Blogs
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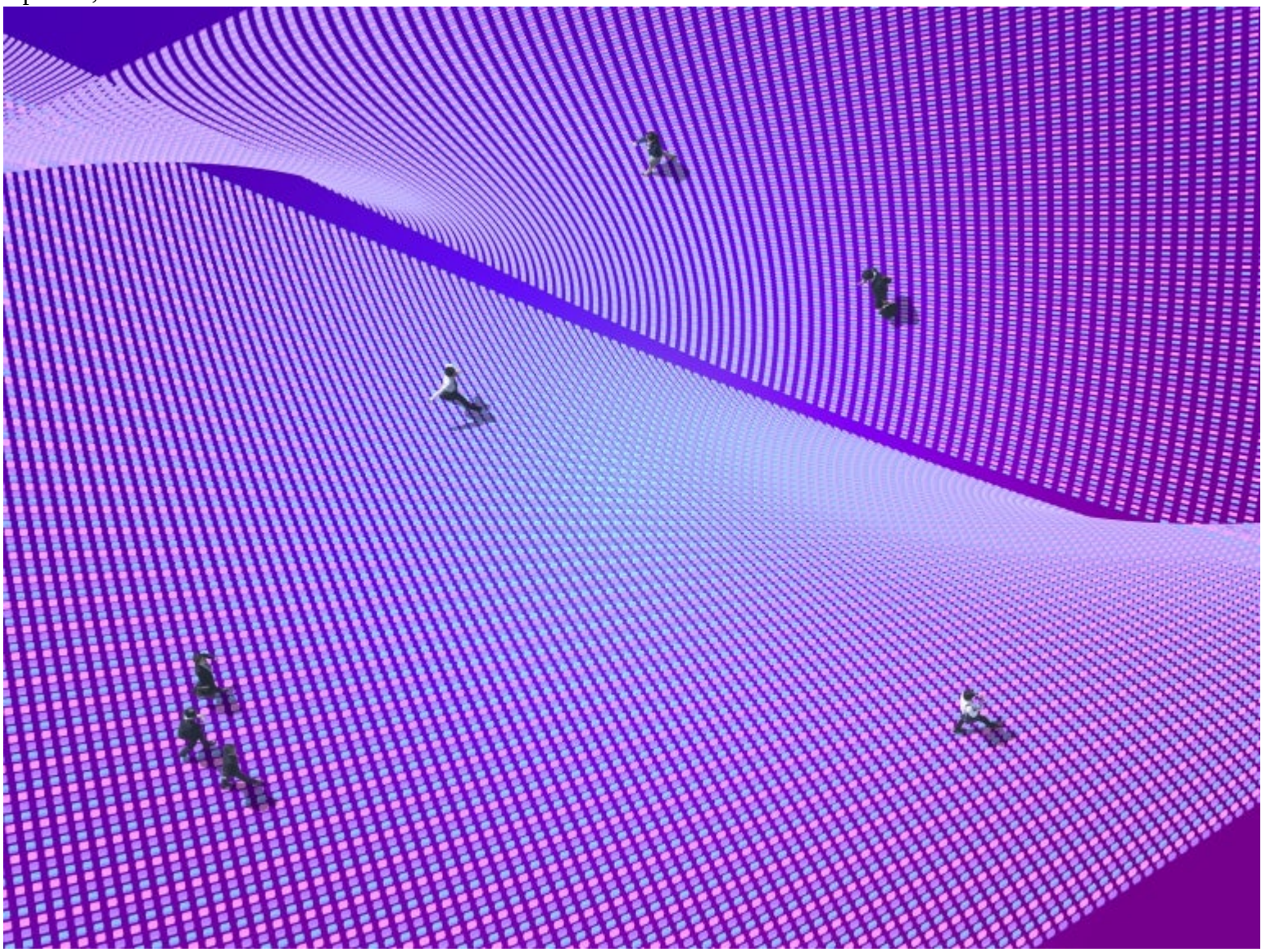

The explosive growth of generative AI has been accompanied by a corresponding growth of contractual provisions addressing generative AI issues.

Website operators in particular are increasingly seeking to use their online terms of service to prohibit the use of content and information hosted on their sites to train AI systems. Disney, for example, recently updated its online Subscriber Agreement for its Disney+ service to clarify that content from the service may not be accessed, copied, or extracted "for the purposes of creating or developing any AI Tool."

Further, at least some generative AI tool providers are seeking to impose contractual restrictions on how generated outputs may be used. Typical prohibitions include restrictions on using outputs to train competing

models (e.g., Runway's Terms of Use) and on commercial uses of outputs generated under free or trial offer plans (e.g., Midjourney's Terms of Service).

But are these types of contractual restrictions enforceable? Recent Second Circuit caselaw suggests that such restrictions may be preempted under U.S. copyright law, at least under certain circumstances.

Preemption of State Laws Under the U.S. Copyright Act

Under the copyright preemption doctrine, the U.S. Copyright Act supersedes and invalidates any state laws to the extent that they impermissibly overlap with the subject matter of federal copyright law. State laws may be preempted under either of two theories:

- **Conflict preemption** (based on the U.S. Constitution's Supremacy Clause) may invalidate a state law when it would be impossible to comply with both the state law and the Copyright Act; and
- **Express preemption** (as set out in Section 301 of the Copyright Act) may invalidate a state law that seeks relief covered by the Copyright Act or that effectively seeks to alter the scope of U.S. copyright protection.

Contractual provisions that seek to impose restrictions or obligations that conflict with the rights and limitations established by the Copyright Act may be preempted under either theory; in practice, however, most contract claims are analyzed under express preemption. Accordingly, we focus on express preemption in this blog post.

Express Preemption of Contract Claims Under the U.S. Copyright Act

An express preemption analysis under the Copyright Act involves two questions:

- Whether the subject matter at issue in a lawsuit fall within the subject matter of the Copyright Act (as set out in Section 102 and Section 103); and
- Whether the state law right claimed by the plaintiff equivalent to one of the exclusive rights reserved for copyright owners under the Copyright Act (as set out in Section 106).

Only if the answer to both questions is *yes* does express preemption apply, which would result in the plaintiff's applicable state law claim being barred. In *Close v. Sotheby's, Inc.*, for example, the Ninth Circuit held that California's Resale Royalty Act (CRRA), which would have required artists to be paid a five percent royalty on all resales of their art made in California, was expressly preempted under the Copyright Act because of the impact that the CRRA would have had on an artist's right to distribute her works.

State contract laws may also be expressly preempted to the extent they are used to enforce contract provisions that effectively create or recognize rights that would themselves be preempted. Although the U.S. Supreme Court has never addressed the application of express preemption to contract claims, the dominant approach among federal appellate courts has been to hold breach of contract claims as categorically not preempted. The Seventh Circuit Court of Appeal's decision in *ProCD v. Zeidenberg* is typical of how courts have routinely rejected copyright preemption challenges by defendants in breach of contract claims, even where such claims involved copyrighted works.

ProCD involved a telephone directory database, SelectPhone, that was licensed to end users under the terms of a "shrink wrap" license that prohibited commercial use of the database. When a SelectPhone customer incorporated information from the licensed telephone directory into his own commercial product, ProCD filed an action for breach of contract against him. In an influential and oft-cited decision by Judge Easterbrook, the Seventh Circuit reversed the district court's holding that ProCD's breach of contract claim was expressly preempted. In the Seventh Circuit's view, contract rights are *not* the equivalent of an author's exclusive rights under the Copyright Act because, while copyright is a property right enforceable against the world, contractual

rights are enforceable only as between the contracting parties.

A minority approach, however, would hold contractual provisions preempted to the extent they only seek to limit actions that are exclusive rights, such as the copying and distribution of copyrighted works. This approach was adopted in 2001 by the Sixth Circuit Court of Appeals, which was the first U.S. circuit court to hold contract claims to be preempted under the current Copyright Act, which was passed in 1976. Even more significantly given its importance as a forum for copyright disputes, the Second Circuit Court of Appeals has also followed this approach twice within the last five years.

The Second Circuit's Approach to Express Preemption of Contract Claims

The Second Circuit first adopted the minority approach in its 2019 decision in *Universal Instruments Corp. v. Micro Systems Engineering Inc*. In that matter, the Second Circuit affirmed the district court's dismissal of the plaintiff-licensor's breach of contract claims alleging that the defendant's modification of the plaintiff's source code exceeded the scope of the license granted by the plaintiff to the defendant. The fact that the plaintiff and defendant were in contractual privity was held to do "nothing to change the fact that vindication of an exclusive right under the Copyright Act [i.e., preparation of derivative works] is preempted by the Copyright Act."

Last year, the Second Circuit again applied the minority approach in its unpublished opinion in *ML Genius Holdings LLC v. Google LLC*. In this matter, the Second Circuit affirmed a district court's dismissal of a plaintiff-licensor's breach of contract claims on express preemption grounds. The plaintiff had sought to enforce restrictions in its terms of service against accessing "the Genius website to copy, modify, sell and/or distribute content appearing on Genius's website." The Second Circuit, however, held that "the right [the plaintiff] seeks to protect is coextensive with an exclusive right already safeguarded by the Act—namely, control over reproduction and derivative use of copyrighted material." Earlier this year, the U.S. Supreme Court declined to hear the appeal of this decision.

These opinions make clear that, although some contract claims concerning copyrighted materials can survive a preemption analysis (e.g., promises to pay for uses of copyrighted works), the Second Circuit nonetheless takes "a restrictive view of what extra elements transform an otherwise equivalent claim into one that is qualitatively different from a copyright infringement claim" and that a wholistic evaluation of claims is required to determine whether or not a claim is preempted.

Implications of the Second Circuit's Approach

The Second Circuit is one of the nation's most important copyright courts given its jurisdiction over New York's publishing, television, movie, music, advertising, and theater industries, and it is not yet known how wide the impact will be from its recent decisions on express preemption. Within the Second Circuit, the effect of these recent decisions can be seen in district court opinions such as the one issued in *IBM Corporation v. Micro Focus*, which held that a prohibition on reverse engineering in a software license was preempted by the Copyright Act.

In jurisdictions that follow the Second Circuit's more restrictive approach, plaintiffs may be limited to bringing copyright infringement claims when the scope of license terms or other contractual restrictions on the use of works has been exceeded. Plaintiffs who do not own or control the copyright interest in the licensed work, however, will not be able to bring such claims and may be left without an enforcement mechanism under traditional contracting approaches. This could leave the operators of sites that host user-generated content, such as social media sites and online marketplaces, in a weaker position to bringing legal actions against web scrapers. This may likewise leave AI tool providers without a means of enforcing their contractual restrictions on how generated outputs may be used. As in *ML Genius Holdings*, such site operators and AI tool providers may find their online terms of service claims preempted while at the same time being unable to bring copyright infringement claims because they do not own or have an exclusive license to the content at issue. Accordingly,

website operators seeking to protect user-generated content from unauthorized scraping, and AI tool providers seeking to protect AI-generated content from unauthorized uses, may want to evaluate the choice of law and venue terms in their respective online terms and perhaps explore alternative legal frameworks and strategies for protecting such content.

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