this new technology.

#### A. COUNTERFEITING & ONLINE DESIGN PIRACY

As 3-D printing technology spreads in the fashion industry, so does the potential for counterfeiting. Counterfeiting fashion is “the act of manufacturing or distributing a product or service bearing a mark that is identical to or substantially indistinguishable from a registered trademark.”<sup>119</sup> Not only is counterfeiting an act of theft, but engaging in such behavior has a substantial negative impact on the value of a brand’s authentic product.<sup>120</sup> This leads to a loss in sales for the trademark owner, as well as harm to consumers who might reasonably believe the product that they are purchasing is authentic.<sup>121</sup> A number of federal criminal statutes have been enacted to combat counterfeiting.<sup>122</sup> Despite this, counterfeiting continues to grow

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EXECUTIVES, AND ATTORNEYS 20 (Guillermo C. Jimenez & Barbara Kolsun 2d eds., 2014).

<sup>116</sup> Auslander, *supra* note 115.

<sup>117</sup> *Id.*

<sup>118</sup> Eleanor Dunne, *Friend of Foe? 3D Printing and the Fashion Industry*, NOTJUSTALABEL.COM (May 27, 2014), <https://www.notjustalabel.com/editorial/friend-or-foe-3d-printing-and-fashion-industry>.

<sup>119</sup> Barbara Kolsun & Heather J. McDonald, *Counterfeiting*, in *FASHION LAW: A GUIDE FOR DESIGNERS, FASHION EXECUTIVES, AND ATTORNEYS* 139 (Guillermo C. Jimenez & Barbara Kolsun eds., 2d. ed. 2014).

<sup>120</sup> *Id.*

<sup>121</sup> Many sophisticated websites exist today that sell seemingly legitimate products, yet are actually unauthentic counterfeits. *See* Kolsun & McDonald, *supra* note 120, at 144.

<sup>122</sup> The *Trafficking in Counterfeit Goods or Services Anticounterfeiting Consumer Protection Act of 1996*, 18 U.S.C. § 2320 states that whoever intentionally traffics or attempts to traffic in goods

in the U.S. with some referring to it as “the crime of the twenty-first century.”<sup>123</sup>

The 3-D printing technology, including 3-D scanners and printers, facilitates counterfeiting; with this technology, consumers are enabled to produce identical replicas of fashion goods.<sup>124</sup> The 3-D scanners “capture physical dimensions of things . . . as a surface coating of digital confetti [in which] [e]ach piece of digital confetti represents a data point . . . documented as a set of x, y, and z coordinates.”<sup>125</sup> As 3-D printers become household items, consumers will have the capability to scan and print designer fashion items, a practice that has been coined “cottage counterfeiting.”<sup>126</sup>

Moreover, this process of scanning designer fashion goods allows users to upload and share designs with other users. This practice resembles the online piracy crisis the music and film industries have experienced.<sup>127</sup> The music industry lost billions of dollars due to illegal peer-to-peer file sharing before taking action to curtail online piracy.<sup>128</sup> Following the music industry’s lead, branded manufacturers of luxury fashion items will begin to police counterfeiting and argue for new legislation that addresses design piracy.<sup>129</sup>

## B. COPYRIGHT ENFORCEABILITY AGAINST DESIGN PIRACY

Fashion brand owners will first use copyright law to enforce any infringements. Copyrights enable brand owners to send Digital Millennium Copyright Act (“DMCA”) takedown notices to Internet service providers who post uploaded fashion designs that infringe on the owner’s copyrights.<sup>130</sup> Because courts recognize certain types of “secondary liability” for

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or services and knowingly uses a counterfeit mark on or in connection with such goods or services shall, if an individual, be fined not more than \$2,000,000 or imprisoned not more than 10 years, or both, and if a person other than an individual, be fine not more than \$5,000,000.

<sup>123</sup> Kolsun & McDonald, *supra* note 120, at 141.

<sup>124</sup> Jimenez, *supra* note 116, at 20.

<sup>125</sup> Lipson & Kurman, *supra* note 100, at 96.

<sup>126</sup> Jimenez, *supra* note 116, at 20.

<sup>127</sup> Auslander, *supra* note 115.

<sup>128</sup> *See id.*

<sup>129</sup> *See* Jimenez, *supra* note 116, at 20.

<sup>130</sup> *See* Auslander, *supra* note 115.



websites who knowingly benefit from infringement,<sup>131</sup> these takedown notices can be effective tools to dis-incentivize websites from continuing to distribute copyrighted designs.

Although not in the realm of fashion, at least one DMCA takedown notice of a 3-D printable design has already occurred.<sup>132</sup> Intellectual property attorney Rose Auslander<sup>133</sup> described the situation as follows:

This past February (2013), HBO sent the 3-D printing service nuPROTO a letter warning it to “cease and desist from continuing to produce and offer for sale the ‘Iron Throne Dock,’” a 3-D manufactured iPod dock inspired by HBO’s “Game of Thrones” fantasy TV series. Referencing copyrights, but also making a trade dress reference to likely consumer confusion, the letter claim that the Iron Throne Dock “will infringe on HBO’s copyright in the Iron Throne, and given the distinctive nature of the Iron Throne, mislead consumers into believing that it is connected with the Series and that it originates with or is sponsored by HBO. The nuproto.com site indicates that the offending Iron Throne Dock is no longer for sale, although pictures of it still appear on the site, along with an explanation of the dispute with HBO.”<sup>134</sup>

This takedown notice demonstrates that fashion designers will soon rely on the Digital Millennium Copyright Act to protect their copyrighted products. However, as previously discussed, copyright law leaves the majority of fashion design unprotected.<sup>135</sup> Therefore, brand owners will be forced to resort to other means for protection from design piracy.

### C. TRADEMARK ENFORCEABILITY AGAINST DESIGN PIRACY

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<sup>131</sup> Colman, *supra* note 28, at 195.

<sup>132</sup> See Auslander, *supra* note 115.

<sup>133</sup> Rose Auslander is a partner at Carter Ledyard & Milburn LLP in their Intellectual Property and Fashion Law practice groups.

<sup>134</sup> Auslander, *supra* note 115 (citing *Throne Dock*, nuPROTO.com, <http://nuproto.com/iThrone.html> (last visited Nov. 29, 2015)).

<sup>135</sup> Colman, *supra* note 42, at 45.

While courts are inclined to find websites that knowingly facilitate copyright infringement secondarily liable, this is not the case with trademark infringement.<sup>136</sup> In fact, case law on this topic “leaves the law of contributory trademark infringement ill-defined.”<sup>137</sup> This can be explained in part by the lack of a trademark law counterpart to the Digital Millennium Copyright Act (“DMCA”).<sup>138</sup> Currently, no legislation provides a guideline for fashion brand owners to send takedown notices for trademark infringement; as a result, brands avoid making frivolous claims against websites they seek to hold secondarily liable.<sup>139</sup>

Fashion brand owners who seek to protect their brands against trademark-infringing- design piracy may be left with the sole option of policing the individuals who post the designs. However, the policing of online piracy is both difficult and unpopular.<sup>140</sup> When the Recording Institute of America sent DMCA takedown notices to third-party websites and sued individuals for “sharing music” via the Internet, they received backlash and online protests ensued.<sup>141</sup> Fashion brands will likely want to avoid this type of negative publicity.

#### IV. INTELLECTUAL PROPERTY REFORM

With its lack of comprehensive intellectual property protection, some view the fashion industry as particularly vulnerable to the negative implications of 3-D printing.<sup>142</sup> To overcome its exceptional vulnerability, the fashion industry must lobby for intellectual property reform, as it has done in the past.<sup>143</sup>

##### A. COPYRIGHT REFORM

The most comprehensive way to protect the fashion industry from online design piracy is to expand the U.S. Copyright Act to include fashion design. A number of arguments have been made against design piracy legislation.

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<sup>136</sup> Colman, *supra* note 28, at 195.

<sup>137</sup> *Id.*

<sup>138</sup> *See id.*

<sup>139</sup> *See id.*

<sup>140</sup> Auslander, *supra* note 115.

<sup>141</sup> *Id.*

<sup>142</sup> *See* Jimenez, *supra* note 116, at 20.

<sup>143</sup> Jimenez et al., *supra* note 54, at 66.

Opponents to expanding such protection argue that design piracy and weak intellectual property laws are beneficial for the fashion industry.<sup>144</sup> According to Professor Kal Raustiala<sup>145</sup> and Professor Christopher Sprigman,<sup>146</sup> knockoffs and copied designs force designers to consistently create new designs, which is advantageous for an industry that prides itself for its innovation.<sup>147</sup> However, this argument rests on shaky economic grounds.<sup>148</sup> Europe has strong intellectual property protection and the European fashion industry does not lack innovation or revenue.<sup>149</sup>

Opponents also argue that design piracy “democratizes” fashion, giving less affluent consumers the opportunity to afford the same styles worn by models on the runway.<sup>150</sup> However, this argument overlooks “fast-fashion” companies like Zara and H&M that sell couture-like fashion at low and affordable prices. Because these companies are based in Europe, they already face rigorous intellectual property protection schemes, but nevertheless have been able to sell couture imitations at a cheap price.<sup>151</sup> Additionally, there is strong evidence to support the notion that design piracy protection would not have an impact on prices.<sup>152</sup>

In addition, opponents argue that design piracy legislation will lead to an increase in frivolous litigation, negatively impacting small and large designers, as well as the U.S. court system.<sup>153</sup> However, Harvard Law Professor Jeannie Suk counters that in a five-year period, the American brand

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<sup>144</sup> *Id.* at 69.

<sup>145</sup> Kal Raustiala is a law professor at UCLA.

<sup>146</sup> Christopher Sprigman is a law professor at the University of Virginia.

<sup>147</sup> See Jimenez et al., *supra* note 54, at 67.

<sup>148</sup> *Id.* at 69.

<sup>149</sup> *Id.*

<sup>150</sup> *Id.* at 70.

<sup>151</sup> *Id.* at 71.

<sup>152</sup> See Jimenez et al., *supra* note 54, at 71 (“The cost-based argument ignores the ‘Zara Solution’: a company can simply hire a designer to interpret or imitate a trend and thus can continue to produce trendy fashion items at low cost and sell them at low prices. Under the legislative proposals, one simply cannot sell identical replicas of particular branded goods.”).

<sup>153</sup> *Id.*

Forever 21 found itself in significantly more litigation disputes than its European counterparts Zara or H&M.<sup>154</sup> Furthermore, most of the proposed legislation, such as the previously mentioned IDPA of 2012, contains elements aimed at preventing the spread of frivolous claims.<sup>155</sup>

Finally, the primary argument put forth for why fashion design is not copyrightable is of little persuasive value. As previously stated, the “functional aspect of fashion design is the primary reason why there is no copyright protection for such designs in the United States.”<sup>156</sup> However, this argument hardly makes any sense “in an age when much of fashion is more ornamental than functional.”<sup>157</sup>

Additionally, stronger arguments can be made for the adoption of design piracy legislation. At the fundamental level, fashion is creative and thus, its artistic value deserves protection under the laws that protect other forms of creativity.<sup>158</sup> Fashion designers are commonly shocked and dismayed upon learning their designs are not protected under U.S. intellectual property law.<sup>159</sup>

The United States should mirror the European Union where fashion brand owners have both an independent right against design copying and a thriving fashion industry.<sup>160</sup> The European Community Design Protection Regulation (the “Regulation”), adopted in all 27 European Union Member States, “provides designers with exclusive rights to use their designs in commerce, to enforce those rights against infringers, and to claim damages.”<sup>161</sup> Given the relative recentness of the

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<sup>154</sup> See C. Scott Hemphill & Jeannie Suk, *The Law, Culture, and Economics of Fashion*, 61 STAN. L. REV. 1147, 1172-73 (2009).

<sup>155</sup> Jimenez et al., *supra* note 54, at 72.

<sup>156</sup> Meaghan McGurrin Ehrhard, *Protecting the Seasonal Arts: Fashion Design, Copyright Law, and the Viability of the Innovative Design Protection & Piracy Prevention Act*, 45 CONN. L. REV. 285, 301-02 (2012).

<sup>157</sup> Colman, *supra* note 28.

<sup>158</sup> Jimenez et al., *supra* note 54, at 74.

<sup>159</sup> Colman, *supra* note 28, at 118.

<sup>160</sup> *Id.* at 118 n. 7.

<sup>161</sup> Jimenez et al., *supra* note 54, at 75. (citing Council Regulation (EC) No. 6/2002 of 12 December 2001 O.J. (L 3, 1.2002, at .1), *amend* by Council Regulation (EC) No. 1891/2006 of 18 December 2006 O.J.

Regulation, the extent of its impact is still uncertain. However, fashion brand owners have successfully utilized the intellectual property protection offered by the Regulation.

Further, adopting design piracy legislation would bring the U.S. laws into compliance with international treaty obligations.<sup>162</sup> Current U.S. intellectual property law violates the Berne Union and the Uruguay Round Agreement on Trade-Related Aspects of Intellectual Property Rights (“TRIPS”) because it fails to “provide for the protection of independently created industrial designs that are new or original.”<sup>163</sup> Amending the U.S. Copyright Act to include protection for fashion design would bring the U.S into compliance with these treaties.<sup>164</sup>

Finally, if fashion design were to receive copyright protection, then fashion brand owners could proceed similarly to the music and film industries in preventing online file sharing. If fashion design is eligible for copyright protection, fashion brand owners could send DMCA takedown notices, serving as an effective means to limit widespread fashion design piracy.<sup>165</sup>

#### B. TRADEMARK REFORM

As previously mentioned, lobbying Congress to expand copyright law to include fashion design has been consistently unsuccessful.<sup>166</sup> While 3-D printing presents a new and grave threat to intellectual property protection in the fashion industry, there is no reason to believe that Congress, given its track record, will confront this threat by expanding copyright law to include fashion design.

Accordingly, the industry may be better off by lobbying for trademark law reform. Currently, third-party distributors can be held liable for knowingly supplying goods that are trademark protected through what is known as contributory trademark

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(L 386, 29.12.2006, at 14) *available at* <http://oami.europa.eu/en/design/pdf/6-02-CV-en.pdf>).

<sup>162</sup> Jimenez et al., *supra* note 54, at 75.

<sup>163</sup> Agreement on Trade-Related Aspects of Intellectual Property Rights art. 25, Annex 1C, Apr. 15, 1994, 33 I.L.M. 81 (1994).

<sup>164</sup> Jimenez et al., *supra* note 54, at 75.

<sup>165</sup> See Auslander, *supra* note 115.

<sup>166</sup> Jimenez et al., *supra* note 54, at 69.

infringement.<sup>167</sup> However, applying contributory trademark infringement to Internet Service Providers (“ISPs”) has been a struggle.<sup>168</sup>

Unlike copyright, contributory liability for trademark is not codified in a statute. Instead, courts rely upon the Supreme Court’s decision in *Inwood Laboratories, Inc. v. Ives Laboratories, Inc.*, 456 U.S. 844, 844 (1982).<sup>169</sup> In *Inwood*, the Supreme Court considered whether a manufacturer or a distributor of generic drugs could be held contributorily liable for the direct infringement of pharmacists.<sup>170</sup> The majority held in the affirmative and provided the following test:

[I]f a manufacturer or distributor intentionally induces another to infringe a trademark, or if it continues to supply its product to one whom it knows or has reason to know is engaging in trademark infringement, the manufacturer or distributor is contributorily responsible for any harm done as a result of the deceit.<sup>171</sup>

Many courts have found it difficult to apply the test set forth in *Inwood* to the Internet context.<sup>172</sup> Because of the vast nature of ISPs, there is often an absence of actual knowledge of infringement on servers, one of the elements required by the

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<sup>167</sup> See *Infringement*, BLACK’S LAW DICTIONARY (10th ed. 2014) (defining contributory trademark infringement as “[a] manufacturer’s or distributor’s conduct in knowingly supplying, for resale, goods bearing an infringing mark”).

<sup>168</sup> Jason Kessler, *Correcting the Standard for Contributory Trademark Liability over the Internet*, 39 COLUM. J.L. & SOC. PROBS. 375, 385 (2006) (“Any attempt to apply the existing tests for contributory trademark liability to cases arising over the Internet will immediately encounter difficulties”).

<sup>169</sup> Fara S. Sunderji, *Protecting Online Auction Sites from the Contributory Trademark Liability Storm: A Legislative Solution to the Tiffany Inc. v. Ebay Inc. Problem*, 74 FORDHAM L. REV. 909, 919 (2005) (citing *Inwood Laboratories, Inc. v. Ives Laboratories, Inc.*, 456 U.S. 844 (1982)).

<sup>170</sup> *Inwood Laboratories, Inc.*, 456 U.S. at 855.

<sup>171</sup> *Id.* at 854.

<sup>172</sup> Emily Favre, *Online Auction Houses: How Trademark Owners Protect Brand Integrity Against Counterfeiting*, 15 J.L. & POL’Y 165, 180 (2007).

*Inwood* test.<sup>173</sup>

The first case addressing contributory trademark infringement over the Internet was *Tiffany v. eBay, Inc.*, 576 F. Supp. 2d 463, 463 (S.D.N.Y. 2008).<sup>174</sup> There, Tiffany brought an action in the Southern District of New York against eBay for contributory trademark infringement, alleging that eBay engaged in “facilitation and participation in the counterfeiting, infringement and false advertising of the federally registered trademarks owned, licensed and/or used by Tiffany.”<sup>175</sup> The district court held that eBay was not liable for contributory trademark infringement.<sup>176</sup>

Applying the test from *Inwood*, the district court determined whether eBay continued to sell and distribute the products after eBay knew or had reason to know of possible infringement.<sup>177</sup> The district court held that eBay did not continue to sell and distribute products after they had knowledge of their infringement, and therefore, eBay was not liable.<sup>178</sup> In reaching its determination, the district court effectively held that the burden rests not on the website, but rather on the trademark owner to enforce its trademark.<sup>179</sup> The Second Circuit agreed on appeal.<sup>180</sup>

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<sup>173</sup> Elizabeth K. Levin, *A Safe Harbor for Trademark: Reevaluating Secondary Trademark Liability After Tiffany v. Ebay*, 24 BERKELEY TECH. L.J. 491, 511 (2009).

<sup>174</sup> *Id.* at 494 (citing *Tiffany Inc. v. eBay, Inc.*, 576 F. Supp. 2d 463, 527 (S.D.N.Y. 2008)).

<sup>175</sup> First Amended Complaint ¶ 4, *Tiffany, Inc. v. eBay, Inc.*, 576 F. Supp. 2d 463, 527 (S.D.N.Y. 2008) (No. 04 Civ. 4607) 2004 WL 1413904, ¶ 4.

<sup>176</sup> *Tiffany Inc.*, 576 F. Supp. 2d at 469.

<sup>177</sup> *Id.* Judge Sullivan wrote:

“In determining whether eBay is liable, the standard is not whether eBay could reasonably anticipate possible infringement, but rather whether eBay continued to supply its services to sellers when it knew or had reason to know of infringement by those sellers.”

<sup>178</sup> *Id.*

<sup>179</sup> Katja Weckström, *Secondary Liability for Trademark Infringement in the United States*, 49 U. LOUISVILLE L. REV. 555, 573 (2011).

<sup>180</sup> *Tiffany (NJ) Inc. v. eBay Inc.*, 600 F.3d 93 (2d Cir. 2010); *see also* Levin, *supra* note 175, at 494. (“The court held that trademark law cannot force online auctioneers to filter for trademarked material.

The rule is now clear: trademark owners must police against infringement of their marks. To do so, trademark owners require an effective Internet solution. Although the DMCA provides a means for copyright owners to police against copyright infringement on the Internet,<sup>181</sup> trademark law does not currently have an equivalent to the DMCA.<sup>182</sup> Therefore, Congress should enact legislation, whether by amending the DMCA or the Lanham Act, to adopt a DMCA-like safe harbor provision, which would protect both 3-D printing websites and trademark owners from contributory trademark infringement.<sup>183</sup> Similar to the DMCA, legislation extending safe harbor to 3-D printing websites from contributory trademark infringement should include the following minimum requirements:

- (1) the [website] must not have actual knowledge of the infringing activity and must not be aware of facts or circumstances from which infringing activity is apparent; (2) if the site has the right and ability to control the infringing activity, it must not receive a financial benefit directly attributable to the infringing activity; and (3) upon receiving proper notification of claimed infringement, the site must expeditiously take down or block access to the material.<sup>184</sup>

Adopting this legislation would provide ISPs, including those that print and distribute 3-D printable products, with clear steps to protect themselves from contributory trademark infringement. It would also provide trademark owners with clear steps on how to protect their trademarks over the Internet.

### CONCLUSION

3-D printing technology is projected to substantially impact the global economy. The fashion industry should prepare

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Rather, provided that the website removes the material when an intellectual property owner files a complaint, trademark owners must monitor for infringement.”).

<sup>181</sup> Kessler, *supra* note 170, at 396-97.

<sup>182</sup> Levin, *supra* note 175, at 521.

<sup>183</sup> Sunderji, *supra* note 171, at 940; *see also* Levin, *supra* note 175, at 493.

<sup>184</sup> Levin, *supra* note 175, at 522.



for both the positive and negative consequences of 3-D printing. The fashion industry is particularly susceptible to 3-D printing technology due to the industry's lack of comprehensive intellectual property protection. Fashion designers and brand owners must advocate for intellectual property reform. Failure to reform intellectual property law may result in the spread of online fashion design piracy. If intellectual property law and the fashion industry mutually adapt, 3-D printing may present an exciting opportunity for designers to be increasingly more creative.

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### COMMENT

## THE CHALLENGES FOR FASHION DESIGNERS UNDER *LENZ* AND THE DIGITAL MILLENNIUM COPYRIGHT ACT

Brian Pouderoyen \*

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### INTRODUCTION

The Ninth Circuit recently decided in *Lenz*<sup>1</sup> that a copyright holder must consider whether a content-user is protected by fair use before issuing a takedown notice under the Digital Millennium Copyright Act (DMCA). This comment applies *Lenz* to the flourishing 3D printing world and explains the new law's potential to burden small copyright holding companies, particularly those in the fashion industry. This comment discusses the relevant sections of the DMCA and the *Lenz* decision, and applies *Lenz* to current and future 3D printing issues.

### I. DMCA, *LENZ*, AND FAIR USE

In 1998, Congress enacted the DMCA in order to update copyright laws for the digital age.<sup>2</sup> Specifically, Congress enacted Title II of the DMCA, the Online Copyright Infringement Liability Limitation Act (OCILLA), to limit liability for Internet service-providers hosting user-generated

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<sup>1</sup> *Lenz v. Universal Music Corp.*, 801 F.3d 1126, 1133 (9th Cir. 2015).

<sup>2</sup> *Ellison v. Robertson*, 357 F.3d 1072, 1076 (9th Cir. 2004).

content, and to ensure copyright holders could still effectively protect their intellectual property.<sup>3</sup> Sections 512(c), (f), and (g) of OCILLA are pertinent to the takedown procedures at issue in *Lenz*.<sup>4</sup>

Service providers like YouTube and Reddit can avoid copyright infringement liability if they remove the potential infringing content from their site after the copyright holder notifies them of infringement.<sup>5</sup> This notice is referred to as a “takedown notification.”<sup>6</sup> Section 512(c)(3)(A) provides that a copyright holder must include certain information in the takedown notice, including identification of the copyrighted work, and the material that is allegedly causing infringement. Importantly, the copyright holder must state that it “has a *good faith belief* that use of the material in the manner complained of is not authorized by the copyright owner, its agent, or the law.”<sup>7</sup>

Furthermore, to avoid liability, the service provider must notify the content-user of the takedown.<sup>8</sup> The user has a right to appeal the takedown, which involves sending a counter-notification to the service provider stating that the user believes in good faith that the content “was removed . . . as a result of mistake or misidentification . . . .”<sup>9</sup> As the intermediary in this process, the service provider must relay this counter-notification to the copyright holder and restore the content online in no more than fourteen days. These steps are often referred to as the DMCA’s put-back procedures.

If a copyright holder or a content user does not act in good faith throughout the DMCA’s takedown or put-back procedures, they may be subject to liability. Section 512(f) provides, in pertinent part, that “[a]ny person who knowingly materially misrepresents under this section (1) that material or

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<sup>3</sup> *Lenz*, 801 F.3d at 1131; 17 U.S.C. § 512.

<sup>4</sup> *Lenz*, 801 F.3d at 1131.

<sup>5</sup> 17 U.S.C. § 512(c)

<sup>6</sup> *Lenz*, 801 F.3d at 1131.

<sup>7</sup> *See id.* § 512(c)

<sup>8</sup> *See id.* § 512(g)(1)-(2)

<sup>9</sup> *See id.* § 512(g)(3)(C)

activity is infringing, or (2) that material or activity was removed or disabled by mistake or misidentification, shall be liable for any damages . . . .”<sup>10</sup> This threat of liability may be a catalyst for copyright holders to expend resources to ensure sufficient takedown notices.

In *Lenz*, the Ninth Circuit evaluated the sufficiency of a takedown notice, specifically, whether the copyright holder had a good faith belief that the law did not authorize the content’s use.<sup>11</sup> The lawsuit was sparked by a takedown notice from Universal Music Corp. (“Universal”) to YouTube regarding a 29-second home video of Lenz’s one-year-old son dancing to *Let’s Go Crazy* by Prince, which was playing on Lenz’s stereo in the background.<sup>12</sup> A Universal legal assistant assigned to monitor YouTube for potential infringement on Prince’s copyrighted music found the video.<sup>13</sup> After receiving Universal’s takedown notice, YouTube removed the video from the website and notified Lenz, who then filed a counter-notification.<sup>14</sup> Lenz argued that although Universal’s notice contained a “good faith” statement, as required by section 512(c), the statement did not address whether Lenz’s use was protected by fair use, and therefore Universal did not actually form a good faith belief about the legality of her use.<sup>15</sup> The court narrowed the issue to whether “copyright holders have been abusing the extrajudicial takedown procedures provided for in the DMCA by declining to first evaluate whether the content qualifies as fair use.”<sup>16</sup>

The Ninth Circuit held that the DMCA takedown procedures require a copyright holder to evaluate fair use before sending a takedown notice under section 512(c).<sup>17</sup> The court reasoned that the DMCA’s fair use provision, as set forth in 17 U.S.C. § 107, is a type of non-infringing use, and that such use is

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<sup>10</sup> *See id.* § 512(f)

<sup>11</sup> *Lenz*, 801 F.3d at 1129.

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

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

<sup>14</sup> *Id.* at 1130.

<sup>15</sup> *Id.* at 1134.

<sup>16</sup> *Id.* at 1129.

<sup>17</sup> *Id.* at 1133.

a content user's right as "authorized by the law."<sup>18</sup> The court explained that "[f]air use is not just excused by the law, it is wholly authorized by the law."<sup>19</sup>

Fair use is a nebulous doctrine. It means that an entity may use another's copyrighted material without permission in certain circumstances. The *Lenz* court seemed to acknowledge that, in the DMCA context, although difficult fair use cases might not arise frequently, human review was necessary when such issues did arise.<sup>20</sup> The court quelled fears that fair use consideration would place a large burden on copyright holders, by emphasizing that the statute only requires a good faith and subjective belief that the use is not fair. The court stated that the consideration of fair use "need not be searching or intensive."<sup>21</sup> The court also stated in dicta, that copyright holder algorithms that scan the internet for infringing material may be sufficient to fulfill the fair use consideration requirement.<sup>22</sup> However, if a copyright holder provides insufficient notice to satisfy the fair use requirement, and there is strong evidence to the contrary, such notice could likely result in section 512(f) liability.<sup>23</sup> In the wake of *Lenz*, questions remains as to how a copyright holder satisfies the fair use consideration requirement.

## II. APPLICATION OF *LENZ* TO 3D PRINTING

Fashion designers who wish to protect their copyrights from infringement by the ever-growing 3D printing community will have to search through service provider websites for potentially infringing content. These designers are subject to the takedown procedures, as set forth in 17 U.S.C. § 512(c)-(g) and *Lenz*. The takedown process for designers is similar to the process detailed in *Lenz*; however, fashion industry designers may have fewer resources to devote to policing their copyrights than entertainment companies such as Universal. Copyrightable

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<sup>18</sup> *Id.* at 1133; 17 U.S.C. § 512(c)

<sup>19</sup> *Lenz*, 801 F.3d at 1132.

<sup>20</sup> *Id.* at 1135-36.

<sup>21</sup> *Id.* at 1135.

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

<sup>23</sup> *Id.* at 1134-35.

fashion designs, which may be expensive and valued in the free market, could be transformed into computer-aided design (“CAD”) files, and those files may become available online. Many fashion designers could struggle to police these infringements. Algorithms, like those used by the entertainment industry to scour the internet for infringing content, will surely be available to fashion designers in the future, but at a cost. Even with such a tool, *Lenz* indicated that an algorithm alone would not always (if ever) fulfill the takedown notice requirements. Adding fair use consideration to the DMCA’s takedown procedure is a positive step toward protecting content users from harassment by big copyright holders, but it appears that it will also be an additional hurdle for small copyright holders, such as fashion designers. These designers now face a higher risk of liability for sending takedown notices.

### III. THE DMCA AND 3D PRINTING

How the DMCA applies to sites, such as Reddit and YouTube, is identical to how it applies to 3D printing-focused sites, such as Shapeways and Thingiverse. These sites, also termed “service providers,” host digital CAD files, which users can create, alter, and upload to the site. Those files are then available to download to home 3D printers. The 3D printer is then able to create a growing array of objects. If, and when, a CAD file on a 3D printing site infringes on a copyright holder’s work, that copyright holder is able to initiate the DMCA takedown procedure. The application of the DMCA to 3D printing sites, such as Shapeways, is evidenced by the site’s legal policy page, which clearly warns users to not infringe on others’ copyrights, provides a basic background on fair use, and also details the takedown process under the DMCA.<sup>24</sup> Although Shapeways’ legal page provides the language of sections 512(c) and (g), it does not specify that a takedown notice must include consideration of fair use.<sup>25</sup> Moreover, Thingiverse does not offer any guidance on the DMCA.<sup>26</sup>

A key case in copyright law offers an example of a

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<sup>24</sup> *Shapeways Content Policy and Notice Takedown Procedure*, SHAPEWAYS, [http://www.shapeways.com/legal/content\\_policy](http://www.shapeways.com/legal/content_policy) (Dec. 12, 2015).

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

<sup>26</sup> THINGIVERSE, <https://www.thingiverse.com> (last visited Dec. 12, 2015).

copyrighted object that could be susceptible to infringement by 3D printers—the belt buckle in *Kieselstein-Cord*. In *Kieselstein-Cord*, the court held that a belt buckle possessed sufficient design qualities, aside from its practical uses, to warrant it being copyrightable.<sup>27</sup> There are many more decorative belt buckles, aside from Kieselstein-Cord's, that are ripe for infringement. Michael Lynch mentions that Ray Kurzweil, Head of Engineering at Google, believes that 3D printing technology will soon allow consumers to print their own fabrics and clothing at home. While such an advancement would trigger a major paradigm shift in the clothing industry, it should not be overlooked that consumer-grade 3D printers already have the technology to print metals and heavy plastics—perfect for making belt buckles.<sup>28</sup> Additionally, as evidenced by the Game of Thrones phone charger, designed by a private user and prepared for sale online without the permission of HBO, the issue of the DMCA and 3D printing extends far beyond the realm of fashion design.

Imagining a scenario where a belt buckle designer's copyright could be infringed is not too difficult. A person could find a beautiful, historical, and justifiably valuable, Western-style belt buckle while antiquing in Bisbee, Arizona for the weekend. Imagine a scenario where a person has advanced knowledge of CAD programing, such that she can effectively recreate most designs into CAD files just by looking at them. She then recreates the fine design of the belt buckle into a CAD file, and uploads it to a 3D printing design host site. She then posts the replica up for sale. This would likely be a violation of the original designer's rights, and assuming the designer finds the newly infringed content, he can initiate the DMCA takedown process with little worry. An attorney may not even be necessary. But what if the antique aficionado and CAD programmer significantly altered the buckle design, and the designer still believes that it infringes on his copyright? In such

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<sup>27</sup> See *Kieselstein-Cord v. Accessories by Pearl, Inc.*, 632 F.2d 989, 993-94 (2d Cir. 1980).

<sup>28</sup> Cite for capabilities of current 3D printing technology.

a scenario, the outcome is less certain.

#### IV. CHALLENGES FOR FASHION DESIGNERS UNDER *LENZ*

The challenge for designers prior to *Lenz* included policing protected content and locating a copyright infringement. In *Lenz*, Universal appointed an assistant in the legal department to monitor YouTube for infringements on Prince's copyrights. It is unlikely designers will have the resources to police their copyrights so tenaciously. Moreover, many entertainment industry copyright holders now employ algorithms to search for infringing content, which dramatically reduces the cost of policing their copyrights. Again, it is unlikely that even the top designers will have such algorithms working for them in the near future. Ultimately, the first challenge is devoting time, a precious resource, to policing these designs.

*Lenz* leaves open the question: once the potentially infringing material is located, does the new fair use consideration require legal insight before a proper takedown notification under the DMCA can be issued? Uncertainties as to what constitutes fair use are sure to arise. Under *Lenz*, this uncertainty is not a major obstacle for copyright holders because they only need to form a subjective, good faith belief that the content is not protected by fair use.<sup>29</sup> These uncertainties may easily be alleviated with the help of an attorney, but with the added complexities brought about by *Lenz*, the uncertainties pose an additional cost and burden. Although the standard for forming a good faith belief remains relatively low under *Lenz*, the complexity of the fair use doctrine requires legal counsel, which may be a burdensome expense. Without an attorney, now more than ever, designers may be more susceptible to liability under section 512(f) for misrepresenting that their copyright is being infringed by a 3D printing CAD file user. Although the cost of an attorney may not be excessive in some circumstances, it is nevertheless another expense in what is already an expensive task—ensuring protection of a valuable copyright.

#### CONCLUSION

*Lenz* holds that fair use must be considered prior to issuing a takedown notification under the DMCA.<sup>30</sup> This is

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<sup>29</sup> *Lenz v. Universal Music Corp.*, 801 F.3d 1126, 1133 (9th Cir. 2015).

<sup>30</sup> *Id.* at 1133.



likely positive news for many content-users, both on sites like YouTube and Reddit, and on the growing number of sites that host 3D printing designs. This requirement could save users from unwarranted harassment by certain copyright holders who send takedown notifications using only an algorithm to identify potential infringing content. However, *Lenz* may also place a burden on the smaller copyright holders, who will have to place additional resources into their takedown notifications so that they can avoid liability under section 512(f)—the enforcement arm of OCILLA. This is an additional strain on the fashion industry, one that already has the short end of the stick in the realm of intellectual property law. Small designers, such as the successful Western belt buckle crafter, must now hire an attorney in order to reduce the risk of liability under OCILLA. Although the end-user may benefit, it is an additional cost for the designers.

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**COMMENT**

***CHRISTIAN LOUBOUTIN, S.A. v. YVES SAINT LAURENT  
AMERICA, INC. AND SINGLE-COLOR TRADEMARK  
PROTECTION THROUGH THE DOCTRINE OF  
SECONDARY-MEANING***

Nicole Metzgar-Schall\*

*The fashion world has seen little protection from  
trademark and copyright mechanisms, but as  
fashion evolves, courts appear ready to adjust  
their analysis to recognize secondary-meaning,  
and to grant and uphold single-color  
trademarks.*

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**I. CHRISTIAN LOUBOUTIN, S.A. v. YVES SAINT LAURENT  
AMERICA, INC.**

In 2012, the United States Court of Appeals for the Second Circuit decided *Christian Louboutin, S.A. v. Yves Saint Laurent America, Inc.* on an interlocutory appeal, when the United States District Court for the Southern District of New York declined to enter a preliminary injunction restraining the defendant's alleged use of Christian Louboutin's trademark.<sup>1</sup>

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\* J.D. 2017, Sandra Day O'Connor College of Law, Arizona State University.

<sup>1</sup> *Christian Louboutin S.A. v. Yves Saint Laurent Am. Holdings, Inc.*, 696 F.3d 206, 212 (2d. Cir. 2012).

The plaintiff, Christian Louboutin S.A., is a high-fashion, French designer catering to ladies' footwear and accessories.<sup>2</sup> For over twenty years, the plaintiff, Christian Louboutin ("Louboutin"), used a bright, high-gloss, red lacquer as a distinguishing color on the underside of his ladies' high-heeled shoes, otherwise known as the "outsoles."<sup>3</sup> The outsole is known as the most striking feature and often sharply contrasts with the rest of the shoe's color.<sup>4</sup> Louboutin filed for, and was granted, a trademark on the "Red Sole Mark," which became effective in January 2008.<sup>5</sup> Investing substantial capital and building a widely known reputation, the designer promoted the Red Sole Mark as its signature, such that the mark became closely associated with the designer's handiwork.<sup>6</sup>

The defendant, high-end French fashion designer, Yves Saint Laurent America Holdings, Inc. ("YSL"), sought to release a line of monochrome shoes, where the entire shoe, including the outsole, would be a single color.<sup>7</sup> This shoe was to be a completely red shoe, including a red outsole.<sup>8</sup> Since the 1970s, this was neither the first monochromatic shoe design, nor YSL's first red-soled footwear design.<sup>9</sup>

After learning of YSL's design, Louboutin requested that YSL remove the shoes from the market due to the red outsole, and the parties entered into negotiations to avoid litigation.<sup>10</sup> The negotiations did not result in settlement; Louboutin filed an action "asserting claims under the Lanham Act, 15 U.S.C. § 1051 *et seq.*, for (1) trademark infringement and counterfeiting, (2) false designation of origin and unfair competition, and (3) trademark dilution, as well as state law

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<sup>2</sup> *Id.* at 211.

<sup>3</sup> *Id.* at 212.

<sup>4</sup> *Id.* at 213.

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

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

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

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

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

<sup>10</sup> *Id.*

claims for (4) trademark infringement, (5) trademark dilution, (6) unfair competition, and (7) unlawful deceptive acts and practices,” as well as a motion for an injunction to prevent YSL from marketing any shoes with the Red Sole Mark or with a red shade on the outsole of shoes that could cause consumer confusion.<sup>11</sup>

The district court denied Louboutin’s motion for preliminary injunction, and the circuit court affirmed and reasoned, “a single color can never be protected by a trademark in the fashion industry.”<sup>12</sup> The circuit court further stated that, “single-color marks are inherently ‘functional,’” and held that any mark registered as a single-color would likely be found invalid and unenforceable.<sup>13</sup>

## II. DEVELOPING THE PRECEDENT OF SINGLE-COLOR TRADEMARKS AND SECONDARY-MEANING

The courts do not appear ready to grant single-color trademarks, absent a specified use with a clearly developed secondary-meaning. In 1906, A. Leschen & Sons Rope Co. argued before the Supreme Court of the United States for the validity of their single-color trademark, a single strand of distinctly colored wire rope, against a defendant who likewise sought to paint a single strand of rope a distinct color.<sup>14</sup> The plaintiff’s theory would effectively find a trademark infringement where a rope contains a streak of *any* color.<sup>15</sup> Concluding that the trademark was not valid,<sup>16</sup> the Court reasoned that the trademark was too broad because it could be infringed by the use of a streak of any color.<sup>17</sup> Further, the Court stated that if that trademark is to be a colored streak, “the figure should be so described that other manufacturers would know how to avoid it.”<sup>18</sup> In its analysis, the Court considered an

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

<sup>12</sup> *Id.* at 212.

<sup>13</sup> *Id.* at 214.

<sup>14</sup> *A. Leschen & Sons Rope Co. v. Broderick & Bascom Rope Co.*, 201 U.S. 166, 167 (1906) *abrogated by* *Hurn v. Oursler*, 289 U.S. 238 (1933) (abrogated on grounds related to jurisdictional issues and unrelated to trademark validity).

<sup>15</sup> *Id.* at 171.

<sup>16</sup> *Id.* at 172.

<sup>17</sup> *Id.* at 171.

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

English statute requiring a trademark to be distinctive.<sup>19</sup> The statute does not afford trademark protection to a mark when its distinction depends upon the color of the trademark.<sup>20</sup>

After *A. Leschen & Sons Rope Co. v. Broderick & Bascom Rope Co.*, a case was decided by the Sixth Circuit containing a more involved analysis of single-color trademarks, including consideration of secondary-meaning. In *Yellow Cab Transit Co. v. Louisville Taxicab & Transfer Co.*, Louisville Taxicab had been painting its vehicles yellow with black trimming for a quarter century, and it also adopted trade names featuring the word “yellow,” effectively allowing the public to identify the company through both the color scheme and trade name.<sup>21</sup> On the other hand, Yellow Cab, operating exclusively as a freight carrier in interstate commerce, also used yellow painted equipment with black trimming with the displayed trade name “Yellow Transit Company.”<sup>22</sup> The Court ultimately modified the district court’s decree, and stated that Louisville Taxicab’s terms were too broad.<sup>23</sup> In its modification, the Court granted limited relief to Louisville Taxicab, and indicated the company had no exclusive right to the color yellow, but stated that the company was “entitled to protection in its long established use of the color yellow on its taxicabs in Louisville, inasmuch as it has acquired a good will by use of the yellow color scheme on taxicabs by virtue of appropriate application of the doctrine of secondary-meaning.”<sup>24</sup>

Although Louisville Taxicab could not deny Yellow Cab use of the yellow color scheme, the Court recognized the developed secondary-meaning, and allocated relief to fairly balance the equities between the parties.<sup>25</sup>

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<sup>19</sup> *Id.* at 172.

<sup>20</sup> *Id.*

<sup>21</sup> *Yellow Cab Transit Co. v. Louisville Taxicab & Transfer Co.*, 147 F. 2d 407, 409 (6th Cir. 1945).

<sup>22</sup> *Id.* at 409-10.

<sup>23</sup> *Id.* at 411.

<sup>24</sup> *Id.* at 415.

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

In 1985, the United States Court of Appeals fully recognized secondary-meaning when it decided whether to allow a trademark to be registered as such.<sup>26</sup> The court considered a section of the Lanham Act<sup>27</sup> providing that “nothing in this chapter shall prevent the registration of a mark used by the applicant which has become distinctive of applicant's goods in commerce”, codifying the common-law doctrine of secondary-meaning.”<sup>28</sup> The court recognized the difficulty in demonstrating distinctiveness and trademark character for single-color trademarks through the doctrine of secondary-meaning, but ultimately found that Owens-Corning Fiberglas had shown large advertising expenditures and consumer recognition sufficient to establish that the pink color of its glass residual insulation had acquired secondary-meaning and could serve as a valid and enforceable trademark.<sup>29</sup>

Prior to the *Christian Louboutin* case involving the Red Sole Mark, the Supreme Court of the United States decided *Qualitex Co. v. Jacobson Products Co., Inc.*, and determined that no law precludes a single color from being registered as a valid and enforceable trademark.<sup>30</sup> Although the special green-gold color that Qualitex used on its dry-cleaning press pads served no other function aside from aesthetics, the color acted as a symbol and had acquired secondary-meaning.<sup>31</sup> In interpreting the same provision from the Lanham Act that the court in *Owens-Corning Fiberglas* considered, the court reiterated that the language of the statute extends protection to descriptive marks that normally would be used for a non-trademark purpose, where the mark has developed “secondary-meaning.”<sup>32</sup>

### III. APPLYING THE PRECEDENT OF SINGLE-COLOR TRADEMARKS TO THE FASHION INDUSTRY

With this precedent in mind, the United States Court of Appeals analyzed whether Louboutin's Red Sole Mark merited

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<sup>26</sup> *In re Owens-Corning Fiberglas Corp.*, 774 F.2d 1116, 1127-28 (Fed. Cir. 1985).

<sup>27</sup> 15 U.S.C. § 1052(f) (2006).

<sup>28</sup> *Id.* § 1124.

<sup>29</sup> *Id.* § 1127.

<sup>30</sup> *Qualitex Co. v. Jacobson Prods. Co.*, 514 U.S. 159, 161 (1995).

<sup>31</sup> *Id.* at 166.

<sup>32</sup> *Id.* at 171; 15 U.S.C. § 1052(f) (2006); see *In re Owens-Corning Fiberglas Corp.*, 774 F. 2d 1116, 1124 (Fed. Cir. 1985).

trademark protection, and ultimately decided that the bright red lacquered outsoles deserved protection only when the Red Sole Mark contrasts sharply with the color of the rest of the shoe.<sup>33</sup> The court discussed the basic structure of a trademark infringement claim: the mark must be distinctive or have gained distinctness by developing a secondary-meaning, and the allegedly infringed mark must not be likely to cause customer confusion.<sup>34</sup> Recognizing that the *Qualitex* decision required a fact-based inquiry, and that it issued no per se rule, the appellate court reasoned that the district court relied on a misunderstanding of aesthetic functionality as adopted from *Qualitex*.<sup>35</sup>

In *Qualitex*, the Supreme Court observed that functional aspects of a product typically cannot serve as a trademark because it renders the product useful, and it inhibits legitimate competition by granting a monopoly to the trademark owner.<sup>36</sup> The district court relied on the doctrine of aesthetic functionality to determine that Louboutin's single color trademark was invalid because, in the fashion industry, such trademarks are inherently functional.<sup>37</sup> Aesthetic functionality is a complete defense to trademark infringement, and may be found where "recognition of trademark rights [in an aesthetic design feature] would significantly hinder competition."<sup>38</sup> The United States Court of Appeals concluded that the district court erred in finding that YSL had rebutted the presumption of Louboutin's exclusive right of use because a single color cannot receive trademark protection because single colors are aesthetically functional.<sup>39</sup>

In considering whether the Red Sole Mark merited

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<sup>33</sup> *Christian Louboutin, S.A. v. Yves Saint Laurent Am. Holdings, Inc.*, 696 F. 3d 206, 212 (2d. Cir. 2012).

<sup>34</sup> *Id.* at 216-17.

<sup>35</sup> *Id.* at 228.

<sup>36</sup> *Id.* at 218.

<sup>37</sup> *Id.* at 214.

<sup>38</sup> *Id.* at 221 (quoting *Qualitex Co. v. Jacobson Prods. Co.*, 514 U.S. 159, 170 (1995)).

<sup>39</sup> *Id.* at 225.

protection via secondary-meaning, the Court of Appeals considered factors such as advertising expenditures, consumer studies linking the mark to its source, unsolicited media coverage of the product, sales success, attempts to plagiarize the mark, and length and exclusivity of the mark's use.<sup>40</sup> In order to develop a distinction through secondary-meaning, the significance of a product feature itself must identify the product brand. Finding that Louboutin had created a brand with worldwide recognition, the court concluded that the Red Sole Mark is firmly associated with the Louboutin name, and that recognition of Louboutin is readily apparent from the red-lacquered outsoles.<sup>41</sup>

After this finding, the court found it unnecessary to determine whether YSL's use created consumer confusion, and whether the doctrine of aesthetic functionality would serve as a defense to Louboutin's claim.<sup>42</sup> Instead, the Court of Appeals modified Louboutin's trademark to be consistent with its holding that the secondary-meaning of the Red Sole Mark extends only to the use of a red outsole that sharply contrasts with the color of the adjoining shoe; the trademark does not apply to any shoe where the entire shoe and the outsole are the same color.<sup>43</sup> In so modifying Louboutin's trademark, YSL's monochrome shoes did not constitute a use of, or infringement upon, Louboutin's exclusive right to the Red Sole Mark.<sup>44</sup>

The court's holding illustrates the readiness to recognize and protect more aspects of the fashion world and source-identifying characteristics, beginning with the protection of a single color via the doctrine of secondary-meaning. When, as in *Louboutin*, a characteristic has become so entwined and associated with the source and identification of the product, the court stands ready to protect that characteristic through granting exclusive rights to the holder of the trademark.

Although the court modified and upheld Louboutin's trademark, special note should be taken in considering the form in which the color is protected. As in *Owens-Corning*, *Qualitex*, and *Louboutin*, the court did not preclude other competitors from

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<sup>40</sup> *Id.* at 226.

<sup>41</sup> *Id.* at 226-27.

<sup>42</sup> *Id.* at 228.

<sup>43</sup> *Id.*

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



using the colors in question: pink, green-gold, and red. Instead, the court deemed the single-color trademark valid through secondary-meaning with regard to the manner in which the color was being used. The Red Sole Mark was upheld as valid only as used on the outsoles of Christian Louboutin shoes, limited further by the outsole's sharp contrast with the rest of the shoe. Comparatively, the pink color of Owens-Corning's glass residual insulation and the green-gold color of Qualitex's dry-cleaning press pads were granted trademark protection, but in no way are other manufacturers precluded from using the color itself. A total exclusivity and right over a color itself would effectively grant the trademark holder a monopoly and could potentially limit the creativity of the fashion industry. Instead, as in the cases before *Louboutin*, only the manner in which the color is used, and to the extent it identifies the product brand, thereby indicating the secondary-meaning of the use of the color, is to be afforded protection.

In analyzing whether or not a single-color trademark merits protection and is valid, the mark should survive the heightened scrutiny and fact-intensive inquiry discussed in *Louboutin*: advertising expenditures, consumer studies linking the mark to its source, unsolicited media coverage of the product, sales success, attempts to plagiarize the mark, and length and exclusivity of the mark's use.<sup>45</sup> Surveys and consumer studies, which may suggest a link between the mark and its manufacturer, may deserve the greatest consideration because the ultimate goal of trademark protection is to provide the consumer an ability to identify the source solely from a mark.

#### IV. CONCLUSION

The recognition and modification of the Red Sole mark may indicate that the courts are ready to recognize single-color trademarks, insofar as they are used in a particular manner in the fashion industry. The current language of the Lanham Act requires a distinctive mark. What may be considered "distinct" can often qualify anything with a developed secondary-

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<sup>45</sup> *Id.* at 226.

meaning.<sup>46</sup> Because of this language, and due to the courts' precedents granting protection to single-color trademarks, it seems unlikely that a single color will be afforded trademark protection absent a source-identifying manner of use through the development of a secondary-meaning.

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<sup>46</sup> 15 U.S.C. § 1052(f) (2006).

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### CHINA'S FILM CENSORSHIP PROGRAM AND HOW HOLLYWOOD CAN ENTER CHINA'S FILM MARKET

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*This article is based on regulations and data prior to 2015. Films that are mentioned as record-breaking may no longer be current due to newer releases. The current quota system allowing 34 films into China was signed into agreement with the World Trade Organization in 2012, and was valid for five years. In 2017–2018, China will need to renegotiate a new agreement, which may increase the number of foreign films that can be imported.<sup>1</sup> Despite the possibility of a quota increase, the trends described in this article may still apply.*

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<sup>1</sup> See Clifford Coonan, *China Film Import Quota Will Open Up in 2017, Says Top Local Producer*, THE HOLLYWOOD REPORTER (Apr. 16, 2014, 9:25 AM), <http://www.hollywoodreporter.com/news/china-film-import-quota-increase-696708>.

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## INTRODUCTION

Films are methods of storytelling, allowing audiences to transcend cultural differences, delve into imaginative realms, and appreciate the interpretation of an often-familiar story told from a unique perspective. Hollywood is globally recognized as the leading film industry for production, development, and distribution. However, the epicenter for distribution is rapidly shifting to China due to the country’s growing presence as an emerging film industry.

Current economic conditions incentivize film industries, such as Hollywood, to turn to China to maximize its box office revenues. General estimates suggest approximately 100 screens are opening per week in China, which amounts to approximately fourteen new screens a day, or about 5,200 screens a year.<sup>2</sup> China’s box office revenue jumped 34 percent in 2014 to a record-breaking \$4.8 billion, making it the first foreign market to

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<sup>2</sup> See Linda Yueh, *Is it a Golden Age for Chinese Cinema?*, BBC NEWS (Oct. 30, 2014), <http://www.bbc.com/news/business-29834530>. “In the US, there are 40,000 movie screens, or one for every 8,000 people, according to EntGroup. There are 20,000 screens in China, but that works out as one for every 70,000 people.” *Id.* See also Patrick Frater, *China Adds 5,000 Cinema Screens in 2013*, VARIETY (Jan. 17, 2014), <http://variety.com/2014/biz/asia/china-adds-5000-cinema-screens-in-2013-1201062132/>.

cross the \$4 billion threshold.<sup>3</sup> Even Hollywood films that domestically showed signs of a decline in revenue were able to receive box office success through its distribution in China.<sup>4</sup> Dan Mintz, from the China-based production company Dynamic Marketing Group Entertainment (DMG Entertainment), commented that “franchises”<sup>5</sup> and “tent-pole”<sup>6</sup> films now must consider China as a factor before “green-lighting”<sup>7</sup> films for production.<sup>8</sup> Reports indicate China has evolved to become the

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<sup>3</sup> Compare Richard Verrier, *China Fuels Record Global Box-Office Revenue in 2014*, L.A TIMES (Mar. 12, 2015), <http://www.latimes.com/entertainment/envelope/cotown/la-et-ct-mpaa-report-china-global-box-office-revenue-20150312-story.html>, with *China Retains Grip on Foreign Film Quota*, BBC NEWS (Feb. 12, 2014), <http://www.bbc.com/news/entertainment-arts-26152190> [hereinafter *China Retains Grip*] (stating China's box office revenue was \$2.7 billion in 2012).

<sup>4</sup> See *Need for Speed*, BOX OFFICE MOJO, <http://www.boxofficemojo.com/movies/?page=intl&country=CH&id=needforspeed.htm> (last visited Jan. 6, 2016); see *Night at the Museum: Secret of the Tomb*, BOX OFFICE MOJO, <http://www.boxofficemojo.com/movies/?page=intl&country=CH&id=nightatthemuseum3.htm> (last visited Jan. 6, 2016); see also *Transformers: Age of Extinction*, BOX OFFICE MOJO, <http://www.boxofficemojo.com/movies/?page=intl&country=CH&id=transformers4.htm> (last visited Jan. 6, 2016).

<sup>5</sup> See *Franchise*, OXFORD DICTIONARY, [http://www.oxforddictionaries.com/us/definition/american\\_english/franchise](http://www.oxforddictionaries.com/us/definition/american_english/franchise) (last visited Jan. 6, 2016) (defining ‘franchise’ as “a general title or concept used for creating or marketing a series of products, typically films or television shows: ‘the Harry Potter franchise’”).

<sup>6</sup> See *Tentpole*, MERRIAM-WEBSTER DICTIONARY, <http://www.merriam-webster.com/dictionary/tentpole> (last visited Jan. 6, 2016) (defining ‘tentpole’ as “a big budget movie whose earnings are expected to compensate the studio for its less profitable movies”).

<sup>7</sup> See *Greenlight*, THE FREE DICTIONARY, <http://www.thefreedictionary.com/greenlight> (last visited Jan. 6, 2016) (defining ‘greenlight’ as “to give permission to proceed with”).

<sup>8</sup> See e.g., *Talking Business with Linda Yueh*, VIMEO, <https://vimeo.com/110803849> (last visited Jan. 6, 2016) [hereinafter *Talking Business*] (BBC News Television Broadcast Jan. 11, 2014).

largest international market for Hollywood films, surpassing Japan, France, Britain, and India.<sup>9</sup>

Although foreign filmmakers are incentivized to distribute in China, Chinese authorities retain a strict quota that permits only 34 foreign films<sup>10</sup> to enter China per year. Prior to an expansion of the quota in 2012, the per-year limit was 20 foreign films.<sup>11</sup> In response to this quota, countries have unsuccessfully implored China to provide exemptions to the annual allowance. Mintz explains that while the quota system is a burdensome obstacle, it is not the key issue at play in the industry because filmmakers have started circumventing the restriction by working with Chinese companies in co-productions.<sup>12</sup> The key issue is now censorship.<sup>13</sup>

This article explores China's unique film industry, focusing on the Chinese government's strict regulation. The discussion will review how Hollywood has succeeded in the past and how filmmakers should approach projects in the future to increase the likelihood that the Chinese government will approve the films for distribution in China. In addition, the article will attempt to answer whether China's film censorship program benefits the country's artists, audiences, and film development.

Part I will introduce the Chinese censorship program, and will compare the U.S. rating system with the Chinese censorship system. Part II will introduce and explain the criteria films must satisfy in order to gain access to Chinese theaters, including the reasoning behind the criteria. This section will also discuss the entities that enforce film censorship in China, and explain the process of gaining entry into China's film industry under China's strict program. This section will proceed

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<sup>9</sup> Verrier, *supra* note 3.

<sup>10</sup> See Clifford Coonan, *Chinese Movies Need Not Fear End of Quota System, Report Says*, THE HOLLYWOOD REPORTER (Jan. 7, 2015, 8:20 AM),

<http://www.hollywoodreporter.com/news/chinese-movies-need-not-fear-761845>.

<sup>11</sup> See Ryan Nakashima, *Hollywood in China? Country's New Foreign Film Quotas Make the Industry Optimistic*, HUFFINGTON POST (Apr. 17, 2012), [http://www.huffingtonpost.com/2012/04/17/hollywood-in-china-countr\\_n\\_1431395.html](http://www.huffingtonpost.com/2012/04/17/hollywood-in-china-countr_n_1431395.html).

<sup>12</sup> *China Retains Grip*, *supra* note 3.

<sup>13</sup> *Talking Business*, *supra* note 8.

to discuss the traditional method of entering through the quota system and the alternative method of creating a co-produced film.

Part III will analyze some of the benefits and consequences of having a Chinese censorship program. Part IV will examine various foreign produced, local produced, and co-produced films that were either admitted or rejected, and will demonstrate a pattern in the government's censorship, thereby helping to hypothesize which future films may be approved for distribution in China. Part V will discuss how potential distribution to China may alter the way films are made creatively, and how surpassing the censorship regulations and distributing in China may be beneficial. The article will conclude with a few considerations that Hollywood studios should keep in mind if they seek to access China's box offices.

### **I. THE CHINESE CENSORSHIP PROGRAM**

There are two entities involved in the process of film distribution in China. The State Administration of Press, Publication, Radio, Film and Television of the People's Republic of China (SARFT) acts as the censorship board tasked with assessing each film that hopes to distribute in China, whether it is Chinese produced or produced elsewhere.<sup>14</sup> This assessment by SARFT is required before a film may be approved for release in China.<sup>15</sup> The China Film Group Corporation (CFGC), which openly admits it is a monopoly state-run film enterprise, is tasked with distribution, control, and regulation of all imported

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<sup>14</sup> See *State Administration of Radio, Film and Television*, EMBASSY OF THE PEOPLES REPUBLIC OF CHINA IN INDIA, <http://in.china-embassy.org/eng/mt/jyjs/t61109.htm> (last visited Jan. 6, 2016). As of 2013, SARFT became the State General Administration of Press, Publication, Radio, Film and Television ("SAPPRFT"), which integrated The General Administration of Press and Publication and SARFT. But see Stephen Cremin, *SARFT Merged with Press Regulator*, FILM BUSINESS ASIA (Mar. 12, 2013, 11:00AM), <http://www.filmbiz.asia/news/sarft-merged-with-press-regulator>. The entity is most commonly referred to as SARFT. For the purposes of this article, the entity will be referred to as SARFT.

<sup>15</sup> See Cremin, *supra* note 14.

foreign films.<sup>16</sup>

This section begins with a brief overview of the U.S. film rating system as a comparative tool for understanding China's censorship program. A delineation of the process and procedures of Chinese censorship regulation follows, focusing on the roles of the CFGC and SARFT within the Chinese censorship system. The proceeding section discusses the impact and consequences of the Chinese censorship system on the film industry.

#### A. THE U.S. RATING SYSTEM

The United States applies a rating system run by an industry committee separate from government affiliation: The Motion Picture Association of America (MPAA). The MPAA serves to promote, protect, and regulate films in the United States.<sup>17</sup> The MPAA's mission is "advancing the business and art of filmmaking, protecting the creative and artistic freedoms of filmmakers, and ensuring the satisfaction of our audiences worldwide."<sup>18</sup>

In accordance with this mission, the MPAA created a rating system operated by the Classification & Ratings Administration (CARA) to inform audiences about the type of content within each film.<sup>19</sup> CARA assesses film content by electing an independent board of parents; this board of parents considers factors such as violence, sex, language, and drug use to

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<sup>16</sup> See *Company Profile*, CHINA FILM CO., LTD. (中国电影股份有限公司), <http://www.zgdygf.com/introduction/index.shtml> (last visited Jan. 6, 2016); see also *China Film Group Corporation*, WIKIPEDIA, [https://en.wikipedia.org/wiki/China\\_Film\\_Group\\_Corporation](https://en.wikipedia.org/wiki/China_Film_Group_Corporation) (last visited Jan. 6, 2016).

<sup>17</sup> See *Our Story*, MPAA.ORG, <http://www.mpa.org/our-story/> (last visited Jan. 6, 2016). Although the MPAA is an entity separate from the government, its current Chairman and CEO is former United States Senator Chris Dodd, who is recognized "for authoring or co-authoring the Family and Medical Leave Act in 1993; the Patient Protection and Affordable Care Act; the Help America Vote Act; and the Dodd-Frank Wall Street Reform and Consumer Protection Act." *Id.*

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

<sup>19</sup> See *Film Ratings*, MPAA.ORG, <http://www.mpa.org/film-ratings/> (last visited Jan. 6, 2016).



assign a rating.<sup>20</sup> A film may be rated as G (general audience), PG (parental guidance suggested), PG-13 (parents strongly cautioned), R (restricted), or NC-17 (no one 17 and under admitted).<sup>21</sup> Using votes of independent parents as the basis for the U.S. rating system ensures the ratings are current and properly indicative of the standards and perspectives of American society. Therefore, a film's rating is an indication of what (the independent board of parents believes) the majority of American parents would rate a film.<sup>22</sup> Although the government still has final authority to censor, restrict, or ban films that are considered morally offensive or obscene, this power of censorship is rarely exercised due to the First Amendment.<sup>23</sup>

#### B. CHINA'S CENSORSHIP SYSTEM: THE CFG AND SARFT

China has no rating system. Instead, the government

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<sup>20</sup> See *What: Guide To Ratings*, THE CLASSIFICATION & RATING ADMINISTRATION (CARA), <http://www.filmratings.com/what.html> (last visited Jan. 6, 2016). A board of parents assigns ratings that they believe a majority of American parents would assign to a movie. *Id.*

<sup>21</sup> See *Film Ratings*, *supra* note 19.

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

<sup>23</sup> See Greg Daugherty, "*The Interview*" Joins the Ranks of These Banned or Restricted Movies, SMITHSONIAN.COM (DEC. 23, 2014), <http://www.smithsonianmag.com/arts-culture/interview-limited-joins-ranks-these-banned-censored-restricted-movies-180953722/?no-ist>. The most recent example of a Hollywood film being cancelled for theater release in the US is *The Interview* (2014). *Id.* Sony Pictures cancelled the film due to threats from North Korea's dictatorship, which was set to open in theaters in December. *Id.* See also Katherine Webb, *4 Movies That Were Banned In The U.S.*, MOVIES CHEAT SHEET (Dec. 2, 2015), <http://www.cheatsheet.com/entertainment/4-movies-that-were-banned-in-the-u-s.html?a=viewall>; see also Ali Jaafar & Anita Busch, *Ban of 'Child 44': Russia Distrib Files Appeal – Update*, DEADLINE (Apr. 15, 2015, 11:50 AM), <http://deadline.com/2015/04/tom-hardy-child-44-blocked-russia-day-lionsgate-gary-oldman-1201410402/>. Similar forms of censorship also occur in other countries. Hollywood's *Child 44* (2015) was banned by the Ministry of Culture in Russia only days prior to its opening because of "distortion of historic facts and willful interpretations of events . . . as well as images and characters of Soviet citizens of the period." *Id.*

reviews all films that aim to distribute in China and approves only those that are “suitable for all ages.”<sup>24</sup> This means every film essentially should be equally non-offensive, family friendly, and appropriate for Chinese audiences based on the subjective standards of the Communist Party of China (CPC) through its various government entities and lower state-run film enterprises.

### 1. China Film Group Corporation (CFG)

Prior to reaching SARFT for approval, the government delegates the task of controlling and regulating all imported foreign films to China Film Group Corporation (CFG) which is the monopoly state-run film enterprise in China.<sup>25</sup> CFG is the central circuit that controls film and television exhibition, importation, exportation, production, advertising, etc.<sup>26</sup>

CFG also owns multiple subsidiaries including the China Film Co-Production Corporation (CFCC).<sup>27</sup> The CFCC is authorized by SARFT as the sole legal entity to administer affairs relating to film co-production, and provide coordination and services, pursuant to the Regulations on Administration of the Film and the Rules on Administration of the Sino-Foreign Film Co-Production.<sup>28</sup> The CFCC’s precise roles and functions

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<sup>24</sup> See Robert Cain, *Hey, You’ve Got to Hide Your @#!\* Away: The Rules of Film Censorship in China*, CHINA FILM BIZ (Nov. 27, 2011), <http://chinafilmbiz.com/2011/11/28/hey-youve-got-to-hide-your-away-the-rules-of-film-censorship-in-china/>. “No distinction is made between children and adults; the government [through SARFT] holds the ultimate right to decide what content is ‘appropriate’ and therefore available for viewing, irrespective of the viewer’s age.” *Id.* See also Ben Child, *Chinese Cinema Manager Invents His Own Ratings Systems*, THE GUARDIAN (Aug. 12, 2014), <http://www.theguardian.com/film/2014/aug/12/chinese-cinema-manager-film-ratings-system> (some Chinese companies have implemented their own rating systems).

<sup>25</sup> See *Company Profile*, *supra* note 16.

<sup>26</sup> See Firedeep & Robert Cain, *How China’s Movie Distribution System Works, Part 1*, CHINA FILM BIZ (Nov. 7, 2012), <http://chinafilmbiz.com/2012/11/07/how-chinas-movie-distribution-system-works-part-1/>.

<sup>27</sup> See *Company Profile*, *supra* note 16 (lists CFG as a joint enterprise of multiple subsidiaries).

<sup>28</sup> See *About*, CHINA FILM CO-PRODUCTION CORPORATION (中国电影合作制片公司), <http://www.cfcc-film.com.cn/introeg/intro.html>

are as follows:

- (1) Process applications of film co-production between Chinese domestic film studios and foreign film companies or filmmakers; execute agreement with all co-operative parties; supervise, coordinate and manage the performance of the agreements.
- (2) Introduce Chinese domestic studios to foreign parties and provide related co-production services.
- (3) Review proposed scripts of the Sino-foreign co-production projects and provide consulting services for the proposed projects.
- (4) Provide assistance in relation to entry visas for foreign crews participating in the production.
- (5) Provide assistance in relation to customs clearance for filming equipment, film stocks and materials to be used in production.
- (6) Conduct preliminary review of the completed films.
- (7) Process application and provide related hospitality services for foreign crews to conduct shooting of short films in Mainland China.
- (8) Organize forums, seminars and symposiums related to Sino-Foreign film co-production.
- (9) Administer other matters instructed by SARFT.<sup>29</sup>

Hollywood studios aiming to co-produce with Chinese companies must deal directly with these government entities in order to access China's markets.<sup>30</sup> These entities will later be

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(last visited Jan. 6, 2016); *see also* *About Co-Productions*, CHINA HOLLYWOOD SOCIETY, <http://www.chinahollywood.org/about-co-productions> (last visited Jan. 6, 2016).

<sup>29</sup> *See Guidelines*, CHINA FILM CO-PRODUCTION CORPORATION (中国电影合作制片公司), <http://www.cfcc-film.com.cn/introeg/busine.html> (last visited Jan. 6, 2016).

<sup>30</sup> *See About*, *supra* note 28.

referred to as the “Censorship Board.”

2. *State Administration of Press, Publication, Radio, Film and Television (SARFT)*

SARFT is an executive branch of the State Council of the People’s Republic of China, tasked with the administration and supervision of state-owned enterprises engaged in television, radio, and film.<sup>31</sup> Unlike the independent group of American parents used by the MPAA to determine film ratings, SARFT is government operated.<sup>32</sup> The SARFT committee consists of roughly 30 members, including representatives from government agencies and interest groups, such as the Communist Youth League and the Women’s Federation, as well as filmmakers.<sup>33</sup> Cai Fuchao, who is a member of the 18<sup>th</sup> CPC Central Committee, has been the director of SARFT since 2011.<sup>34</sup> Cai allows his reputation for being strict on regulation and enforcement of media content to be evident.<sup>35</sup> For example, in a prior municipal post in Beijing, Cai was widely reported to have policed websites for banned materials with the help of 10,000 volunteers, and to have joined in a roundup of a million illegally published books in 2004.<sup>36</sup> It comes as no surprise that the

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<sup>31</sup> See *State Administration of Press, Publication, Radio, Film and Television of the People’s Republic of China*, THE STATE COUNCIL THE PEOPLE’S REPUBLIC OF CHINA (Sep. 4, 2014, 9:42 AM), [http://english.gov.cn/state\\_council/2014/09/09/content\\_281474986284063.htm](http://english.gov.cn/state_council/2014/09/09/content_281474986284063.htm).

<sup>32</sup> See *Film Ratings*, *supra* note 19.

<sup>33</sup> See Robert Cain, *How to be Censored in China: A Brief Filmmaking Guide*, INDIEWIRE (Nov. 30, 2011, 10:00 AM), <http://www.indiewire.com/article/how-to-be-censored-in-china-a-brief-filmmaking-guide>.

<sup>34</sup> See Cai Fuchao (蔡赴朝), CHINA VITAE, [http://www.chinavitae.com/biography/Cai\\_Fuchao/bio](http://www.chinavitae.com/biography/Cai_Fuchao/bio) (last visited Nov. 30, 2015).

<sup>35</sup> See Clifford Coonan, *China Censorship, Piracy Rules in Focus at Annual Legislative Meeting*, BILLBOARD (Mar. 9, 2015), <http://www.billboard.com/articles/business/6494967/china-censorship-piracy-rules-in-focus-at-annual-legislative-meeting>.

<sup>36</sup> See Michael Cieply & Brooks Barnes, *To Get Movies into China, Hollywood Gives Censors a Preview*, N.Y. TIMES (Jan. 14, 2013), <http://www.nytimes.com/2013/01/15/business/media/in-hollywood-movies-for-china-bureaucrats-want-a-say.html>.

censorship policies carried through by SARFT under his control are equally stringent.

SARFT has the authority to issue mandatory guidelines for media content and prohibit specific genres of film from production and distribution.<sup>37</sup> Without providing extensive detail on what it tends to prefer, SARFT takes a more negative approach by advising filmmakers on what they will not tolerate. In 2008, SARFT issued a few codifications to attempt to clarify its standards. Films containing any of the following content must be cut or altered:

- (1) Distorting Chinese civilization and history, seriously departing from historical truth; distorting the history of other countries, disrespecting other civilizations and customs; disparaging the image of revolutionary leaders, heroes and important historical figures; tampering with Chinese or foreign classics and distorting the image of the important figures portrayed therein;
- (2) Disparaging the image of the people's army, armed police, public security organ or judiciary;
- (3) Showing obscene and vulgar content, exposing scenes of promiscuity, rape, prostitution, sexual acts, perversion, homosexuality, masturbation and private body parts including the male or female genitalia; containing dirty and vulgar dialogues, songs, background music and sound effects;
- (4) Showing contents of murder, violence, terror, ghosts and the supernatural; distorting value judgment between truth and lies, good and evil,

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<sup>37</sup> See People's Republic of China State Council (中华人民共和国国务院令) (No. 342) (promulgated by St. Admin. of Press, Publ'n, Radio, Film and T.V. of the P.R.C. (中华人民共和国国家新闻出版广电总局) (Dec. 25, 2001, effective Feb. 1, 2002), [http://www.sarft.gov.cn/art/2007/2/16/art\\_1602\\_26266.html](http://www.sarft.gov.cn/art/2007/2/16/art_1602_26266.html).

beauty and ugliness, righteous and unrighteous; showing deliberate expressions of remorselessness in committing crimes; showing specific details of criminal behaviours; exposing special investigation methods; showing content which evokes excitement from murder, bloodiness, violence, drug abuse and gambling; showing scenes of mistreating prisoners, torturing criminals or suspects; containing excessively horror scenes, dialogues, background music and sound effects;

- (5) Propagating passive or negative outlook on life, world view and value system; deliberately exaggerating the ignorance of ethnic groups or the dark side of society;
- (6) Advertising religious extremism, stirring up ambivalence and conflicts between different religions or sects, and between believers and non-believers, causing disharmony in the community;
- (7) Advocating harm to the ecological environment, animal cruelty, killing or consuming nationally protected animals;
- (8) Showing excessive drinking, smoking and other bad habits;
- (9) Opposing the spirit of law.<sup>38</sup>

The regulations are long and appear rather strict and constraining on filmmakers. The most daunting element of the code is the regulation “opposing the spirit of law,” which creates a broad all-encompassing element giving SARFT sweeping authority to basically disapprove anything in their discretion. SARFT also focuses its attention on disallowing unconventional storylines, such as “unpunished breaches of morality, gestures towards the supernatural, and any work ‘distorting value judgment between truth and lies, good and evil, beauty and ugliness, righteous and unrighteous.’”<sup>39</sup> In a directive issued in 2009, SARFT deemed violence, pornography, and content which

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<sup>38</sup> Cain, *supra* note 24.

<sup>39</sup> *SARFT 101: The Rules of the Censorship Game*, D GENERATE FILMS, <http://dgeneratefilms.com/critical-essays/sarft-101-the-rules-of-the-censorship-game> (last visited Dec. 1, 2015).

may “incite ethnic discrimination or undermine social stability,” as prohibited content for online media.<sup>40</sup> Additionally, with little explanation, SARFT chose to limit the number of historical dramas permitted in 2012, especially those that involved time travel back to a Chinese historical era, resulting in cancellation of many previously approved and planned films.<sup>41</sup> The restrictions may have been imposed because the CPC does not welcome assembly or resistance. The CPC is especially concerned with government opposition, and knows that films allow immediate dissemination of ideas to the public.<sup>42</sup> Unlike the United States’ liberal standard that affords citizens the freedom to create any film, regardless of the controversy, SARFT takes the opposite approach: stifling creativity in order to protect the ideals and values of the CPC.

Analyst Robert Cain posits that China’s censorship may stem from traditional Chinese ideals of Confucian morality, political stability, and social harmony.<sup>43</sup> Deeper analysis of Chinese regulations illuminates some of CPC’s principles, and may suggest that although seemingly oppressive compared to the U.S., the two sets of regulations are somewhat similar in theory. Prohibitions that are rather relatable to the US are: “(3) showing obscene and vulgar content...” and “(7) advocating harm... to animal cruelty.” In the U.S., the First Amendment affords protection to filmmakers unless the content created is obscene<sup>44</sup>; similarly, part (3) of SARFT’s guidelines also prohibits any content that is “obscene”. Similar to SARFT’s concern for animal cruelty in part (7), President Obama signed the “Animal

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<sup>40</sup> Vivian Wu, *Censors Strike at Internet Content After Hit Parody*, SOUTH CHINA MORNING POST (Apr. 3, 2009, 12:00 AM), <http://www.scmp.com/article/675609/censors-strike-internet-content-after-hit-parody>.

<sup>41</sup> See Edward Wong, *China: TV Limits May Hit the Web*, N.Y. TIMES (Jan. 6, 2012), [http://www.nytimes.com/2012/01/07/world/asia/china-tv-limits-may-hit-the-web.html?\\_r=0](http://www.nytimes.com/2012/01/07/world/asia/china-tv-limits-may-hit-the-web.html?_r=0).

<sup>42</sup> See Jaafar & Busch, *supra* note 23.

<sup>43</sup> Cain, *supra* note 24.

<sup>44</sup> See 18 U.S.C. §§ 1460-70 (2012).

Crush Video Prohibition Act of 2010,”<sup>45</sup> which prohibits interstate commerce in animal crush films to try and limit the spread of animal cruelty. The comparison suggests both the U.S. and China share similar concerns. Thus, it may be important to understand the values and cultural beliefs of the CPC, as well as the people in China, before one criticizes Chinese regulations. That being said, it is undeniable that SARFT’s code creates considerably more restrictions than U.S. regulations. This stifles filmmakers in their capacity to produce inventive and provocative films, if they wish to distribute in China.

Following the government’s recent initiatives for economic reform, SARFT relaxed its authority over censorship by delegating some responsibility to lower branches of government.<sup>46</sup> SARFT previously held the authority to deliver final approval or rejection of all films that attempted to distribute in the country, either foreign or domestic.<sup>47</sup> Since 2010, SARFT has outsourced or “released the regulation” of domestic films to local bureaus.<sup>48</sup> It continues to hold authority to approve foreign films, co-productions, or any domestic films dealing with “important revolutionary, historic themes and literature.”<sup>49</sup>

## II. GAINING ACCESS TO CHINA’S FILM MARKET

There are two ways for films produced by foreign studios to access China’s markets: (1) the traditional quota system,<sup>50</sup> and (2) the alternative co-production method.<sup>51</sup>

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<sup>45</sup> 18 U.S.C. § 48 (2010).

<sup>46</sup> Lilian Lin, *China is Decentralizing Movie Censorship. But Will it Make a Difference?*, WALL ST. J. (Mar. 17, 2014), <http://blogs.wsj.com/chinarealtime/2014/03/17/china-is-decentralizing-movie-censorship-but-will-it-make-a-difference/>.

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

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

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

<sup>50</sup> See Robert Cain, *Handicapping China’s 2012 Import Quota Slot Derby*, CHINA FILM BIZ (Oct. 22, 2012), <http://chinafilmbiz.com/2012/10/22/handicapping-chinas-2012-import-quota-slot-derby/>. See also Cain, *supra* note 24.

<sup>51</sup> See Robert Cain, *How (and Why) to Qualify Your Film as an Official Chinese Co-production*, CHINA FILM BIZ (Dec. 18, 2011), <http://chinafilmbiz.com/2011/12/18/how-and-why-to-qualify-your-film-as-an-official-chinese-co-production/>. “Co-productions are the only type of film foreign producers can participate in that are not



Despite the 2012 quota increase, it is still difficult for foreign films to enter the Chinese market using the quota system. For this reason, a new trend<sup>52</sup> has emerged, and foreign production studios are now forming joint ventures with local Chinese companies and co-producing films. The joint venture business model eliminates the restriction of the 34-film quota. However, the burden of meeting China's censorship standards still remains.

On its face, the joint venture business model appears to be a simplified and mutually beneficial model for both parties. Chinese filmmakers benefit from working with Hollywood filmmakers by gaining knowledge and experience with western methods and new techniques. Hollywood films benefit by bypassing the quota system and affording a seemingly more secure chance of entering into China's market. However, this outlook may be deceptive for Hollywood filmmakers. Indeed, although co-produced films may not implicate the quota system, China's government grants this privilege in exchange for strict censorship of film content, ensuring government control over all films entering China.

#### A. THE QUOTA SYSTEM

The quota system is the traditional method by which a foreign film may enter China's film market. This method involves following the rules, completing the paperwork, and hoping the film obtains the government's approval before the quota is filled.<sup>53</sup> Filmmakers are required to submit their screenplay or finished film to the Censorship Board for review and comment, they then hope for a response within 15 days, sometimes longer. The Censorship Board may provide suggestions for altering and cutting the film, or altogether reject it at this stage. Filmmakers must then make the necessary

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subject to import quotas and that return to the foreigner a "fair" share—that is, around 40 percent—of the box office receipts." *Id.*

<sup>52</sup> *Id.*

<sup>53</sup> See Firedeep & Cain, *supra* note 26; see also Firedeep & Robert Cain, *How China's Movie Distribution System Works, Part 2*, CHINA FILM BIZ (Nov. 9, 2012), <http://chinafilmbiz.com/2012/11/09/how-chinas-movie-distribution-system-works-part-2/>.

changes and resubmit the film. The edited version eventually reaches SARFT, which reviews the changes and makes an approval decision.<sup>54</sup>

Films not gaining Censorship Board approval are typically those films that did not consider China's "suitable for all ages" criteria. The Censorship Board is able to control the content in the approval process, sometimes severely quashing such creative liberties before the film enters China. Even if SARFT approved a film as "suitable for all audiences," if 34 films had already been admitted, the film would have no chance to enter China's film market. This traditional method of producing is not only risky, but it is also ill advised, considering how profitable it is to distribute in China.<sup>55</sup>

#### B. CO-PRODUCED CHINESE FILMS

An alternative method to enter China's film market, and one that has become increasingly popular in recent years, is to partner with a Chinese company to co-produce a "Chinese" film.<sup>56</sup> This process entails a multitude of efforts, but analysis suggests this method ultimately provides a higher chance of being rewarded with distribution throughout China. Joining in co-production with a Chinese company bypasses the quota limitation at the cost of requiring extra procedures,<sup>57</sup> to ensure the film is as equally Chinese, as it is foreign creative-wise, production-wise, and profit-wise.<sup>58</sup> Censorship oversight is arguably greater for co-productions than for a foreign film attempting to enter through the quota system, but foreign studios voluntarily welcome the guidance because of its immense benefits.

The CFCC lists certain procedures for both the Chinese company and the foreign company in creating a co-produced

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<sup>54</sup> See Cain, *supra* note 24.

<sup>55</sup> *Id.*

<sup>56</sup> Firedeep & Cain, *supra* note 53.

<sup>57</sup> See *About Co-Productions*, *supra* note 28 (explaining the procedural requirements for a Sino-Foreign Co-Production).

<sup>58</sup> *Id.* Joint productions are regarded as domestic films and can be directly released in Mainland China after it is completed and passes censorship review. *Id.* See also Cain, *supra* note 51. Joint productions are the only types exempted from import quotas. *Id.*

film.<sup>59</sup> First, the Chinese company, which is either a state-run company like CFGC or a private company with co-production credentials, and the foreign party should sign a co-production agreement or letter of intent.<sup>60</sup> The Chinese company should then serve as a liaison to validate that the film is a “Chinese” film.<sup>61</sup> Before production, the Chinese party should submit the film script to the provincial film authority, or the CFCC for preliminary comments.<sup>62</sup> After CFCC’s preliminary review, the script and necessary documents are sent to SARFT for approval and issuance of a co-production permit.<sup>63</sup> Once the film acquires the permit, the CFCC creates a signed agreement amongst all parties.<sup>64</sup> At this point, the film is green-lit for production.<sup>65</sup> However, this does not mean that the film is guaranteed distribution in China upon completion.

There are certain requirements the film must meet during production in order to justify its title as a co-production.<sup>66</sup> At least one-third of the crew must be Chinese, Chinese actors should be included in the cast in vital roles, and producers need to maintain a close relationship with CFCC throughout the entire process.<sup>67</sup> The Chinese party must also file to CFCC a list of the

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<sup>59</sup> See Sino-Foreign Cooperation in Film Production Regulations (中外合作摄制电影片管理规定) (Decree No. 31) (promulgated by the St. Admin. of Radio, Film and Television) (Jul. 6, 2004), <http://www.cfcc-film.com.cn/polic/content/id/22.html>. See also *About Co-Productions*, *supra* note 28.

<sup>60</sup> See Sino-Foreign, *supra* note 59, at Article IX. See also Cain, *supra* note 51.

<sup>61</sup> Sino-Foreign, *supra* note 59; see also Cain, *supra* note 51.

<sup>62</sup> See Sino-Foreign, *supra* note 59, at Article X; see also Cain, *supra* note 51.

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

<sup>64</sup> See Sino-Foreign, *supra* note 59; see also Cain, *supra* note 51.

<sup>65</sup> See Cain, *supra* note 51.

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

<sup>67</sup> See Sino-Foreign, *supra* note 59, at Article XIII. See also Cain, *supra* note 51. “This hiring provision is extremely vague—the term “major actors” is often interpreted to mean all personnel of any kind.” *Id.*

film's talent from abroad, file for entry visas for the cast and crew, and clear customs for any equipment, facilities, film negatives, or other production goods.<sup>68</sup> Members of the Censorship Board keep a close eye on every project to ensure that the filmmakers are in compliance at every step.<sup>69</sup>

Even post-production is controlled by CFCC. Once an English title has been determined, it needs to be filed with the CFCC for approval.<sup>70</sup> Moreover, if post-production and film development is to be conducted outside China, an application of such action needs to be submitted to the CFCC.<sup>71</sup> The completed film must be submitted to the provincial film authority for preliminary comments, and then submitted to the CFCC, which eventually submits their comments and the film to SARFT for final approval.<sup>72</sup>

The economic benefits of co-producing are very rewarding. According to Mathew Alderson from China Law Blog, co-productions may receive approximately 38 percent of box-office revenue, as opposed to the 13-25 percent available to imported foreign films.<sup>73</sup> China also guarantees a certain return on co-produced films because they are considered domestic, and Chinese authorities require that approximately 55 percent of total box office revenue is received by domestic films.<sup>74</sup> These numbers are an important incentive for Hollywood filmmakers to seek out Chinese companies to co-produce.

#### C. BOTH METHODS REQUIRE *GUAN-XI*

Each method carries along its risks and challenges. If foreign companies desire to do business in China, they need to

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<sup>68</sup> See WIKIPEDIA, *supra* note 16.

<sup>69</sup> See Cain, *supra* note 24. Robert Cain explains, that in 2006, after filming the scenes for the day, the film crew decided to shoot an outtake that humorously mocked the issue of illegal pirating in China. Although the shot was a joke not intended to be in the movie, the Censorship Board discovered the outtake, and the following day, immediately cancelled further production of the film. *Id.*

<sup>70</sup> See WIKIPEDIA, *supra* note 16.

<sup>71</sup> See *id.*

<sup>72</sup> See Lin, *supra* note 46.

<sup>73</sup> See Dan Harris, *Hollywood Goes China*, CHINA LAW BLOG (July 10, 2012), <http://www.chinalawblog.com/2012/07/hollywood-goes-china.html>.

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

adapt to China's preferences in business practice. Like any international business transaction, companies should welcome and respect the customs of the country in which they hope to negotiate. As New Yorker Dan Mintz explains:

We have many Chinese elements in our company [DMG Entertainment], but most important in our collaboration [between Hollywood and China] is taking time to getting to know one another through our filmmaking, through our international language, our common points. We need to make sure that our films meet the tastes of the Chinese audience. It's not enough to have the American viewpoint. We need to have the Chinese view.<sup>75</sup>

In China, foreign companies should understand the concept of *guan-xi* in order to improve their chances of getting into China's film market. *Guan-xi* literally translates to mean "connection," and is defined by the Oxford Dictionary as "the system of social networks and influential relationships that facilitate business and other dealings."<sup>76</sup> According to the Los Angeles Chinese Learning Center, obtaining the right *guan-xi* minimizes "risks, frustration, and disappointments when doing business in China."<sup>77</sup> The concept is essentially a "you scratch my back, I'll scratch yours" type of philosophy, such that a former party's favor will be remembered and paid back for by a latter party. *Guan-xi* is a deeply rooted, yet unwritten custom in China that applies in almost all relationships and not only between business

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<sup>75</sup> Jonathan Landreth, *China Co-Producers Share Views on the Future of the Business*, THE HOLLYWOOD REPORTER (June 13, 2011), <http://www.hollywoodreporter.com/news/china-producers-share-views-future-200797>.

<sup>76</sup> *Guanxi*, OXFORD DICTIONARY, [http://www.oxforddictionaries.com/us/definition/american\\_english/guanxi](http://www.oxforddictionaries.com/us/definition/american_english/guanxi) (last visited Jan. 6, 2016).

<sup>77</sup> *Guanxi*, INVESTOPEDIA, <http://www.investopedia.com/terms/g/guanxi.asp> (last visited Jan. 6, 2016).

partners, but family members as well.<sup>78</sup> *Guan-xi* relationships should be formed between the foreign company and Chinese government in order to connect with, and gain access into the industry.

*Guan-xi* resonates with both the traditional quota method and the alternative co-production method. Choosing to go through the quota system is a daunting and nearly impossible task if studios choose to navigate independently without the aid of a Chinese representative. At the macro level, any film that tells a story in a light favorable to Chinese audiences, and that pleases the Censorship Board, is arguably “scratching China’s back” in order to gain entry into its market. It may be speculated, or assumed that there are underground relationships with government members being formed in order to strengthen the likelihood of a film being approved.<sup>79</sup>

With co-productions, *guan-xi* is much more evident. The foreign company provides the Chinese with a complete film production. By filming at least one third of the film in China, foreign studios show the Chinese how they make films, introduce new technology, and share unique techniques and dynamic styles used in the production process.<sup>80</sup> The co-production also promotes Chinese talent and topography to gain exposure and stardom in box offices outside of China. As a result of such “back scratching,” the Censorship Board provides the foreign studio with higher returns in revenue, and a greater likelihood of approval for wide distribution throughout China.<sup>81</sup> Foreign companies should familiarize themselves with the correct companies and the correct people to talk to in order to establish *guan-xi*.

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<sup>78</sup> Lee C. Simmons & James M. Munch, *Is Relationship Marketing Culturally Bound: A Look at Guanxi in China* (1996), in NA - Advances in Consumer Research Volume 23, eds. Kim P. Corfman and John G. Lynch Jr., Provo, UT: ASSOCIATION FOR CONSUMER RESEARCH, Pg. 92-96, available at <http://www.acrwebsite.org/volumes/7922/volumes/v23/NA-23>.

Although personal relationships may exist without *guanxi*, business relationships are difficult for Chinese people to express in the absence of a *guanxi* relationship.

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

<sup>80</sup> See Sino-Foreign, *supra* note 59, at Article XIII. See also Cain, *supra* note 51.

<sup>81</sup> Harris, *supra* note 73.

#### D. HOW TO ESTABLISH *GUAN-XI*

There is an array of Chinese based companies with which foreign filmmakers may contract to create co-productions or bypass the quota system.<sup>82</sup> One trend is for Hollywood agents, managers, or business executives to relocate to China to establish an expertise in China's business practices and film industry so they can consult in assisted productions, or become the "Chinese company" that satisfies the criteria for co-productions. Robert Cain, Dan Mintz, the Huayi brothers, and Oriental Dreamworks are four such examples of the relocation trend.

##### 1. *Robert Cain of Pacific Bridge Pictures*

Robert Cain is an example of an expert who consults with Hollywood studios to assist productions in China. Cain is a producer consultant at Pacific Bridge Pictures, a contributive writer for ChinaFilmBiz.com, and he guides filmmakers through China's system.<sup>83</sup> He moved to China in 1987 and has since conducted business there, including helping to finance and distribute films such as *The Usual Suspects*, *Blade 2*, and *Cabin Fever*.<sup>84</sup> He emphasizes the heightened interest in seeking out official co-productions because "they can bypass the Chinese quota system and bring their distributors a 43 percent share of ticket sales, rather than the 25 percent allotted to foreign-made films."<sup>85</sup> As a local living in China, Cain is a resource who has developed a deep understanding of the industry, and has written dozens of articles from China's perspective that help Hollywood producers navigate through the process.

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<sup>82</sup> See Anousha Sakoui, *China Has Hollywood's Attention. It Wants More*, BLOOMBERG BUSINESS (Sept. 4, 2015, 9:45 AM), <http://www.bloomberg.com/news/articles/2015-09-04/china-has-hollywood-s-attention-it-wants-more>. Such companies include: Alibaba, Oriental Dreamworks, Disney, Viacom. *Id.*

<sup>83</sup> See *About Rob Cain*, CHINAFILMBIZ, <http://chinafilmbiz.com/about/> (last visited Jan. 6, 2016).

<sup>84</sup> See *id.*

<sup>85</sup> Cieply & Barnes, *supra* note 36.

## 2. *Dan Mintz and Dynamic Marketing Group Entertainment*

Dynamic Marketing Group Entertainment (DMG Entertainment), which has been very successful in creating a liaison relationship between Hollywood and China, is a Beijing based production company established in the 1990s that is best known for co-producing *Iron Man 3* (2013), *Looper* (2012), and *Transcendence* (2014).<sup>86</sup> DMG Entertainment has also been very successful aiding in the distribution of Hollywood blockbusters, such as *Twilight* and *Resident Evil 4* in China.<sup>87</sup>

Although DMG Entertainment is a Beijing company, CEO Dan Mintz, a New York native, provides a very approachable space for Hollywood filmmakers.<sup>88</sup> Mintz has been named Mr. China by *Forbes* magazine for his expertise in China's film industry, and for his tremendous success in the China film market, despite his foreign status.<sup>89</sup> Mintz's partners at DMG Entertainment include Bing Wu,<sup>90</sup> a prominent Chinese producer, and Peter Xiao, a financial expert of China's market.<sup>91</sup>

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<sup>86</sup> See Patrick Brzeski, *DMG's Dan Mintz on How to Work With China, Remaking 'Point Break' and Johnny Depp's Next Film*, THE HOLLYWOOD REPORTER (Nov. 25, 2013, 11:00 AM), <http://www.hollywoodreporter.com/news/dmgs-dan-mintz-how-work-659132>; see also Clifford Coonan, *DMG's Dan Mintz: Hollywood's Man in China*, VARIETY (June 5, 2014), <http://variety.com/2013/film/news/dmgs-dan-mintz-hollywoods-man-in-china-1200492311/>; see also Anousha Sakoui, *China's DMG Entertainment Seeks to Expand in Hollywood*, BLOOMBERG BUSINESS (Sep. 16, 2014), <http://www.bloomberg.com/news/articles/2014-09-16/china-s-dmg-entertainment-seeks-to-expand-in-hollywood>; see also *Talking Business*, *supra* note 8.

<sup>87</sup> See *Talking Business*, *supra* note 8.

<sup>88</sup> See Simon Montlake, *Hollywood's Mr China: Dan Mintz, DMG*, FORBES (Aug. 29, 2012), <http://www.forbes.com/sites/simonmontlake/2012/08/29/hollywoods-mr-china-dan-mintz-dmg/>.

<sup>89</sup> See *id.*

<sup>90</sup> See Bing Wu, IMDB, <http://www.imdb.com/name/nm0082895/> (last visited Jan. 6, 2016).

<sup>91</sup> See Jamie Bryan, *The Mintz Dynasty*, FAST COMPANY, <http://www.fastcompany.com/56104/mintz-dynasty> (last visited Jan. 6, 2016). An agent from Creative Artist's Agency in Hollywood says, "Let's put it this way . . . the Chinese market is driven by relationships,



Xiao is not only a “financial guy,” his family is connected to the military, which provides access to those at the “highest level of relationships.”<sup>92</sup> As a resident of China for over two decades, Mintz understands Chinese culture and understands the importance of *guan-xi*.<sup>93</sup> In a statement to FastCompany.com, Mintz explains:

China has become a modern country, but we're still talking about 5,000 years of history. It's not like they go around quoting Confucius every five minutes, but the Chinese inherently think in terms of building a strong power base for the future, because if you crumble under the pressure of China, they will have helped you for nothing. So they've got to know two things: 1) that you understand how to build relationships in China, because it's done very differently than back home, and 2) that you have the juice, the strength, the contacts, and the understanding to be able to withstand the test of time.<sup>94</sup>

The second element tacks a different concept onto *guan-xi*, which Mintz calls *shi-li*.<sup>95</sup> *Shi-li* emphasizes motivation and drive to produce good work; a distinction Mintz insists is required in modern day China, as compared to old China.<sup>96</sup>

### 3. *Huayi Brothers*

According to Hollywood entertainment sources, the Huayi Brothers Media Corporation (Huayi Brothers) holds the

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and the relationships that Dan and his firm don't have are probably the only ones you don't need." *Id.*

<sup>92</sup> *Id.* Russell Flannery, *DMG's Backdoor Listing Turns Peter Xiao into China's Latest Billionaire*, FORBES (Nov. 16, 2014), <http://www.forbes.com/sites/russellflannery/2014/11/16/dmgs-backdoor-listing-turns-peter-xiao-into-chinas-latest-billionaire/>.

<sup>93</sup> See Bryan, *supra* note 91.

<sup>94</sup> *Id.*

<sup>95</sup> See *id.*

<sup>96</sup> See *id.*

record as China's largest privately held film firm to date.<sup>97</sup> The company is changing the landscape of the business by showing that Chinese companies are now more welcoming and able to promise long-term deals with foreign companies. As of April 2015, the company officially signed a deal to partner with STX Entertainment for three years, to produce 12 to 15 projects per year.<sup>98</sup> This does not mean the filmmaking process will be any easier for STX Entertainment. They will still need to ensure the Censorship Board is satisfied at every step. Nevertheless, signing a three-year business deal with the Huayi Brothers is significant enough to provide STX Entertainment with the comfort of knowing they have established *guan-xi* with a Chinese company for the long-term.<sup>99</sup>

#### 4. *Oriental DreamWorks*

Hollywood studios are also shifting their business practices to China by creating joint ventures with Chinese companies, thereby satisfying the co-production requirement. Oriental DreamWorks is a recently opened joint venture based in Shanghai, which includes DreamWorks Animation, China Media Capital, Shanghai Media Group, and Shanghai Alliance

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<sup>97</sup> See Anita Busch & Nancy Taraglione, *STX Entertainment Pacts with China's Huayi Bros For 12-15 Pics Per Year*, DEADLINE HOLLYWOOD (Apr. 1, 2015), <http://deadline.com/2015/04/stx-entertainment-china-huayi-bros-produce-12-to-15-films-per-year-1201402506/>.

<sup>98</sup> See *id.*

<sup>99</sup> See *id.* Similar deals between US and Chinese companies are starting to trend. For example, Village Roadshow made a deal with Hairun Pictures on April 20, 2015. See also Ali Jaafar, *Village Roadshow Inks Five-Picture Deal With China's Beijing Hairun Pictures*, DEADLINE HOLLYWOOD (Apr. 20, 2015), <http://deadline.com/2015/04/village-roadshow-inks-five-picture-deal-with-chinas-beijing-hairun-pictures-1201412799/>. Also, former Disney Chairman Dick Cook recently embarked on his newest venture, Dick Cook Studios, with Citic Guoan Group Co. LTD., a division of the Chinese conglomerate, Citic Group. See Ali Jaafar, *Dick Cook Launches New Company with \$150 Million Investment from China's Citic Guoan*, DEADLINE HOLLYWOOD (Apr. 20, 2015), <http://deadline.com/2015/04/dick-cook-china-citic-guoan-disney-huayi-lionsgate-hunan-1201412769/>.

Investment.<sup>100</sup> The goal of Oriental DreamWorks is “to create films that are based on Chinese stories, made by Chinese people, for the Chinese people.”<sup>101</sup> This tactic is a beneficial investment because it provides DreamWorks Animation a foot in the door with China to co-produce with its partners, and bypass the strict quota system.<sup>102</sup> For example, in April 2015, DreamWorks’ *Kung Fu Panda 3* (2016) became the first animated film to ever receive official co-production status.<sup>103</sup> They initiated the process by submitting scripts to the Censorship Board in advance, and invited representatives to be present on set to guard against deviation.<sup>104</sup> Oriental DreamWorks is the prime example of bringing foreign studios and businesses into China to create strong *guan-xi* in a mutually beneficial relationship between

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<sup>100</sup> See *Contact Information*, ORIENTAL DREAMWORKS, <http://www.oriental-dreamworks.com/contact-information> (last visited Jan. 7, 2016).

<sup>101</sup> Interview with an insider at Oriental DreamWorks, publicist, at DreamWorks Studios (Mar. 2015); see also Clarence Tsui, ‘*Kung Fu Panda 3*’ to Begin Production in August, THE HOLLYWOOD REPORTER (June 17, 2013, 9:13 AM), <http://www.hollywoodreporter.com/news/kung-fu-panda-3-begin-569896>.

<sup>102</sup> Patrick Frater, *Live-Action Features, Animated TV, Reality Shows Added, Set to Accelerate Income*, VARIETY (Sep. 16, 2013), <http://variety.com/2013/film/asia/oriental-dreamworks-rewrites-its-china-production-strategy-1200601504/>.

<sup>103</sup> See Daniel Paul, *Future American-Chinese Blockbuster Kung Fu Panda 3 Gets Same Release Date in US and China*, Jan. 29, 2016, SHANGHAIIST (Nov. 5, 2015, 2:30 PM), [http://shanghaiist.com/2015/11/05/kung\\_fu\\_panda\\_3\\_release\\_date.php](http://shanghaiist.com/2015/11/05/kung_fu_panda_3_release_date.php). *Kung Fu Panda 3* is set to be the first major American animated feature co-produced with China and is the result of collaboration between DreamWorks and its Chinese counterpart Oriental DreamWorks. See also Tsui, *supra* note 101.

<sup>104</sup> Cieply & Barnes, *supra* note 36. “[T]here is an unofficial expectation that the government’s approved version of the film will be seen both in China and elsewhere, though in practice it is not unusual for co-productions to slip through the system with differing versions, one for China, one for elsewhere in the world.” *Id.*

DreamWorks Animation and China's film industry.

Creating co-productions with companies, such as those listed above, increases the odds that a film will be approved for distribution in China, but it does not guarantee that privilege. Even with the help of such companies, producers should be as courteous and cooperative with the Censorship Board as possible. This entails submitting scripts prior to shooting, altering scripts or storylines to better suit the viewpoints of the Chinese, allowing Chinese bureaucrats on set during filming to observe the production, and inviting their critiques throughout the process. When the potential reward for a co-production is so profitable, it is wise to ensure a strong *guan-xi* relationship at every aspect of the filmmaking process to ensure the film is approved.

### III. EFFECTS AND CONSEQUENCES OF CHINA'S CENSORSHIP SYSTEM

It is difficult to pinpoint the exact motivations behind China's emphasis on censorship, but many critics have commented on the issue. Robert Cain attempts to explain:

Censorship [in China] is designed not only to protect the innocent, but even more to protect the status quo of authoritarian rule. No distinction is made between children and adults; the government holds the ultimate right to decide what content is "appropriate" and therefore available for viewing, irrespective of the viewer's age.<sup>105</sup>

By maintaining this sort of power over the content distributed in China, the government can control—or at the very least attempt to control—the attitudes of the Chinese audience.

#### A. THE 2012 FOREIGN FILM BLACKOUT AND CHINA'S URGE TO PROMOTE DOMESTIC ECONOMIC GROWTH

The Censorship Board has an interest and a desire to promote the profits of locally produced films. China, like many countries, often fears the potential for Hollywood films to swallow up the whole Chinese market to the detriment of Chinese films.<sup>106</sup> In an attempt to address this issue, SARFT

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<sup>105</sup> SARFT 101, *supra* note 39.

<sup>106</sup> See Stanley Rosen, *How Hollywood and the Chinese Film Industry are Eyeing Each Other Off*, THE SYDNEY MORNING HERALD

imposed a three-month summer “domestic film protection” period in 2012, which created a blackout of foreign films, thereby providing local Chinese films and Chinese language co-productions the opportunity to succeed in the market without competition against outside films.<sup>107</sup> Initial results appeared promising. The Chinese film *Painted Skin: Resurrection* (2012) received the highest grossing debut ever for a Chinese language film during the blackout.<sup>108</sup> However, the success did not last long. China’s box offices suffered one of the worst losses of box office revenues in history, and audience attendance diminished drastically.<sup>109</sup>

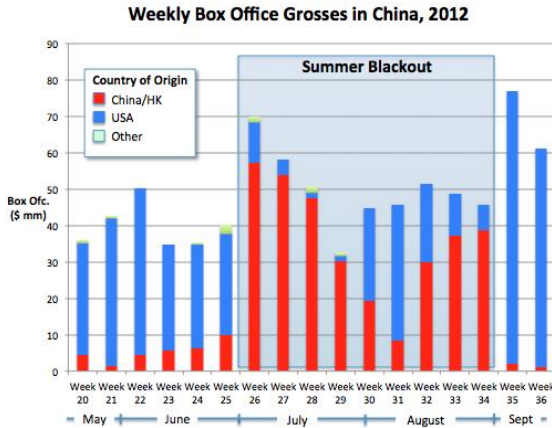
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(June 5, 2015), <http://www.smh.com.au/entertainment/how-hollywood-and-the-chinese-film-industry-are-eyeing-each-other-off-20150603-ghfly9.html#ixzz3vDBHYs3f> (explaining that despite the quota increase since 2012, the Chinese government enacts various administrative measures to try to ensure domestic films gain at least 50 percent of the market).

<sup>107</sup> Bilge Ebiri, *China's Film Industry Is Gaining on Hollywood*, BLOOMBERG (July 30, 2015), <http://www.bloomberg.com/news/articles/2015-07-30/china-s-homegrown-film-industry-gains-on-hollywood>. There are three blackouts annually—one during the Lunar New Year, or spring festival period in February; one in mid-to-late summer, after the first wave of Hollywood summer releases open in China; and one in December. *Id.*

<sup>108</sup> Robert Cain, *6 Key Lessons from SARFT's Foreign Film Blackout*, INA GLOBAL (Oct. 25, 2012), <http://www.inaglobal.fr/en/cinema/article/6-key-lessons-sarft-s-foreign-film-blackout> (last updated Nov. 6, 2012) [hereinafter *6 Key Lessons*].

<sup>109</sup> *See id.* (stating, “July was down by 9 percent, and August was down by 8 percent, even though China has thousands more screens operating now than it did a year ago.”).



The chart depicts the sudden increase and decline of China and Hong Kong films during the Summer Blackout. In addition, the chart depicts the non-existence of USA films, which may have contributed to China's domestic success and decline, and the resulting change upon USA film reintroduction.

SARFT insists its intention was to promote domestic films, and not necessarily to stifle the profits of Hollywood movies.<sup>110</sup> However, as a result of the blackout, tent-pole films, such as *The Amazing Spider-Man* and *The Dark Knight Rises*, which initially had different opening dates, were released simultaneously, effectively forcing the two films to compete against each other and "crush" each other's revenues.<sup>111</sup> The same event occurred with animated feature films *Ice Age: Continental Drift* and *The Lorax*, which opened in Chinese theatres jointly in the same weekend.<sup>112</sup> Nevertheless, both films produced global profits and were successful. *Ice Age* grossed over \$72 million, becoming the second-highest total ever for an animated feature film in China.<sup>113</sup> Moreover, all of these films, plus many other foreign films, are listed as among China's

<sup>110</sup> See *id.*

<sup>111</sup> See *id.* See also Ben Fritz et al., *China Blockbusters Face off on Same Days*, L.A TIMES (Aug. 28, 2012), <http://articles.latimes.com/print/2012/aug/28/entertainment/la-et-ct-china-movies-20120828>.

<sup>112</sup> 6 *Key Lessons*, *supra* note 108.

<sup>113</sup> *Id.*

twelve top-grossing films of the year in 2012.<sup>114</sup>

Robert Cain suggests the blackout revealed several issues with China's film industry, which leaves room for improvement.<sup>115</sup> First, it revealed that Chinese films do not meet the expectations of domestic Chinese audiences as successfully as Hollywood films. Cain states, "[o]nly *Painted Skin 2* reached that level [\$75-100 million], and no other Chinese summer release earned even \$40 million. More than half the Chinese films that opened during the blackout earned less than \$1 million."<sup>116</sup> Despite SARFT's efforts, the blackout was not as successful as it hoped, due to the lack of ability by the Chinese to produce films at the same level as Hollywood. Second, the blackout deprived Chinese audiences of Hollywood films, which led to a greater demand and anticipation for their eventual release. The week that *Spider-Man* and *The Dark Knight* opened in theatres was the second-highest grossing week in China's history, with attendance nearly doubling from the week before.<sup>117</sup>

Cain predicted that blackouts would be a recurring "solution" by SARFT, and by extension, the CPC would continue to control the economy of the film industry without violating any WTO agreements.<sup>118</sup> Blackouts may be the best way for regulators to balance their desire to produce a successful local film industry, while still preserving international obligations.<sup>119</sup> Most recently, China again implemented a film

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<sup>114</sup> *Id.*

<sup>115</sup> *Id.*

<sup>116</sup> *Id.*

<sup>117</sup> *Id.*

<sup>118</sup> *Id.* Cain suggests that China's films czars are determined to protect the market for local Chinese films, largely for political reasons. It's extremely irksome to the Communist Party propagandists that Chinese moviegoers strongly prefer Hollywood movies with their "corrupt" western values over censored and 'politically correct' Chinese films. Blackouts seem to be the most effective method for the party to ensure that they retain some cultural influence without breaking their WTO commitments. *Id.*

<sup>119</sup> *Id.*

industry blackout during the summer of 2015.<sup>120</sup> Because of its success, SARFT will likely make blackouts recurring to boost local film sales.<sup>121</sup>

Despite the blackouts, the Internet is a force that remains a concern for the Chinese Censorship Board. The limit on foreign films in Chinese box offices causes Chinese audiences to redirect to video-streaming sites to illegally pirate the films.<sup>122</sup> It may be speculated that the blackout encouraged more illegal piracy and streaming by Chinese audiences.<sup>123</sup>

#### IV. PATTERNS OF THE CENSORSHIP BOARD'S DECISIONS

The Censorship Board does not specify the criteria it seeks when approving films for release into China's market. An analysis of domestic and foreign films, which attempted to distribute in China, establishes a pattern to better explain the government's decisions.

##### A. FILMS NOT RELEASED IN CHINA

A review of films that were not distributed in China within the past decade suggests the Censorship Board has logical reasons for rejecting a film.<sup>124</sup> The following films did not release in China for a wide range of reasons.

##### 1. *Non Co-Produced Films*

*Farewell My Concubine* (1993) was a domestically

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<sup>120</sup> Robert Cain, *China's National Summer Blackout is a Roaring Success*, FORBES (Aug. 1, 2015), <http://www.forbes.com/sites/robccain/2015/08/01/chinas-national-summer-blackout-is-a-roaring-success/>.

<sup>121</sup> *Id.*

<sup>122</sup> See Lin, *supra* note 46.

<sup>123</sup> See Oliver Ting, *Pirates and the Orient: China, Film Piracy, and Hollywood*, 14 JEFFREY S. MOORAD SPORTS L.J. 399, 414, n. 70 (2007), <http://digitalcommons.law.villanova.edu/cgi/viewcontent.cgi?article=1086&context=mslj> (last visited Dec. 1, 2015).

<sup>124</sup> See, e.g., *List of Films Banned in China, Hong Kong and Taiwan*, IMDB (Oct. 13, 2014), <http://www.imdb.com/list/ls077956148/> (last visited Jan. 11, 2016); see also, e.g., *List of Banned Films*, WIKIPEDIA, [http://en.wikipedia.org/wiki/List\\_of\\_banned\\_films#People.27s\\_Republic\\_of\\_China](http://en.wikipedia.org/wiki/List_of_banned_films#People.27s_Republic_of_China) (last visited Jan. 11, 2016).



produced Chinese film banned by the Censorship Board.<sup>125</sup> The film followed the lives of two Peking Opera actors through five turbulent decades of recent Chinese history.<sup>126</sup> Despite attaining initial approval for a censored version to distribute in China, authorities abruptly halted its distribution only weeks prior to its arranged release, without offering an explanation.<sup>127</sup> Most disheartening was the fact that the film was the first Chinese film to win the top prize at the Cannes International Film Festival, along with many other awards when it released in countries such as the U.S.<sup>128</sup> The Censorship Board appeared concerned for parts of the film that dealt with homosexuality and suicide, during the 1977 Communist period under the rule of current Chinese leaders, such as Deng Xiaoping.<sup>129</sup>

*The Departed* (2006) was a Hollywood film banned in China, despite being a remake of the Hong Kong film, *Infernal Affairs* (2002).<sup>130</sup> The Censorship Board told the Hong Kong distributors, Media Asia Entertainment, that the film was “unsuitable for Chinese audiences, though it gave no reason.”<sup>131</sup> This film is interesting for at least two reasons. First, the film was an adaptation of a Chinese film, leading some to assume the film would easily be approved. Unlike the original, however, *The Departed* included an additional subplot involving a crime

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<sup>125</sup> *Banned Mainland Films*, HKFILMS.150M.COM, <http://hkfilms.150m.com/Chinese/bannedmainlandfilms> (last visited Jan. 11, 2016).

<sup>126</sup> *Id.*

<sup>127</sup> The film was rated R in the US. See *Farewell My Concubine*, IMDB, <http://www.imdb.com/title/tt0106332/> (last visited Dec. 1, 2015).

<sup>128</sup> Nicholas D. Kristof, *China Bans One of its Own Films; Cannes Festival Gave it Top Prize*, N.Y. TIMES (Aug. 4, 1993), <http://www.nytimes.com/1993/08/04/movies/china-bans-one-of-its-own-films-cannes-festival-gave-it-top-prize.html>.

<sup>129</sup> *Id.*

<sup>130</sup> ‘*Departed*’ Banned from China Theaters, USA TODAY (Jan. 18, 2007), [http://usatoday30.usatoday.com/life/movies/news/2007-01-18-departed-china\\_x.htm](http://usatoday30.usatoday.com/life/movies/news/2007-01-18-departed-china_x.htm).

<sup>131</sup> *Id.* The film was Rated R in the US. *The Departed*, IMDB, <http://www.imdb.com/title/tt0407887/> (last visited Dec. 1, 2015).

boss who sold stolen missile-guidance microprocessors to the Chinese government.<sup>132</sup> This plot undoubtedly upset the Censorship Board. An official told reporters:

There is no chance *The Departed* will be shown in mainland [China] cinemas because the US side declined to change a plot line... That part of the plot is definitely unnecessary. The regulators just cannot understand why the movie wanted to involve China. They can talk about Iran or Iraq or whatever, but there's no reason to get China in.<sup>133</sup>

Second, the film was rejected even before it was submitted to the Censorship Board for review.<sup>134</sup> This example emphasizes the CPC's sensitivities towards corruption, and portraying China in a negative light. Despite the ban in Chinese markets, the film performed well in other box offices, earning approximately \$250 million worldwide.<sup>135</sup>

*Memoirs of a Geisha* (2005) was a Hollywood film that was banned, despite starring Chinese actresses Zhang Ziyi and Gong Li.<sup>136</sup> The Censorship Board feared that a portrayal of Chinese as Japanese courtesans was offensive to Chinese viewers, and could potentially produce Sino-Japanese tensions.<sup>137</sup> The decision to reject this film for distribution may reasonably be concluded as politically motivated due to national security concerns.

*Pirates of the Caribbean: Dead Man's Chest* (*Pirates II*) (2006) was a Hollywood film banned in China, despite the franchises' earlier success getting *Pirates of the Caribbean: The*

<sup>132</sup> Shu-Ching Jean Chen, *Scorsese's China Problem*, FORBES (Jan. 1, 2007), [http://www.forbes.com/2007/01/23/scorsese-china-movies-face-lead-cx\\_jc\\_0123autofacescan02.html](http://www.forbes.com/2007/01/23/scorsese-china-movies-face-lead-cx_jc_0123autofacescan02.html).

<sup>133</sup> *'The Departed' Banned in China?*, HOLLYWOOD.COM, <http://www.hollywood.com/news/movies/3609368/the-departed-banned-in-china?page=all> (last visited Dec. 1, 2015).

<sup>134</sup> *'Departed' Banned*, *supra* note 130.

<sup>135</sup> *Id.*

<sup>136</sup> *See Dark Knight Won't Be on Big Screen in China*, CBCNEWS (Dec. 26, 2008), <http://www.cbc.ca/news/arts/dark-knight-won-t-be-on-big-screen-in-china-1.740993>.

<sup>137</sup> *Id.*

*Curse of the Black Pearl (Pirates I)* admitted.<sup>138</sup> What is interesting about this film is that *Pirates II* was rated PG-13 in the U.S.<sup>139</sup> Although PG-13 does not equate to “suitable for all ages” in the U.S., it is a lower restriction than the R ratings of both *Farewell My Concubine* and *The Departed*. The film was still not permitted for distribution in China.<sup>140</sup> *The Shanghai Daily* reported that the ban was a result of objection to the portrayal of human cannibalism,<sup>141</sup> and ghosts that were offensive to the Chinese.<sup>142</sup> The CPC could reasonably consider the content not “suitable for all audiences,” or perhaps its implications were to the Chinese what the U.S. would consider “obscene.” However, an official from SARFT commented that the government did not ban the film; and instead, the film was never submitted to the agency for approval.<sup>143</sup>

*Pirates II* also illustrates just how risky and unpredictable it is to distribute in China. SARFT has the unequivocal power and discretion to approve or reject films without consideration to its prior decisions. SARFT follows no precedent or rule of law in exercising its decision-making authority to approve or ban films. *The Da Vinci Code* (2006), for example, was a Hollywood film initially approved for distribution in China, which SARFT abruptly overturned and

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<sup>138</sup> See *China Sinks Dead Man's Chest*, THE GUARDIAN (July 10 2006), <http://www.theguardian.com/film/2006/jul/10/news1>

<sup>139</sup> *Parents Guide for Pirates of the Caribbean: Dead Man's Chest*, IMDB, [http://www.imdb.com/title/tt0383574/parentalguide?ref\\_=tt\\_stry\\_pg#certification](http://www.imdb.com/title/tt0383574/parentalguide?ref_=tt_stry_pg#certification) (last visited Jan. 11, 2016).

<sup>140</sup> Nate Saienni, *China's Ban on Ghosts in Movies Deals Another Blow to Crimson Peak*, FILMSCHOOLREJECTS.COM (Oct. 21, 2015), <http://filmschoolrejects.com/news/crimson-peak-china-ban-ghosts.php>.

<sup>141</sup> See *China Sinks*, *supra* note 138.

<sup>142</sup> *'Pirates of the Caribbean' Banned by Chinese Censors*, JAMAICA GLEANER (July 11, 2006), <http://old.jamaica-gleaner.com/gleaner/20060711/ent/ent3.html>.

<sup>143</sup> *'Pirates of the Caribbean' Not Banned in China*, PRAVDA.RU (July 7, 2006), <http://english.pravda.ru/news/world/10-07-2006/83113-china-0/>.

forced out of cinemas only weeks after it opened.<sup>144</sup> Another example is *Django Unchained* (2013). *Django Unchained* was a unique case, where for the first time, SARFT cancelled screenings of the film on its opening day while it was being screened.<sup>145</sup> Chinese cinema-goers were watching the film in theaters, when suddenly, the broadcast stopped.<sup>146</sup> For fans of Quentin Tarantino films, it was no surprise that *Django*, like many of his other works, would be vulgar, graphic and very provocative. Apparently, this fact was overlooked by SARFT before its wide release. SARFT's authority to force an instantaneously stop of screenings throughout China quickly corrected the mistake.

## 2. Co-Produced Films

The following are examples where Hollywood studios signed co-production deals with Chinese companies, hoping to guarantee distribution in China, but still failed to gain Censorship Board approval.

For *The Mummy: Tomb of the Dragon Emperor* (*Mummy 3*) (2008), Universal Pictures Hollywood co-produced the film with Chinese company Shanghai Film Group, but approval for distribution in China was retracted and delayed.<sup>147</sup> The film was among the first projects to co-produce with a Chinese company and star Chinese superstar Jet Li.<sup>148</sup> *Mummy 3* was a historical fantasy set in 1946 about an evil Chinese emperor who is magically resurrected by the sequel's foreign

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<sup>144</sup> *Chinese Ban Da Vinci Code Movie*, BBC NEWS (June 8, 2006), <http://news.bbc.co.uk/2/hi/entertainment/5059658.stm>.

<sup>145</sup> Clarence Tsui, *Chinese Moviegoers Turn to Piracy After 'Django' Ban*, THE HOLLYWOOD REPORTER (Apr. 11, 2013), <http://www.hollywoodreporter.com/news/chinese-moviegoers-turn-piracy-django-437802>.

<sup>146</sup> *Django Unchained Opening Cancelled in China*, BBC NEWS (Apr. 11, 2013), <http://www.bbc.com/news/entertainment-arts-22105591>.

<sup>147</sup> Patrick Frater & Clifford Coonan, *China Unwraps 'The Mummy' Ban*, VARIETY (July 15, 2008), <http://variety.com/2008/film/asia/china-unwraps-the-mummy-ban-1117988983/>.

<sup>148</sup> Matt Holmes, *China Lift The Mummy 3 Ban*, WHATCULTURE.COM, <http://whatculture.com/film/china-lift-the-mummy-3-ban.php> (last visited Jan. 11, 2016).

adventurers.<sup>149</sup> The film was shot on location throughout China, and included many famous landmarks, such as The Great Wall of China and the Terracotta Army.<sup>150</sup> The Censorship Board preapproved the script with only minor changes, such as altering the name of the emperor to a fictional character that did not resemble Mao Zedong.<sup>151</sup> However, upon completion and despite initial approval, the film's release date was postponed due to its underlying plot of "White Westerners saving China."<sup>152</sup> The release delay in China caused a substantial decrease in box office profits because audiences in China resorted to pirated versions.<sup>153</sup>

*The Karate Kid* (2010) was a co-production between Sony Pictures and CFG, which was not approved by SARFT until drastic changes were made to the original version, to create a Chinese version suitable for Chinese audiences.<sup>154</sup> The film starred Chinese superstar Jackie Chan and Will Smith's son Jaden Smith, in a story about a Chinese Kung-Fu master training an African-American boy to become a martial artist in China.<sup>155</sup> The producers submitted the script to SARFT for preapproval, dutifully altered parts of the story to suit SARFT's interests, and even invited Chinese bureaucrats on set during filming to oversee its progress.<sup>156</sup> Prospects for the film's release appeared well throughout the process.<sup>157</sup> Nevertheless, upon completion,

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<sup>149</sup> Cieply & Barnes, *supra* note 36.

<sup>150</sup> *Id.*

<sup>151</sup> *Id.*

<sup>152</sup> *Id.*

<sup>153</sup> *Id.* Director of *The Mummy: Tomb of the Dragon Emperor* Rob Cohen states, "[a]ny movie about China made by outsiders is going to be very sensitive." *Id.*

<sup>154</sup> YIMWAN WANG, REMAKING CHINESE CINEMA: THROUGH THE PRISM OF SHANGHAI, HONG KONG, AND HOLLYWOOD 145 (2013).

<sup>155</sup> See John Horn, 'Karate Kid' Update Breaks Down Some Chinese Walls, L.A. TIMES (May 30, 2010), <http://articles.latimes.com/2010/may/30/entertainment/la-ca-karatekid-20100530>.

<sup>156</sup> *Id.*

<sup>157</sup> *Id.*

the film was rejected because the film bureaucrats found the Chinese villains to be unsettling.<sup>158</sup> As a result, producers were forced to delete many scenes and severely alter the story line to better suit the preference of Chinese audiences.<sup>159</sup> First, many of the provoking school fight scenes were deleted to portray the Chinese students less violent and not as bullies.

[Lunch room of hallway fight scenes at school] were all made shorter or cut out. This drastically changed the story. In the American version, the Chinese students brutally pick on the poor foreign boy. This makes the Chinese characters look very violent and petty, viciously picking on the new guy for no apparent reason. In the edited for Chinese audiences version, the Chinese students do not fight him unless provoked . . . . Without the violence between these two fights, it makes the American look bad.<sup>160</sup>

Additionally, the Kung Fu master in the Chinese version was less of a barbaric, in-it-to-win-it coach, and more of a wise strong master.<sup>161</sup> Deleting scenes that portrayed the Kung Fu master as a bloodthirsty coach resulted in some continuity issues when dialogue of a “bad teacher” appeared.<sup>162</sup> The Chinese version placed the antagonistic Chinese in the background and altered the film to be one about self-realization, instead of a film about the rivalry between American and Chinese Kung Fu kids.<sup>163</sup> The film was not well received by Chinese audiences because of continuity issues after deleting vital scenes. Many likely flocked to illegal piracy sites to download and stream the original version.

The previously listed films suggest that simply signing a co-production deal with a Chinese company does not guarantee

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<sup>158</sup> *Id.*

<sup>159</sup> *Chinese Censoring of the Karate Kid*, SHANGDONGXIFU’S BLOG (July 24, 2010), <https://shandongxifu.wordpress.com/2010/07/24/chinese-censoring-of-the-karate-kid/> (last visited Jan. 11, 2016).

<sup>160</sup> *Id.*

<sup>161</sup> *Id.*

<sup>162</sup> *Id.*

<sup>163</sup> *Id.*

the film will be distributed in China. Even welcoming the Censorship Board's hands-on oversight during the production process is not a guarantee. It is important to ensure the film's messages, or any subplots in the film, do not offend the Chinese people or its government, and must be from China's perspective.

## B. FILMS RELEASED IN CHINA

### 1. *Foreign Film Successfully Approved by SARFT*

*Mission: Impossible III* (2006), an American film produced by Paramount Pictures, with the assistance of CFG, chose the traditional method of entry into China through the quota system.<sup>164</sup> One-third of the film was shot in Shanghai to appease Chinese audiences.<sup>165</sup> However, it was approved for distribution only after Paramount agreed to cut parts that the Censorship Board found insulting; specifically, these were scenes of laundry hanging from washing lines and old people playing mahjong.<sup>166</sup> Although the depictions of clothes outside windows or aged game players may appear insignificant, SARFT was sensitive to the matter because they felt it painted the Chinese in a negative light.<sup>167</sup> Paramount made the correct decision to abide by SARFT's preferences, as a sign of compromise and respect to *guan-xi*. The film was very profitable.<sup>168</sup>

### 2. *Learning From Mistakes and Ensuring a China Release*

To reinforce Dan Mintz' point, whether studios choose the traditional quota method, or the alternative co-production method, it is imperative for production studios to strongly consider distribution in China to make a film more profitable. The following are two film sequels that restructured their production methods after a few failed attempts, to ensure the

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<sup>164</sup> See *China Film Co-Production Corporation [cn]*, IMDB, <http://www.imdb.com/company/co0078389/> (last visited Jan. 11, 2016) (note "with the assistance of" as opposed to "co-production").

<sup>165</sup> *China Sinks*, *supra* note 138.

<sup>166</sup> *Id.*

<sup>167</sup> *Id.*

<sup>168</sup> *Id.*

films entered the Chinese market.

*Resident Evil: Afterlife* (*Resident Evil 4*) (2010) decided to hire DMG Entertainment for distribution in China after noticing that *Resident Evil 1*, *2*, and *3* were all rejected.<sup>169</sup> The producers took an additional step to tailor to Chinese audiences by shooting the film in 3D, which is very popular in China.<sup>170</sup> As a result, *Resident Evil 4* was the highest-grossing edition of the series.<sup>171</sup>

It is possible that producers for *Pirates of the Caribbean: At World's End* (*Pirates III*) may have taken notice of SARFT's ban of *Pirates II*, and took steps to try to ensure *Pirates III* would gain entry into China.<sup>172</sup> Disney contracted with CFG to co-produce the film, and thereby attempted to establish a safeguarded way into Chinese markets.<sup>173</sup> They also casted Hong Kong superstar Chow Yunfat to star as the Singapore pirate Captain Sao Feng.<sup>174</sup> Like *Karate Kid*, Disney even cut scenes from its original version to create a Chinese version with less violence and content potentially offensive to the Chinese.<sup>175</sup> Chow was featured in 20 minutes of the original version, whereas in the Chinese version his scenes were cut down to 10 minutes.<sup>176</sup> A SARFT official explains the deleted scenes were made according to China's "relevant regulations on film censorship" and "China's actual conditions."<sup>177</sup> However, although producers promised the cuts would not "impair either the continuity of plot or the image of the characters," deleting scenes like Chow's recitation of a poem in Cantonese resulted in

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<sup>169</sup> Jonathan Landreth, *Exclusive: 'Resident Evil: Afterlife' to Open on 1,000-Plus 3D Screens in China*, The Hollywood Reporter (Nov. 4, 2010), <http://www.hollywoodreporter.com/news/resident-evil-afterlife-open-1000-35918>.

<sup>170</sup> *Id.*

<sup>171</sup> See *Resident Evil*, BOX OFFICE MOJO FRANCHISES, <http://www.boxofficemojo.com/franchises/chart/?id=residentevil.htm> (last visited Dec. 1, 2015).

<sup>172</sup> See Saienni, *supra* note 140.

<sup>173</sup> *Disney's 'Pirates 3' Slashed in China*, CHINA DAILY (June 15, 2007), [http://www.chinadaily.com.cn/china/2007-06/15/content\\_895296.htm](http://www.chinadaily.com.cn/china/2007-06/15/content_895296.htm).

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

<sup>175</sup> *Id.*

<sup>176</sup> *Id.*

<sup>177</sup> *Id.*



inconsistent storylines and confused Chinese audiences.<sup>178</sup> For these reasons, like *Karate Kid*, the censorship likely led Chinese audiences to turn to the Internet to illegally watch the Hollywood version.

Indeed, Disney took appropriate steps to consider *guan-xi* and how not to offend Chinese audiences. However, they still failed to consider the Chinese's perspective. Even though the edited version may have satisfied the Censorship Board, Chinese audiences still highly criticized the film as offensive.<sup>179</sup> The portrayal of Chow's character as scarred, bald, with a long beard and long nails, and dressed in a Qing dynasty costume, was "demonizing" to the Chinese, and the film may have appeared to portray "the image of the Chinese in the eyes of Hollywood producers."<sup>180</sup> This issue illustrates the often-difficult task of foreign studios incorporating more Chinese elements into a film to satisfy a co-production, while also making sure they are portraying such elements as the Chinese would prefer to see it. Foreign studios must fully understand Chinese culture, as well as its people, before trying to depict them on screen.

### 3. *The Iron Man 3 Exception to Co-Production*

*Iron Man 3* (2013) is perhaps the most widely known success story regarding joint ventures between Hollywood's Walt Disney Co., Marvel Studios, and China's DMG Entertainment. The film made \$1.2 billion worldwide, raking in \$21.1 million from China alone on its opening day, making it the biggest opening day ever in Chinese history, despite being a

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<sup>178</sup> *Id.* (stating many viewers expressed similar opinions on the internet); see also *China Censors 'Cut' Pirates Film*, BBC NEWS (June 12, 2007), <http://news.bbc.co.uk/2/hi/entertainment/6744245.stm>; see also *Pirates of the Caribbean Censored by China*, CHINATOWNCONNECTION.COM (June 15, 2007), <http://www.chinatownconnection.com/pirates-caribbean-censor-china.htm>.

<sup>179</sup> *China Censors*, *supra* note 178.

<sup>180</sup> *Id.*

Wednesday.<sup>181</sup> By working closely with the Chinese government, *Iron Man 3* secured many of the benefits afforded to co-productions, such as: (1) day-and-date release that precedes the US release date, (2) year-long early promotion of the film, rather than the typical 2-3 week marketing window prior to release, and (3) a high degree of media access in China typically reserved for high-profile Chinese films.<sup>182</sup> This production did not apply for *official* co-production status, however.<sup>183</sup> Robert Cain suggests that the producers may have taken this approach in order to limit creative control by the Chinese government.<sup>184</sup> Statistically speaking, with *Pirates III* being an example, co-productions that were well received in one territory were not popular in others.<sup>185</sup> *Iron Man 3* producers wanted to ensure its success globally in all regions.<sup>186</sup>

Despite the choice not to file for co-production status, *Iron Man 3* producers did dedicate a strong level of *guan-xi* to Chinese audiences, which resulted in its profitable distribution in

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<sup>181</sup> Pamela McClintock, '*Iron Man 3* Breaks Records in China', THE HOLLYWOOD REPORTER (May 2, 2013), <http://www.hollywoodreporter.com/news/box-office-report-iron-man-450932>; Clarence Tsui, '*Iron Man 3* Smashes China's Box Office', THE HOLLYWOOD REPORTER (May 1, 2013), <http://www.hollywoodreporter.com/news/iron-man-3-smashes-chinas-450413>.

<sup>182</sup> Robert Cain, *Will 'Iron Man 3' Get China Co-Pro Status?*, CHINA FILM BIZ (Mar. 7, 2013), <http://chinafilmbiz.com/2013/03/07/will-iron-man-3-get-china-co-pro-status-and-does-it-really-matter-most-of-the-co-pro-benefits-have-come-already/> [hereinafter '*Iron Man 3* Co-Pro'].

<sup>183</sup> *Id.* The partners' strategy made it impractical to hire enough Chinese citizens to comply with the rule requiring that one-third of "major actors" be Chinese nationals, and they didn't incorporate the requisite level of Chinese cultural content to qualify the film as an official co-pro under the Chinese guidelines. *Id.*

<sup>184</sup> Cieply & Barnes, *supra* note 36.

<sup>185</sup> *Disney's 'Pirates 3' Slashed in China*, *supra* note 173.

<sup>186</sup> See Laurie Burkitt, '*Iron Man 3* Blasts China Co-Production Myth', THE WALL ST. J. (Mar. 8, 2013), <http://blogs.wsj.com/chinarealtime/2013/03/08/iron-man-3-blasts-away-at-china-co-production-myth/>; '*Iron Man 3* Co-Pro', *supra* note 182.

China.<sup>187</sup> Producers chose to film multiple scenes within China and even featured Chinese stars Wang Xueqi and Fan Bingbing.<sup>188</sup> Additionally, they invited Chinese bureaucrats to the set during filming and welcomed their advice regarding creative decisions.<sup>189</sup> *Iron Man 3* also took advantage of China's interest in 3D productions and created a 3D version targeted to that audience.<sup>190</sup> Similar to *Karate Kid* and *Pirates III*, the producers created a Chinese version of the film specifically for distribution to China.<sup>191</sup> But instead of cutting scenes from the original to be less offensive to the Chinese, producers added additional scenes to the Chinese *Ironman 3*, which included an exclusive scene near the end of the film starring Chinese actress Fan Bingbing.<sup>192</sup> In this case, instead of Chinese audiences

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<sup>187</sup> James Daniel, *Iron Man 3 Execs 'Changed Film for Chinese Audience' by Adding Four Minutes to the Film with Chinese Actors*, DailyMail.com (May 13, 2013), <http://www.dailymail.co.uk/news/article-2324077/Iron-Man-3-execs-changed-film-Chinese-audience-adding-4-minutes-Chinese-actors.html> (last updated May 17, 2013).

<sup>188</sup> *'Iron Man 3' Co-Pro*, *supra* note 182.

<sup>189</sup> William Wan, *'Iron Man 3' is Latest Hollywood Movie to Court Chinese Censors*, THE WASHINGTON POST (May 6, 2013), [https://www.washingtonpost.com/world/asia\\_pacific/iron-man-takes-heroic-efforts-to-satisfy-chinas-state-censors/2013/05/06/62d11e08-b62e-11e2-92f3-f291801936b8\\_story.html](https://www.washingtonpost.com/world/asia_pacific/iron-man-takes-heroic-efforts-to-satisfy-chinas-state-censors/2013/05/06/62d11e08-b62e-11e2-92f3-f291801936b8_story.html).

<sup>190</sup> Luke Westaway, *Iron Man 3 is Fresh, Ferrous Fun, But Should You See It in 3D?*, CNET (May 2, 2013), <http://www.cnet.com/news/iron-man-3-is-fresh-ferrous-fun-but-should-you-see-it-in-3d/>. Creating a 3D version was likely a decision made in post-production, because cinematically the 3D aspect brought little extra to the film. Thus, we can speculate the producers hoped releasing a 3D version would interest audiences that preferred 3D to 2D films.

<sup>191</sup> Clarence Tsui, *'Iron Man 3' China-Only Scenes Draw Mixed Response*, THE HOLLYWOOD REPORTER (May 5, 2013), <http://www.hollywoodreporter.com/news/iron-man-3-china-scenes-450184>. James Marsh, *China Beat: What Did China See in IRON MAN 3?*, TWITCH FILM (May 18, 2013, 9:00 AM), <http://twitchfilm.com/2013/05/china-beat-what-did-china-see-in-iron-man-3.html>.

<sup>192</sup> *Id.*

turning to the Internet to download the illegally pirated Hollywood version of the film, the reverse happened: U.S. audiences that heard about the exclusive Chinese version sought it out online.<sup>193</sup>

After discussing these examples, the message we arrive at is: there are many ways to get a film released in China, but filmmakers will be better equipped if they perform due diligence, understand *guan-xi*, and respect the sensitivities of the Chinese people from a Chinese person's perspective.

## V. DOES DISTRIBUTION IN CHINA IMPROVE PROFITS FOR HOLLYWOOD FILMS?

The argument that China is a necessary industry to focus on warrants the question: to what extent does distribution in China actually improve film profits?

### A. DISTRIBUTION IN CHINA OFTEN IMPROVES PROFITS

Indeed, the sheer population of China is an indication of its potential. Cinemas are being built in the country at an exponential rate, which means admission into China's theaters amounts to thousands more screens broadcasting the film.

Fortunately for now, Hollywood boasts as having some of the best producers and filmmakers in the world who create incredible motion pictures with advanced state-of-the-art technology, which China has not yet developed. Chinese audiences prefer large tent-pole action films, especially in IMAX and 3D; Hollywood producers have the correct technology to produce such films, which may be another reason why Hollywood films are so successful in China.<sup>194</sup> There are even cases where Hollywood films that nearly tanked in U.S. markets, were saved by its success in China.<sup>195</sup> *Night at the Museum 3*:

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<sup>193</sup> Todd Spangler, 'The Hobbit,' 'Django Unchained' and 'Fast & Furious 6' Are Most-Pirated Films of 2013, VARIETY (Dec. 13, 2013 6:19 AM), <http://variety.com/2013/digital/news/the-hobbit-django-unchained-and-fast-furious-6-are-most-pirated-films-of-2013-1201015119/>.

<sup>194</sup> Tim Walker, *Hollywood Targets Asian Audiences as US Films Enjoy Record-Breaking Run at Chinese Box Office*, THE INDEPENDENT (July 9, 2014), <http://www.independent.co.uk/arts-entertainment/films/features/hollywood-targets-asian-audiences-as-us-films-enjoy-record-breaking-run-at-chinese-box-office-9596052.html>.

<sup>195</sup> Lous Dietz-Henderson, *Hollywood Summer Slump? It's China to the Rescue*, THE WALL ST. J. BLOG (June 12, 2012),

*Secret of the Tomb* (2015) is a great example. Despite receiving very little success in the U.S.,<sup>196</sup> the film topped Chinese box office charts in its first full week, earning \$26.93 million, out of a total \$30.91 million, in only eight days.<sup>197</sup> China saved *Night at the Museum 3* from a devastating flop—even providing a profit after a \$127 million budget for production.<sup>198</sup> *The Da Vinci Code* is also an example of the profitability of distribution in China. Despite sudden cancellation after a few weeks of screening, the film grossed more than \$12.8 million in China, making it the second top-grossing foreign film.<sup>199</sup>

Hollywood films in China are so successful that local Chinese filmmakers now prefer to release their films during times when no Hollywood films are in theaters. For example, Chinese produced *The Great Magician* (2012), China's greatest domestic film success, was released during the Chinese New Year, because no Hollywood films were screening.<sup>200</sup>

#### B. NON-DISTRIBUTION IN CHINA IS STILL AN OPTION

The previous examples support Robert Cain's hypothesis, that China is simply attempting to uphold its values and cultural beliefs by controlling the content distributed to its people. Most of the films that the Censorship Board had issues with were censored because of content deemed offensive to Chinese audiences. Analyzing the Censorship Board's criticisms and issues with films brings to light the very difficult task of deciding whether to give up creative control of a film for the

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<http://blogs.wsj.com/chinarealtime/2012/06/12/hollywood-summer-slump-its-china-to-the-rescue/>.

<sup>196</sup> See *Night at the Museum*, *supra* note 4. *Night at the Museum: Secret of the Tomb* only made 31.5% of its profits domestically, earning \$113 million in the U.S. *Id.*

<sup>197</sup> Brent Lang, 'Night at the Museum 3' Tops Foreign Box Office Thanks to China Opening, VARIETY (Jan. 11, 2015), <http://variety.com/2015/film/news/night-at-the-museum-3-tops-foreign-box-office-thanks-to-china-opening-1201400229/>.

<sup>198</sup> *Id.*

<sup>199</sup> Shu-Ching, *supra* note 132.

<sup>200</sup> Dietz-Henderson, *supra* note 195.

benefit of pleasing the Censorship Board and distributing in China. Choosing to distribute in China's market forces producers to focus their attention on the sensitivities of Chinese audiences, regardless of whether they choose the traditional or alternative method of entering the market. This means giving up elements of creativity, downplaying scenes to be more family friendly, or even altering the story to tailor to Chinese interests.

Some producers have found the cost of entering China's film industry is not worth the loss of creative control. *The Dark Knight* (2008) was a Hollywood film that Warner Brothers chose not to release in China.<sup>201</sup> Warner Brothers cited "cultural sensitivities in some elements of the film" as its reasoning, and opted entirely not to present the film to SARFT, but there are a few other potential reasons why the studio chose this route.<sup>202</sup> First, a scene in which Batman nabs a Chinese money launderer could have potentially upset the government. It is likely producers felt the scene would have received a similar response from the Censorship Board, similar to the subplot of corruption from *The Departed*. Second, Hong Kong singer, Edison Chen, had an appearance in the film, and was recently scrutinized in China for a leak of his sexually explicit photographs.<sup>203</sup> *The Dark Knight* producers took a different route by choosing to release and distribute the film in Hong Kong, which is governed separately from mainland China.<sup>204</sup> *The Dark Knight* is a prime example of a successful record-breaking blockbuster foreign film<sup>205</sup> that retained complete creative control of the production, and dealt entirely without China, abandoning the motive to satisfy "suitable for all [Chinese] audiences."

### CONCLUSION

China's censorship criterion remains vague because the Censorship Board often provides little to no guidance for why it censored or banned a film. However, a pattern emerges showing that the government is most concerned with what is suitable for

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<sup>201</sup> *Dark Knight*, *supra* note 136.

<sup>202</sup> *Id.*

<sup>203</sup> *Id.*

<sup>204</sup> *Id.*

<sup>205</sup> See *All Time Box Office Domestic Grosses*, BOX OFFICE MOJO, <http://www.boxofficemojo.com/alltime/domestic.htm> (naming *The Dark Knight* number 6 all time domestic grossed film).

*Chinese* audiences.<sup>206</sup> For example, the Censorship Board rejected *Farewell My Concubine* for homosexuality (along with Communist turmoil and suicide),<sup>207</sup> *The Departed* for corruption,<sup>208</sup> and *Memoirs of a Geisha* for ethnic tensions.<sup>209</sup> These films had storylines that were politically controversial or unorthodox from the Chinese perspective. With this in mind, filmmakers should remember to be sensitive to the cultural and moral differences between their country and China.

Connecting with sources in China, such as Robert Cain or Dan Mintz at DMG Entertainment, make the transition into China easier because these individuals understand the nuances of the Chinese market. This may mean choosing the co-production route by casting Chinese stars for the film, shooting more of the film in China, and working jointly with a Chinese company, or it may mean choosing the traditional quota method. Regardless, producers must accept the possibility that parts of their film may be censored or altered, and that full creative control of the project will be sacrificed. The sooner filmmakers are aware of this fact, the more they can use it to their advantage. For example, *Karate Kid* and *Pirates III* had to create Chinese versions after those films were completed to meet the approval of the Censorship Board. As previously discussed, creating a Chinese version different from the Hollywood version may hurt those films, and force deprived audiences to go online and illegally stream and download the originals.<sup>210</sup> On the other hand, producers of *Ironman 3* intended to make a Chinese-friendly film, which enhanced the original version with

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<sup>206</sup> Jaafar & Busch, *supra* note 23.

<sup>207</sup> Kristof, *supra* note 128.

<sup>208</sup> 'Departed' Banned, *supra* note 130.

<sup>209</sup> *Dark Knight*, *supra* note 136.

<sup>210</sup> Alexandre M. Mateus & Jon M. Peha, *Quantifying Global Transfers of Copyrighted Content Using BitTorrent* (2011), [http://users.ece.cmu.edu/~peha/quantifying\\_global\\_P2P.pdf](http://users.ece.cmu.edu/~peha/quantifying_global_P2P.pdf) (last visited Jan. 11, 2016). See also *Oscar Nominees Fuel Chinese Movie Piracy*, USA TODAY (Feb. 17, 2015), <http://www.usatoday.com/videos/news/world/2015/02/17/23538367/> (view at 1:39).

additional scenes.<sup>211</sup> Producers were very successful with this endeavor because they were careful not to alter the story.<sup>212</sup>

China's film industry conditions will not remain unchanged. Like many other aspects of China, the film industry is emerging and growing rapidly. The initial quota system is a prime example. China began its film industry with no foreign films allowed, to permitting 20 films per year, to now allowing 34 films (14 of which should be 3D or IMAX fitted).<sup>213</sup> This shows China is slowly opening its markets.

The censorship program benefits Chinese talent by giving them opportunities to star in more foreign films. The co-production method also benefits China's film industry by incentivizing foreign film companies to work with, and train Chinese companies. This is something to take advantage of because it may not be the case for long. Foreign filmmakers have the knowledge and technology to improve China's film industry, which China should be open to receive. The landscape is now one that is mutually beneficial to both the foreign studios and Chinese studios.

Following the same argument, companies are now creating alternative ways to bypass the quota system and get films into China. This article focused on co-productions, but DMG Entertainment's work on *Iron Man 3* shows there are other ways to achieve distribution in China. We must remember that China is a flourishing country, deeply rooted in its culture and history, which recently opened its markets to the public with hopes to grow and develop. Its film industry is no different. Foreign producers must understand that China's film industry is not just a business; it is a protected Chinese asset. Films like *Night at the Museum 3* and *The Da Vinci Code* show that distributing in China can often save a film from tanking at the box office. In order to tap into the Chinese market, producers must understand the meaning of *guan-xi* and start building relationships with the Chinese so they can create films that interest Chinese audiences and its government.

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<sup>211</sup> Daniel, *supra* note 187.

<sup>212</sup> *Id.*

<sup>213</sup> *The Rise and Rise of the Film Business in China*, STEPHENFOLLOWS.COM (Jan. 26, 2015), <https://stephenfollows.com/film-business-in-china/>.



At times, the strictness of China's regulation may prove to be counter-active when studios are forced to create multiple versions of a film only to satisfy the Censorship Board.<sup>214</sup> When censorship regulation goes too far, it does not benefit Chinese audiences, who may actually prefer the original versions of films. The increased demand for illegal piracy may be a direct result.<sup>215</sup> This is a global issue that affects all film markets. The MPAA in the U.S. recently created a "Where to Watch" campaign that compiles a list of legal websites to access films and TV shows.<sup>216</sup> As a suggestion, this may be an effective option for China to combat illegal downloading and piracy.

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<sup>214</sup> See discussion *supra* pp. 41-50.

<sup>215</sup> *Oscar Nominees*, *supra* note 210. At 90 percent, piracy rates are highest in China. See *The Cost of Movie Piracy*, L.E.K. 4 (2005), <http://austg.com/include/downloads/PirateProfile.pdf> (last visited Jan. 11, 2016).

<sup>216</sup> Anthony D'Alessandro, *MPAA Chief Battles Piracy with 'WhereToWatch' Campaign – CinemaCon*, DEADLINE HOLLYWOOD (Apr. 21, 2015), <http://deadline.com/2015/04/mpaa-chief-chris-dodd-battles-piracy-with-wheretowatch-campaign-cinemacon-1201413684/>.

# SPORTS & ENTERTAINMENT LAW JOURNAL

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### COMMENT

## ONE COUNTRY, TWO SYSTEMS: THE INTEGRATION OF HONG KONG INTO CHINA AND ITS IMPACT ON FREEDOM OF EXPRESSION

John Keiter\*

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### INTRODUCTION

While under British rule, the Island of Hong Kong enjoyed a plethora of civil liberties, which have also become prevalent and fundamental in many of today's Western societies.<sup>1</sup> Those freedoms, however, were short lived as the British government's sovereignty over the island expired and China ruled Hong Kong once again.<sup>2</sup> Surprisingly, however, Mainland China underwent social reform in preparation for the reunification.<sup>3</sup>

This comment analyzes the contrasting views of the People's Republic of China and Hong Kong's freedom of expression as it concerns film censorship. This comment also explores how the reunification of Hong Kong may influence

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<sup>1</sup> See *infra* Section I. Historical Background.

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

<sup>3</sup> See *infra* Section III. Surging Forward: Creating One System, p. 9.

China's social norms in the future.

## I. HISTORICAL BACKGROUND

### A. ONE COUNTRY, TWO SYSTEMS

The United Kingdom's interest in the island of Hong Kong primarily grew out of conflicts resulting from British exporters' opium trading operations in the early 1800's.<sup>4</sup> During that time, British traders established a lucrative opium trade between India and China, which resulted in widespread addiction amongst the Chinese people.<sup>5</sup> In an attempt to thwart the trading operations, which had caused severe social disruption among the Chinese people, the Chinese government confiscated and destroyed several thousand chests of British merchants' opium.<sup>6</sup> The resulting tension between the Chinese government and the British merchants eventually led to a British sailor killing a Chinese villager.<sup>7</sup> The sailor sought asylum with the British government to avoid being tried by the Chinese courts; tensions between the Chinese and British governments ultimately increased until the nations succumbed to war.<sup>8</sup>

British military forces proved far superior to the Chinese military, and the war quickly resulted in peace negotiations in which the Chinese ceded control of Hong Kong to the British.<sup>9</sup> Complete control over the island was eventually the result of additional military feuds between the British and Chinese governments.<sup>10</sup> The negotiations ended with an agreement which ceded complete control of Hong Kong and other

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<sup>4</sup> Kenneth Pletcher, *Opium Wars*, ENCYCLOPEDIA BRITANNICA (Apr. 17, 2015), <http://www.britannica.com/topic/Opium-Wars>.

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

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

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

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

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

<sup>10</sup> William I. Friedman, *China's One Nation, Two-System Paradigm Extends Itself Beyond the Mainland's Borders to the Southern Provincial Government of Hong Kong*, 11 J. TRANSNAT'L L. & POLY 65, 73 (2001).

surrounding islands to the British under a 99-year lease.<sup>11</sup>

After several years under British control, Hong Kong grew and became “one of the great economic powers in the world.”<sup>12</sup> Under the influence of the British political system, Hong Kong created a democratic system of rule, and established laws and freedoms for its people.<sup>13</sup>

Hong Kong’s laws are clear, predictable, and easily understandable, and therefore not arbitrary, capricious or uncertain, like in China. Moreover, the laws offer transparency and openness . . . through the guarantee of such democratic values as freedom of speech and press . . . . In sum, Hong Kong’s “rule of law” has transformed this once “barren” island into a safe haven for the world’s investments . . . .<sup>14</sup>

The concept of “One Country, Two Systems” was originally formulated as a method to encourage the Taiwanese people to rejoin the ranks of Mainland China<sup>15</sup> after the Chinese Communist Party founded the People’s Republic of China and exiled the nationalist party to Taiwan.<sup>16</sup> The proposal permitted Taiwan to “maintain its political and economic systems,” and did not require Taiwan to adopt the systems of China.<sup>17</sup> Although Taiwan did not accept the model or the proposal of reunification, the Chinese government remained convinced of its viability, and brought the concept to the negotiating tables with the British government in anticipation of the reversion of Hong Kong to the People’s Republic of China.<sup>18</sup>

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

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

<sup>13</sup> *Id.* at 67.

<sup>14</sup> *Id.* at 66-67.

<sup>15</sup> George E. Edwards, *Applicability of the “One Country, Two Systems” Hong Kong Model to Taiwan: Will Hong Kong’s Post-Reversion Autonomy, Accountability, and Human Rights Record Discourage Taiwan’s Reunification with the People’s Republic of China?*, 32 NEW ENG. L. REV. 751, 754 (1998).

<sup>16</sup> Brian J. Safran, *A Critical Look at Western Perceptions of China’s Intellectual Property System*, 3 NO. 2 U PUERTO RICO BUS. L.J. 135, 138 (2012).

<sup>17</sup> Edwards, *supra* note 15.

<sup>18</sup> *Id.* at 756.

In 1984, the British and Chinese governments signed the Joint Declaration on the Question of Hong Kong (“Joint Declaration”), which provided for the transfer of sovereign powers over Hong Kong from the United Kingdom, to China, on July 1, 1997.<sup>19</sup> Pursuant to the Joint Declaration, the people of Hong Kong continue to enjoy a “high degree of autonomy,” and the “laws previously in force in Hong Kong”<sup>20</sup> will remain in effect at least until June 30, 2047, when the provisions of the Joint Declaration expire.<sup>21</sup> After this point, it is unclear what will happen to the two systems.

#### B. THE YEAR 2047: MERGING THE TWO SYSTEMS

The constitutional documents concerning Hong Kong’s future omit any indication that the “One Country, Two Systems” policy will end on any specific date.<sup>22</sup> Rather, many look to a provision of Hong Kong Basic Law, a companion document to the Joint Declaration, in order to determine the possible date.<sup>23</sup> That relevant provision states: “[t]he socialist system and policies shall not be practised [sic] in the Hong Kong Special Administrative Region, and the previous capitalist system and way of life shall remain unchanged for 50 years.”<sup>24</sup> The exact implications of this provision are unclear. Some parties, looking to statutory interpretation, place strong emphasis on the location of the comma and argue that the term, “[t]he socialist system and policies shall not be practised [sic] in Hong Kong Special Administrative Region,” is an independent clause.<sup>25</sup>

Whatever the intention may be, there seem to be few answers regarding the original intention of the drafters. Some argue that this is likely due to the fact that many did not believe

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

<sup>20</sup> *Id.*

<sup>21</sup> Danny Gittings, *What Will Happen to Hong Kong After 2047?*, 42 CAL. W. INT’L L.J. 37, 37 (2011).

<sup>22</sup> *Id.* at 47.

<sup>23</sup> *Id.*

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

<sup>25</sup> *Id.* at 48.

that the separate systems would survive very long after its original implementation in 1997.<sup>26</sup> With this in mind, people are left only to speculate about Hong Kong's future. Many believe that after June 30, 2047, most of the liberties that Hong Kong now enjoys, including its independent legislative system, will end, and the people of Hong Kong will be transitioned into the political system currently in force on Mainland China.<sup>27</sup> Others speculate that the "One Country, Two Systems" policy will continue to surge forward indefinitely.<sup>28</sup>

## II. CONTRASTING VIEWS ON MEDIA CENSORSHIP AND FREEDOM OF EXPRESSION

Section 23 of the Joint Declaration provides that "Hong Kong residents shall have freedom . . . of the press and publication."<sup>29</sup> This section also provides the Hong Kong government with the power to establish its own laws prohibiting acts of treason, secession, and subversion against the Central People's Government of China.<sup>30</sup> The degree of authority provided to the Hong Kong government has established what has essentially become an unrestricted media outlet for entertainment and information flow.<sup>31</sup>

Consistent with the "One Nation, Two Systems" policy, China's regulation of media is in stark contrast to that of Hong Kong's policy. China's censorship requirements and regulations are so severe, that its policies have been dubbed "The Great Firewall of China."<sup>32</sup> Oddly, the People's Republic of China's Constitution contains promises of freedom of speech;<sup>33</sup> however, the concept of free speech is viewed much differently in China

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<sup>26</sup> *Id.* at 47.

<sup>27</sup> *Id.* at 39.

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

<sup>29</sup> Frances H. Foster, *Translating Freedom for Post-1997 Hong Kong*, 76 WASH. U. L.Q. 113, 119 (1998).

<sup>30</sup> C. George Kleeman, IV, *The Proposal to Implement Article 23 of the Basic Law in Hong Kong: A Missed Opportunity for Reconciliation and Reunification Between China and Taiwan*, 33 GA. J. INT'L & COMP. L. 705, 709 (2005).

<sup>31</sup> *Id.*

<sup>32</sup> See generally Kristina M. Reed, *From the Great Firewall of China to the Berlin Firewall: The Cost of Content Regulation on Internet Commerce*, 13 TRANSNAT'L LAW. 451 (2000).

<sup>33</sup> *Id.* at 459.

than it is in Western democracies.<sup>34</sup> China views the right as merely an instrument for promoting the objectives of the government.<sup>35</sup> Under the Chinese communist system, all rights should be sacrificed for the good of the whole.<sup>36</sup> The Chinese government uses a wide variety of laws, technology, and human oversight to control information portrayed to the people within its borders, to promote and sustain its societal ideals.<sup>37</sup>

Given the Hong Kong government's long history of unrestricted media censorship, it is not surprising that the influx of Hollywood cinemas to hit Hong Kong box offices varies significantly from that of Mainland China. In 2014, the Cinemas of Hong Kong enjoyed over 300 box office titles over the course of one year.<sup>38</sup> Comparatively, China's cinematic collection tallied in at just over half that number.<sup>39</sup> This is due, in large part, to the different policies implemented by the "two systems" in determining what content is appropriate for audiences.

Hong Kong's Policy on Film Censorship allows "adults wide access to films, while protecting young people under the age of 18 from exposure to material which might be harmful to them."<sup>40</sup> Under this policy, films are submitted to Hong Kong's motion picture authority, which classifies the film under one of three categories: the lowest category, Category I, is suitable for

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

<sup>35</sup> *Id.*

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

<sup>37</sup> Christopher Stevenson, *Breaching the Great Firewall: China's Internet Censorship and the Quest for Freedom of Expression in a Connected World*, 30 B.C. INT'L & COMP. L. REV. 531, 537 (2007).

<sup>38</sup> *Hong Kong Yearly Box Office*, BOX OFFICE MOJO, <http://www.boxofficemojo.com/intl/china/yearly/> (last visited Dec. 12, 2015).

<sup>39</sup> *China Yearly Box Office*, BOX OFFICE MOJO, <http://www.boxofficemojo.com/intl/china/yearly/?yr=2014&p=.htm> (last visited Dec. 12, 2015).

<sup>40</sup> *Film Classification and Control of Obscene Articles*, COMMC'N AND CREATIVE INDUS. BRANCH COMMERCE AND ECON. DEV. BUREAU, [http://www.cedb.gov.hk/ctb/eng/film/film\\_1.htm](http://www.cedb.gov.hk/ctb/eng/film/film_1.htm) (last visited Dec. 12, 2015).

all ages, and the highest category, Category III, is restricted to persons aged 18 or older.<sup>41</sup> The standards for classifications are based on “community standards,” as determined by “regular surveys of community views.”<sup>42</sup>

On the other hand, China does not have a film rating system. Rather, the government has tasked the State Administration of Radio, Film and Television (SARFT) to determine which films should be permitted.<sup>43</sup> SARFT prohibits or restricts films that, among other things, do not accurately portray the history of its country or other countries, have obscene or vulgar content, and include portrayals of unpunished breaches of morality.<sup>44</sup> In navigating these subjective policies, many filmmakers have resorted to making films “suitable for all ages” as the surest way to receive SARFT approval.<sup>45</sup>

### III. SURGING FORWARD: CREATING ONE SYSTEM

Over the last 30 years, China has already experienced some rather drastic changes in its policies and regulations.<sup>46</sup> In 1978, China’s Premier Minister, Deng Xiaoping, initiated an “open door” policy to help utilize foreign resources and market mechanisms to accelerate the country’s economic growth.<sup>47</sup> Further changes arose when China enacted a new constitution in 1982, enabling the country to support different economic and

<sup>41</sup> *Id.*

<sup>42</sup> *Id.*

<sup>43</sup> *SARFT 101: The Rules of the Censorship Game*, DGENERATEFILMS.COM, <http://dgeneratefilms.com/critical-essays/sarft-101-the-rules-of-the-censorship-game> (last visited Dec. 12, 2015).

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

<sup>45</sup> Clifford Coonan, *Chinese Cinemagoers Keen on Film Ratings System*, THE HOLLYWOOD REPORTER (Aug. 26, 2013), <http://www.hollywoodreporter.com/news/chinese-cinemagoers-keen-film-ratings-614450>.

<sup>46</sup> William I. Friedman, *China’s One Country, Two Systems Paradigm Extends Itself Beyond the Mainland’s Borders to the Southern Provincial Government of Hong Kong*, 11 J. TRANSNAT’L L. & POL’Y 65, 65-66 (2001).

<sup>47</sup> Todd Kenneth Ramey, *China: Socialism Embraces Capitalism? An Oxymoron for the Turn of the Century: A Study of the Restructuring of the Securities Markets and Banking Industry in the People’s Republic of China in an Effort to Increase Investment Capital*, 20 HOUS. J. INT’L L. 451, 456 (1998).



political systems in preparation for its reunification with Hong Kong.<sup>48</sup> These changes caused China to gradually shift from its Marxist political and economic system, to a more capitalistic system.<sup>49</sup> Thus, China is already embracing social reform to enable it to surge its economic growth and establish itself as a world power.

Notwithstanding these changes, the reunification of Hong Kong with China is not without controversy. In the months leading up to the July 1, 1997 reunification, Chinese leaders made disingenuous statements regarding China's intentions of honoring the "One Country, Two Systems" policy.<sup>50</sup> Evidence of these intentions surfaced in 2003, when nearly half a million protesting Hong Kong residents dismantled Chinese regulation Article 23. Hong Kong residents believed the regulation would be used to severely limit freedom of expression rights, particularly in regards to government criticism.<sup>51</sup> Since that time, China has decided to be more responsive and respectful of the independent law making powers of Hong Kong.<sup>52</sup> In light of these events, the impact that Hong Kong has had on Chinese policies and ideology is evident, even with its short history under Chinese rule.

With each passing year signifying the impending dissolution of the Joint Declaration, upon which the liberties of Hong Kong citizens may hinge, the need for a new and workable models seems more and more pressing to prepare for the establishment of the hypothetical "One Country, One System." Many models have been proposed to resolve this issue,<sup>53</sup> but only few seem plausible. Among these options is "The Balancing Approach."<sup>54</sup> This model suggests a "balance between individual rights and social order for the good of the

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<sup>48</sup> Edwards, *supra* note 15, at 755.

<sup>49</sup> Friedman, *supra* note 46, at 65-66.

<sup>50</sup> Foster, *supra* note 29, at 114.

<sup>51</sup> Kleeman, IV, *supra* note 30, at 706.

<sup>52</sup> *Id.* at 707.

<sup>53</sup> See generally Foster, *supra* note 29.

<sup>54</sup> Foster, *supra* note 29 at 134.

entire community.”<sup>55</sup> In essence, it requires China to loosen its grip on censorship, while requiring Hong Kong to surrender its unrestricted approach.<sup>56</sup> In other words, it’s the proverbial “meeting in the middle” approach between two very different systems.

### CONCLUSION

We are left to speculate about the events that will transpire upon the Joint Agreement’s expiration. For the time being, the separate systems are operating smoothly and China appears to respect the independent policies of the Hong Kong legislature. Whatever the future holds for the “One Country, Two Systems” policy, one idea seems evident: in light of the effort that China has made to enter the world spotlight, and considering the civil liberties that have become so engrained amongst the culture and citizens of Hong Kong, when the ball drops and the negotiations cease, the surrender of Hong Kong’s liberties may not come easily.

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<sup>55</sup> *Id.*

<sup>56</sup> *Id.* at 134-35.

