




## America's Favorite Pastime:

# LITIGATION

By Mike DiSilvestro



One of the most hotly contested series of the 2007 Major League Baseball season has yet to be decided. The series stands at 3-0 with the home team in the hole. This series is not being played out on the diamond, but rather in the Federal Courts.

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## A Letter from the President

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Dear Colleague:

The ripple effects of revolutionary developments in technology are unending and often unexpected. The current writers' strike that has dramatically impacted the entertainment industry — and by extension, our industry and many others as well — is one example. Perhaps the strike will have been resolved by time this issue of *M/PI Source* comes to print, but I doubt it.

How has the strike impacted our industry? It has caused a sudden and dramatic reduction in the production of new programming — and, therefore, in the purchase of entertainment errors & omissions insurance. Here at M/PI, our new business submissions in this segment are down significantly as a direct result. I am sure our colleagues in the underwriting and brokerage community are experiencing the same effect. As if the soft market weren't bad enough!


The principal issue in the writers' strike is whether and to what extent the writers should profit from the digital redistribution of their work, on DVD, over the Internet, and through other new technologically created distribution channels. The rapid development of these new technologies has outpaced and fundamentally challenged the traditional economic model of the entertainment industry. Similar issues have impacted the newspaper publishing industry (in the seminal case of *Tasini v. New York Times*, freelance writers argued successfully that they should be compensated for the digital redistribution of their work), the music industry (everyone knows the story of Napster, MP3.com, and the continuing struggles over digital music distribution), and even the retail industry (discount online retailers such as bluefly.com have been sued by prominent clothing manufactures for alleged trademark infringement for selling their brands online).

So too have these new technologies challenged and outpaced the traditional model of E&O insurance. In this issue, you will find an article about social networking and the phenomenon of "user-generated content." These new media businesses turn the traditional model of media E&O upside-down. Traditionally, when an underwriter examined a media risk, the insured created and took responsibility for the content that it distributed. That provided a framework for the underwriter to examine the insured's risk management practices and evaluate the risk. If, on the other hand, the insured's business model is to distribute "user-generated content," by definition, the insured is not creating — and certainly is not taking responsibility for! — the underlying content. How then can the underwriter possibly evaluate the risk and properly price the business, particularly when the legal rules establishing the degree of responsibility for user-generated content have yet to be established?

These are issues that our industry will have to grapple with over the years to come, as our friends in the technology community continually find new ways to vex and challenge our conventional ideas of how insurance should be delivered to this segment. We will continue to use *M/PI Source* to explore these issues and, hopefully, keep you current on these developments.

Sincerely,

Leib Dodell  
Chairman

 Media/Professional Insurance

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# INCOMING: PROFESSIONAL LIABILITY AND THE SUBPRIME CRISIS

By Johnathan Wynn  
and Val McDonald

Attention to the “Subprime Mortgage Crisis” is generally focused on the period 2005 through 2006 when massive deterioration in subprime mortgages materialized. However, to fully appreciate the scope of professional liability exposure to this systemic crisis, one must understand the events and practices that lead to the unprecedented expansion of subprime mortgages during the years 2001 through 2006.

In the early 1990s, the real estate industry was in tough shape. Concern for negative impact on the overall economy brought about changes in both governmental policies and mortgage origination and servicing practices. These changes included (1) the virtual elimination of down payment requirements, (2) the advent of automated underwriting models that required limited documentation and were more tolerant of riskier loan products, (3) corruption of the appraisal process, (4) expansion of refinance options facilitating the conversion of home equity into cash, and (5) circumvention of Private Mortgage Insurance. As a result, consumers eligible for homeownership increased at a time when the real estate market was poised for significant growth.

As the real estate market boomed, the practice of packaging and selling mortgages to investors through instruments known as Mortgage Backed Securities (MBS) also increased. In the 1990s, investors pumped much needed liquidity to lenders in exchange for mortgages pooled as underlying assets for MBS.

By 2001, high-risk investors such as hedge funds, flush with capital, began clamoring for risky, high-yield mortgage

products to serve as the underlying assets in MBS. Demand for these loans was met primarily through a channel of mortgage brokers, mortgage companies, and firms that securitize mortgages.

Mortgage companies were not subject to safety and soundness regulations governing federal or state banks. Because mortgage companies sell their loans to financial markets rather than government sponsored entities, there was little regulatory influence over their underwriting standards by secondary markets. Lack of regulatory oversight and minimal responsibility for the performance of mortgages moved off of the balance sheet to secondary markets allowed further deterioration of underwriting standards. A prime objective of these mortgage companies was originating high-yield mortgages desired by secondary market investors.

Mortgage brokers selling these products derived much of their incentive from the mortgage companies who paid them additional fees for selling mortgages with higher interest rates or prepayment penalties. Moreover, the brokers owed no particular duty—fiduciary or otherwise—to the borrower.

Driven by investor demand for high yield mortgage products and facilitated by an imbalanced incentive and regulatory structure, risky adjustable rate, negative amortization and interest-free mortgages were sold to financially vulnerable borrowers, often with little or no loan documentation.

The results are mind boggling. In 2001, subprimes represented about 8.6% of all origination, about \$190 billion. By 2005, the subprime percentage of all originations grew to 20% or \$625 billion.

Borrowers’ ability to sustain these mortgages depended on house price appreciation: take out an ARM, let the value of the house appreciate until the mortgage resets and then refinance. Unfortunately, these homeowners soon faced a perfect storm. In 2004, the Federal Reserve began raising the short term interest rate. The economy’s growth rate soon dipped, and housing prices turned south.


Consequently, borrowers were unable to refinance their homes as their mortgages reset at higher than imagined rates.

Failed subprime mortgages pooled in MBS have driven down the value of the securities. Devaluation of these securities results in serious reductions in the re-investment of capital into the mortgage industry, increasing the difficulty homeowners will have financing or refinancing their homes.

We are now witnessing a systemic breakdown in the mortgage industry. The enormity of the mess is apparent in the subprime losses recently posted by the top financial institutions: Citigroup \$9.8 billion, Bear Stearns \$450 million, Morgan Stanley \$3.7 billion and Merrill Lynch \$7.9 billion. As is often the case in systemic failures of this nature, there will be a lot of finger pointing and litigation will increase. Professionals directly involved in the system and those providing advisory services may be implicated.

The exposure of directors and officers of financial institutions is materializing in current litigation: flawed lending practices, improper margin calls, errors related to collateral valuation, etc. Mortgage brokers could encounter litigation for abusive and predatory practices. Trustees responsible for distributions related to bonds may also face claims when they cannot make distributions. A wide variety of fund managers and their advisors may be questioned for imprudent investment practices, flawed pricing and misrepresentation. Most recently, the credit rating agencies have been criticized for their rating of debt securities and their close relationships with investment banks. Other professionals who were involved in transactions throughout the system are vulnerable to allegations of misrepresentation and omission.

Therefore, to protect themselves and their clients, insurance brokers must be prepared to identify the obvious and the obscure exposure professionals may have to the subprime crisis.

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<sup>1</sup> See, Mason and Rosner, *How Resilient Are Mortgaged Backed Securities to Collateralized Debt Obligation Market Disruptions?*, preliminary version of forthcoming paper, as presented at Hudson Institute, 2/15/2007, available at [http://www.hudson.org/files/publications/Mason\\_RosenFeb15Event.pdf](http://www.hudson.org/files/publications/Mason_RosenFeb15Event.pdf), at pp. 4-15

<sup>2</sup> See, Senate Joint Economic Committee Report, *The Subprime Lending Crisis: The Economic Impact on Wealth, Property Values and Tax Revenues, and How We Got Here*, at pp. 18, available at <http://www.jec.senate.gov/>; See also, Mason and Rosner, *How Resilient Are Mortgaged Backed Securities to Collateralized Debt Obligation Market Disruptions?*, at pp. 14

<sup>3</sup> *Ibid*

<sup>4</sup> *Ibid*, pp. 20

<sup>5</sup> *Ibid*, pp. 10

<sup>6</sup> Tully, Shawn, *Wall Street's Money Machine Breaks Down*, *Forbes* Nov. 26, 2007 at pp. 74

# User-Generated Balancing Act:

## New UGC Principles aim to foster online innovation while protecting copyrights

By Jon Van Meter

As web traffic and advertising revenue continue to pour into “social networking” websites like MySpace, YouTube and Facebook, it has become clear that people can’t get enough of the technology behind User-Generated Content (UGC). It’s also obvious that copyright law is starting to succeed in its efforts to catch up.

The latest development came in October, when five commercial content owners (CBS, Disney, Fox Entertainment, NBCUniversal and Viacom) collaborated with disseminators of user-uploaded and user-generated content (Dailymotion, Soapbox on MSN Video, MySpace and Veoh.com) to establish principles that will, in theory, mutually benefit each side by establishing industry standards regarding the protection of copyrighted materials online. The principles can be found at [www.ugcprinciples.com](http://www.ugcprinciples.com).

At their core, these principles, while not legally binding, oblige website owners to proactively block infringing content. Namely, the UGC service provider must post conspicuous notices discouraging users from uploading infringing content; it must prominently inform users they must not upload infringing content and that by posting content they are agreeing with the terms of use; it should have “effective content identification technology” that will filter the content and permit a site to match uploaded infringing content with original content.

The tangible effect of the effort remains to be seen.

This collaboration may turn out to be the cornerstone of change in the way website companies block infringing content, and in turn, could have a lasting and commercially viable effect for the future of content generation, dissemination and sharing. Alternatively, the creation of these principles might be little more than a dog-and-pony show by a few of the industry’s largest companies that will have little effect on the real world. After all, noticeably absent from the collaboration were some of the largest providers of user-generated services, namely Google, Yahoo!, Facebook and AOL. Further, how will the principles affect related burgeoning technology such as Virtual Life.




Either way, there is little debate that the principles raise at least a few issues. What impact, if any, will be made on the Notice-and-Takedown provisions of the Digital Millennium Copyright Act (DMCA)? For example, if the principles become industry standard, will courts start expecting sites to filter content? Will sites not

employing filtering software automatically be presumed to encourage infringing activity?

As recently as May 2007, the appellate court for the Ninth Circuit declined to shift the burden of identifying infringing material from the copyright owner to the provider. However, if the answers to the questions above are “yes,” it will mean greater protection for content owners at the expense of websites hosting user-generated content. Needless to say, the issue is far from settled.

The most publicized test of the DMCA is the pending *Viacom v. YouTube* litigation, which asks whether a website operator has a duty to find infringing activity on its site. The answer may have an effect on the safe harbor provision of the DMCA. For a more in-depth look at the Ninth Circuit’s decision and the issues surrounding the safe harbor provision of the DMCA, see Russell Hickey’s [Looking for a Safe Harbor: The future of video-sharing websites may hang in the balance](#) in the Fall 2007 issue of *M/PI Source* (available at [www.mediaprof.com](http://www.mediaprof.com)).

For now, it appears the UGC service providers are taking proactive action. Recently, YouTube, MySpace and Dailymotion agreed to use filtering software. Will others follow suit? Stay tuned as this complex issue is decided before our eyes.

 Jon Van Meter is an Underwriter at Media/Professional Insurance.

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Member Benefits Program  
Partner

# PARTNERING FOR SUCCESS

## Giving Radio & Television Broadcasters Tools to Compete

By Chris Shepard

For almost 30 years, the National Association of Broadcasters has partnered with Media/Professional Insurance to provide NAB members with the NAB/Libel First Amendment Insurance program, which offers its members a comprehensive, tailored, and competitive insurance policy.

“NAB has had a long and profitable relationship with Media/Professional Insurance,” said Ken Walsh, Director of Member Services at the NAB. “M/PI serves our clients well, and I have received numerous notes from our members complimenting NAB on the coverage and rates offered through M/PI.”

The NAB program is M/PI's first and longest running association program.

The NAB is a trade association that advocates on behalf of more than 8,300 free local radio stations, television stations, and broadcast networks before Congress, the Federal Communications Commission and the Courts. It exists to proactively and vigilantly advance the rights and interests of free local radio and television broadcasters. Benefits of membership include strong grass roots action and a unified voice to the FCC, Congress and the Courts.

Since the founding of Media/Professional Insurance in 1979, the NAB and M/PI have partnered to provide NAB members with an insurance policy tailored to fit the unique needs of NAB members.

The basic NAB/Libel First Amendment Insurance program policy provides broadcasters with protection for their broadcasting activities on an occurrence basis for defamation, invasion of privacy, plagiarism, piracy, copyright infringement, misappropriation of ideas, and infringement of title, slogan or trademark. The NAB plan also includes coverage for errors and omissions in content, as well as newsgathering activities, including trespass. Optional coverage is available for syndicated programs produced and distributed to others, content of websites, and legal expense incurred to resist attempts to restrict the broadcaster's First Amendment rights. NAB members receive discounts for automation and simulcasting. Discounts are also available for insuring multiple stations under one policy.


This unique policy was created by broadcasters for broadcasters. When this policy was first envisioned, the NAB and M/PI consulted with NAB members to craft the coverage that

broadcasters wanted and needed to protect their broadcasting activities.

The benefits of the partnership, however, have created other avenues to serve NAB members.

“This year, we were able to partner with M/PI to conduct an online seminar that educated our members on how to avoid costly litigation,” Walsh said. “M/PI is looking out for the best interests of our members by providing them with the tools to eliminate risk in their businesses, which is beneficial to all of our members in the long-run.”

Currently the NAB/Libel First Amendment insurance program has over 1,200 member stations insured. The success and longevity of the NAB program is a result of the established partnership between M/PI and the NAB and M/PI's ability to provide broadcasters with the coverage they need and the service and expertise to handle claims when they occur.

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Feedback or story ideas? Please send to [mpisource@mediaprof.com](mailto:mpisource@mediaprof.com).

# America's Favorite Pastime: **LITIGATION**

Continued from front page

CBC Distribution and Marketing, Inc., which operates a fantasy baseball service, and Major League Baseball are fighting over use of players' names and statistics. The two had coexisted under a licensing arrangement for a number of years, but recently the terms changed and CBC decided to ask the courts if a license was necessary. The issue isn't only about baseball. The NFL, NBA, NHL, WNBA, PGA and NASCAR joined the lawsuit in support of MLB.

Millions of dollars are being made without compensating the players or the leagues for using intellectual property they produce, and CBC would like to keep it that way. So far, CBC is winning because the courts say the information they exploit is of such general interest that the First Amendment protects their right to use it without compensation.

Nowadays, sports is business—big business. And as businesses recognize that their intellectual property assets are among their most valuable, more and more are engaging in legal battles to protect their financial interests in that intellectual property. Sports teams and the companies that make and sell products capitalizing on those teams are also being more careful about their intellectual property.

In sports, this can mean any number of things. Millions are spent each year on apparel, posters, equipment, toys and publications bearing team logos. One of the major paint companies even makes a line of paints that allow you to redecorate your home in your favorite team's colors. The value of these items is their association with the teams. The teams are becoming more ac-

tive in protecting their images and the products that capitalize on those images.

It is not only professional teams making money and turning to the courts. College teams can play the game too. Last year, the University of Alabama sued a local artist for trademark infringement. The school contended that paintings by Daniel Moore depicting famous plays and players in the history of Alabama football violated the school's rights by, among other things, using the famous Crimson and White color scheme. In fact, the legendary Alabama coach Bear Bryant was one of the first to recognize the value of his image and to profit from it.

Texas A&M University has litigated when they felt their trademarked phrase, "The Twelfth Man," was being used without proper permission. And NBA coach Pat Riley trademarked the word "Three-peat," and has collected royalties from its use.


Teams are not the only ones aware of the value of their intellectual property. Individual athletes have made money from their images for years and fought those who sought to use those images without compensating them. Tiger Woods has probably made more money off the golf course than on it by selling Nike products, Buicks and watches. Tiger filed a copyright infringement lawsuit against an artist who painted a picture of Woods' 1997 Masters win, though the artist ultimately prevailed in court. But other athletes have been successful in protecting their images, such as tennis star Andre Agassi, who obtained an injunction against Target from selling sandals with his name on them; and race car

driver Danica Patrick, who sued over the use of pictures of her without her permission.

The desire to tighten the reins on the use of intellectual property caused the NFL to limit the use of game footage by local television stations. They realized that by allowing local stations to shoot and use as much of the game highlights as they wanted, the league was giving away one of their most valuable assets.

In most of these situations, there was a company making and selling something that referenced or was associated with a sports team or athlete. These companies make clothing, toys or sporting goods and are profiting from the thrills created on the field of play. Companies who want to mine the gold in those thrills would do well to make sure they have all the necessary licenses and permission before they do. After all, the CBC vs MLB series is not over and, in any event, may be limited to the fantasy industry.

The result of not having the proper permissions means expensive copyright, trademark and misappropriation litigation. General liability policies are too often inadequate to cover these exposures, yet that coverage is what most companies rely on. The risk is enormous and potentially devastating to a company without proper coverage. If you have clients in sports related industries, review their coverage to make sure their intellectual property is adequately protected.

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# Fourth Estate or Fifth Wheel?

*Government Curbs on Free Speech*

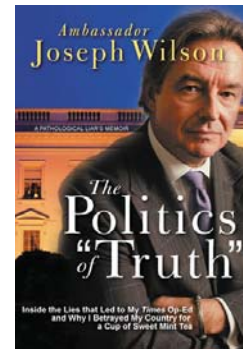
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