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REGULATION TOMORROW: WHAT HAPPENS WHEN TECHNOLOGY IS FASTER THAN THE LAW?

MARK FENWICK,* WULF A. KAAL,** AND ERIK P.M. VERMEULEN***

In an age of constant, complex and disruptive technological innovation, knowing what, when, and how to structure regulatory interventions has become more difficult. Regulators find themselves in a situation where they believe they must opt for either reckless action (regulation without sufficient facts) or paralysis (doing nothing). Inevitably in such a case, caution tends to trump risk. But such caution merely functions to reinforce the status quo and makes it harder for new technologies to reach the market in a timely or efficient manner.

The solution: lawmaking and regulatory design needs to become more proactive, dynamic, and responsive. So how can regulators actually achieve these goals? What can regulators do to promote innovation and offer better opportunities to people wanting to build a new business around a disruptive technology or simply enjoy the benefits of a disruptive new technology as a consumer?

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INTRODUCTION

Imagine the following near future experience of shopping online:

> *You are in a café thinking about a last minute birthday present for a friend or relative who you will be meeting later that day. Using a smartphone, you find something suitable via Amazon or similar web–based retailer. You place the order, paying a slight premium for instant delivery. Twenty minutes later you receive a notification that a drone will be arriving shortly at a delivery–port close to the café. You make the five minute walk to the designated meeting point. A drone then swoops down beside you and releases the package having confirmed your identity and location via phone connection.*

Most commentators seem to agree that the combination of online transaction and drone delivery represents the future of fast, clean, and efficient shopping.[1]

And yet, for the moment, this type of service is not available. Thinking about some of the reasons why this technology is not available can teach us something important about how we currently deal with disruptive technology and how we might want — or need — to adapt our approach to a new world in which innovation cycles are shorter and new technology is constantly being developed.

Returning to the example of drone–based delivery, a major reason why this type of service is not yet available is technological.[2] Clearly, there are technological issues that need to be overcome.[3] For example, ensuring that the service is reliable and safe is crucial before fleets of drones are released on to the world. But even when all of the main technology issues are

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1. *See* Tom Simonite, *Amazon Lays Out Its Vision for a Sky Thronging with Delivery Drones*, MIT TECH. REV. (July 28, 2015), https://perma.cc/D9AR-DA4J (quoting Gur Kimchi, a cofounder of Amazon's drone project, saying, "[w]e think it's going to be more economical, faster, environmentally sound, and that customers are going to like it"); Sally French, *Drone Delivery Is Already Here — and It Works*, MKT.WATCH (Dec. 15, 2015, 7:32 AM), https://perma.cc/57XC-EBT7 (explaining how the drone delivery process might work).

2. Erik P.M. Vermeulen, *Artificial Intelligence, FinTech, Big Data . . . Or, What Happens When Technology is Faster than the Law?,* Emergent Future (Sept. 3, 2016), https://medium.com/emergent-future/artificial-intelligence-fintech-big-data-or-what-happens-when-technology-is-faster-than-the-6c2c1528738c#.k4ohle1im; Keith Wagst aff, *Could Drone Delivery Really Take Off? Experts Weigh In*, NBC NEWS: MACH (Nov. 15, 2016, 4:32 PM), http://www.nbcnews.com/mach/technology/could-drone-delivery-really-catch-experts-weigh-n456806; Farhad Manjoo, *Think Amazon's Drone Delivery Idea Is a Gimmick? Think Again*, N.Y. TIMES (Aug. 10, 2016), https://www.nytimes.com/2016/08/11/technology/think-amazons-drone-delivery-idea-is-a-gimmick-think-again.html; Samuel Gibbs, *Are Drone Deliveries a Realistic Prospect?*, GUARDIAN (July 29, 2016), https://www.theguardian.com/te chnology/2016/jul/29/are-drone-deliveries-a-realistic-prospect.

3. Vermeulen, *supra* note 2.

resolved there are other obstacles that can prevent consumers and entrepreneurs from enjoying the benefits and opportunities offered by new technologies or services, such as drone delivery.

These obstacles are not the result of technological limitations, but human choice. The law — and other regulations — can often prohibit, or otherwise limit, commercial exploitation of, and public access to, new technology. However, as disruptive technologies arrive more frequently and at a faster pace, debates around such regulatory constraints on new technologies are more pressing.[4]

II. DISRUPTIVE INNOVATION IN THE LITERATURE

Since the mid–1990s, the literature on management has studied the implications of disruptive technologies and innovation.[5] The literature warned businesses to act quickly when disrupters appear by either acquiring the disrupter or incubating a competing business that embraces the disruptive technology, because disrupter startup companies could attract new lower–end consumers by offering inexpensive substitutes for products and gradually move upmarket by attracting higher-end consumers.[6] A lack of investment in disruptive technologies can result in the abrupt loss of market dominance and often even total replacement in such markets.[7] When market leaders do not extend their market dominance through the use of disruptive technologies, smaller entrepreneurial firms with no established customer base can take advantage of disruptive technologies and redefine such markets.[8]

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4. *See* Wulf A. Kaal, *Dynamic Regulation for Innovation, in* PERSPECTIVES IN LAW, BUSINESS & INNOVATION (Mark Fenwick et al. eds., forthcoming 2017) [hereinafter Kaal, *Innovation*].

5. *See* GEOFFREY A. MOORE, CROSSING THE CHASM (Harper Bus. 1991). *See generally* CLAYTON M. CHRISTENSEN, THE INNOVATOR'S DILEMMA: WHEN NEW TECHNOLOGIES CAUSE GREAT FIRMS TO FAIL (Harv. Bus. Rev. Press 1997).

6. Larry Downes & Paul Nunes, *Big-Bang Disruption*, 91 HARV. BUS. REV. 44, 46 (2013). *Contra* Andrew A. King & Baljir Baatartogokh, *How Useful Is the Theory of Disruptive Innovation?*, MIT SLOAN MGMT. REV. (Sept. 15, 2015), http://sloanreview.mit.edu/article/how-useful-is-the-theory-of-disruptive-innovation ("In summary, although Christensen and Raynor selected the 77 cases as examples of the theory of disruptive innovation, our survey of experts reveals that many of the cases do not correspond closely with the theory. In fact, their responses suggest that only seven of the cases (9%) contained all four elements of the theory that we asked about.").

7. Joseph L. Bower & Clayton M. Christensen, *Disruptive Technologies: Catching the Wave*, 73 HARV. BUS. REV. 43, 43 (1995) ("One of the most consistent patterns in business is the failure of leading companies to stay at the top of their industries when technologies or markets change.").

8. *Id.* at 51 ("Small, hungry organizations are good at placing economical bets, rolling with the punches, and agilely changing product and market strategies in response to feedback from initial forays into the market."); Constantinos D. Charitou &

So–called big–bang disruptions differ from more–traditional innovation. First, big–bang disruptors often offer more innovative products that are cheaper and often better integrated with other products and services.[9] Second, big–bang disrupters typically launch businesses without a foundation, using cloud computing, open platforms built on the internet, and fast–cycling mobile devices. Finally, big–bang disrupters often produce multiple new products to identify which products may take hold in the market. While most such products will fail, the payoff associated with the unconstrained growth of those products that succeed is substantial and facilitates and often accelerates other forms of disruptive innovation.[10]

In the foreseeable future, artificial intelligence ("AI") is likely the most significant field of disruptive innovation. AI is different from a regular computer algorithm. AI tries to emulate human thought processes and rational human behavior through self–learning and storage of experiences.[11] Because it emulates human behavior, AI can act differently in the same situations, depending on the actions previously performed. However, AI still lacks the ability to engage in creative new ways of combining previously learned contexts.[12] The rapid advances of AI have

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Constantinos C. Markides, *Responses to Disruptive Strategic Innovation*, MIT SLOAN MGMT. REV. (Jan. 15, 2003), http://sloanreview.mit.edu/article/responses-to-disruptive-strategic-innovation ("[D]isruptive strategic innovations usually start out as small and low–margin businesses. That's why they rarely gain support or long–term commitment from established competitors. The innovations are small and are not attractive until they start growing."). *Contra* Downes & Nunes, *Big–Bang Disruption*, *supra* note 6, at 46 (explaining that the strategic model of disruptive innovation we've all become comfortable with has a blind spot. It assumes that disrupters start with a lower–priced, inferior alternative that chips away at the least profitable segments, giving an incumbent business time to start a skunkworks and develop its own next–generation products. That advice hasn't been much help to navigation–product makers like TomTom, Garmin, and Magellan. Free navigation apps, now preloaded on every smartphone, are not only cheaper but better than the stand–alone devices those companies sell. And thanks to the robust platform provided by the iOS and Android operating systems, navigation apps are constantly improving, with new versions distributed automatically through the cloud).

9. Downes & Nunes, *supra* note 6, at 46.

10. *See id.*

11. *See* Paulius Cerka et al., *Liability for Damages Caused by Artificial Intelligence*, 31 COMPUTER L. & SEC. REV. 376, 378 (2015). *See generally* STUART RUSSELL & PETER NORVIG, ARTIFICIAL INTELLIGENCE: A MODERN APPROACH 5 (2013) (describing the different major definitions for AI); Robert D. Hof, *10 Breakthrough Technologies 2013: Deep Learning With Massive Amounts of Computational Power, Machines Can Now Recognize Objects and Translate Speech in Real Time. Artificial Intelligence is Finally Getting Smart*, MIT TECH. REV., http://www.technologyreview.com/featuredstory/513696/deep-learning/ (last visited Sept. 27, 2017).

12. Jeanne Carstensen, *Robots Can't Dance: Why the Singularity Is Greatly Exaggerated*, Nautilus (Jan. 22, 2015), http://nautil.us/issue/20/creativity/robots-cant-dance ("We may be making progress in being able to do things like recognize a cat in a

already affected many of the sectors of the economy during the past decade.[13] The exponential development of AI and the associated disruptive innovation pose substantial challenges for policy makers in education, financial markets, labor markets, and other areas.[14]

Big data in combination with AI and machine learning is a significant driver of disruptive innovation.[15] Big data in the form of digitized data that grows at exponential rates and can be captured and manipulated electronically draws on several core sources including the internet of things, public records, social media, and cameras, as well as satellite tracking.[16] Downsides associated with big data include its use of such

photograph. But there's a huge gulf between that and doing something creative."); Margaret A. Boden, *Artificial Creativity: Why Computers Aren't Close to Being Ready to Supplant Human Artists*, MIT TECH. REV. (Oct. 20, 2015), https://www.technologyreview.com/s/542281/artificial-creativity/; Margaret A. Boden, *Creativity and Artificial Intelligence*, 103 ARTIFICIAL INTELLIGENCE 347, 355 (1998), ("These two bottlenecks interact, since subtle valuation requires considerable domain expertise. Valuation, thus far, is mostly implicit in the generative procedures used by the program, or interactively imposed by a human being. Only a few AI-models can critically judge their own original ideas. And hardly any can combine evaluation with transformation. The ultimate vindication of AI-creativity would be a program that generated novel ideas which initially perplexed or even repelled us, but which was able to persuade us that they were indeed valuable. We are a very long way from that.").

13. *See* Craig E. Karl, *The Three Breakthroughs That Have Finally Unleashed AI on the World*, WIRED (Oct. 27, 2014, 6:30 AM), http://www.wired.com/2014/10/future-of-artificial-intelligence/ ("Over the past five years, cheap computing, novel algorithms, and mountains of data have enabled new AI–based services that were previously the domain of sci–fi and academic white papers.").

14. *See* ERIK BRYNJOLFSSON & ANDREW MCAFEE, THE SECOND MACHINE AGE: WORK, PROGRESS, AND PROSPERITY IN A TIME OF BRILLIANT TECHNOLOGIES 205–28 (2014) (discussing policy in the face of projected automation of low–skill labor); Tess Townsend, *Peter Diamandis: A.I. Will Lead to Massive Disruption Across Industries*, INC. (Sept. 24, 2015), http://www.inc.com/tess-townsend/diamandis-artificial-intelligence.html.

15. *See* James Canton, *From Big Data to Artificial Intelligence: The Next Digital Disruption*, HUFFINGTON POST, http://www.huffingtonpost.com/james-canton/from-big-data-to-artifici_b_10817892.html (last updated July 6, 2017); Jitendra Waral, Anurag Rana & Sean Handrahan, *Artificial Intelligence: Disruption Era Begins*, BLOOMBERG PROF. SERVS.: BLOOMBERG INTELLIGENCE (Sept. 29, 2016), https://www.bloomberg.com/professional/blog/artificial-intelligence-disruption-era-begins/; Rebecca Merrett, *Intelligent Machines Part 1: Big Data, Machine Leaning and the Future*, CIO (June 4, 2015), http://www.cio.com.au/article/576664/intelligent-machines-part-1-big-data-machine-learning-future/.

16. *See* Townsend, *supra* note 14; JOHN PODESTA ET. AL., EXEC. OFFICE OF THE PRESIDENT, BIG DATA: SEIZING OPPORTUNITIES, PRESERVING VALUES 53 (2014), ("Big data technologies, together with the sensors that ride on the 'Internet of Things,' pierce many spaces that were previously private. Signals from home WiFi networks reveal how many people are in a room and where they are seated."). *See generally* JAMES MANYIKA ET AL., BIG DATA: THE NEXT FRONTIER FOR INNOVATION, COMPETITION, AND PRODUCTIVITY 15 (McKinsey Glob. Inst., 2011).

disparate sources, which creates challenges for the integration of data and normalizing.[17] The literature mostly takes issue with the big data inaccuracies that occur when collecting data from databases that merely require generalized accuracy.[18] Big data is often not the output of instruments designed to generate valid and reliable data suitable for scientific analysis. Foundational data issues of construct validity, measurement, reliability, and data dependencies are the same regardless of data quantities.[19] Some critique the implicit assumption of big data researchers that big data is a substitute for traditional data collection and analysis rather than a mere supplement,[20] while others see big data and small data not as mutually exclusive, but as reinforcing and supporting

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17. MANYIKA ET AL., *supra* note 16, at 12 ("To capture value from big data, organizations will have to deploy new technologies (e.g., storage, computing, and analytical software) and techniques (i.e., new types of analyses). The range of technology challenges and the priorities set for tackling them will differ depending on the data maturity of the institution. Legacy systems and incompatible standards and formats too often prevent the integration of data and the more sophisticated analytics that create value from big data. New problems and growing computing power will spur the development of new analytical techniques. There is also a need for ongoing innovation in technologies and techniques that will help individuals and organizations to integrate, analyze, visualize, and consume the growing torrent of big data."); *see also* Christian Bizer et al., *The Meaningful Use of Big Data: Four Perspectives — Four Challenges*, 40 SIGMOD REC. 56, 57 (2011) ("My challenge is meaningful data integration in the real, messy, often schema–less, and complex Big Data World of databases and the (Semantic) Web using multi–disciplinary, multi–technology methods.").

18. *See* Bizer et al., *supra* note 17, at 57; IAN AYRES, SUPER CRUNCHERS: WHY THINKING–BY–NUMBERS IS THE NEW WAY TO BE SMART 60–63 (2007) (identifying big data phenomenon). *See generally* Andrea Lancichinetti et al., *High–Reproducibility and High–Accuracy Method for Automated Topic Classification*, 5 PHYSICAL REV. X 011007 (2015) (detailing the inaccuracy problems associated with big data text analysis/machine reading (called LDA)).

19. *See* David Lazer et al., *The Parable of Google Flu: Traps in Big Data Analysis*, 343 SCI. 1203 (2014); Gary Marcus & Ernest Davis, *Eight (No, Nine!) Problems with Big Data*, N.Y. TIMES (Apr. 6, 2014), http://www.nytimes.com/2014/04/07/opinion/eight-no-nine-problems-with-bigdata.h tml (suggesting that "[r]eliable statistical information can be compiled about common trigrams, precisely because they appear frequently. But no existing body of data will ever be large enough to include all the trigrams that people might use, because of the continuing inventiveness of language."); Tim Harford, *Big Data: Are We Making a Big Mistake?*, FIN. TIMES (Mar. 28, 2014), https://www.ft.com/content/21a6e7d8-b479-11e3-a09a-00144feabdc0#axzz30INfAyMi ("Statisticians have spent the past 200 years figuring out what traps lie in wait when we try to understand the world through data. The data are bigger, faster and cheaper these days — but we must not pretend that the traps have all been made safe. They have not.").

20. Jeff Leek, *Why Big Data Is in Trouble: They Forgot About Applied Statistics*, SIMPLY STATS. (May 7, 2014), http://simplystatistics.org/2014/05/07/why-big-data-is-in-trouble-they-forgot-about-applied-statistics/ ("Statistical thinking has also been conspicuously absent from major public big data efforts so far.").

each other.[21] Big data shortcomings can largely be addressed with artificial intelligence, and the combination of big data and artificial intelligence opens up significant additional big data applications.[22] Being able to analyze entire populations via big data applications, rather than being required to deal with limited sample sizes, allows researchers to understand correlations that are completely unprecedented and can help revolutionize our world.[23]

III. THE FACTUAL BASIS OF MODERN REGULATION

Reforming the regulatory framework to address increasing and growing regulatory concerns associated with disruptive technologies becomes increasingly important. Designing a regulatory framework that ensures the safety of users and the public, whilst facilitating the commercial use and consumer enjoyment of disruptive innovation is by no means easy.[24] This is particularly true in contemporary settings, where innovation is quicker and the global dissemination of that technology is much faster.[25] In such

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21. Lazer et al., *supra* note 19, at 1205.

22. Jo Ann S. Barefoot, *Disrupting Fintech Law*, 18 FINTECH L. REP. 3, 6 (2015); Daniel E. O'Leary, *Artificial Intelligence and Big Data*, 28 IEEE INTELLIGENT SYS. 96, 97, 99 (2013) ("AI researchers have long been interested in building applications that analyze unstructured data, and in somehow categorizing or structuring that data so that the resulting information can be used directly to understand a process or to interface with other applications. As an example, Johan Bollen and Huina Mao [footnote omitted] found that stock market predictions of the Dow Jones Industrial average were improved by considering the overall 'sentiment' of the stock market — this is an unstructured concept, but based on structured data generated from Google."); Maryam M. Najafbadi et al., *Deep Learning Applications and Challenges in Big Data Analytics*, 2 J. BIG DATA 1, 11 (2015) ("[P]erforming discriminative tasks in Big Data Analytics one can use Deep Learning algorithms to extract complicated nonlinear features from the raw data, and then use simple linear models to perform discriminative tasks using the extracted features as input. This approach has two advantages: (1) extracting features with Deep Learning adds nonlinearity to the data analysis, associating the discriminative tasks closely to Artificial Intelligence, and (2) applying relatively simple linear analytical models on the extracted features is more computationally efficient, which is important for Big Data Analytics.").

23. *See generally* KENNETH CUKIER & VIKTOR MAYER–SCHONBERGER, BIG DATA: A REVOLUTION THAT WILL TRANSFORM HOW WE LIVE, WORK AND THINK (2013).

24. Anna Butenko & Pierre Larouche, *Regulation for Innovativeness or Regulation of Innovation?*, 7 L. INNOVATION AND TECH. 52, 72 (2015).

25. Rita McGrath, *The Pace of Technology Adoption is Speeding Up*, HARV. BUS. REV. (Nov. 25, 2013), https://hbr.org/2013/11/the-pace-of-technology-adoption-is-speeding-up; Drew Desilver, *Chart of the Week: The Ever–Accelerating Rate of Technology Adoption*, PEW RES. CTR. (Mar. 14, 2014), http://www.pewresearch.org/fact-tank/2014/03/14/chart-of-the-week-the-ever-accelerating-rate-of-technology-adoption/. *But see* Bronwyn H. Hall & Beethika Khan, *Adoption of New Technology* 1 (Nat'l Bureau of Econ. Research, Working Paper No. 9730, 2003) (explaining that the diffusion of technology usually "appears as a continuous and rather slow process").

circumstances, regulators can often struggle to keep up.[26] The last two decades offer multiple examples of such regulatory struggles: genetically modified food, artificial intelligence, and, of course, driverless cars.[27]

AI and its disruptive capabilities present a prominent example for the possible disruptive potential and regulatory challenges associated with such disruption in the existing regulatory framework. Because national and international law do not currently recognize AI as a subject of law, AI has no legal personality and as such cannot be held personally liable for damages.[28] With autonomous AI playing an expanding role in society, an increasing number of scientists and entrepreneurs suggest that government regulation may be necessary to reduce the risks to the public associated with the rapid advances in AI.[29] While some favor an indirect form of AI

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26. *See* BRADEN A. ALLENBY, THE GROWING GAP BETWEEN EMERGING TECHNOLOGIES AND LEGAL–ETHICAL OVERSIGHT: THE PACING PROBLEM 3 (Gary E. Marchant et al. eds. 2011) ("Moore's Law notoriously states that the 'functional capacity of ICT products roughly doubles every 18 months', with the same dynamics manifesting in biotechnology, and namely in sequencing human genome. As a result, regulating innovation involves what is called a 'pacing problem' in the academic literature from the US, or the 'challenge of regulatory connection' or 'regulatory disconnection' in European–based scholarship."); Butenko & Larouche, *supra* note 24, at 66 ("The 'pacing problem' commonly refers to the situation when technology develops faster than the corresponding regulation, the latter hopelessly falling behind. The metaphor of 'the hare and the tortoise' is often conjured up. As summed up by Marchant and Wallach, 'at the rapid rate of change, emerging technologies leave behind traditional governmental regulatory models and approaches which are plodding along slower today than ever before'.").

27. *See* GREGORY N. MANDEL ET AL., INNOVATIVE GOVERNANCE MODELS FOR EMERGING TECHNOLOGIES 44, 45 (Gary E. Marchant et al. eds. 2013) ("One obstacle to this goal is that new technologies are often met with highly polarized debates over how to manage their development, use and regulation. Prominent examples include nuclear energy and genetically modified foods."); *see id.*, at 136 ("Emerging technologies such as nanotechnology, biotechnology, personalized medicine, synthetic biology, applied neuroscience, geoengineering, social media, surveillance technologies, regenerative medicine, robotics and artificial intelligence present complex governance and oversight challenges. These technologies are characterized by a rapid pace of development, a multitude of applications, manifestations and actors, pervasive uncertainties about risks, benefits and future directions, and demands for oversight ranging from potential health and environmental risks to broader social and ethical concerns. Given this complexity, no single regulatory agency, or even group of agencies, can regulate any of these emerging technologies effectively and comprehensively."); Tracy Hresko Pearl, *Fast & Furious: The Misregulation of Driverless Cars* 1, 50 (Aug. 5, 2016) (unpublished manuscript) (SSRN Working Paper), http://papers.ssrn.com/sol3/ papers. cfm?abstract_id=2819473 ("The United States is on the cusp of a revolution in transportation. The sale and widespread use of both semi–autonomous and fully autonomous vehicles, also known as 'driverless cars,' are both imminent and likely to significantly change the way in which citizens commute, interact, and travel.").

28. *See* Pearl *supra* note 27.

29. *See* Sharon Gaudin, *A.I. Researchers Say Elon Musk's Fears 'Not Completely Crazy*', COMPUTERWORLD (Oct. 29, 2014, 1:16 PM), http://www.computerworld.com/

regulation based on differential tort liability,[30] others oppose rigid regulation of AI because regulation may inhibit the socially beneficial innovations associated with AI, or they suggest such regulation is impossible in the face of such a powerful and exponentially growing technology.[31] While AI is currently not able to match human–level reasoning,[32] and for the foreseeable future, lacks the ability to be creative, it can still have an impact on the service industries, among others.[33]

To take an even simpler, but nevertheless important, example: current rules in many jurisdictions do not allow self–driving cars on the roads. Making this change is relatively simple. For example, the 1968 *Vienna Convention on Road Traffic,* to which seventy-two countries are party, was amended in March 2014 to take such new technologies into consideration.[34]

However, there are many other more complex regulatory issues that will need to be addressed. The driverless car will generate an enormous amount of data for possible alternative usage, which is likely to create new issues related to data security and privacy concerns.[35] In a tort context, questions

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article/2840815/ai-researchers-say-elon-musks-fears-not-completely-crazy.htmlgoo.gl/3K91LD ("'I think we should be very careful about artificial intelligence,' Musk said when answering a question about the state of AI. 'If I were to guess at what our biggest existential threat is, it's probably that . . . [w]ith artificial intelligence, we are summoning the demon. In all those stories with the guy with the pentagram and the holy water, and he's sure he can control the demon. It doesn't work out.'"); Rory Cellan–Jones, *Stephen Hawking Warns Artificial Intelligence Could End Mankind*, BBC NEWS (Dec. 2, 2014), http://www.bbc.com/news/technology-30290540 ("The development of full artificial intelligence could spell the end of the human race.").

30. *See* Matthew U. Scherer, *Regulating Artificial Intelligence Systems: Risks, Challenges, Competencies, and Strategies*, 29 HARV. J. L. & TECH. 353, 393 (2016).

31. *See You, Robot?*, ECONOMIST (Sept. 1, 2012), http://www.economist.com/node/21560986 ("Regulators must tread carefully. Noel Sharkey, a computer scientist at the University of Sheffield, observes that overly rigid regulations might stifle innovation. But a lack of legal clarity leaves device–makers, doctors, patients and insurers in the dark. The RoboLaw researchers hope to square this circle when they deliver their findings in 2014. So far, though, they seem to have more questions than answers."). *See generally* John Danaher, *Is Regulation of Artificial Intelligence Possible?*, HUMAN. + MAG. (July 15, 2015), http://hplusmagazine.com/2015/07/15/is-regulation-of-artificial -intelligence-possible/.

32. Richard Waters, *Artificial Intelligence: Machine v. Man*, FIN. TIMES (Oct. 31, 2014), https://www.ft.com/content/abc942cc-5fb3-11e4-8c27-00144feabdc0.

33. Harry Surden, *Machine Learning and Law*, 89 WASH. L. REV. 87, 88 (2014).

34. Vienna Convention on the Law of Treaties, art. 31, May 23, 1969, 1155 U.N.T.S. 331, 8 I.L.M. 679. *See generally* Economic and Social Counsel, Inland Transportation Committee, Working Party on Road Traffic Safety, U.N. Doc. ECE/TRANS/WP.1/145 (Mar. 24-6, 2014); Press Release, UNECE, UNECE paves the way for automated driving by updating UN international convention (Mar. 23, 2016).

35. Mark van Rijmenam, *Self–driving Cars Will Create 2 Petabytes of Data, What Are The Big Data Opportunities for the Car Industry?,* DATAFLOQ (July 18, 2016), https://datafloq.com/read/self-driving-cars-create-2-petabytes-data-annually/172 ("The

will need to be resolved as to who is at fault in the event of an accident involving driverless cars.[36]

Moreover, driverless cars will need to communicate both among themselves and with the transport infrastructure to be most effective in their operation. To facilitate this, regulators will need to safeguard telecommunication frequencies and protect against security threats, most obviously the possibility of "car–hacking."[37]

This all seems fairly obvious. But a less–documented aspect of this issue

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self–driving car from Google already is a true data creator. With all the sensors to enable the car to drive without a driver, it generates nearly 1 Gigabyte every second. It uses all that data to know where to drive and how fast to drive. It can even detect a new cigarette butt thrown on the ground and it then knows that a person might appear all of a sudden from behind a corner or car. 1 Gigabyte per second, imagine the amount of data that will create every year: On average, Americans drive 600 hours per year in their car. That equals 2.160.000 seconds or approximately 2 Petabyte of data per car per year. With the amount of cars worldwide to surpass one billion, it is almost unimaginable how much data will be created when Google's self–driving car will become common on the streets."); Adrienne LaFrance, *How Self–Driving Cars Will Threaten Privacy,* ATLANTIC (Mar. 21, 2016), http://www.theatlantic.com/technology/archive/2016/03/self-driving-cars-and-the-looming-privacy-apocalypse/474600/ ("The companies building self-vehicles have been cagey, so far, about how they're thinking about using individual data.").

36. *See* Adam Thierer & Ryan Hagemann, *Removing Roadblocks to Intelligent Vehicles and Driverless Cars*, 5 WAKE FOREST J.L. & POL'Y 339, 340 (2015) ("Living in fear of hypothetical worst–case scenarios and basing policy on them will mean that the best–case scenarios associated with intelligent vehicles will never come about. Thus, patience and regulatory forbearance are generally the wise policy dispositions at this time, bearing in mind that the tort system will continue to evolve to address harms caused by intelligent–vehicle systems."); *see also* Bryant Walker Smith, *Proximity–Driven Liability*, 102 GEO. L.J. 1777 (2014) ("This Article first describes how companies are embracing new technologies that expand their information, access, and control, with primary reference to the increasingly automated and connected motor vehicle. It next analyzes how this proximity to product, user, and use could impact product–related claims for breach of implied warranty, defect in design or information, post–sale failure to warn or update, and negligent enabling of a third–party's tortious behavior.").

37. *See* Jeffrey K. Gurney, *Driving into the Unknown: Examining the Crossroads of Criminal Law and Autonomous Vehicles*, 5 WAKE FOREST J.L. & POL'Y 393, 433 (2015) ("In addition to physically interfering with an autonomous vehicle, people will be able to virtually interfere with the operation of an autonomous vehicle, also known as hacking."); *see also* Tom Simonite, *Your Future Self–Driving Car Will Be Way More Hackable*, MIT TECH. REV. (Jan. 26, 2016), https://www.technologyreview.com/s/546086/your-future-self-driving-car-will-be-way-more-hackable/ ("'We are a long way from securing the non–autonomous vehicles, let alone the autonomous ones,' said Stefan Savage, a computer science professor at the University of California, San Diego, at the Enigma security conference in San Francisco on Tuesday. The extra computers, sensors, and improved Internet connectivity required to make a car drive itself increase the possible weak points, he said. 'The attack surface for these things is even worse,' said Savage.").

concerns what we might think of as the basis or foundation of any regulation, namely some empirical facts about that technology and its likely social, economic or health effects.[38] In this respect, regulation is always premised on a selection of relevant facts about a particular technology.

Crucially, the selected facts are those that are seen as relevant by the regulators in deciding *what*, *when* and *how* they should make a regulatory intervention.

The "what question" concerns identifying the disruptive technology that must be regulated or requires regulatory reform.[39] Demarcating the scope of a technology may not always be self–evident. For example, when should a car be thought of as autonomous, rather than merely providing driver–assistance? Facts about a particular technology are crucial for this kind of definitional judgment.

The "when question" concerns the timing of any regulatory intervention.[40] This entails ensuring that regulation is not adopted too soon

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38. Andrew Askland, *Why Law and Ethics Need to Keep Pace with Emerging Technologies, in* THE GROWING GAP BETWEEN EMERGING TECHNOLOGIES AND LEGAL–ETHICAL OVERSIGHT: THE PACING PROBLEM, xix, xx (Gary E. Marchant et al. eds., Springer. 2011) ("Accelerating advances in science and technology exacerbate the problem of unrevised statutes, but the crux of the problem is the same: a dissymmetry between law and newly arising facts because the law has not anticipated these new facts and attempts to govern them with an antiquated grasp of their meaning. Reprising the description of law as the matching of facts and principles, the challenge for law is to be keenly attentive to new facts in order to fashion principles that will sort out the challenges that they present.").

39. Alberto Alemanno et al., *Conclusions*, *in* BETTER BUSINESS REGULATION IN A RISK SOCIETY 285, 287 (Alberto Alemanno et al. eds., 2013) ("The concept of trust shapes not only the relationship between regulators and regulated (e.g. pharmaceutical industry), but also the very object (i.e. the 'what' question) of policies.").

40. Lyria Bennett Moses, *Agents of Change: How the Law 'Copes' with Techno logical Change*, 20 GRIFFITH L. REV. 763, 768-69 (2011) ("The urge for legal change in response to technological change has a greater sense of *timing:* laws regulating railroads are only needed after track is laid; uncertainties relating to the split of genetic and gestational motherhood need only be resolved *in response to* the availability of *in vitro* fertilisation. There is no doubt that legal change may be demanded as a result of changes in our collective knowledge and beliefs, or social change more broadly, but differences in how such changes are timed and perceived (as well as limitations of space) explain why this article focuses only on part of the story (which is not to say that it might not, in some places, have a broader resonance)."); *see* SHRUPTI SHAH ET AL., THE REGULATOR OF TOMORROW, DELOITTE 2, 3 (June 11, 2015) ("The exponential pace of technological change. New technologies that used to have two–year cycle times now can become obsolete in six months, and the pace of change is not slowing. Moore's Law posits that computer processing power will double every two years, and this exponential rate of increase has also been shown to hold true in industries beyond computing. When combined with software that is 'eating the world,' new technologies can be developed, deployed, and iterated faster than ever. This presents a unique timing challenge for regulatory agencies: Regulate too early and you risk stymieing innovators; wait too long and you risk losing the opportunity to regulate a technology

and stifles or distorts technological development, but not so late that problems arise as a result of the absence of effect regulation. The time frame for rulemaking in the existing regulatory infrastructure is largely inadequate to address regulatory challenges associated with disruptive innovation. While rulemakers may be able to update regulations and regulatory guidance to address regulatory issues created by disruptive innovation, given the exponential nature of disruptive innovation, they are less able to *adequately* update existing rules in the existing regulatory framework where regulators and commentators are engaged in a long, drawn–out feedback process that involves hearings, proposed rules, the submission of comment letters, before finally agency lawyers finalize a rule after considering the comments.[41] Formal rulemaking is simply too time–consuming.[42] The speed of product innovation makes it possible to bring a new product to market while formal rulemaking in the existing regulatory infrastructure, taking months and often years of regulatory procedure, is still dealing with the last product launch. New regulations pertaining to an innovative product could be obsolete before they are finalized.[43]

The "how question" is about the form and substance of the regulation.[44]

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or service before it becomes widespread, potentially harming consumers or markets in the interim.").

41. Lynn E. Blais & Wendy E. Wagner, *Emerging Science, Adaptive Regulation, and the Problem of Rulemaking Ruts*, 86 TEX. L. REV. 1701, 1706 (2008).

42. Cass R. Sunstein, *Is the Clean Air Act Unconstitutional?*, 98 MICH. L. REV. 303, 371 (1999) ("With respect to systematic effects: A great deal of attention has been paid to the phenomenon of the 'ossification' of notice–and–comment rulemaking, and indeed a high priority, for the future of administrative law, is to devise means to overcome the problem. Originally intended as a quick and effective alternative to formal, on–the–record rulemaking, executive and especially judicial innovations have converted notice–and–comment rulemaking into an exceptionally time–consuming affair, often consuming many years, frequently half a decade and more. In fact EPA estimates that informal rulemaking typically takes five years."); Thomas O. McGarity, *Some Thoughts on "Deossifying" the Rulemaking Process*, 41 DUKE L.J. 1385, 1385 (1992) ("Although informal rulemaking is still an exceedingly effective tool for eliciting public participation in administrative policymaking, it has not evolved into the flexible and efficient process that its early supporters originally envisioned. During the last fifteen years the rulemaking process has become increasingly rigid and burdensome.").

43. Barefoot, *supra* note 22, at 10.

44. *See* Julia Black, *Forms and Paradoxes of Principles Based Regulation*, LSE L., SOC'Y & ECON. WORKING PAPERS 1, 14 (2008) ("A rule, any rule —legal or non–legal, issued by a regulator or formed within a firm — has a number of different dimensions. These are first its substance: what it concerns. Second, its status: whether it is legally binding or not, and the sanction, if any, which attaches to its breach. Third, its character, whether it prohibits, permits, discourages or mandates certain behaviour. Fourth, its linguistic structure: whether the language which the rule uses is vague or precise, whether the rule is simple or complex in its requirements, whether its language is clear and easily understood, or opaque.").

Should the technological innovation be encouraged, prohibited or restricted in some way? And what substantive rules or principles should be adopted to achieve this regulatory goal? The existing regulatory infrastructure cannot sufficiently distinguish and harness beneficial innovation. In fact, the existing rulemaking process often prohibits ex parte communications,[45] involves very little brainstorming, and undermines innovation.[46] Because technological transition is going to be a permanent state in the age of disruptive innovation, rulemakers' inability to address regulatory issues associated with disruptive innovation will likely generate high levels of legal uncertainty and inconsistency[47] that inhibit innovation during technological transition periods. The current regulatory framework lacks a mechanism that succinctly and anticipatorily informs rulemakers of beneficial innovative ideas.

In each case, these policy judgments are made by politicians and bureaucrats based — in large part — on facts provided by experts. The delegation of regulatory decisions to a combination of democratically chosen politicians and bureaucrat–experts is one way of conceptualizing the distinctiveness of political modernity.

In this context, however, we are more interested in the identification of the relevant facts. Some of the relevant facts may be obvious. The fact that drones may interfere with low flying planes or inadvertently land on innocent bystanders, for example, makes establishing reliable information on the likelihood of such occurrences vital. However, there are various potential problems with this fact–identification exercise. Some facts may be difficult to empirically establish or contested, even amongst experts in

45. 5 U.S.C. § 557(d)(1) (2012); Ex Parte Communications in Informal Rulemaking Proceedings (Recommendation 77–3), 42 Fed. Reg. 54,251, 54,253 (Oct. 5, 1977) (listing other advantages associated with restraining ex parte communications, including reducing possibility of unfair influence over decision makers and affording interested parties opportunity to respond to information relied upon in the decision–making process).

46. *See* Peter H. Schuck, *When the Exception Becomes the Rule: Regulatory Equity and the Formulation of Energy Policy Through an Exceptions Process*, 1984 DUKE L.J. 163, 197 (1984) ("Hastily prepared, overbroad rules can be disastrous for those who technically are covered by the rules but to whom the rules should not, in justice or sound policy, be applied. Inflexible application of such rules may quickly create grave competitive distortions, perhaps even driving firms out of business before the rules can be refined or eliminated."); *see also* Blais & Wagner, *supra* note 41, at 1705 ("Agencies are increasingly turning to even more informal methods — which lack adequate opportunities for public participation and evade meaningful judicial oversight — to promulgate important policies. And, not surprisingly, agencies are increasingly reluctant to revisit rules after enactment, even if the factual or policy predicates underlying them have changed.").

47. Barefoot, *supra* note 22, at 9.

that field. The task of establishing facts about new technology may be made difficult by the lack of an adequate sample or other reliable data on the effects of new technology.[48]

Identification of relevant or irrelevant facts may also be distorted or otherwise influenced by the concerns of entrenched interests about new (and commercially threatening) technologies.

Finally, other facts may be — to quote Donald Rumsfeld — "unknown unknowns."[49] We simply lack the experience or imagination to predict what negative possibilities may be associated with a piece of new technology.[50]

In this respect, the "relevant facts" that form the basis of regulation are never going to be obvious or settled. The regulation of any disruptive new technology is always going to be reactive and based on an uncertain and politicized factual basis.

We need to be careful not to overstate the newness of this issue. To some degree, these kind of difficulties have always been around, at least since the rise of industrial capitalism and the acceleration in technological advancement that it facilitated.[51]

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48. Gregory N. Mandel, *Emerging Technology Governance*, *in* INNOVATIVE GOVERNANCE MODELS FOR EMERGING TECHNOLOGIES 44, 62 (Gary E. Marchant et. al. eds., 2013) ("Given the uncertainty surrounding an emerging technology's development and risks, there will be inherent limitations concerning how specific a framework can be developed at early stages.").

49. Press Conference, Donald Rumsfeld, U.S. Sec'y of Def., NATO HQ, Brussels (June 6, 2002), http://www.nato.int/docu/speech/2002/s020606g.htm ("The message is that there are no "knowns." There are thing we know that we know. There are known unknowns. That is to say there are things that we now know we don't know. But there are also unknown unknowns. There are things we don't know we don't know. So when we do the best we can and we pull all this information together, and we then say well that's basically what we see as the situation, that is really only the known knowns and the known unknowns. And each year, we discover a few more of those unknown unknowns.").

50. *See* Wulf A. Kaal, *Dynamic Regulation of the Financial Services Industry*, 48 WAKE FOREST L. REV. 791, 799 (2014) [hereinafter Kaal, *Financial Services Industry*] ("Anticipation of unknown future contingencies and the preemption of possible future crises do not play a significant role in the current regulatory framework or in the literature on financial regulation.").

51. Schumpeter described as early as the 1940s the "gaels of creative destruction," often unleashed by technology, that periodically sweep through industries and sink weak and outdated firms. JOSEPH A. SCHUMPETER, CAPITALISM, SOCIALISM, AND DEMOCRACY 83–84 (3d ed. 1962) ("The opening up of new markets, foreign or domestic, and the organizational development from the craft shop and factory to such concerns as U.S. Steel illustrate the process of industrial mutation that incessantly revolutionizes the economic structure from within, incessantly destroying the old one, incessantly creating a new one. This process of Creative Destruction is the essential fact about capitalism. It is what capitalism consists in and what every capitalist concern has got to live in . . . Every piece of business strategy acquires its true

An obvious solution to this regulatory dilemma might be to adopt some form of policy experimentation, i.e., testing different regulatory schemes and then comparing the results.[52] But such experimentation poses a problem for regulators.[53] Too often, regulators define "success" in negative terms, as in the avoidance of catastrophe.[54] Avoiding grounds for criticism inevitably results in an overly cautious approach, called the "precautionary principle."[55]

From the perspective of entrepreneurs and consumers, such caution can be a "disaster" or at least less preferable.[56] The result is that, all too often, there is a disconnect between regulation and commercial and consumer access to that innovation.[57]

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significance only against the background of that process and within the situation created by it. It must be seen in its role in the perennial gale of creative destruction; it cannot be understood irrespective of it or, in fact, on the hypothesis that there is a perennial lull."); *see also* John Komlos, *Has Creative Destruction Become More Destructive?* (Nat'l Bureau Econ. Research, Working Paper No. 20379, 2014), (suggesting that the creative destruction aspect of capitalism is being amplified, especially in labor markets, by the exponential pace of technology).

52. Wulf Kaal, *What Happens When Technology Is Faster Than the Law?*, CLS BLUE SKY BLOG (Sept. 22, 2016), http://clsbluesky.law.columbia.edu/2016/09/22/what-happens-when-technology-is-faster-than-the-law/.

53. *Id.*

54. *See* Noah M. Sachs, *Rescuing the Strong Precautionary Principle from Its Critics*, 2011 U. ILL. L. REV. 1285, 1298 (2011) ("One defining feature of the Strong Precautionary Principle is that it places a governmental entity in a role as a risk gatekeeper. Implicit in the Principle is the idea that there must be a 'decider' who will determine whether the proponent of the activity has met its burden of proof on safety. The preventive thrust of Strong Precaution further implies that this review of risks should occur *before* the activity commences or the potentially risky product reaches the market.").

55. The "precautionary principle" is a term used prominently by the UN on declaring regulatory policy on environmental issues. *See, e.g.*, United Nations Conference on Environment and Development, Rio de Janiero, Braz., June 3–14, 1992, The Rio Declaration on Environment and Development, U.N. Doc. A/CONF.151/5/Rev.1 (June 13, 1992), reprinted in 31 I.L.M. 874, 879 (1992) (showing the UN's prominent use of the precautionary principle when declaring regulatory policy on environmental issues); *see also* Robert W. Kahn & Cass R. Sunstein, *The Precautionary Principle as a Basis for Decision Making,* 2 ECONOMISTS' VOICE, 1, 1 (2005) ("We argue that the precautionary principle does not help individuals or nations make difficult choices in a non–arbitrary way. Taken seriously, it can be paralyzing, providing no direction at all."); John D. Graham, *The Perils of the Precautionary Principle: Lessons from the American and European Experience*, HERITAGE FOUND.: HERITAGE LECTURES (Jan. 15, 2004), http://www.heritage.org/research/lecture/the-perils-of-the-precautionary-principle-lessons-from-the-american-and-european-experience.

56. Kaal, *supra* note 52.

57. *Id.*

A. Facts Today

In spite of these problems, a fact–based approach to regulation may have worked relatively well in the past when innovation cycles were longer and the pace of disruptive innovation occurred over decades.[58] Regulators had the necessary time to get their facts in order before making a regulatory intervention.[59]

In this respect, it is again instructive to consider the origins of the modern automobile industry. Karl Benz was awarded a patent for the internal combustion engine in 1879, and started producing automobiles in the mid–1880s.[60] However, Benz's engine did not disrupt the horse and carriage industry or bring the automobile into the mainstream of everyday life. This only occurred much later, in 1908, when Henry Ford started to mass produce the Model T.[61]

The slower pace of technological disruption explains why, until relatively recently, the public was happy to delegate regulatory decisions about new technology to policy makers relying on the scientific advice of

58. Vermeulen, *supra* note 2; Rick Rieder, *Tech Adoption Rates Have Reached Dizzying Heights*, MKT. REALIST (Dec. 24, 2015, 9:32 AM), http://marketrealist.com/2015/12/adoption-rates-dizzying-heights/; Rita Gunther McGrath, *The Pace of Technology Adoption Is Speeding Up*, HARV. BUS. REV. (Nov. 25, 2013), https://hbr.org/2013/11/the-pace-of-technology-adoption-is-speeding-up.

59. *See* ALLENBY, *supra* note 26, at 10 ("But it is not just that each NBRIC technology system is powerful; it is that they are combining in unexpected ways that are both beyond any single technological domain, and very potent."); Steven W. Popper, *Technological Change and the Challenges for 21st Century Governance*, AAAS SCI. AND TECH. POL'Y Y.B. 83, 86 (2003) ("We see a growing divergence between time cycles of government and those of technology development. Quite simply, this presents government operations with a Hobson's choice: Either live within a shorter response time and run the concomitant risk of ill–considered actions (or inactions) or see government input become less relevant and assume reduced stature. The risk of insufficient access to information is large. This goes beyond the problem of gaining awareness of and collating relevant data series. A related and in many ways more problematic issue is that of managing and accounting for data and other knowledge resources. There is then, of course, the central task of analyzing and providing an interpretation of the data. These issues are already of concern and will increase in time.").

60. JOHN COAD, FINDING AND USING OIL 48 (2008) ("He received his first patent in 1879, and founded Benz & Company to produce industrial engines in Germany. He began designing a 'motor carriage.' Benz designed his three–wheel carriage engine with an electric ignition, differential gears and water cooling. It was first driven in Mannheim in 1885. On January 29, 1886, he was granted a patent for his gasoline–fuelled automobile.").

61. ALAN AXELROD & CHARLES PHILLIPS, WHAT EVERY AMERICAN SHOULD KNOW ABOUT AMERICAN HISTORY: 225 EVENTS THAT SHAPED THE NATION 210 (3d ed. 2008) ("The company was profitable from the start but become even more so in 1908, when Ford introduced the Model T. Up to this point, all manufacturers, including Ford himself, had seen the automobile as a custom–made luxury item for the wealthy.").

experts.[62] Although the public once had a relatively high degree of trust in both the political process and the scientific/expert method, consistent empirical evidence demonstrates that both trust in government and experts has declined in recent years.[63]

In today's world, the incessant speed of technological change means that this kind of approach faces insurmountable challenges. The pressure of time means that the facts surrounding a piece of new technology or other innovation may not be there, or the regulators may simply select the "wrong" — or at least contested or otherwise irrelevant — facts as the basis of regulation. The lack of time means that establishing facts or negotiating with entrenched interests becomes much more difficult.[64]

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62. Rebecca M. Bratspies, *Regulatory Trust*, 51 ARIZ. L. REV. 575, 576–77 (2009) ("Beck explains that unceasing technological innovation significantly contributes to risk and uncertainty in modern industrial society by forcing a constant reassessment of the relationships between scientific knowledge, technology, and public policy. In particular, new technologies underscore a growing divergence between market incentives and social welfare. As a society, we often turn to regulation to bridge that gap. But, in contexts as diverse as the licensing of agricultural biotechnology, the approval of new drugs or oversight of new financial instruments, the same refrain plays over and over — regulators must make high–stakes regulatory choices that implicate poorly understood risks.").

63. *See* Cary Funk & Lee Rainie, *Public and Scientists' Views on Science and Society*, PEW RES. CTR., (Jan. 29. 2015), http://www.pewinternet.org/2015/01/29/public-and-scientists-views-on-science-and-society/ ("Despite broadly similar views about the overall place of science in America, citizens and scientists often see science-related issues through different sets of eyes. There are large differences in their views across a host of issues."); *Beyond Distrust: How Americans View Their Government*, PEW RES. CTR., (Nov. 23, 2015), http://www.people-press.org/2015/11/23/1-trust-in-government-1958-2015/ ("The erosion of public trust in government began in the 1960s. The share saying they could trust the federal government to do the right thing nearly always or most of the time reached an all–time high of 77% in 1964. Within a decade — a period that included the Vietnam War, civil unrest and the Watergate scandal — trust had fallen by more than half, to 36%. By the end of the 1970s, only about a quarter of Americans felt that they could trust the government at least most of the time . . . . Amid the war in Iraq and economic uncertainty at home, trust in government continued to decline. By July 2007, trust had fallen to 24%. Since then, the share saying they can trust the federal government has generally fluctuated in a narrow range, between 20% and 25%."); *see also* Bratspies, *supra* note 62, at 577 ("Trustworthy regulators have the potential to enhance society's overall resilience, but uncertainty erodes the public's trust and alienates citizens from the regulatory institutions intended to serve them. Declining levels of trust in government institutions both document and reflect this grim reality. Loss of trust undermines regulatory effectiveness and diminishes society's overall capacity to persevere and even thrive in the face of multiple, unpredictable risks.").

64. Vermeulen, *supra* note 2; Wulf A. Kaal, *Dynamic Regulation via Investment Data as a Remedy for Law's Diminishing Capacity to React to Innovation*, OXFORD BUS. L. BLOG (Sept. 18, 2016), https://www.law.ox.ac.uk/business-law-blog/blog/2016/09/dynamic-regulation-investment-data-remedy-law%E2%80%99s-diminishing-capacity; Kaal, *Innovation*, *supra* note 4.

Moreover, there is a much greater degree of skepticism about the policy makers and scientists. Most people may not be familiar with terms such as "agency capture" or "minoritarian bias,"[65] but they are acutely aware of the way that political and scientific processes have been distorted by vested interests and lobbying on the part of well–organized interest groups.[66]

Take *Airbnb*, for example. Regulators in some countries have become concerned that individuals looking to get rich from renting out properties via *Airbnb* are buying housing in desirable urban residential areas, thus distorting property prices and — potentially — creating housing shortages in such areas.[67]

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65. *See* Neil K. Komesar, *A Job for the Judges: The Judiciary and the Constitution in a Massive and Complex Society*, 86 MICH. L. REV. 657, 671 (1988) ("Minoritarian bias supposes an inordinate power of the few at the expense of the many. The power of these few stems from better access to the seats of power through personal influence, organization, information, or sophistication. In our society, influence can be gained by identifying important political figures and delivering what those political figures want. The terms of trade may be as crass as graft or as innocent as information."); Neal D. Fortin, *The Hang–Up with HACCP: The Resistance to Translating Science into Food Safety Law*, 58 FOOD & DRUG L.J. 565, 582 (2003) ("Agency capture has been described as the occasion when a regulated firm wins 'the hearts and minds of the regulators.' Capture in this instance, however, is not an all–or–nothing phenomenon, but a matter of degrees. In the subtlest sense, capture exists any time an agency moves too far toward accommodating a single interest while moving away from its statutory mission.").

66. *See* John C. Coffee, Jr., *The Political Economy of Dodd–Frank: Why Financial Reform Tends to Be Frustrated and Systemic Risk Perpetuated*, 97 CORNELL L. REV. 1019, 1036 (2012) ("The alternative view, here presented, agrees that crisis is a precipitant, allowing legislative inertia to be overcome. After a crisis, Congress tends to adopt proposals long–favored by the relevant administrative agency but frustrated by powerful lobbies. Only with a crisis can reformers — or 'political entrepreneurs' in the political science vernacular — aggregate sufficient support to pass reform legislation. For example, in the years prior to the Enron and WorldCom crisis in 2001 and 2002, SEC Chairman Arthur Levitt sought to respond to a soaring number of financial statement restatements and campaigned to restrict auditor conflicts of interest. Levitt was rebuffed, however, by the industry. With the Enron and WorldCom insolvencies and the evidence of financial impropriety manifest to all, Levitt and others — most notably, Senator Paul Sarbanes — convinced Congress to replace auditor self–regulation with a new body: the Public Company Accounting Oversight Board (PCAOB)."); Roberta Romano, *Regulating in the Dark* 4 (Yale Law Sch. John M. Olin Ctr. for Studies in Law, Econ., and Pub. Pol'y, Research Paper No. 442, 2011), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1974148 ("A typical pattern in a financial crisis is a media clamor for action, reflecting, if not spurring, a similar popular demand, and as a crisis intensifies, an accompanying suggestion that government inaction is prolonging the pain and suffering. A risk averse legislator, whose objective is reelection, will, no doubt, conclude that there is a need to respond without seeking to ascertain, if it were even possible, whether such demands are media–driven, or popularly shared, or, in fact, necessary to resolve the problem.").

67. *See* Tim Logan et al., *Airbnb and Other Short–Term Rentals Worsen Housing Shortage, Critics Say*, L.A. TIMES (Mar. 11, 2015, 3:00 AM), http://www.latimes

The solution? A rule that requires those renting accommodation via *Airbnb* to be actually living in the property when it is being used.[68]

Of course, the selection of the "relevant facts" in this case and the resulting rule benefits certain vested interests, most obviously the hotel industry who stand to lose out from the new competition from *Airbnb*.[69]

But are the selected facts in this case relevant or even correct? A possible effect of a rule requiring residency of rented accommodation is that it may limit *Airbnb* in certain markets, so it is clearly important to get this right.[70]

Are the people intending to offer *Airbnb* accommodation really only in it for the money? In many cases, renting accommodation may be about connecting with people from other cultures or offering a welcoming experience for tourists visiting a new city.[71]

The "factual" premise or basis of the regulation — i.e., individuals looking to make easy money from residential properties — may simply be

.com/business/realestate/la-fi-airbnb-housing-market-20150311-story.html ("A study rel eased Wednesday from Los Angeles Alliance for a New Economy, a labor–backed advocacy group, estimates that more than 7,000 houses and apartments have been taken off the rental market in metro Los Angeles for use as short-term rentals."); *see also* Biz Carson, *The Fight Between Airbnb and San Francisco Just Got Nastier*, BUS. INSIDER (May 15, 2015, 9:00 PM), http://www.businessinsider.com/san-francisco-report-blames-airbnb-for-housing-shortage-airbnb-strikes-back-2015-5 ("On Monday, the Board of Supervisors Land Use and Transportation Committee will vote on how to amend the regulation. One proposal from the Mayor's office puts the cap at 120 days a year for short term rentals. Another option set forward by Supervisor David Campos was to limit short term rentals to a max of 60 days a year and compels Airbnb to release its data to the city.").

68. *See, e.g.,* Will Coldwell, *Airbnb's Legal Troubles: What are the Issues?*, GUARDIAN (July 8, 2014), https://www.theguardian.com/travel/2014/jul/08/airbnb-legal-troubles-what-are-the-issues ("For example, in New York owners or tenants cannot legally rent their apartments out for short periods (less than 30 days) unless they are also living in the property.").

69. Vermeulen, *supra* note 2; Ahmed Mahmoud, *The Impact of Airbnb on Hotel and Hospitality Industry*, HOSPITALITYNET (Mar. 7, 2016), http://www.hospitalitynet.org/news/4074708.html (noting that HVS Consulting & Valuation "estimated that hotels lose approximately $450 million in direct revenues per year to Airbnb. Between September 2014 and August 2015, 480,000 hotel room nights were reserved while over 2.8 million room nights were booked on Airbnb. By 2018, HVS estimates that Airbnb room nights will reach 5 million per year").

70. Vermeulen, *supra* note 2; Gideon Yaffe, Op-Ed, *Activists Say Airbnb Drives Up Rents. But Is That Actually True? L.A. Needs to Find Out*, L.A. TIMES (May 13, 2016, 5:00 AM), http://www.latimes.com/opinion/op-ed/la-oe-0513-yaffe-airbnb-ordinance-la-20160513-story.html.

71. Vermeulen, *supra* note 2; Airi Lampinen & Coye Cheshire, *Hosting via Airbnb: Motivations and Financial Assurances in Monetized Network Hospitality*, *in* PROCEEDINGS OF THE 2016 CHI CONFERENCE ON HUMAN FACTORS IN COMPUTING SYSTEMS 1669 (2016).

incorrect. The selected facts may not even be facts, or at least, the most relevant facts about a particular innovation.[72]

As a second example, consider *Uber* or similar "taxi–like" car sharing services. There is no doubt that services like *Uber* are disrupting the taxi industry.[73] The effect is that regulatory debates around *Uber* are currently dominated by an unfair competition argument:

"Trustworthy and reliable taxi companies are facing unfair competition from Uber and this kind of unlicensed activity poses enormous risks for consumers."[74]

"US startup companies, in particular, don't respect the legal order that protects the European labor market."[75]

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72. Vermeulen, *supra* note 2; *Proposed MA House Bill #2816 and Your Airbnb*, MYURB.BNB (June 18, 2015), http://myurbanbnb.com/proposed-ma-house-bill-2816-and-your-airbnb/ (noting that "many use this income to help pay off mortgages, college tuition, fix up their property or to supplement their earnings due to retirement, unemployment or an unexpected occurrence").

73. *See* Megan Garber, *After Uber, San Francisco Has Seen a 65% Decline in Cab Use*, ATLANTIC (Sept. 17, 2014), http://www.theatlantic.com/technology/archive/2014/09/what-uber-is-doing-to-cabs-in-san-francisco-in-1-crazy-chart/380378/ ("The news was . . . not good, for San Francisco's taxi industry, anyway. The precipitous rise of services like Uber (and its fellow shared–ride services, like Lyft and Sidecar) has meant — markets being what they are — a precipitous decline in taxi rides taken across the city. The SFMTA's interim director Kate Toran reported to her board that the average trips per taxicab in the city had declined from 1,424 a month in March 2012 to only 504 as of July 2014."); *see also* Brishen Rogers, *The Social Costs of Uber*, 82 U. CHI L. REV. DIALOGUE 85, 86 (2015) ("Uber is sparking two major transformations of the car–hire sector. First, it is eliminating various transaction costs that have plagued the sector, particularly search costs, thereby creating something akin to a free market for car–hire services. Second, it is encouraging vertical and horizontal integration of the sector, which is highly fragmented in many cities.").

74. Vermeulen, *supra* note 2; *see, e.g.*, Dean Baker, *Don't Buy the 'Sharing Economy' Hype: Airbnb and Uber are Facilitating Rip–Offs*, GUARDIAN, https://www.theguardian.com/commentisfree/2014/may/27/airbnb-uber-taxes-regulation (last modified July 14, 2017) ("Insofar as Airbnb is allowing people to evade taxes and regulations, the company is not a net plus to the economy and society — it is simply facilitating a bunch of rip–offs. Others in the economy will lose by bearing an additional tax burden or being forced to live next to an apartment unit with a never–ending parade of noisy visitors, just to cite two examples. The same story may apply with Uber. Uber is currently in disputes with regulators over whether its cars meet the safety and insurance requirements imposed on standard taxis. Also, many cities impose some restrictions on the number of cabs in the hopes of ensuring a minimum level of earnings for drivers, but if Uber and related services (like Lyft) flood the market, they could harm all drivers' ability to earn even minimum wage.").

75. *Id.*; *see also* Evan Rudowski, *Uber, Uber Alles? Not in Europe*, TECHCRUNCH (Feb. 17, 2016), https://techcrunch.com/2016/02/17/uber-uber-alles-not-in-europe/ ("Germans love speed, but they don't love recklessness: the reason one can drive fast on the autobahn is because one can be confident that other drivers will follow the rules of the road. American companies, by contrast, are accustomed to a culture built on rejecting rules and deregulation has been gospel to the American political and

These "facts" are then used to justify regulatory intervention that effectively attempts to kill *Uber* in certain markets.

But, as with the *Airbnb* case, are these facts really facts? Or, at least, are they the most relevant facts? Do taxis really offer a better service than *Uber*? Is *Uber* any less safe than a licensed taxi? And is a lack of respect for labor laws a pertinent factor motivating companies like *Airbnb*?

The two–way rating system (drivers rate customers and customers rate drivers) and an algorithm–based system for matching up drivers and customers appear to offer an effective means of policing *Uber* drivers and ensuring a safe ride for customers.[76] And is most people's experience of licensed taxis really so great, at least when compared with *Uber*?

Most consumers just want a quick, clean and respectful service, but — all too often — incumbent taxi companies offer a disrespectful or unreliable driver and a dirty cab. There is a disconnect between the facts that regulators identify as important and the experience and wishes of most consumers.

None of this is to necessarily blame the regulators. Agency capture, in which entrenched interests distort regulatory decisions, has always posed some risk,[77] but the acceleration in innovation cycles means that even in the best conditions and with the best of intentions, selecting relevant facts is a difficult task. And the option of simply waiting seems likely to result in further complications and criticism.

In an age of constant, complex and disruptive technological innovation,

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economic mainstream since the 80s . . . . In European markets, succeeding within the rules is a badge of honor. Breaking the rules, even in pursuit of a seemingly worthy goal such as improving market efficiency or consumer choice, can be seen as offensive and not something to necessarily be applauded."); *Should Uber Be Allowed to Compete in Europe and if so How*?, COMPETITION POL'Y INT'L (Jun. 18, 2015), https://www.competitionpolicyinternational.com/should-uber-be-allowed-to-compete-in-europe-and-if-so-how/ ("Uber's arrival in Europe has generated massive demonstrations by taxi drivers and a number of court judgments banning or restricting Uber's services on the ground that the company engaged in 'unfair competition.' Uber and other online–enabled car transportation services to connect passengers with drivers offer an attractive alternative to regular taxi services. The difficulty is that these services are protected by regulatory measures that create significant barriers to entry.").

76. *See How Uber Ratings Work | 5-Star Tips*, UBER, http://ubermovement.com/ratings-are-a-two-way-street/ (last visited Sept. 8, 2016) ("Providing two–way ratings and feedback allow us to celebrate the riders and drivers who make Uber great. This system also lets us know if the quality of service provided is consistently below Uber's standards.").

77. *See* Thomas O. McGarity, *MTBE: A Precautionary Tale*, 28 HARV. ENVTL. L. Rev. 281, 325-26 (2004) (explaining that conflicts of interests arise within regulatory agencies when the agency only receives feedback on the effectiveness of regulations from regulatees and lead to the agency's regulations reflecting the economic needs of the regulate rather than the public interest).

knowing *what*, *when,* and *how* to structure regulatory interventions has become much more difficult.[78] Regulators can find themselves in a situation where they believe they must opt for either reckless action (regulation without sufficient facts) or paralysis (doing nothing). Inevitably in such a case, caution tends to trump risk. The precautionary principle becomes the default position.[79] But such caution merely functions to reinforce the status quo and the result is that new technologies struggle to reach the market in a timely or efficient manner.

B. A "Post–Fact Society"?

Should we conclude from the above analysis of the contemporary regulatory dilemma that we live in a "post–fact society?" A "post–fact society" means that facts no longer matter or that they can be reduced to the mere expression of political interests.[80]

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78. *See* Kaal, *Innovation*, *supra* note 4, at 5–6 (identifying the "pacing problem" faced by regulatory agencies; technological developments are occurring at an accelerating rate, while state and federal agencies are responding to these developments and a decelerating rate); Gary E. Marchant, *The Growing Gap Between Emerging Technologies and the Law*, *in* THE GROWING GAP BETWEEN EMERGING TECHNOLOGIES AND LEGAL–ETHICAL OVERSIGHT: THE PACING PROBLEM, 21–23 (Gary E. Marchant et al. eds., 2011) (identifying two causes of the pacing problem; first, legal frameworks are based on a static rather than dynamic view of technology and, second, regulatory institutions are slowing down with respect to their capacity to adjust to changing technologies); Moses, *supra* note 40, at 764 (explaining that the pacing problem is particularly evident in nanotechnology, biotechnology, robotics, information and communications technologies, and applied cognitive science); Lyria Bennett Moses, *How to Think About Law, Regulation and Technology: Problems with 'Technology' as a Regulatory Target*, 5 L. INNOVATION & TECH. 1, 7 (2013) (presenting different methods for approaching the pacing problem).

79. *See* Cass R. Sunstein, *Throwing Precaution to the Wind: Why the 'Safe' Choice Can Be Dangerous*, BOS. GLOBE (July 13, 2008), http://archive.boston.com/bostonglobe/ideas/articles/2008/07/13/throwing_precaution_to_the_wind/ ("[t]he precautionary principle, for all its rhetorical appeal, is deeply incoherent. It is of course true that we should take precautions against some speculative dangers. But there are always risks on both sides of a decision; inaction can bring danger, but so can action. Precautions, in other words, themselves create risks—and hence the principle bans what it simultaneously requires."); Jonathan Adler, *The Problems with Precaution: A Principle without Principle*, AEI (May 25, 2011), http://www.aei.org/publication/the-problems-with-precaution-a-principle-without-principle/ (analyzing the tendency of regulators to identify the risks of new technology without regard for the risks of existing technology).

80. *See e.g.*, Michiko Kakutani, *Texts Without Context*, N.Y. TIMES (Mar. 17, 2010), http://www.nytimes.com/2010/03/21/books/21mash.html?_r=0 ("As Mr. Manjoo observes in 'True Enough: Learning to Live in a Post–Fact Society' (2008), the way in which 'information now moves through society — on currents of loosely linked online groups and niche media outlets, pushed along by experts and journalists of dubious character and bolstered by documents that are no longer considered proof of reality' — has fostered deception and propaganda and also created what he calls a

Much of the current discussion on this issue seems to go in this kind of direction.[81] The stalemate resulting from competing claims to scientific authority has damaged — possibly even destroyed — trust in the capacity of science to provide definitive or indisputable knowledge that can form the basis of regulation.[82] And a similar skepticism surrounds politicians and their ability to exercise independent judgment, fueling the rise of a populist style of "anti–politics" in many countries.[83]

According to this type of skeptical account, we are left with a plurality of competing narratives and no criteria with which to make reliable judgments about which facts are "true."[84] We inhabit a world of theatrics and instant messaging, where truth and facts are reduced to a game — albeit a very serious one — of image management and a rhetoric of persuasion.[85]

The problem with this view is that it reinforces the type of regulatory

'Rashomon world' where 'the very idea of objective reality is under attack.' Politicians and voters on the right and left not only hold different opinions from one another, but often can't even agree over a shared set of facts, as clashes over climate change, health care and the Iraq war attest.").

81. *See* William Davies, *The Age of Post–Truth Politics*, N.Y. TIMES (Aug. 24, 2016), http://www.nytimes.com/2016/08/24/opinion/campaign-stops/the-age-of-post-truth-politics.html (questioning whether facts can still be called "'facts' when they no longer provide us with a reality that we all agree on?").

82. *Id.* ("The problem is the oversupply of facts in the 21st century: There are too many sources, too many methods, with varying levels of credibility, depending on who funded a given study and how the eye–catching number was selected . . . . Like statistics or other traditional facts, this data is quantitative in nature. What's new is both its unprecedented volume (the "big" in big data) and also the fact that it is being constantly collected by default, rather than by deliberate expert design. Numbers are being generated much faster than we have any specific use for. But they can nevertheless be mined to get a sense of how people are behaving and what they are thinking.")

83. *See e.g.,* Gerald F. Seib, *Behind the Rise of Populism, Economic Angst*, WALL ST. J., (Jan. 20, 2016), http://www.wsj.com/articles/behind-the-rise-of-populism-economic-angst-1453199402 (reporting on the increasing public mistrust of formerly authoritative figures to represent reality accurately); *Trust in Government*, GALLUP, http://www.gallup.com/poll/5392/trust-government.aspx (last visited Sept 8, 2016) (A record 81% of Americans reported in 2015 to have only have some or no trust in the government in Washington to do what is right); Coffee, *supra* note 66, at 1078–79 (detailing the tendency for those mistrustful of government to blame economic downturns on overregulation despite mountainous evidence to the contrary).

84. *See, e.g.*, Katherine Viner, *How Technology Disrupted the Truth*, GUARDIAN (July 12, 2016), https://www.theguardian.com/media/2016/jul/12/how-technology-disrupted-the-truth; Davies, *supra* note 81.

85. *See* Davies, *supra* note 81 ("As politics becomes more adversarial and dominated by television performances, the status of facts in public debate rises too high. We place expectations on statistics and expert testimony that strains them to breaking point. Rather than sit coolly outside the fray of political argument, facts are now one of the main rhetorical weapons within it.").

paralysis highlighted above. If we live in a post–truth world then we don't have any objective basis on which to act, leading to inertia or the reproduction of the status quo.

And yet, rather than abandoning facts, we should be thinking about some alternative grounds for regulation that would allow the regulation of innovative products and services to be more effective and legitimate.

After all, many consumers want instant drone delivery and many entrepreneurs are willing to provide such a service.[86] Moreover, those markets that are "first movers" stand to gain the financial and other benefits that offering such a service promises. In a global society in which regulatory competition is the "new normal,"[87] regulators can pay a heavy economic price for being overly cautious or abandoning the project of trying to establish a meaningful basis for regulation.[88]

IV. THREE PRINCIPLES FOR REGULATION TOMORROW

Lawmaking and regulatory design needs to become more proactive, dynamic and responsive.[89] So how can regulators actually achieve these goals? What can they do to promote innovation and offer better

86. *See* Teresa Hayes, *The Rising Demand for Drones in the Retail Sector*, MKT.RES.COM (June 29, 2016), http://blog.marketresearch.com/the-demand-for-drones-in-the-retail-sector ("Interest in drones from the retail sector is growing rapidly as competitive pressures push retailers and distributors to develop new ways to make their supply chains more efficient, to automate warehouses, and to reduce delivery costs. Walmart, the nation's largest retailer, recently announced plans to use drones for inventory management in its warehouses. Amazon, the nation's largest internet retailer, is researching the use of drones to deliver packages to consumers. Global e–commerce giant Alibaba is testing delivery drones in China while DHL is already using drones to deliver packages in Germany.").

87. *See* Ehud Kamar, *Beyond Competition for Incorporations*, 94 GEO. L.J. 1725, 1725 (2006) ("This [a]rticle documents and analyzes a powerful form of regulatory competition—competition for investments—that has been transforming national corporate laws in the European Union in recent years. Unlike the competition for incorporations, competition for investments shapes corporate law when firms cannot easily incorporate outside the jurisdiction in which they operate . . . . High political payoffs await successful participants in the competition for investments, which enables enable them to overcome opposition that can stifle competition for incorporations.").

88. *See id.*

89. *See* Kaal, *Innovation*, *supra* note 4, at 14–20; Kaal, *Financial Services Industry*, *supra* note 50, at 818–20 (noting financial rulemaking with dynamic elements); Wulf A. Kaal, *Evolution of Law: Dynamic Regulation in a New Institutional Economics Framework* 1, 1–4 (Univ. of St. Thomas (Minn.) Legal Studies Research Paper No. 13-17, 2013), http://ssrn.com/abstract=2267560 [hereinafter Kaal, *Evolution of Law*]; Wulf A. Kaal & Erik P.M. Vermeulen, *How to Regulate Disruptive Innovation — From Facts to Data* 2, 17 (Univ. of St. Thomas (Minn.) Legal Studies Research Paper No. 16–13, 2016), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2808044 [hereinafter Kaal & Vermeulen, *Disruptive Innovation*].

opportunities to people wanting to build a new business around disruptive technology or simply enjoy the benefits of a disruptive new technology as a consumer?

Here are three principles that we believe can form the basis of regulation tomorrow:

A. Data Driven Regulatory Intervention

Relying on different sources of data surrounding new technologies can provide some signals or clues about *what, when* and, to a certain extent, *how* to regulate.

Of particular importance in this context, is data relating to investment in new technology and innovation.[90] Such data can be used as an index or proxy of the necessity of regulation.[91]

Collecting and collating such data may appear to be a tedious task for policy makers, regulators, lawmakers and alike. However, since government funding is often considered to be the main driver behind disruptive innovations, a plethora of investment data is readily available to make accurate predictions regarding what the next "big thing" is likely to be.[92]

Moreover, the fact start–up companies usually challenge existing rules, laws, and regulations means that private data sources are widely available.[93] The proliferation of the better hand–collected global databases on the market, such as *CB Insights*, *PitchBook* and *Mattermark*,[94] can make an important contribution to a "data–driven" regulatory approach.[95]

Figure 1 gives an indication of what such a data–set might look like. The Figure shows the global venture capital investment deals per industry

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90. *See* Kaal & Vermeulen, *Disruptive Innovation*, *supra* note 89, at 7–8 ("We apply a data–driven approach that enables dynamic regulation as established by Kaal to regulatory issues associated with disruptive innovation.").

91. *Id.*

92. Vermeulen, *supra* note 2.

93. Brian Park & Erik P.M. Vermeulen, *Debunking Myths in Corporate Venture Capital: What Works, What Does Not, and How to Make It Happen*, 12 J. U.S.–CHINA PUB. ADMIN. 764, 773 (2015) ("The proliferation of global databases on the market such as Dow Jones VentureSource, CB Insights, PitchBook, and PWC MoneyTree contribute to improving the selection process for investors a great deal.").

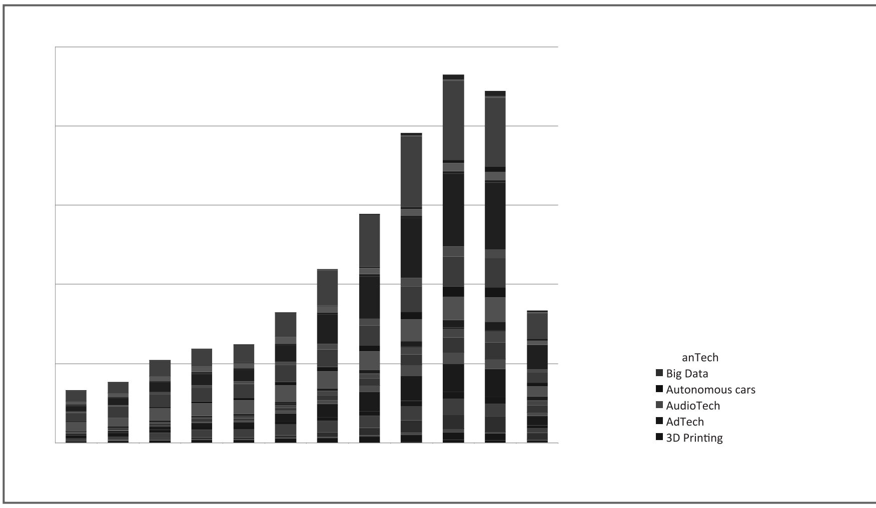
94. *Id.*

95. Vermeulen, *supra* note 2. The massive amounts of data provided by these sources, including company overviews, data on investors and investments, and on deals, people, financials, funds, mergers and acquisitions, and various other growth signals, such as web traffic and media mentions, provide emerging trends and early predictive intelligence which can provide insights into the potential timing and nature of regulatory actions.

tracked by data–provider *PitchBook* from 2005 to the first half of 2016. We could go much more granular than this, but even a broad perspective clearly indicates that certain areas, such as Fintech and the Internet–of–Things, are attracting more and more attention from investors.

In this way, investment data can help to develop a list of technologies and issues that need to be the focus of regulatory attention. From such data, we can get a better — and earlier — sense of which technologies are developing and which technologies need regulatory attention. This might then allow regulators to be more pro–active and avoid wasting resources on technologies that are unlikely to make it to market. It would also allow regulators to more accurately define the scope of a technology by focusing on the type of firm that is attracting attention.

Figure 1: Investment Data Used for Identifying Technology Trends



As to the question of *when* to make a regulatory intervention, investment data can be similarly helpful. When early stage investments peak and later stage investments are taking off, it arguably shows demand both on the commercial and consumer side. Data on the timing of investment appears to provide a reliable indicator of the commercial maturity of a technology, in the sense that high levels of investor activity indicate that a particular technology is about to be ready for commercial exploitation.[96] *Figures 2* and *3* give examples in the field of "artificial intelligence" and "robotics and drones."

As to the question of "*how* to regulate", the starting point is that regulation needs to be "demand driven," i.e., the substantial direction of the regulation needs to be based on the interests of consumers. If there is a genuine demand for certain products or technologies, then such technologies should, in principle, be permitted.[97]

The focus on the demands of the consumers does not mean that policy makers, lawmakers and regulators should ignore the negative side effects or other risks of new technologies. What it does mean, however, is that entrenched interests with a clear interest in obstructing a disruptive product or service should not be allowed to dominate the debate.[98]

Figure 2: Artificial Intelligence – Venture Capital Investments

96. *Id.*
97. *Id.*
98. *Id.*

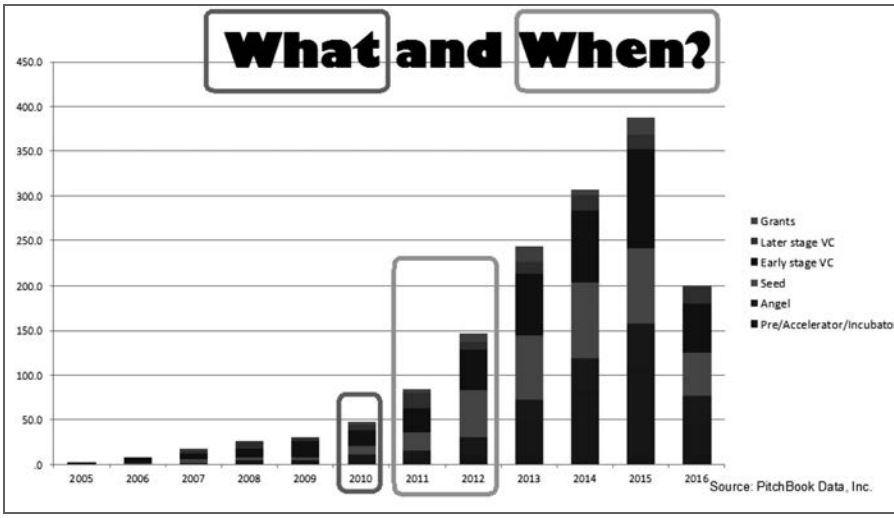
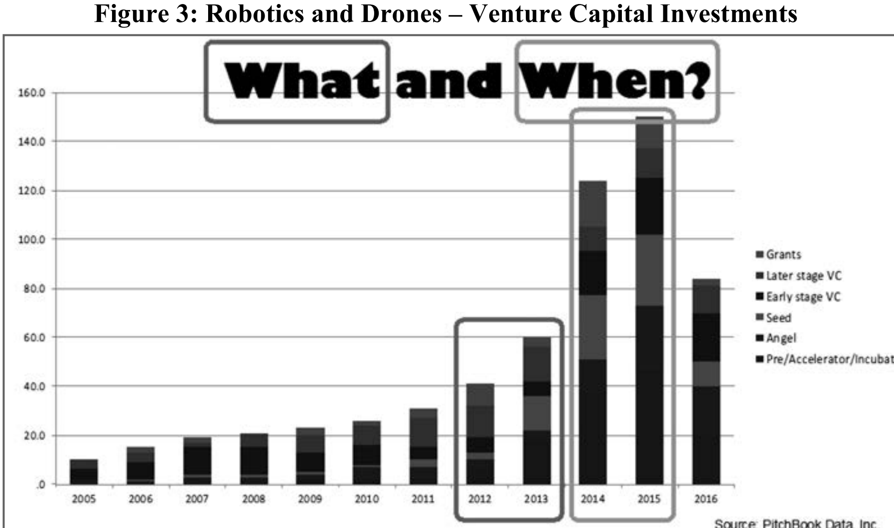


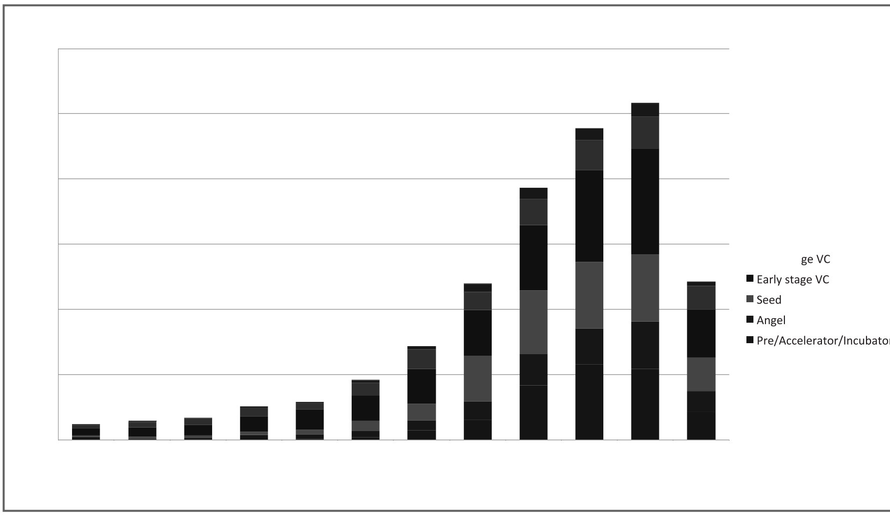
Figure 3: Robotics and Drones – Venture Capital Investments



Big Data is an example of this (see Figure 4). Clearly, the principle of respecting privacy is important, but is not without exception and can, for example, be overridden if there are clear diagnostic benefits in allowing people's private health information to be used. In this context, regulatory experimentation strategies may offer a potential solution.[99]

99. *Id.*; *see also* Michael Greenstone, *Toward a Culture of Persistent Regulatory Experimental and Evaluation*, *in* NEW PERSPECTIVES ON REGULATION 111 (David Moss & Asternino eds., 2009) (noting "we cannot know a regulation's benefits and costs

Figure 4: Big Data – Venture Capital Investments



B. A Principle–Based Approach

Regulators need to take the idea of regulatory competition seriously. Most obviously, this entails a greater willingness to engage in policy and regulatory experiments in which different regulatory regimes are adopted and results compared.[100] To some extent, regulatory competition will occur "naturally," as different jurisdictions adopt different regulatory models.[101] But such experimentation is also important *within* a particular jurisdiction as it provides regulators with data on the real–world effects of a particular regulatory scheme in a comparable setting.

Embracing regulatory experimentation involves a re–thinking — or re–framing — of what decision–making involves in a regulatory context. French sociologist, Michel Callon, emphasizes how regulatory decisions should not be thought of as "final events" (to be made for all–time and from which we "all move on").[102] Rather, we should think of them as "measured decision–making," i.e., open–ended and highly contingent

until it has been tested").

100. *See, e.g.,* Christian Kirchner, Richard W. Painter & Wulf A. Kaal*, Regulatory Competition I EU Corporate Law After Inspire Art: Unbundling Delaware's Product for Europe,* 2 EUR. COMPANY & FIN. L. REV. 159 (2005).

101. *See id.* at 167–70.

102. *See generally* MICHEL CALLON ET AL., ACTING IN AN UNCERTAIN WORLD: AN ESSAY ON TECHNICAL DEMOCRACY (Wiebe E. Bijkeyet al. eds., Graham Burchell trans., The MIT Press) (2009).

choices that form one stage in a longer process.[103] Regulators need to abandon a fixation on finality and legal certainty and embrace contingency, flexibility and an openness to new ideas.[104]

This shift in perspective also affects *how* we regulate disruptive technologies. A key element of a more open approach involves a shift from rules to principles. Certainly, a principle–based approach facilitates a greater degree of openness and flexibility on the part of regulators, and prevents innovative technologies (and the companies that have developed them) from becoming bogged down in the regulatory thicket that often results from a rule–focused approach.[105]

Re–framing regulation in this way and adopting a principle–based approach facilitates action and allows future revisions in the regulatory regime to be based on the incorporation of new knowledge or subsequent discoveries.

In this way, the solution to the regulatory dichotomy of recklessness or paralysis is a willingness to move beyond the expectation of finality that surrounds regulatory decision–making. Principle–based "contingency" can facilitate a new flexibility, especially if it is combined with more open communication on the part of regulators.

However, despite the clear benefits, companies often raise concerns

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103 Nathan Young, *Book Review*, 35 CANADIAN J. SOC./CAHIERS 327, 328 (2010) (reviewing MICHEL CALLON ET. AL, *supra* note 102) ("Rather than approaching decisions as final events (to be made for all–time and from which we all 'move on'), *Acting in an Uncertain World* advances the alternative notion of 'measured action' or measured decision–making, where 'you do not decide [an outcome], you take measures' that are based on inclusive processes that involve both experts and the public, but that ultimately remain open–ended so as to incorporate new knowledge, discoveries, and claims. The need for finality, the authors argue, is usually overstated, more the product of expediency and habit than actual necessity. The antidote to the false dichotomy of recklessness versus paralysis is a willingness to remove the artificial temporal horizon that currently defines decision–making, while at the same time creating new mechanisms for consistent citizen involvement in the ongoing process of determining measured actions.").

104 *See* Kaal, *Evolution of Law, supra* note 89, at 1212 ("[T]he institutional infrastructure for rulemaking was geared towards the creation of rules for governing a relatively stable society with less upward mobility and relatively stable economic and market environments."); *see also* KARL R. POPPER, THE POVERTY OF HISTORICISM 46 (3d ed. 1961).

105 Kaal, *Innovation*, *supra* note 4, at 18 ("The law and technology literature heralded principles–based regulation as another promising remedy for the pacing problem. As contrasted with more rigid rules–based regulation, principles–based regulation emphasizes general and abstract guiding principles for desired regulatory outcomes . . . . The downsides of principles–based regulation include a costly and time consuming change from rules–based regulations to principles–based regulation, uncertainty, and compliance problems because of uncertainty.")

about risks related to doing business in a principle–based environment.[106] The argument is that it is usually impossible to comply with principles that could change "after the fact."[107] That is to say, a principle–based approach may facilitate policy makers, lawmakers, and regulators in promulgating facts–based laws and rules through the backdoor.[108] How then can we deal with this potential shortcoming of a principle–based strategy?

C. The Minimum Regulatory "Sandbox"

The Financial Conduct Authority ("FCA"), the financial regulatory body in the United Kingdom, may offer some clues. In April 2016, the FCA broke new ground by announcing the introduction of a "regulatory sandbox," which allows both startups and established companies to roll out and test new ideas, products, and business models in the area of Fintech (i.e., new technologies aimed at making financial services, ranging from online lending to digital currencies, more efficient).[109] The investment data suggests that the UK regulator is moving in the right direction with this kind of decision (see Figure 5).

The idea behind the sandbox is to provide a safe space for testing innovative products and services without being forced to comply with the applicable set of rules and regulations.[110] With the sandbox, the regulator

106. Julia Black et al., *Making a Success of Principles–Based Regulation*, 1 L. & FIN. MKTS. REV. 191, 196 (2007) ("One of the criticisms usually raised against Principles–based regimes is that they do not give the industry the comfort of knowing where it stands because the meaning of the Principles is not sufficiently certain.").

107. Kaal, *Innovation*, *supra* note 4, at 18 ("Dynamic regulatory mechanisms can avoid the downsides of principles–based regulation. Similarities between dynamic regulatory mechanisms and principles–based regulation include the ability to respond to changing industry practices and the ability to improve relationships between regulators and regulated companies. Dynamic regulation can respond to changing industry practices through feedback effects and enhanced information for regulation. Dynamic regulation improves the relationship between regulators and companies through for–cause regulation based on real–time high quality information for regulation and associated feedback effects.").

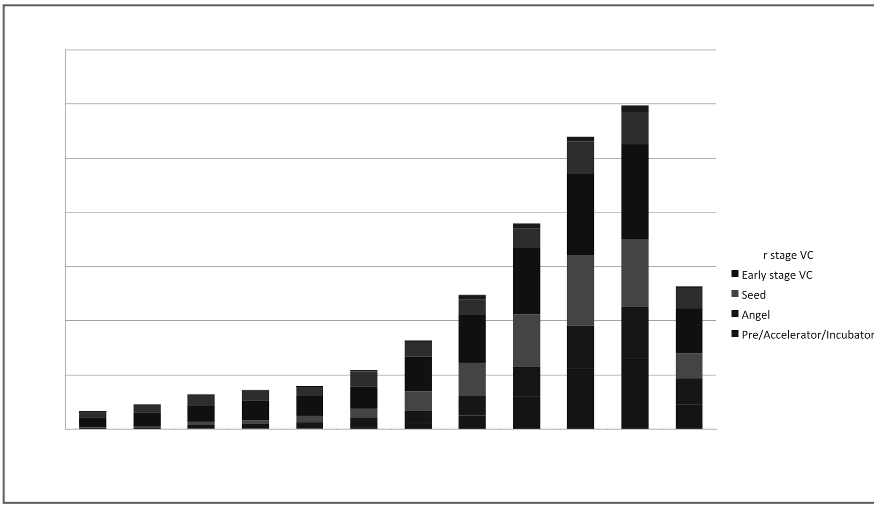
108. *Id.*

109. *See generally* Christopher Woolard, FCA Dir. of Strategy and Competition, Address at the Innovate Finance Global Summit (Apr. 11, 2016).

110. FCA, *Foreword* to REGULATORY SANDBOX 1, 1 (2015), ("This paper is a report to Her Majesty's Treasury on the feasibility and practicalities of developing a regulatory sandbox that is a 'safe space' in which businesses can test innovative products, services, business models and delivery mechanisms without immediately incurring all the normal regulatory consequences of engaging in the activity in question. We believe there is opportunity to expand Project Innovate and introduce a regulatory sandbox. In this report, we set out our plans for implementing the sandbox and proposals for how we can work with industry and the Government to further support businesses.").

aims to foster innovation by lowering regulatory barriers and costs for testing disruptive innovative technologies, while ensuring that consumers will not be negatively affected.[111]

Figure 5: FinTech – Venture Capital Investments



What is perhaps most interesting about the sandbox is that new ideas, product, and services can be tested in a "live" environment.[112] In order to create this environment, the *FCA* defined a set of default parameters that can be altered on a case–by–case basis.[113] These parameters include:

> ***Duration*** — as a default the FCA considers three to six months to be appropriate.

111. *See id*. at 3 (noting that the three key questions that were investigated by the FCA on the sandbox proposal were the following: regulatory barriers[(how and to what extent can they be lowered?], safeguards [(what safeguard should be in place to ensure safety], and legal framework [(what regulatory arrangement are mandated by EU law]).

112. *See* Chris Tobey, *The Financial Conduct Authority (FCA) Went Live With Project Innovate in October 2014 With the Aim to Encourage Competition in the Finance Industry Through Disruptive Innovation in the Interest of Consumers*, SWORD APAK (June 16, 2016, 15:54 PM), http://sword-apak.com/blog/posts/2016/june/the-fca-regulatory-sandbox-is-here-to-disrupt-the-finance-industry-in-a-big-way/ ("Unauthorized firms will be given restricted authorization to test their products/strategies in a live environment without the concerns of costs and standard regulatory requirements.").

113. FCA, *supra* note 110, at 3 ("The FCA sandbox unit will offer a range of options: Firms face different regulatory challenges depending on a range of factors, including regulatory status and type of activity. We have identified a range of available options for helping firms to address some of these challenges while testing in the sandbox (see section 3.5 and following).").

> ***Customers*** — the number of customers should be big enough to generate statistically relevant data and information. This means that customers should be selected based on certain criteria that are appropriate for the product and service. Clearly, pre–agreed safeguards and protections should be in place.
>
> ***Disclosure*** — customers should be accurately informed about the test and available compensation (if needed). Moreover, indicators, parameters and milestones that are used during the testing phase should be clear set out from the outset.

What makes the regulatory sandbox so attractive is that, insofar as technology has consequences that flow into everyday lives, such technology will be open to discussion and democratic supervision and control. In this way, public entitlement to participate in regulatory debates can help to create a renewed sense of legitimacy that justifies the regulation.

It should come as no surprise that "regulatory sandboxes" are currently being discussed and considered by other regulators, such as the Australian Securities and Investment Commission (*ASIC*), Singapore's Monetary Authority (*MAS*) and Abu Dhabi's Financial Services Regulatory Authority (*FSRA*).[114]

CONCLUSION

Regulators seem to understand that we have moved away from a model in which regulatory decision–making is fact–based and delegated to politicians and experts. In a data–based regulatory environment there is a clear need for measures that are built on flexible and inclusive processes that involve startups and established companies, regulators, experts and the public. This regulatory approach is already adopted in the financial industry. It is only to be expected that this trend will expand to other areas

114. *See* Patrick Dwyer, *Regulatory Sandboxes: 'Safe Spaces' for Start–Ups*, FIN TECH BUS. (June 27, 2016), http://www.fintechbusiness.com/blogs/399-regulatory-sandboxes-safe-spaces-for-startups ("These sandboxes will allow start–ups to test their services in a live environment with a reduced level of regulation, much like a clinical trial for a new drug. In the words of the UK's Financial Conduct Authority (FCA), the regulatory sandbox is a 'safe space' for fintech start-ups. A regulatory sandbox scheme was launched by the FCA last year. The Monetary Authority of Singapore (MAS), keen to promote Singapore as a fintech innovation centre, released a proposal paper on its regulatory sandbox on 6 June."); *see also Innovation Hub*, AUSTL. SEC. & INV. COMMISSION (last updated Nov. 7, 2016), http://asic.gov.au/for-business/your-business/innovation-hub/ ("Through the hub, eligible businesses can request to receive informal guidance from ASIC on the licensing process and key regulatory issues that should be considered as you set up your business. This information is designed to help you understand your options and, if relevant, prepare your applications for licenses or waivers from the law.").

of innovation and technology.

PROTECTING FASHION DESIGNS: NOT ONLY "WHAT?" BUT "WHO?"

JULIE ZERBO*

> *"Design piracy can wipe out young careers in a single season. The most severe damage from lack of protection falls upon emerging designers, who every day lose orders, and potentially their businesses, because copyists exploit the loophole in American law."*[1]
>
> – *Lazaro Hernandez, Fashion Designer & Co–Founder, Proenza Schouler*

 The author would like to thank Barbara Kolsun, Benjamin Landry, Jennifer Williams, and Robert A. Destro for their guidance and valuable comments. She would also like to thank her parents, Dr. and Mrs. Joseph Zerbo.

1. *Innovative Design Protection & Piracy Prevention Act: Hearing on H.R. 2511 Before the Subcomm. on Intell. Prop., Competition and the Internet of the H. Comm. on the Judiciary*, 112th Cong. 4 (2011) [hereinafter *Hernandez Statement*] (statement of Lazaro Hernandez, Fashion Designer & Co–Founder, Proenza Schouler).

INTRODUCTION

The focus of this paper is on design piracy, the rampant copying of fashion designs by "fast fashion" retailers — those in the business of rapidly manufacturing and selling inexpensive copies of others' original designs — and the most fitting form of protection to shield against such piracy.[2] Due to the structure of intellectual property laws in the United States (copyright law, in particular), such copying often falls within the parameters of legal activity, allowing retailers to engage in the manufacture and sale of fast fashion without consequence.[3]

While both patent and trademark laws provide noteworthy protections for fashion designs, as discussed below, both doctrines contain significant procedural and substantive complications with respect to protecting garments and accessories against blatant fast fashion copying.[4] As a result, scholars and lawmakers, alike, have turned to copyright law in their quest to defend fashion designs from piracy. Copyright law, however, is similarly not without its own insufficiencies.[5] Historically, fashion designs have fallen outside of the scope of copyright protection because — as garments and accessories — they have an "intrinsic utilitarian function,"[6] and copyright law does not protect such useful articles. The underlying policy that drives copyright law in the United States is the encouragement creativity so that the public can benefit. Thus, the doctrine aims to strike a balance between (1) awarding "authors"[7] enough rights to incentivize them to continue to create,[8] (2) making those rights limited enough so that the

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2. Julie Zerbo, *Fast Fashion*, FASHION L. (Oct. 3, 2016), http://www.thefashionlaw.com/learn/fast-fashions-green-initiatives-dont-believe-the-hype (defining "fast fashion" as "the practice of rapidly translating high fashion design trends into low-priced garments and accessories by mass-market retailers at low costs").

3. *See* Nicole Martinez, *How Fast Fashion Retailers Built Billion–Dollar Businesses by Stealing Designs*, ART L.J. (June 18, 2015), http://artlawjournal.com/fast-fashion-retailers-built-billiondollar-businesses-stealing-designs/ (explaining why fashion is not generally protected by copyright law).

4. *See id.* (describing how patent and trademark laws provide only limited protections for fashion designers).

5. *Id.*

6. 17 U.S.C. § 101 (2012); *see also Useful Articles*, U.S. COPYRIGHT OFF., https://www.copyright.gov/register/va-useful.html (last visited May 9, 2017) (defining "useful articles" as those objects which have an "intrinsic utilitarian function" and explicitly stating that "clothing" is an example of "an object having an intrinsic utilitarian function that is not merely to portray the appearance of the article or to convey information").

7. Burrow–Giles Lithographic Co. v. Sarony, 111 U.S. 53, 58 (1884) (defining "author" as "he to whom anything owes its origin; originator; maker; one who completes a work of science or literature").

8. Specifically, giving them the ability to control how a work is initially distributed.

public may eventually utilize such creations, and (3) furthering the social benefits that arise from the widespread use of creative works.[9]

This Article asserts that the existing intellectual property protections in the United States fail to adequately protect garments and accessories. While others have written extensively on the subject, none have been able to suggest a viable approach capable of gaining enough traction in Congress to result in adopted legislation. As a result, this Article proposes an alternative that permits a designer to protect the "value–added" to a useful item, while not unduly restricting the freedom of the fashion industry to simultaneously manufacture clothing, and create and sustain trends. Fashion is, after all, largely predicated on the use and reworking of existing design elements and staples. This proposed approach markedly differs from existing literature on this subject, as it calls attention to and places substantial value in the intangible asset of reputation, an element that proves essential to the establishment and maintenance of high fashion and luxury brands.

Part II of this Article speaks to the widespread issue of design piracy and the detriment it poses for the fashion industry, especially emerging design talent. Part III concentrates on where the existing laws fall short of adequately protecting against design piracy. This includes an examination of the concept of useful articles, a key classification in the understanding of copyright protection and the corresponding doctrine of separability. Both of these principles serve as barriers to truly sufficient copyright–specific protection of fashion designs. Part IV analyzes and identifies *exactly* what we should endeavor to protect in terms of fashion designs — namely, the value–added elements of a design, as well as the reputation of designers and design brands — and how such a focus is, in fact, supported by the language of the United States Constitution and the intent of the framers.

Ultimately, Part V considers ways to reconcile the interests of both *what* and *who* we endeavor to protect. It proposes that the focus of such protection should not depend on whether a garment or accessory is useful and separable, and thus, subject to traditional copyright protection. Instead, the focus should resemble a defamation–style analysis, as defamation law's goal of guarding against the tarnishment and/or diminishment of reputation can be applied to address fast fashion retailers' hijacking of brands' design signatures and more broadly, their brand images. By removing the utility and separability inquiries from the equation, we are not only able to

9. *See* Twentieth Century Music Corp. v. Aiken, 422 U.S. 151, 156 (1975) ("The immediate effect of our copyright law is to secure a fair return for an 'author's' creative labor. But the ultimate aim is, by this incentive, to stimulate artistic creativity for the general public good." The underlying policy that drives copyright law in the United States is encouragement of creativity so that the public can ultimately benefit).

formulate more meaningful protection for garments and accessories, but we are able to advance protection that addresses *who* we aim to protect and not merely *what* we strive to protect.

II. FASHION AND THE IMPACT OF DESIGN PIRACY

Based on designs that are shown on the runway each season, fast fashion retailers are able to build enormous businesses that rely on the practice of design piracy.[10] As a result, blatant — yet entirely legal — copies make it to store shelves and e–commerce websites long before the original, authentic designs do and for a tiny fraction of the price.[11] Forever 21, H&M, Zara, Primark, Nasty Gal, ASOS, and Topshop are just a few of the most widely renowned fast fashion retailers, as their business models are based almost entirely on the offering of inexpensive, line–for–line replicas of designs of both established design houses and sought–after emerging design labels, alike.[12] Thus, enabling them to "earn a profit thanks to lower unit costs and the avoided expense of design."[13]

Such piracy commonly comes in the form of retailers replicating some of the most striking and recognizable elements of a designer's creation.[14] Take for instance, Cushnie et Ochs' Spider Halter Dress, a standout look from the New York–based brand's Fall/Winter 2011 collection. Consumers were drawn to that dress for its ornamental design elements, namely, the angled web–like strips of fabric that adorn the chest and ribs portions of the dress. These design elements were uniformly cited in nearly every fashion critic's review of this collection. For instance, writing for Style.com (now Vogue Runway), Alison Baenen, noted: "[e]lastic boning — think thin strips of fabric crisscrossing the back or side of the body — had its origins in elaborate Native American body jewelry; here it made for sexy, organic cutouts on superbly tailored dresses in molten stretch moiré or rich wool crepe."[15]

10. *See* Teri Agins, *Copy Shops: Fashion Knockoffs Hit Stores Before Originals as Designers*, WALL ST. J., Aug. 8, 1994, at A1.

11. *Id.*

12. *See* C. Scott Hemphill & Jeannie Suk, *The Law, Culture, and Economics of Fashion*, 61 STAN. L. REV. 1147, 1172 (2009) (describing how many retailers sell copies of the original design at a lower quality, and profit thanks to lower unit costs and minimal – if any – design expense).

13. *Id.*

14. *See* Nia Porter, *Are High-Fashion Copies Actually Legal?*, RACKED (Aug. 18, 2016, 11:02 AM), https://www.racked.com/2016/8/18/12428004/fast-fashion-copy-sites-legal-knockoff (detailing fast fashion retailers' "spot on" copies of runway designs).

15. Alison Baenen, *Cushnie et Ochs Fall 2011 Ready–to–Wear*, VOGUE (Feb. 12, 2011), http://www.vogue.com/fashion-shows/fall-2011-ready-to-wear/cushnie-et-ochs.

With this in mind, it should come as little surprise that in copying the Cushnie et Ochs dress,[16] ASOS, a British fast fashion giant, focused on and incorporated these key elements in creating a replica version. ASOS's Midi Dress with Cut Out Panels[17] contains the aforementioned design features and placements. These value–added elements were copied specifically to elicit the look and feel of the original design in the minds of consumers.

Figure 1: Comparison Between Cushnie et Ochs dress (left) and ASOS's Midi Dress with Cut Out Panels (right)

Let us consider another example: Loéil.com's Lighter Heeled Mules.[18] The shoe, with its prominent lighter–inspired cylindrical stiletto heel, is a dead–ringer for Paris–based "it" brand Vetements' own Lighter Heeled Mule,[19] which it showed as part of its Spring/Summer 2016 collection to much fanfare, media attention and editorial coverage.

16. *See* Figure 1 (left).
17. *See* Figure 1 (right).
18. *See infra* Figure 2 (right).
19. *See infra* Figure 2 (left).

Figure 2: Comparison Between Vetements' Lighter Heeled Mule (left) and Loéil.com's Lighter Heeled Mules (right).

Another illustration comes from Joseph Altuzarra's Spring/Summer 2015 collection, namely, his latticework leather skirt,[20] which was a noteworthy design in this specific collection.[21] Not long after Altuzarra's runway show, a highlight of the bi-annual New York Fashion Week calendar, Nasty Gal began offering its "Laser Cut Skirt" for sale.[22] The copy bears markedly similar design elements, including, the diamond-shape cut–outs, front slit, and long leather–ribbon waist closure.

Figure 3: Comparison between Joseph Altuzarra's Spring/Summer 2015 latticework leather skirt (left) and Nasty Gal "Laser Cut Skirt" (right).

20. *See* Figure 3 (left).

21. *See* Nicole Phelps, *Altuzarra Spring 2015 Ready-to-Wear*, VOGUE (Sept. 6, 2014), http://www.vogue.com/fashion-shows/spring-2015-ready-to-wear/altuzarra (des cribing the design as having "[f]etish–y leather latticework pieces").

22. *See* Figure 3 (right).

Still yet, another recurring target of design piracy is Proenza Schouler.[23] In the past several years alone, Target, Steve Madden, Nasty Gal, Forever 21, and ASOS have offered versions of the brand's famed PS1 and PS11 handbag styles, two of "the most knocked off designs on the market today."[24] This prompted the label's co–founder, Lazaro Hernandez, to speak out on behalf of one of the recent bills proposing an amendment to the Copyright Act to include *sui generis* protection for fashion designs.[25]

As intellectual property scholars Scott Hemphill and Jeannie Suk aptly noted in their own study of the state of protections for fashion designs, fast–fashion copying is dangerous.[26] It "pulls the direction of innovation toward fashion's status conferral aspects and away from its expressive aspects."[27] Professor Amy Landers echoed this sentiment, writing: "[f]ashion knockoffs present a problem that is not faced in other industries . . . . The early replication of one or a few early designs can be problematic."[28]

The negative effects borne from design piracy extend beyond fast fashion retailers' ability to rapidly manufacture and offer copies for sale at a fraction of the cost. Such tactics also serve to directly undermine the cycle of legitimate fashion design:

> The most striking consequence of low–cost, high–scale, rapid copying is not in beating an original to market, but in the ability to wait and see which designs succeed, and copy only those. Copyists can choose a target after retailers have made their buying decisions, or even after the product reaches stores, and customers have begun to buy. Such copyists can reach market well before the relevant trend has ended.[29]

Furthermore, fast fashion–style copying presents additional adversities. From a designer's perspective, there are two primary issues: (1) the loss of sales and licensing deals that result from widespread copying and (2) the less tangible but potentially even more harmful effect of damage to their brand image as a result of the proliferation of cheap knockoffs, which directly correlates to sales.[30] The following sections will examine these

23. *About*, PROENZA SCHOULER, https://www.proenzaschouler.com/about/ (last visited May 9, 2017) (describing Proenza Schouler as a New York based womenswear and accessories brand).

24. *Hernandez Statement*, *supra* note 1, at 6.

25. *See generally id.*

26. Hemphill & Suk, *supra* note 12, at 1170.

27. *Id.*

28. Amy L. Landers, *The Anti–Economy of Fashion; An Openwork Approach to Intellectual Property Protection*, 24 FORDHAM INTELL. PROP. MEDIA & ENT. L.J. 427, 501 (2014).

29. *Id.* at 1171.

30. Distinct from copyright and/or trademark infringing goods and counterfeits, knockoffs, which are defined as unauthorized copies or imitations of a product, are

issues in turn.

A. Loss of Sales and Business Opportunities

The cost of producing a collection and showing it during one of the respective seasonal fashion weeks in the form of a presentation or runway show is very costly.[31] Brands routinely spend at least $100,000 for one season.[32] With these up–front expenses, the subsequent sale of garments is essential to the viability of a brand.

While the overwhelming belief is that low–priced knockoffs have very minimal, if any, effect on the sale of luxury items,[33] this is not entirely correct. Even as Hernandez states:

> Designers are only able to recoup their investments when they later offer their own affordable ready–to–wear lines based on those high end collections. They then can lower the prices at which their designs are sold because they sell more of them. Just like other businesses — it's dependent on volume.[34]

This problem has been compounded in recent years as a result of the downturn in the global economy. For instance, the Great Recession[35] has had significant and enduring effects on the state of fashion, including styling and merchandizing, which impacts consumer buying practices.[36] As Harper's Bazaar journalist Anamaria Wilson wrote in 2008, "[f]inancial woes are putting fashion lovers in a panic. Survive with one big–ticket item, something in between, or a little bit of both."[37] As such, it is no

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legally permissible because they do not make use of legally protected intellectual property.

31. *See* Guy Trebay, *At Marc Jacobs, the Show Before the Show*, N.Y. TIMES (Feb. 16, 2011), http://www.nytimes.com/2011/02/17/fashion/17Curtain.html.

32. *Id.*; *see also Hernandez Statement*, *supra* note 1, at 2 ("Just one of our collections — and we produce 4 collections a year — costs $3.8 million. The cost of a typical show is approximately $320,000.").

33. *See* Kal Raustiala & Christopher Sprigman, *The Piracy Paradox: Innovation and Intellectual Property in Fashion Design*, 92 VA. L. REV. 1687, 1688 (2006) (arguing that pirated designs increase awareness for the original designs and, thus, can have a potentially positive effect on the original, in addition to ensuring the proliferation of trends and innovation in the industry).

34. *Hernandez Statement*, *supra* note 1, at 4.

35. *The Great Recession*, ST. OF WORKING AM., http://stateofworkingamerica.org/great-recession/ (last visited May 9, 2017) (explaining that the Great Recession was a period of economic downturn that lasted from approximately December 2007 to June 2009).

36. Lee Joon–Hawn et. al., *Fast Fashion: Out–of–the–Box Thinking in the Apparel Industry*, SAMSUNG ECON. RES. INST. 3, 6–7 (May 2011) (explaining the recession's impact on fash-ion).

37. Anamaria Wilson, *Gucci or Gas?*, HARPER'S BAZAAR (Aug. 27, 2008), http://www.harpersbazaar.com/fashion/fashion-articles/gucci-or-gas-0908.

longer taboo to mix high fashion and fast fashion, something that represented a significant fashion misstep in prior generations.[38] Consequently, it is not uncommon to see high fashion shoppers dipping their toes in the pool of fast fashion for certain items.[39] Furthermore, consumers have become less loyal to their favorite high fashion brands.[40] Women that once only wore head–to–toe designer looks have branched out by way of more individualized, diversified looks. This results in wardrobes that seamlessly combine both high fashion garments and accessories, with less investment–worthy articles.

In terms of sales, "the entry of a knockoff has an overall negative effect on the financial performance of the original,"[41] because "[t]hey cut into sales."[42] While this was an unpopular and largely unfounded notion as recently as a decade ago, the shift in consumer activity has made it so that the effect on sales is not only well–documented, but can be perceived in two distinct ways. First, there is the issue of substitution, which represents the loss of sales due to individuals buying a knockoff — a Balenciaga copy from Zara in lieu of the real thing, for instance — instead of the original design.[43] Second, there is the loss of sales that "occurs when a design becomes more ubiquitous as a result of the knockoff."[44] Both serve as roadblocks for designers that are either aiming to profit directly from sales of their original designs or to parlay their original designs into more affordable versions.[45]

In terms of the latter, an increasingly popular approach for designers to

38. The stigma that comes with mainstream collections, which had a hand in destroying the appeal of designer Roy Halston Frowick's main collection in the 1980′s, is long gone. Frowick, professionally known as Halston, signed on to do a collection with JC Penney in the 1980′s. When he teamed up with the retailer for a line of affordable dresses in 1983, one of his most celebrated stockists, Bergdorf Goodman, immediately dropped his collection from its store floor for fear that Halston's association with JC Penney would hamper the luxury image of his main collection.

39. *See* Ruth La Ferla, *Zara, Where Insiders Look for an Edge*, N.Y. TIMES (June 4, 2014), https://www.nytimes.com/2014/06/05/fashion/zara-where-insiders-look-for-an-edge.html? (stating that even high fashion shoppers "tap Zara routinely, and repeatedly, for timely, decently priced approximations of the runways' greatest hits").

40. *See* Steve Olenski, *Only One Quarter of American Consumers Are Brand Loyal*, FORBES (Mar. 26, 2012, 8:06 AM), http://www.forbes.com/sites/marketshare/2012/03/26/only-one-quarter-of-american-consumers-are-brand-loyal/.

41. Gil Appel, Barak Libai & Eitan Muller, *The Short and Long-term Impacts of Fashion Knockoffs on Original Items*, MKTG. SCI. INST. (2013), http://www.msi.org/reports/the-short-and-long-term-impacts-of-fashion-knockoffs-on-original-items.

42. Robin Givhan, *The End of 'Gown in 60 Seconds'?*, WASH. POST, Aug. 10, 2007, at C02.

43. *See* Appel et al., *supra* note 41.

44. *Id.*

45. *See generally id.*

profit from their original creations is by partnering with a mass–market retailer, such as Target, J. Crew, the Gap, Uniqlo, and H&M, to produce low–priced collections based on their main line for a more expansive audience.[46] In essence, they partner to create authorized or licensed fast fashion copies.

Widespread design piracy, however, can prove a hindrance to the establishment of such partnerships. This "[d]esign piracy makes it difficult for a designer to move from higher priced fashion to developing affordable renditions for a wider audience. It also makes it impossible to sell collections to stores when the clothes have already been knocked off."[47] This is, in part, because mass–market retailers have far less incentive to pay — oftentimes, large sums[48] — to partner with a designer or design brand if it is already stocking unauthorized copies of that brand, and thereby unofficially benefiting from the association with the brand. For example, if unauthorized replicas of Proenza Schouler's well–known PS1 handbag and garments bearing the brand's design signatures are readily available from third–party manufacturers, a fast fashion retailer, in an effort to keep costs low, is more likely to stock those goods rather than to pay to partner with Proenza Schouler. It would therefore, choose the third–party manufacturer over licensing Proenza Schouler's name and associated intellectual property in furtherance of an official collection.

B. Reputational Harm and Damage to a Brand's Identity

The less tangible, but equally — if not more harmful — issue is the reputational damage that comes about as a result of the saturation (or the appearance of saturation) of the market with copies of a designer's original creations.[49] This is particularly true if the garments and/or accessories are

46. *See* Steff Yotka, *Every H&M Fashion Collaboration, Ranked*, VOGUE (Oct. 19, 2016, 1:06 PM), http://www.vogue.com/article/hm-designer-collaborations-ranked (listing H&M's collaborative projects with high end brands/designers, such as: Chanel's creative director Karl Lagerfeld, former Lanvin creative director Alber Elbaz, Versace, Alexander Wang, Matthew Williamson, Stella McCartney, Balmain, Jimmy Choo, Maison Martin Margiela, Isabel Marant, Marni, and Kenzo); *see also* Kerry Folan, *Target's Collab History: A Timeline*, RACKED (June 25, 2012, 10:30 AM), https://www.racked.com/2012/6/25/7720279/targets-collab-history-a-timeline (providing a list of brands/designers that collaborated with Target, such as: Missoni, Alexander McQueen, Proenza Schouler, Rodarte, Jason Wu, Jean Paul Gaultier, and Liberty of London).

47. *Hernandez Statement*, *supra* note 1, at 4.

48. *See* Eric Wilson, *A Marriage of Economic Convenience*, N.Y. TIMES (Nov. 16, 2011), http://www.nytimes.com/2011/11/17/fashion/designer-retailer-union-remains-lucrative.html (explaining that designers who have partnered with H&M to license their name and design signatures have been paid approximately one million dollars for such a collaboration).

49. *See* Julie Zerbo, *Fashion in an Industry Filled with Fakes*, FASHION L. (Feb. 11,

of significantly inferior quality, which they most commonly are.[50] In addition to the loss of revenue that results from the sale of knockoffs, design piracy stands to tarnish and/or diminish a brand's reputation and goodwill.[51] This is a major barrier for young designers, in particular, who are working to establish their identity in the marketplace.[52]

When a brand becomes synonymous with mass–market availability in the mind of luxury shoppers, in particular, this can be a death knell for the brand because "in fashion, reputation matters, and overexposure plays a large role in this. It undermines a luxury brand's identity, which is often based on ideals of grandeur and exclusivity, and often leads the discerning consumer to look to another brand that still has its image of exclusivity, and thus, luxury, in check."[53]

As designers work to develop a brand, they become known for signature designs and/or aesthetics, which thereby enable them to stand out in a market filled with talent and similarly situated brands. For instance, Thom Browne, a New York–based menswear designer, is known for the exaggerated and distinct proportions of his namesake suiting.[54]

2015), http://www.thefashionlaw.com/tbt-fashion-in-an-industry-filled-with-fakes (" Not only are brands losing sales to fast fashion retailers, they stand to lose their air of exclusivity as copies are widely available."); *see also* Andrew Roberts, *Less Is More as Vuitton Stays Atop Luxury List in Brands Ranking*, BLOOMBERG (May 20, 2014, 7:01 PM), https://www.bloomberg.com/news/articles/2014-05-20/less-is-more-as-vuitton-stays-top-luxury-brand-in-ranking ("If you lose exclusivity, you lose your luxury status.").

50. *See, e.g.*, Marc Bain, *Burberry Is Suing J.C. Penney for "Inferior Quality" Knockoffs of Its Famous Check Pattern*, QUARTZ (Feb. 10, 2016), https://qz.com /614024/burberry-is-suing-j-c-penney-for-inferior-quality-knockoffs-of-its-famous-check-pattern/ (describing the inferior quality of a knockoff scarf).

51. *See* Givhan*, supra* note 42, at C02.

52. *Hernandez Statement*, *supra* note 1, at 4.

53. Julie Zerbo, *Louis Vuitton and the Danger of Over-Exposure*, FASHION L. (Apr. 30, 2015), http://www.thefashionlaw.com/louis-vuitton-the-danger-of-over-ex posure.

54. Guy Trebay, *Being Thom Browne: His Moment Is Now*, N.Y. TIMES (Feb. 8, 2013), http://www.nytimes.com/2013/02/10/fashion/the-designer-thom-browne-is-in-his-moment.html?pagewanted=all ("An expanse of hairy leg stretched between trouser hem and shoe, an unsettling bit of erogenous peekaboo that is a Thom Browne signature" and "what once looked weird now seems oddly proportionate and correct"); *see also Mary Katrantzou*, BRIT. FASHION COUNCIL, http://www.Britishfashion council.com/designer_profile.aspx?DesignerID=939 (last visited May 9, 2017) (explaining that London–based Mary Katrantzou's name is synonymous with her "hyperrealist aesthetic, bold graphics and industrial jewellery"); Emily Farra, *Monse Fall 2017 Ready-to-Wear*, VOGUE (Feb. 13, 2017), http://www.vogue.com/fashion-shows/fall-2017-ready-to-wear/monse (noting that Monse, the emerging New York–based brainchild of Laura Kim and Fernando Garcia, is known for its sought–after "Monse–isms," which include intricate crafted shirting designs and "twisted tailoring"); Alexander Fury*, A Screw Loose: The Secret of Rei Kawakubo's Signature Look*, INDEP. (June 28, 2013), http://www.independent.co.uk/life-style/fashion/news/a-screw-loose-the-secret-of-rei-kawakubos-signature-look-8679284.html (stating that Rei

When fast fashion retailers flood the market with inexpensively made and very modestly priced garments and accessories that are blatant rip–offs of designers' original garments and accessories — particularly those derived from designers' brand signatures — it creates the appearance of saturation, and thus, accessibility.[55] This thereby, undermines the foundation of high fashion, which is based not only on quality and originality, but exclusivity, as well.[56] This can have a damning effect on a brand's image, and "the dilution of a design can cut into sales, for instance, when a design [falls out of favor] in the industry [because] it becomes too widespread or associated with a less exclusive image."[57]

III. WHY EXISTING LAW IS NOT ENOUGH

Existing forms of intellectual property in the U.S. fall short in protecting fashion designs in large part because they prove either to be substantively or procedurally challenging. A brief review of the applicable forms of intellectual property that exist in the U.S. — beginning with trademark and patent law, followed by a more in–depth examination on copyright law — demonstrates that these doctrines fail to provide adequate protection for garments and accessories.

A. *Trademark and Trade Dress*

Trademark protection generally extends to "any word, name, symbol, or device, or any combination [used] to identify and distinguish goods, including a unique product, from those manufactured or sold by others and

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Kawakubo, the mastermind behind Comme des Garçons, has been recognized for the distress and decay of her clothing. Some of her earliest designs included "random holes in the garments . . . the fabrics were creased and rumpled, felted, with seams exposed. Some had raw–edged panels peeling away").

55. *See* Julie Zerbo, *Is the Internet Era Slowly Killing High Fashion?*, FASHION L. (May 8, 2014) [hereinafter Zerbo, *Internet Era*], http://www.thefashionlaw.com/is-the-internet-era-slowly-killing-high-fashion (explaining that the downsides of the instant-aneous nature of modern-day fashion is the "increased speed of copying and the overall dilution of the essence of high fashion, which whether you like it or not is founded on exclusivity and unattainability").

56. *See id.*; *see also* Deepti Chaudhary, *We Strengthen Ties by Selling a Dream: Fendi CEO*, FORBES INDIA (Nov. 12, 2014), http://forbesindia.com/article/best-things-money-can-buy/we-strengthen-ties-by-selling-a-dream-fendi-ceo/38971/1#ixzz3JYmjEr9h ("At Fendi, we are constantly trying to strengthen our ties with the audience by selling a dream, selling a lifestyle, and offering our customers a luxurious taste of our products.").

57. Silvia Beltrametti, *Evaluation of the Design Piracy Prohibition Act: Is the Cure Worse Than the Disease? An Analogy with Counterfeiting and A Comparison with the Protection Available in the European Community*, 8 NW. J. TECH. & INTELL. PROP. 147, 160 (2010).

to indicate the source of the goods."[58] This type of protection most commonly extends to a designer or brand's logo or name in accordance with the Lanham Act and state trademark law.[59] However, because this protection is limited to the trademark specimen alone, it is not broad enough to protect the underlying fashion designs, themselves.[60]

Trade dress[61] may, on its face, seem fitting for fashion designs. However, much like classic trademark protection, it is not ideal for the vast majority of designs.[62] In order to be protected as trade dress, a product must entail distinctiveness in the marketplace, either because (1) such distinctiveness is inherent or (2) it results from the development of "secondary meaning" in the minds of consumers.[63] The "secondary meaning" standard is a markedly difficult one to meet, as it requires the expenditure of great amounts of time and resources.[64] For example, the appearance of a Birkin bag — which historic French house Hermès began producing in 1984 and is one of the most famous handbags in history — is an example of a design that embodies the requisite level of secondary meaning and thus, is subject to trade dress protection.[65]

Given the resource–intensive nature of establishing secondary meaning, as is required for trade dress protection, this is an arguably ill–fitting form

58. 15 U.S.C. § 1127 (2012).

59. *See* 15 U.S.C. § 1125; *see also State Trademark Information Links*, USPTO, https://www.uspto.gov/trademarks-getting-started/process-overview/state-trademark-information-links (last modified Jan. 10, 2017) (listing state trademark laws).

60. Martinez, *supra* note 3.

61. *Trade Dress*, CORNELL L. INFO. INST., https://www.law.cornell.edu/wex/trade dress (last visited May 9, 2017) (defining trade dress as "[t]he design and shape of the materials in which a product is packaged. Product configuration, the design and shape of the product itself, may also be considered a form of trade dress"); *see also* Two Pesos, Inc. v. Taco Cabana, Inc., 505 U.S. 763, 765 (1992); Am. Greetings Corp. v. Dan–Dee Imports, Inc., 807 F.2d 1136, 1141(3d Cir. 1986); Rose Art Indus., Inc. v. Raymond Geddes & Co., 31 F. Supp. 2d 367 (D.N.J. 1998)).

62. *See generally* Jennifer S. Shultz & Jessica Bruder, *Design Patents and Trade Dress: A Fashion Pairing as Good as Dolce & Gabbana*, FASHION L. BRIEFS (June 30, 2016), http://documents.lexology.com/d0910bb5-5cd6-4430-9907-7ad01c95fdf e. pdf.

63. 15 U.S.C. § 1125(a).

64. In order to claim trade dress infringement in connection with a product's design, one must first establish that the trade dress has obtained "secondary meaning" or "acquired distinctiveness" in the marketplace. In other words, a designer must show that the public associates the product design with the particular producer of the goods or services. This may be established through a showing of a combination of the following six factors: "(1) advertising expenditures, (2) consumer studies linking the mark to a source, (3) unsolicited media coverage of the product, (4) sales success, (5) attempts to plagiarize the mark, and (6) length and exclusivity of the mark's use." (Cartier Inc. v. Sardell Jewelry, Inc, 294 F. App'x 615 (2d Cir. 2008)).

65. *See generally* Hermés Int'l v. Emperia, Inc., No. 2:14–CV–03522-SVW-VBK (C.D. Cal. 2014).

of protection for nearly all but the most established, well–funded design houses.

B. Patent

Patent law provides a significant amount of protection for fashion designs. Design patents, in particular, protect the appearance of an "article of manufacture" that is "new, original and ornamental," such as some garments and accessories.[66] While this form of protection is being increasingly utilized by established brands for their staple products and/or best–selling goods, it is not ideal for most fashion designs.[67] This is primarily because it entails a time–consuming filing and pendency process that is not cohesive with the rapid turnaround time that comes hand–in–hand with the highly seasonal nature of the fashion industry.[68] Within the average patent pendency time of roughly 19.9 months,[69] a womenswear–only fashion brand will have shown seven collections.[70] Moreover, within that year and a half time frame, before the patent is even issued, at least three of the seven collections that were shown on the runway will have been sold in stores and be "so last season," making a patent for anything other than staple items that will be reintroduced after more than one season virtually useless (particularly given that fast fashion retailers tend to beat the original designer item to stores).

Further complicating matters is the fact that design patents entail a costly process.[71] This makes them unattractive and/or unrealistic for the vast majority of design brands, which operate as small businesses.[72]

C. Copyright

On its face, copyright law appears to be an effective doctrine to protect fashion designs. While garments and accessories are not explicitly cited in the list of copyrightable subject matter set out in Section 101 of the

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66. 35 U.S.C. § 171 (2012).

67. *See generally* GUILLERMO C. JIMENEZ & BARBARA KOLSUN, FASHION LAW: A GUIDE FOR DESIGNERS, FASHION EXECUTIVES, AND ATTORNEYS 55-65 (2d ed. 2014).

68. *See id.* ("Patents are relatively expensive and time–consuming.").

69. Remy Yucel, *Patent Operations Update*, USPTO (May 5, 2016), https:// www .uspto.gov/sites/default/files/documents/20160505_PPAC_Operations_Update.pdf.

70. For instance: Fall/Winter 2017, Pre–Fall 2017, Spring/Summer 2017, Resort 2017, Fall/Winter 2016, and Pre–Fall 2016. *See* Pamela Simmons, *When Do Fashion Seasons Start?*, LEAF, https://www.leaf.tv/articles/when-do-fashion-seasons-start/ (last visited May 9, 2017) (describing the four main fashion seasons).

71. See Gene Quinn, The Cost of Obtaining a Patent in the US, IPWatchdog (Apr. 4, 2015) http://www.ipwatchdog.com/2015/04/04/the-cost-of-obtaining-a-patent-in-the-us/id=56485/ (stating that an "extremely simply" design patent costs between "$5,000 to $7,000").

72. JIMENEZ & KOLSUN, *supra* note 67, at 61.

Copyright Act,[73] this does not preclude them from protection because this list is non–exhaustive.[74] Additionally, case law suggests that fashion designs do, in fact, fall under the umbrella of copyright.[75]

To date, copyright law has provided protection for creative expressions within the realm of fashion, including, but not limited to, "original prints and patterns, unique color arrangements, and novel combinations of elements used on apparel or accessories."[76] In connection with such works, copyright law gives owners "the exclusive right to make copies, prepare derivative works, sell or distribute copies, and display the work publicly."[77]

Problematic, however, is the fact that copyright protection does not extend to useful articles, such as garments and accessories, in their entirety, as copyright law does not protect functionality.[78] Copyright law was "never intended to nor would the Constitution permit them to protect monopolies on useful articles."[79] As a result, separability is a prerequisite to copyright protection for the design of a useful article.[80] In accordance

73. Works of authorship that fall within the scope of protection of the Copyright Act of 1976 include: "(1) literary works, including computer programs in source code or object code, databases, operating systems programs embedded in ROMS, PROMS, etc., and microcode; (2) musical works and any accompanying words; (3) dramatic works and any accompanying music; (4) pantomimes and choreographic works; (5) pictorial, graphic, and sculptural works; (6) motion pictures and other audiovisual works; (7) sound recordings; and (8) architectural works." 17 U.S.C. § 102(a) (2012).

74. H.R. REP. NO. 94–1476, at 51 (1976) ("Section 102 implies neither that subject matter is unlimited nor that new forms of expression within that general area of subject matter would necessarily be unprotected.").

75. *See* Kirtsaeng v. John Wiley & Sons, Inc., 568 U.S. 519, 533 (2013) ("[W]ithout some such qualification a copyright holder could prevent a buyer from domestically reselling or even giving away copies of a video game made in Japan, a film made in Germany, or a dress (with a design copyright) made in China, even if the copyright holder has granted permission for the foreign manufacture, importation, and an initial domestic sale of the copy."); *see also* Star Athletica, LLC v. Varsity Brands, Inc., 137 S. Ct. 1002, 1016 (2017) ("We hold that an artistic feature of the design of a useful article [a cheerleading uniform in this case] is eligible for copyright protection.").

76. Oliver Herzfeld, *Protecting Fashion Designs*, FORBES (Jan. 3, 2013, 9:14 AM), https://www.forbes.com/sites/oliverherzfeld/2013/01/03/protecting-fashion-designs /#7462b37bb317.

77. *Copyright Registration for Pictorial, Graphic, and Sculptural Works*, U.S. COPYRIGHT OFF., https://www.copyright.gov/circs/circ40.pdf (last modified Sept. 2015).

78. *See* Herzfeld, *supra* note 76 (explaining that while copyright law provides protection for novel combinations of elements embodied in apparel or accessories, this protection does not extend to the designs themselves).

79. Kieselstein-Cord v. Accessories by Pearl, Inc., 632 F.2d 989, 993 (2d Cir. 1980).

80. *See, e.g.*, MELVILLE B. NIMMER, NIMMER ON COPYRIGHT § 2.08[B][3] (2000); *see also* Raymond M. Polakovic, Comment, *Should the Bauhaus Be in the Copyright Doghouse? Rethinking Conceptual Separability*, 64 U. COLO. L. REV. 871, 874 (1993)

with the legislative intent that underlies the Copyright Act:

> The shape of an industrial product may be aesthetically satisfying and valuable, [but] the Committee's intention is not to offer it copyright protection under the bill. Unless the shape of an automobile, airplane, ladies' dress, food processor, television set, or any other industrial product contains some element that, physically *or conceptually,* can be identified as separable from the utilitarian aspects of that article, the design would not be copyrighted under the bill.[81]

A "useful article" is one that has "an intrinsic utilitarian function that is not merely to portray the appearance of the article or to convey information."[82] This classification is germane, as useful articles[83] are subject to the separability construct that courts use to determine whether the design of a useful article qualifies for copyright protection as a "[p]ictorial, graphic, and sculptural" ("PGS") work.[84]

The PGS work that is protected under Section 101 includes: "two–dimensional and three–dimensional works of fine, graphic, and applied art, photographs, prints and art reproductions, maps, globes, charts, diagrams, models, and technical drawings, including architectural plans."[85] These works are protectable:

> [I]nsofar as their form but not their mechanical or utilitarian aspects are concerned; the design of a useful article, as defined in this section, shall be considered a pictorial, graphic, or sculptural work only if, and only to the extent that, such design incorporates pictorial, graphic, or sculptural features that can be identified separately from, and are capable of existing independently of, the utilitarian aspects of the article.[86]

Following therefrom, the corresponding copyright inquiry when a useful article is involved takes the form of a newly–clarified two–step test, as set

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("In determining whether a useful article should be copyrightable, the court must decide whether the artistic element of the article is separable from its utilitarian application."). Until very recently, separability was broken into two separate doctrines depending on jurisdiction: physical and conceptual separability. However, this distinction was later eliminated. Star Athletica, LLC v. Varsity Brands, Inc., 137 S. Ct. 1002, 1016 (2017) ("[W]e necessarily abandon the distinction between 'physical' and 'conceptual' separability, which some courts and commentators have adopted based on the Copyright Act's legislative history.").

81. H.R. REP. at 105; S. REP. NO. 94–473, 94th Cong., 1st Sess. 86–87 (1975).

82. 17 U.S.C. § 101 (2012).

83. Copyright: Useful Articles, FL–103, LIBRARY OF CONG. (Dec. 2011) http://www.copyright.gov/fls/fl103.html (explaining that useful articles include: "clothing; automobile bodies; furniture; machinery, including household appliances; dinnerware; and lighting fixtures").

84. *See id.*

85. 17 U.S.C. § 101.

86. *Id.*

forth by the Supreme Court in *Star Athletica, LLC v. Varsity Brands, Inc.*[87] In that case, the Court held that:

> [A] feature incorporated into the design of a useful article is eligible for copyright protection only if the feature (1) can be perceived as a two–or three–dimensional work of art separate from the useful article, and (2) would qualify as a protectable pictorial, graphic, or sculptural work—either on its own or fixed in some other tangible medium of expression—if it were imagined separately from the useful article into which it is incorporated.[88]

The doctrine of conceptual separability has strong foundational roots in the Second Circuit, particularly in a string of cases following the enactment of the Copyright Act of 1976, and has since been interpreted by several other circuits.[89] For instance, in 1980, the Second Circuit initially looked to the issue of separability under the Copyright Act in *Kieselstein–Cord v. Accessories by Pearl, Inc.*[90] The court in this case held that two decorative belt buckles were subject to copyright protection.[91] The court followed up this case, which is discussed in more depth below, with *Carol Barnhart Inc. v. Economy Cover Corp.*,[92] in which it applied a variation of its conceptual separability test, and ultimately found that clothing mannequins were not protectable by copyright law.[93]

In terms of Supreme Court treatment of conceptual separability, the Court held in *Mazer v. Stein*[94] that the base design of a lamp, which consisted of statuettes, was protectable by copyright law, despite the utilitarian nature of the lamp, itself.[95] The Court explained that "the use or intended use of the statuettes in lamp bases did not bar their subsequent registration as copyrightable works of art."[96] The Court allowed for their

87. 137 S. Ct. 1002 (2017).

88. *Id.*

89. *See* Inhale, Inc. v. Starbuzz Tobacco, Inc., 755 F.3d 1038 (9th Cir. 2014), *cert. denied*, No. 14–396, 2014 WL 5025796 (U.S. Dec. 8, 2014); Universal Furniture Int'l, Inc. v. Collezione Europa USA, Inc., 618 F.3d 417 (4th Cir. 2010); Galiano v. Harrah's Operating Co., 416 F.3d 411 (5th Cir. 2005); Am. Dental Ass'n v. Delta Dental Plans Ass'n, 126 F.3d 977 (7th Cir. 1997); Masquerade Novelty, Inc. v. Unique Indus., Inc., 912 F.2d 663 (3d Cir. 1990); Gay Toys, Inc. v. Buddy L Corp., 703 F.2d 970 (6th Cir. 1983); Norris Indus., Inc. v. Int'l Tel. & Tel. Corp., 696 F.2d 918 (11th Cir. 1983); Esquire, Inc. v. Ringer, 591 F.2d 796 (D.C. Cir. 1978).

90. 632 F.2d 989 (2d Cir. 1980).

91. *Id.* at 994.

92. 773 F.2d 411 (2d Cir. 1985).

93. *Id.* at 421.

94. 347 U.S. 201 (1954).

95. *Id.* at 214.

96. *Id.*; *see also* Barton R. Keyes, *Alive and Well: The (Still) Ongoing Debate Surrounding Conceptual Separability in American Copyright Law*, 69 OHIO ST. L.J. 109, 117 (2008).

protection as "works of artistic craftsmanship, in so far as their form, but not their mechanical or utilitarian aspects are concerned."[97]

The less commonly applied standard of physical separability[98] is also worth noting, albeit very briefly. In *Esquire, Inc. v. Ringer*,[99] the court addressed "whether the overall shape of a utilitarian object is an article eligible for copyright protection."[100] Specifically, the case centered on the protectability of the artistic design of lighting fixtures as a whole.[101] The court held that the fixtures contained no elements capable of independent existence as copyrightable works of art apart from their utilitarian aspect.[102] The court explained that the "overall design or configuration of a utilitarian object, even if it is determined by aesthetic as well as functional considerations, is not eligible for copyright."[103] The court differentiated the lighting fixtures at issue from those in *Mazer* because the Mazer "statuettes were undeniably capable of existing as a work of art independent of the utilitarian article into which they were incorporated. And they were clearly a 'feature' segregable from the overall shape of the table lamps."[104]

Looking to an array of fashion–centric cases, in which the separability requirement is applied, is telling of what elements of a design are simply too "utilitarian" to be called "design." Generally speaking, these cases can be divided into two categories: (1) those that provide a thin level of copyright protection and (2) those that fail entirely to provide any copyright protection for the designs at issue.

1. Cases that Provide a Thin Copyright for Fashion Designs

One of the most highly cited and most generously protective cases in the realm of separability is *Kieselstein–Cord*.[105] In this case, a manufacturer of fine jewelry, belt buckles, and leather goods filed a copyright infringement claim, alleging that a knockoff manufacturer was copying its belt buckle design and creating inexpensive knockoffs.[106] The court found that the

97. *Mazer*, 347 U.S. at 212–13 (citing 37 C.F.R. § 202.8 (1949)).

98. Star Athletica, LLC v. Varsity Brands, Inc., 137 S. Ct. 1002, 1016 (2017) ("[W]e necessarily abandon the distinction between 'physical' and 'conceptual' separability, which some courts and commentators have adopted based on the Copyright Act's legislative history.").

99. 591 F.2d 796 (D.C. Cir. 1978), *cert. denied*, 440 U.S. 908 (1979).

100. *Id.* at 804.

101. *Id.*

102. *Id.*

103. *Id.*

104. *Id.*

105. *See generally* Kieselstein-Cord v. Accessories by Pearl, Inc., 632 F.2d 989 (2d Cir. 1980).

106. *Id.* at 991.

knockoff manufacturer had been constructing "line–for–line copies . . . made of common metal rather than precious metal" in violation of manufacturer's copyright.[107] The court held that "elements that 'physically or conceptually, can be identified as separable from the utilitarian aspects of' a useful article"[108] are protectable by copyright law. Consequently, the court found that the plaintiff's belt buckles contained "conceptually separable sculptural elements, as apparently have the buckles' wearers who have used them as ornamentation for parts of the body other than the waist,"[109] and that the "primary ornamental aspect of the . . . buckles is conceptually separable from their subsidiary utilitarian function."[110] As a result, the court found that the defendant's near–exact copies of the plaintiff's buckles amounted to copyright infringement.[111] The rest of the belt design, however, did not receive protection.[112]

Additionally, in *Express, LLC v. Fetish Group, Inc.*,[113] the court held that "lace and embroidery accents that were totally irrelevant to the utilitarian functions" of a women's shirt may be subject to a "thin copyright."[114] In that case, Express, an American retail chain, argued for "copyright protection for the decorative details and look of [its] GH268 Tunic as a whole,"[115] but the court ultimately concluded, "the embroidery design is the only aspect of the GH268 Tunic entitled to copyright protection."[116] The court, thereby granted Express much more limited copyright protection in terms of scope than it had hoped for, removing from the scope of protection "the placement of the lace along the hemline, bustline, etc." and protection for the tunic as a whole.[117]

In another case, *Banff Ltd. v. Express, Inc.*,[118] a knitwear manufacturer filed suit against Express, for allegedly infringing the copyright in its Aran fisherman's sweater.[119] In regards to the availability of copyright protection for the cable design on Banff Ltd.'s sweaters, the court held that the single design aspect, itself, was copyright protected (as distinct from

107. *Id.*

108. *Id.* (citing H.R. REP. NO. 1476, at 54–55 (1976), *as reprinted in* 1976 U.S.C.C.A.N. 5659, 5668).

109. *Id.* at 993.

110. *Id.*

111. *Id.*

112. *Id.*

113. *See generally*, 424 F. Supp. 2d 1211 (C.D. Cal. 2006).

114. *See Id.* at 1216.

115. *Id.* at 1218.

116. *Id.* at 1222.

117. *Id.* at 1221.

118. 921 F. Supp. 1065 (S.D.N.Y. 1995).

119. *Id.* at 1067.

entire sweater), and therefore, Express was liable for infringing upon the copyright.[120]

The most recent treatment of garments in connection with the doctrine of separability comes by way of the Supreme Court. In *Star Athletica*, while the Court explicitly refused to determine whether the specific uniforms at issue are "sufficiently original to qualify for copyright protection,"[121] it did hold that "two–dimensional designs — consisting of various lines, chevrons, and colorful shapes—appearing on the surface of the cheerleading uniforms" are, in fact, protectable by copyright law.[122] As further noted by the Court, such protection extends only to the design created by the "surface designs on a uniform."[123] It does not cover the "shape, cut, or dimensions to the uniforms."[124]

2. *Cases that Fail to Find Separability, and Thus, Rule Out Copyright Protection for Fashion Designs*

In *Jovani Fashion, Ltd. v. Fiesta Fashions*,[125] a manufacturer of special occasion dresses alleged that the decoration of a dress warranted copyright protection.[126] The manufacturer argued that the decoration, itself, did not serve as a useful article because it only contributed to the appearance of the dress.[127] The court disagreed, holding that the "artistic judgment exercised in applying sequins and crystals to a dress's bodice and in using ruched satin at the waist and layers of tulle in the skirt"[128] did not meet the standard for separability required to achieve copyright protection.[129] Instead, the design only served to "enhance the functionality of the dress as clothing for a special occasion,"[130] and "the aesthetic merged with the functional to cover the body in a particularly attractive way for that special occasion."[131] As a result, the court held that the prom dress lacked

120. *Id.*

121. Star Athletica, LLC v. Varsity Brands, Inc., 137 S. Ct. 1002, 1012 n.1 (2017).

122. *Id.* at 1012.

123. *Id.* at 1006.

124. *Id.*

125. 500 F. App'x 42 (2d Cir. 2012), *cert. denied*, 133 S. Ct. 1596 (2013), *reh'g denied*, 133 S. Ct. 2821 (2013). Though not a precedential decision, the opinion serves as an indication of how courts may rule on the issue of separability in cases involving fashion designs.

126. *Id.* at 44.

127. *Id.* (finding that "the prom dress at issue merits copyright protection because its design constitutes a combination of features 'that can be identified separately from and are capable of existing independently of, the utilitarian aspects of the article'").

128. *Id.* at 45.

129. *Id.*

130. *Id.*

131. *Id.*

copyrightable elements, and thus, the knockoff manufacturer was not liable for copyright infringement for creating and selling a nearly exact copy.[132]

Similarly, in *Morris v. Buffalo Chips Bootery, Inc.*,[133] the court held that the elements implicit in the design of a vest and a dress, which included "handmade unique leather artwork," were not protectable by copyright law, as they lacked separability.[134] The court stated, "[e]ach and every arguably aesthetic element of [fashion designer Ligia Morris]'s designs plays a utilitarian function in the clothing in which it is embodied."[135] It further held that the fashion designer "failed to specify in any objectively identifiable fashion the copyrightable elements of her designs that are capable of existing independently of the articles of clothing themselves,"[136] which is "fatal" to her copyright claim.[137] Essentially, "the artistic and the functional elements of [Morris]'s designs are inextricably interwoven in the articles of clothing in which they appear"[138] and as a result, they did not amount to articles that could be protected by copyright law.

In *Eliya, Inc. v. Kohl's Department Stores*,[139] a shoe designer claimed copyright infringement based on allegations that a department store copied one of his shoe designs. According to the shoe designer, the original shoe at issue consisted of "patterned stitching on the front and sides of the shoe, a strap with visible stitching, and a sole with a pattern of spots that wraps around the shoe and extends up the back, sides, and front."[140] The court declined to find that the design elements at issue were sufficiently separable from the functional components of the shoe, itself, to warrant copyright protection. The court stated, "[u]nlike a fanciful design on the base of a lamp, or the ornamentation on a belt buckle, the features of the SHOE design described by [the shoe designer] are not purely aesthetic."[141] It continued on to state:

> Removing the strap, stitching, or sole of a shoe would, to some degree, adversely impact a wearer's ability to locomote by foot, either because the shoe would fall off (without a strap), fall apart (without stitching), or provide no protection against the ground (without a sole). Nor could any of the design elements, once removed, be separately sold or exist as an

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132. *Id.*
133. 160 F. Supp. 2d 718 (S.D.N.Y. 2001).
134. *Id.* at 721.
135. *Id.*
136. *Id.*
137. *Id.*
138. *Id.*
139. No. 06 Civ 195(GEL), 2006 WL 2645196, at *1 (S.D.N.Y. Sept. 13, 2006).
140. *Id.* at *1.
141. *Id.* at *12.

> independent work of art.[142]

Furthermore, the court in *Galiano v. Harrah's Operating Co.*[143] held that garments in their entirety are not subject to copyright protection.[144] In that case, in which a copyright infringement claim centered on the design of uniforms for casino employees, the court held that although "there is little doubt that clothing possesses utilitarian and aesthetic value,"[145] the question of "[h]ow to conduct the conceptual separation is . . . what continues to flummox federal courts."[146] Ultimately, the court applied the "likelihood–of–marketability"[147] standard for garment design, which essentially views a design as conceptually separable if it would have market value on its own. Thus, the court held that absent a showing that the design of casino uniforms was independently marketable, there was no copyright infringement.[148]

In *Poe v. Missing Persons*,[149] a fashion designer argued that a clear plastic bikini filled with crushed rock was conceptual art, not a swimsuit. The court held:

> Nothing in our legal training qualifies us to determine whether the work, entitled, Acquaint No. 5, can be worn as an article of clothing for swimming or any other utilitarian purpose. We are also unable to determine merely by looking at [the fashion designer]'s creation whether a person wearing this object can move, walk, swim, sit, stand, or lie down without unwelcome or unintended exposure.[150]

The court did not decide whether the work in question was or was not protected by copyright.[151] However, it did hold that there was a disputed issue of material fact as to whether the sculptural work in question was a useful article.[152]

From these cases, it can be determined that when garments and accessories are at issue, courts are extremely hesitant to provide copyright protection. For that reason, it is not difficult to see how copyright law, in its current state, is not an entirely sufficient form of protection for the majority of fashion designs.

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142. *Id.* at *11.
143. 416 F.3d 411 (5th Cir. 2005).
144. *Id.* at 419.
145. *Id.* at 417.
146. *Id.* at 419.
147. *Id.* at 421.
148. *Id.*
149. 745 F.2d 1238 (9th Cir. 1984).
150. *Id.* at 1242.
151. *Id.* at 1243.
152. *Id.*

In order to determine whether a useful article, such as a garment or accessory, should fall under the umbrella of copyright protection, a court must decide whether the artistic element(s) of the article is separable from its utilitarian application.[153] Such separability is a prerequisite to copyright protection for the design of a useful article. This is where we routinely experience notable difficulty in terms of considering copyright protection for fashion designs. Under the Copyright Act, there is a prohibition against the protection of utilitarian aspects of clothes that would otherwise amount to copyrightable material.[154] As such, utilitarian items are typically not covered under the copyright regime, but instead, fall under the jurisdiction of patent law. Thus, the challenge, in terms of copyright law, is the absence of a gray area; once an object, such as a dress or a shoe, is classified as useful in nature, that object as a whole will not be granted copyright protection.

IV. NOT ONLY "WHAT?" BUT "WHO?"

As previously explained, existing intellectual property law fails to provide fitting protection for fashion designs. These shortcomings arise from an overarching focus on *what* we would like to protect, in lieu of considering *who* we aim to protect.[155]

While discussions over how best to protect fashion designs are important, they often omit considerations of a more primary inquiry: what *exactly* was intellectual property law, as a whole, intended to protect? Very little, *if any*, of the existing scholarship that focuses on legislation for fashion designs explicitly takes the full extent of this fundamental inquiry into account.

This is undoubtedly a complex issue, especially in the realm of fashion because the exact appeal of a garment or accessory can be difficult to

153. *See* 17 U.S.C. § 101 (2012) ("[T]he design of a useful article . . . shall be considered a pictorial, graphic, or sculptural work only if, and only to the extent that, such design incorporates pictorial, graphic, or sculptural features that can be identified separately from, and are capable of existing independently of, the utilitarian aspects of the article.").

154. *See* 17 U.S.C. § 101.

155. To date, most scholarship in this realm has been dedicated to discussions of the requisite level of protection – primarily copyright in nature – that should be provided for fashion designs, including the duration of that protection (three years, as opposed to the standard life of the author plus seventy years duration for copyrights), the pleading standards that are appropriate for such lawsuits, and the level of similarity required for copying to constitute infringement. The most recent version of proposed fashion-focused legislation, the Innovative Design Protection Act, requires that the secondary design be "substantially identical" to the original rather than "substantially similar." Such discussions were also carried out in connection with two other relatively recent fashion-related Copyright Act amendment bills, Design Piracy Prohibition Act and Innovative Design Protection and Piracy Prevention Act.

distinctly pinpoint. Nonetheless, this is the core issue in the discussion of legislation and one that simply cannot be left unexplored. In fact, before we can adequately establish pleading and infringement requirements, duration standards, and draft legislation – copyright or otherwise – that is worthy of ratification (as we have not yet been able to accomplish), the dialogue must revolve around identifying and clearly expressing the full extent of what it is that intellectual property law aims to protect.

Dating back to the Statute of Anne,[156] "the first statute of all time to specifically recognize the rights of authors and the foundation of all subsequent legislation on the subject of copyright both [in England] and abroad,"[157] it is clear that creators represent the crux of the intent behind copyright protections. In fact, it has been posited that "the most significant shift in English law was [the Statute of Anne's] recognition of the rights of authors, and not merely those of printers and booksellers."[158]

The preamble of the Statute of Anne takes a marked focus on the author, his rights and the impact of infringement on his livelihood:

> Whereas printers, booksellers, and other persons have of late frequently taken the liberty of printing, reprinting, and publishing, or causing to be printed, reprinted, and published, books and other writings, without the consent of the authors or proprietors of such books and writings, to their very great detriment, and too often to the ruin of them and their families: for preventing therefore such practices for the future, and for the encouragement of learned men to compose and write useful books.[159]

Thereafter, and even prior to the ratification of the U.S. Constitution, the state of Massachusetts, in as early as March 1783, enacted legislation, entitled, "[a]n act for the purpose of securing to authors, the exclusive right and benefit of publishing their literary productions for twenty-one years."[160] The preamble of that artist-centric statute reads:

> Whereas, the improvement of knowledge, the progress of civilization, the public weal of the community, and the advancement of human happiness greatly depend on the efforts of learned and ingenious persons, in the various arts and sciences; as the principal encouragement such persons can have, to make great and beneficial exertions of this nature, must exist in the legal security of the fruits of their study and industry, to themselves; and as such security is one of the natural rights of all men, there being no property more peculiarly a man's own, than that which is produced by the labour of his mind: therefore, to encourage learned and ingenious persons to write useful books, for the benefit of mankind, be it

156. 8 Ann. 19.
157. *Id.*
158. *Id.*
159. *Id.*
160. *See generally* 1783 Mass. Acts 369.

enacted.[161]

The Intellectual Property Clause of the U.S. Constitution ("IP Clause")[162] followed from this in 1787, granting Congress the power "[t]o promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries."[163] It is widely accepted that the plain language of the IP Clause indicates that the framers intended Congress to extend protection to creators as a means to an end: "the promotion of science and the useful arts."[164] At the core of copyright protection is creative expression.[165] Hence, while a work, itself, may appear to be at the heart of such protection, the language of the Constitution suggests, instead, that the creator of that work (or the rights holder, if the ownership structure is varied by way of an assignment) and the general public are the more appropriate focal point.[166]

From these early statutes, we can elicit quite a bit about *what* but maybe even more critically, *who* the framers intended to protect. This focus is somewhat intuitive given the subsequent drafting of the Copyright Act of 1909,[167] which established a bundle of rights that vest in the creators of original works of art for a limited duration.[168] It thereby protects the owner against "those who copy or otherwise take and use the form in which the original work was expressed" by the author,[169] and ensures that the work will eventually reside in the public domain.

In enacting the Copyright Act of 1909 and the subsequent Copyright Act of 1976,[170] Congress held that giving artists exclusive rights over their

161. *Id.*

162. U.S. CONST. art. I, § 8, cl. 8.

163. *Id.*; *see also* Goldstein v. California, 412 U.S. 546, 561 (1973) (interpreting the term "writings" to include "any physical rendering of the fruits of creative intellectual or aesthetic labor").

164. U.S. Const. art. I, § 8, cl. 8.

165. *See* Edward L. Carter, *Harmonization of Copyright Law in Response to Technological Change*: *Lessons from Europe About Fair Use and Free Expression*, 30 U. LA VERNE L. REV. 312, 315 (2009).

166. *See generally* U.S. CONST. art. I, § 8, cl. 8.

167. The Copyright Act of 1909 was derived from Article I, Section 8, of the Constitution, with influences from Britain's Statute of Anne, and the earliest copyright legislation in the U.S., the Copyright Act of 1790. *See generally* 17 U.S.C. § 101 *et seq*. (2012).

168. *See id.* § 106 (providing copyright holders with the exclusive right to reproduce, distribute, perform, display, or prepare derivative works of their copyrighted work).

169. *Understanding Copyright and Related Rights*, WORLD INTELL. PROP. ORG. 2, 6, http://www.wipo.int/edocs/pubdocs/en/wipo_pub_909_2016.pdf (last visited July 7, 2017).

170. 17 U.S.C. § 102(a) (2012) (providing protection for "original works of author-

creations "is believed to be for the benefit of the great body of people, in that it will stimulate writing and invention, to give some bonus to authors and inventors."[171] Courts have construed this to include two key goals: (1) to "allow the public access to the products of [the artist's] genius after the limited period of exclusive control has expired,"[172] and (2) to reward the owner.[173]

From these dual objectives arises the need to balance the "interests of authors and inventors in the control and exploitation of their writings and discoveries on the one hand, and society's competing interest in the free flow of ideas, information, and commerce."[174] In an effort to protect tangible "writings and discoveries," existing and proposed legislation fail to fully encompass the entirety of the legislative intent set forth within the Statute of Anne and subsequent copyright protections. With this language in mind, what we should strive to protect in terms of fashion designs is two–fold: primarily, we should protect specific, original elements that are part of a garment or accessory, and we should also protect the reputation of a brand in connection therewith.

Instead of protecting the underlying design of a simple dress or pair of trousers, it is the additions, alterations, and/or modifications thereto that we are seeking to protect. These value-added elements are the ones that fast fashion copyists identify and ultimately, bank on. Such elements may take the form of an ornate neckline of a dress that ASOS "borrows" from Cushnie et Ochs or a skirt that Nasty Gal copies from Altuzarra.[175] It is an additional element of an otherwise commonplace dress design that is distinctly Cushnie et Ochs' in nature and one to which Cushnie et Ochs' fans and other consumers, alike, are drawn and identify as Cushnie et Ochs.[176]

In addition to protection that extends to the concrete, tangible aspects of a design (the value-added elements that attract consumers to a given garment or accessory), lawmakers need to endeavor to shield the reputations of individual designers and/or design brands from harm. Efforts to protect the "interests of authors and inventors" in connection with the broader, more esoteric elements at play should also be embodied in any proposed legislation. This is a truly critical element that has been

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ship fixed in any tangible medium of expression").

171. Sony Corp. of Am. v. Universal City Studios, Inc., 464 U.S. 417, 429 (1984). (citing H.R. REP. NO. 60–2222, at 7 (1909)).

172. *Id.*

173. *Id.*

174. *Id.*

175. *See supra* Figures 1 & 3.

176. *See supra* Figure 1.

uniformly excluded from or perhaps, more accurately, not considered in, discussions of proposed protections for fashion designs to date.

Practically speaking, lawmakers should strive to safeguard a brand's intangible assets, namely, a designer's brand image (and corresponding brand signatures). These intangible assets are the foundations of luxury and high fashion businesses. In the upper echelon of the fashion industry, reputation is largely built upon a brand's ability to be a purveyor of garments and/or accessories that are simultaneously: (1) original and appealing in terms of design; (2) oftentimes limited in quantity (i.e., not as mass produced as fast fashion); (3) existing in a certain price category (i.e., expensive); and (4) demonstrative of a certain caliber in terms of quality.[177]

Designers are the foremost talents in the fashion industry, each bringing distinct abilities and insights to their collections.[178] They are the artists, and the resulting garments and accessories are their creative expressions.[179] It is based in large part on these individuals' skills and unique vantage points that discerning consumers are drawn to and purchase certain garments and accessories.[180]

Jack McCollough and Lazaro Hernandez, for instance, the design duo behind New York–based brand, Proenza Schouler, have been hailed for the "craftsmanship, attention to detail, and relaxed yet refined style"[181] of their garments and accessories. Their collections "draw inspiration from contemporary art and youth culture and feature fine tailoring and custom-developed fabrics."[182] The designers learned these techniques through years of education and training. McCollough spoke of his formal design education, saying, at design school, "they teach you how to put together a collection, draw, drape, and do everything on a technical level."[183] The

177. *See* INFO. RES. MGMT. ASS'N, ADVERTISING AND BRANDING: CONCEPTS, METHODOLOGIES, TOOLS, AND APPLICATIONS ch. 41 (2017) (speaking to consumers' penchant for high fashion due to the level of quality associated with the garments and accessories).

178. Imran Amed, *Why Creative Directors Matter More Than Ever*, BUS. OF FASHION (June 12, 2013), https://www.businessoffashion.com/articles/right-brain-left-brain/why -creative-directors-matter-more-than-ever.

179. Zandra Rhodes & Alice Rawsthorn, *Is Fashion a True Art Form?*, GUARDIAN (July 13, 2003, 10:31 AM), https://www. theguardian.com/artanddesign/2003/jul/13/art.artsfeatures1 (presenting both sides of the argument about whether fashion is an art form).

180. *Id.*

181. *Brands*, ENTREPRENEURA, https://luciaallende.wordpress.com/categoryfashion-news/ (last visited July 15, 2017).

182. *Id.*

183. Kelsey Garcia, *Proenza Schouler Goes Back to School for the Parsons 2013 Fashion Benefit*, ELLE (May 23, 2013), http://www.elle.com/news/fashion-style/parsons-fashion-benefit-proenza-schouler.

degree of skill and specificity that the Proenza Schouler duo possesses results in their attention to "the tiniest of details—button sizes, the length of an inseam, fabric finishes."[184]

As discussed above, when a fast fashion retailer copies the design signature and/or specific garments of another brand, the harm is profound; and it is by no means limited to immediate sales. The potential harm extends to the dilution of the brand image and its esteemed position in the hierarchy of the fashion system.[185] This reputation–based consumer perception of a brand and the design talent that sustains the brand are its greatest assets, even if they are intangible ones.

In this way, the appeal of high fashion and/or luxury brands is also based on the image that a brand creates for itself. Brands are built upon dedication to quality and original design, in addition to the use of large–scale, meticulously crafted media and advertising initiatives.[186] Fast fashion retailers select garments and accessories to duplicate and offer for sale based on these unique design elements, as well as the popularity of a brand, in order to attract consumers. This is particularly true given that such retailers tend to boast about their ability to provide "the look for less," which takes the form of copies of well–known and in–demand runway and red carpet looks for a fraction of the price.[187]

Zara, a well-known purveyor of fast fashion garments and accessories, for instance, does not sell a blatant copy of an Altuzarra dress because it is inherently utilitarian; the retailer selects such a dress because of its creative elements, those that are additional to the useful nature of the dress and that can be traced back to Altuzarra. As a result, Zara is banking on the designer's expression of talent, insight and creativity, the exact things we aim to protect with copyright law, as well as on the esteem and widespread popularity of the brand, one that is popular amongst fashion editors and

184. David Amsden, *Gen W: Proenza Schouler*, W (Oct. 1, 2012, 12:00 AM), http://www.wmagazine.com/fashion/2012/10/proenza-schouler-10th-anniversary-and-flagship-opening/.

185. *Id.*

186. Jayson DeMers, *The Top 7 Characteristics of Successful Brands*, FORBES (Nov. 12, 2013, 1:01 PM), https://www.forbes.com/sites/jaysondemers/2013/11/12/the-top-7-characteristics-of-successful-brands/2/#2dd90dbb61be; *see also* JEAN – NOEL KAPFERER & VICENT BASTIEN, THE LUXURY STRATEGY: BREAK THE RULES OF MARKETING TO BUILD LUXURY BRANDS (2d ed. 2012) (explaining that the "Luxury Strategy" model aims to create the highest pricing power by leveraging all of a brand's intangible elements, including time, heritage, craftsmanship, handmade products, small series ranges, and prestigious clients, exclusivity, and aspirationality).

187. *See* The Budget Babe, *The Look for Less: Givenchy Fur Slide Sandals*, BUDGET BABE (May 1, 2017, 8:01 AM), http://www.thebudgetbabe.com/categories/10-The-Look-for-Less (providing an example of how to get a famous fashion trend on a budget).

Hollywood celebrities, alike.

With the critical role that brand image plays in the minds of consumers – at least some of which purchase luxury fashion items because they wish to be associated with a particular brand and the image it presents to society – and considering that copyright law does not provide adequate protection of garments and accessories, it may be more prudent to look beyond the scope of copyright law for sources of protection.

V. DOES THE SOLUTION EXIST IN ANOTHER AREA OF LAW?

Having identified exactly what it is that should be protected — the original elements of a garment or accessory (i.e., the value–added elements), *as well as* the reputation of designers and design brands (which are developed in commerce in much the same way a reputation is bred) — it is clear that intellectual property laws in the United States do not provide appropriate protection. Having said that, lawmakers do not need to eradicate the existing intellectual property doctrines in order to achieve such protection. Because copyright law is rooted in the IP Clause of the Constitution and because that language supports a focus on *who* as opposed to merely *what* we aim to protect, there is a strong parallel between the situation at hand and the tort of defamation. Thus, there may be a way to supplement existing copyright statutory and common laws to embody a sufficient level of protection.

It is worth noting that embodying a defamation–style analysis within the bounds of the existing copyright law, as is permitted by the IP Clause, is logical, especially given the connection between an individual or company's reputation in the marketplace, and the reputation of a designer or brand, as developed via his signature designs and quality of goods. Employing such a construct would enable us to not only protect the original value–added elements of a garment or accessory, but it would also take into account the need to provide protection for a brand's image in connection with such copying. Furthermore, such an approach permits lawmakers to largely remove the hurdles that prevent the adequate protection of fashion designs, namely, the copyright doctrines of utility and separability. From this perspective, it would not be outlandish to liken the case at hand — one in which a fast fashion retailer replicates a design's most salient features for a fraction of the cost and at a substantially lessened quality, while specifically trading on the esteem and appeal of such a brand — to one of slander or libel.

In accordance with the theory of defamation — which serves as an all–encompassing term that covers any statement that hurts an individual's reputation — individuals and entities have a right to not have false statements made that will damage their reputation.[188] This body of tort law provides redress for "injuries affecting a man's reputation or good name."[189] As such, reputation is held to be intangible property that is protectable by law.[190] Reputation is fostered in an individual's field as a result of efforts and labor, through "the exertion of talent in the learned professions [and] the emoluments acquired by mechanical skill and ingenuity."[191]

Furthermore, reputation is "understood to be a form of 'capital' since it 'creates funds' and the potential for 'patronage and support.'"[192] It plays a central role in the creation and maintenance of a thriving business, and despite its status as an intangible asset, it is a measure of reputation, and/or harm thereto. The various elements of reputation — which include, but are not limited to, "quality, value, and variety of goods"[193] — "connect themselves with credit and character, affixing to them a value, not merely ideal, but capable of pecuniary measurement, and consequently recommending them as the proper objects of legal protection."[194] Consequently, the loss resulting from harm to reputation may be gauged in a manner similar to that of the value of tangible property loss.

With the foregoing in mind, defamation is an apt comparison here for several reasons, but primarily because of what it aims to protect and shield against: reputation and the diminishment thereof or other harm thereto. This is relevant in the context of design piracy, as fast fashion retailers are primarily and very intentionally looking to designers' individual creations and their larger brand signatures, as well as the name and renown associated with their brands as a whole. A retailer is not merely copying an unknown garment originating from an unfamiliar brand. Fast fashion

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188. 28 U.S.C. § 4104(1) (2012).

189. Robert C. Post, *The Social Foundations of Defamation Law: Reputation and the Constitution*, 74 CAL. L. REV. 691, 692 (1986).

190. Ronald J. Krotoszynski, Jr., *Fundamental Property Rights*, 85 GEO. L.J. 555, 592 (1997) (explaining that the necessity of protecting "reputation as a property interest" is a longstanding principle, dating back to English common law); *see also* Post, *supra* note 189, at 693 (describing how reputation as a property interest was "subsequently incorporated into domestic law by the American colonial governments via the common law of slander and libel, which is designed to effectuate society's pervasive and strong interest in preventing and redressing attacks upon reputation") (internal quotations and citations omitted).

191. THOMAS STARKIE, A TREATISE ON THE LAW OF SLANDER, LIBEL, SCANDALUM MAGNATUM, AND FALSE RUMORS xxvi, xxvi (1832).

192. *Id.* at 694.

193. Isabelle Lundmark, Joanna Mainaud & Katarina Sjögren, *The Link Between Consumer Perception and Satisfaction: A Comparative Study of Shopping Malls and City Centres*, LINNAEUS U. (May 30, 2014), https://www.diva-portal.org/ smash/get/ diva2:721747/FULLTEXT01.pdf.

194. Post, *supra* note 189, at 693.

piracy commonly targets well–known, sought–after garments in order to benefit from the proven appeal of the garments, *and* to benefit from the already–established esteem of the brand being targeted.[195]

The copying of a brand's design by a fast fashion retailer proves detrimental both in terms of the loss of sales but also in terms of damage that results from the saturation (or the appearance of saturation) of the market with inferior–quality copies of a designer's original creations. By manufacturing garments and accessories that closely resemble those of another, often much more respected and high quality brand, fast fashion retailers are able to profit from the work and the reputation of that other brand, thereby harming the original designer and diluting the reputation he has built for himself in the luxury fashion sector.

Thus, at issue for us is how to properly balance the protection of a designer or brand's reputation with the protections afforded by the First Amendment, which provides for somewhat expansive freedoms of expression. If we consider the guidance courts have offered in the context of defamation, the answer that courts have given is intent: i.e. the "knowing or reckless disregard of the truth" standard.[196]

Part II of this series will provide a detailed proposal for such a defamation–style copyright analysis.

CONCLUSION

To date, the attempts to shield original fashion design from design piracy by way of *sui generis* copyright law protection have fallen short. Specifically, such proposed legislation fails to explicitly consider what *and* who we aim to protect in the realm of fashion design. As a result, existing approaches to the protection of fashion designs fail to grapple with the problem presented when the invaluable asset of reputation of a designer or design brand — and the necessary element of exclusivity and quality connected therewith — is diminished or tarnished by way of widespread fast fashion–induced piracy.

The existence of the doctrine of defamation provides meaningful support for protection that can be applied to shield value–added elements inherent in original fashion designs from harm without subjecting such works to the copyright theories that make protection difficult to achieve. This alternative provides an opportunity to rethink the aforementioned

195. *See* LOÉIL, https://theloeil.com/ (last visited May 26, 2017), (showing an example of a website that is notorious for offering high fashion knockoffs. Such a business model allows this company to not only benefit from the sale of affordable copies of designer brand goods, but also from the established reputation and established appeal of those brands).

196. N.Y. Times Co. v. Sullivan, 376 U.S. 254, 280 (1964).

approaches to protecting fashion designs exactly where they are deficient.

THE MULTIFACETED MANIFESTATIONS OF THE POOR DOOR: EXAMINING FORMS OF SEPARATION IN INCLUSIONARY HOUSING

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INTRODUCTION

Despite the 2008–2009 recession, American metropolitan areas have experienced tremendous growth.[1] While demand for real estate in places like New York, San Francisco, and Washington, D.C., has exploded, the housing stock in many of these popular regions has often failed to keep pace.[2] As a result, housing costs have dramatically increased, outpacing the stagnant wage growth of low–income workers.[3] Due to these economic dynamics, entire metropolitan areas are becoming financially inaccessible for low–income individuals.[4] Consequently, local governments face mounting pressure from both residents and business leaders to address this affordability crisis by facilitating the creation of more accessible housing options.[5]

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1. *See* Claire Cain Miller, *More New Jobs Are in City Centers, While Employment Growth Shrinks in the Suburbs*, N.Y. TIMES (Feb. 24, 2015), https://www.nytimes.com/2015/02/24/upshot/more-new-jobs-are-in-city-centers-while-employment-growth-shrinks-in-the-suburbs.html (stating that well-paying jobs are increasingly found in large urban centers, while working-class jobs are more predominantly located in the outer suburbs). *But see* Alan Berube, *Political Rhetoric Exaggerates Economic Divisions Between Rural and Urban America*, BROOKINGS (Aug. 3, 2016), https://www.brookings.edu/blog/the-avenue/2016/08/03/political-rhetoric-exaggerates-economic-divisions-between-rural-and-urban-america/ (arguing that the divisions between rural and urban economies are exaggerated and that the two are deeply intertwined).

2. *See* Mark Gimein, *Why the High Cost of Big–City Living is Bad for Everyone*, NEW YORKER (Aug. 25, 2016), http://www.newyorker.com/business/currency/why-the-high-cost-of-big-city-living-is-bad-for-everyone (arguing that, despite decades of conventional thinking regarding the inevitable demise of cities, a strong desire to access high–paying jobs and urban amenities has fueled a wave of migration to a few "imperial" urban in recent years); *see also,* Alexi Barrionuevo, *Lack of New Construction Pushes Bay Area to the Brink of a Bubble*, CURBED (Feb. 24, 2016, 10:30 AM), http://www.curbed.com/2016/2/24/11102278/bay-area-housing-crisis-bubble (explaining that despite the fact that 64,000 new jobs have been created in San Francisco, less than 5,000 new homes have been constructed); Justin Fox, *Sometimes a Nimby Is a Just a Nimby*, BLOOMBERG (May 5, 2016, 8:00 AM), https://www.bloomberg.com/view/ articles/2016-05-05/sometimes-a-nimby-is-a-just-a-nimby (demonstrating local resistance's view that new construction is selfish and negatively impacts the communities, which explains why it has been so difficult to construct new homes).

3. *Home Prices Rising Faster than Wages: Report*, CNBC (Mar. 24, 2016, 6:45 AM), http://www.cnbc.com/2016/03/24/home-prices-rising-faster-than-wages-report.html.

4. *See* Justin Fox, *Urban Living Becomes a Luxury Good*, BLOOMBERG (May 24, 2016, 1:32 PM), https://origin-www.bloombergview.com/articles/2016-05-24/urban-living-becomes-a-luxury-good (positing that living in urban centers is increasingly becoming a luxury good, because high demand — in conjunction with the tepid growth in supply — has fueled an intense rise in housing costs, which is making downtown real estate an exclusive product only attainable for wealthy people).

5. *See, e.g.*, Patrick Sisson, *Why the Rent Is Too Damn High: The Affordable Housing Crisis*, CURBED (May 19, 2016, 12:47 PM), http://www.curbed.com/ 2016/5/19/11713134/affordable-housing-policy-rent-apartments.

In response, municipalities are implementing an array of solutions, including programs that promote inclusionary housing.[6] Inclusionary housing is a mechanism that compels private stakeholders to engage in otherwise economically irrational behavior.[7] These inclusionary housing programs encourage residential projects to provide some lower–cost housing by creating a distinction between "affordable" and "market–rate" dwellings.[8] Furthermore, these programs may require participating developers to build affordable units on the same street or floor as market–rate units.[9]

Real estate developers are further motivated to participate in inclusionary housing programs because they either provide business incentives or are an unavoidable cost of constructing certain projects within a housing zone.[10] However, developers still have the discretion to forgo the program's economic incentives or avoid building in the municipality if the regulations are too onerous.[11] Given this degree of discretion for developers, small changes and uncertainty can upset this regulatory ecosystem by discouraging developer participation en masse.[12]

To account for these various considerations, this Comment will analyze Montgomery County's Moderately Priced Dwelling Units ("MPDU") program, which is one of the first and most extensively implemented inclusionary housing programs.[13] Consequently, this analysis will provide

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6. *See, e.g.*, Brian Johnson, *Here's How DC's Inclusionary Zoning Program Works*, GREATER GREATER WASH. (Sept. 1, 2015), https://ggwash.org/view /39157/ heres-how-dcs-inclusionary-zoning-program-works (discussing how DC's inclusionary housing program provides local residents with more affordable options).

7. *See* Jolie Milstein, *Affordable Housing Will Only Work With For–Profit Developers in the Mix*, OBSERVER (Sept. 6, 2016, 7:30 AM), http://observer.com/ 2016/09/affordable-housing-will-only-work-with-for-profit-developers-in-the-mix/ (arguing that developers in New York City need a profit motive to build more affordable housing).

8. *See generally,* Johnson, *supra* note 6.

9. *See, e.g.*, *id.* (discussing how New York's poor door ban implemented such a prohibition on housing separation in the context of apartment buildings).

10. *See* Scott Beyer, *Inclusionary Housing Is Rent Control 2.0*, FORBES (May 27, 2015, 3:22 AM), http://www.forbes.com/sites/scottbeyer/2015/05/27/inclusionary-zoning-is-rent-control-2-0/#3b6dfe692c10 (arguing that inclusionary housing programs reflect rent control in that they both function as an obligatory business expense for developers).

11. *Id.*

12. *See* Benjamin Powell & Edward Stringham, *The Economics of Inclusionary Zoning Reclaimed: How Effective are Price Controls?,* 33 FLA. ST. L. REV. 471, 472–73 (2005) (arguing that inclusionary zoning puts a high burden on private developers, which can discourage participation under certain circumstances).

13. Andrew Rice, *The Suburban Solution*, N.Y. TIMES (Mar. 5, 2005), http://www. nytimes.com/2006/03/05/magazine/the-suburban-solution.html.

some clarity to real estate professionals and help municipalities determine the prudent regulatory path forward. To properly assess whether Montgomery County's inclusionary housing program violates the Fair Housing Act ("FHA"), Section II addresses: (1) the MPDU program's statutory structure and demographic context; (2) the relationship between the FHA's Doctrine of Disparate Impact and municipal zoning ordinances such as Montgomery County's MPDU program; (3) the legal standards for bringing a disparate impact claim against a municipality for housing discrimination; and (4) an alternative approach of housing separation through New York's 421–a program. Section III examines potential avenues for bringing a FHA disparate impact claim under each the New York's 421–a program and the MPDU program. Finally, this Comment concludes that the MPDU program is vulnerable to a housing discrimination lawsuit and therefore should adopt the same street stipulation — a provision resembling New York's 421–a program.

II. THE DEVELOPMENT OF INCLUSIONARY HOUSING PROGRAMS

In the 1960s, the government began to develop a way to provide housing to low income individuals through a series of public housing initiatives.[14] Unfortunately, this large–scale government intervention resulted in tragedy. These idealistic housing projects often became uninhabitable havens for drugs, crime, and violence.[15]

In response, the government adopted a more conservative and neo–liberal approach in the 1970s and 80s.[16] Many believed this hands–off regulatory approach was a better solution to deal with systemic problems such as high concentrations of poverty, weak funding, and housing projects that are detached or segregated from urban life.[17] Thus, instead of

14. Jamelle Bouie, *How We Built the Ghettos*, DAILY BEAST (Mar. 13, 2014, 2:40 PM), http://www.thedailybeast.com/articles/2014/03/13/how-we-built-the-ghettos.html (discussing the construction of public housing projects in the context of racial segregation).

15. *See* J.S., *Why the Pruitt–Igoe Housing Project Failed*, ECONOMIST (Oct. 15, 2011), http://www.economist.com/blogs/prospero/2011/10/american-public-housing (discussing the unhealthy and dangerous conditions in a St. Louis housing project).

16. *See generally*, Kiran Sandhu & Stanislaw Korzeniewski, *The Impact of Neo–Liberal Ideology on Housing Policy and Practice*, 1 ITPI J. (2004) (explaining that according to the 1980s neo–liberal housing approach, "[t]he state's role in production, ownership finance marketing and regulations should be rolled back and its activities should be restricted to those of market enablement").

17. *See* Jasmine Coleman, *Why is America Pulling Down the Projects?*, BBC NEWS (Apr. 14, 2016), http://www.bbc.com/news/magazine-35913577 (discussing the pervasiveness of drugs and crime in D.C. housing projects due to neglect and planning failures); *see also* Howard Husock, *How Public Housing Harms Cities*, CITY J., https://www.city-journal.org/html/how-public-housing-harms-cities-12410.html (last visited Sept. 25, 2017) (describing the differences between urban housing and

engaging in direct intervention, the statutory initiatives created during that time merely attempted to influence or control the behavior of private actors.[18]

Current inclusionary housing regulations reflect this shift in housing law.[19] In general, inclusionary housing regulations function as a government–sponsored effort to ensure that new residential development includes affordable options.[20] To comply, developers must set aside some units to sell or rent at a reduced cost when constructing market–rate apartments or subdivisions.[21] Consequently, through this legal framework, municipalities can delegate the job of providing affordable housing to private developers.[22]

A. The MPDU Program's Legal and Demographic Context

Like other mandatory inclusionary housing initiatives, the MPDU program requires private developers of market–rate subdivisions to set aside some units for low–income individuals.[23] Its goals include expanding affordability and rectifying past instances of racial housing discrimination.[24] This is accomplished under section 25A of the Montgomery County Code, which provides that the County determines the number of affordable units a developer must build through a ratio.[25] While the ordinance is applicable throughout the County, its requirements for providing affordable options are confined to a specific subset of private development, namely, those buildings with thirty–five or more dwelling units.[26] Officials may not grant a building permit to a developer unless he

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segregated housing projects).

18. *See, e.g.*, TIM IGLESIAS & ROCHELLE E. LENTO, THE LEGAL GUIDE TO AFFORD ABLE HOUSING DEVELOPMENT 13 (2d ed. 2011) (stating that federal programs such as the Low–Income Housing Tax Credit worked to modify the behavior of private actors).

19. ALEX F. SCHWARTZ, HOUSING POLICY IN THE UNITED STATES 265 (3d ed. 2015) (discussing how programs designed to promote affordable housing such as inclusionary housing regulations have shifted from the federal government to the state and local level).

20. *See id.* at 283 ("Inclusionary zoning requires or encourages developers to designate a portion of the housing they produce for low–or moderate–income individuals.").

21. *Id.*

22. *Id.*

23. *Id.* at 287.

24. Rice, *supra* note 13.

25. *See* Moderately Priced Housing Law, Montgomery County Code, Md., Code § 25A–5(c)(3) (2017) (requiring that "the number of moderately priced dwelling units is a variable percentage not less than 12.5% of the total number of dwelling units at that location").

26. *Id.* § 25A–2(5) (stating that "all subdivisions of 35 or more dwelling units

or she signifies that the building will comply with the ordinance's stipulations.[27]

The Montgomery County Code provides specific requirements regarding the conditions of affordable units and the cost for residents under the MPDU program.[28] However, it also gives developers a high degree of autonomy to determine the placement of the affordable units within the larger development project.[29] Consequently, developers often group the required affordable units together on a side street — away from the subdivision's market–rate dwellings.[30]

Despite the MPDU's shortcomings, it has contributed to the increased racial diversity of Montgomery County.[31] According to the Census Bureau, the County's white population declined from 49.3% in 2010 to 45.2% in 2015, whereas the Hispanic population increased from 17% in 2010 to 19% in 2015.[32] As a result, the majority of the current population identifies as a racial or ethnic minority.[33]

B. *Federal Housing Discrimination Standards for Municipal Zoning Ordinances*

In general, the FHA bans housing discrimination due to a person's race, religion, gender, or national origin.[34] The FHA specifically prohibits

include a minimum number of moderately priced units of varying sizes with regard to family needs").

27. *Id.* §§ 25A–5(a), (g)–(h) (stating that the County enforces these zoning regulations through written agreements between developers and the Department of Housing and Community Affairs); *see also* IGLESIAS & LENTO, *supra* note 18, at 101 (discussing how the County's regulations require that the agreement be approved by both the Director of the County Department of Housing and Community Affairs and the County Attorney).

28. § 25A–5 (b) (requiring certain developers seeking a building permit to submit a written agreement approved by the County that establishes legal obligations — such as building a specified number of affordable units and to provide three or more bedrooms for affordable dwellings in single–family subdivisions).

29. *Id.* § 25A–5B (a)–(b) (stating that a developer of higher–density housing may fulfill its statutory obligations by building the allotted number of MPDUs on a separate parcel of land, which demonstrates the statute's flexible requirements regarding the placement and physical location of affordable units).

30. *See* Rice, *supra* note 13 (discussing how an especially large project in Potomac, Maryland complied with the MPDU program's requirements by dividing market–rate and affordable units into two separate subdivisions).

31. *See* MONTGOMERY CTY., MD., 2015 ANALYSIS OF IMPEDIMENTS TO FAIR HOUSING CHOICE 24 (2015) ("The MPDU program has resulted in economically and racially diverse communities throughout the County, expanded housing choice, and resulted in other desirable public outcomes.").

32. *See id.* at 6 (comparing the County's population between 2010 and 2015).

33. *See id.*.

34. The Fair Housing Act, 42 U.S.C. § 3604(a) (2012).

refusing "to sell or rent after the making of a bona fide offer, or to refuse to negotiate for the sale or rental of, or otherwise make unavailable or deny, a dwelling to any person because of race, color, religion, sex, familial status, or national origin."[35] Given this statutory language, the FHA provides potential plaintiffs wide latitude to bring a housing discrimination claim.[36]

Furthermore, the FHA clearly states that large commercial real estate entities may be found liable for these types of housing discrimination claims.[37] However, suing a municipality for discriminatory housing laws or practices has more complex legal foundations. Over several decades of statutory interpretation, federal regulations, and court opinions have shaped the legal infrastructure surrounding a municipality's liability for FHA violations.[38]

The primary regulatory body involved in this interpretative process is the Department of Housing and Urban Development ("HUD").[39] Municipalities receiving federal funds from HUD have a legal obligation to comply with the FHA and affirmatively further the interests of fair housing.[40] Consequently, a municipal government can be found liable in a HUD administrative hearing for enacting a discriminatory housing law.[41]

Similarly, courts have supported an individual plaintiff's ability to bring a housing discrimination claim against a municipality as a public actor for implementing discriminatory housing regulations and zoning ordinances.[42]

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35. *Id.*

36. *Id.* § 3604(b) ("To discriminate against any person in the terms, conditions, or privileges of sale or rental of a dwelling, or in the provision of services or facilities in connection therewith, because of race, color, religion, sex, familial status, or national origin."); *see* Trafficante v. Metropolitan Life Ins. Co., 409 US 205, 209 (1972) (describing the FHA's statutory language pertaining to prohibiting housing discrimin ation as "broad and inclusive").

37. § 3605(a) ("It shall be unlawful for any person or other entity whose business includes engaging in residential real estate–related transactions to discriminate against any person in making available such a transaction, or in the terms or conditions of such a transaction, because of race, color, religion, sex, handicap, familial status, or national origin.").

38. *See generally* Implementation of the Fair Housing Act's Discriminatory Effects Standard, 78 Fed. Reg. 11,460, 11,461–62 (Feb. 15, 2013) (to be codified at 24 C.F.R. pt. 100) (providing historical and legal background on the FHA's enactment and interpretation).

39. § 3608(a).

40. *See* 78 Fed. Reg. at 11,477 ("[R]ecipients of HUD funds already must comply with a variety of civil rights requirements. This includes the obligation . . . under the Fair Housing Act to affirmatively further fair housing in carrying out HUD programs; and HUD program rules designed to foster compliance with the Fair Housing Act and other civil rights laws.").

41. *See generally id.*

42. *See*, *e.g.*, Casa Marie, Inc. v. Super. Ct. of P.R., 988 F.2d 252, 257 (1st Cir. 1993) (holding a municipality liable for housing discrimination); United States v. City

For instance, in *United States v. Yonkers Board of Education*,[43] the municipality's regulations regarding the geographic placement of subsidized housing amounted to a form of race–based housing discrimination.[44] By almost exclusively placing low–income housing in heavily minority neighborhoods, the local government's zoning decisions had the effect of perpetuating racial segregation, which amounted to a form of illegal housing discrimination.[45]

Additionally, courts permit the use of the disparate impact doctrine and the disparate treatment doctrine as alternative methods of pursuing housing discrimination claims under the FHA.[46] The disparate impact doctrine focuses on whether the a practice has a "disproportionately adverse effect on minorities" while the disparate treatment doctrine focuses on whether there is a discriminatory intent.[47] In other words, disparate impact claims concentrate on discriminatory results of practices and policies, while deemphasizing the issue of discriminatory purpose.[48] In this way, disparate impact claims allow claimants to avoid the onerous burden of proving intent.[49] All that is necessary to demonstrate a discriminatory effect under the disparate impact doctrine, is a showing that (1) the ordinance perpetuates residential segregation or (2) the government action at issue disproportionately affects a protected class.[50]

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of Parma, 661 F.2d 562 (6th Cir. 1981) (same); Otero v. N.Y.C. Housing Auth., 484 F.2d 1122, 1133–34 (2d Cir. 1973) ("[A]n authority may not . . . select sites for projects which will be occupied by non–whites only in areas already heavily concentrated with a high proportion of non–whites, ... [Because] Congress' desire in providing fair housing throughout the United States was to stem the spread of urban ghettos and to promote open, integrated housing").

43. 837 F.2d 1181 (2d Cir. 1988).

44. *Id.* (finding a § 3604 violation due to the practice of constructing subsidized housing in predominantly minority neighborhoods).

45. *See id.* at 1226 ("[T]he City may properly be held liable for the segregative effects of a decision to cater to this 'will of the people.'").

46. Tex. Dep't of Hous. & Cmty. Affairs v. Inclusive Cmtys. Project, Inc., 135 S. Ct. 2507, 2513 (2015); *see also* THE LEGAL GUIDE TO AFFORDABLE HOUSING DEVELOP MENT 65 (Tim Iglesias & Rochelle E. Lento eds., 2006) ("There are three principal theories by which a local land–use ordinance can be found to have violated the FHA: (1) intentional discrimination, (2) disparate impact, or . . . (3) failure to provide reasonable accommodation.").

47. *Inclusive Cmtys. Project*, 135 S. Ct. at 2513.

48. *See, e.g.*, *id.* (stating that a housing practice is discriminatory under disparate impact if it has a disproportionately adverse impact upon a protected class).

49. *Inclusive Cmtys. Project*, 135 S. Ct. at 2513.

50. *See* Huntington Branch, NAACP v. Huntington, 844 F.2d 926, 936 (2d Cir. 1988) (holding that based on a local regulatory action relating to housing was discriminatory because it disproportionately affected a racial minority group in a negative manner); Trafficante v. Metropolitan Life Ins. Co., 409 US 205, 221 (1972) (finding that losing the social and economic benefits associated with living in a racially

For example, in *Huntington Branch, NAACP v. Huntington*,[51] plaintiffs filed suit against a municipality for discriminatory housing practices under the FHA's theory of disparate impact.[52] In *Huntington*, the primary issue was whether a predominantly suburban white community's regulatory practice of physically separating housing disproportionately occupied by racial minorities violated the FHA.[53] The court explained that under the disparate impact doctrine, the challenged practice must "actually or predictably [result] in racial discrimination" or, in other words, have a discriminatory *effect*, and therefore, it is unnecessary to show that it was made with a discriminatory *intent*.[54] A discriminatory effect arises where: (1) there is an adverse impact on a particular minority group and (2) there is harm to the community generally by the perpetuation of segregation.[55] The court held that the zoning ordinance had a discriminatory effect because it impeded integration by restricting low–income housing needed by minorities to an area that was already mostly inhabited by minorities, which significantly perpetuated segregation.[9]

On the other hand, the court in *Dews v. Sunnyvale*,[56] utilized both a disparate impact and disparate treatment analysis. In that case, the claim brought against a municipality centered on the discriminatory impact of its low–density zoning restrictions.[57] The court first considered whether there was a discriminatory effect under the disparate impact doctrine.[58] It found that there was a discriminatory effect where the zoning restrictions excluded racial minorities by prohibiting the construction of multi–family housing that would have been disproportionally occupied by African Americans.[59] The court then considered whether there was a discriminatory intent under the disparate treatment doctrine.[60] Under the

integrated environment is a valid injury for a plaintiff to allege).

51. 844 F.2d 926 (2d Cir. 1988).

52. *Id.* at 928.

53. *See id.* (discussing how the subject of the court's legal analysis pertained to whether the town's practice of placement housing projects — largely occupied by racial minorities — in a separate "urban renewal area" amounted to a discriminatory housing practice that contradicted the FHA's policy goal of promoting racial integration).

54. *Id.* at 934.

55. *Id.* at 937–38.

56. 109 F. Supp. 2d 526 (N.D. Tex. 2000).

57. *Id.* at 529.

58. *Id.* at 572–73.

59. *See id.* at 526 ("It is these zoning laws, allegedly enacted by the residents of Sunnyvale to preserve their rural lifestyle, which are being challenged by Plaintiffs on the grounds that they were enacted with . . . an effect which falls disproportionately on African–Americans looking for housing in the Dallas Metropolitan Area.").

60. *Id.*

disparate treatment doctrine, there is a discriminatory intent where (1) the defendant's stated reasons for its decision are pretextual and (2) there is a reasonable inference that race was a significant factor in the refusal.[61] To determine whether there is a discriminatory intent, courts consider: "(1) discriminatory impact; (2) the historical background of the challenged decision; (3) the specific sequence of events leading up to the decision; (4) any procedural and substantive departures from the norm; and (5) the legislative or administrative history of the decision."[62] The court held that the zoning restrictions were done with discriminatory intent.

In *Texas Department of Housing and Community Affairs v. Inclusive Communities Project*,[63] the Court held that under the FHA, both the disparate impact and disparate treatment doctrines can support a discriminatory housing claim.[64] Here, a nonprofit organization made a housing discrimination claim against Texas regarding its interpretation of a low–income tax credit statute.[65] The Court found that the plaintiff could rely on statistical evidence to support that there was a discriminatory effect pursuant to its disparate impact claim.[66] Otherwise, plaintiffs would need to rely on the disparate treatment doctrine, which required plaintiffs to provide documentation regarding a practice's discriminatory intent, which was not present in that case.[67] The Court created a three part, burden–shifting test for a disparate impact claim.[68] First, the plaintiff must make a prima facie case that there is a disparate impact.[69] Specifically, the plaintiff must demonstrate that "a challenged practice caused or predictably will

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61. *Id.* at 532.

62. *Id.* at 533.

63. 135 S. Ct. 2507 (2015).

64. *Id.* (affirming the validity of using disparate impact claims under the Fair Housing Act, which may consequently empower more potential litigants to file disparate impact claims against municipalities for engaging in discriminatory housing practices). *But see* Alana Semuels, *Supreme Court vs. Neighborhood Segregation*, ATLANTIC (June 25, 2015), https://www.theatlantic.com/business/archive/2015/06/supreme-court-inclusive-communities/396401/ (arguing that the long–term status of disparate impact is uncertain, because the Court's majority opinion cautioned against using race–based quotas as a remedy).

65. *Inclusive Cmtys. Project*, 135 S. Ct. at 2513.

66. *Id.* at 2514.

67. *See* Lyle Denniston, *Opinion Analysis: A Civil Rights Law Made Broader, But Not Too Broad*, SCOTUSBLOG (June 25, 2015 12:22 PM), http://www.scotusblog.com/2015/06/opinion-analysis-a-civil-rights-law-made-broader-but-not-too-broad/ (describing how the holding functioned as a compromise between Justice Kennedy and the more liberal wing of the Court, because it cautioned against excessive litigation but still preserved the fundamentals of disparate impact as a litigation strategy).

68. *Inclusive Cmtys. Project*, 135 S. Ct. at 2514.

69. *Id.*

cause a discriminatory effect."[70] Second, the burden shifts to the defendant to "prov[e] that the challenged practice is necessary to achieve one or more substantial, legitimate, nondiscriminatory interests."[71] Finally, the burden shifts back to the plaintiff to prove that "the substantial, legitimate, nondiscriminatory interests supporting the challenged practice could be served by another practice that has a less discriminatory effect."[72] By validating the use of disparate impact in the context of the FHA, the Court provided two distinct, but equal causes of action for potential plaintiffs under the disparate impact and disparate treatment doctrines.[73]

C. Statutory Changes to New York's 421–a Program

New York City's 421–a Program provides tax incentives for developers to include affordable units in their market–rate apartment buildings.[74] The 421–a program is purely voluntary for developers; it offers optional tax benefits to developers in exchange for providing affordable options.[75]

Over the past few years, the 421–a program's lack of regulatory restrictions regarding a specific housing practice became a highly contested issue.[76] Until recently, developers receiving 421–a tax incentives could physically separate an apartment building's affordable units from its market–rate dwellings.[77] Although developers built both affordable and market–rate units within a single structure, the affordable units were placed in isolated floors and the residents had separate accommodations.[78] Here, the most infamous design feature is the separate entrance provided for low–income residents.[79] The separate entrances are now almost ubiquitously labeled "poor doors."[80] In response, many in the region condemned the

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70. *Id.* (quoting 24 C.F.R. § 100.500(c)(1) (2014)) (internal quotations omitted).

71. *Id.* at 2515 (quoting § 100.500(c)(2)).

72. *Id.* (quoting § 100.500(c)(3)).

73. *See generally id.*

74. *See generally* N.Y. Real Prop. Tax Law § 421–a (McKinney 2015) (allowing developers of multi–unit residential buildings in cities with over a million people in the State of New York to forgo local taxes for up to three years for making twenty percent of the units affordable for low–income people).

75. *Id.* (stating that developers can renounce or terminate participation and providing tax exemptions for newly constructed multiple–unit residential buildings that include lower–cost housing options).

76. *See generally* Mireya Navarro, *'Poor Door' in a New York Tower Opens a Fight Over Affordable Housing*, N.Y. TIMES (Aug. 26, 2014), http://www.nytimes.com/2014/08/27/nyregion/separate-entryways-for-new-york-condo-buyers-and-renters-create-an-affordable-housing-dilemma.html?_r=4.

77. *Id.*

78. *Id.*

79. *Id.*

practice of building poor doors.[81]

Following public outcry, the New York Legislature enacted statutory changes with added language pertaining to poor doors.[82] Under this new provision in the 421–a statute, people living in these affordable units must share the same entrances and common areas with the occupants of market–rate units.[83] The provision also prohibits developers from isolating these affordable units to a specific floor or area of a building.[84] If a developer fails to comply with these requirements, it is not eligible to receive 421–a's tax incentives for providing mixed–income housing.[85]

III. ASSESSING THE VIABILITY OF A POTENTIAL DISPARATE IMPACT CLAIM AND THE COMPATIBILITY OF A POSSIBLE STATUTORY REFORM

A. Determining the Likelihood of a Successful Disparate Impact Claim Against Montgomery County Under the FHA

The FHA's legal structure may allow a plaintiff to bring a housing discrimination claim against Montgomery County based on the MPDU program's regulatory practices.[86] A concern for a potential Montgomery County plaintiff is that he or she may lack a substantial basis for arguing that there was a discriminatory intent in creating the MPDU program pursuant to the disparate treatment doctrine.[87] However, a plaintiff may be able to make a successful claim pursuant to the disparate impact doctrine.[88] Consequently, the primary legal issue to resolve involves a focus on applying the legal framework of disparate impact and investigating possible

80. *See*, *e.g.*, Justin Wm. Moyer, *NYC Bans 'Poor Doors' – Separate Entrances for Low-Income Tenants*, WASH. POST (June 30, 2015) (describing the poor door controversy and the statutory changes that followed outrage over the practice's perceived unfairness and cruelty).

81. *See id.* ("Though such a system might smack of Victorian England — or worse, the Jim Crow South or apartheid South Africa — plans for it existed in New York City until last week.").

82. *See id.* (describing how the Mayor of New York City added language in a bill that was passed by the state legislature).

83. *See* N.Y. Real Prop. Tax Law § 421–a(7)(d)(ii) (McKinney 2015) ("[A]fford able units shall share the same common entrances and common areas as market rate units, and shall not be isolated to a specific floor or area of a building.").

84. *Id.*

85. *Id.*

86. Tex. Dep't of Hous. & Cmty. Affairs v. Inclusive Cmtys. Project, Inc., 135 S. Ct. 2507, 2522 (2015) (stating that disparate impact claims under the Fair Housing Act are often used against municipalities with discriminatory housing ordinances).

87. MONTGOMERY COUNTY, MD., 2015 ANALYSIS OF IMPEDIMENTS TO FAIR HOUS ING CHOICE, *supra* note 31.

88. *See generally* Dews v. Sunnyvale, 109 F. Supp. 2d 526, 531 (N.D. Tex. 2000).

avenues for making a successful claim on these grounds. The following sections will evaluate the three part *Inclusive Communities* test to demonstrate that MPDU is vulnerable to a housing discrimination claim.[89]

i. Plaintiff's Prima Facie Case of Disparate Impact

To make a successful disparate impact claim, the plaintiff must first make an initial showing that a housing practice has a discriminatory effect upon a protected class of individuals.[90] Particularly, the plaintiff must demonstrate that a housing practice either (1) institutes a form of segregation or (2) disproportionately effects a protected class in a negative manner.[91] These avenues for proving a discriminatory effect can be more concisely referred to as the segregation–based and disproportionate effect approaches.

The segregation–based approach is more advantageous in those circumstances where the discriminatory effect is less clearly defined.[92] Under this approach, the discriminatory effect is racial segregation, which impermissibly deprives litigants of the social and economic benefits of integration, while also compromising the dignity of the population being segregated.[93] Thus, this approach is centered around the generalized benefits of integration and the injury is interrelated and mutually connected to the act of physical separation based on race.[94] However, an argument under this approach may be difficult to make if there are not enough facts to demonstrate segregation is actually occurring.[95]

This segregation–based approach offers the strongest basis for establishing the plaintiff's prima facie disparate impact claim in a suit against Montgomery County. Montgomery County's zoning ordinance permits developers to separate affordable units from market–rate dwellings,

89. *See Inclusive Cmtys. Project*, 135 S. Ct. at 2514–15.

90. *See, e.g.*, *id.* (discussing how a plaintiff must demonstrate an adverse impact on a certain community).

91. *See* Huntington Branch, NAACP v. Huntington, 844 F.2d 926, 937 (2d Cir. 1988) ("The discriminatory effect of a rule arises in two contexts: adverse impact on a particular minority group and harm to the community generally by the perpetuation of segregation.").

92. *See* United States v. Yonkers Bd. of Educ., 837 F.2d 1181, 1186 (2d Cir. 1988) (showing how such an approach may be used); *see also* Casa Marie, Inc. v. Super. Ct. of P.R., 988 F.2d 252, 257 (1st Cir. 1993) (discussing the nature of this approach's burden of proof); United States v. City of Parma, 661 F.2d 562 , 565 (6th Cir. 1981).

93. Trafficante v. Metropolitan Life Ins. Co., 409 U.S. 205, 211 (1972).

94. *See generally id.*

95. *See Huntington*, 844 F.2d at 928 (finding that a practice satisfied the burden of proof under a discriminatory effects model, but it could not have met the requirements under the segregation–based approach, because the practice was less clearly connected to the outcome of increasing segregation).

two forms of housing with starkly different racial compositions.[96] Thus, these housing practices can foster racial segregation. This racial segregation deprives the occupants of both affordable and market–rate units from the social and economic benefits of integration.[97] Therefore, a plaintiff could establish a prima facie disparate impact claim under the segregation–based approach.

The disproportionate effect approach may also provide a successful, though more problematic, avenue for a successful prima facie disparate impact claim. This approach requires a showing on two fronts: the action at issue must (1) disproportionately impact a protected class and (2) place a negative burden on that class.[98] A potential plaintiff suing the County for its MPDU program has a strong basis for satisfying the first component, because there is strong statistical evidence supporting the notion that a disproportionate number of MPDU program participants are racial minorities, compared to the County at large.[99]

However, the grounds for proving the negative burden on the protected class are more difficult. The disproportionate effects approach requires a more concrete showing of an injury.[100] Essentially, the plaintiff must prove that the housing program resulted in a substantial harm to the protected class.[101] If the grounds for claiming a harm run in conjunction with clear social benefits, like greater social and economic opportunities, the argument could expose the plaintiff to a higher risk of judicial skepticism and pushback from the defense.[102]

If the disproportionate effect approach is used in a housing discrimination case against Montgomery County, a potential plaintiff would need to prove that separating MPDU units from market–rate

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96. *See, e.g.*, *Trafficante*, 409 U.S. at 205 (holding that a regulation discriminatory under similar circumstances for depriving residents from enjoying the benefits of racial integration).

97. *See id.*

98. *See* Dews v. Sunnyvale, 109 F. Supp. 2d 526, 526 (N.D. Tex. 2000) (finding a practice discriminatory after the plaintiff demonstrated that the practice disproportionately impacted a protected class and placed a negative burden on that class).

99. *See* Florence Wagman Roisman, *Opening the Suburbs to Racial Integration: Lessons for the 21st Century*, 23 W. NEW ENG. L. REV. 65, 79 (2001).

100. *See id.*

101. THE LEGAL GUIDE TO AFFORDABLE HOUSING DEVELOPMENT, *supra* note 46, at 66 (stating that a showing of an adverse impact must be made, along with the statistical evidence).

102. *Cf.* Huntington Branch, NAACP v. Huntington, 844 F.2d 926, 940 (2d Cir. 1988) (stating that if the defendant is a municipality, it can make a showing that the discriminatory practice serves an important government interest to invalidate the claim).

dwellings creates a substantial harm.[103] If the argument relies on demonstrating how the separation inflicts an economic or social harm, opposing counsel could respond by highlighting the economic benefits that the program provides to low–income residents.[104] However, while a municipality may provide a predominantly minority community with a form of social assistance like subsidized housing, it would still deprive them of racial integration's benefits.[105] When assessing the disproportionate effect, evidence of both a program's costs and benefits are more difficult to ascertain, making the harm more difficult to distinguish and accentuate.[106] While other arguments may be available, these constraints and risks make the disproportionate effect approach a less likely route for pursuing a claim against Montgomery County. Therefore, a potential plaintiff is more likely to utilize the segregation–based approach in a disparate impact claim.

ii. Defendant's Burden of Demonstrating Substantial, Legitimate, Nondiscriminatory Interest

After determining that a prima facie disparate impact claim has been established, the next step is to consider whether Montgomery County has a legitimate purpose for the housing separation.[107] In general, the County has a strong basis for satisfying its burden of proof because the MPDU program was intended to promote diversity and increase the area's economic accessibility.[108] Thus, the County may be able to argue that permitting housing separation in the MPDU program is essential for supporting its core mission.[109]

Furthermore, the County could claim that granting developers the discretion to engage in housing separation helps sustain demand for market–rate homes.[110] First, housing separation helps assuage the fears of those wealthy buyers who may be uncomfortable living in a mixed–income

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103. THE LEGAL GUIDE TO AFFORDABLE HOUSING DEVELOPMENT, *supra* note 46, at 66.

104. *Id.*

105. United States v. Yonkers Bd. of Educ., 837 F.2d 1181, 1186 (2d Cir. 1988).

106. THE LEGAL GUIDE TO AFFORDABLE HOUSING DEVELOPMENT, *supra* note 46, at 67.

107. *Huntington*, 844 F.2d at 939 ("Once a plaintiff has made a prima facie showing of discriminatory effect, a defendant must present bona fide and legitimate justifications for its action with no less discriminatory alternatives available.").

108. *See, supra* note 31 (stating that the intent behind the County's inclusionary housing program was to promote diversity and increase the area's economic accessibility).

109. *Id.*

110. *See generally* Beyer, *supra* note 10.

environment.[111] Second, mixed–income subdivisions could damage the perceived exclusivity and status of the market–rate units, which would in turn result in high–end buyers avoiding the project.[112] Consequently, the project would be less profitable, because the lack of demand may depress real estate values.[113] As a result, permitting housing separation creates higher profits for developers and a greater willingness for them to build subdivisions subject to the MPDU program's affordable housing requirements.[114]

iii. Plaintiff's Burden of Demonstrating a Less Discriminatory Alternative

Finally, the plaintiff can undermine Montgomery County's stated interest by presenting a less discriminatory alternative that still serves the County's interest. As will be described below, New York's 421–a program's poor door ban would be a suitable alternative to the MPDU program. Consequently, all three parts of the *Inclusive Communities* test have been met, which can support a successful housing discrimination claim under the FHA.

B. Comparing Montgomery County's MPDU Program to New York's 421–a Program

Given the MPDU program's vulnerability to a successful housing discrimination claim, it is worth considering whether an urban municipality's statutory solution to housing separation could work in a suburban context like Montgomery County. For the MPDU program to adopt a housing separation ban resembling the 421–a program's statutory changes, the statutory structures of both programs must be sufficiently compatible. If there is a strong enough resemblance between the two programs, it is likely that it would be possible to apply the poor door ban to the MPDU program.

Although there are clear distinctions between a tax incentive program and a zoning regulation, both programs promote forms of inclusionary housing.[115] Given this common goal, the programs share similar

111. *See id.*

112. *See* Emily Badger, *When Separate Doors for the Poor Are More Than They Seem*, WASH. POST (July 31, 2014) (discussing how some owners of market–rate units don't want to live near affordable units).

113. *Id.*

114. *See* Moderately Priced Housing Law, Montgomery County Code, Md., Code § 25A (2017).

115. *See* N.Y. Real Prop. Tax Law § 421–a (McKinney 2015) (outlining the exemptions for various types of new dwellings); Moderately Priced Housing Law, Montgomery County Code, Md., Code § 25A (2017) (assessing the need for

approaches to increasing the number of affordable units within a jurisdiction.[116] They are both market–oriented legal mechanisms that modify the private real estate market with regulatory incentives or requirements.[117]

These programs are also similar in the context of housing separation. By concentrating the occupants of affordable units on a separate side street, developers in Montgomery County create physical and social divisions between the occupants of subsidized units and market–rate units.[118] In this way, the MPDU program permits a form of separation that resembles the practice of creating poor doors in urban apartment buildings.[119] Additionally, housing separation in a suburban context can, in some ways, operate in a more subtle and nefarious manner because these settings offer more physical space to isolate and conceal low–income housing.[120]

Therefore, the parallels between the inclusionary housing regulations in New York and Montgomery County demonstrate that the recent changes to the 421–a program are compatible in Montgomery County. Thus, Montgomery County could similarly require developers to provide common entrances for both affordable and market–rate units. In this instance, a common point of entry would be the road providing access to the subdivision. Similar to the 421–a program requirement that affordable and market–rate apartments share the same floor,[121] the MPDU program can require developers to place affordable dwellings within the same cul–de–sacs as market–rate homes in an evenly distributed manner.

IV. MONTGOMERY COUNTY SHOULD IMPLEMENT A SAME STREET STIPULATION

Enacting regulatory changes to the MPDU program resembling New York's poor door ban is both a legally feasible and advisable option for Montgomery County. As described above, the similarities between these two forms of housing separation demonstrate that Montgomery County can

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moderately priced housing in Montgomery County, Maryland and offering alternative solutions for suitable housing for multiple income houses).

116. *See* SCHWARTZ, *supra* note 19, at 283 (discussing how both mandatory or incentives based inclusionary housing programs work off the statutory model of zoning ordinances).

117. *Id.*

118. *See generally* Rice, *supra* note 13 (highlighting the divide created between incomes in the community by offering housing at market rate with subsidies for the poor).

119. Moyer, *supra* note 80 (discussing how "poor doors" work to physically separate people of different class backgrounds).

120. *See generally id.*

121. *See* N.Y. Real Prop. Tax Law § 421–a(7)(d)(ii) (McKinney 2015).

use New York's methodology in a suburban context.[122]

While banning poor doors may look different in a suburban context, it still serves the same purpose of creating common entrances for subsidized and market–rate units.[123] By adding a same street stipulation in Chapter§ 25 of the Montgomery County Code, the County could ensure that there are common access points for all residents.[124] This same street stipulation would state, "[a]ffordable units shall share the same common entrances and common areas, including roads and sidewalks, as market rate units." For example, developers could then place affordable dwellings within the same cul–de–sacs as market–rate homes in a more evenly distributed manner.

Due to the greater number of physical factors at play when designing a subdivision, including the street design and the positioning of detached dwellings,[125] the County could add additional compliance requirements onto its current zoning approval process.[126] If a developer's plan fails to reasonably incorporate and integrate affordable units within the subdivision's design, the County would have the power to reject the application and ask for revisions. While considering this extra regulatory factor may slow down the housing approval process, it could also foster a more cooperative process between these private and public entities.

However, this oversight may stymie new development if businesses find these additional procedures prohibitively bureaucratic.[127] Therefore, the best solution may be to implement the statutory reforms with an additional oversight process, but make participation in the supplementary compliance process purely voluntary.[128] To encourage participation, Montgomery County could offer limited tax incentives to developers that satisfy the additional compliance requirements.

Additionally, given the Court's recent holding in *Inclusive Communities* and the limited budgets that local governments have available to pay legal fees, municipalities should prohibit housing separation as a precaution.[129]

122. *See generally id.* § 421–a; Moderately Priced Housing Law, Montgomery County Code, Md., Code § 25A (2017).

123. *See generally* Rice, *supra* note 13.

124. *See generally* Moyer, *supra* note 80.

125. *See generally* Rice *supra* note 13.

126. *See generally* Moderately Priced Housing Law, Montgomery County Code, Md., Code § 25A (2017).

127. *Cf.* Jawhar Sircar, *The Bureaucracy Is Ailing*, TELEGRAPH, https://www.telegraphindia.com/1170914/jsp/opinion/story_172999.jsp (lasted visited Sept. 25, 2017) (describing how excessive bureaucracy can have negative business consequences).

128. *See generally id.*

129. *See* Tex. Dep't of Hous. & Cmty. Affairs v. Inclusive Cmtys. Project, Inc., 135 S. Ct. 2507, 2514–15 (2015).

Housing separation deprives the occupants of affordable units from the potential opportunity to socialize with people from more economically advantaged backgrounds and implies that they are undesirable neighbors.[130] Therefore, by permitting this practice, jurisdictions are, in effect, endorsing a regulation that imputes inferiority upon the occupants of those affordable units on a symbolic and actual basis.[131]

In this way, metropolitan areas, including urban centers and the surrounding suburbs, could empower low–income individuals to make their own decisions about where to live in a manner that may be more politically palatable.[132] That said, this type of solution would only work in a city with a strong real estate market and high demand for market–rate units.[133] Otherwise, this tax–based approach may just further exacerbate an area's housing problems by discouraging construction and restricting the overall housing supply.[134] It is important that housing policymakers devote more attention to this issue to avoid perpetuating the kind of segregation that many have fought hard to prevent.

CONCLUSION

Montgomery County's mandatory inclusionary housing program permits a form of housing separation. This practice raises issues pertaining to FHA compliance under the disparate impact doctrine. Montgomery County may be susceptible to a lawsuit, because the County permits a discriminatory housing practice that deprives a protected class of individuals from enjoying the benefits of integration.[135] Consequently, banning housing separation is a prudent legal precaution for local governments and fosters a less uncertain business environment. Instead, Montgomery County should implement a same street stipulation resembling New York's poor door ban.

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130. Tanvi Misra, *Fair Housing Faces an Uncertain Fate*, ATLANTIC (Feb. 3, 2017), http://www.citylab.com/housing/2017/02/fair-housing-faces-an-uncertain-fate/515133/?utm_source=atlfb.

131. *See generally id.*

132. *See generally* Rice, *supra* note 13.

133. *See generally id.*

134. *See generally id.*

135. *See* SCHWARTZ, *supra* note 19, at 283.

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THE ULTIMATE FIGHTING CHAMPIONSHIP AND ZUFFA: FROM 'HUMAN COCK-FIGHTING' TO MARKET POWER

CARL J. GAUL IV*

The Ultimate Fighting Championship ("UFC") is the premier mixed martial arts ("MMA") promotion in the world and is the most recent athletic organization to attain a dominant market share that arguably constitutes a monopoly or monopsony. Antitrust law prohibits organizations from restraining trade or intentionally stamping out market place competition to attain or maintain monopoly power. The UFC's behavior has raised significant concerns about competition in two separate markets: the MMA Promotional Market and Elite MMA Labor Market. While the MMA Promotional Market appears more competitive than it has ever been, the Elite MMA Labor Market has seen significant reductions in competition. This reduction in competition has left MMA fighters vulnerable to exploitation and coercion. Without some regulatory oversight and with major gaps in relevant legislation, the fighters are left with few choices.

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INTRODUCTION

Mixed martial arts ("MMA") has grown faster than any sport in the world for the last twenty-five years.[1] From brutal beginnings with almost no rules or regulations to a mainstream sport captivating millions of fans and earning billions of dollars, the MMA community is facing one problem common to every sport in its early days, a single economic entity dominating market place competition.[2] The Ultimate Fighting Championship ("UFC") emerged as the first major MMA promotion and has been the driving force behind the growth of the sport as a whole.[3] As a result, the UFC and its former parent company, Zuffa, LLC ("Zuffa"),[4] have grown to be the most powerful organization in the MMA industry, having achieved what can only be described as market dominance.[5] The association of the sport with the organization is so prevalent that many consumers confuse the organization

1. Derek Bolender, *MMA: Get to Know the Fastest Growing Sport in America*, BLEACHER REP. (June 4, 2008), http://bleacherreport.com/articles/27230-mma-get-to-know-the-fastest-growing-sport-in-america; Daniel Schorn, *Mixed Martial Arts: A New Kind of Fight*, CBS NEWS (Dec. 10, 2006), http://www.cbsnews.com/news/mixed-martial-arts-a-new-kind-of-fight/.

2. Paul Gift, *Former FTC Commissioner: UFC Investigations, Antitrust Lawsuit 'Ultimately About Consumers'*, SBNATION (Apr. 12, 2016, 8:00 AM), http://www.bloodyelbow.com/2016/4/12/11404276/former-commissioner-joshua-wright-ftc-investigation-antitrust-lawsuit-ufc-news; *see also* Law v. NCAA, 134 F.3d 1010 (10th Cir. 1998); Fed. Baseball Club of Baltimore, Inc. v. Nat'l League of Prof'l Baseball Clubs, 259 U.S. 200, 207–08 (1922); Radovich v. NFL, 352 U.S. 445 (1957).

3. Andrew Binner, *The Rise of Mixed Martial Arts*, AL–JAZEERA (Apr. 11, 2014), http://www.aljazeera.com/sport/othersports/2014/04/rise-mixed-martial-arts-201441094427103582.html.

4. Darren Rovell & Brett Okamoto, *Dana White on $4 billion UFC Sale: 'Sport Is Going to the Next Level*, ESPN (July 11, 2016), http://www.espn.com/mma/story/_/id/16970360/ufc-sold-unprecedented-4-billion-dana-white-confirms (explaining that Zuffa recently sold a majority share in the UFC. This sale does not affect the overall analysis of this comment).

5. Greg Byron, *Industry Dominance: The UFC and its 'Monopoly' in the MMA Market*, MMA CORNER (Jan. 24, 2014), http://themmacorner.com/2014/01/24/industry-dominance-the-ufc-and-its-monopoly-in-the-mma-market/; *see also* Am. Tobacco Co. v. United States, 328 U.S. 781, 792–95 (1946) (analyzing the degree of market control necessary to achieve market dominance).

with the sport itself; the UFC is synonymous with MMA the way "Kleenex" is synonymous with "tissue."[6]

The UFC formed in November 1993 and quickly became a political pariah.[7] Senator John McCain described mixed martial arts as "human cock–fighting"[8] and led a successful campaign against the sport, forcing it into temporary anonymity.[9] When the UFC returned to the public eye, it was a regulated, professional, and respectable sport.[10]

The UFC's market success began after it was purchased by Zuffa in January 2001.[11] Between 2001 and 2010, the UFC's viewership increased exponentially, due in large part to the more than tripling number of pay–per–view events produced annually and effective marketing.[12] The UFC then entered deals with Spike TV and Fox Sports, which further expanded the UFC and MMA consumer base.[13] Zuffa then bought out the UFC's five top competitors[14] leaving only small competitors, all with hardly a fraction of Zuffa's market share.[15]

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6. Martin Rogers, *UFC Sold to WME–IMG for $4 Billion; Dana White Will Still Run Day–to–Day Operations*, USA TODAY (July 11, 2016), http://www.usatoday.com/story/sports/ufc/2016/07/11/ufc-sale-wwe-img-dana-white/86937834/ (quoting UFC president Dana White confusing the organization for the sport itself, "no other sport compares to UFC").

7. *See* Amy Silverman, *John McCain Breaks Up a Fight*, PHX. NEW TIMES (Feb. 12, 1998), http://www.phoenixnewtimes.com/news/john-mccain-breaks-up-a-fight-6422460.

8. *Id.*

9. *Id.*

10. *See, e.g.*, N.J. ADMIN. CODE §§ 13:46–24A.01–.17, 13:46–24B.1–.5 (2010); Adam Hill, *A Timeline of UFC Rules: From No–Holds–Barred to Highly Regulated*, BLEACHER REP. (Apr. 24, 2013), http://bleacherreport.com/articles/1614213-a-timeline-of-ufc-rules-from-no-holds-barred-to-highly-regulated# (detailing the MMA comm unity's regulatory response to John McCain's crusade against "human cock–fighting").

11. Matthew Miller, *Ultimate Cash Machine*, FORBES (Apr. 17, 2008), https://www.forbes.com/forbes/2008/0505/080.html (detailing the market success and revenue growth following Zuffa's purchase of the UFC).

12. Kelefa Sanneh, *Ultimate Fighting Versus Boxing*, NEW YORKER (May 22, 2015), http://www.newyorker.com/news/sporting-scene/ultimate-fighting-versus-box i ng.

13. Michael David Smith, *Spike TV Says Goodbye to the UFC*, MMA FIGHTING (Aug. 18, 2011), http://www.mmafighting.com/2011/08/18/spike-tv-says-goodbye-to-the-ufc#2912082.

14. Chris Harty, *5 MMA Organizations Bought Out by UFC*, RICHEST (Jan. 16, 2016), http://www.therichest.com/sports/mma-sports/5-mma-organizations-bought-out-by-ufc/ (detailing Zuffa's purchases of the World Fighting Alliance, World Extreme Cagefighting, Pride Fighting Championship, International Fight League, and Strike force).

15. Dave Doyle, *Is Bellator a Real Rival to the UFC?*, MMA FIGHTING (Nov. 8, 2013), http://www.mmafighting.com/2013/11/8/5079324/fightweets-is-bellator-a-real-rival-to-the-ufc.

Through business expertise and acquisitions, Zuffa gained control of at least 90% of the MMA Promotional Market and more than 60% of the Elite MMA Labor Market.[16] While this market dominance is an impressive feat of business expertise, it raises concerns about potential antitrust violations.[17] Zuffa's market dominance is at least partially the result of eliminating competition through mergers and acquisitions supplemented by stringent non–compete agreements preventing fighters from participating in other promotions.[18] While these transactions are not *per se* illegal, such business practices become illegal when their result or purpose is to restrain trade or suppress competition.[19] And, although antitrust law has been applied unevenly in the world of professional athletics,[20] it is clear that exercising market power in a way that harms competition is illegal.[21]

Firms with market power maintain their dominance by preventing new competitors from entering the market, or by constructing barriers to market entry, and market power presents the opportunity for firms to raise prices such that consumers are forced to pay more than they would in a competitive market.[22] These business practices destroy the "potentiality of competition" and are the exact kind of practices prohibited by the Sherman Antitrust Act ("Sherman Act").[23] The simplest example of this business practice is anticompetitive monopolization that creates or maintains barriers to market entry. A monopoly occurs when a single company controls all or nearly all of the market for a given type of product or service, dominating the market.[24] As a result, the dominant firm has no incentive to set competitive prices, improve products, or produce at a competitive level because consumers have no substitute seller to buy from.[25]

A monopsony is the mirror image of a monopoly—where monopoly is the

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16. *See infra*, Figures 1, 2, 3, & 4.

17. Am. Tobacco Co. v. United States, 328 U.S. 781, 810 (1946).

18. Byron, *supra* note 5.

19. Law v. NCAA, 134 F.3d 1010 (10th Cir. 1998); *see also Am. Tobacco Co.*, 328 U.S. 781, 810.

20. *Compare* Radovich v. NFL, 352 U.S. 445 (1957), *with* Fed. Baseball Club of Baltimore, Inc. v. Nat'l League of Prof'l Baseball Clubs, 259 U.S. 200, 218 (1922).

21. *See, e.g.*, Mackey v. NFL, 543 F.2d 606, 622 (8th Cir. 1976).

22. *See* James May, *Antitrust in the Formative Era: Political and Economic Theory in Constitutional and Antitrust Analysis*, 50 OHIO ST. L.J. 257, 355 (1989).

23. Standard Oil Co. v. United States, 221 U.S. 1, 74 (1911).

24. May, *supra* note 22, at 266.

25. John D. Culbertson & Roy Weinstein, *Antitrust Aspects of Barriers to Entry*, *in* UCLA LAW FIRST ANNUAL INST. ON US AND EU ANTITRUST ASPECTS OF MERGERS AND ACQUISITIONS (2004); Shuntian Yao & Lydia Gan, *Monopoly Innovation and Welfare Effects*, ECONS. (Feb. 16, 2010), http://www.economics-ejournal.org/economics/discussionpapers/2010-10/file.

domination of a market on the selling side, a monopsony is the domination of a market on the buying side.[26] Monopsony occurs when there is a single buyer of a product or service.[27] While different in structure, monopoly and monopsony create the same distortion of economic competition.[28] Market entry becomes impossible when a business dominates the market for an essential product input and prevents the input producers from selling to other businesses.[29] Specialized, non–unionized laborers are uniquely vulnerable to monopsonies because their performance and work are product inputs and individual laborers do not have bargaining power comparable to a large business.[30]

In 1890, Congress began to address the issue of dominant firms exercising market power by passing the Sherman Act[31] to prevent anticompetitive business practices that restrain trade or result in monopolization.[32] The Sherman Act was a response to a small number of businessmen dominating markets, not through superior skill and effective business, but by "the use of means which made it impossible for other persons to engage in fair competition."[33] Such practices were viewed as economically destructive.[34] Consequently, the Sherman Act section 1 prohibits "[e]very contract, combination in the form of a trust or otherwise, or conspiracy, in restraint of

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26. Law v. NCAA, 134 F.3d 1010 (10th Cir. 1998); Smith v. Pro Football, 593 F.2d 1173 (D.C. Cir. 1978); Jonathon M. Jacobson, *Monopsony 2013: Still Not Truly Symmetric*, ANTITRUSTSOURCE (Apr. 12, 2013), https://www.wsgr.com/attorneys/BIOS/PDFs/jacobson-0413.pdf.

27. Fraser v. Major League Soccer, 284 F.3d 47, 62–63 (1st Cir. 2002) (defining a monopoly as "the power to pay lower than competitive wages for the services being acquired without having the sellers of those services — the players — turn to another league or team for employment"); *In re* Beef Indus. Antitrust Litig., 907 F.2d 510, 514 (5th Cir. 1990) ("[M]onopoly is the term used to describe the situation where there is only one seller of a product, monopsony where there is only one buyer . . . .") (quoting R. POSNER & F. EASTERBROOK, ANTITRUST: CASES, ECONOMIC NOTES AND OTHER MATERIALS 148 (2d ed. 1981)).

28. Vogel v. Am. Soc'y Of Appraisers, 744 F.2d 598, 601 (7th Cir. 1984) (equating Sherman Act violations of monopoly and monopsony in that "[j]ust as a sellers' cartel enables the charging of monopoly prices, a buyers' cartel enables the charging of monopsony prices; and a monopoly and monopsony are symmetrical distortions of competition from an economic standpoint").

29. *See, e.g.*, Standard Oil Co. v. United States, 337 U.S. 293, 294, 295–96, 305–06 (1949) (affirming an injunction to keep Standard Oil Co., the largest seller of oil gasoline in the area, from enforcing or entering exclusive supply contracts with any independent dealer in petroleum products and automobile accessories).

30. Jacobson, *supra* note 26, at 6.

31. Sherman Antitrust Act, 15 U.S.C. § 1 (2012).

32. May, *supra* note 22, at 292–96.

33. 21 CONG. REC. S3152 (Apr. 8, 1890) (statement by Rep. Hoar).

34. *Id.*

trade or commerce among the several States, or with foreign nations."[35] Section 2 outlaws the acquisition and maintenance of monopoly power.[36] It is not illegal to acquire monopoly power, but it is illegal to do so by intentionally eliminating competition or preventing competitors from entering the market.[37]

Application of antitrust law to sports has been, at best, inconsistent.[38] While baseball has been largely exempted from antitrust law,[39] every other sport and league is subject to every facet of antitrust law. There has not yet been a ruling on antitrust law in regards to MMA.

This Comment will explore the antitrust implications of Zuffa and the UFC's business practices from 2001-2015. Section II of this Comment will focus on the antitrust laws, their purpose, and application to various business practices. It will also explain Zuffa and the UFC's industry dominance and business practices. Section III will apply antitrust law to Zuffa's business practices, the MMA Promotional Market, and the Elite MMA Labor Market. Section IV will recommend two specific changes necessary to stop injurious behavior in the MMA industry: acquisition of collective bargaining power by the fighters through an athletes association or union and expansion of the Muhammad Ali Boxing Reform Act to MMA.

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35. 15 U.S.C. § 1 (2012); *see* May, *supra* note 22, at 265 (addressing the extensive debate over the legislative intent behind the Sherman Antitrust Act and the Clayton Antitrust Act as to whether the intention was consumer welfare or anti-cartelization); FTC & DOJ, ANTITRUST GUIDELINES FOR COLLABORATIONS AMONG COMPETITORS 3 (2000).

36. 15 U.S.C. § 2.

37. United States v. Microsoft Corp., 253 F.3d 34, 50 (D.C. Cir. 2001) (quoting United States v. Grinnell Corp., 384 U.S. 563, 570–71 (1966)) (explaining that illegal monopolization has two elements: "(1) the possession of monopoly power in the relevant market and (2) willful acquisition or maintenance of that power").

38. *Compare* Radovich v. NFL, 352 U.S. 445 (1957) (reversing judgment for defendants because "the volume of interstate business involved in organized professional football places it within the provisions of the antitrust laws"), *with* Fed. Baseball Club of Baltimore, Inc. v. Nat'l League of Prof'l Baseball Clubs, 259 U.S. 200, 218 (1922) (affirming judgment for defendants because conduct charged against defendants was not an interference with commerce amongst the States and therefore not within purview of the Antitrust Acts).

39. Flood v. Kuhn, 407 U.S. 258 (1972) ("Justice Blackmun delivered the opinion of the Supreme Court that longstanding exemption of professional baseball's reserve system from federal antitrust laws is an established aberration in which Congress has acquiesced and is entitled to benefit of stare decisis, and any inconsistency or illogic is to be remedied by the Congress and not by the Supreme Court."); *see* Curt Flood Act of 1998, 112 Stat. 2824, 15 U.S.C. § 26b (2012) (removing baseball's exemption from antitrust law with respect to the major–league baseball player market).

II. BEHAVIOR PROHIBITED BY ANTITRUST LAW AND ZUFFA'S BUSINESS PRACTICES

Antitrust law is the blanket definition of all laws that are intended to prevent anticompetitive business practices.[40] The legislative intent to punish anticompetitive conduct should not be confused with the intent to punish big business.[41] A big business is defined as a business that dominates a market through superior efficiency rather than anticompetitive practices.[42] While pro–competitive business practices increase supply and reduce prices, anticompetitive practices reduce supply and raise prices.[43] The following sections will outline the steps required to find an abuse of market power: (a) establishing a relevant market in which a business may exercise market power; (b) the methods by which market power is exercised including barriers to market entry, market foreclosure, and exclusionary practices; (c) the methods courts use to determine whether an antitrust violation occurred; and (d) the unique applications of antitrust law to sports and professional athletics. The Section will conclude by summarizing Zuffa's business practices.

A. Establishing the Relevant Market

Antitrust laws are designed to protect markets and the competitive process from anticompetitive behavior. Thus, antitrust analysis requires a market in which competition may have been harmed. A market is defined as a set of goods or services that are reasonably interchangeable with one another.[44] In

40. *Antitrust Laws and You*, DOJ (Jan. 5, 2017), https://www.justice.gov/atr/antitrust-laws-and-you.

41. 21 CONG. REC. S2461 (Apr. 8, 1890) (explaining that the purpose of antitrust law is only to regulate the conduct of businesses in so far as they harm competition); Thomas C. Arthur, *A Workable Rule of Reason: A Less Ambitious Antitrust Role for the Federal Courts*, 68 ANTITRUST L. J. 337, 380 (2000). *See generally* 21 CONG. REC. S2461-62 (daily ed. Apr. 8, 1890) (statement of Sen. Sherman) (explaining the purpose of the Sherman Act is to alleviate the harms induced by trusts and combinations which collaborate to dominate the American economy through harm to competition).

42. *See* Verizon Commc'ns, Inc. v. Law Offices of Curtis V. Trinko, 540 U.S. 398, 872, 879 (2004); Standard Oil Co. v. United States, 221 U.S. 1, 525–26 (1911) (interpreting the Sherman Act as targeting only those who "shall monopolize or attempt to monopolize," that is, those who act to obtain monopoly power rather than those who merely possess it); Arthur, *supra* note 41, at 380.

43. Thomas G. Krattenmaker et al., *Monopoly Power and Market Power in Antitrust Law*, 76 GEO. L.J. 241, 248 (1987).

44. Rothery Storage & Van Co. v. Atlas Van Lines, Inc., 792 F.2d 210, 218 (D.C. Cir. 1986). It is important to note that there is some dispute as to whether it is necessary to the antitrust analysis to define the market. *Compare* Nat'l Hockey League Players Ass'n v. Plymouth Whalers Hockey Club, 419 F.3d 462, 466, 470 (6th Cir. 2005) (ruling that identifying a relevant market is necessary to bring action under federal antitrust law), *with* United States v. Brown Univ., 5 F.3d 658, 669 (3d Cir. 1993) (citing 7 P. Areeda, Antitrust Law 1503 at 376) ("[C]ourts typically allow proof of the defendant's 'market

defining a market, the court must look to all reasonable substitutes for the product or services in question.[45] A firm cannot have market dominance or a monopoly in a market where its product can be easily substituted with a competitor's "because the ability of consumers to turn to another supplier restrains a firm from raising prices above the competitive level."[46] The relevant market must include all other products "reasonably interchangeable by consumers for the same purposes."[47] Courts accept evidence of direct, indirect, or even probable injury to competition as sufficient to support a successful antitrust claim.[48]

Whether two products are in the same market depends on consumers' ability to use them for the same purposes.[49] For example, in *United States v. Aluminum Co. of America*,[50] the Supreme Court found the defendant monopolized the virgin aluminum ingot market.[51] Rejecting the argument that recycled aluminum could be used in place of pure virgin ingot,[52] the Court explained that although recycled aluminum could be used in the place of virgin ingot, it was not a reasonable substitute because recycled aluminum cannot serve all the same purposes as virgin ingot.[53] As a result, the products were not reasonably interchangeable and they were not in the same market.[54] A broader market definition would have undermined the government's argument against Aluminum Company because market power was only demonstrable in the virgin ingot market.[55]

Contrastingly, in *United States v. E. I. Du Pont De Nemours & Co.*,[56] the

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power' [instead of defining a relevant market] due to the difficulty of isolating the market effects of challenged conduct . . . .").

45. United States v. Microsoft Corp., 253 F.3d 34, 81 (D.C. Cir. 2001).

46. *Id.* at 50 (quoting *Rothery Storage & Van Co.*, 792 F.2d at 218).

47. Fred Johnson Cement Block Co. v. Waylite Co., 184 F. Supp. 855, 857 (D. Minn. 1960).

48. *See* Am. Tobacco Co. v. United States, 328 U.S. 781, 809–10 (1946) (accepting evidence companies acting in concert as evidence of collusion and harm to competition); Addamax Corp. v. Open Software Found., 888 F. Supp. 274, 281 (D. Mass. 1995) (accepting internal memoranda concerning intentionally anticompetitive conduct as evidence of anticompetitive conduct); Stop & Shop Supermkt. Co. v. Blue Cross & Blue Shield, 239 F. Supp. 2d 180, 184 (D.R.I. 2003) (accepting evidence that output had been reduced and prices increasing as evidence of probable anticompetitive conduct).

49. United States v. Aluminum Co. of America, 148 F.2d 416, 425–26 (2d Cir. 1945).

50. 148 F.2d 416 (2d Cir. 1945).

51. *Id.* at 423.

52. *Id.*

53. *Id.* at 434–44.

54. *Id.*

55. *Id.* at 425–26.

56. 351 U.S. 377 (1956).

Court held that defining the relevant market requires that all products that are reasonably interchangeable with the one in question be included in the relevant market, but products that are not reasonably interchangeable should be excluded.[57] Here, the government argued that Du Pont had market power in the cellophane wrapping market.[58] The Court rejected this argument because although Du Pont did have market power over the cellophane wrapping market, cellophane wrapping was reasonably interchangeable with a number of other wrapping products that could be used for all the same purposes.[59]

B. Prohibited Conduct in the Relevant Market: Foreclosure, Exclusion, and Barriers to Entry

For a monopoly to profitably exercise market power and maintain its market dominance, there must be barriers to market entry.[60] Otherwise, new firms will enter the market offering products at a more competitive price.[61] The only way a monopoly can profit from the exercise of market power is if consumers have no reasonable substitute producer to buy from.[62]

Among other things, monopolies prevent market entry through exclusionary conduct such as implementing exclusive contracts and foreclosing inputs.[63] The Clayton Act section 3,[64] proscribes exclusive dealings contracts which "substantially lessen competition or tend to create a monopoly in any line of commerce" by prohibiting one or more of the parties from dealing with competitors.[65] Input foreclosure occurs when the supplier of an input is forced to only deal with a single buyer.[66] Should a buyer create an exclusive dealings contract with each supplier of a given input, the buyer's competitors will be unable to access the input entirely

57. *Id.* at 395–400.

58. *Id.*

59. *Id.*

60. CHRISTOPHER L. SAGERS, ANTITRUST 46–47 (2d ed. 2014) (explaining the economic principals of how monopolies profit from excluding competition).

61. *Id.* at 48 (explaining that monopolies are able to maximize their profits by selling their products at an above competitive–market price).

62. *Id.* at 196 (explaining the importance of excluding competitors from the market and maintaining market power or market dominance in order to continue charging monopoly prices).

63. *See, e.g.*, Standard Oil Co. v. United States, 337 U.S. 293, 314–15 (1949) (finding that Standard Oil used an exclusive contracting scheme to foreclose inputs, specifically transportation, from competitors).

64. 15 U.S.C. § 14 (2012).

65. *Id.*

66. United States v. Dentsply, 399 F.3d 181, 187 (3d Cir. 2005).

foreclosing the market to competitors.[67] Such arrangements restrain trade by preventing the relevant market from growing in size and scope.[68] Under recent jurisprudence, an exclusive dealings contract must foreclose at least thirty percent of the relevant market to competitors,[69] have a term greater than one year, and not be easily terminated to violate the Clayton Act section 3.[70]

For example, in *Standard Oil Co. v. United States*, the Supreme Court held that an exclusive contracting agreement violated antitrust law due to market foreclosure.[71] Standard Oil formed contracts with 6.7% of the railway market, preventing competitors from using those railways in a cost–effective manner.[72] Due to this inhibition on competitors, an essential input to the sale of oil, transportation, was foreclosed and the practice reduced competition in the oil market.[73] The Supreme Court held that the contracting scheme was anticompetitive in violation of the Clayton Act section 3.[74]

In contrast, the Supreme Court balanced its approach to input foreclosure in *Tampa Electric Co. v. Nashville Coal Co.*,[75] when it held that for exclusive dealings contracts to violate antitrust law, the contracts must foreclose a significant portion of the market to competitors and harm competition.[76] In this case, an electrical company entered a twenty-year exclusive dealings contract with a coal company.[77] The Supreme Court held that all contracts foreclose the market in some capacity and that the foreclosure must be significant enough to have a negative impact on competition.[78] Because the portion of the market foreclosed by the contract was less than one percent, the Court found that there was no negative impact on competition.[79]

A more extreme example of input foreclosure is a monopsony; an economic phenomenon which forces all suppliers of a product or service to

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67. *Id.*

68. *Id.* at 191 ("[W]hen a monopolists' actions are designed to prevent one or more new or potential competitors from gaining a foothold in the market by exclusionary conduct, its success in that goal is not only injurious to the potential competitor but also to competition in general . . . .").

69. Omega Envtl., Inc. v. Gilbarco, Inc., 127 F.3d 1157, 1162–63 (9th Cir. 1997) (finding foreclosure of thirty–eight percent of the relevant market to be lawful).

70. Roland Mach. Co. v. Dresser Indus., Inc., 749 F.2d 380, 395 (7th Cir. 1984).

71. Standard Oil Co. v. United States, 337 U.S. 293, 314–15 (1949).

72. *Id.* at 305.

73. *Id.* at 314–15.

74. *Id.*

75. 365 U.S. 320 (1961).

76. *Id.* at 333–35.

77. *Id.* at 322.

78. *Id.* at 333–35.

79. *Id.*

deal with a single buyer.[80] When a company achieves monopsony power it is able to set its buying prices below the market price and sometimes below the suppliers' production costs.[81] Such a monopsony was alleged in *In re Beef Industries Litigation*,[82] where a major beef packer, IBP, was alleged to have acquired monopsony power and used it anticompetitively.[83] IBP was acquitted of the charges because the court found that that IBP did not abuse its position of market dominance.[84] Further, the court stated, "[i]f IBP had monopsony power, it would take illegal advantage of that situation by reducing its purchases of fed cattle in order to reduce its costs and make a higher profit on each head of cattle processed."[85] In other words, IBP acted procompetitively, as a big business rather than restraining trade.

C. Modes of Antitrust Analysis

The relevant modes of antitrust analysis are *per se* and rule of reason analysis.[86] Courts implement *per se* analysis when the violations are based on business practices that are expressly prohibited due to their well–established anticompetitive effects.[87] Examples of *per se* violations include: group boycotts, concerted refusals to deal, and agreements among competitors not to compete.[88] Courts do not give *per se* violations the benefit of any balancing test because these violations do not have any procompetitive justifications.[89] For example, in *United States v. Andreas*,[90] the defendant companies were caught red–handed colluding to fix the price and production rate of their goods. Further, ranking executives were recorded saying "the competitor is our friend, the consumer is our enemy."[91] Such business practices have a clear harmful effect on competition,

80. *See generally* Culbertson & Weinstein, *supra* note 25.

81. *Id.*

82. *See generally* Meat Price Investigators Assoc. v. Iowa Beef Processors Inc., 907 F.2d 510 (5th Cir. 1990).

83. *Id.* at 515.

84. *Id.*

85. *Id.* at 516.

86. Geoffrey D. Oliver, *Of Tenors, Real Estate Brokers and Golf Clubs: A Quick Look at Truncated Rule of Reason Analysis*, 24 A.B.A. ANTITRUST 40 (2010) (asserting that 'quick look' rule of reason is a tool for courts during summary judgment to save time when there is a clear outcome to the case without doing a full–blown rule of reason analysis; this method is known as a truncated rule of reason analysis).

87. 15 U.S.C. § 1 (2012); May, *supra* note 22, at 365.

88. May, *supra* note 22, at 365.

89. *The Antitrust Laws*, FTC, https://www.ftc.gov/tips-advice/competition-guidance/guide-antitrust-laws/antitrust-laws (last visited Nov. 16, 2016).

90. *See generally* United States v. Andreas, 150 F.3d 766 (7th Cir. 1998).

91. JAMES M. LIEBER, RATS IN THE GRAIN: THE DIRTY TRICKS AND TRIALS OF ARCHER DANIELS MIDLAND, THE SUPERMARKET OF THE WORLD (2002).

consumers, and markets.[92] Courts will not accept any arguments in favor of these or similar practices.[93]

Rule of reason analysis is an in depth economic analysis conducted to determine whether a business practice is anticompetitive or restrains trade.[94] Practices challenged under the rule of reason are given the benefit of a balancing test weighing procompetitive benefits of the practice against potentially anticompetitive effects.[95] Rule of reason jurisprudence interprets the Sherman Act to prohibit business practices which have the "actual or probable" effect of imposing an undue restraint on trade and requires a balancing test.[96] This balancing test incorporates economic benefits brought about by potentially justifiable restraints of trade, such as contracts.[97] Specifically, courts will balance: (1) whether there is a potential harm to the competitive process; and (2) whether there are procompetitive justifications for the allegedly illegal behavior, called "efficiencies," to determine whether there is an illegal net anticompetitive effect.[98]

The term "efficiencies" refers to economic and competitive benefits that ultimately reach consumers resulting from business practices challenged under antitrust law.[99] The concept of efficiencies was first introduced in *United States v. Addyston Pipe & Steel*[100] where the court held that contracts in restraint of trade are legal so long as they are ancillary to a lawful purpose.

This *Addyston* ruling is interpreted today to allow restraints of trade that directly benefit consumers.[101] For example, in *Broadway Music Inc. v. Columbia Broadcast System, Inc.*,[102] the defendant music companies allegedly engaged in a horizontal price fixing agreement.[103] This agreement

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92. May, *supra* note 22, at 365.

93. *Id.*

94. PHILLIP AREEDA ET. AL., ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION, 15–16 (1978).

95. May, *supra* note 22, at 365.

96. Arthur, *supra* note 41, at 388; *see, e.g.*, Am. Tobacco Co. v. United States, 328 U.S. 781, 794 (1946) (the Court focused its industry analysis on a set number of years, 1931–1939, in which the defendants were alleged to have violated the antitrust laws); Standard Oil Co. v. United States, 221 U.S. 1, 74 (1911).

97. United States v. Microsoft Corp., 253 F.3d 34, 50 (D.C. Cir. 2001); United States v. Addyston Pipe & Steel Co., 85 F. 271, 282 (6th Cir. 1898).

98. *Microsoft Corp.*, 253 F.3d at 50; *Addyston Pipe & Steel Co.*, 85 F. at 282.

99. Thomas B. Leary, *Efficiencies and Antitrust: A Story of Ongoing Evolution*, FTC (Nov. 8, 2002), https://www.ftc.gov/public-statements/2002/11/efficiencies-and-antitrust-story-ongoing-evolution.

100. 85 F. 271 (6th Cir. 1898).

101. *See, e.g.*, Broadway Music Inc. v. Columbia Broad. Sys., Inc., 441 U.S. 1 (1979).

102. 441 U.S. 1 (1979).

103. *Id.* at 2.

would have been illegal under antitrust laws, if not for the fact that Broadway Music was able to demonstrate that the agreement benefited consumers by reducing costs; the horizontal agreement allowed music producers to avoid repeat transactions, each one with associated costs that reached consumers.[104] This increased efficiency justified the otherwise illegal behavior by benefiting consumers.[105]

Rule of reason analysis incorporates market data and industry analysis, when both relevant and available, as this information provides direct evidence of the effects that business practices have had on the relevant market.[106] This method is exemplified in *American Tobacco Co. v. United States*[107] where the Supreme Court focused on a set number of years, 1931–1939, in which the defendants were alleged to have violated antitrust laws.[108] The Court compared the defendants' rate of cigarette production and sales to the rest of the tobacco industry.[109] The size of the defendant companies in relation to competitors was found to be enough to establish a conspiracy to restrain trade and to monopolize the tobacco industry.[110] The Court went on to justify the method of economic analysis based on the commonly held belief that insurmountable competition discourages market entry by new market competitors.[111]

D. Antitrust Law in the Sports Industry and Labor Markets

Competition between firms creates the best products and the best market conditions for employees within that industry.[112] Labor market competition forces firms to offer employees competitive wages or risk losing employees to firms offering higher wages.[113] The result is usually a split of the best employees between different companies within the relevant industry.[114]

Professional sports are unique in that dividing the best employees into different promotions reduces the quality of the final product.[115] This is

104. *Id.* at 21.

105. *Id.*

106. *See* Am. Tobacco Co. v. United States, 328 U.S. 781 (1946).

107. *Id.*

108. *Id.* at 794.

109. *Id.*

110. *Id.* at 796 (quoting United States v. Swift & Co., 286 U.S. 106, 116 (1932)) ("Size carries with it an opportunity for abuse that is not to be ignored when the opportunity is proved to have been utilized in the past.").

111. *Id.* at 813 (quoting United States v. Aluminum Co. of America, 148 F.2d 416, 427 (1945)).

112. GEORGE J. BORJAS, LABOR ECONOMICS 188 (7th ed. 2015).

113. *Id.*

114. *Id.*

115. *See* Sherwin Rosen & Allen Sanderson, *Labor Markets in Professional Sports* 4

because the most competitive products in the sports industry are the best athletes competing against each other,[116] hence, football's Super Bowl, soccer's World Cup, and the pinnacle of every other sport.

Team sports, such as football, basketball, and baseball have dealt with this problem by defining different teams as separate economic entities[117] and defining games, the product, as joint ventures.[118] Individual sports like MMA present a paradox with production of the most desirable product on the one side and the antitrust issue of competition on the other. The best product necessitates most, if not all, of the best athletes in the sport competing in a single promotion.[119]

A strong example of increasing market place competition while uniting more athletes in a single promotion took place in *Fraser v. Major League Soccer, LLC*.[120] In *Fraser*, the defendant, Major League Soccer ("MLS"), acquired another soccer league in order to make itself more competitive on an international scale.[121] Rather than eliminate competing teams from the industry and create a less competitive market, MLS promoted competition within the soccer industry internationally by acquiring a competitor to better compete (economically and athletically) with international teams.[122]

On the other hand, labor market competition is inhibited in various professional sports by contractual clauses that limit athletes' ability to change employers.[123] Infamously, the National Football League ("NFL") implemented what was known as the "Rozelle Rule"[124] while Major League Baseball ("MLB") implemented the "Reserve Clause."[125] The function of the Rozelle Rule was to allow the NFL to manage disputes between players and teams when the player wanted to move to a different team for increased

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(Nat'l Bureau of Econ. Research, Working Paper No. 7573, 2000).

116. *Id.*

117. Am. Needle, Inc. v. NFL, 560 U.S. 183, 196 (2010) (defining sports teams as legally distinct entities and cooperation between teams as joint ventures); Fraser v. Major League Soccer, 284 F.3d 47, 55 (surveying conflicting opinions as to whether sports teams constitute distinct entities).

118. *Am. Needle*, 560 U.S. at 196. *See generally* Roger G. Noll, *The Organization of Sports Leagues* (Stanford Inst. for Econ. Policy Research, Discussion Paper No. 02–43, 2003).

119. Rosen & Sanderson, *supra* note 115, at 6 (explaining how top athletic performers draw large audiences while even slightly less competitive athletes see significantly smaller audiences and therefore incomes drop off).

120. *See* 284 F.3d 47 (1st Cir. 2002).

121. *Id.* at 55.

122. *Id.* at 59.

123. *See, e.g.*, Flood v. Kuhn, 407 U.S. 258 (1972); Toolson v. N.Y. Yankees, 346 U.S. 356 (1953); Mackey v. NFL, 543 F.2d 606 (8th Cir. 1976).

124. *Mackey*, 543 F.2d at 610.

125. *Toolson*, 346 U.S. 362 n. 10.

wages.[126] The disputes would be resolved by the NFL Commissioner, Pete Rozelle, by instructing the team receiving the moving player to pay the player's previous team a fee.[127] The actual effect of the Rozelle Rule reduced player mobility and depressed player wages.[128] The Rozelle Rule was found to be an unreasonable restraint of trade in violation of the Sherman Act section 1 because the rule was not essential to the league's function and it was more restrictive than necessary.[129]

Contractual restrictions on athletes' abilities to move from one organization to another should be no more restrictive than necessary and essential to the organization's function, otherwise, the restrictions may violate antitrust law.[130] Despite the presence of antitrust laws, lack of wage competition due to a dominant firm with monopsony power has been a prevailing problem for athletes throughout the sports industry, most notably in baseball.[131] Baseball was exempt from antitrust laws until relatively recently.[132] For decades, the MLB enforced the Reserve Clause, which kept players bound to the team they first signed with for the extent of their career and after retirement.[133] The MLB's contracting scheme was challenged in *Toolson v. New York Yankees*[134] and *Flood v. Kuhn*.[135] In *Toolson*, the Supreme Court held that baseball is a pastime, not a part of interstate commerce and, therefore, the contracting scheme was outside the constitutional scope of the Commerce Clause.[136] In *Flood*, the Supreme Court held that the legality of the MLB's contracting scheme was a political question.[137] This holding was met with criticism, none more harsh than that of Justice Marshall stating in his dissent that "[t]o non–athletes it might appear that petitioner was virtually enslaved by the owners of major league baseball clubs who bartered among themselves for his services."[138] Despite

126. *Mackey*, 543 F.2d at 615.

127. *Id.*

128. *Id.*

129. *Id.* at 622–23.

130. *Id.* at 620.

131. Andrew Tarman, *The Effect of Monopsony Power in Major League Baseball on the Salaries of Players with Less Than Six Years in the Major*, ILL. WESLEYAN U. DIGITAL COMMONS 1, 1 (2005).

132. *See* The Curt Flood Act of 1998, 112 STAT. 2824, 15 U.S.C. § 26b (2016) ("An Act requiring the general application of the antitrust laws to major league baseball, and for other purposes.").

133. Toolson v. N.Y. Yankees, 346 U.S. 356, 357, 362–64 (1953).

134. 346 U.S. 356 (1953).

135. 407 U.S. 258 (1972).

136. *Toolson,* 346 U.S. 356-57.

137. *Flood*, 407 U.S. 258, 273–74.

138. *Id.* at 289 (Marshall, J. dissenting).

the judiciary's avoidance of applying antitrust law to baseball, baseball players advocated for themselves and improved market conditions for themselves by engaging in collective bargaining.[139] Rather than fight an uphill battle against the dominant firm, baseball players unionized forming the Major League Baseball Players Association ("MLBPA") to demand minimum contractual terms and collective bargaining opportunities.[140]

Athletes in the boxing industry faced similarly coercive contracts prior to the passage of the Muhammad Ali Boxing Reform Act ("Ali Act").[141] Although there was no monopolist, boxers faced coercive and one–sided contracts.[142] Among other things, the Ali Act set minimum safety and contract requirements for participants in the boxing industry.[143] Regular conflicts of interest among judges and referees resulted in questionable outcomes as to who won or lost a bout.[144] The most important feature of the Ali Act is to prohibit contracts allowing managers and promoters to unfairly control and manipulate athlete pay.[145]

139. *Id.* at 294.

140. Clarett v. NFL, 369 F.3d 124, 130–131 (2d Cir. 2004) (quoting Brown v. Pro Football, 50 F.3d 1041, 1056 (D.C. Cir. 1995)) (holding that "the non–statutory labor exemption waives antitrust liability for restraints on competition imposed through the collective bargaining process, so long as such restraints operate primarily in a labor market characterized by collective bargaining"); MLBPA Basic Agreement, art. III (2012–2016); *Our History*, MAJOR LEAGUE BASEBALL PLAYERS, http://www.mlbplayers.com/ViewArticle.dbml?ATCLID=211042995&DBOEMID=34000 (last visited Sept. 30, 2017).

141. 15 U.S.C. § 6301 (2012).

142. H.R.5365, 114th Cong. (2015); John S. Nash, *Congressman Markwayne Mullin Talks About Bringing the Ali Act to MMA*, BLOODY ELBOW (Apr. 18, 2016), http://www.bloodyelbow.com/2016/4/18/11449348/congressman-markwayne-mullin-talks-about-bringing-the-ali-act-to-mma.

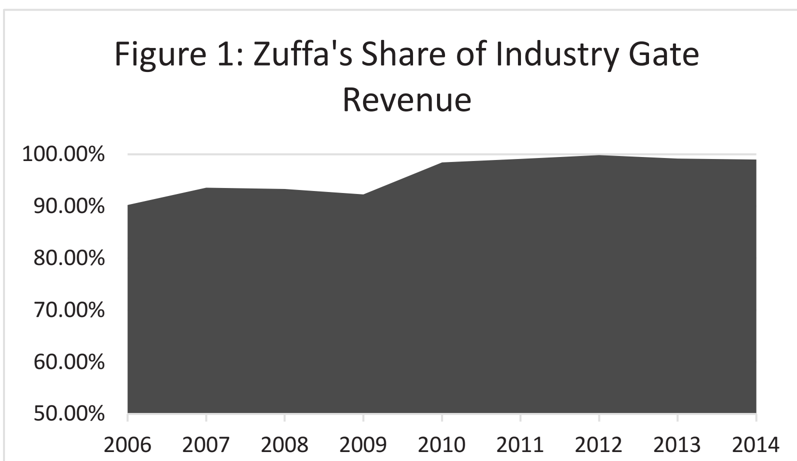
143. Brad Ehrlichman, *In This Corner: An Analysis of Federal Boxing Legislation*, 34 COLUM. J.L. ARTS 421, 421, 423 (2011).

144. *Id.* at 423.

145. H.R.5365, 114th Cong. (2015).

E. Zuffa's Business Practices

Zuffa's business practices implicate two closely related, but technically distinct, markets: the MMA Promotional Market and the Elite MMA Labor Market (fighters ranked in the top thirty world–wide). Zuffa controls an enormous share of both markets. A company's level of control over a given market is readily demonstrated by its share of industry revenue.[146] Figure 1 below, illustrates Zuffa's enormous share of industry gate revenue.[147] As it demonstrates, since 2006, Zuffa has taken in a minimum 90.23% of industry gate revenue, a maximum of 98.85%, and averaged 96.11%.[148]



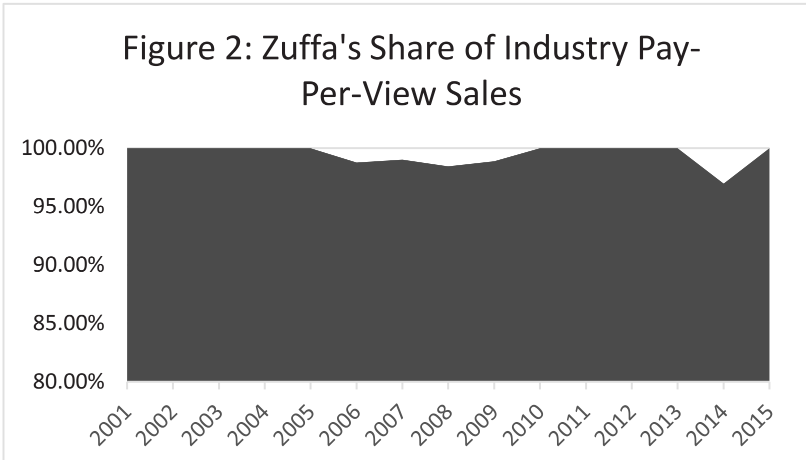
Further, as demonstrated in Figure 2 below, Zuffa averaged 99.47% of industry pay–per–view sales from 2008 to 2015.[149]

146. Am. Tobacco Co. v. United States, 328 U.S. 781 (1946); Nobody in Particular Presents, Inc. v. Clear Channel Commc'ns, Inc., 311 F. Supp. 2d 1048, 1102 (D. Colo. 2004).

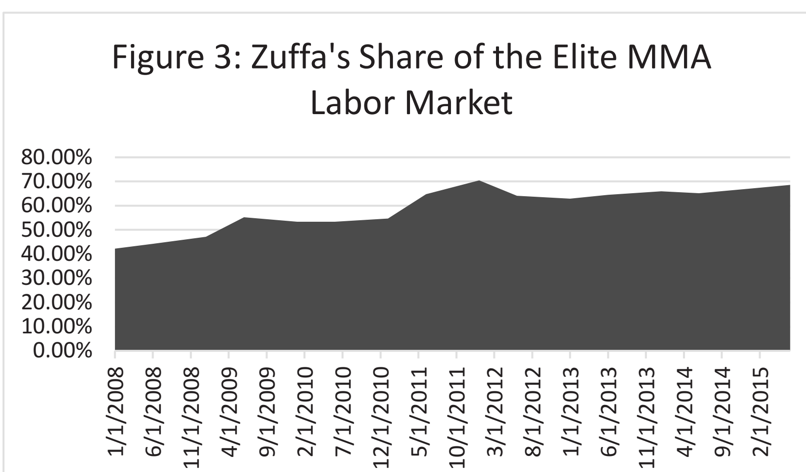
147. Figure 1 was created using information compiled from: *Live Gate & Atten dance*, PAYOUT THE BUS. OF MMA, http://mmapayout.com/blue-book/live-gate-att endance/ (last visited Mar. 15, 2017).

148. *See* Figure 1.

149. *See infra* Figure 2. Figure 2 was created using information compiled from: *Pay–per–View*, PAYOUT THE BUS. OF MMA, http://mmapayout.com/blue-book/pay-per-view/ (last visit-ed Mar. 15, 2017).



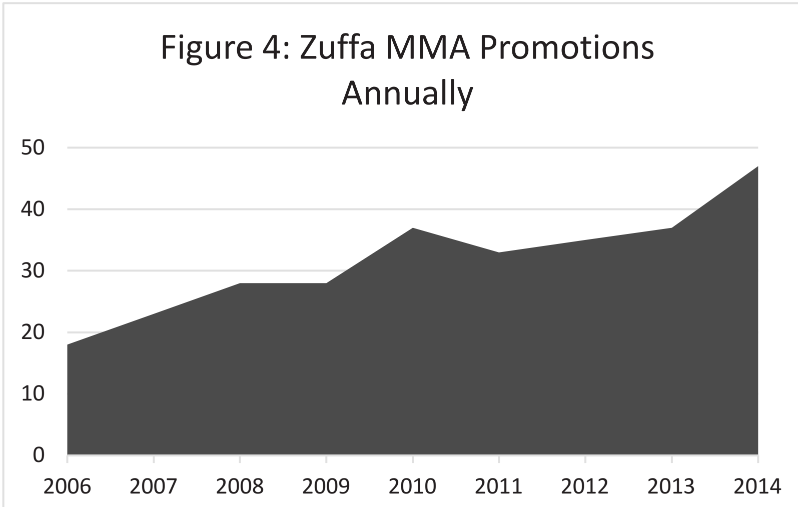
As demonstrated in Figure 3 below, Zuffa has steadily grown its dominant share in the Elite MMA Labor Market: in 2008, Zuffa's share was 42.29% and rose to 68.67% in 2015.[150]



Additionally, as demonstrated in Figure 4 below, Zuffa has increased the number of MMA promotions every year while lowering the cost to consumers by expanding out of pay–per–view only and into television.[151]

150. Figure 3 was created using information compiled from: *Current MMA Rank ings*, FIGHT MATRIX, http://www.fightmatrix.com/mma-ranks/ (last visited Mar. 15, 2017) and SHERDOG, http://www.sherdog.com/ (last visited Mar. 15, 2017).

151. Sanneh, *supra* note 12. Figure 4 was created using information compiled from: *Blue Book*, PAYOUT THE BUS. OF MMA, http://mmapayout.com/blue-book/ (last visited



Zuffa's market dominance alone is not enough to cause an antitrust injury.[152] However, several of Zuffa's business practices do raise antitrust concerns, specifically Zuffa's (1) specific intent to reduce competition through the purchase of PRIDE FC,[153] (2) indefinite contractual length,[154] (3) widespread use of non-compete clauses,[155] and (4) reduction in fighter pay that was not followed by a significant reduction in labor market share.

First, specific intent to reduce competition was revealed (accidentally) by the UFC during litigation in an internal memo to the UFC from one of its lawyers; the purpose of the PRIDE FC acquisition was "to stop others from buying Pride and to acquire Pride to shut the business down and acquire its fighters for the UFC."[156] Zuffa acquired two additional firms under similar circumstances, Strikeforce and World Extreme Cagefighting ("WEC").[157]

Mar. 15, 2017).

152. Arthur, *supra* note 41, at 380.

153. *Id.*

154. *See* Zane Simon, *UFC Fighter Contract Details Revealed and Analyzed*, BLOODY ELBOW (May 14, 2013) (quoting section 4.2 of Eddie Alvarez's UFC contract), http://www.bloodyelbow.com/2013/5/14/4330572/ufc-fighter-contracts-rev ealed-dana-white-fertitta-mma-news.

155. Paul Gift, *Dissecting the Fighter's Antitrust Lawsuit Against the UFC, Part 2*, BLOODY ELBOW (Dec. 18, 2014), https://www.bloodyelbow.com/2014/12/18/7414 267/mma-ufc-fighter-antitrust-lawsuit-monopoly-monopsony-cung-le-nate-quarry-jon-fitch-part-2.

156. Cung Le v. Zuffa, 2:15-cv-01045-RFB-PAL, 2016 U.S. Dist. LEXIS 69813, at *23 (D.C. Nev. 2016).

157. Harty, *supra* note 14.

Strikeforce distinguished itself by promoting female fighters which quickly gained traction and viewership.[158] Before acquiring Strikeforce, Zuffa weakened the business through the practice of "counter–programming," or strategically planning UFC events to occur at the same time as Strikeforce events in order to reduce Strikeforce viewership, TV ratings, and thereby company value.[159] The WEC similarly attempted to distinguish itself by promoting fights in smaller weight classes.[160] Both of these MMA promotions were competing with the UFC by offering competitive wages, lower prices to consumers, and a product that, in one way or another, was distinguishable from what the UFC produced until Zuffa eliminated them as competitors.[161]

Second, the UFC's Championship Clause prevents top-ranked fighters from negotiating with other organizations or leaving the UFC by "automatically extend[ing] the contract if the fighter should win a UFC title."[162] This clause states:

> If, at the expiration of the Term, Fighter is then a UFC champion, the Term shall automatically be extended for the period commencing on the Terminate Date and ending on the later of (i) one (1) year from the Termination Date; or (ii) the date on which Fighter has participated in three (3) bouts promoted by ZUFFA, regardless of weight class or title, following the Termination Date ("Extension Term").[163]

The Champions Clause extends indefinitely, holding the fighter bound to Zuffa.

Third, Zuffa's contracts always contain non–compete clauses which prevent the fighters from participating in other promotions for the extent of the contractual relationship without Zuffa or the UFC's express consent.[164] The UFC's contracts allow them to hold a fighter on contract without having any fights (and therefore keeping the fighter from generating income) for

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158. Josh Gross, *UFC Buys Rival Strikeforce*, ESPN (Mar. 13, 2011), http://espn.go.com/extra/mma/news/story?id=6209923.

159. MMAjunkie Staff, *Saturday's Strikeforce Show Countered by Spike TV "UFC's Ultimate Fighters" Special*, MMA JUNKIE (May 12, 2010), http://mmajunkie.com/2010/05/saturdays-strikeforce-show-countered-by-spike-tv-ufcs-ultimate-fights-special.

160. Harty, *supra* note 14.

161. *See id.* (detailing Zuffa's purchase of the WEC once it had success marketing fighters who were physically smaller than those in the UFC and, similarly, Strikeforce was purchased once it had success marketing female fighters).

162. Simon, *supra* note 154.

163. *Id.*

164. Jeffrey B. Same, Comment, *Breaking the Chokehold: An Analysis of Potential Defenses Against Coercive Contract in Mixed Martial Arts*, 2012 MICH. ST. L. REV. 1057, 1062, 1072, 1086 (2012).

years at a time.[165] These non–compete clauses also prevent other promotions from competing for the athlete's contracts by offering higher wages than the UFC.

Fourth, in 2015, the UFC eliminated one of the primary income generators for fighters as part of the Reebok Deal of 2015 ("Reebok Deal") and greatly increased revenue in the process.[166] Previously, fighters made up for the low wages paid by the UFC by wearing articles of clothing and flying a banner with brand logos in exchange for payment.[167] The Reebok Deal eliminated that source of income by requiring fighters to wear Reebok clothing[168] and excluding all other clothing sponsorships.[169] This resulted in widespread criticism for its effect on fighter income.[170]

In a competitive labor market, reduction in pay leads to laborers working elsewhere;[171] however, industry data indicates that the UFC's share in the Elite MMA Labor Market held steady through 2015 despite the reduction in fighter income.[172] While some fighters have left the UFC for more competitive wages elsewhere, the number of fighters who have been able to leave is a small portion of the UFC's large fighter roster, which contains over four-hundred fighters.[173] It is important to note that the fighters who left the

165. Marc Raimondi, *UFC Says Georges St. Pierre is Still Under Zuffa Contract*, MMA FIGHTING (Oct. 17, 2016), http://www.mmafighting.com/2016/10/17/13313082/ufc-says-georges-st-pierre-is-still-under-zuffa-contract (detailing a dispute between Zuffa and a contracted fighter after failure to come to a payment agreement and the fighter claimed to have been released from his contract); Guilherme Cruz, *Jose Aldo Requests to be Released from the UFC*, MMA FIGHTING (Sept. 27, 2016), https://www.mmafighting.com/2016/9/27/13083694/jose-aldo-requests-his-release-from-the-ufc (detailing another dispute between Zuffa and a contracted fighter who wanted to be released after being repeatedly deceived; the UFC refused); Paul Gift, *Does the Length of Fight Careers Matter in the UFC Antitrust Lawsuit*, BLOODY ELBOW (Dec. 30, 2014), bloodyelbow.com/2014/12/30/7465287/mma-ufc-antitrust-law suit-fight-career-length.

166. Andrew Brennan, *Why Is The UFC–Reebok Deal Exploiting UFC Fighters and Condoning Pay Gaps?*, FORBES (May 16, 2016), http://www.forbes.com/sites/andrewbrennan/2016/05/16/is-it-the-ufc-or-is-it-reebok-that-is-exploiting-ufc-fighters-and-condoning-pay-gaps/#70dce6cd657f; Gareth A. Davies, *UFC's £45 Tie-Up With Reebok a Big Deal as Fighters Get Dressed for Financial Success*, TELEGRAPH (Dec. 2, 2014), http://www.telegraph.co.uk/sport/othersports/ufc/11268220/UFC-signs-70-mill ion-deal-with-Reebok-will-see-500-fighters-wearing-firms.html (detailing the amount Reebok paid the UFC in exchange for the Reebok Deal contract; $70 million in revenue that was previously unrealized).

167. *Id.*

168. *Id.*

169. *Id.*

170. *Id.*

171. BORJAS, *supra* note 112, at 188.

172. *See supra* Figure 4.

173. Zane Simon, *Fighters Talk Moving to Bellator: "There is No Negotiation" With the UFC*, BLOODY ELBOW (Apr. 6, 2016), http://www.bloodyelbow.com/2016/

UFC by choice for more competitive contracts were all well-known names in the sport and major revenue generators with significantly more bargaining power than the average fighter.[174]

III. ZUFFA'S MARKET DOMINANCE

Zuffa appears to have significantly increased competition in the MMA Promotional Market by lowering prices and increasing output, but has decreased competition in the labor market and, arguably, acted in restraint of trade. The UFC possesses dominant market shares in both the MMA Promotional Market and the Elite MMA Labor Market.[175] The market for MMA Promotions is the sales side of the UFC's business while the Elite MMA Labor Market is the input side. These market definitions are appropriate because neither is reasonably interchangeable with other products or services. Elite MMA Promotions consist of one–on–one violence with limited rules.[176] The only promotion that is comparable in concept and scope is professional wrestling; both involve minimal rules and one-on-one hand to hand combat.[177] However, the dominant firm in professional wrestling, World Wrestling Entertainment ("WWE"), is a subsidiary of WME–IMG, which purchased a controlling share of the UFC from Zuffa in 2016.[178] Therefore, even if professional wrestling were reasonably interchangeable with MMA, this point would be irrelevant for purposes of antitrust analysis since the organizations dominating the two industries are owned by the same holding company. Defining the relevant labor market as Elite MMA Fighters is also appropriate because no other athletes, or laborers, are reasonably interchangeable with MMA fighters which qualify as "elite" or are ranked in the top thirty world-wide. The fact that other athletes are not interchangeable with MMA fighters has been demonstrated by attempts by other athletes to compete in the UFC and, for the most part, failing.[179]

4/6/11378328/ufc-vs-bellator-fighters-speak-out-ben-henderson-josh-thomson-matt-mitrione-mma-news.

174. *Id.*

175. *See supra* Figures 1, 2, 3, & 4.

176. *See What Is MMA and the UFC?*, UFC, http://www.ufc.com/discover/sport (last visited Nov. 16, 2016) (defining MMA as "[a] full contact sport . . . with minimal rules . . . promoted as a competition to determine the most effective martial art for unarmed combat situations").

177. Michael Wickham, *Differences Between WWE and UFC*, EZINE ARTICLES (Sept. 5, 2010), http://ezinearticles.com/?Differences-Between-WWE-and-UFC&id=4967504.

178. Rogers, *supra* note 6.

179. *See, e.g.*, Brett Okamoto, *Mickey Gall Submits CM Punk by Rear–Naked Choke in First Round*, ESPN (Sept. 11, 2016), http://www.espn.com/mma/story/_/id/17517456/cm-punk-submitted-mickey-gall-debut-ufc-203 (detailing a former professional

Neither the UFC nor Zuffa have committed a *per se* violation of antitrust law. Any argument that the UFC and Zuffa have committed a *per se* violation of antitrust law is without merit as there have been no boycotts, price fixes, or other established *per se* antitrust violations comparable to the actions in *United States v. Andreas*.[180] As a result, the proper mode of analysis is rule of reason. Rule of reason analysis requires a relevant market, market data, a history of the relevant entity's business practices, and an economic analysis of the effects those practices have on the market.[181] Under rule of reason analysis, if Zuffa's business practices are justified by procompetitive benefits which increase efficiency and benefit consumers then it has not violated antitrust law.

Additionally, it is clear that the business of Elite MMA Promotions and activity in the Elite MMA Labor Market, fighters constitutes "trade or commerce among the several states" within the meaning of the Sherman Act.[182] It is also uncontroversial to define the relevant geographic markets as international because MMA promotions occur throughout the world and fighters from dozens of countries enter the Elite MMA Labor Market.[183]

To violate antitrust law, Zuffa must have exercised its market power in an anticompetitive manner which harmed competition.[184] Such an exercise of market power appears differently in the two relevant markets. In the MMA Promotional Market, exercise of market power would be characterized by increasing prices and decreasing supply while still profiting.[185] On the other hand, exercise of market power in the Elite MMA Labor Market would be characterized by decreasing wages without losing laborers.[186]

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wrestler's failed attempt to compete in the UFC); Michael David Smith, *UFC: 118 Randy Couture Submits James Toney*, MMA FIGHTING (Aug. 28, 2010), http://www.mmafighting.com/2010/08/28/ufc-118-randy-couture-submits-james-toney (detailing a former boxing world champion's failed attempt to compete in the UFC). *But see* Lewis Mckeever, *UFC 200's Mark Hunt: Brock Lesnar is 'Juiced to the Gills'*, BLOODY ELBOW (June 9, 2016), http://www.bloodyelbow.com/2016/6/9/11894244/ufc-200s-mark-hunt-brock-lesnar-is-juiced-to-the-gills (detailing a professional wrestler's success competing in the UFC, despite serious questions about his use of performance enhancing drugs).

180. *See Are UFC Contracts, Like a Diamond, Forever?*, COMBAT SPORTS L. (Sept. 28, 2015), https://combatsportslaw.com/2015/09/28/are-ufc-contracts-like-a-diamond-forever/ (detailing an arguably coercive contracting practice that was discontinued by the UFC).

181. Oliver, *supra* note 86.

182. *See* United States v. Int'l Boxing Club, 348 U.S. 236, 240–41 (1955).

183. FighterMan, *100 New Countries Join The Fight*, MMA FED'N (May 10, 2016), http://mmafederation.com/2016/05/10/100-new-countries-to-join-the-fight/.

184. United States v. Microsoft Corp., 253 F.3d 34, 51 (D.C. Cir. 2001).

185. *Id.*

186. Tejvan Pettinger, *Monopsony Exploitation*, ECONS. HELP (Jan. 6, 2012), http://www.economicshelp.org/blog/4840/labour-markets/monopsony-exploitation/ (exercising monopsony power allows employers to decrease wages without losing

A. MMA Promotional Market Analysis

Zuffa dominates the MMA Promotional Market,[187] but that alone is not sufficient to violate antitrust law.[188] Under rule of reason analysis, Zuffa's business practices are suspect. The pattern of eliminating competing firms reduces competition, thus implicating the Clayton Antitrust Act[189] and the Antimerger Act of 1950,[190] which prohibit mergers and acquisitions when "the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly."[191]

In almost identical fashion to *Standard Oil*,[192] Zuffa bought out competition, took control of management, and attained market dominance. The UFC took control of the World Fighting Alliance, the WEC, International Fight League, Strikeforce, and PRIDE FC with the aforementioned specific intent to reduce competition.[193] The UFC's consistent reaction to competing firms offering innovative products distinguishable from the UFC's is to buy them out.[194]

The actual effects of these practices are demonstrated in Figure 1, Figure 2, Figure 3, and Figure 4, which show the gradual increase in various indicators of market share approaching, if not exactly, 100%.[195] Such a level of promotional market dominance reduces competition in the market for MMA fighters and reduces the number of competitors in the market for MMA promotions.[196]

Despite eliminating competitors from the industry for the MMA Promotional Market, the UFC has not reduced the level of competition in the industry, evidenced by the consistent increase in the number of MMA events

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employees because employees have no other employers to turn to or use as bargaining leverage).

187. *See supra* Figures 1, 2, & 3 (holding a more than ninety percent share of industry pay-per-view sales and gate attendance as well as more than a sixty share of the relevant labor market).

188. *Microsoft Corp.*, 253 F.3d at 50 (quoting United States v. Grinnell Corp., 384 U.S. 563, 570–71 (1966)) (defining the illegal monopolization as having two elements: "(1) the possession of monopoly power in the relevant market and (2) willful acquisition or maintenance of that power").

189. 15 U.S.C. §§ 12–27 (2012); 29 U.S.C. §§ 52–53 (2012).

190. 15 U.S.C. § 18.

191. *Id.*

192. 221 U.S. 1, 31 (1911) (detailing the extent of Standard Oil's elimination of competition throughout the United States to corner the market on crude oil).

193. *See generally* Harty, *supra* note 14.

194. *Id.*

195. *See supra* Figures 1, 2, 3, & 4.

196. *See supra* Figure 4; *see also* SAGERS, *supra* note 60, at 46–47 (demonstrating that the probable effects of any one firm dominating a market include reduction in output, increase in prices above market levels, and other restraints of trade).

the UFC promotes annually.[197] Further, the UFC has reduced prices for consumers by bringing the UFC to TV rather than just pay–per–view.[198] Increasing production while lowering prices is the exact opposite of the anticompetitive tendency to reduce output while raising prices. In other words, the UFC's conduct in the market for MMA Promotional Market has been procompetitive. Therefore, the UFC likely has not violated antitrust law or conducted itself in an anticompetitive manner in the market for MMA Promotional Market.

Zuffa's business practices in the market for MMA Promotional Market are comparable to the defendant's actions in *Fraser v. Major League Soccer*.[199] Like MLS, the UFC bought out competition and, in the process, increased the level of competition in the relevant market. The acquisitions of competing firms and MMA promotions[200] eliminated major competitors in the MMA Promotional Market. Nonetheless, the number of events produced by the UFC indicates an increase in competition.[201]

While the UFC's acquisitions appear to have increased competition in the MMA Promotional Market, these acquisitions have reduced labor market competition. This effect was not seen in *Fraser* because there was still an international community of teams competing in the labor market for soccer players.[202] The economic effect of Zuffa's acquisitions was the creation of a monopsony in which the UFC was the only buyer of a specific input: Elite MMA Labor. Although the market for elite MMA fighters is a labor market, it is also protected by antitrust law designed to prevent monopsony as well as monopoly.[203]

B. Elite MMA Labor Market Analysis

Zuffa's consistent reaction to firms that offer a product which is able to compete with the UFC's is to buy them out.[204] When the WEC produced professional MMA in weight–classes that the UFC did not, the UFC bought

197. Smith, *supra* note 13; *see also supra* Figure 4.

198. Smith, *supra* note 13.

199. Fraser v. Major League Soccer, 284 F.3d 47, 52–55 (1st Cir. 2002).

200. Jonathon Snowden, *The Business of Fighting: A Look Inside the UFC's Top–Secret Fighter Contract*, BLEACHER REP. (May 14, 2013), http://bleacherreport.com/articles/1516575-the-business-of-fighting-a-look-inside-the-ufcs-top-secret-fighter-contract.

201. *See supra* Figure 4.

202. *See* Jacobson, *supra* note 26 (explaining that the only difference in antitrust analysis regarding a labor market monopsony is viewing laborers as "consumers" of labor subject to the same protections as consumers of any other good or service). *See generally Fraser*, 284 F.3d at 47.

203. *See* Jacobson, *supra* note 26.

204. Harty, *supra* note 14.

out the WEC.[205] The same is true of Strikeforce,[206] the acquisition that brought one of MMA's greatest stars and revenue generators to the UFC, Ronda Rousey.[207] When Invicta FC produced a women's straw–weight division (115 pounds), which the UFC did not have, the UFC bought out each fighter's contract to form their own women's straw–weight division.[208] Historically, whenever another MMA firm creates a distinguishable or competitive product, the UFC acquires it and thereby reduces labor market competition.

The market impact of these business practices is clear: reducing the number of firms competing in a labor market reduces employee wage competition and limits those employees to fewer potential employers.[209] While there are a small number of firms who are also in the professional MMA market, none are comparable to the UFC in terms of size, wages, or overall promotional quality.[210]

The UFC grew its own labor market share by eliminating viable wage competitors by acquiring and out-competing them.[211] In doing so, the UFC created unequal bargaining positions between the UFC and its athletes.[212] The result of unequal bargaining positions has been fighters' inability to significantly influence contractual terms or wages.[213] The UFC is able to offer fighters lower wages than they would if the fighters had any bargaining power.[214] Without the opportunity to receive competitive wages from any other promotion, the UFC is often the only option.[215]

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205. *Id.*

206. Josh Gross, *UFC Buys Rival Strikeforce*, ESPN (Mar. 13, 2011), http://espn.go.com/extra/mma/news/story?id=6209923.

207. Nathan Ryan, *Power Rankings: UFC's 10 Biggest Draw Cards Based on Star Power*, FOX SPORTS (Jan. 1, 2016), http://www.foxsports.com.au/ufc/power-rankings-ufcs-10-biggest-draw-cards-based-on-star-power/news-story/03df1b7fc2c827cdf90081e2138b3e09.

208. Zane Simon, *UFC Announces Signing of 11 Women Strawweights for TUF Season, Winner Becomes First UFC 115lb Champ*, BLOODY ELBOW (Dec. 11, 2013) [hereinafter Simon, *UFC Announces*], http://www.bloodyelbow.com/2013/12/11/5201972/ufc-strawweight-tuf-invicta-contracts-first-champion-gadelha-esparza-calderwood-torres-mma-news.

209. BORJAS, *supra* note 112, at 187–89.

210. Riley Kontek, *Power Ranking the Top 5 MMA Organizations Outside the UFC*, BLEACHER REP. (May 6, 2013), http://bleacherreport.com/articles/1630207-power-ranking-the-top-5-mma-organizations-outside-the-ufc.

211. Snowden, *supra* note 200.

212. *Id.*

213. Same, *supra* note 164, at 1064–66; Brennan, *supra* note 166.

214. Same, *supra* note 164, at 1066.

215. *Id.*

The UFC's behavior in the Elite MMA Labor Market is distinguishable from IBP's actions in the beef industry.[216] While IBP did not "reduce its costs and make a higher profit" by decreasing output, the UFC used its monopsony power to reduce its costs through the Reebok Deal. The Reebok Deal had the "actual effect"[217] of allowing the UFC to "take . . . advantage of that situation by reducing its [payment of fighters] in order to reduce its costs and make higher profit on each [fight]."[218] Zuffa's use of monopsony power to reduce wages and thereby increase profits from promotions is the exact inverse of the IBP's legal practices.

As an input to the final product of MMA promotions, widespread application of exclusive dealings contracts requires a foreclosure analysis.[219] The non–compete clauses present in every Zuffa signed fighter's contract constitutes an exclusive dealings agreement.[220] Both consumers and competition are injured by a foreclosure of an input preventing "potential competitors from gaining a foothold in the market by exclusionary conduct."[221]

Zuffa's labor market share is identical to the market share that is foreclosed to competitors: sixty–six percent.[222] These metrics are identical because Zuffa includes non–compete clauses in all of its fighter contracts.[223] Sixty–six percent is well over the 6.7% market foreclosure found to violate the Clayton Act section 3 in *Standard Oil Co. v. United States*[224] and the thirty percent minimum consensus market share.[225] Further, Zuffa fighter contracts are neither short-term nor easily terminated.[226] Specifically, the "Championship Clause" permits Zuffa to extend some contracts indefinitely.[227] Fighter contracts have also been used to prevent fighters who no longer want to work for the UFC from competing in other promotions.[228]

216. *In re* Beef Indus. Antitrust Litig., 907 F.2d 510 (5th Cir. 1990).

217. Standard Oil Co. v. United States, 221 U.S. 1, 74 (1911).

218. *In re* Beef Indus. Antitrust Litig., 907 F.2d at 516.

219. Standard Oil Co. v. United States, 337 U.S. 293, 313–14 (1949).

220. Simon, *supra* note 154.

221. United States v. Dentsply Int'l. Inc., 399 F.3d 181, 191 (3d Cir. 2005) (citing LePage's, Inc. v. 3M, 324 F.3d 141 (3d Cir. 2003)).

222. *See supra* Figure 3.

223. Gift, *supra* note 155.

224. *Standard Oil Co.*, 337 U.S. at 305.

225. SAGERS, *supra* note 60, at 157.

226. Roland Mach. Co. v. Dresser Indus., Inc., 749 F.2d 380, 395 (7th Cir. 1984).

227. Simon, *supra* note 154.

228. Cruz, *supra* note 165.

The "Championship Clause"[229] is a near replica of the MLB's "Reserve Clause."[230] Like the Reserve Clause, the UFC's Championship Clause prevents fighters from negotiating with other organizations or leaving the UFC by "automatically extend[ing] the contract if the fighter should win a UFC title."[231] In and of itself, holding an athlete on contract is not illegal; however, when compared to the average career length of an MMA fighter,[232] it is evident that the UFC takes near complete control over a fighter's career.[233]

The actual or probable effects of Zuffa's control over the labor market are: (1) harming to both labor market and promotional market competition; and (2) creating barriers to market entry. The UFC's unilateral application of the Reebok Deal significantly reduced the ability of fighters to generate income.[234] The fact that fighters have not left the UFC in significant numbers is evidence that: (1) there are few MMA promotions that compete with the UFC in the MMA labor market and;[235] (2) the exclusive dealings contracts are not easily terminated.

However, even if the Elite MMA Labor Market is monopsonized, this is not dispositive of an antitrust violation; although written in the context of a monopoly, *Trinko*[236] authoritatively states that market power sufficient "to charge monopoly prices—at least for a short period—is what attracts 'business acumen' in the first place."[237] In other words, a short period allowing the opportunity to charge monopoly prices is the economy's reward for superior efficiency.[238] Further, "the possession of monopoly power will not be found unlawful unless it is accompanied by an element of anticompetitive conduct."[239]

229. Nathaniel Grow, *Defining the "Business of Baseball": A Proposed Framework for Determining the Scope of Professional Baseball's Antitrust Exemption*, 44 U.C. DAVIS L. REV. 557, 561–62 (2010) (explaining that the "reserve clause" was "a provision included at the time in all baseball player contracts that precluded players from negotiating future contracts with anyone but their current employer").

230. *Id.* at 561; Toolson v. N.Y. Yankees, 346 U.S. 356, 362 n. 10 (1953).

231. Simon, *supra* note 154.

232. Gift, *supra* note 155 (conducting an analysis of the average career length of elite MMA fighters to be five hundred thirty–three days within which fighters average 3.3 bouts).

233. *See id.*

234. Brennan, *supra* note 166.

235. BORJAS, *supra* note 112, at 188; *see also supra* Figure 3.

236. Verizon Commc'ns, Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398 (2004) (quoting United States v. Grinnell Corp., 384 U.S. 563, 570-71 (1996)).

237. *Id.* at 407.

238. *Id.*

239. *Id.*

The UFC's contracting scheme is anticompetitive. The contracting scheme provides that (1) fighters cannot compete in other promotions for the duration of their contractual relationship; (2) the contracts can last indefinitely; and (3) the contracts are not easily terminated.[240] Because of these contractual elements, fighters can be forced to accept uncompetitive, potentially below cost, wages.[241] Therefore, through this series of contractual clauses, Zuffa has successfully foreclosed sixty–six percent of the market and likely violated the Clayton Act section 3 prohibition on widespread exclusive dealings. Although no single act alone would violate the Sherman Act, simultaneous use of coercive contracting practice to require stringent non–compete agreements, use of contract length to hold fighters in a contract for a period longer than average career length,[242] and reducing fighter income amounts to restraint of trade for purposes of the Sherman Act section 2.[243]

C. Balancing Pro and Anti–Competitive Effects

To counterbalance anticompetitive effects and restraints of trade, the UFC must demonstrate that the practices generate "efficiencies," or practices that, in the end, benefit consumers.[244] There are significant factors that weigh in the UFC's favor in the MMA Promotional Market. MMA has grown faster than any other sport since its formation in 1993, and the UFC is widely acknowledged as the driving factor behind that growth.[245] Without the UFC's growth, marketing, and attraction of both new fighters and fans to MMA, the MMA industry would not produce the revenue or fighter pay that it does.[246] It is also probable that the UFC's competitors in the MMA Promotional Market benefit from the UFC's success in expanding the

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240. *See* Simon, *supra* note 154; Gift, *supra* note 155.

241. *See* Simon, *supra* note 154; Brennan, *supra* note 166; Same, *supra* note 164, at 1072; *see also supra* Figure 3.

242. *See* Simon, *supra* note 154; Brennan, *supra* note 166; Same, *supra* note 164, at 1072; *see also supra* Figure 3.

243. *See* 15 U.S.C. § 1 (2012) ("Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is hereby declared to be illegal.").

244. *See* Smith v. Pro Football, 593 F.2d 1173, 1185 (D.C. Cir. 1978) (explaining that sometimes natural monopolies may be justified by efficiencies such as an economy of scale that provides the lowest possible costs for consumers); United States v. Addyston Pipe & Steel Co., 85 F. 271, 282 (6th Cir. 1898) (holding that contracts which restrain trade are enforceable when "[t]he covenant embodying it is merely ancillary to the main purpose of a lawful contract").

245. David Segal, *Fighting a Cage Match to Turn the UFC Into a National Phenomenon*, N.Y. TIMES (Mar. 27, 2016), http://www.nytimes.com/2016/03/27/business/fighting-a-cage-match-to-turn-the-ufc-into-a-national-phenomenon.html?_r=0.

246. *See* Binner, *supra* note 3 (describing the rise of MMA synonymously with the rise of the UFC).

market. Despite eliminating many competitors from the industry for MMA promotions, the UFC has increased industry competition in two respects: consistently increasing the number of MMA events the UFC produces annually[247] and reducing the cost of viewership by expanding outside of pay-per-view.[248]

Additionally, not every firm that competed with the UFC was eliminated by a UFC buyout; competitors simply went out of business due to business decisions gone wrong.[249] Importantly, some of these competitors went out of business after Zuffa's most recent acquisitions, disqualifying an illegal merger claim against Zuffa under the Clayton Act.[250] The UFC became a monopoly without buying out its competitors, but by means of superior efficiency. Companies which achieve market dominance through superior efficiency are not necessarily safe from antitrust claims.[251] However, the UFC does not present insurmountable competition nor has it created insurmountable barriers to market entry, as evidenced by the rise of ONE FC and Bellator.[252]

The UFC's pattern of increasing production while lowering prices is the exact opposite of the anticompetitive tendency to reduce output while raising prices. While the UFC's history of counter–programming may appear predatory, this practice is common, legal, and has even been used by the UFC's competitors to draw viewership away from UFC events.[253] Therefore, the UFC has not violated antitrust law nor conducted itself in an anticompetitive manner in the MMA Promotional Market, but rather has increased competition.

Although the MMA Promotional Market remains competitive, the labor market for Elite MMA Labor Market is not. The UFC's unilateral application of the Reebok Deal significantly reduced the ability of fighters to generate income.[254] The fact that fighters have not left the UFC in significant numbers is evidence that there are few MMA promotions that can offer wages comparable to the UFC's or effectively compete with the UFC in the Elite

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247. *See supra* Figure 2.

248. Smith, *supra* note 13.

249. Clarett v. NFL, 369 F.3d 124, 134 n.14 (2d Cir. 2004) (quoting Brown v. Pro Football, 50 F.3d 1041, 1056 (D.C. Cir. 1995)) (holding that "the non–statutory labor exemption waives antitrust liability for restraints on competition imposed through the collective bargaining process, so long as such restraints operate primarily in a labor market characterized by collective bargaining").

250. Tarman, *supra* note 131.

251. *See, e.g.*, Am. Tobacco Co. v. United States, 328 U.S. 781 (1946) (holding that power to monopolize and intent to monopolize are sufficient to sustain an antitrust claim).

252. Doyle, *supra* note 15.

253. MMAjunkie Staff, *supra* note 159.

254. Brennan, *supra* note 166.

MMA Labor Market.[255] But, even if the Elite MMA Labor Market is monopsonized, this is not always dispositive of an antitrust violation.[256] Most convincing is the UFC's steady labor market share despite reducing fighter income through the Reebok Deal.[257] The effects of the Reebok Deal and its aftermath create a strong case that the UFC has exercised monopsony power; in a competitive labor market, a reduction in income should lead to laborers moving to a different company, but this has not been the case.[258] If a greater number of fighters leave the UFC for more competitive wages, as is expected by economic theory, it will be more likely that a court will find that greater profits at the expense of fighters was Zuffa's reward for superior efficiency under *Trinko*.[259] However, there is little evidence to suggest that significant numbers of fighters are leaving the UFC, though not for lack of trying.[260]

The UFC may also be able to raise a strong defense of its activity in the MMA labor market under *United States v. Addyston Pipe and Steel*.[261] Such a defense would proceed by claiming that the UFC's labor market dominance creates efficiencies that benefits both consumers in the promotional market and MMA fighters in the labor market. Increasing the number of fighter contracts the UFC holds may be what allows the UFC to increase the number of promotions it holds annually, increasing output, and decrease the price of viewership, thereby benefiting consumers. Fighters may benefit from the UFC's labor market dominance due to the increase in prestige that comes with being a dominant UFC fighter; increasing the number of fighters in the promotion increases the athletic competitiveness of the promotion. Further, the increases in promotional viewership has significantly increased wages for the UFC's most dominant and popular fighters.[262] The argument that

255. BORJAS, *supra* note 112, at 187; *see also supra* Figure 3.

256. United States v. Microsoft Corp., 253 F.3d 34, 50 (D.C. Cir. 2001) (quoting United States v. Grinnell Corp., 384 U.S. 563, 570–71 (1966)) (defining the illegal monopolization as having two elements: "(1) the possession of monopoly power in the relevant market and (2) willful acquisition or maintenance of that power").

257. Brennan, *supra* note 166.

258. *See supra* Figure 3 (demonstrating the UFC's labor market share holding steady after the inception of the Reebok Deal, decreasing by only 2.67% of the market).

259. 540 U.S. 398 (2004).

260. Raimondi, *supra* note 165 (detailing a dispute between Zuffa and a contracted fighter after failure to come to a payment agreement and the fighter claimed to have been released from his contract); Cruz, *supra* note 165 (detailing another dispute between Zuffa and a contracted fighter who wanted to be released after being repeatedly deceived; the UFC refused); Gift, *supra* note 165.

261. 85 F. 271, 282 (6th Cir. 1898) (holding that contracts which restrain trade are enforceable when the "covenant embodying it is merely ancillary to the main purpose of a lawful contract").

262. Mike Bohn & John Morgan, *UFC 202 Salaries: Conor McGregor Pulls in Record $3 Million; Nate Diaz Gets $2 Million*, MMA JUNKIE (Aug. 20, 2016), http://

labor market dominance increases competition in the promotional market is strong, but the argument that this dominance benefits fighters is quite weak. Zuffa would have to argue that the extensive contractual restrictions imposed on fighters by their contracts are "merely ancillary to the main purpose of [the] lawful contract[s], and necessary to protect the covenantee in the [full] enjoyment of the legitimate fruits of the contract"[263] and that the contracts are not "more restrictive than necessary."[264] It is unlikely that this argument would succeed because it would require the UFC to argue that reducing fighter pay and preventing those fighters from finding employment elsewhere is a "legitimate fruit of the contract," which it is not.[265]

There is also some argument that the UFC's labor market foreclosure has damaged competition in the MMA Promotional Market. This argument proceeds by claiming that the UFC's dominance in the labor market and use of non-compete contracts harms competition by preventing other would–be employers from hiring top-thirty fighters and, thereby, prevents other MMA promotions from competing effectively for viewership.[266] Competition is injured by foreclosure when "potential competitors [are prevented] from gaining a foothold in the market by exclusionary conduct."[267] However, in the context of the UFC and Zuffa, this argument is without merit because the harm is entirely to competitors, not competition and "[i]t can't be said often enough that the antitrust laws protect competition, *not* competitors."[268] While the UFC's competitors in the promotional market are certainly harmed by this practice, the evidence suggests that the UFC's behavior in the MMA Promotional Market is procompetitive.[269] Further, there is no basis for a claim that competitors have been prevented from gaining a foothold in the MMA Promotional Market. Bellator and ONE FC are companies which have a foothold and compete with the UFC in the MMA Promotional Market. Therefore, competitors have not been prevented from gaining a foothold in the market and the competitive harm appears to be entirely in the Elite MMA Labor Market as a result of the Reebok Deal.

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mmajunkie.com/2016/08/fc-202-salaries-conor-mcgregor-pulls-in-record-3-million-purse-nate-diaz-gets-2-million-1.

263. United States v. Addyston Pipe & Steel Co., 85 F. 271, 282 (6th Cir. 1898).

264. Mackey v. Nat'l Football League, 543 F.2d 606, 622-23 (8th Cir. 1976).

265. *Addyston Pipe,* 85 F. at 282.

266. United States v. Syufy Enters., 903 F.2d 659, 668 (9th Cir. 1990.

267. United States v. Dentsply, 399 F.3d 181, 186-87 (3d Cir. 2005) (quoting LePage's Inc. v. 3M, 324 F.3d 141, 159 (3d Cir. 2003)).

268. *Id.* at 188.

269. *See supra* Figures 1, 2, 3, & 4.

IV. NECESSARY CHANGES IN THE MMA INDUSTRY

Although UFC fighters have been harmed by the organization's business practices, no regulatory agency is likely to come to their aid. Therefore, UFC fighters must protect themselves from unfair business practices by doing one or both of two things: (1) acquire collective bargaining power through an association or union; and (2) lobbying for the expansion of the Ali Act[270] to cover MMA.[271] The heart of the issue for MMA fighters is lack of bargaining power,[272] which can be remedied by unionization and collective bargaining, and lack of access to revenue data for use in contractual negotiations,[273] which can be remedied by expansion of the Ali Act.

Federal agencies are unlikely to interfere with the UFC's business practices because there is no indication that consumers have been harmed. The Federal Trade Commission ("FTC") rarely acts in such circumstances as the antitrust and competition preservation policies are geared toward protecting consumers.[274] Further, the FTC's Bureau of Competition investigated the UFC in 2012 following the Strikeforce acquisition and concluded that "no further action is warranted and the investigation is now closed."[275]

Two fighters associations have already begun the unionization process: the Mixed Martial Arts Athletes Association ("MMAAA")[276] and the Professional Fighters Association ("PFA").[277] Further, several of the UFC's highest level fighters have recently formed the MMAAA.[278] Fighters joining any of these organizations would likely lead to the formation of a bilateral cartel between the fighter's association and the UFC. While some problems do come with unionization, the benefits of collective bargaining outweigh

270. 15 U.S.C. § 6301 (2012).

271. Rob Maysey, *Battle Lines Being Drawn: Why the Muhammad Ali Act Should Apply to MMA*, MMAFA (July 1, 2008), http://mmafa.tv/battle-lines-being-drawn-why-the-muhammad-ali-act-should-apply-to-mma/.

272. Snowden, *supra* note 200.

273. *Id.*; *see also* Abhinay Muthoo, *The Economics of Bargaining*, UNIV. OF WARWICK 25 (2017), https://www2.warwick.ac.uk/fac/soc/economics/staff/amuthoo/publications/unesco.pdf (explaining how asymmetric information in bargaining situations works to the disadvantage of the party lacking information).

274. Gift, *supra* note 155.

275. Luke Thomas, *Federal Trade Commission Ends Second Investigation of UFC*, MMA FIGHTING (Nov. 24, 2015), http://www.mmafighting.com/2015/11/24/9796478/federal-trade-commission-ends-second-investigation-of-ufc.

276. *See MMAFA Mission Statement*, MMAFA, http://mmafa.tv/about-mmafa/ (last visited Sept. 30, 2011).

277. *See* PROF'L FIGHTERS ASS'N, profighters.org (last visited Nov. 16, 2016).

278. Brett Okamoto, *UFC Fighters Form Mixed Martial Arts Athletes Association*, ABC NEWS (Nov. 30, 2016), http://abcnews.go.com/Sports/ufc-fighters-form-mixed-martial-arts-athletes-association/story?id=43889432.

the detriments. That said, some of the problems with unionization are not present in the formation of an association; namely, a union's vulnerability to challenges based on fighters' status as independent contractors rather than employees.[279] The ability to set minimum contractual requirements in favor of the fighters would prevent coercive contracting and give the fighters a seat at the negotiation table whenever a major change is considered for the sport. This would prevent events like the UFC's Reebok Deal.[280] When the deal was made, fighters did not have any say in the matter and the result was untold losses in fighter income.[281] A MMA fighters' union would be able to use its ability to bargain collectively and prevent such deals happening in the future without the fighters' consent.

MMA fighters are far from the first athletes to be exploited by a dominant firm. Athletes within tennis, NASCAR, and boxing have all been injured by anticompetitive business practices by their governing bodies; each group of athletic competitors has reacted differently.[282] Tennis reacted by forming a players association through which effectively took the place of promoters in the sport.[283] Stock car racers have effectively submitted to the sport's governing body, the National Association of Stock Car Auto Racing ("NASCAR"), and accepted the resulting bargaining positions as the status quo.[284] Boxing, the sport most comparable to MMA, has seen the benefit of legislative action in the form of the Ali Act.[285] The MMAAA and the PFA

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279. *See id.* (clarifying the UFC fighters are not employees, but are rather independent contractors that do not receive many of the labor and employment benefits of federal employment laws including protections for unions).

280. Brennan, *supra* note 166.

281. Guilherme Cruz, *Vitor Belfort Says He Lost "Millions of Dollars" with UFC–Reebok Deal, But Free Agency Isn't the Solution*, MMA FIGHTING (Mar. 30, 2016), http://www.mmafighting.com/2016/3/30/11327066/vitor-belfort-says-he-lost-millions-of-dollars-with-ufc-reebok-deal; Jesse Holland, *Brendan Schaub Loses Six Sponsors Following Announcement of UFC Deal With Reebok*, MMA MANIA (Dec. 9, 2014), http://www.mmamania.com/2014/12/9/7361523/brendan-schaub-loses-six-sponsors-following-announcement-ufc-reebok-uniforms-mma.

282. S. Joseph Modric, *The Good Ole' Boys: Antitrust Issues in America's Largest Spectator Sports*, 1 DEPAUL J. SPORTS L. & CONTEMP. PROBS. 156, 170–71 (2003) (outlining the antitrust issues in the National Association for Stock Car Auto Racing and how participants have reacted to the issue); Jonathan Snowden, *Combating the UFC Monopoly: Tennis as a Model for Organizing Fighters*, BLOODY ELBOW (Mar. 16, 2011, 7:29 PM), http://www.bloodyelbow.com/2011/3/16/2053887/combating-the-ufc-monopoly-tennis-as-a-model-for-organizing-fighters (proposing that MMA fighters follow the lead of tennis players who faced many of the problems MMA fighters do currently).

283. *History*, ATP WORLD TOUR, http://www.atpworldtour.com/en/corporate/history (last visited Nov. 16, 2016).

284. *See* Ky. Speedway, LLC v. NASCAR, Inc., 588 F.3d 908, 914, 920–21 (6th Cir. 2009).

285. 15 U.S.C. § 6301 (2012).

are both currently lobbying for the expansion of the Ali Act to cover MMA.[286]

Congress passed the Ali Act in 2000, an amendment to the Professional Boxing Safety Act of 1996,[287] with the intent to prevent the anticompetitive and unfair business practices which were common in the boxing industry.[288] Legislation has been introduced in Congress to expand the Ali Act to MMA.[289] Expansion of the Ali Act to MMA would entail three main changes to the sport: (1) third party organization(s) controlling the fighter ranking system, thereby preventing conflicts of interest and manipulation; (2) revenue transparency; and (3) make coercive contracting clauses unenforceable.[290] The only parts of the Ali Act which should be expanded to cover MMA are the formation of third party ranking committees and mandating revenue transparency. Rather than expand the enforceability of contracts clauses to cover MMA, the fighters should join one of these unions and negotiate for more favorable contracts.

The UFC's control over the ranking system has been used as a coercive tool during contractual negotiations.[291] Such practices were once common in boxing and are being used in MMA to push fighters into unfavorable contracts.[292] Formation of an independent rankings committee would increase the likelihood that rankings are objective and based on fighter skills and accomplishments rather than what is expedient for the UFC. This area of the Ali Act has been effective in the boxing industry and would likely work just as well in MMA.[293] The Ali Act ensures compliance with rankings provisions by preventing promoters from receiving the revenue from events:

286. *See* Brett Okamoto, *Ali Amendment Could Expand Federal Law's Coverage To MMA*, ESPN (May 19, 2016), http://www.espn.com/mma/story/_/id/15589773/bill-aims-expand-muhammad-ali-boxing-reform-act-mma.

287. 15 U.S.C. § 6301.

288. H.R. REP. NO. 106-449, pt. 1 at 1, 7–8 (1999), *as reprinted in* 2000 U.S.C.C.A.N. 329.

289. H.R. 5365, 114th Cong. § 2 (2016).

290. Nash, *supra* note 142.

291. Ben Fowlkes, *With Ali Act, A Long Battle for MMA's Future is Just Beginning*, MMA JUNKIE (June 14, 2016, 12:45 PM), http://mmajunkie.com/2016/06/with-ali-act-a-long-battle-for-mmas-future-is-just-beginning (detailing the UFC's coercive negotiation tactic of removing fighters from official rankings and thereby reducing the fighter's contracting value during difficult negotiations).

292. *See generally* Scott Baglio, Note, *The Muhammad Ali Boxing Reform Act: The First Jab at Establishing Credibility in Professional Boxing*, 68 FORDHAM L. REV. 2257, 2268–69 (2000) (emphasizing and explaining the contractual abuses in the box-ing industry).

293. Lydia De Pillis, *The Battle to Protect Fighters in the Fastest Growing, Least–Regulated Sport in America*, WASH. POST (Apr. 23, 2016), https://www.washingtonpost.com/business/economy/the-battle-to-protect-fighters-in-the-fastest-growing-least-regulated-sport-in-america/2016/04/22/b9484fe0-fc21-11e5-886f-

> [U]ntil, with respect to a change in the rating of a boxer previously rated by such organization in the top 10 boxers the organization–(1) posts a copy, within 7 days of such change, on its Internet website or home page, if any, including an explanation of such change, for a period of not less than 30 days; and (2) provides a copy of the rating change and explanation to an association to which at least a majority of the State boxing commissions belong.[294]

Within the sports industry, almost every organization discloses revenue other than the UFC.[295] The purpose of revenue disclosures is to allow athletes the same access to information as the promotion. Revenue disclosures would allow fighters to see how much money the promoters make from their fights and likely lead to increased fighter wages. The UFC distributes a smaller percentage of revenue to its athletes than any other major sports organization.[296] Disclosure of revenue would balance the scales between the UFC and its fighters while negotiating and resolve much of the controversy surrounding the UFC's treatment of its fighters by making the bargaining positions between the fighters and the UFC more equal.

The Ali Act's provisions regarding enforceability of coercive contracts should not be expanded to cover MMA because these provisions have not been effective in the boxing industry and there is no indication that they would be any more effective in the MMA industry. These provisions were included in the Ali Act because boxers were commonly coerced into unfavorable contracts which gave the promoters an unreasonable amount of power over the boxer's life and career. Although the unenforceability provisions were well intended, they have never been effective because they have *never* been enforced.[297] The problem with the enforcement provisions is that, although section 6309(b)(3) grants the United States Attorney General the power to "bring a civil action against any individual who is reasonably believed to be in violation of any provision of the Ali Act,"[298] the provision also provides that "[n]othing in this chapter authorizes the enforcement of any provision of this chapter against the Federal Trade Commission, the United States Attorney General, or the chief legal officer . . . for . . . failing to act in an official capacity."[299] In other words, the

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a037dba38301_story.html.

294. 15 U.S.C. § 6307c(c) (2012).

295. *See, e.g.*, *Which Professional Sports Leagues Make the Most Money?*, HOW MUCH, https://howmuch.net/articles/sports-leagues-by-revenue (last visited Nov. 16, 2016).

296. Snowden, *supra* note 200.

297. Ehrlichman, *supra* note 143, at 439–40.

298. 15 U.S.C. § 6309(b)(3).

299. *Id.* § 6309(e)(1).

enforcing body is not required to enforce this area of law and, more importantly, the enforcing bodies in fact do not enforce the Ali Act.[300] The state boxing commissions "are most likely not equipped to enforce the Ali Act" for those states that have boxing commissions, "are understaffed and under-funded."[301] Unfortunately, these provisions have been hamstrung by lack of funding and Congressional disinterest in remedying the issue.[302] Boxers are also authorized to bring civil actions "in the appropriate Federal or State court and recover damages suffered,"[303] but there are issues with this provision as well. Due to the resources consumed and length of litigation,[304] fighters are often unable to pursue their chosen career while participating in litigation against coercive contracts. As a result, fighters are likely to accept an unfair (and possibly illegal) contracts if it means they are able to pursue the dream of a title belt, even if the fighter's chances of retaining a title belt are little more than a pipe-dream.

CONCLUSION

The UFC is responsible for the incredible growth rate in the MMA industry and has increased the competitiveness of the MMA Promotional Market by immeasurable proportions. However, the UFC has accomplished this feat, in part, through behavior injurious to its labor market, MMA fighters. The best course of action for MMA fighters to halt this injurious behavior is to unionize, lobby for the expansion of the Ali Act to cover MMA, and insist on fairness in contractual negotiations and the resulting obligations.

300. *But see* Baglio, *supra* note 292, at 2284–85 (analyzing the potential positive effects of the Ali Act, but overlooking the fact that enforcement clauses are ineffective without funding for enforcement personnel).

301. *But see* Devin J. Burstein, Note, *The Muhammad Ali Boxing Reform Act: Its Problems and Remedies, Including the Possibility of a United States Boxing Administration*, 21 CARDOZO ART & ENT. L. J. 433, 462 (2003).

302. *See, e.g.*, S. 275, 108th Cong. (2004) (federal legislation to provide funding for Ali Act enforcement has been introduced repeatedly since 2002 and never voted on).

303. 15 U.S.C. § 6309(d).

304. *See, e.g.*, Le v. Zuffa, No. 2:15cv–01045–RFB–PAL, 2016 WL 6134520, at *2 (D. Nev. Oct. 19, 2016) (an antitrust lawsuit against the UFC that began in 2014 and is both still active and appears far from over as of November 2016).

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