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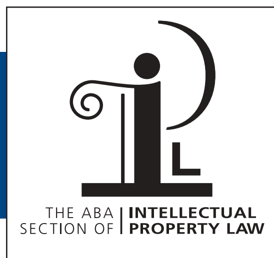

NEWSLETTER

VOLUME 21, NUMBER 4 SUMMER 2003

Pharmaceutical Trade Dress
Should Generics Be Permitted to Copy?

BY TRACY-GENE G. DURKIN, KENNETH C. BASS III AND JULIE D. SHIRK

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The United States Court of Appeals for the Third Circuit recently rendered a decision in a generic drug trade dress case that may contain the seeds of a reevaluation of fundamental Lanham Act principles. The issue on appeal was the validity of the district court's denial of a preliminary injunction against distribution of a generic drug that the plaintiff claimed illegally mimicked its brand name drug's trade dress. The court of appeals affirmed that ruling and in the process took a deep look into the state of trade dress law in light of recent Supreme Court decisions and the sea change in the pharmaceutical marketplace spurred by the Hatch-Waxman Act. While the decision itself is a narrow one that may be confined to the specific facts of the case, it holds open the possibility for a future reassessment of whether trade dress protection should apply at all to the shape, color, or size of prescription drugs.

On May 23, 2003, the Court of Appeals for the Third Circuit ruled that Barr Laboratories, a generic drug manufacturer, cannot be preliminarily enjoined from making a generic drug that looks like Shire U.S.'s Adderall. The case, *Shire U.S., Inc. v. Barr Laboratories, Inc.*,[1] was originally filed in the U.S. District Court for the District of New Jersey. In August of 2002, District Judge Joel A. Pisano denied Shire's motion for preliminary injunction to prevent Barr from selling its generic equivalent of Adderall, a treatment for attention deficit and hyperactivity disorder (ADHD). Judge Pisano had ruled that Shire could not show a likelihood of success in meeting its burden to prove that the appearance of its drug was not functional, a requirement of any claim for trade dress infringement under the Lanham Act.[2]

In affirming the lower court's ruling, the court of appeals agreed that Barr's use of color for its drug, which was similar to the color of Shire's drug, was permissible because it enhanced patient safety by promoting patient acceptance.[3] The court thoroughly discussed several older district court decisions in the Third Circuit that had refused to let generic drug manufacturers use colors, shapes, and sizes that were very similar to the appearance of an established branded drug. In distinguishing this case, the court relied on two U.S. Supreme Court cases, *TrafFix Devices, Inc. v. Marketing Displays, Inc.*,[4] and *Inwood*

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Keeping Current with the Chair

MARK T. BANNER

Footnote 17

> My law clerk Sabrina Fève requests that I disclose that she now despises patent law. I cannot believe that anyone who displays such competence in a field of inquiry feels so vehemently. Her response must be less than forthcoming: the traditional line between love and hate lives on.

Illinois Tool Works, Inc. v. Ion Systems, Inc., 250 F. Supp. 2d 477, 505, n.17 (E.D. Pa. 2003) (Anita B. Brody, Judge).

What could make a law clerk so vigorous in her denunciation of patent law, and a federal district court judge so moved by the sentiment, to include this footnote in an opinion? An analysis of the decision might give guidance.

The quotation comes at the end of a long *Markman* opinion. In nearly thirty pages, the district court construed at least nineteen disputed terms from two of the four patents in suit. All of the patents involved systems that control the amount of static electricity in a room by supplying ions of the opposite polarity from the charges built up in the room. The footnote appears at the very end, following a lengthy discussion of the sometimes conflicting and confusing legal principles that govern claim construction, the contentions of the parties, and construction of the disputed terms.

One might be tempted to say the footnote followed the "ultimate" claim construction, it coming at the end of such a lengthy decision. However, it is far from "ultimate" in today's legal climate. At best it is the penultimate claim construction. Reversal rates of district court judges on claim construction issues continues to run at very high rate.

One can surmise that the footnote gently (and with good humor) was intended to remind the reader of the difficulties confronting district court judges approaching the *Markman* task. Nothing I have written this past year generated as much mail as the article proposing a review of the *Markman* process.[1] Letters, e-mails, and comments came from members of the user community, district court judges, individual inventors, and colleagues in the outside bar. Few submissions to me have been as colorful as the quotes attributed to Judge Samuel Kent of the Eastern District of Texas, who was quoted in a March 2002 issue of *IP Worldwide* as having said (during a summary judgment hearing in a patent case), "Frankly, I don't know why I'm so excited about trying to bring this [patent case] to closure. It goes to the Federal Circuit afterwards. You know, it's hard to deal with things that are ultimately resolved by people wearing propeller hats." In that same article he was quoted as having told *The National Law Journal* that the Federal Circuit is full of "little green men who don't know Tuesday from Philadelphia."

The mail and comments to me may not have been as colorful, but they certainly have been as heartfelt. My update in the March 2003 issue of the Section's *Chair's Bulletin* pointed out that since the beginning of the year to that time the reversal rate on claim construction issues continued at 40 percent. (As of that time there were twelve cases in which claim construction was reviewed, eight precedential and four nonprecedential. Of the twelve cases, five resulted in result-impacting reversals.)

Much has been written about the reversal rate on claim construction issues in the Federal Circuit. As I noted in my previous article, Federal Circuit judges, academics, and even clerks of court had debated and written about the reversal rate, some suggesting a rate as high as 47 percent and others concluding a 33 percent rate. The author propounding the lower estimate, Kimberly A Moore, Associate Professor of Law at the George Mason University School of Law, concludes that the reversal rate is too high for the legal and business community to have confidence in the predictability of outcome in patent infringement cases. Her solution is greater use of interlocutory appeals by the Federal Circuit. My earlier article suggested other possibilities should be considered as well. I concluded by pointing out that our Committee 108 is studying issues relating to claim construction.

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Lisa A. Dunner

Nick Setty

From the Editors

This is the second installment of the new editors' column of IPL Newsletter. *True to our editorial promise, this column's focus this quarter is on a significant patent issue, namely the* Vornado *decision and its aftermath. My only request is that you not treat this editorial like other articles in the newsletter, but instead that you consider your position or experience with the* Vornado *decision's implications and then enter the debate. Please provide your thoughts on this and future editorials to Ms. Dunner and me, so that we can publish selected excerpts and ensure that this column evolves into a true Op/Ed Section, a "town hall" in which intellectual property issues can be debated freely.*

Vornado—Sea Change or Sea Spray: The Year in Review

Roughly one year ago, the Supreme Court issued its decision in *Holmes Group, Inc. v. Vornado Air Circulation Sys., Inc.*,[1] the so-called *Vornado* case. By now, most of us who practice patent litigation, or at least keep abreast of material developments in the area, know that the *Vornado* decision clarifies the Federal Circuit's jurisdictional bounds and limits that jurisdiction to matters in which "a patent-law claim appears on the face of the plaintiff's well pleaded complaint."

In other words, appeals of cases involving a patent counterclaim, but no patent law-based claim in the complaint, must now be decided by the appropriate regional circuit court of appeals. For those who have studied this development, it is apparent that this result is precisely the opposite of the conclusion the Federal Circuit reached in the *Aerojet*[2] case. In *Aerojet*, Chief Judge Markey reasoned that congressional intent in creating the Federal Circuit—uniformity in the patent law nationwide—could be served only if the Federal Circuit decided *all* claims "arising under" the patent laws.

Backdrop for *Aerojet*

One can only pass judgment on Judge Markey's reasoning in *Aerojet* with a meaningful understanding of congressional intent leading to the Federal Circuit's creation. While a detailed examination of congressional intent is beyond the scope of this editorial, one must at least scrape the surface to understand why the Federal Circuit was created and whether *exclusive* domain over patent claims was part of the congressional dictate.[3]

Initially, the "Freund Committee," which Chief Justice Berger appointed in 1971 with Harvard Professor Paul A. Freund as chair, recommended a National Court of Appeals to act as a clearinghouse for the Supreme Court and to reduce the latter's docket congestion.[4] After rejecting the notion of a National Court of Appeals with such broad jurisdiction, in 1972 Congress appointed the Hruska Commission, with Senator Roman L. Hruska as chair, to investigate appellate court improvement measures.[5]

The Hruska Commission emphasized the "lack of definitive declaration of national [patent] law" and the "acute" forum shopping in patent cases.[6] Based on those observations, the Hruska Commission recommended a national court of appeals for patent issues. Considerable time passed before the Department of Justice considered the reports of these investigatory bodies and issued a 1978 memorandum suggesting that an additional court of appeals be formed by merging the Court of Customs and Patent Appeals and the Court of Claims.[7]

Congress reacted in 1979 through Senate bills proposing that a federal appellate court have exclusive jurisdiction over all patent and trademark appeals.[8] After committee debate and another year passing, Congress reconsidered a version of the bill that deleted the trademark appellate jurisdiction. The reports on point focused heavily on the unique and "special need for uniformity" in the patent law.[9]

Equally important, Congress considered hypotheticals in which litigants could include frivolous patent claims to manipulate appellate jurisdiction, similar to the *Vornado* facts, except that the *Vornado* patent counterclaim was deemed not frivolous. Based on the possibility of such manipulation, the congressional history requires that a patent claim be determined to be legitimate before Federal Circuit jurisdiction was conferred over an appeal.[10] If the patent issue was not legitimate, the regional court would hear the appeal. President Reagan ultimately signed into law the Federal Courts Improvement Act of 1982.

Because such issues were debated and nevertheless decided in favor of a broad jurisdiction-conferring statute, 28 U.S.C. § 1295(a)(1),[11] then was Judge Markey not directly on point in *Aerojet* by reasoning that compulsory patent counterclaims must trigger Federal Circuit jurisdiction? The majority in *Vornado* did not see it that way.

The *Vornado* Decision

Justice Scalia made short shrift of the *Aerojet* premises. Perhaps because of fears over a newly coined "well pleaded counterclaim rule" spilling over beyond patent law, or because of concerns over the Federal Circuit's growing reliance on its own law through choice of law analysis of nonpatent claims, the Supreme Court rejected all of the stated goals of the Federal Courts Improvement Act.[12] Instead, the Supreme Court defaulted to the "well pleaded complaint" rule in the course of rejecting the notion that patent counterclaims confer Federal Circuit jurisdiction.

Implications of *Vornado*

Regardless of the apple carts upset in the process, *Vornado* is now the law of the land. Our attention must thus

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Pharmaceutical Trade Dress

(continued from page 1)

Laboratories, Inc. v. Ives Laboratories, Inc.[5] The appeals court noted that the prior district court decisions Shire relied on were not binding precedent, and those cases were distinguishable on their facts.[6] Most importantly, all of the earlier cases relied on by Shire involved illegal activity such as the passing off of the defendant's product by pharmacists, or illegal substitution, practices that pre-date the 1984 Hatch-Waxman Act.[7]

Background

Shire manufactures its Adderall tablets in two colors and in two shapes. The shape and color of Shire's Adderall tablets vary depending on the dosage of the tablet. Tablets having a strength less than 12.5 mg are blue, while tablets having a strength of 12.5 mg or greater are orange/peach. Shire embosses its tablets with the letters "AD" on one side and the dosage strength on the other. Shire claims unregistered trade dress rights in the color and shape of its Adderall tablets.[8]

Barr manufactures its generic equivalent of Adderall tablets in blue and peach colors similar, but not identical, to Shire's. Barr's tablets are manufactured in only one shape, round, and are embossed with the dosage strength on one side of the tablet, and a stylized "b" or the word BARR on the other.[9]

At the time of the appeal, Shire had filed several trademark applications with the U.S. Patent & Trademark Office to register the trade dress of its Adderall tablets. However, those applications were under rejection for functionality.[10] As a result, to establish infringement of an unregistered trade dress, Shire had to prove that (1) the allegedly infringed feature is nonfunctional; (2) the feature is inherently distinctive or has acquired secondary meaning; and (3) consumers are likely to confuse the source of its product with that of Barr's.[11] Judge Pisano denied Shire's motion for preliminary injunction on the basis that Shire had not credibly carried its burden of establishing that the color and shape of Adderall is nonfunctional.[12] Therefore, the court concluded that Shire was not likely to succeed on the merits of its case.[13]

In reaching the decision, Judge Pisano found that the two products were similar, but not identical, and did not contain similar source-identifying features.[14] The Barr product had different shapes and markings on it, such as its house mark. In addition, the court relied on the declarations of several expert witnesses which explained that color coding of pharmaceuticals leads to, among other things, less confusion in correctly identifying the drug or its dosage strength.[15] Such lessening of confusion, the declarations noted, enhance patient safety, compliance, and acceptance of the drug.[16]

Appellate Decision

The Third Circuit recognized that while district courts in that circuit during the 1980s had rejected the same functionality arguments credited in this case, it also recognized that district courts in other circuits have credited them. For example, in *Ives Laboratories, Inc. v. Darby Drug Co.*,[17] the district court found that capsule colors were functional because patients were known to rely on color to identify their drugs, particularly where they commingle their drugs in a single container. In addition, the *Ives* court found that drug color can be useful for identifying overdoses in emergency situations.[18] Thus, the Third Circuit accepted the district court's crediting of Barr's evidence that similarity of tablet appearance enhances patient safety by promoting psychological acceptance.[19]

Implications

The scope and impact of the ruling in *Shire* is not certain. The decision arose from the denial of a motion for a preliminary injunction. It is possible that the case will proceed to trial in the district court, in which case a different record may emerge. Given the detailed factual evidence at the preliminary injunction hearing, that does not appear likely.

There were two factors in the case that may affect its impact on other cases. The drugs are Schedule II controlled drugs available only by prescription.[20] Because the drug was used to treat attention deficit disorder patients, Barr was able to rely on expert evidence that this patient population was particularly dependent on visual clues, and thus, appearance was especially functional. Where such evidence is lacking, the decision may not provide broad support for similarity of appearance for other generic drugs.

The fact that the drugs were sold only by prescription may, however, become the basis for a more significant change in the trade dress used by generic drugs. The analytic basis of the Lanham Act trade dress decisions rests on the possibility of confusion between the established manufacturer and the newcomer. That analysis in turn rests on the underlying dynamics of the purchasing decision, though that reality is often not examined in any detail by the courts.

The dynamics of the prescription drug market do not fit easily into traditional Lanham Act analysis. In the normal consumer market, the individual consumer makes the product purchasing decision, and the trade dress of a particular product may alter that decision. The prescription drug market is totally different. In that market the consumer—the patient—has very little choice over the purchase decision. In some cases the prescribing physician may require the prescription be filled with the brand name and preclude substitution of a generic. In many, if not most, cases the patient's health insurance carrier will insist on the generic and not pay for the branded drug. Thus, the choice of a

branded instead of a generic drug is frequently not a decision the patient makes.

It is obvious that the physical appearance of the tablets will not confuse the pharmacist who dispenses the drug. Drugs are sold to pharmacies in bulk in clearly labeled bottles. The pharmacist will dispense the generic or the branded drug based on clear labeling differences on the bulk containers. It therefore will not matter whether the individual tablets have the same appearance or are plainly distinguishable.

The combination of these two factors undercuts application of the traditional Lanham Act trade dress analysis to the prescription drug market. When the choice is controlled by the doctor or the insurance company, it makes little sense to ask whether the appearance of the individual tablet may be confusingly similar to the patient. Even in cases where the patient actually makes the purchasing decision, that choice likely occurs without any consideration of the appearance of the tablet. The patient will choose the branded or the generic based on price or subjective preferences (method of administration, for example, tablet versus capsule), not on appearance, particularly if the patient has never seen the drug before.

The *Shire* decisions in the district court and the court of appeals do not discuss the fundamental differences between the "consumer choice" market theory and the marketplace of prescription drugs. The decisions apply traditional trade dress analysis to a very different marketplace. The end result—perhaps increased freedom for generic drug manufacturers to use an appearance similar to the branded drug—seems to be entirely consistent with the realities of the prescription drug market. But the realities of that market call in question the basic assumption of both decisions: Should the Lanham Act's trade dress doctrine apply at all in the prescription drug environment?

The answer to that broader question remains hidden in the body of some future judicial decision. But for now, the *Shire* decisions seem to open the door for generic drug manufacturers. It remains to be seen whether that opening is wide or narrow.

Endnotes

1. Shire U.S., Inc. v. Barr Laboratories, Inc., No. 02-3647 (3d Cir. May 23, 2003).
2. Lanham Act, 15 U.S.C. ‘ 1125(a).
3. Shire U.S., Inc. v. Barr Laboratories, Inc., No. 02-3647, slip op. at 17 (3d Cir. May 23, 2003).
4. TrafFix Devices, Inc. v. Marketing Displays, Inc., 532 U.S. 23 (2001).
5. Inwood Laboratories, Inc. v. Ives Laboratories, Inc., 456 U.S. 844 (1982).
6. Shire U.S., Inc. v. Barr Laboratories, Inc., No. 02-3647, slip op. at 12 (3d Cir. May 23, 2003).
7. *Id*. at 11 n.14.
8. *Id*. at 3.
9. *Id.* at 4-5.
10. *Id*. at 3 n.2.
11. *See*, Wal-Mart Stores, Inc. v. Samara Bros., Inc., 529 U.S. 205, 210–211, 120 S. Ct., 1339, 1343 (2000).
12. Shire U.S., Inc. v. Barr Laboratories, Inc., No. 02-2023, slip op. at 10–11 (D. N.J. Sept. 16, 2003).
13. *Id*. at 13.
14. *Id*. at 9–10.
15. *Id*. at 11–12.
16. *Id*.
17. Ives Laboratories, Inc. v. Darby Drug Co., 488 F.Supp. 394 (E.D.N.Y. 1980).
18. *Id*. at 398–99.
19. Shire U.S., Inc. v. Barr Laboratories, Inc., No. 02-3647, slip op. at 16–17 (3d Cir. May 23, 2003).
20. Drugs in Schedule II of the Controlled Substances Act are those substances that have a high potential for abuse with severe liability to cause psychic or physical dependence, but have some approved medical use.

Patents That Cover Industry Standards

Companies risk losing patents by failing to disclose

BY DON FEATHERSTONE AND EVAN SMITH

Don Featherstone

Evan Smith

Companies that send representatives to standards-setting meetings are usually obligated to disclose patent filings relevant to the standards under consideration. Many companies do not realize that failure to disclose, whether intentional or inadvertent, might destroy their patent rights. Enforcement actions against companies like Rambus, Inc., Dell Computer, and Wang illustrate the potentially serious consequences of attending standards meetings without careful attention to disclosure obligations.

How Standards Are Set

Major national and international standards-setting bodies, like the American National Standards Institute (ANSI), International Organization for Standardization (ISO) and the International Electrotechnical Commission (IEC), act as nonprofit umbrella organizations for standards-setting activities. Government agencies and nonprofit organizations participate in many standards committees, but most delegates represent private interests. Participation offers significant corporate benefits and many companies, large and small, send delegates to standards meetings. At the meetings, company delegates offer technical input, influence standards decisions in favor of their commercial interests, and gather intelligence about industry trends.

Rules established by the standards-setting bodies provide due process through public review, comment, and revision of draft standards and by permitting all interested parties to join and participate. These and other standards-setting bodies establish working committees, each tasked to develop industry standards in a specific area. Committee work is performed by "volunteers" assigned by their employer to help develop the new standards. The committees meet periodically to seek input, consensus, and compromise among interested members.

Standards and IP Rights

To prevent unfair surprises and overreaching by private interests, standards groups typically set two rules relating to intellectual property:

1. Members of the group are obligated to disclose their pending patent applications and issued patents that cover the proposed standard.
2. Member-owned proprietary technology is ineligible for standards consideration unless the owner of the rights pledges to offer commercially reasonable and nondiscriminatory licenses.

Voluntary disclosure is essential for standard-setting committees; they lack the resources to conduct infringement clearance searches, and in any case pending applications are often known only to the applicants. By sending representatives to standards-setting groups and accepting the benefits of participation, companies also accept the above disclosure rules. This process allows the group to evaluate the scope of the rights and the option of revising the standard to define an alternative, public domain technology.

The rules subject companies to conflicting motivations. If a company discloses its patent filings, a standards committee may design the standard to avoid the patented technology, reducing or eliminating the value of the company's patent rights. If a committee does adopt a proprietary standard, it will do so only with assurances that royalty levels will not be a barrier to broad implementation of the standard. As a result, companies are tempted to allow (or even induce) the industry to adopt a standard, and to wait until the standard is widely adopted before revealing blocking patent rights and demanding substantial royalties.

Mechanisms for Disclosure

Delegates may disclose a patent or pending application applicable to the standard under discussion during a committee meeting, or by written submission to the group. If a member encourages adoption of a standard potentially covered by its own patent filings, its disclosure may be accompanied by a commitment to offer commercially reasonable (or even free) nondiscriminatory licenses.

A large company with many pending applications and issued patents may need a formal system to ensure that it meets these disclosure requirements. For such companies, a clearly defined process is needed to track standards committee attendance, understand proposed standards, identify relevant patent rights and convey that information to delegates, train delegates to spot and

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report issues to designated counsel, and document these efforts. Small companies with only a few patent filings may adopt a less formal system, which still meets the same requirements.

Enforcement Actions

The Federal Trade Commission (FTC) has filed antitrust charges against companies that asserted blocking patent rights covering a standard, but failed to disclose their patent rights during the standards-setting process. At least one court found that similar conduct granted an implied license to the infringer.

Most recently the FTC charged Rambus, Inc. with abusing patent rights to illegally monopolize the market for SDRAM, the industry-standard plug-in memory for PCs and other computing devices.[1] The FTC seeks an order barring Rambus from enforcing U.S. and international patents. The proposed penalty is substantial because Rambus reportedly collects royalties of $50 million to $100 million a year from computer memory manufacturers. A hearing before FTC Administrative Law Judge Stephen J. McGuire was underway as this article was written.

The case arises from Rambus' participation in meetings of the Joint Electron Device Engineering Council (JEDEC)[2] from 1991 to 1996. This standards-setting body includes most major electronics manufacturers and established the SDRAM standard in 1999. The FTC contends that Rambus violated JEDEC rules by failing to disclose SDRAM-related patent applications.[3]

Rambus is accused of remaining silent when specifically asked about its patent rights during committee meetings.[4] A document allegedly written by Rambus CEO Geoff Tate directs company employees "not to indicate/ hint/ wink/ etc." that the JEDEC standard might infringe Rambus patents.[5] The FTC also alleges that the company amended its patent claims in response to what it learned at JEDEC meetings.[6] The FTC does not contend that amending patent applications to cover competing technology is normally improper, but argues that Rambus' actions violated JEDEC rules and procedures.[7]

Rambus denies the allegations and asserts that the disclosure rules were too vague to be enforced.[8] In support, Rambus points to a January 2003 decision in Rambus' patent infringement suit again Infineon Technologies. Infineon convinced a jury in 2001 that Rambus committed fraud under Virginia law by failing to disclose pending applications to the standards committee.[9] On appeal, the Court of Appeals for the Federal Circuit overturned the fraud count.[10] The CAFC held that JEDEC's patent disclosure policy was not specific enough to support a finding that noncompliance constituted fraud.[11] Infineon petitioned the Supreme Court for a writ of certiorari on July 3, 2003. The Court had not acted on the petition as this article was being written.

Rambus is not the first company to run into problems with disclosures in standards-setting groups. Previous FTC enforcement actions include a 1996 charge against Dell Computer involving Dell's role in setting the Video Electronics Standards Association (VESA) VL-Bus standard used in 486-based computers.[12] Dell allegedly represented that it had no patent rights relating to the standard and then tried to enforce rights covering the standard.[13] That case was settled; Dell agreed not to enforce that patent or any other patents that Dell intentionally failed to disclose on request of a standard-setting organization.[14]

In a 1993 case, a jury refused to enforce a Wang patent after Wang participated in standards-setting activities without disclosing a pending application, which later issued, covering the standard.[15] Wang sued adopters of the standard for infringement. Most defendants settled, but Mitsubishi went to trial. The jury found that Wang gave an implied license by encouraging Mitsubishi to adopt the standard and begin its manufacturing activities.[16]

Establishing Good-Faith Procedures

Valuable patent rights have been lost through failure to disclose them during the standards-setting process. Intentional cover-ups have foreseeable results, but inadvertent actions could also impair key patents. Joseph J. Simons, director of the FTC Bureau of Competition, says the recent Rambus complaint sends a deliberate signal: "The message is this: If you are going to take part in a standards process, be mindful to abide by the ground rules and to participate in good faith."[17]

Established corporate compliance procedures can be helpful in meeting disclosure requirements and in showing good faith if an oversight occurs. Corporate "best practices" may include the following steps:

1. Monitor and control standards committee participation. It is helpful if designated legal counsel (in-house or outside) is kept informed of proposed attendance or other participation in standards groups. Counsel may then ensure that participation is approved by appropriate management and is reviewed regularly for consistency with corporate business and legal objectives. Note that some companies choose to avoid participating in standards committees in areas where they have substantial patent rights.

2. Train standards committee delegates. Briefing by counsel on how to spot legal issues arising in a standards-setting process is desirable before sending an employee to attend a standards-setting meeting.

3. Debrief. Counsel and management may require that standards committee delegates keep them informed with regular reports during and after committee meetings.

4. Identify relevant patent rights. When kept informed of events, counsel can evaluate pending standards proposals in relation to pending applications and issued patents to identify relevant rights.

5. Obtain opinions as needed. In close cases, the company may wish to obtain a formal opinion of counsel. If the company's disclosure decision is later challenged, reliance on a well-reasoned and fully informed opinion can be presented as evidence of good faith, analogous to reliance on a non-infringement opinion.

6. Respond strategically. Counsel and management can use information received to evaluate the effect of new standards developments on the company's competitive position, research and development priorities, and patent activities, and make appropriate strategic adjustments.

7. Establish disclosure strategy. Determine whether a disclosure is necessary or otherwise desirable, and what business actions should accompany the formal disclosure (such as personal communication with influential delegates or simultaneously announcing an open-licensing commitment).

8. Properly execute and document disclosures. Complete the planned actions and retain complete documentation of the information provided to the group.

Regardless of the outcome of the pending *Rambus* case, technology company executives and counsel should be aware of dangers arising from standards-setting activities. Savvy companies are taking note of recent high profile cases and are establishing appropriate procedural safeguards to protect key patent rights.

Endnotes

1. In re Rambus, F.T.C. Docket No. 9302 (2002).
2. Now known as the "JEDEC Solid State Technology Association," JEDEC is the semiconductor engineering standardization body of the Electronic Industries Alliance (EIA), a trade association that represents all areas of the electronics industry.
3. Administrative Complaint at ¶2, In re Rambus, F.T.C. Docket No. 9302 (2002).
4. *Id.* at ¶72.
5. Opening arguments of M. Sean Royall, deputy director Bureau of Competition, In re Rambus, F.T.C. Docket No. 9302 (Apr. 30, 2002) (displaying document).
6. *See* Administrative Complaint at ¶54, In re Rambus, F.T.C. Docket No. 9302 (2002).
7. *See id.* at ¶¶ 79–80.
8. Trial Brief of Respondent Rambus Inc. at 47–51, In re Rambus, F.T.C. Docket No. 9302 (2002).
9. Rambus, Inc. v. Infineon Tech. AG, 164 F. Supp. 2d 743 (E.D. Va., 2001), *aff'd in part, rev'd in part, vacated in part, and remanded,* 318 F.3d 1081 (Fed. Cir. 2003), *reh'g denied*, 2003 U.S. App. LEXIS 8845 (Apr. 4, 2003), *petition for cert. filed* (U.S. July 3, 2003) (No. 03-37).
10. *Id.*, 318 F.3d 1081 at 1081.
11. *Id.*
12. In re Dell Computer Corp., 121 F.T.C. 616 (1996).
13. *See* Administrative Complaint, In re Dell Computer Corp., F.T.C. Docket No. C-3658 (1995).
14. Consent Agreement, In re Dell Computer Corp., F.T.C. . Docket No. C-3658 (June 17, 1996).
15. Wang Laboratories, Inc. v. Mitsubishi Electronics America, Inc., 29 U.S.P.Q.2d (BNA) 1481 (C.D. Cal. 1993), *aff'd*, 103 F.3d 1571, 1580-1582 (Fed. Cir. 1997).
16. *Id.*
17. Fed. Trade Comm., FTC Issues Complaint Against Rambus, Inc. (June 19, 2002) (Press release).

RIAA's Latest Legal Attack on P2P File-Sharing

BY SHEILA M. HEIDMILLER

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Overview

In a test case[1] addressing the scope of a copyright owner's subpoena power under the Digital Millennium Copyright Act (DMCA), the Recording Industry Association of America (RIAA)[2] recently convinced a federal judge to order Verizon Internet Services (Verizon) to turn over the name of a subscriber who allegedly shared copies of music recordings via peer-to-peer (P2P) file-sharing (from personal computer to personal computer) using Verizon's site as a conduit.[3]

This case represents the entertainment industry's latest legal attack on P2P piracy. Invoking the DMCA,[4] RIAA argued that it has subpoena power to force Internet Service Providers (ISPs) such as Verizon to turn over the identity of subscribers who are using the ISP solely as a conduit for P2P file-sharing/-trading that may constitute copyright infringement.[5] The district court agreed, ordering Verizon to divulge to RIAA the identity of a Verizon subscriber who allegedly downloaded a large number of copyrighted songs.[6]

In defense, Verizon argued that the DMCA subpoena provision applies only to an ISP storing copyrighted material on its computers (a hosting ISP), and not to an ISP, such as Verizon, merely serving as a conduit (where the copyrighted material is stored on the ISP subscriber's own computer and shared by an individual via P2P software over the Internet by subscribing to an ISP service for the Internet connection). This distinction is important because the DMCA clearly distinguishes between types of ISPs. As discussed below, one of the primary questions before the court was whether this distinction applies in the context of the subpoena provision.

Verizon informed the court that it obviously supports RIAA's and other copyright owners' rights to take an individual to court and have the court order the ISP to reveal the identity of a particular subscriber/infringer (known as a John Doe case). However, this process, as pointed out by Verizon, is very different from RIAA obtaining the identity of a subscriber from the ISP by way of a subpoena without judicial oversight.[7] Unlike a usual subpoena, including John Doe subpoenas, which require some underlying claim of a crime and must be signed by a judge or magistrate, a DMCA subpoena can be issued by a court clerk without presenting evidence of a crime having been committed.

Obviously, because of the lower threshold of proof and the lack of judicial oversight, it is far faster and cheaper for RIAA to rely on the subpoena power under the DMCA than to initiate a John Doe lawsuit. However, the dire implication of the court's ruling is that any copyright owner who claims infringement can force an ISP to reveal a subscriber's identity merely by obtaining a subpoena from a district court clerk (without filing a complaint). Such a broad subpoena power as an investigative tool outside the context of a pending case should be questioned—especially as applied to a conduit ISP merely providing a connection to the Internet. Indeed, Verizon has filed for a stay of the court order that it comply with RIAA's subpoena, and it has appealed the decision. On appeal, Verizon will likely expand its legal defense to a full-blown constitutional review of the subpoena power provision of the DMCA.

The Issues

Who should be responsible for enforcing RIAA's copyright rights?

We would probably all agree, as does Verizon, that online copyright infringement via P2P file-sharing should not be allowed to occur. The question is, what is the best way to stop it? Giving RIAA subpoena power over conduit ISPs under the DMCA effectively shifts the burden of copyright enforcement from RIAA's own members to an ISP that does nothing more than provide an Internet connection to its customers.

Moreover, this will place a heavy burden on conduit ISPs. Complying with what will likely be a large number of subpoenas to access the identity of an ISP subscriber suspected of copyright infringement could threaten the viability of conduit ISPs. Providing access to the Internet is legitimate e-commerce. Between the time and expense involved to comply with the subpoenas and the potential impact of ratting out its own customers, conduit ISPs will essentially be incurring costs associated with copyright enforcement. Conduit ISPs are not contributing to the infringing behavior, so arguably this burden should not fall upon them. Rather, it should fall on the copyright owners (RIAA).

Does such a broad subpoena power justify potentially violating privacy rights?

Additionally, forcing ISPs to serve as the enforcement arm for P2P copyright infringement jeopardizes online privacy rights—given that a corporation is being asked to reveal personal information about customers without a

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judge's order (i.e., without the due process protections afforded by the courts). The subpoena power under the DMCA does not require an analysis about whether copyright infringement has actually occurred, whether the alleged infringer can claim fair use, whether there is jurisdiction over the individual, and so forth. Rather, the subpoena power essentially gives RIAA (the copyright holder) unilateral power to require an ISP to disclose a subscriber's identity based upon a mere suspicion of copyright infringement by one of its subscribers. It is not at all clear that such a broad subpoena power (essentially being used as an investigative tool) justifies potentially violating the ISP subscriber's privacy rights.

It is important to point out that RIAA would not be left without a remedy if the subpoena power could not be used to demand the identity of a user of a conduit ISP. As stated above, RIAA could file a John Doe lawsuit and go through the proper judicial channels to obtain from an ISP the identity of a P2P pirate. Indeed, this is the usual and proper way of obtaining this information in copyright and other intellectual property cases.

The Bigger Picture

This test case will be an important one to follow on appeal, as it has far-reaching implications not only for the relationship between RIAA, ISPs, and P2P file-sharers, but also for any entity providing a P2P file-sharer access to the Internet, because the holding of this case could extend to copyrights in and to any sort of work. Although online music rights have received the most attention, the DMCA and its subpoena provision apply to copyright rights in and to any work.

The DMCA and the Court's Holding

RIAA v. Verizon presented a core issue of statutory interpretation relating to the scope of the subpoena authority under the DMCA.[8] Accordingly, it is necessary to have some understanding of the DMCA.

The Purpose of Section 512

The DMCA amended Chapter 5 of the U.S. Copyright Act, 17 U.S.C. §§ 501 *et seq.*, and created a new Section 512 entitled "Limitations on liability relating to material online." "As the title indicates, the DMCA is designed primarily to limit the liability of Internet service providers for acts of copyright infringement by customers who are using the providers' systems or networks."[9]

The Subpoena Provision of Section 512

The subpoena provision is 17 U.S.C. § 512(h)(1), which provides, in pertinent part, that "A copyright owner or a person authorized to act on the owner's behalf may request the clerk of any U.S. district court to issue a subpoena to a service provider for identification of an alleged infringer in accordance with this subsection."[10] RIAA argued that this provision applies not only to a hosting ISP (where the copyrighted material is stored on the ISP's computers) but also to a conduit ISP such as Verizon (where the copyrighted material is stored on the subscriber's computer and transferred by the subscriber over the Internet through a connection with an ISP).[11] However, as will be shown below, arguably, the wording of the statute does not support RIAA's argument.

The Safe Harbor Provisions of Section 512

Subsections 512(a) through 512(d) provide a "safe harbor" for qualifying ISPs. The safe harbor is different for each type of ISP. Subsections 512(a) and (c) are the two in question in this case. Under subsection 512(a), if the ISP meets certain conditions, it will not be liable for a user's copyright infringement where the ISP serves as a mere conduit for transmission of copyrighted material stored on a user's computer and made available by the user.[12] Under subsection 512(c), if the ISP meets certain conditions, it will not be liable for a user's copyright infringement where the ISP stores copyrighted material on its system or network.[13] In short, there are different (and less stringent) requirements for a conduit ISP to qualify for a safe harbor than there are for a hosting ISP. This makes sense, given that a hosting ISP actually plays some part in the infringement because the infringing material is stored on the ISP's system.

Essentially, RIAA argues that the distinction between hosting and conduit ISPs does not apply in the context of the subpoena provision.[14] However, again, the actual wording of the statute arguably does not support such an argument.

The Notification Requirement of Section 512(c)

Subsection 512(c)(3)(A) spells out requirements to be met by copyright owners for effective notification of copyright infringement to hosting ISPs. The court acknowledges that this notification requirement is located only within subsection 512(c) (which is applicable only to hosting ISPs), and that there is no similar notification requirement within subsection 512(a) (applicable to conduit ISPs) or elsewhere in Section 512.[15]

The reason the 512(c) notification requirement is so important is because it is referenced in the subpoena provision. Subsection (5) of the 512(h) subpoena provision provides, in pertinent part, that

> Upon receipt of the issued subpoena, either accompanying or subsequent to the receipt of a notification described in subsection (c)(3)(A), the service provider shall expeditiously disclose to the copyright owner or person authorized by the copyright owner the information required by the subpoena, notwithstanding any other provision of law and regardless of whether the service provider responds to the notification.[16]

Thus, arguably, this requirement in the subpoena provision that the copyright owner requesting a subpoena from the court clerk include a copy of the notification described in subsection 512(c)(3)(A) is strong evidence that the subpoena provision only applies to 512(c) (hosting) ISPs (and not to 512(a) (conduit) ISPs. Indeed, this was one of Verizon's arguments.[17]

The Two Definitions of "Service Provider" in Section 512

In further support of its argument, Verizon points out that subsection 512(k) of the DMCA sets forth two sepa-

rate definitions of "service provider": the first definition defines subsection 512(a) (conduit) ISPs; the second definition defines all other ISPs.[18]

This is further evidence of Congress' intent to have two different sets of rules for conduit ISPs and hosting ISPs. At a minimum, there is at least ambiguity as to whether the subpoena provision applies only to hosting ISPs or also to conduit ISPs. However, the Court states that "the statutory language and structure lead to a single result—the section 512(h) subpoena authority applies to service providers within not only subsection (c) but also subsections (a), (b), and (d) of section 512."[19] To get there, the Court finds that the second definition (the broader definition that applies to all other ISPs) applies to conduit ISPs in the context of a subpoena because that broader definition applies to the subpoena subsection and the subpoena subsection applies to 512(a) (conduit) ISPs.[20] This is a circular argument, and the court makes no real effort to unravel it. It's like saying, x + 2 = y because we know x is valid and therefore y is valid—without proving that x is actually valid. This is a logical fallacy.

Legislative Intent

Instead of unraveling its circular argument, the Court focuses primarily on a "legislative intent" argument to reach its holding.[21] "It is unlikely, the Court concludes, that Congress would seek to protect copyright owners in only some of the settings addressed in the DMCA, but not in others."[22] By focusing on the protection given to the copyright owner under the DMCA rather than the balancing safe harbor given to the ISP, the Court misses the point, which is that the DMCA does in fact treat different types of ISPs differently. That is the whole point of having two definitions and two separate safe harbors for hosting and conduit ISPs. This distinction makes sense because hosting ISPs store infringing material on their systems and should therefore have a greater burden than conduit ISPs who merely provide a connection to the Internet.

In the end, the Court places the burden on Congress to make the subpoena power clearer if it intended something other than what the Court held.[23] The Court states that "…if Congress had intended subsection (h) subpoenas to apply solely to subsection (c) [conduit] service providers, it could have stated such a limitation…."[24] Ironically, this statement is actually evidence that there is at least ambiguity as to whether the subsection (h) subpoena power applies to conduit ISPs (and that the Court's holding that the statute is absolutely clear on its face is therefore a suspect holding).

Complicating the assessment of this issue "is the fact that two new technology developments underlying the issues in this case—peer-to-peer (P2P) software and "bots," a software tool used by copyright owners to monitor the Internet and detect unauthorized distribution of copyrighted material—were "not even a glimmer in anyone's eye when the DMCA was enacted" by Congress in 1998."[25] With this statement, the court again acknowledges that the statute as written is not clear and cannot be appropriately applied to the case before it, making the Court's holding further suspect).

"John Doe" Actions as an Alternative

Verizon correctly argues that, under its proffered construction of the DMCA (that the subpoena provision applies only to hosting ISPs), copyright owners would still have an adequate means to protect their copyrights.[26] RIAA could continue to use bots to identify infringement, but instead of using the subpoena power under the DMCA that is arguably only applicable to hosting ISPs, RIAA could bring a "John Doe" action to obtain information identifying the P2P infringer.[27] In a "John Doe" suit, the copyright owner files a complaint against John Doe (the unidentified P2P infringer), a third-party subpoena issues and is served on the entity able to identify the John Doe, who then informs the infringer of the lawsuit.

The Court rejected this is an alternative, stating that there is nothing in the DMCA indicating that Congress contemplated John Doe actions.[28] However, the Court fails to acknowledge that this is the standard way of going after infringers whose identity is unknown to the copyright owner and is used in infringement cases involving other kinds of intellectual property (e.g., trademarks and patents) as well. There is no clear indication made by the Court as to why the P2P context is somehow uniquely inappropriate for John Doe actions. A John Doe action should not be viewed as an unattractive or unworkable option. It is the standard and proper way to do things. A John Doe subpoena process involves court oversight, thereby protecting the identity of a user until copyright infringement has been proved. A DMCA subpoena, on the other hand, does not require the initiation of a lawsuit and essentially only requires the mere suspicion of copyright infringement.

This creates a potential violation of an individual's privacy rights when the conduit ISP turns over the individual's identity to RIAA. A John Doe action would eliminate this problem. Moreover, a John Doe action would properly place the burden of enforcing RIAA's rights in and to its copyrights where it belongs: upon RIAA rather than upon conduit ISPs.

Interestingly, as discussed above, the Court earlier acknowledged that P2P technology and bots were not contemplated by Congress when it drafted the DMCA. Therefore, it seems logical that Congress would not have contemplated the need for John Doe actions.

Will Technology Continue to Stay One Step Ahead of RIAA and the DMCA?

Even if Verizon loses on appeal, it is possible—probably even likely—that technology will stay one step ahead of RIAA. P2P users are already coming up with ways to hide or cloak their digital identity such that the ISP will not be able to identify them. Many wonder when RIAA is finally going to understand that the Internet has forever changed the way music is experienced and come up with

ways to work with ISPs to embrace a model that protects RIAA's rights rather than trying to shut down P2P file sharing, which it will probably never be able to do. Open-source technology, in particular, makes it next to impossible to obtain the identity of a user. Thus, rather than logging into an ISP for access, for example, we may start seeing more open-source solutions to retaining anonymity and privacy. Short of that, it is likely that P2P users will simply learn to disguise their activities from their ISP.

P2P file-sharers will likely stay one step ahead of the DMCA as well. The statute is not technologically neutral in that it contemplates differences in the technology used by the various types of ISPs. The *Verizon* Court's holding seems to ignore these differences, but they are nonetheless present in the DMCA. The *Verizon* Court does drop hints that Congress may want to think about revising the DMCA. However, revising the DMCA to make it technologically neutral may not be the best answer because doing so would create a "Catch 22." It would remove the ability of online infringers to stay one step ahead of the technological parameters of the DMCA (but they could still find ways to avoid having their identity known), but it would also presumably remove the important distinction between conduit and hosting ISPs. At any rate, it seems clear from the *Verizon* Court's holding that the DMCA has become outdated.

Regardless of whether Congress revises the DMCA, many argue that RIAA, rather than relying on the law to enforce its copyright rights, should work with ISPs to implement a subscription model that appeals to P2P file sharers. If marketed properly, this would likely be far more successful than RIAA's current strategy, which ultimately ends with RIAA chasing its tail as P2P infringers stay one step ahead of the law.

Summary and Conclusion

If the appellate court upholds the lower court's holding, the burden on conduit ISPs to respond to what will likely be large numbers of subpoenas from RIAA (and other copyright holders who will likely hop on the bandwagon) will be heavy. The costs associated with this, as well as turning over the identity of its own customers could threaten the viability of conduit ISPs, a legitimate form of e-commerce. Additionally, the DMCA arguably does not support removing the distinction between conduit and hosting ISPs. An appellate court holding affirming such a holding would likely lead to a rash of lawsuits taking advantage of and pushing the boundaries of such a holding. The privacy rights entangled in this issue must also be considered.

If the appellate court reverses the lower court's holding, RIAA will likely bring at least one John Doe suit to set an example, and the distinction written into the DMCA between hosting and conduit ISPs will be preserved. Either way, it appears that RIAA has started down the path of going after P2P pirates directly, some of whom are its own paying customers. The bigger question is whether this will even prevent P2P piracy. P2P pirates probably will eventually figure out a way to engage in this activity without leaving an identity trail. A better answer might be for RIAA to fully embrace working with ISPs to implement a subscription model that P2P file sharers can buy into. Granted, it may take a few John Doe suits to convince P2P infringers of the value of a subscription system, but this would be a more sustainable, long-term solution to the problem. One thing is clear: placing enforcement costs on conduit ISPs and potentially violating privacy rights is not the best solution.

Endnotes

1. The parties, and several amici curiae, agreed that this was an issue of first impression of great importance to the application of copyright law to the Internet and conceded that this case was presented as a test case to determine the parameters of the DMCA subpoena power. Recording Industry Association of America v. Verizon Internet Services, 2003 U.S. Dist. LEXIS 681, *3-4 (D.D.C. 2003).
2. RIAA is the industry trade association for sound and music recordings, whose members create and distribute almost all of the music sold in the U.S. RIAA is authorized to enforce the copyrights of its members. *See* Recording Industry Association of America v. Verizon Internet Services, 2003 U.S. Dist. LEXIS 681, *3 (D.D.C. 2003).
3. Recording Industry Association of America v. Verizon Internet Services, 2003 U.S. Dist. LEXIS 681 (D.D.C. 2003).
4. The DMCA amended Chapter 5 of the Copyright Act, 17 U.S.C. §§ 501 *et seq*., and created a new Section 512 entitled "Limitations on liability relating to material online." As the title indicates, the DMCA is designed primarily to limit the liability of Internet service providers for acts of copyright infringement by customers who are using the providers' systems or networks. *See* Recording Industry Association of America v. Verizon Internet Services, 2003 U.S. Dist. LEXIS 681, *4-5 (D.D.C. 2003).
5. *Id*. at *12.
6. Recording Industry Association of America v. Verizon Internet Services, 2003 U.S. Dist. LEXIS 681 (D.D.C. 2003).
7. *Id*. at 44.
8. Id. at *3.
9. *Id.* at *4.
10. *See also id*. at *9.
11. *Id*. at 12.
12. *Id*. at *6.
13. *Id*. at *7.
14. *Id*. at 12.
15. *Id.* at *8.
16. 17 U.S.C. § 512(h)(5). See also i*d*. at *9.
17. *Id*. at 18.
18. *Id*. at 16–17.
19. *Id.* at *15.
20. *Id*. at 17–18.
21. Recording Industry Association of America v. Verizon Internet Services, 2003 U.S. Dist. LEXIS 681 (D.D.C. 2003).
22. *Id*. at *30.
23. *Id*. at 40.
24. *Id.* at *25.
25. *Id*. at *40 (quoting Br. of *Amicus Curiae* Alliance for Public Technology, et. al., at 6).
26. *Id*. at 43.
27. *Id*. at 43–44.
28. *Id*. at 44.

From the Chair

(continued from page 2)

Since that time an additional thirty-four cases in which claim construction was at issue have been decided by the Federal Circuit.[2] Twenty of the thirty-four cases involve reversal on the claim construction issues, but three of the reversals were not the type that impact of the result, making the number of "effective" claim construction reversals seventeen. Thus the reversal rate on claim construction for the first six months of 2003 is 48 percent, or twenty-two out of the forty-six cases.

A thorough study of this situation cannot be done too soon. The *Markman* procedure is broken. The analytical framework is confusing and the results are confounding. The lack of predictability is not serving the patent system well.

As is commonly known, the Federal Circuit was created to bring uniformity to the law of patents. Prior to its creation hefty criticism was leveled at the various circuit courts of appeals for lacking uniformity in the application of the patent laws. The outcome of a patent infringement lawsuit, it was said, too often depended on which regional circuit the case was filed. At the time the Eighth Circuit was widely criticized for never holding a patent valid, while other circuits were criticized for almost never holding a patent invalid. The "race to the courthouse" was considered outcome-determinative. This led to unpredictability. The prevailing wisdom reasoned that it made no sense to have the value of significant research and development investments and the validity of the patents that flowed from and protected those investments depend on what circuit would hear the appeal of a patent infringement lawsuit. The situation, said the user community, diminished the value of patents because the outcome of litigation was so uncertain and so highly dependent on the circuit in which the case was filed.

Were those the "good old days?" At least then the outcome of the race to the courthouse often provided a significant predictor of the outcome, and this came early

STATUS	CASE NAME	Number	Was Claim Construction at issue?	Was one or more claim constructions reversed?	Did it impact the result?
(NON-PRECEDENTIAL)	MOLTEN METAL EQUIPMENT INNOVATIONS, INC. v. METAULLICS SYSTEMS CO., L.P. and METAULLICS SYSTEMS CO.	01-1409	Yes	No	No
(NON-PRECEDENTIAL)	OLD TOWN CANOE COMPANY v. GLENWA, INC.	02-1144	Yes	Yes	Yes -Reverse in-part, Vacate in-part (summary judgment) & Remands
(NON-PRECEDENTIAL)	WITOLD A. ZIARNO v. THE AMERICAN NATIONAL RED CROSS	02-1147, -1253	No	No	No
(NON-PRECEDENTIAL)	KENSEY NASH CORPORATION and ST. JUDE MEDICAL, INC. and SHERWOOD MEDICAL COMPANY and TYCO INTERNATIONAL (U.S.) INC. v. PERCLOSE, INC.	02-1149	Yes	No	No -Fed. Cir. agreed with claim construction
(NON-PRECEDENTIAL)	SYSTEMS DIVISION, INC. v. TEKNEK LLC	02-1229	Yes	Yes-Construction not really reversed, but noted as incorrect	Yes-Vacated Remanded
(NON-PRECEDENTIAL)	KIS, S.A., PMI PHOTOMAGIC, LTD., and IMAGE DYNAMICS, LLC v. FOTO FANTASY, INC. (doing business as Fantasy Entertainment, Inc.) and AMERICAN PHOTO BOOTHS, INC.	02-1253, -1254	Yes	Yes	Yes-Vacated Remanded
(NON-PRECEDENTIAL)	PHONOMETRICS, INC. v. CHOICE HOTELS INTERNATIONAL, INC.	02-1360	No	No	No
(NON-PRECEDENTIAL)	DONALD W. NUTTING, an individual doing business as Foothills Distributing Co. v. RAM SOUTHWEST, INC., doing business as Violets, and RON SHEPPEARD	02-1361	No	No	No
(NON-PRECEDENTIAL)	JOSEPH PASTORE v. STRUCTURE GUARD INC. and FLORIDA POWER AND LIGHT COMPANY	02-1381	No	No	No
(NON-PRECEDENTIAL)	MARLOW INDUSTRIES, INC. v. IGLOO PRODUCTS CORP	02-1386	No	No	No
(NON-PRECEDENTIAL)	VERSA CORPORATION v. AG-BAG INTERNATIONAL LIMITED	02-1416	Yes	Yes	No
(NON-PRECEDENTIAL)	T.F.H. PUBLICATIONS, INC. v. HARTZ MOUNTAIN CORPORATION	02-1460	Yes	No	No
(NON-PRECEDENTIAL)	RANDY WILLIAMS, Chapter 7 Trustee for the Estate of Lana Davis-Johnson, and JEFFREY W. JOHNSON v. GENERAL SURGERICAL INNOVATIONS, INC. and TYCO INTERNATIONAL, LTD., and ORIGIN MEDSYSTEMS, INC.	02-1474	No	No	No
(NON-PRECEDENTIAL)	GLAXO GROUP LTD. and SMITHKLINE BEECHAM CORPORATION v. APOTEX, INC.	02-1492	Yes	No	No
(NON-PRECEDENTIAL)	JOHN B. ADRAIN v. HYPERTECH, INC.	02-1514	Yes	Yes	Yes - Reversed and Remanded.
(NON-PRECEDENTIAL)	GARRY L. CAPUTO v. SEALED AIR CORPORATION (US)	02-1556	Yes	No	No
(NON-PRECEDENTIAL)	MORRIS REESE v. U.S. WEST, INC., U.S. WEST DEX, INC., and U.S. WEST COMMUNICATIONS, INC. v. NORTEL NETWORKS INC. (formerly known as NORTHERN TELECOM INC.), and LUCENT TECHNOLOGIES INC.	02-1539	Yes	No	No
(NON-PRECEDENTIAL)	YOON JA KIM v. THE EARTHGRAINS COMPANY	03-1047	No	No	No

in the litigation. Today, the uncertainty inherent in the manner in which *de novo* review of *Markman* rulings takes place has created a widely held belief in the business and user community that the outcome of patent cases cannot be determined until after the Federal Circuit has ruled on claim construction. The Federal Circuit, the argument goes, has created a morass of confused and contradictory claim construction canons. As the court said in *Illinois Tool Works:*

> The Federal Circuit's enthusiasm for dictionary definitions as a means of determining the proper scope and meaning of a claim illustrates the conundrum that claim construction can pose for the courts. The blackletter law of patent analysis presents a clear hierarchy of authority: the court should consider first the claim language, then the remaining intrinsic evidence, and, thereafter, in limited circumstances, extrinsic evidence. *See, e.g., Interactive Gift*, 231 F.3d at 866. Yet cases like *Texas Digital* suggest that the court should begin its claim construction by looking to a dictionary. This apparent paradox recalls the oft-cited decision of *Autogiro Company of America v. United States*, 384 F.2d 391, 397 181 Ct. Cl. 55, 155 U.S.P.Q. 697 (1967), wherein the predecessor to the Federal Circuit, the U.S. Court of Claims, noted with exasperation that "[p]atent law is replete with major canons of construction of minor value," and concluded that, despite previous judicial decisions to the contrary, claims "cannot be clear and unambiguous on their face. A comparison must exist." Similarly, while the doctrine of claim construction urges courts to limit their analysis to the claim language itself, the practice of claim construction requires the courts to refer to intrinsic and extrinsic evidence to determine the proper meaning of a term. This reality raises confusion as to how and when a court should consult evidence other than the claim language.[3]

Statistics about reversal rates are not the whole story and, when the merits of any individual case are considered, are irrelevant. As many who defend the work of the Federal Circuit say, their job is to decide the case right, not decide it in accord with a statistical model. The job of the judge is to "do the *right* thing," they say, not to do the *predictable* thing.

Yet the same was true before the Federal Circuit was

STATUS	CASE NAME	Number	Was Claim Construction at issue?	Was one or more claim constructions reversed?	Did it impact the result?
(NON-PRECEDENTIAL)	BELL COMMUNICATIONS RESEARCH, INC. (now known as Telcordia Technologies, Inc.) v. FORE SYSTEMS, INC. (now known as Marconi Communications, Inc.)	02-1083, -1084	Yes	Yes	Yes - Vacated Remanded
(NON-PRECEDENTIAL)	J.G. PETA, INC. (doing business as Coverall Manufacturing) v. CLUB PROTECTOR, INC., and WILLIAM T. HELD	02-1127,-1128	Yes	No	No
(NON-PRECEDENTIAL)	Deere & company v. The toro company	02-1136	Yes	Yes	Yes - Reverse summary judgment as to non-infringament - Remanded
(NON-PRECEDENTIAL)	RICHARD LOPES v. HARDWARE DISTRIBUTORS, LTD. and R.C. RUBBER COMPANY, and JEFF WAYTASHEK	02-1146	No	No	No
(NON-PRECEDENTIAL)	WILLIAM FREDERICK ROBINSON and ROSA ROBINSON and WILLIAM HENRY ROBINSON II v. FAKESPACE LABS, INC.	02-1152	No	No	No
(NON-PRECEDENTIAL)	XEROX CORPORATION v. 3COM CORPORATION, U.S. ROBOTICS CORPORATION, U.S. ROBOTICS ACCESS CORP., and 3COM COMPUTING, INC.	02-1186,-1305,-1321	Yes	No	No
(NON-PRECEDENTIAL)	JAMES P. LOGAN, JR. v. THE ORIGINAL HONEYBAKED HAM COMPANY OF GEORGIA, INC., HONEYBAKED FOODS, INC., and MARY J. SCHMIDT	02-1279	No	No	No
(NON-PRECEDENTIAL)	STEWART LAMLE v. MATTEL, INC.	02-1359	No	No	No
(NON-PRECEDENTIAL)	PHONOMETRICS, INC. v. ITT SHERATON CORP.	02-1417	No	No	No
(NON-PRECEDENTIAL)	NEWSPRING INDUSTRIAL CORPORATION v. SUN GEM PLASTICS ENTERPRISE CO., LIMITED, and BING RONG HSIU and NEW MAYLINE CO., INC., MAYLINE ENTERPRISES, INC., JEN-HSIEN LIU, and GEORGE LI	02-1450	Yes	No	No
(NON-PRECEDENTIAL)	ATLANTIC CONSTRUCTION FABRICS, INC. and GEORGE E. LOGUE, JR. v. DANDY PRODUCTS, INC.	02-1451	Yes	No	No
(PRECEDENTIAL)	PIONEER MAGNETICS, INC. v. MICRO LINEAR CORPORATION	00-1012	No	No	No
(PRECEDENTIAL)	LOCKHEED MARTIN CORPORATION v. SPACE SYSTEMS/LORAL, INC.	00-1310	Yes	No	No
(PRECEDENTIAL)	HOFFMANN-LA ROCHE, INC., and ROCHE MOLECULAR SYSTEMS, INC. v. PROMEGA CORPORATION	00-1372	No	No	No
(PRECEDENTIAL)	BIOGEN, INC. v. BERLEX LABORATORIES, INC. and SCHERING AG	01-1058, -1059	Yes	No	No
(PRECEDENTIAL)	MOBA, B.V., STAALKAT, B.V. and FPS FOOD PROCESSING SYSTEMS, INC. v. DIAMOND AUTOMATION, INC.	01-1053, -1083	Yes	Yes	Yes - AFFIRMED-IN-PART, REVERSED-IN-PART, and REMANDED
(PRECEDENTIAL)	AMGEN INC. v. HOECHST MARION ROUSSEL, INC. (now known as Aventis Pharmaceuticals Inc.) and TRANSKARYOTIC THERAPIES, INC.	01-1191, -1218	Yes	No	No

created. The commentators who criticized the Eight Circuit for never holding a patent valid, or other circuits for never holding a patent invalid, did not question the integrity or sincerity of the members of those courts. Everyone assumed that each judge in each case was trying to "do the right thing" and that their decisions reflected their true beliefs that the outcomes they reached were, indeed, "right." The statistical arguments about the performance of the Federal Circuit today are as valid—or invalid—as the statistical arguments were about the regional circuits. The regional circuits were criticized as disserving the public interest. Despite their trying to "do the right thing," they were replaced.

There is a doctrine in the law called *res ipsa loquitur,* "the thing speaks for itself." The phrase may have significance here. District court judges, so highly talented in assessing facts, evaluating witnesses, judging credibility, and sifting through complex and difficult arguments in areas of law with which they are unfamiliar, simply cannot be the "doing the *wrong* thing" nearly half the time. We need to find a way to make the *Markman* process more predictable. We need to find a way to make footnote 17, so charming in its prose but damning in its point, an anachronism. We need to fix the law of claim construction.

Endnotes

1. *See* "Is Markman Right?," *Chair's Bulletin* (Nov 2002); www.abanet.org/intelprop/nov02chair.html.

2 A table listing each of these more recent cases is published with this article. When combined with the prior table all of the Federal Circuit cases from 2003 in which claim construction was at issue are listed and analyzed. I am indebted to my colleague, William Allen, for assisting with this research.

3 Illinois Tool Works, 250 F. Supp. 2d at 483–84. The ABA Section of Intellectual Property Law has implicitly criticized the decision in Texas Digital Systems, Inc. v. Telegenix, Inc., 308 F.3d 1193 (Fed. Cir. 2002). Resolution 604-1, passed at the recent

STATUS	CASE NAME	Number	Was Claim Construction at issue?	Was one or more claim constructions reversed?	Did it impact the result?
(PRECEDENTIAL)	LACKS INDUSTRIES, INC. v. MCKECHNIE VEHICLE COMPONENTS USA, INC. (doing business as Thompson International), and HAYES WHEEL INTERNATIONAL, INC. (now known as Hayes Lemmerz International, Inc.)	01-1371, -1395, -1396	Yes	No	No
(PRECEDENTIAL)	RAMBUS INC. v. INFINEON TECHNOLOGIES AG, INFINEON TECHNOLOGIES NORTH AMERICA CORP., and INFINEON TECHNOLOGIES HOLDING NORTH AMERICA INC.	01-1449, -1583, -1604, -1641, 02-1174, -1192	Yes	Yes	Yes -Vacates grant of JMOL of noninfringement & Remands
(PRECEDENTIAL)	DR. RAYMOND G. TRONZO v. BIOMET, INC.	01-1585	No	No	No
(PRECEDENTIAL)	ARJUN SINGH v. ANTHONY J. BRAKE	01-1621	No	No	No
(PRECEDENTIAL)	EATON CORPORATION v. ROCKWELL INTERNATIONAL CORPORATION and MERITOR AUTOMOTIVE INCORPORATED	01-1533, 02-1034, -1206	Yes	Yes	Yes-Vacated-in-part, Reversed-in-part, Affirmed-in-part.
(PRECEDENTIAL)	PLANT GENETIC SYSTEMS, N.V. and BIOGEN, INC. v. DEKALB GENETICS CORPORATION	02-1011	Yes	No	N/A -Fed. Cir. agreed with claim construction
(PRECEDENTIAL)	THE REGENTS OF THE UNIVERSITY OF NEW MEXICO v. GALEN D. KNIGHT and TERENCE J. SCALLEN	02-1018, -1019	No	No	No
(PRECEDENTIAL)	NORTHROP GRUMMAN CORPORATION v. INTEL CORPORATION and XIRCOM CORPORATION and 3COM CORPORATION and D-LINK SYSTEMS, INC. and THE LINKSYS GROUP, INC.	02-1024, -1182	Yes	Yes	Yes - Reverse and Remand.
(PRECEDENTIAL)	BOEHRINGER INGELHEIM VETMEDICA, INC. v. SCHERING-PLOUGH CORPORATION and SCHERING CORPORATION	02-1026, -1027	Yes	Yes-Construction not really reversed, but noted as incorrect	No
(PRECEDENTIAL)	RIVERWOOD INTERNATIONAL CORPORATION v. R. A. JONES & CO., INC.	02-1030, -1154	Yes	Yes	No
(PRECEDENTIAL)	INTEGRA LIFESCIENCES I, LTD. and THE BURNHAM INSTITUTE and TELIOS PHARMACEUTICALS, INC. v. MERCK KGaA and THE SCRIPPS RESEARCH INSTITUTE and DR. DAVID A. CHERESH	02-1052, -1065	Yes	No	No
(PRECEDENTIAL)	PANDROL USA, LP and PANDROL LIMITED v. AIRBOSS RAILWAY PRODUCTS, INC., AIRBOSS OF AMERICA CORP., ROBERT M. MAGNUSON, and JOSE R. MEDIAVILLA	02-1057, -1355	Yes	No	No
(PRECEDENTIAL)	WARNER-LAMBERT COMPANY v. APOTEX CORP., APOTEX, INC., and TORPHARM, INC.	02-1073	No	No	No
(PRECEDENTIAL)	THE BOARD OF EDUCATION (for and on behalf of the Board of Trustees of Florida State University), MDS RESEARCH FOUNDATION, INC., and TAXOLOG, INC. v. AMERICAN BIOSCIENCE, INC. (formerly known as VivorX Pharmaceuticals, Inc.) and CHUNLIN TAO	02-1109	No	No	No
(PRECEDENTIAL)	IN RE RICHARD A. BERG, PAUL D. TOMAN, and DONALD G. WALLACE	02-1120, -1160	No	No	No
(PRECEDENTIAL)	MICRO CHEMICAL, INC. v. LEXTRON, INC. (formerly known as Great Plains Chemical Co., Inc.)	02-1121	No	No	No
(PRECEDENTIAL)	IN RE LANCE G. PETERSON and IOANNIS VASATIS	02-1129	No	No	No

business meeting of the Section, opposes in principle any court's reliance on dictionaries in construing or interpreting disputed portions of a patent claim "unless (a) that material has been made part of the record and (b) the parties have had a full and fair opportunity to address, challenge, or rebut that material." It thus opposed the Federal Circuit's endorsement of the sua sponte use by trial and appellate courts of dictionaries, encyclopedias, and treatises as a primary basis for interpreting patent claim terms. Section members Rich Beem and Phil Swain worked hard to bring the matter to a head this year as the Section Officers had recommended it not come before the membership for debate this year.

STATUS	CASE NAME	Number	Was Claim Construction at issue?	Was one or more claim constructions reversed?	Did it impact the result?
(PRECEDENTIAL)	OAKLEY, INC. v. SUNGLASS HUT INTERNATIONAL, LENSGRAFTERS, INC., RAY BAN SUN OPTICS, LUXOTTICA GROUP S.P.A., and LEONARDO DEL VECCHIO	02-1132	Yes	No	No
(PRECEDENTIAL)	ALTIRIS, INC. v. SYMANTEC CORPORATION	02-1137, -1138	Yes	Yes	Yes -Vacate (summary judgment) & Remands
(PRECEDENTIAL)	BROOKHILL-WILK 1, LLC v. INTUITIVE SURGICAL, INC.	02-1145	Yes	Yes	Yes - Reversed and Remanded.
(PRECEDENTIAL)	MICRO CHEMICAL, INC. v. LEXTRON, INC. and TURNKEY COMPUTER SYSTEMS, INC.	02-1155	No	No	No
(PRECEDENTIAL)	PRIMA TEK II, L.L.C. and SOUTHPAC TRUST INTERNATIONAL, INC. v. POLYPAP, S.A.R.L., PHILIPPE CHARRIN, and ANDRE CHARRIN	02-1164	Yes	Yes	Yes -Vacate (summary judgment) & Remands
(PRECEDENTIAL)	FLEUR T. TEHRANI, Ph.D., P.E. v. HAMILTON MEDICAL, INC. and HAMILTON MEDICAL, A.G.	02-1177, -1178, -1227	Yes	Yes	Yes - Vacated and Remanded.
(PRECEDENTIAL)	ALAN WANER v. FORD MOTOR COMPANY	02-1184, -1185	Yes	Yes	Yes - Affirmed-in-part, Reversed in-part.
(PRECEDENTIAL)	BIO-TECHNOLOGY GENERAL CORP. v. DURAMED PHARMACEUTICALS, INC.	02-1195	Yes	Yes	Yes - Reversed and Remanded.
(PRECEDENTIAL)	INVITROGEN CORPORATION v. BIOCREST MANUFACTURING, L.P., STRATAGENE HOLDING CORPORTION and STRATAGENE, INC.	02-1207, -1260	Yes	Yes	Yes - Vacated and Remanded.
(PRECEDENTIAL)	INTEL CORPORATION v. VIA TECHNOLOGIES, INC., a California Corporation, VIA TECHNOLOGIES,INC., a Taiwain Corporation	02-1212,1213	No	No	No
(PRECEDENTIAL)	DURO-LAST, INC. v. CUSTOM SEAL, INC.	02-1218, -1262	No	No	No
(PRECEDENTIAL)	STORAGE TECHNOLOGY CORPORATION v. CISCO SYSTEMS, INC. and CISCO TECHNOLOGY, INC. and LEVEL ONE COMMUNICATIONS, INC.	02-1232	Yes	Yes	Yes - Affirmed-in-part, Vacated-in-part, and Remanded.
(PRECEDENTIAL)	DARREL A. MAZZARI and MICHAEL T. SHEEDY v. James E. Rogan, DIRECTOR, PATENT AND TRADEMARK OFFICE	02-1269	No	No	No
(PRECEDENTIAL)	BRISTOL-MYERS SQUIBB COMPANY v. RHONE-POULENC RORER, INC., RHONE-POULENC RORER, S.A. and CENTRE NATIONAL DE LA RECHERCHE SCIENTIFIQUE RHONE-POULENC RORER, INC., RHONE-POULENC RORER, S.A. and CENTRE NATIONAL DE LA RECHERCHE SCIENTIFIQUE v. BRISTOL-MYERS SQUIBB COMPANY	02-1280, -1281	No	No	No
(PRECEDENTIAL)	PARADISE CREATIONS, INC. v. U V SALES, INC.	02-1283	No	No	No
(PRECEDENTIAL)	APEX INC. v. RARITAN COMPUTER, INC.	02-1303	Yes	Yes	Yes - Vacated and Remanded.
(PRECEDENTIAL)	SPRINGS WINDOW FASHIONS LP, SHADE-O-MATIC LTD, and MANOR TEC, INC. v. NOVO INDUSTRIES, L.P.	02-1309, -1347	Yes	No	No
(PRECEDENTIAL)	PHONOMETRICS, INC. v. WESTIN HOTEL CO.	02-1314	Yes	No	No
(PRECEDENTIAL)	SILENT DRIVE, INC. v. STRONG INDUSTRIES, INC. and BROOKS STRONG	02-1329	No	No	No
(PRECEDENTIAL)	ABBOTT LABORATORIES and FOURNIER INDUSTRIE ET SANTÉ and LABORATOIRES FOURNIER S.A. v. NOVOPHARM LIMITED	02-1387	Yes	No	No
(PRECEDENTIAL)	ALLERGAN, INC. and ALLERGAN SALES, INC. v. ALCON LABORATORIES, INC., ALCON RESEARCH, LTD., and ALCON UNIVERSAL, LTD. and BAUSCH & LOMB INCORPORATED	02-1449	No	No	No
(PRECEDENTIAL)	ANTONBAUER, INC. and ALEX DESORBO v. PAG, LTD.	02-1487	No	No	No
(PRECEDENTIAL)	DAYCO PRODUCTS, INC. v. TOTAL CONTAINMENT, INC.	02-1497	Yes	Yes	Yes - Vacated and Remanded.
(PRECEDENTIAL)	RF DELAWARE, INC. v. PACIFIC KEYSTONE TECHNOLOGIES, INC., BCA INDUSTRIAL CONTROLS (1998) LIMITED, CLEAR WATER TECHNOLOGIES, INC., and MICHAEL MORRIS	02-1508	Yes	Yes	Yes - Reversed and Remanded.
(PRECEDENTIAL)	RF DELAWARE, INC. v. PACIFIC KEYSTONE TECHNOLOGIES, INC., BCA INDUSTRIAL CONTROLS (1998) LIMITED, CLEAR WATER TECHNOLOGIES, INC., and MICHAEL MORRIS	02-1508	Yes	Yes	Yes - Reversed and Remanded.

The Madrid Protocol

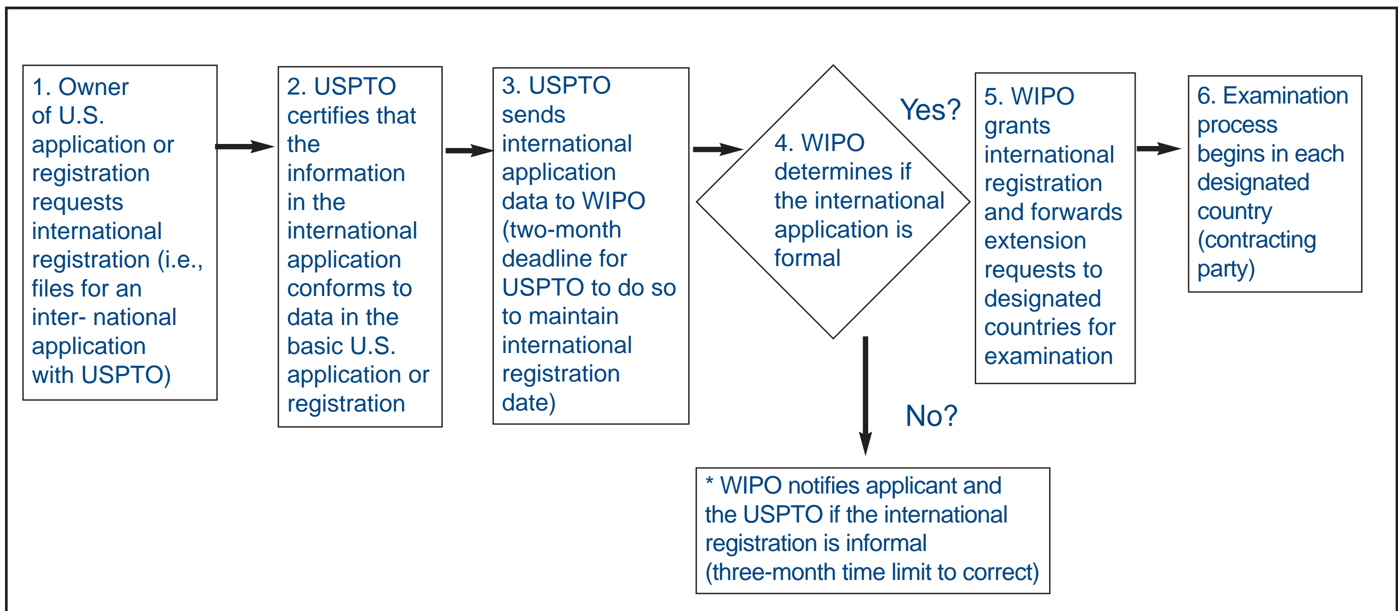
Sea Change or Tempest in a Teapot?

BY PAUL KILMER

Paul Kilmer

The Madrid Protocol (Protocol)[1] has been held out as a way for trademark owners to extend protection to almost sixty[2] nations in a cost-effective one-stop process. Because it is likely that U.S. regulations implementing the Protocol will go into effect on November 2, 2003,[3] trademark owners will soon have the option of using this device to extend their protection abroad.

Ideally, the procedure under the Protocol is for a trademark owner to file an application[4] in its home country[5] and then ask that the application be sent to the International Bureau (at the World Intellectual Property Organization, WIPO)[6] for international registration and subsequent "extension" to some or all of the nations that have implemented the Protocol.



In the flowchart above,[7] the Madrid Protocol process from the perspective of U.S. applicants would look like this:

If effective, the Protocol will produce substantial cost savings over the current system, which consists of filing "national" applications in each nation or group of nations (such as the European Community) where protection is desired. However, the Protocol may not always be the best way to obtain international trademark protection and poses some significant risks for trademark owners, and these risks are not generally featured in the promotional materials from WIPO or the U.S. Patent and Trademark Office.

Before embarking on a critique of the pitfalls of the Madrid Protocol, it is useful to appreciate its nomenclature:

1. Basic application: This is the home-country application that must be filed *before* the applicant can take advantage of the Madrid Protocol system.[8] In the U.S. this will be either the garden variety "use" or "intent to use" application provided for under the current Trademark Act.[9]

2. Basic registration: This is the home-country registration.[10] Under the Madrid Agreement,[11] someone who wishes to take advantage of the system needed a "basic registration." Under the Madrid Protocol, one may rely upon either a basic application or a basic registration.[12]

3. International application: This is the application filed with the home-country trademark office requesting that particulars regarding one's basic application or basic registration in the home-country be used as the basis for filing with WIPO and for requesting that WIPO issue an international registration (defined below).[13] As currently envisioned by the USPTO draft regulations, all international applications emanating from the United States will need to be filed electronically through the Trademark Electronic Application System (TEAS).[14]

4. International registration: When WIPO receives the international application, WIPO ensures that all formalities are met (there is no substantive examination by WIPO for things such as conflicts with existing international registrations), and WIPO then notifies those Madrid Protocol member nations where protection is desired that extension protection is requested by the applicant.[15]

5. Extension protection: This is the protection one receives in each nation after successful examination under

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its laws and regulations. Therefore, each nation in which extension protection is desired will receive an extension request from WIPO, with particulars of the international registration, and each nation will then decide if the mark is eligible for protection in that country.[16] It is not really a "registration" under the local laws and regulations of the individual countries because protection of the mark claimed continues to depend on the existence of the international registration.[17]

I. Possible Pitfalls

Although the Madrid Protocol system may work well and save costs for many trademark owners, there are pitfalls that should be taken into consideration in making the decision whether to pursue a series of national or regional applications or use the Protocol process.

A. Description of Goods and Services

In the United States, the goods or services in a trademark or service mark application must often be described in almost painful detail. In most instances, changes in the description of goods or services in the U.S. application will result in identical changes to every "extension" application filed through the Protocol mechanism.[18] However, if "national" applications are filed instead, a number of nations will accept very broad claims of goods and services, thus giving the trademark owner greater protection in those countries.

B. Central Attack and Dependency

All of the extension filings under the Protocol remain dependent upon the continued existence of the "home country" filing for five years.[19] If the home country application does not attain registration or the home-county registration is canceled or successfully challenged (so-called central-attack) by an opposition or cancellation proceeding filed within the five-year term, *all* of the "extension" filings are nullified.[20]

Under the Protocol, there is the possibility of transforming the extension filings to new national applications.[21] This conversion or transformation process will incur additional costs that eliminate any savings the trademark owner reaped under the Protocol.[22]

If the transformation application is filed within three months of the date on which the international (WIPO) registration was canceled, the transformation applicant will receive the benefit of the international (WIPO) registration date or the date of recordal of the request for extension of protection with WIPO. Otherwise, the applicant begins the registration process anew.[23]

C. Continued Validity of the International Registration

Any extension protection obtained through the Protocol is completely dependent upon the international registration (at the International Bureau of WIPO) remaining in force.[24] This has *nothing* to do with a "central attack" or the rule regarding five-year dependency of the international registration on the continued validity of the home-country registration, discussed above.

If the trademark owner, through an unintentional oversight, fails to renew its international registration, *all* of its extension protection will terminate. By contrast, the risk of this occurring with a series of national registrations is minimized by the fact that a domestic filing agent will be used in each country and that agent will generally remind the applicant or its outside counsel when maintenance of the national registration is required. This additional "failsafe," as well as "grace periods" in most nations, will generally prevent the loss of rights.

In addition, even if errors are made in maintaining one in a series of national trademark filings, the most that the trademark owner will stand to lose is a single registration in one nation—not a cascading "domino effect" of all of its extension filings being canceled through inadvertent failure to maintain its international registration.

D. Supplemental Register

If the trademark is arguably descriptive, a surname or a geographical reference, there is a risk that it might end up being registered on the U.S. Supplemental Register.[25] Such marks may not be entitled to extension protection under the Protocol,[26] but might have a chance for national registration if filed directly.

E. "Form of the Mark"

Under the Madrid Protocol, the form in which a mark is filed in the applicant's "home country" dictates the form in which it will be extended to all other nations, and the wrong choice can be fatal.[27] For example, the United States is fairly liberal in allowing registration of marks consisting of a single letter or a double-letter combination (for example the simple typed letter "V" has been registered by different parties for "periodical magazines," "protective gloves," "dietary and nutritional supplements," and "chemicals)."[28]

However, many nations will not register single or double-letter marks *unless* they are in color or part of a logo or some other device. Therefore, filing a single letter mark in the U.S. and seeking to extend that filing under the Madrid Protocol may result in refusals of registration by numerous nations.

This problem can often be avoided by making national filings under the rules of each nation's practice (e.g., if a nation will register a single letter mark only if it is in color, a national application can be filed in color there and in black-and-white in the United States).

F. Domestic Representative

If a Protocol extension filing is being handled by outside counsel, there is a risk that communications (including various national refusals of registration) may be directed to the applicant, not its outside counsel.[29] This can lead to loss of rights if official communications are misplaced by the trademark owner or not promptly forwarded to the trademark owner's outside counsel.

G. Updated Mark

Amendments to the form of internationally registered marks is prohibited.[30] However, under the practice in a number of nations, including the United States, amend-

ments of national registrations may be permitted under certain circumstances. Therefore, if your mark (such as a logo) may go through "updating" over time, it may be best to use the national filing systems rather than the Protocol.

II. Beyond the Pitfalls

There are other practice and cautionary notes that may not qualify as pitfalls of the Madrid Protocol system, but nevertheless deserve consideration.

A. National Substantive Examination Rules

The substantive examination rules of each member nation apply to Madrid Protocol filings.[31] Therefore, simply because an applicant has secured an international registration from WIPO does not mean that all requests for extension protection will be accepted by national trademark offices.

B. "Use" Rules

In nations such as the United States that require use of marks within certain prescribed periods of time after registration, those rules will continue to apply to marks granted extension protection.[32] Although all extension protection theoretically has a duration corresponding to that of the international registration, the time periods for proving use may arise from dates corresponding to national extension protection, not the date of the international registration.[33] Thus docketing will take on new complexity for those who choose to rely upon the Madrid Protocol system.

C. Time Periods for Examination and Opposition

The USPTO will have only eighteen months after the date on which WIPO transmits an extension request to: (a) notify WIPO of a refusal of registration; or (b) notify WIPO of the filing of an opposition or the possibility that an opposition may be filed after the end of the 18 month period.[34] All grounds for opposition must be submitted within seven months after the beginning of the opposition period or within one month after the end of the opposition period, whichever is earlier.[35]

D. Paris Convention Priority May Be Claimed

Applicants using the Madrid Protocol system may rely upon Paris Convention priority.[36]

E. Central Maintenance of International Registrations and Extensions

All renewals of international registrations and extension protection will be made directly with WIPO, not through national trademark offices.[37] WIPO will also be the central filing authority for most assignments and security interests that apply to international registrations and extension filings.[38]

F. Timing Extension Applications

U.S. applicants may decide not to file for extension under the Protocol immediately upon filing the basic application in the USPTO. It may be prudent to await at least the first action in the USPTO to ensure that the basic application will be accepted for registration on the principal register. Because Paris Convention priority may be used under the Protocol system,[39] applicants will have six months from filing at the USPTO to extend their applications and benefit from Paris Convention priority.

G. Additional Extension Requests May Be Made

Not all nations to which extension is desired need to be listed in the first extension request to the USPTO.[40] There are provisions in the draft regulations for "subsequent designation" of extension countries.[41] However, the applicant should consider issues such as filing priority (Paris Convention priority) and the possibility of intervening national rights in determining the list of extension nations to be included in the original extension application.

H. Fee Calculation

Because each nation may set its own fees for extension applications, the math involved can be tricky. Failure to properly calculate fees can lead to loss of rights. For example, in the United States, all fees will need to be paid at the time the international application is requested.[42] Fortunately, WIPO maintains a fee calculator on its website at www.wipo.int/madrid.

I. Electronic Filing with the USPTO

As previously indicated, under the current draft of the U.S. regulations implementing the Protocol, all requests for international applications must be filed with the USPTO through its TEAS (electronic) system.[43] In addition, under the proposed rules, all extensions of time to oppose and oppositions against extension applications filed in the United States must also be made through the USPTO electronic system (ESTTA).[44] Cancellation petitions can apparently still be filed on paper. It should also be noted that under the rules proposed by the USPTO, failure to pay the required fees through ESTTA for all opposers or petitioners in relation to all classes of goods or services challenged will result in no proceeding being instituted.[45] However, for oppositions or cancellations filed on paper, failure to pay sufficient fees will result in the proceeding being instituted only as to the number of classes for which a fee was paid and those classes will be selected by the USPTO in "ascending numerical order."[46]

In view of the foregoing, very careful consideration should be given by trademark owners as to whether to file under the Madrid Protocol rather than through national registration systems.

Endnotes

1. Protocol Relating to the Madrid Agreement Concerning the International Registration of Marks (June 27, 1989).

2. Currently, there are fifty-seven members of the Madrid Protocol. The only existing members in the Western Hemisphere as of this writing are Cuba and Antigua and Barbuda. As of June, 2003, the United States had not submitted its accession document. The European Union is not a member of the Protocol as of this writing, although a number of individual member nations of the EU are Protocol members.

3. The United States will become a member of the Madrid

Protocol either on November 2, 2003 (one year after the effective date of the 21st Century Department of Justice Appropriations Authorization Act, H.R. 2215ENR, 107th Cong., 2d Sess. (2002), to which the Madrid Protocol amendments to the Lanham Act were attached, commonly referred to as the "Madrid Protocol Implementation Act of 2002" (hereinafter MPIA), or the date on which the Madrid Protocol treaty enters into force with respect to the United States, which will be three months from the date on which the U.S. accession document is deposited with the World Intellectual Property Organization. H.R. 2215, § 13403 and Madrid Protocol, art. 14(4)(a).

4. The Madrid Protocol international application (the application sent to WIPO by the USPTO which results in WIPO issuing an international registration which is then extend to other Madrid Protocol Members) may also be based on the USPTO trademark or service mark registration. Madrid Protocol, art. 2(2) and MPIA § 61.

5. The U.S. applicant for an extension application must specify that the applicant is a national of, is domiciled in, or has a real and effective commercial establishment in the United States. *See* MPIA § 61(b) and Rules of Practice for Trademark Related Filings under the Madrid Protocol Implementation Act; Notice of Proposed Rulemaking; Notice of Hearing, 68 Fed. Reg. 15,119–15,138 (Mar. 28, 2003) (to be codified at 37 C.F.R. § 7.11(a)(10)) (hereinafter, Proposed 37 C.F.R. § __).

6. Madrid Protocol, art. 2 and MPIA § 60(9).

7. Derived from: "The Madrid Protocol, The U.S. Perspective," Lynne Greene Beresford, Deputy Commissioner for Trademark Examination Policy, USPTO (Mar. 5, 2003).

8. Madrid Protocol, art. 2(1) and MPIA § 60(1). This article uses "home-country" as a shorthand for the requirement that an applicant must be a national of, or domiciled in, or have a real and effective commercial establishment in the country in which the basic application is filed in order to take advantage of the Madrid Protocol system. MPIA §61.

9. 15 U.S.C. § 1051.

10. Madrid Protocol, art. 2(1) and MPIA § 60(2).

11. Arrangement of Madrid for the International Registration of Marks (April 14, 1891). The Madrid Agreement has many of the same features as the Madrid Protocol. However, the United States has refused to join the Madrid Agreement since a home-country registration (as opposed to only an application) is required to apply for extension protection under the Madrid Agreement, only twelve months (as opposed to eighteen months under the Madrid Protocol) are allowed to national trademark offices to process extension requests, national offices cannot charge their own fees to process extension requests and all international application are required to be in French. In addition, there are no provisions in the Madrid Agreement for membership by regional offices (e.g., the Benelux and the EU).

12. Madrid Protocol, art. 2(1).

13. Madrid Protocol, art. 2(2) and MPIA § 60(8).

14. Proposed 37 C.F.R. § 7.11(a).

15. Madrid Protocol, art. 2(1) and MPIA § 60(11).

16. MPIA § 60(6).

17. *See* MPIA § 70(a) and (b).

18. Madrid Protocol, art. 9*bis*(iii) and MPIA §63. This section provides that if at anytime within five years after international registration by WIPO "the basic application or basic registration which is the basis for the international application has been restricted, abandoned, or canceled, or has expired, with respect to some or all of the goods and services listed in the international registration" the USPTO shall so notify WIPO. This provision also applies to changes made in the basic application or basic registration that arise from actions instituted before the expiration of the five year period (e.g., a cancellation begun four years and 364 days after U.S. registration).

19. *Id.* and Madrid Protocol, art. 6(2) and (3).

20. *Id.*

21. Madrid Protocol, art. 9*quinquies*; MPIA § 70(c) and Proposed 37 C.F.R. § 7.31.

22. Proposed 37 C.F.R. § 7.31(b)(3).

23. Madrid Protocol, art. 9*quinquies* and MPIA § 70(c).

24. MPIA § 70(b).

25. 15 U.S.C. § 1091.

26. *See, e.g.*, MPIA § 68(a)(4) and Proposed 37 C.F.R. § 2.47(c).

27. *See* Proposed 37 C.F.R. § 7.11(a)(3), (4) and (5).

28. *See* USPTO Registration Nos. 2,385,133; 2,471,036; 2,320,934; and 2,569,790.

29. *See* MPIA §68(d); Proposed 37 C.F.R. §§ 2.18(d), 2.105 and 2:113; and current 37 C.F.R. §§ 2.24 and 2.119 (published in 67 Fed. Reg. 79,520–79,523 (Dec. 30, 2002)).

30. Madrid Protocol, art. 9*bis*. *See* WIPO, *Protecting Your Trademark Abroad: Twenty Questions About the Madrid Protocol*, at 14 (2001).

31. Madrid Protocol, art. 5 and MPIA § 68.

32. MPIA § 71(a).

33. *Id.*

34. Madrid Protocol, art. 5(b) and (c) and MPIA § 68(c)(1).

35. MPIA § 68(c)(2).

36. Madrid Protocol, art. 4(2); MPIA § 67 and Proposed 37 C.F.R. § 7.27.

37. Madrid Protocol, art. 7 and Proposed 37 C.F.R. § 7.41.

38. Madrid Protocol, art. 9 and art. 9*bis* and Proposed 37 C.F.R. §§ 7.22. Exception to this rule are set forth in Proposed 37 C.F.R. §§ 7.23 and 7.24.

39. Note 35, *supra*.

40. MPIA, § 64.

41. Proposed 37 C.F.R. § 7.21.

42. Proposed 37 C.F.R. § 7.11(a)(9).

43. Proposed 37 C.F.R. § 7.11(a).

44. Proposed 37 C.F.R. §§ 2.101(b)(2) and 2:102.

45. Proposed 37 C.F.R. §§ 2.101(d)(2) and 2.111(c)(2).

46. Proposed 37 C.F.R.§§ 2:101(d)(3)(ii) and 2:111(c)(3)(ii).

Technology Import and Export in Post-WTO China

BY CATHERINE SUN

Catherine Sun

Pre-WTO, China imposed numerous restrictions on foreign-related technology transfer. Burdensome prior approval and registration requirements for importing and exporting technology, compounded by inadequate intellectual property enforcement significantly discouraged cross-border technology transfer to China. The pre-WTO regime also encouraged offshore technology transactions, to avoid, in part, the mandatory regulatory approval and registration requirements and tax liabilities.

Since China signed the agreement to enter the WTO, the laws and regulations governing foreign-related technology transfer have been modified dramatically and continuously. Prior approval was eliminated for most cross-border transactions, and various restrictions preventing effective technology transfer also were lifted. Although intrusive governmental registration and/or approval requirements still apply to some extent, the revised legal framework has generally provided a more liberal technology import and export scheme, with less intervention by the Chinese government. Continued deregulation will be essential for shaping a better and friendlier legal environment, and encouraging high volumes of technology import and export in post-WTO China.

I. Legal Framework Post-WTO

Besides the new laws on patent, trademark, and copyright governing licensing and technology transfer which were modified within twelve and eighteen months of China's WTO accession, following also govern the cross border technology transfer: the 1994 Foreign Trade Law, the Unified Contract Law of 1999, the 2002 Regulations on Administration of Technology Import and Export by the Ministry of Foreign Trade and Economic Cooperation (MOFTEC), 2002 Measures for Administration of the Registration of Technology Import and Export Contracts, the 2001 Notice on How to Adjudicate Disputes on Technology Contracts by the Supreme People's Court, and the 2001 regulations on royalty remittance by the State Administration of Foreign Exchange (SAFE), 2003 Notice on Strengthening Patent Administration in Foreign Trade issued by the MOFTEC and the State Intellectual Property Office (SIPO). Many laws and regulations in this area promulgated in 1985, 1988, and the 1990s were abolished or substantially modified, so foreign companies must conduct even more careful research in evaluating current regulatory requirements.

Specifically, the newest regulations and rules affecting foreign-related technology transfer or licensing issued for the past twelve to eighteen months include:

- *The Regulations on Administration of Technology Import and Export* (adopted by the State Council on October 31, 2001, promulgated on December 10, 2001 and came into force on January 1, 2002)
- *The Measures for Administration of the Registration of Technology Import and Export Contracts* (issued by the MOFTEC on November 16, 2001 and came into force on January 1, 2002)
- *Catalogue of Technology of Which China Prohibits or Restricts the Import* (First Batch) (*promulgated* by the MOFTEC and the State Economic and Trade Commission on December 30, 2001 and came into force on January 1, 2002)
- Catalogue *of Technology of Which China Prohibits or Restricts the Export* (promulgated by *t*he MOFTEC on December 12, 2001 and came into force on January 1, 2002)
- The *Catalogue for Guidance on Foreign Investment in Industries* (issued by the State Development Planning Commission, the State Economic and Trade Commission and the MOFTEC on March 11, 2002 and came into force on April 1, 2002)
- *The Regulations on Guiding the Direction of Foreign Investment* (promulgated by the State Council on February 11, 2002 and came into force on April 1, 2002)
- *Notice on How to Adjudicate Disputes on Technology Contracts by National Intellectual Property Courts* (issued by the Supreme People's High Court on June 19, 2001)
- *Notice on Strengthening Patent Administration in Foreign Trade* (issued by the MOFTEC and the SIPO on December 20, 2002, and came into force on January 20, 2003)
- *The Supplemental Notice Concerning Strengthening Administration for Technology Import Contracts and the Sale and Payment of Foreign Exchange* (issued by the MOFTEC and the SAFE on March 19, 2001)

II. Applicable Transactions

Transactions that are subject to regulatory restrictions can be very extensive under the post-WTO regime. According to Articles 16 and 17 of Chinese Foreign Trade Law, Chapter 18 of the Unified Contract Law, the Supreme Court's 2001 judicial interpretation, and Article 2 of the 2002 Regulations on Administration of

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Technology Import & Export (2002 Regulations), the following transactions may be subject to approval/registration requirements:

- Patent assignment
- Assignment of patent application rights
- Patent licensing
- Assignment of Know-how or trade secrets
- Technical service and other unspecified forms of technology transfer
- Cooperative research and development contracts
- Technology consultancy contracts
- Technical training contracts
- Technology brokerage contracts
- Software importation contracts
- Trademark licensing or assignment combined with patent or non-patent technology

III. Prohibited, Restricted, and Permitted Technology

Under the new regulations, there are three categories of technology: prohibited technology, restricted technology, and permitted technology. No prior approval is needed for licensing or transferring permitted technology, but prior approval must be sought for licensing or transferring restricted technology. No approval can be issued for licensing or transferring prohibited technology. Anything outside the prohibited and restricted categories, by default, falls within the permitted category.

A. Import Prohibited and Restricted Technology

According to the Catalogue of Technology of Which China Prohibits or Restricts the Import (First Batch) issued by the MOFTEC on December 30, 2001, there are twenty-five categories of prohibited technology, ranging from steel mining technology, colored mineral mining technology, chemical technology, petroleum refinery technology, petroleum chemical technology, fire-fighting technology, electricity technology, light industry technology, printing technology, medical technology to construction materials production technology. These categories are numbered from 010101J to 011102J. The numbering is systematic: the first two digits represent the year, the second two digits represent classification, the last two digits represent the technology name, and the letter in the end represents the control level, where J signifies import prohibited and X signifies import restricted.

There are sixteen categories of restricted technology, ranging from biotechnology, chemical technology, petroleum refinery technology, petroleum chemical technology, biochemical technology to currency production technology. These categories are numbered from 010101X to 010601X. Anything that is not in the catalogue, presumably, falls within the permitted category for import purposes.

B. Export Prohibited and Restricted Technology

On December 12, 2001, MOFTEC published a Catalogue of Technology of Which China Prohibits or Restricts the Export. This catalogue is relevant to foreign companies who plan to export products employing such technology from China. The catalogue has an extensive range of prohibited and restricted categories. There are thirty-three categories of prohibited technology, ranging from Chinese medicine, tea manufacturing, to textile technology, among others. These categories are numbered from 980201J to 984405J (J here signifies export prohibited).

There are about 170 categories of restricted technology for export purposes, numbered from 980101X to 984804X (X signifies export restricted). The coverage of the restricted area is fairly broad. Computer- and software-related technology such as computerized technology for processing Chinese characters and certain computer network technology is export restricted.

Both catalogues became effective on January 1, 2002. The catalogues for technology import and export are published by MOFTEC and may be revised from time to time. A foreign company is therefore strongly advised to consult the most up to date catalogues when undertaking technology transfer with a Chinese company. This is preferably being done prior to drafting a technology contract.

IV. Approval

Approval is only applicable to importing or exporting of restricted technology. Because most technology transactions are transferring or licensing technology to China, the scope of import-restricted technology is more relevant to foreign companies than that of export-restricted technology. Before importing restricted technology, the importer must file an Application for Importing PRC Restricted Technology with MOFTEC. The importers could be assignees, licensees, joint venture parties or any other entities that do not have to possess foreign trading rights. Upon receiving the application, MOFTEC examines it together with the Commission for Foreign and Economic Trade (COFTEC), and must make an approval or rejection decision within thirty working days.

The examination covers both trade and technology aspects. The criteria for examining trade aspects are: first, whether the importation of restricted technology will conform to China's foreign trade policy, and second, whether it will comply with China's foreign trade commitments. The criteria for examining technology aspects are: first, whether importation will jeopardize national security or public interest; second, whether it will endanger the life and health of Chinese people; third, whether it will destroy the ecological environment; and fourth, whether it will be consistent with national industry development policy and social development strategy, and promote China's technology progress and interests.

These criteria are broadly and vaguely drafted, and many prove difficult to uniformly implement and consistently interpret. If a targeted technology falls within the restricted category, as a rule of thumb a foreign company should ask whether the importation would be politically correct and economically sound for Chinese people.

Upon approval, the importer will be issued a Proposal for Technology Import License of the PRC. The importer can sign the technology import agreement upon receiving the proposal. After signing the technology import agreement, the importer must submit the proposal, a copy of the agreement and related appendices, and certificates of the parties' legal status to MOFTEC for issuance of a license for technology import. MOFTEC must examine the signed technology-import agreement within ten working days of receiving the application materials. MOFTEC and COFTEC must examine the technology to be imported within thirty working days, and an approval or rejection decision must be made within thirty working days after submission of the relevant documents. If the restricted technology is approved for importation, the importer will be issued a Technology Import License for the PRC.

The underlying agreement then takes effect on the date of issue of the Technology Import License. The Technology Import License is only valid for the specified technology. Should the parties decide to modify the import technology, they must apply for approval all over again. The importer must subsequently arrange for foreign exchange, banking, tax, and customs by presenting the Technology Import License.

V. Registration

Registration is applicable to both permitted technology import and export agreements, as well as restricted technology import and export agreements. Under the new system, the registration does not affect the validity or effectiveness of the underlying technology agreement importing or exporting permitted technology. The technology import registration application form, which eventually will be online at http://info.ec.com.cn, includes the title of the contract, name of supplier, name of technology user, and name of technology recipient. Registration can be done online when the above website is activated. At the time of writing this article, the registration website is still under construction. It only takes three working days to complete the registration, as part of the post-WTO streamlining reform.

However, a contract that contains the following prohibited terms is not registrable:

- Requirements for the transferee to accept tying conditions to the imported technology, including the purchase of unnecessary technology, raw materials, products, equipment, or services.
- Requirements for the transferee to pay for, or undertake obligations related to an expired or invalidated patent.
- Restriction of the transferee from improving transferred technology, or from using the improved technology.
- Restriction of the transferee from acquiring competitive or similar technology from a third party.
- Unreasonable restriction of the transferee's channels or sources for purchase of raw materials, parts and components, products or equipment.
- Unreasonable restriction of the quantity, variety or price of products produced by the transferee.
- Unreasonable restriction of the export channels for products produced by the transferee employing the imported technology.

It is therefore highly advisable not to draft an agreement that obviously contains these prohibited terms. However, under the new system, the registration agency is not required to conduct a substantive review. Thus, the hurdle to registration is substantially lowered, so long as these prohibited terms are not detected through a formality review. However, the specific terms will have to be contested and interpreted in later dispute proceedings, without the safeguard of the registration.

VI. Judicial Review

As a WTO commitment, China must offer judicial review of various administrative functions. Under Article 53 of the 2002 Regulations, approval or registration decisions are subject to judicial review. A dissatisfied foreign party can now bring an administrative action in the People's Courts against MOFTEC, COFTEC, or their respective provincial and municipal field offices, after exhausting applicable administrative remedies.

VII. Term

Pre-WTO, China mandated all technology contracts for a maximum term of ten years. After extensive recent regulatory modifications, the laws and regulations leave the choice of term to the parties, but a patent assignment or licensing agreement should not exceed the patent term, and a copyright assignment or licensing agreement should not exceed the copyright term. A trademark assignment, or licensing agreement, or a trade secret or know-how assignment or licensing agreement technically can be perpetual. But the agreement itself may not explicitly state it will be perpetual, but only employ a term within the validity of the underlying trademark or technology rights (which may be rolled over).

VIII. Royalty

Making royalty payments after the expiration or invalidation of a patent, copyright or trademark is illegal. Otherwise, the parties are free to decide the royalty structure and amount. Although it is likely that there might be "internal" rules regarding royalty rates in various industries "internally administered" by approval or registration agencies, any rejection decision based on an exorbitant royalty under the new system is unlikely to survive judicial review. Due to foreign exchange controls in China, foreign assignors or licensors might have to present registration forms and other documents to a Chinese bank before royalties can be remitted out of China.

IX. Warranty and Indemnification

Articles 24 and 25 of the 2002 Regulations mandate the assignor or licensor to warrant that it is the "lawful holder," or "authorized" assignor or licensor, of the tech-

nology and that the technology is "complete, error-free, valid, and capable of accomplishing contracted technical objectives." Other than this, the parties can freely negotiate warranty clauses.

Accordingly, there is a mandatory indemnification clause. The technology supplier must bear the liability/indemnify the licensee if technology use in accordance with the contract infringes a third party's rights. It is unclear what must be indemnified, presumably financial losses, litigation costs, and attorneys' fees. Foreign suppliers can minimize the liability by arranging a limited liability intermediary to act as the supplier under the technology import contract.

X. Grant Back

Article 27 of the 2002 Regulations mandates that during the validity of the contract, the ownership of improved technology shall be granted to the improving party. So foreign licensors who naturally expect to be granted back the rights and interests of improving technology developed by Chinese licensees, should pay special attention to this provision. Foreign transferors are advised to limit the geographical area of licensed technology and its improvements, and to negotiate a nonexclusive license and an exclusive license outside China on improved technology.

Article 27 is designed to keep improvements from reverting back to foreign licensors, but it may hinder foreign licensors from licensing the most advanced technology to China. Eventually this provision will have to be phased out, replaced by free negotiation by the parties, as it does not promote technology transfer.

XI. Confidentiality

There is a three-party confidentiality commitment. The government employees who are responsible for approving and registering the technology import and export contracts must keep business secrets and know-how received from transferors and/or transferees confidential. Article 26 of the 2002 Regulations mandate that the assignees and licensees shall keep trade secrets and know-how received from assignors and licensors confidential during the validity of the technology contract. However, should the confidential information be publicly disclosed through no fault of assignees or licensees during the validity of the contract, the confidentiality obligation would not be binding.

Unlike the pre-WTO system, the parties now can freely negotiate confidentiality obligations after expiry of the agreement. In another words, the confidentiality obligation can last beyond the term of the underlying technology contract.

Confidentiality is always crucial to a successful technology transaction. Confidentiality requirements should not only be incorporated into and specified in joint venture agreements and/or attached/independent technology transfer contracts, but should also be incorporated into each individual employee's employment agreement, to obtain maximum protection and enforceability.

XII. Arbitration and Governing Law

Transferors can require that transferees agree to foreign governing law and arbitration, ideally in a jurisdiction that is likely to find the above-mentioned prohibited terms reasonable. However, rules of conflict law may from time to time mandate Chinese law as substantive law even though a foreign law is specified in a contract. Ironically, it is very expensive to arbitrate in a jurisdiction where Chinese law has to be testified frequently by experts.

Even if a foreign law is stipulated as governing, the approval and registration agency will still examine whether a contract conforms with Chinese law, before granting a license or registration. As specified in Item 9 of the 2003 Notice on Patent Administration in Foreign Trade, licensing or assigning patents and patent application rights during the importation or exportation of technical equipment must abide by the 2002 Regulations.

Often, the Chinese party does not agree to submit to foreign laws and arbitration. The parties have to be bound by Chinese law. So the contract may incorporate the recommended arbitration clause published by China International Economic and Trade Arbitration Commission (CIETAC) as follows:

> Any dispute arising from or in connection with this Contract shall be submitted to the China International Economic and Trade Arbitration Commission for arbitration which shall be conducted in accordance with the Commission's arbitration rules in effect at the time of applying for arbitration. The arbitral award is final and binding upon both parties.

If a technology transfer contract is an appendix of a joint venture agreement, the Chinese law must govern. In that case, the parties cannot opt for foreign laws for the technology transfer portion.

Post-WTO, China has a faster and more responsive legislation but there is a delay in its implementation. The implementation of post-WTO technology import and export scheme is still at a very early stage, and the practitioners have to rely upon regulations and speculation to predict future development. Predictably, China as a new WTO member will continue to deregulate foreign trade and trade-related technology transfer, so the future will be more liberal and predictable, and China will experience an explosion of incoming technology transfer in the years to come.

New Trademark Regime in Hong Kong Now in Force

BY RODNEY GOH AND LINDSAY ESLER

Rodney Goh

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As of April 4, 2003, a new regime has been introduced for the registration and protection of trademarks in Hong Kong (which remains as a separate jurisdiction from China until the year 2047). The new law, Trade Marks Ordinance (Chapter 559), has resulted in a substantial number of changes in the way Hong Kong businesses can protect and deal with their trademarks. Some of the key issues are:

- Registering a trademark in Hong Kong has become much less expensive. The official fee for filing an application has been reduced and advertising and official registration fees have been abolished. A cost-saving of at least US$525 per mark in official fees has resulted from these changes. Also, as in the United States and other jurisdictions, it is now possible to file a single *multiclass* application for one mark covering more than one class.

- Registration procedures and time limits have been tightened and an applicant will know whether its application will succeed or fail within a shorter time period of time.

The Trade Marks Registry will first examine the application for "formalities," such as whether the application form has been properly completed and if the specification of goods and services is sufficiently clear. An applicant will need to respond quickly because there is a nonextendable two-month deadline for satisfying any deficiency objection raised.

The application will then be substantively examined. The examiner will consider whether the mark is inherently registrable and will check whether any earlier trademarks conflict with the application. Previously, the Trade Marks Registry could raise objections on a larger number of issues. In general, where an official objection is raised, an applicant will only have the opportunity to make one set of written submissions followed by a hearing at the Trade Marks Registry. If the official objection is still maintained after the hearing then the application fails.

Applications that neither encounter substantive objections on registrability nor conflict with prior marks will automatically proceed through to advertisement (this is equivalent to publication in the U.S.) followed by prompt registration if unopposed or if any opposition fails.

All of these changes should enable the speedier handling of trademark applications in Hong Kong. Applications that face no obstacles at all may proceed to registration within a matter of months, while even those applications with serious difficulties should have their outcome known within two years even if a hearing is required.

- The standards of distinctiveness required for the registration of a trademark have been lowered. Applicants who have had difficulties registering their trademarks in Hong Kong in the past may now wish to consider refiling applications for registration of their marks. Similarly, applicants with an existing pending application which has experienced significant problems may convert their application for reexamination under the new law to increase the chances of registration.
- There is no longer any distinction between Parts A and B of the register (which were comparable to registration in the "Principal" and "Supplemental" registers in the United States). All registrations will confer the same uniform rights upon a proprietor in relation to acts of infringement taking place after the coming into force of the new law.
- The period for opposing registration of another party's trademark has been increased from two months after publication to three months. However, only one extension of this deadline for a single two-month period may be obtained. Previously, it was possible to obtain multiple extensions of time for three-month periods. Again, this is aimed at minimizing the time involved in opposition procedures.
- Trademarks that have not been registered in Hong Kong, but that are "well-known" in Hong Kong have been granted additional protection. A party may oppose registration of a mark or bring infringement proceedings against the use of that mark on the grounds that its mark is well-known.
- The definition of what constitutes trademark infringement has been broadened. If a proprietor knows of an infringement, but no steps have been taken to enforce its rights, then the possibility of action should be reconsidered under the new law.
- Trademark owners will need to act promptly to pro-

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Intellectual Property Transactions and the Potential for Antitrust Liability

BY J.C. BECKSTEAD

J.C. Beckstead

I. Introduction

Intellectual property, while probably the second most valuable asset of a company,[1] can also produce liabilities. This article discusses intellectual property in the context of antitrust and presents examples of the types of transactions that can give rise to antitrust liability.

As a threshold point, it should be noted that intellectual property rights do not provide shelter from liability under antitrust statutes.[2] A safe harbor from antitrust liability does not exist under the patent or trademark laws. For instance, the patent statutes explicitly provide that "[n]othing . . . [in the patent statutes] shall be deemed to convey to any person immunity from civil or criminal liability, or to create any defense to actions under any antitrust law."[3] Similarly, the trademark statutes provide that the right to use a registered mark is defective when the mark has been or is "being used to violate the antitrust laws of the United States[.]"[4]

Antitrust statutes attempt to prevent prices and competition from being affected by artificial manipulation of supply and demand.[5] It is at the intersection of supply and demand where the policy goals of antitrust are found. Succinctly, antitrust statutes attempt to ensure that competition in the free market system is maintained in a natural state. It is all about prices and competition.

Actions and agreements that artificially manipulate competition and prices violate antitrust statutes and may lead to enormous liability.[6] For a recent example, consider Microsoft's willingness to settle an antitrust suit with America Online (Netscape) for $750 million.[7] Additional examples of transactions held to violate the antitrust laws are discussed later and include conspiracies to restrain trade, monopolization, vertical restraints, tying, and exclusive dealing.

II. Applicable Law

A. Agency Regulation

Both the Department of Justice and the Federal Trade Commission consider patents, copyrights, trademarks, and "know-how" as being essentially equivalent to other forms of property under the antitrust laws.[8] That is, generally speaking, antitrust statutes do not have special rules peculiar to the analysis of intellectual property. Accordingly, in this context, one can analogize from a non-intellectual property asset to an intellectual property asset fairly easily in a given case.

B. Statutes

The Sherman Act,[9] originally passed in 1890, is the foremost statute in the antitrust genre. The Sherman Act states that "[e]very contract, combination . . . or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal."[10] The Department of Justice enforces the Sherman Act under the direction of the U.S. Attorney General through the several United States Attorneys using the various district courts.

The Clayton Act[11] presents similar elements, making it illegal to "substantially lessen competition or to create a monopoly"[12] and further provides that "[a]ny person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefore in any district court . . . and shall recover threefold the damages by him sustained . . ."[13] The Department of Justice and the Federal Trade Commission (FTC) share jurisdiction under both the Sherman and Clayton Acts, with enforcement being divided along industry lines with jurisdiction provided in the various district courts. Additionally, private parties are allowed to bring suit in district court under section four of the Clayton Act.[14]

The Federal Trade Commission Act[15] (FTC Act) makes "unfair methods" of competition illegal.[16] It is the strict purview of the FTC to bring suit under this Act.[17]

C. Procedural Aspects

Antitrust case law requires that certain procedural aspects be determined prior to, or during, trial. These include a determination that the plaintiff has proper antitrust standing.[18] That is, the plaintiff must demonstrate an injury to an interest protected by the antitrust laws and attributable to the antitrust violation.[19] Economist expert witnesses typically show antitrust injury through financial modeling and trade/industry analysis of competition.

Beyond antitrust injury, a building block of the expert witnesses' testimony centers on the definition given to the product at issue (sometimes an intellectual property product) and the geographic scope given to this product. The definitions given to the product at issue and the geographic scope of the product are ultimately issues for the court to determine and are provided the legal catchphrase of relevant market.[20]

Once the court has determined the "relevant market," it will turn its attention to analyzing the antitrust case using one of two analytical formats.[21] The first format, *per se*,

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concerns itself with the situation where the type of antitrust violation is so well known and egregious that the violation is held to be an automatic violation of the law.[22] The second format, *rule of reason*, requires a balancing of the procompetitive aspects of the case to the anticompetitive aspects of the case.[23]

Beginning with the assertion that one or more of the above-named acts have been violated, if a plaintiff possesses antitrust injury/standing, the court will likely entertain consideration of the plaintiff's cause of action.

III. Transactions Held to Violate the Antitrust Laws

An antitrust plaintiff's cause of action is likely to aver one or more of the following as the nexus of the alleged violation: monopolization, conspiracies to restrain trade, vertical restraints, tying, and/or exclusive dealing. These specific transactions are discussed below.

A. Monopolization (What NOT To Do When Patent Rights Expire)

Monopolization is both a civil and criminal wrong.[24] Monopolization may include outright monopolization,[25] attempted monopolization,[26] exclusionary conduct,[27] predatory conduct[28] and price squeezes.[29]

In antitrust analysis a distinction is drawn between "monopolization" and "monopoly."[30] Monopolization is impermissible. A monopoly, contrastingly, might by permissible simply as a result of "superior skill, foresight and industry" as first noted in *United States v. Aluminum Co. of America* (Alcoa).[31] The distinction between monopolization and monopoly is important to owners of intellectual property because of the fine line between the legal monopoly of patent rights and the civil and criminal wrongs of monopolization.

In Alcoa, the defendant owned a patent for a method of isolating aluminum as a metal in addition to patent rights for the manufacture of pure aluminum.[32] The court held that the defendant held a legal monopoly on the production of aluminum until 1909, when the last of these patents expired.[33] The defendant's conduct subsequent to the expiration of the patents, including attempts to stifle competition, were held to violate the Sherman Act.[34]

Intellectual property owners should learn from this case that the court's definition of "superior skill, foresight and industry" might be the only thing separating them from potentially massive liability. That is, a patent is generally held to fall within the gambit of "superior skill, foresight and industry." To avoid potential liability, however, a company should shun using market dominance to keep a lock on prices and to keep out competition, *particularly after patent rights expire*.

B. Vertical Restraints (Trade Secrets Fail to Justify Resale Price Maintenance)

Vertical restraints of trade generally relate to the manufacturer-wholesaler-retailer "channel" by which goods and services are delivered to the consumer. "Vertical" describes the relationship between different entities in the market process whereby there is often a "reseller" or middleman between the consumer and producer.

Impermissible vertical restraints are often agreements between the product producer and the product distributor. Such agreements are generally characterized as either price restraints[35] or nonprice restraints.[36]

An excellent vertical restraint case in the context of intellectual property concerns the resale price of a drug that was manufactured using a trade secret.[37] The main issue concerned the price arrangement in the contract between the drug maker and the drug retailers who resold the drugs in question, wherein prices were to be maintained at a predetermined level.[38] The defendant unsuccessfully argued that a secret process was akin to a patent and that the only way to recoup the investment in the process was to maintain the price of the drugs sold by the retailers.[39] The Court held that a secret process does not give rise to the same level of protection as that provided by a patent.[40]

The Court also held that restraints on alienation are generally invalid, that the use of resale price maintenance is *per se* illegal, and that those vertical contracts that stifle competition and fix prices are void and unenforceable.[41] For those dealing with intellectual property, this case provides at least two lessons: (1) secretive methods or inventions are not entitled to the broad protection and rights of a patent, and (2) vertical agreements to fix prices are void as against public policy and may expose those engaging in them to *per se* liability.

C. Tying (Trademarks Are Not a Shield to Antitrust Liability)

"Tying," or conditioning the sale of one product to the sale of another, can lead to antitrust liability.[42] For instance, in *Siegel v. Chicken Delight, Inc.*, a chicken franchiser (Chicken Delight) was successfully sued for treble damages by franchisees under the Sherman Act for an illicit tying agreement.[43]

The specific agreement required participating franchisees to purchase chicken cookers, fryers, packaging products, and mixes for the creation of chicken products with the Chicken Delight trademark. Chicken Delight unsuccessfully argued that its trademark, for the purposes of preservation of distinctiveness, uniformity, and product quality, required the tying agreement.[44] On appeal, the Ninth Circuit held that "[o]ne cannot immunize a tie-in from the antitrust laws by simply stamping a trade-mark symbol on the tied product—at least where the tied product is not itself the product represented by the mark."[45]

Owners of intellectual property should take the following lessons from this case: (1) tie-in agreements should be carefully structured (or even avoided),[46] (2) trademarks fail to justify tie-in agreements, and (3) franchise (or other contractual agreements) should be based on a percentage of sales for earnings (or something similar) instead of relying upon tied products to determine a profit.

D. Exclusive Dealing (Potential for Liability If a Secondary Market Is Created by Your Patent or Trade Secret)

Because intellectual property is analogous to other forms of property under the *Antitrust Guidelines for the Licensing of Intellectual Property*[47] (promulgated by the

Department of Justice and FTC), it is easy for one to analogize from an agreement involving a non-intellectual property asset to an agreement involving intellectual property. Thus, in the following example, it is quite possible to imagine a situation where the parts used to repair the copiers might either have been patented or derived from a trade secret.

In *Eastman Kodak v. Image Tech. Services, Inc.*,[48] Kodak argued that it could choose not to provide the plaintiffs with replacement parts with which to fix Kodak copiers.[49] On remand, however, the lower court found that Kodak, in an illicit attempt to drive out competition, was liable for more than $70 million in damages on the grounds of abuse of substantial market power in the market for repair of Kodak copiers.[50]

A lesson to take away from this case includes carefully considering (or even avoiding) deals that exclude other market participants, especially, as noted above, in cases where your product creates a secondary market in which you might possess substantial market power (e.g., parts for repair of your own equipment).

E. Conspiracies to Restrain Trade (Potential for Liability If Your Patent or Trademark Licensing Agreement Fixes Prices)

Conspiracies to restrain trade are generally characterized as price-fixing schemes and may include outright agreements to fix prices,[51] tacit agreements to do so,[52] agreements to exchange information,[53] and refusals to deal with those in the marketplace.[54]

As noted earlier and in light of the *Antitrust Guidelines for the Licensing of Intellectual Property*,[55] it is quite simple to analogize from an agreement involving a non-intellectual property asset to an agreement involving intellectual property under the antitrust laws. Thus, in the following example, it is possible to imagine a situation where the conspiracy would involve a patent or trademark license.

In *United States v. Trans-Missouri Freight Ass'n*,[56] an agreement between several railroads was alleged to violate the Sherman Act. The agreement included clauses under which prices would be maintained at a certain level.[57] The Court held that the agreement violated the Act, stating "[c]ompetition will itself bring charges down to what may be reasonable, while, in the case of an agreement to keep prices up, competition is allowed no play."[58]

In the intellectual property context, lessons to be learned from this case include avoiding any type of agreement with competitors (even collegial competitors) that sets the price of patented products in any fashion outside the parameters of competition. While an individual firm or company may generally choose to charge as much as they want for a product (whether or not that product is patented), entering an agreement with competitors or suppliers/resellers where prices are not set by the market can lead to enormous *per se* liability.

IV. Conclusion

It cannot be stressed enough that antitrust liability can be huge. The antitrust arena is replete with many cases involving huge sums. As noted in the introduction to this article, Microsoft recently settled allegations of civil antitrust violations for $750 million, an indisputably large amount of cash. This amount grows exponentially larger, however, when considering that the plaintiff (AOL-Netscape) is only a single party and that Microsoft has spent many millions more – potentially even billions – on settlements with other plaintiffs.[59]

This article has provided rudimentary exposure to the types of deals that one should carefully structure or altogether avoid in transactions involving intellectual property. The name of the game is to avoid liability. Structuring agreements properly to avoid potential liability requires an understanding of the distinctions between permissible activity regarding the use of intellectual property and impermissible activity that might lead to antitrust litigation.

Endnotes

1. A company's most valuable assets are the employees. Without employees, products—including intellectual property—cannot be produced.

2. *See, e.g.*, 35 U.S.C. § 211 (2000) (as to patents); and 15 U.S.C. § 1115(b)(7) (as to trademarks).

3. *Id.*

4. *Id.*

5. Economic analysis of the antitrust laws remains as probably the most coherent explanation for their necessity. *See, generally,* Phillip Areeda & Herbert Hovenkamp, An Analysis of Antitrust Principles and Their Application Vol. 1, Part 1, Chapter 1, ¶ 112 (2000).

6. *See generally,* Charles Goetz & Fred McChesney, Antitrust Law (1st ed. 1998).

7. John R. Wilke, Julia Angwin and Robert Guth, *Microsoft and AOL Settle Claims; Companies Pledge Collaboration*, Wall St. J. (May 30, 2003) at http://online.wsj.com/article/0,,SB10542388475007100,00.html. While involving copyright and/or "know-how," this example is analogous to all forms of intellectual property.

8. Department of Justice and Federal Trade Commission, *Antitrust Guidelines for the Licensing of Intellectual Property* (Apr. 6, 1995) at www.usdoj.gov/atr/public/guidelines/ipguide.html.

9. 15 U.S.C. § 1-7 (2000) (originally passed in 1890).

10. 15 U.S.C § 1 (2000).

11. 15 U.S.C. § 12-27 (2000) (originally passed in 1914).

12. 15 U.S.C. § 13 (2000).

13. 15 U.S.C. § 15 (2000).

14. *Id.*

15. 15 U.S.C. § 41–45 (2000) (originally passed in 1914).

16. 15 U.S.C. § 41(2000).

17. In doing so, the five Commissioners of the FTC vote. A majority is able to bring a complaint. This complaint first goes to an Article 1 administrative law judge. The Commissioners, whose decision may be appealed to any federal Circuit Court of Appeal in the United States, hear appeals from the Article 1 court.

18. The concept of antitrust standing applies to private litigants, not the government. *See generally* n19.

19. *See, e.g.*, Cargill, Inc. v. Monfort of Colorado, Inc., 479 U.S. 104, 116 (1986) ("the antitrust laws do not require the courts to protect small businesses from the loss of profits due to continued competition, but only against the loss of profits from practices forbidden by the antitrust laws"). Accordingly, the failure to make out antitrust injury equates to a failure to make out antitrust standing.

20. *See* United States v. Waste Management, Inc., 743 F.2d 976, 979–82 (2d Cir. 1984) (defining the "relevant market"). In this instance the relevant market centered on trash collection in the Dallas area.

21. Both analytical formats could be papers in their own right.

As our focus concerns the transactions that may give rise to antitrust liability, this paper only provides a gloss on the two predominant analytical formats: (1) *per se* and (2) *rule of reason*. *See generally* nn. 22 and 23.

22. *See, e.g.*, Palmer v. BRG of Georgia, Inc., 498 U.S. 46, 49–50 (1990) (territorial allocations are generally *per se* violations of the antitrust statutes based on anticompetitive effects). In the instant case, Barbri and BRG territorially allocated competition for bar review. The S.Ct. reverses trial and appeals court, saying that territorial allocations are exactly what the Sherman Act is supposed to prevent. Compare and contrast the previous to 35 U.S.C. § 261 (2000), wherein the statute explicitly allows for territorial allocations in patent ownership, assignment and licensing, stating that the "applicant, patentee or his assigns or legal representatives may in like manner grant or convey an exclusive right . . . to the whole or any specified part of the United States." Accordingly, Section 261 is a minor exclusion to the general antitrust rule that territorial allocations among competitors is a *per se* violation of the law.

23. *See, e.g.,* United States v. Addyston Pipe and Steel Co., 85 F. 271, 279–302 (6th Cir. 1898) (characterization by Judge (and later Chief Justice) William Howard Taft, of the differences between "naked" price fixing (per se illegal) and agreements to divide markets that are "ancillary" or "collateral" to an otherwise valid agreement (this being the basis for the modern day rule of reason analysis)).

24. *See generally* n9 (the Sherman Act).

25. *See, e.g.,* United States v. Aluminum Co. of America, 148 F.2d 416 (2d Cir. 1945) (defendant held to have monopolized the aluminum market after expiration of patents). *See* Part II (A) of this article for additional details on this case.

26. *See, e.g.,* Abcor v. AM International, 916 F.2d 924, 26 (4th Cir. 1990) (attempted monopolization requires: i) specific intent, ii) anti-competitive activity designed to further that intent, and iii) a dangerous probability of success).

27. *See, e.g.,* United States v. United Shoe Mach. Co., 391 U.S. 244, 246–52 (1968) (requiring competitors to lease your patented machines (vis-à-vis letting them buy the machines so that competitors may devise around the patents) may be anticompetitive). The lease contracts in the instant case were deemed to be something other than "honestly industrial." Vertical integration (in itself) may be indicative of an intent to monopolize.

28. *See, e.g.,* A.A. Poultry Farms, Inc., v. Rose Acre Farms, Inc., 881 F.2d 1396, 1398–1408 (7th Cir. 1989) (promotional pricing (as in newspaper subscriptions being free or reduced in price to increase circulation) is generally held to not rise to the level of an antitrust violation). The court held in this case that "no price" means "promotion," and thus does not rise to the level of an antitrust violation. To explain somewhat, over time it is expected that the promotional price will eventually lead to a price above any costs, leading to what the court calls "the blended price," or the future price averaged in some way with the promotional price. Plaintiffs need to show predatory pricing to make out § 2 Clayton Act or § 2 Sherman Act violations.

29. *See, e.g.,* Town of Concord v. Boston Edison Co., 915 F.2d 17, 22–23 (4th Cir. 1990) (price squeeze held to not violate antitrust laws because electricity distribution is a regulated industry).

30. Note that the Sherman Act carefully articulates "monopolizing" and "monopolization[,]" but avoids using the term "monopoly." *See* 15 U.S.C. § 1 – 7 (2000).

31. *Aluminum Co. of America*, 148 F.2d at 430.

32. *Id*. at 422.

33. *Id.*

34. *Id.* at 422–46.

35. *See, e.g.,* Monsanto v. Spray-Rite Serv. Corp., 465 U.S. 752, 759 (1984) (price constraint concerned the MSRP of chemicals sold be a distributor; unilateral action, such as a manufacturer telling a distributor that they need to meet the suggested MSRP or they will be dismissed, is generally not held to the level of an antitrust violation; "there is [a] . . . basic distinction between concerted and independent action . . .").

36. *See, e.g.,* Continental T.V. v. GTE Sylvania, Inc., 433 U.S. 36, 42–43 (1977) (the Court held that a locational restriction should be analyzed under the *rule of reason* analytical format).

37. Dr. Miles Med.. Co. v. John D. Park & Sons, 220 U.S. 373 (1911).

38. *Id.*

39. *Id.* at 401–02.

40. *Id.*

41. *Id.* at 402–10.

42. *See, e.g.,* Jefferson Parish Hospital District No. 2 v. Hyde, 466 U.S. 2, 18–45 (1984) (holding that tying is illegal under a modified *per se* analysis). This decision is often described as "muddled", in that the Court holds tie-ins as "*per se*" illegal, but then further requires additional analysis beyond the normal "*per se*" violation. Accordingly, the analysis is much more similar to that of *rule of reason* than *per se*. In any event, tie-ins require inquiries into the following questions. i) Are there two products? ii) Is there economic power with the two products? iii) Is there any justification for the tie-in?

43. Siegel v. Chicken Delight, Inc., 448 F.2d 43 (9th Cir. 1971).

44. *Id.* at 47–8.

45. *Id.* at 52.

46. Consider, for instance, the following comments from a former Assistant Attorney General in charge of the Antitrust Division: "I think it is pretty risky to tie something to a patent or a patented product because of all the cases . . . which make it clear that it doesn't really matter that there are other patents out there, that there are substitute technologies, or substitute products . . . [A] lawyer advising a client should not presume that the courts are going to apply the same kind of rational economic rules to tie-ins that they apply to everything else, particularly in the patent area. I think there is still some risk in terms of tying something to a patented product" (as quoted by CHARLES GOETZ & FRED MCCHESNEY, ANTITRUST L. at 576 (1st ed. 1998) (*citing to* Rule, Patent-Antitrust: Dead or Alive?, 59 ANTITRUST L.J. 755 (1991), at 775). Compare and contrast the previous to the fact that the AG's analysis would place the court at odds with the administrative agencies. *See, e.g.*, Department of Justice and Federal Trade Commission, *Antitrust Guidelines for the Licensing of Intellectual Property* (April 6, 1995) at www.usdoj.gov/atr/public/guidelines/ipguide.html (stating that intellectual property does not automatically create market power). The nuance of legal interpretation as to the differences between the two previous positions may be explained by the holding in *Eastman Kodak v. Image Tech. Serv., Inc.*, 504 U.S. 451 (*see* FN 50 and accompanying text).

47. *See* n8.

48. Eastman Kodak Co. v. Image Tech. Serv., Inc., 504 U.S. 451, 497–98 (1992).

49. *Id.*

50. Image Tech. Servs. V. Eastman Kodak Co*.,* 97 Cal. Daily Op. Service 7197, 97 D.A.R. 11684 (9th Cir. Cal. Aug. 26, 1997).

51. *See, e.g.,* United States v. Trans-Missouri Freight Ass'n*,* 166 U.S. 290 (1897) (*as explained in* Part III (E) of this article).

52. *See, e.g.*, City of Tuscaloosa v. Harcros Chems., Inc., 158 F.3d 548, 563–74 (11th Cir. 1998) (with no direct evidence of any conspiracy, *e.g.*, no record of meetings, phone calls, etc. . ., this type of case is one of the toughest to make out in that Plaintiffs must rely entirely on expert testimony that fulfills the *Daubert* standards and in doing so answers the following questions. Is it something that has been tested outside the courtroom? Is it something that has been subject to a peer review process? What is the potential rate of error? Is it something that has been generally accepted within the field? Daubert v. Merrell Dow Pharms., 509 U.S. 579 (1993)).

53. *See, e.g.,* The Five Smiths, Inc., v. NFL Players Ass'n, 788 F. Supp. 1042 (D.Minn. 1992) (alleged "contract, conspiracy or

(continued on page 44)

The New Technology Transfer Block Exemption

Will the New Block Exemption Balance the Goals of Innovation and Competition?

BY MAURITS DOLMANS AND ANU PIILOLA

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Licensors and licensees have long enjoyed the benefit of block exemption regulations for technology licensing. Block exemption regulations were adopted in the mid-80s for patent licensing and know-how licenses.[1] These were combined and replaced in 1996 by a unified Technology Transfer Block Exemption Regulation (TTBE).[2] This block exemption is currently under review.

DG Competition is writing a draft for a new TTBE. It is expected to be ready for review by the member states in September, and to be published for comments in October. The Commission hopes to have the new block exemption adopted and published in the first quarter of 2004, just before the accession of the new member states and the entry into force of the Regulation 1/2003 on the Implementation of Article 81 and 82 EC.[3]

The review of the TTBE forms part of the wider modernization process including the adoption of the Vertical Restraints Block Exemption Regulation,[4] Guidelines on Horizontal Cooperation Agreements,[5] block exemption regulations on the applicability of Article 81(3) EC to research and development (R&D)[6] and specialization agreements,[7] an updated Notice of Agreements of Minor Importance ("*De Minimis* Notice"),[8] and finally, Regulation 1/2003 on the Implementation of Article 81 and 82 EC.[9]

The new TTBE is expected to reflect more sophisticated economic thinking compared to the current BER, which has been criticized as overly formalistic and legalistic. This would be in line with the new generation of regulations and guidelines, which have moved away from a "straitjacket" approach and provide a more flexible analytical framework.

It may be that the current TTBE does not provide a sufficiently refined regulatory framework for the appraisal of modern complex licensing arrangements. It may be that the new TTBE ought to reflect a more sophisticated economic approach and bring flexibility to the assessment of the competitive effects of technology-licensing agreements. However, one can doubt that the reform is best carried out by imposing market share ceilings and by tightening the rules on territorial restrictions, as the Commission is proposing. Such proposals contribute to maintaining a complex and restrictive regulatory framework. This is worrying, because with modernization, national courts will be asked to make difficult economic assessments that they were not expected to deal with in the past. Moreover, with the accession of the new member states, differences between national economies and prices within the common market are becoming more pronounced.

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I. Framework for Analysis

Before discussing the proposed changes in detail, it is worthwhile to consider the exercise that the Commission has to go through to decide what agreements should be exemptible and what clauses should be excluded. We discuss (a) the compatibility of the goals of intellectual property (IP) law and competition law; (b) criteria to distinguish what clauses are compatible with Article 81(1) and what clauses merit an exemption; and (c) some economic policy considerations.

A. The Compatibility of the Goals of Competition and Intellectual Property Rights

Both competition law and IP law must be seen in the context of the overall objectives of the European Community. The EC Treaty lists the following basic policy considerations, all of which are also relevant for the application of Article 81 EC and which the Commission therefore must take into account in assessing which agreements merit group exemption in the TTBE:

1. Effective competition. Article 3(g) EC calls for "a system ensuring that competition in the internal market is not distorted."[10]

2. Promotion of innovation. Article 3(n) EC lists as an objective equal to that of effective competition and market integration "the promotion of research and technological development." Article 157 EC adds that in the context of industrial policy, the community's and member states' action shall be aimed at "fostering better exploitation of the industrial potential of policies of innovation, research and technological development." This will be relevant in particular for the application of the criteria for exemption in Article 81(3) EC, especially 81(3)(b).

3. Market integration. Article 3 EC of the EC Treaty requires "(c) an internal market characterized by the abolition, as between Member States, of obstacles to the free movement of persons, goods, services and capital"[11] and "(k) the strengthening of economic and social cohesion".

4. Protection of property rights. Finally, Article 30 EC balances the principle of market integration against property protection, stating that restrictions on imports or exports may be allowed if "justified on the grounds of … the protection of industrial and commercial property." Article 295 EC (ex 222) extends this to antitrust law, providing that "*This Treaty shall in no way prejudice the rules in Member States governing the system of property ownership*."

It is now widely recognized that the goals of competition policy, promotion of innovation, and intellectual property laws are complementary and mutually reinforcing.[12] All three serve to promote technical progress to the benefit of consumers.[13] Competition laws are designed to promote consumer welfare by protecting competition as the driving force of efficient markets and innovation. Efficient competition ensures that consumers can benefit from the best quality products at the lowest prices.[14] Intellectual property rights (IPRs) are aimed at creating an incentive to engage in research and development by ensuring a sufficient reward for the innovator.[15]

While the goals are broadly consistent, it is still necessary to make choices, and giving too much weight to any one factor may skew the balance:

- **Excessive IP protection and scope for abuse?** Intellectual property laws strike a delicate balance between granting IP rights that are broad enough to create incentives for innovation, but not so broad as to hamper further improvements by competitors.[16] New and previously unknown IPRs have been and are being created in order to address technical and economic developments (e.g., software copyright, software patents, business patents, *sui generis* database rights, semiconductor topographies, rental and lending rights, satellite broadcasting rights, etc.). At the same time, market players have discovered activities such as "patent mining" (systematic review of a firm's activities to file patents for every conceivable innovation), creation of "patent thickets" (a tangle of overlapping patent claims that is too expensive to cut through)[17] or "patent floods." In the context of standards, a few companies have been tempted to set "patent traps" that they snap shut when the standard is adopted, in order to extract royalties from all implementers.[18] Worse, patent bodies especially in the US, do not properly review patent applications, resulting in the grant of patents on methods as absurd as the "method of swinging sideways on a swing." It is tempting to conclude, as some Commission officials do, that:

> The truth is that, in certain sectors, there has been an enormous growth of IPR protection, whereby applications are often filed to shield existing market positions from competitors rather than to protect innovative efforts (e.g., the filing of "blocking patents"). In such circumstances, the presumption that IPRs safeguard the incentives to innovations may not always stand up against economic reality.[19]

This is worrying. It is the responsibility of the IP community to avoid excesses that could hinder innovation and jeopardize society's support for IP protection.

- **Temptation to apply competition law too broadly?** At the same time, the Commission ought to recognize that the growth of IP is not just the result of abuses, but rather a reflection of the fact that our society and economy are becoming more innovation-oriented and more dependent on addition of "non-material" value to products and services. Also, technology is becoming more complex, and the pace of development and the associated costs are increasing. As a result, IP is becoming more important.[20] There are undoubtedly incidents of abuse, but these should be addressed by sensible IP legislation (or community harmonization), better patent scrutiny, and a proper use of competition law in individual cases. "Patent trap" and "patent thicket" cases are currently pending before the Commission, and these are good opportunities to give signals to the market. If the Commission were influenced by abuse cases in drafting a block exemption, it would risk throwing the baby away with the bath water. The Commission should strike a balance, not strike a blow at the heart of IPRs. It is tempting to use competition law to curb IPRs without having to involve the legislator.[21] As the *IMS* case testifies, the Commission seems to be yielding to this temptation, and it is hoped that the same does not happen in the context of the new TTBE.

- **Too much emphasis on market integration?** One of the core aims of EC competition law is the integration of the common market. This aim is likely to become even more important with the accession of the new member states next year. License agreements must not artificially divide the common markets, but one should be careful not to ignore differences between the economies of the member states. IPRs are territorially defined, and a license to exploit an IPR in country A does not entitle the licensee to engage in exploitation elsewhere. Tightening the rules on territorial restrictions in the new TTBE (e.g., not exempting active sales bans into unlicensed territories that are not exclusively allocated to another licensee, active sales bans between competitors, and all passive sales bans longer than two years) can have unintended side effects. Licensors may be reluctant to grant licenses in new member states if they cannot during at least a transitional period ensure that the licensee concentrates its efforts on developing the local markets. If the result of a license in, say, Poland is that Germany is flooded with cheaper products, the licensor will think twice granting a Polish license at a royalty that is appropriate for the Polish market.

The effect of tightening the exemption for territorial restrictions may be that fewer licenses are granted in the

new member states, or that they are granted against higher royalties than local market conditions would support.

B. Are there Objective Criteria to Apply Articles 81(1) and 81(3)?

It is easy to state that a balance must be struck between the various policy objectives, but difficult to identify objective criteria to determine that balance. The following criteria have been considered:[22]

- **Existence and exercise**. Recognizing the requirement of Article 295 EC (ex 222), the ECJ held that "Whilst the Treaty does not affect the existence of rights … in matters of industrial and commercial property, yet the exercise of those rights may nevertheless, depending on the circumstances, be restricted by the prohibitions contained in the Treaty."[23] On this basis, the ECJ has defined different notions of "specific subject matters," or core bundles of rights, for different IPRs, which define the scope of the right's "existence."[24] So long as a license clause remains within the "specific subject matter" of the IP, it should not be found in breach of Article 81 (although it might be in breach of Article 82 if the firm is dominant and the right is being abused[25]). Several white-listed clauses in the current TTBE are examples of such use within the "specific subject matter" of know-how or patents.[26] The criterion does not, however, provide much guidance for exemption under Article 81(3) of clauses that are outside the specific subject matter of the licensed IP.

- **The U.S. "counterfactual analysis" and emphasis on inter-brand competition**. The U.S. Guidelines for the Licensing of Intellectual Property (U.S. Guidelines) adopt a lenient approach toward intrabrand restraints in licensing agreements, especially when the licensor and licensee are not competitors.[27] The U.S. agencies "will not require the owner of intellectual property to create [intrabrand] competition in its own technology."[28] They take the view that competition concerns generally arise only when the licensing agreement harms competition between companies that would have been competitors in the absence of the license.[29] If the parties are not actual or potential competitors, the license creates competition where there was none before, and this is beneficial even if the license imposes restrictions such as exclusivity. Such restrictions therefore cannot be attacked under competition law (absent foreclosure or unless they facilitate collusion by licensees[30]).

The Commission has reportedly largely rejected the "counterfactual" analysis that the U.S. authorities apply (although remnants are found in the more liberal approach proposed for licensing between noncompetitors).[31] It gives as a reason that EC competition policy attaches higher importance to intrabrand restrictions in general and territorial restrictions in particular. According to the Commission, "It is considered important to protect intra-brand competition as distribution costs make up a substantial part of the end-price of most products and competition between distributors may help to reduce these costs."[32] This approach can be questioned.

First, while vigorous intrabrand competition may well reduce distribution costs,[33] distribution costs are relatively less significant in highly innovative industries compared to the costs associated with R&D activities.

Second, the "counterfactual analysis" is not limited to US law, but also part of EC competition law. In the seminal case of *STM/MBU,* the ECJ held that:

> It is necessary first to consider the precise purpose of the agreement in the economic context… Where an analysis of the said clauses does not reveal the effect on competition to be sufficiently deleterious, the consequences of the agreement should then be considered, and for it to be caught by the prohibition it is then necessary to find that those factors are present which show that competition has in fact been prevented or restricted or distorted to an appreciable extent. The competition must be understood within the actual context in which it would occur in the absence of the agreement in dispute."[34]

Third, as explained, emphasizing territorial integration could have unintended side effects. Such side effects are plausible especially if the TTBE is to be tightened just when new member states join the common market. Territorial restrictions not only to protect against free riding, but (especially if high costs are sunk in R&D) also encourage the licensor to license its technology in the first place.[35] Moreover, considering that the EU has already moved and continues to move towards a single market, the focus of the competition assessment should shift more and more towards protecting dynamic interbrand competition. The Commission seems to want to go the other way.

- ***Proportionality test***. The Commission seems to have chosen for a proportionality test, in part based on Article 81(3)(a). According to this test, clauses are rightly white-listed if they are objectively necessary for the license to be granted.[36] They are exempted if they effectively encourage investment by the licensees and protect them against free riding, and the benefits for interbrand competition outweigh the disadvantages for intrabrand competition.

C. How to Apply the Proportionality Test–Economic Considerations

1. The Bag of Gold at the Finish Line of the Innovation Race

Competition policy in innovative industries is heavily debated. Contrary to mature industries, where new entrants gradually acquire market share, some recent studies point out that in hi-tech sectors characterized by rapid technological progress, high risk, and expensive R&D, ground-breaking firms have the potential to rapidly acquire a significant market share. David Encaoua and Abraham Hollander, for example, argue that in highly innovative industries with network effects, and that are prone to tipping, innovating companies compete *for* the

market rather than *in* the market.[37] Dynamic competition through innovation creates more consumer benefit (better and potentially cheaper products) than price competition fostering mainly allocative efficiencies (cheaper imitations of existing products). Undertakings in innovative industries are constantly in a race to be the first to bring a new product or new technology to the market. Successful entry in new dynamic industries often leads to a rapid replacement of the dominant incumbent. Winning the race does not mean, however, that the new market leader can just sit back and rest on its laurels. Maintaining leadership requires the new market leader to enter a new race immediately.[38] This kind of competition, which is often called "Schumpeterian rivalry," is based on the assumption that competition takes form of a succession of "temporary monopolists" who displace one another after winning each new innovation race.[39]

The incentive to enter the innovation race is the glitter of the bag of gold at the finish line. Consumers tend to regard monopoly profits as exploitative, but Schumpeter and others have argued that they stimulate innovation and are likely to lead to technical advances. They are a proper reward for past innovation and will be invested in follow-on R&D if the leader wants to enter the next race. Without these "surplus" funds, firms would not engage again in risky and costly research activities. Similarly, the possibility of attaining (or the desire of maintaining) a monopolistic position provides an important incentive for newcomers to join the race.

2. Could price competition in the market be good for innovation?

The view that innovation is driven by competition *for* the market rather than competition *in* the market is not shared by all, and will not apply to all markets. Not all markets have network effects, and producers of older products may be evicted from the market only gradually. Some economists (*e.g.* Arrow) note that monopolists already reap monopoly rent and therefore have the ability, but not the incentive, to innovate (except perhaps strategically to deter entry or to expand their market by creating new demand). They believe that in certain markets, competition *within* the product market may well provide incentives to innovate.[40] An evaluation of these theories suggest that at least two different situations should be distinguished:

- "In industries where innovation leads to a small cost reduction … it would be better to aim for low intensity competition. This gives the follower an incentive to leapfrog the technological leader."[41] Increasing intra-brand competition may actually lower the incentive to innovate, because it reduces the ability to recover the fixed costs sunk in incremental R&D. If the R&D is not expected to result in radical cost savings, the expected reward does not come from a dramatically higher market share, but from relatively small marginal increase in the market share in the interbrand market. If the resulting higher returns are eaten away by increased intrabrand competition, however, the incentive to innovate decreases.
- In industries where innovation typically results in major cost reduction, increasing competitive pressure may be appropriate, because it increases the most efficient player's incentive to innovate. By innovating in a competitive market, it can gain market share, push its rival out, and gain monopoly status. The reward for R&D comes from a lower cost structure and a resulting dramatically higher market share. In a noncompetitive market, it already gains supracompetitive profits and therefore has less reason to innovate to evict its rivals.

While the prospect of high returns is needed to provide firms with incentives to engage in risky, uncertain and expensive R&D efforts, vigorous competition can be seen as a driving force behind innovation if the innovation dramatically reduces costs. However, Encaoua and Hollander find that in these sectors, "one is likely to see persistent dominance of a single firm."

Conclusion 1 – Avoid creating artificial intra-brand competition. Competition policy should concentrate on creating interbrand competition rather than creating intra-brand competition. Excessive intervention with the licensor's freedom in markets with incremental innovation could in fact be counterproductive. "Artificial" intra-brand competition (which would not have existed but for the license), reducing prices in the short term, also reduces the attractiveness and increases the risks of new investments, especially if the innovation does not dramatically reduce costs. This is a reason for the Commission to be lenient toward intrabrand restrictions.

Conclusion 2 – The TTBE need not be geared to tipped markets. In markets where innovation results in great cost reductions or radical product improvements, dominance is likely to arise. In such cases, increased competition may foster further innovation, but Article 82 is available in such cases to create competition, and it would therefore not seem necessary to adjust the TTBE to increase intra-brand competition for such sectors. It is better to gear the TTBE provisions to the first category, where there is doubt whether intra-brand competition has a beneficial effect on innovation, and indications of harmful effects. This is especially so if market share ceilings are imposed.

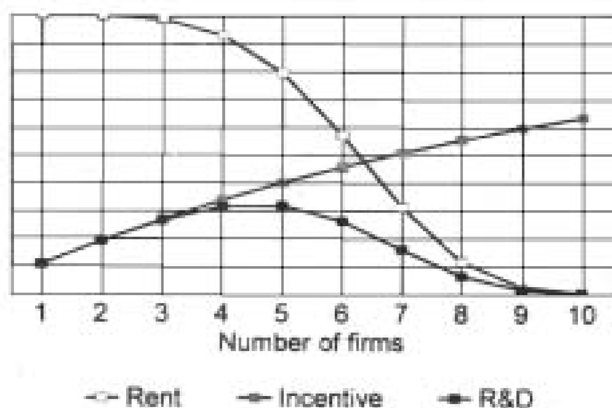
3. How many firms are needed for innovation?

John Barton developed a model to explore the way oligopoly rents and incentives to innovate vary with the number of firms in a market, and what effects that has on actual innovation.[42] He found, quite naturally, that the incentive to innovate increases with the number of firms playing in the market, but that the oligopoly rent decreases and with it, the ability to fund innovation. He concludes that the actual research level is the product of available finance (which is a function of expected oligopoly rent) times the incentive to do research. The optimal is reached where the rent curve begins to fall steeply. Whereas the curves may be different in various sectors (and in particular the rent curve may fall more

quickly), this model suggests that a concentration of four to five firms results in optimal innovation.

Conclusion 3 – Some concentration ceiling could be appropriate, but not if rules on restrictions of intra-brand competition are tightened at the same time. The TTBE should arguably not exempt agreements that reduce the available independent poles of research to a number below four to five. This should not be equated with a market share ceiling of 20 percent to 25 percent. The number of firms includes not only incumbents, but also credible new entrants, whose market share is small but whose promise is significant.

Increasing intrabrand competition by imposing more stringent requirements on exemption for territorial restrictions lowers the revenues of IP owners. Their licensees will compete more vigorously, the royalty



stream will slow down. This reduces available funds for R&D. The "rent curve" will fall more quickly, and the top of the "R&D curve" will as a result move to the left. One can conclude that the TTBE should not both impose a market share ceiling (i.e., insist on more interbrand competition) and at the same time impose more conditions on territorial restrictions (i.e., insist on more intra-brand competition).

4. Focusing on entry and encouraging inter-brand competition

It will be clear from the above that the more firms participate in the innovation race, the greater the incentive to innovate. This is especially important in network markets that might lead to sequential monopolies. Competition should be designed to ensure that there are enough players for each race, and that the incumbent does not artificially exclude new rivals or cancels the race. A monopolist will continue to innovate if there are firms that have the potential to enter the market within a short time at a sufficient scale. Competition policy should therefore prevent raising artificial barriers to entry and prevent exclusionary abuses.

In innovation industries it is even more important to avoid artificial barriers to entry, and to avoid the impression that the antitrust authorities will tolerate exclusionary conduct by the incumbents: Potential entrants consider it profitable to enter a new market only if the entry is expected to lead (within a reasonably short time) to the acquisition of a considerable share of the market.[43]

Conclusion 4 – Fostering interbrand competition and preventing entry barriers. Competition policy should concentrate on preventing the winner of the innovation race from raising barriers to entry in the next race. The TTBE should be tough on restrictions that raise barriers to entry or have an exclusionary effect (such as conduct or clauses preventing a licensee from developing competing technology). This does not mean that, for instance, noncompete clauses should be blacklisted. They may in fact be reasonably necessary in "normal" competitive markets to encourage an adequate exploitation of the licensed technology. Exempting them is appropriate, considering that sequential monopolists will have a market share in excess of the ceiling (see below) and it is possible to attack sequential monopolists under Article 82 if they try to raise barriers to entry.

5. Encouraging voluntary licensing to foster incremental improvements

Licensing to allow new entry. Entry barriers are high if a new entrant with new technology does not possess all the complementary assets needed in the production and distribution of the product. In such a case, technology licensing can make the entry easier. The owner of the new technology does not need to possess all the necessary complementary inputs needed for a successful entry.[44] Licensing—including cross-licensing among competitors—therefore should be encouraged.

An economic model developed by Encaoua and Ulph offers further support for the argument that spreading knowledge fosters innovation.[45] When there is a low degree of diffusion of knowledge in the industry, follower firms are able to innovate only based on their own technology. By doing that, the follower is at best able to catch up with the leader. But when knowledge in the industry, a follower firm may innovate—not solely from its own technological base—but also from the base of the technological leader. The ability to innovate from the current knowledge frontier enables the follower (if its innovative efforts turn out to be successful) to "leapfrog" the leader. Standing on the shoulders of a giant, anyone can look further.

When the diffusion of knowledge is sufficiently high, an increase in competitive pressure increases the speed of development, as the follower has a higher incentive to innovate. When knowledge is not shared, the effect of competition on innovation and growth may become negative, as the follower is unable to win the race for the market by "leapfrogging" the leader.[46] This suggests that knowledge diffusion is crucial for the pace of innovation. Giving adequate incentives to the IPR holders to license therefore becomes an essential objective.[47]

Licensing to increase efficiency. Technology licensing not only encourages new entry, but may also lead to

more efficient exploitation of the intellectual property. The owner of the IP may not be able to make the necessary investments to realize the full value of the IP. Licensing also increases the value of IP to consumers (through reduction of costs and introduction of incremental improvements) and to the developers of new technology (by potentially increasing the expected returns from IP[48]).[49]

Conclusion 5 – Encouraging licensing. If we agree that there is no general obligation to license, IPR owners should be encouraged (but not forced) to license. This applies also to the cross-licensing of competitors. A license imposing restrictions to the use of the license is better than no license at all, and the ability to include restrictions may be necessary to induce the licensor to disseminate its technology in the first place.

6. Protecting Licensees' Investments by Avoiding Free Riders

It is well recognized that some restrictions in the technology licenses are justified to protect the investment of the licensee and prevent free-riding on its investment. The different forms of exclusivity (such as field of use or territorial restrictions) are examples of procompetitive provisions designed to increase the incentives of the licensee to invest in the commercialization and distribution of products embodying the licensed IP.[50]

Restrictions must not go so far as to raise competition concerns. For example, a licensing agreement that divides markets among firms that would have competed on the market using different technologies if no license had been granted is likely anticompetitive. A licensing agreement between competitors has the potential to restrict competition by facilitating coordination between them and leading to, for example, increased priced or reduced outputs.[51] These are examples of situations where competition policy should intervene.[52]

7. Is IP like any other property?

It has been suggested that for the purpose of the competition analysis, intellectual property ought to be treated like any other property. In our view, however, competition analysis should not disregard some important characteristics of the IPRs that distinguish licenses from ordinary vertical agreements such as distribution. There are several differences that merit special attention:

- The fixed costs of IP development by a licensor are greater than the fixed costs sunk by a producer of physical products. This suggests that the TTBE should exempt restrictions reasonably necessary to allow the licensor to recover fixed costs sunk in R&D.
- The risks associated with entering an innovation race are often greater than the risks of manufacturing physical products, especially in markets characterized by network effects before the market has tipped in favor of the IP owner. This argues in favor of allowing the licensor maximum freedom to determine its commercial policy (e.g., by maximum price-fixing if that is needed to reach critical mass quickly).
- New-economy technologies change rapidly and product life cycles are short, requiring a speedier recovery of these higher fixed costs. This suggests again that the TTBE should exempt restrictions reasonably necessary to allow the licensor to recover fixed costs rapidly.
- The ease of misappropriation of the IPR owner's investment is much greater, calling for greater control over the licensee and over the end-user of products such as software.
- The level of investment required of a licensee tends to be greater than that required of a distributor. This justifies a more liberal approach to intrabrand restrictions than in the Vertical Restraints BER.
- Competition laws ought to promote market structures that do not only benefit consumers through lower prices (the emphasis for distribution) but also through bringing more sophisticated products into the markets.[53] This suggests a greater emphasis on inter-brand competition.

We doubt that it is correct merely to harmonize the TTBE with the Vertical Restraints BER. It is probably appropriate that the Vertical Restraints BER concentrates on protecting a distributor's investments. A licensee would merit at least equal protection and probably even more. At the same time, however, the Commission should not ignore the investments of a licensor, which must often sink significant costs in R&D. It seems to make sense to allow licensors a greater scope for, for instance, territorial price discrimination than a supplier of physical products, so as to give it an incentive also to license in countries where it can only recover part of its fixed costs. In the end, the consumer in those countries is likely to have greater access to licensed products at a lower price.

II. The Modernization of the TTBE: What Is Going to Change?

A. An Overview of the Most Important Changes

The Commission issued a report evaluating the TTBE (Evaluation Report) in January 2002. The new draft TTBE has not yet been made public. However, some remarks can be made based on the Evaluation Report and the informal comments made by officials of the DG Competition.

The current TTBE divides the clauses that licensing agreements may contain into four categories: (1) exempted clauses; (2) "white clauses," that generally do not violate Article 81(1) and that can safely be included in the licensing agreement, (3) "black clauses" that are caught by Article 81(1) and that do not benefit from the block exemption,[54] and finally (4) "grey clauses" that are neither exempted nor expressly excluded and the competitive effects of which have to be analyzed case-by-case.[55] This classification of clauses is thought to be formalistic and rigid. The Commission identified five main categories of concerns:

1. Straitjacket. The TTBE was apparently considered

too prescriptive, and according to some commentators worked as a straitjacket that discouraged efficient transactions and hampered dissemination of new technologies. This criticism is arguably exaggerated. After all, the TTBE is merely a "safe harbour." It provides useful guidance, but there is no obligation to comply with it. Non-compliant clauses that merit individual exemption can be (and in practice often have been) included.

2. Narrow scope. The current block exemption is also criticized for being too narrow in scope:

- The TTBE covers only patents (and similar or related IPRs) and know-how. It excluded other forms of IP that were licensed, unless ancillary to the patent or know-how license.
- The TTBE is limited to agreements between two companies. The Evaluation Report discussed the possibility to extend the scope of the block exemption to multiparty licenses and pooling agreements. However, the Commission has recently indicated that this is unlikely to happen.[56]

3. Too restrictive. Some constraints were blacklisted or excluded from exemption without economic justification. These include:

- Noncompete obligations (now considered reasonably necessary to encourage the licensee to dedicate adequate resources to the licensed technology); and
- Tying clauses (which are now considered efficiency enhancing if imposed by nondominant firms).[57]

4. Inconsistent. The TTBE treated other clauses differently even though they had similar effects, e.g.,

- Territorial restrictions and customer restrictions, which both serve to resolve free riding problems, and may both create foreclosure and market division concerns;
- Bilateral patent pools and cross-licenses, which are essentially the same, although the latter was exempted between non-competitors even with territorial restrictions. Bilateral pools between non-competitors should be treated the same.

5. Too liberal. By concentrating on the form of the agreement, the TTBE appeared to exempt agreements that might restrict competition. These include:

- Passive sales restrictions,
- Active sales restrictions between competitors,
- Active sales restrictions into territories not exclusively licensed to other licensees,
- Agreements between parties with a strong market position (even though the TTBE is without prejudice to Article 82 EC, as the ECJ made clear in *Tetrapak*[58]), and
- Arrangements between competitors, which cloak collusion.

In essence, the new TTBE is expected to be more flexible and economically oriented.

Shorter. The white list and grey list will be eliminated, and the exempted list will be generalized and nonexhaustive (although some clauses will be exempted subject to conditions similar to the Vertical Restraints BER). Guidelines will provide information on white-listed clauses.

Broader exemption. Efficiency-enhancing restraints that are currently presumed illegal or excluded from the scope of the TTBE without a valid economic justification will be brought within the framework of the block exemption. This includes customer and output restrictions between noncompetitors, as well as noncompete and tying clauses.

Short blacklist and tighter rules for competitors. Some restrictions that now benefit from the block exemption but do not fulfill the conditions of Article 81(3) EC will be removed from the TTBE. The new block exemption will contain a short list of "hardcore clauses" that are seen to be seriously restrictive of competition. This black list will be harmonized with the Vertical Restraints BER for agreements between noncompetitors and with the Joint R&D and Specialization BERs for agreements between competitors. This means that active sales restrictions are allowed only between non-competitors and only to protect exclusive licensees elsewhere.

Market-share ceilings. Finally, the new regulation is also expected to distinguish between agreements concluded between competitors on one hand and noncompetitors on the other, and introduce a range of different market share ceilings that would limit the licensing agreements that can benefit from the block exemption. Guidelines will discuss the application of Article 81(1) and (3) to agreements above the ceiling.

The annex contains a more detailed overview (including a comparison of the current and the proposed new TTBE) and some comments—although the draft is not yet finished and changes are likely to be made. The current "balance" is as follows:

B. Distinction between Competitors and Noncompetitors

The new TTBE is expected to distinguish between agreements between competitors (horizontal licenses) and licenses between noncompetitors (vertical licenses). There is more scope for negative effect on competition in agreements between actual or potential competitors. Nevertheless, problems arise in this regard. It is not always clear when the parties to a licensing agreement will be regarded as "competitors," especially in circumstances where the licensed process or product presents a sweeping breakthrough or where the IPRs owned by the licensor and the licensee are in mutual blocking position.[59]

Breakthrough innovation. In case of a "sweeping breakthrough," the parties compete in the product market but are unlikely to do so in the future because the new

product will replace existing products. The Evaluation Report indicated that it was planning to treat the licensor and licensee as noncompetitors if the product in question can be considered to represent a sweeping breakthrough. More recently, however, the Commission apparently changed its mind. This seems contrary to the Commission's original intention to adopt a sound economic approach:

- If the new technology is a sweeping breakthrough, the "old" product would disappear, and the licensee would be unable to compete but for the license.
- The licensor might not be willing to license the licensee if it could not impose certain territorial, customer, or output restrictions needed to earn a return on its investment in R&D, and protect its licensees' investments in bringing the product to market. In that case, it might prefer to exploit it itself, leading to less dissemination of knowledge, and possible inefficiencies in exploitation.
- Finally, sweeping breakthroughs could lead to rapid increase of market shares above 20 percent, casting doubt on the enforceability of the license, prejudicing legal certainty.

This situation may arise also if the processes or products do not represent sweeping breakthroughs, for instance, in case of firms that currently compete in the same product market, but that dedicate their R&D efforts to creating next-generation products that are not close substitutes.[60] The firms would be likely to be considered competitors under the new TTBE, even though they would not compete in the future product market (as they compete in the relevant product market of the current products).

Mutual blocking patents. Should parties holding mutually blocking patents be regarded as competitors? According to the Commission, it would be difficult to determine whether patents are legally valid and actually mutually blocking. Treating parties as competitors is supposed to give them an incentive to settle their patent disputes. Finally, it is argued that treating them as noncompetitors would give them disproportional concessions not necessary to solve the mutual hold-up problem.

In our view, treating parties with blocking patents as competitors ignores actual market conditions. But for the license, they would not compete. Either both patents survive, or one of them survives, excluding at least one party from the market. The argument that settlement is encouraged by withholding exemption if the parties have a market share in excess of 20 percent or withholding exemption for territorial, customer, or output restrictions in the license, is incomprehensible. To the contrary, increasing the costs and opportunity costs of the license increases the attractiveness of continuing the litigation in an attempt to exclude the other party altogether. Finally, in *Odin/Metal Box*, a JV case, the Commission recognized that parties that have mutually blocking know-how should not be regarded as competitors.[61] It heralded that case as a sign of the Commission's practical economic approach, and it would be wrong to deviate from that in the TTBE.

The Balance

More Restrictive Than Current TTBE	Neutral	More Liberal Than Current TTBE
Introduction of market share ceilings	White list moved to Guidelines	Extension to software copyright (but not other IPRs…?)
Limitation of territorial restrictions (only exempted for exclusively allocated territories, and not exempted between competitors)	Elimination of opposition procedure	Nonexhaustive list of exempted clauses
Shorter time limit for passive sales ban?	No coverage for multiparty agreements and pools	Elimination of time limits for active sales restrictions on noncompetitors
Blacklisting validity no-challenges (now grey listed)		Exemption of noncompete, customer and output restrictions between noncompetitors and tying

C. Market-Share Ceilings and Associated Difficulties

1. The introduction of a range of market share ceilings

The Commission is planning to introduce several market share ceilings. The Evaluation Report proposed that restrictions relating to the exploitation of intellectual property rights between *noncompetitors* would be exempted up to the level of dominance. The ceiling is now lowered to 30 percent and the distinction between clauses that do or do not relate to the exploitation of IPRs is abandoned. A licensing agreement *between competitors* could only benefit from the block exemption up to the 20 percent (or possibly 25 percent) market share ceiling. This table illustrates the range of market share ceilings that would apply to licensing agreements:

A serious concern is that the application of market share ceilings unduly complicates the block exemption and seriously reduces legal certainty. The calculation of market shares is especially difficult if the definition of market is uncertain, which is a notorious problem in technology and innovation markets. The problem is compounded because the Commission proposes to analyze ceilings in at least two markets: the market of the

product that will be replaced or improved by the licensed technology, and the market for the technology in which the licensed technology competes.

One of the fundamental objectives behind the reform of the TTBE was to reduce complexity and increase legal certainty, so that the provisions of the block exemption can be easily applied by national courts and authorities, whose powers to enforce Article 81 EC will increase in May next year (following the entry into force of the new regulation implementing Articles 81 and 82 EC). Moreover, market share ceilings do not always accurately represent the pro- and anticompetitive effects of the licensing agreements.

Another concern is that market shares are backward-looking, whereas analysis in innovation markets should be forward-looking. A high market share in a market characterized by ongoing innovation may not at all be indicative of power. What matters is not how many firms currently sell products, but how many firms can challenge or contest the licensor's position.

Ceiling	Category of license agreement
Dominance	Application of Article 82
40%	For withdrawal
30%	Restrictions between non-competitors
25%	Licenses between competitors under Reg 1659/2000 on R&D agreements
20/25%	Restrictions relating to licensing agreements between competitors
20%	Agreements under Reg 2658/2000 on specialization agreements
15%	Vertical agreements under the *de minimis* notice
10%	Horizontal agreements under the *de minimis* notice

2. Problems Associated with Delineating Relevant Markets

The definition of relevant product markets is difficult enough for normal products,[62] but can be very complicated in high-technology industries characterized by a high pace of innovation. In such industries, the delineation of markets may not only include a definition of a product market, but may often also require a definition of markets for technology and for research and development (innovation markets). Also, yesterday's market share may be out of date by the time the market share data are available.

The Commission acknowledges the difficulties in defining technology markets and calculating market shares in those markets. To calculate market shares in technology markets the Commission is planning to use the market shares in the product market as a basis. Technology market would then be calculated by combining all the market shares of the products that incorporate the relevant technology. The Commission is unlikely to incorporate provisions on innovation markets into the TTBE due to the difficulties in defining such markets.

The definition of product and technology markets requires information that may not be available or too unclear. As a result, courts (who must apply Article 81 *ex officio* if they are not certain whether the TTBE applies) may be forced to ignore the TTBE simply because the parties do not have the necessary information available. They would have to apply the full force of Article 81(1). This could have serious consequences for legitimate transactions. Even though in the innovative industries the markets cannot be easily defined merely by focusing on substitutes to existing products,[63] predicting the future demand for the licensed technology or products that have not yet been put on the market is an even more challenging exercise.

Encaoua and Hollander conclude that market definition in innovative industries should focus on future products, and suggest that it be based on the degree of overlap between the next-generation products that, based on the estimation at present, can be perceived to emerge from the R&D efforts of different firms.[64] On a theoretical level, this is interesting, but it involves speculation and there are serious doubts as to the ability of the Commission or the national courts and authorities to apply the market share ceilings in practice.

3. Alternative "Technology Center" Approach

An alternative might be the "technology center approach," adopted in the U.S. Guidelines. Section 4.3 of the Guidelines provide:

> In rule of reason cases, if market share data are unavailable or do not accurately represent competitive significance, the following safety zone criteria will apply. Absent extraordinary circumstances, the Agencies will not challenge a restraint in an intellectual property licensing arrangement that may affect competition in a technology market if (1) the restraint is not facially anticompetitive and (2) there are four or more independently controlled technologies in addition to the technologies controlled by the parties to the licensing arrangement that may be substitutable for the licensed technology at a comparable cost to the user.

Identifying (potentially) competing technologies that are commercially viable is likely less difficult than defining relevant markets and calculating shares, especially where the application of the relevant technology is uncertain.

It is also more appropriate, because it is forward-looking, and concentrates on whether the licensor's position can be contested. Past market shares in "old" technology may very well be meaningless, because they convey no power in the "new" technology. If we assume that contestability and the pace of innovation rather than the existing degree of market power is critical in assessing

the respective competitive positions of the undertakings in innovative industries, the technology center approach would be a more appropriate indicator of the degree of competition in the market than the market shares that the undertakings presently hold. The technology center approach would also encourage the dissemination of technology. Companies with leading innovations and necessary resources often have high market shares. The market share ceiling could discourage them to enter into technology transfer agreements.

Conclusion. It would be better not to subject the application of the TTBE to the condition precedent of market share ceilings (which creates the risk that the TTBE will be ignored if the market or market share cannot be proven), but to allow the Commission, NCAs and courts to disapply it in case there is clear evidence that the market is too concentrated and there are not enough poles of technology to ensure sufficient interbrand competition (a kind of condition subsequent resulting in nonapplicability). This should avoid annulment of agreements that in reality merit exemption.

D. Application to Other Intellectual Property Rights

The current block exemption only covers know-how and patent licenses. The possibility to extend the coverage of the TTBE to other types of IPRs was discussed in the Evaluation Report. The Commission has recently indicated that it is not likely to extend the block exemption to cover other types of IPRs (such as non-software copyright, or trademark licenses), unless they have similar effects as know-how and patent licenses, i.e., the purpose of the license is technology transfer). In practice this means that pure trademark and copyright licenses, such as merchandising agreements, would be excluded, whereas software copyright licenses could benefit from the TTBE. Why exclude databases, non-software copyright and related rights (phonographic producers, performing artists, broadcasters/satellite rights, rental rights), and trademarks?

- The rationale for including them (i.e., license enables licensee to provide services or products to consumers) is the same as for technology transfer.
- There would appear to be no fundamental difference between investment in technological innovation and investment in other IP for which there is consumer demand.
- There is little or no need to adjust provisions for such rights (e.g., provisions mirroring moral rights in copyright law would fall outside Article 81 anyway).
- Licenses are often mixed, and it is difficult to determine which IP is ancillary and which is the main object of the agreements.

Despite the differences in the purpose, extent, and duration of protection provided under various IPR regimes, competition assessment and principles governing patent, copyright and trade secret, for example, are often very similar.[65] This would justify a simple umbrella block exemption regulation, embracing IPRs other than know-how and patent licenses currently covered by TTBE. The new TTBE or the Guidelines should at the very least provide sufficiently clear guidance as to which types of licensing agreements have "similar effects to know-how and patent" licenses.

E. Multiparty Licenses and Patent Pools

The Evaluation Report discussed the possibility to extend the TTBE to cover multiparty licenses. As the Commission is currently only empowered to regulate *bilateral* technology transfer agreements, extending the block exemption to cover multiparty licensing would require authorization by the Council. It seems, however, that the Commission is abandoning the idea of bringing multiparty agreements within the scope of the TTBE. In essence, the Commission considers not extending the TTBE to cover multiparty licenses because:

- the cooperation of Council and Parliament would be required, and the need for the Council regulation would delay the adoption of the TTBE;
- multiparty licensing rules in the TTBE would be of limited added value since typically patent pools have high market shares and would fall outside the block exemption;
- patent pools meeting conditions of recent cases are not caught by 81 anyway (if limited to essential and complementary patents, open, non-exclusive, and licensing on FRAND terms);
- pools not meeting these conditions may lead to foreclosure and facilitate collusion and therefore require ad hoc analysis; and
- an inclusion of multiparty licenses would complicate the TTBE.

The Commission is however considering to address multiparty licensing and patent pools in the Guidelines (that the Commission is planning to issue to accompany the block exemption). The Guidelines are likely to provide, for example, that patent pools typically raise no issues if the patents are (1) truly essential, complementary and not including substitutes, (2) nonexclusive, (3) nondiscriminatory, and (4) licensed on fair, reasonable and nondiscriminatory royalties.[66]

III. Conclusion

To balance the goals of innovation and competition, the new TTBE ought to be drafted with the following principles in mind:

The TTBE should avoid creating artificial intrabrand competition. Even though "artificial" intrabrand competition (which would not have existed but for the license) could lower prices in the short term, it could also reduce the incentives to innovate (by increasing the risks of new investments), especially if the innovation is not expected to dramatically reduce costs.

Distinction between competitors and noncompetitors would be too rigid. It makes sense to be more lenient

toward licensing agreements between noncompetitors as opposed to competitors. However, the definition of a "competitor" is unclear and licensors with breakthrough innovations, or parties with mutually blocking patents should not be treated as competitors.

Tightening rules for territorial restrictions may discourage licensing. If licensors were not entitled to price discriminate between territories, they may be reluctant to license in member states with lower price levels, or refuse to lower royalties to a level that the local market can bear. This is particularly relevant with the accession of new member states. The Commission's proposals to exclude passive sales bans or reduce their duration to two years, to allow active sales bans only into territories exclusively licensed to other licensees, and to prohibit passive and active sales bans in unilateral licenses between competitors (especially if the notion of competitors is widely defined) could backfire. They make it more difficult for licensors to recover fixed costs of R&D. The result could be reduced licensing in the new member states, or an increase of royalties from the current to the Western-European level.

Harmonization with the Vertical Restraints BER should not be a goal in itself. There are significant differences between licensing and distribution of physical products that justify a more lenient treatment of licenses.

A concentration ceiling could be appropriate, but not if rules on restrictions of intrabrand competition are tightened at the same time. The TTBE should arguably not exempt agreements that reduce the available independent poles of research to a number below four to five (taking into account not only incumbents, but also credible new entrants). However, imposing market share ceilings (i.e., insisting on more interbrand competition) is not justified if conditions on territorial restrictions are at the same time tightened (i.e., insisting on more intrabrand competition).

Imposing market share ceilings could be counterproductive. Market shares are backward-looking, whereas analysis in innovation markets should be forward-looking. A high market share in a market characterized by ongoing innovation may not be indicative of power. What matters is not how many firms currently sell products, but how many firms can challenge or contest the licensor's position. Using market share ceilings also raises difficulties of market definition and calculation of market shares in innovative industries. Courts are not well-equipped to deal with this, and may be forced to ignore the TTBE simply because the relevant market data are unavailable. Instead of imposing market share ceilings as a condition precedent for application of the TTBE, it should provide for disapplication of the TTBE if it is proven that there are insufficient poles of research and insufficient interbrand competition.

Inclusion of other IPRs. Despite the differences in the purpose, extent, and duration of protection provided under various IPR regimes, competition assessment and principles governing patents, trade secrets, copyrights, and trademarks are sufficiently similar to cover them in one block exemption. There appears to be no fundamental difference between investment in technological innovation and investment in other IP for which there is consumer demand. This would justify a simple umbrella block exemption regulation, embracing IPRs other than know-how and patent licenses currently covered by TTBE.

Endnotes

1. Commission Regulations (EEC) 2349/84 of July 23, 1984, and 556/89 of November 30, 1988.

2. Commission Regulation 240/96 on the application of Article 81(3) of the Treaty to certain categories of technology transfer agreements.

3. This proposed timeframe seems warranted considering that Regulation 1/2003 on the Implementation of Articles 81 and 82 EC, which will enter into force on the date of accession of the new Member states into the EU (May 1, 2004), confers national courts and authorities increased powers to enforce Articles 81 and 82 EC. One of the objectives behind the reform of the TTBE is to reduce complexity and increase legal certainty, so that national courts and authorities can without difficulty enforce the provisions of the block exemption.

4. Commission Regulation 2790/1999 for vertical agreements.

5. Guidelines on the applicability of Article 81 of the EC Treaty to horizontal co-operation agreements.

6. Commission Regulation 2659/2000 for research and development agreements.

7. Commission Regulation 2658/2000 for specialisation agreements.

8. Commission Notice on agreements of minor importance which do not appreciably restrict competition under Article 81(1° of the EC Treaty (*de minimis*)

9. Council Regulation No 1/2003 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty.

10. *See also* Article 4 of the EC Treaty, referring to "the principle of an open market economy with free competition".

11. *See also* Article 2 of the EU Treaty, which establishes as a key objective "the creation of an area without internal frontiers,… the strengthening of economic and social cohesion…"

12. *See, e.g.,* Commission Evaluation report on the transfer of technology block exemption regulation n° 240/96 – technology transfer agreements under Article 81 (TTBE Evaluation Report), at 10–11.

13. Competition policy and innovation, OECD publication, DAFFE/CLP(98)18, at 7.

14. K. Mehta & L. Peeperkorn, Licensing of intellectual property under EU competition rules: the review of the technology transfer block exemption regulation, at 4.

15. *Id.*

16. Tom Willard, Summary, in: Competition policy and innovation, OECD publication, DAFFE/CLP(98)18, p. 455. For examples of limitations in IP protection, see TTBE Evaluation report, p. 11, para. 30.

17. *See, e.g.,* Carl Shapiro, Navigating the patent thicket: cross-licenses, patent pools, and standard-setting.

18. *See Standards for Standards*, 26 FORDHAM INT'L L.J. 1 (2002).

19. Richard Wainwright, Principal Legal Advisor of the European Commission, paper presented "IP Transactions and Infringements of Articles 81 and 82 – New Developments in EU Law", at the 2nd Magister Lvcentinvs Conference on Competition Law and IP, Alicante, Mar. 14, 2003.

20. Even the open source community, which often rails against IP, needs IP for its very existence. If no IP protection were available for open source technology, no conditions could be imposed on the GNU license, and it would not be possible to preserve the integrity of products such as Linux or Java.

21. *See* TTBE Evaluation Report para. 58, "If it is assumed that

IPR laws are striking the right balance between over- and under-protection of innovators' efforts, such approach [allowing broad freedom for licenses between non-competitors] helps to stimulate innovation. *The assumption may however not be correct for all cases*." (emphasis added).

22. *See, e.g.*, Commission Evaluation report on the transfer of technology block exemption regulation n° 240/96 – technology transfer agreements under Article 81, pp.11 ff.

23. *See, e.g.*, Case 102/77, *Hoffmann-La Roche v Centrafarm*, [1978] ECR 1139, para. 6.

24. *See* Coates & Finnigan, Intellectual Property, ch. 8, para. 8.27, in Faull & Nikpay, *The EC Law of Competition*, 1999; and the overview of specific subject matters defined in early cases in Myrick, "Will IP on Technology Still be Viable in a Unitary Market?" in [1992] 9 EIPR 299. The specific subject matter can arguably be curbed under competition law if its breadth is beyond what is necessary for its "essential function" (encouraging and rewarding innovation).

25. *See, e.g.,* Joined cases C-241/91P and C-242/91P *RTE and ITV v. Commission (Magill)*, [1995] ECR I-74.

26. *See, e.g.*, Articles 2(1)(1) (confidentiality), (2) (ban on sublicenses), (3) (post-term use ban), (12) (ban on building facilities for third parties), (14) (territorial reservation of rights).

27. K. Mehta & L. Peeperkorn, Licensing of intellectual property under EU competition rules: the review of the technology transfer block exemption regulation, at 6.

28. U.S. Guidelines section 3.1. See also Section 2.3 (example 1) and 3.3.

29. *See* U.S. Antitrust Guidelines for the Licensing of Intellectual Property; at 2.3 (example 1), 3.1 and 3.3.

30. U.S. Guidelines section 4.1.1.

31. The initial proposal was to subject licensing restraints that related directly to the use of the licensed IPR to 40 percent market share ceiling for noncompetitors and 20 percent to 25 percent for competitors. Restraints not relating to the use of the licensed IPR would be subject to a 30 percent market share ceiling for non-competitors and 20 percent to 25 percent for competitors. The distinction between clauses that are and those that are not directly related to the IPR is now abandoned, but agreements between non-competitors would still be treated more liberally and "benefit" from a 30 percent instead of a 20 percent ceiling.

32. TTBE Evaluation Paper, para. 55, at 17.

33. This argument is made in defense of focusing on "intra-brand" restrictions by K. Mehta & L. Peeperkorn in: Licensing of intellectual property under EU competition rules: the review of the technology transfer block exemption regulation, at 6.

34. Case 56-65, *Société Technique Minière (L.T.M.) v Maschinenbau Ulm GmbH (M.B.U.),* [1966] ECR English special edition, p. 235. Emphasis added.

35. *See also* Joint Comments of the American Bar Association's Section of Antitrust Law, Section of International Law and Practice and Section of Intellectual Property Law on the Commission Evaluation Report on the Transfer of Technology Block Exemption Regulation No. 240/96, at 28–29.

36. Examples in the current TTBE are Article 2(1)(4) (limited grant-back of improvements), (5)(ties necessary for a technically proper exploitation of the licensed technology), (6)(cooperation with litigation against third parties), (7)(limited post-term royalties), (8) technical field of use restrictions, (9)(minimum royalties), (10)(most-favored licensee clauses), (11)(trademarking), (13)(second source license), (15) and (16)(termination in case of challenge), (17)(best efforts), and (18)(termination of exclusivity in case of competition).

37. *See also* David S. Evans and Richard Schmalensee in "Some economic aspects of antitrust analysis in dynamically competitive industries." Evans and Schmalensee argue that sound competition analysis of industries, which center on investment in IP requires explicit consideration of dynamic competition. Even if many leading firms in these industries can have considerable short-run market power, they are continuously vulnerable to entry powered by drastic innovation. A short-term monopolist can hence rapidly be replaced by another firm that wins a subsequent race to innovate ("sequential winner-take-all races to produce drastic innovations").

38. David Encaoua & Abraham Hollander, Competition policy and innovation, at 2–3. *See also* David S. Evans & Richard Schmalensee, Some Economic aspects of Antitrust Analysis in Dynamically Competitive Industries, NBER Working Paper 8268, May 2001.

39. Joseph Farrell & Michael L. Katz, Competition or Predation? Schumpeterian Rivalry in Network Markets, at 3

40. *See, e.g.,* K. Arrow, Economic welfare and the allocation of resources for invention, in R. Nelson (ed.), The rate and direction of incentive activity: economic and social factors.

41. David Encaoua & Abraham Hollander, Competition policy and innovation, at 6.

42. John Barton, "Antitrust Treatment of Oligopolies with Mutually Blocking Patent Portfolios", 69 ANTITRUST L.J. 3 (2002), 851.

43. In practical terms this often means that the potential entrant must possess superior technological know-how that has not yet been exploited in the relevant product market, either in the form of a radical alternative or a significant improvement. *See* David Encaoua & Abraham Hollander, Competition policy and innovation, at 8.

44. David Encaoua & Abraham Hollander, Competition policy and innovation, at 8. However, Encaoua and Hollander note that as licensing and transfer of knowledge entail costs, entry is more likely when all necessary inputs are owned by the same entity.

45. *See* D. Encaoua and D. Ulph, Catching-up or leapfrogging? The effects of competition on innovation and growth. The model is based on an assumption that successive innovations take place at different points in time. The model further assumes that there are two firms in each industry: one firm that is a "technological leader" and the other one that is a "follower"

46. David Encaoua & Abraham Hollander, Competition policy and innovation, at 6.

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47. David Encaoua & Abraham Hollander, Competition policy and innovation, at 6.

48. If the owner of the IPR can expect greater returns on his investment, he naturally has an increased incentive to engage in the creation and development of new products and is consequently likely to increase his R&D spending.

49. *See* Annex to the United States Federal Trade Commission and Department of Justice submissions: Antitrust guidelines for the licensing of intellectual property, in: Competition policy and innovation, OECD publication, DAFFE/CLP(98)18, at 247.

50. *See* Annex to the United States Federal Trade Commission and Department of Justice submissions: Antitrust guidelines for the licensing of intellectual property, in: Competition policy and innovation, OECD publication, DAFFE/CLP(98)18, at 247.

51. *See* Annex to the United States Federal Trade Commission and Department of Justice submissions: Antitrust guidelines for the licensing of intellectual property, in: Competition policy and innovation, OECD publication, DAFFE/CLP(98)18, at 247–48.

52. Further examples include *e.g.,* using licensing to leverage IPR to create an advantage outside of the market where the innovation took place, requiring royalty payments for a term that exceeds the life of a patent or in some situations including a provision in the licensing agreement that prohibits a licensee from challenging the validity of a patent. *See* Competition policy and innovation, OECD publication, DAFFE/CLP(98)18, at 9.

53. John H. Barton, Paradigms of intellectual property/competition balances in the information sector, OECD publication, DAFFE/CLP(98)18, at 295.

54. The inclusion of a "black clause" would bring the entire agreement outside the scope of the block exemption.

55. For this category of agreements, the TTBE provides for an opposition procedure, whereby the Commission carries out a case-by-case assessment and (within a period of four months) establishes whether the agreement falls within the scope of the TTBE. *See* Article 4 of the TTBE.

56. The Evaluation Reports also discussed the possibility to distinguish between licensing restraints that *relate to the exploitation of the licensed IPR* (e.g. territorial, customer and field of use restraints) and restraints *not relate to the exploitation of the licensed IPR* (e.g. non-compete and tying). The Commission is unlikely to introduce such a distinction into the new TTBE. It is considered difficult to determine whether a restriction actually relates to the use of the licensed IPR. Moreover, such a distinction would add to the formalism of the TTBE, which is exactly what the Commission intends to avoid by the ongoing reform.

57. In the current TTBE, tying is subject to opposition procedure and exempted only if tying is considered necessary for technically proper exploitation of the IP or to ensure minimum quality standards.

58. See Case T-51/89, *Tetra Pak v. Commission,*1990 ECR II 390, where the Court held Article 82 EC prevails over a block exemption regulation.

59. "Sweeping breakthrough" refers to a situation where parties that compete on existing products will no longer compete on future products as innovation of one of the parties leads to a fundamental breakthrough that has the ability to replace completely the existing products. "Mutual blocking position" refers to a situation where the use of one IPR requires access to another IPR. For example, an improvement on a patented machine can be blocked by the owner of the patent on the machine. *See e.g.,* Annex to the United States Federal Trade Commission and Department of Justice submissions: Antitrust guidelines for the licensing of intellectual property, in: Competition policy and innovation, OECD publication, DAFFE/CLP(98)18, at 247.

60. David Encaoua & Abraham Hollander, Competition policy and innovation, at 7.

61. Case IV/32.009 *Elopak/Metal Box - Odin*, Commission decision of July 13, 1990, paras. 24–25. ("Elopak and Metal Box were not competitors, actual or potential, in the relevant product market ... neither party could in the short term enter the market alone as such entry would require a knowledge of the other party's technology which could not be developed without significant and time-consuming investment. Both Metal Box's and Elopak's experience and resources are necessary to develop the new product which will be a combination of their respective technical and commercial know-how").

62. *See* Commission Notice on Market Definition (December 9, 1997), OJ 1997 C 372.

63. David Encaoua & Abraham Hollander, Competition policy and innovation, at 7.

64. David Encaoua & Abraham Hollander, Competition policy and innovation, at 7. Encaoua and Hollander note that a single R&D program might profit several future products that are not regarded as substitutes to each other. The antitrust enforcers are unlikely to be in a position to predict the future products and expected returns generated by the different firms' R&D spending. The market definition process in innovative industries therefore always entails through consultation with industry.

65. *See* Annex to the United States Federal Trade Commission and Department of Justice submissions: Antitrust guidelines for the licensing of intellectual property, in: Competition policy and innovation, OECD publication, DAFFE/CLP(98)18, at 246.

66. For further discussion and recommendations that could be included in the Guidelines to deal with issues such as patent traps and excessive royalties, *see* Dolmans, *Standards for Standards*, 2002 FORDHAM INT'L L.J.

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(continued from page 31)

combination" included the exchange of salary information).

54. *See, e.g.,* Northwest Wholesale Stationers v. Pacific Stationery, 472 U.S. 284, 290–98 (1985) (wherein the defendant-cooperative refused to deal with a competitor, the Court held that cooperatives can be good things (analogizing them to college sports teams) that should be analyzed under the rule of reason because of their potential for outweighing the injustice of abuse of market power).

55. *See* n8.

56 *Trans-Missouri Freight Ass'n*, 166 U.S. 290 (1897).

57. *Id.* at 311.

58. *Id.* at 339.

59. Thought provokingly, consider that other plaintiffs have settled their antitrust suits with Microsoft for many millions—perhaps even billions—of dollars. *See, e.g.,* Carrie Kirby, *Microsoft Will Pay Consumers $1.1 Billion, 13 Million in State to Get Vouchers in Settlement of Lawsuit*, S.F. CHRON. (Jan. 11, 2003) at http://sfgate.com/cgi-bin/article.cgi?file=/chronicle/archive/2003/01/11/MN37564.DTL; Robert Guth, *West Virginia Settles Microsoft Antitrust Suit*, WALL ST. J. (June 17, 2003) at http://online.wsj.com/article/0,,SB105580682071789600,00.html (for $ 21 million); and Dow Jones Newswires, *Microsoft to Settle NC Suit, Reimburse Customers*, WALL ST. J. (June 14, 2003) at http://online.wsj.com/article/0,,BT_CO_20030614_000026,00.html (for $ 89 million).

Oh What Tangled Webs We Stream

A History and Analysis of Webcasting Royalty Rates

BY DANIEL OSMAN

Daniel Osman

Introduction

With the passage of the Digital Millennium Copyright Act in 1998, legal battles have swept across the entire field of the recording industry. Technology continues to develop at a faster rate than the law can handle and the legal questions of today are ones even lawmakers from last session could not have imagined. The changes in the law lag behind recent revolutions in technology, especially as they pertain to the Internet and online transmissions.[1] From Napster to TiVo, CD burners to mini-discs, the courts, Congress and various agencies work nonstop to try to answer two very basic questions: Who owns what, and who owes what?

The same issues are at the core of the debate over radio webcasting. Webcasting, also known as Internet streaming, is the act of transmitting audio or video over the Internet for simultaneous viewing.[2] Music broadcast on the Internet can be divided into three music delivery models: (1) AM/FM Radio webcasting, (2) Internet webcasting, and (3) Personalized Internet webcasting [3]

The first music delivery model is the transmission of AM/FM radio broadcast signals over the Internet by a radio station. It is the simultaneous transmission of the identical AM/FM broadcast signal without a playlist, skip forward function, method to influence playlists, or search engine.[4]

The debate over the copyright of radio webcasting is the main focus of this article. Specifically, it examines the questions asked time and again when it comes to copyright and royalties: Who owns what and who owes what?

Who owns what? A brief history of copyright law and technology through 1998

United States copyright law has long recognized that the copyright owner has an exclusive right of public performance for a musical composition.[5] Under the 1909 Copyright Act, the public performance right for musical works was limited to performances made "for profit."[6] The recording industry first requested a broad performance right in the 1920s.

Still, it was not until recently that Congress gave any form of copyright protection to sound recordings of musical compositions. One explanation is that, until Phillps introduced the first compact audio cassette in 1963, the general public was not able to easily record music for personal use.

The Sound Recording Act of 1971 was enacted to counter the unauthorized commercial copying and sale of sound recordings through advances in duplicating technology.[7] This Act only affected those on the receiving end of sound recordings. The owner of the copyright still had no authority to dictate terms over the rights of public performance as the law of copyright was limited to the direct reproduction of the original recording.

The Copyright Act of 1976 eliminated the "for profit" limitation of the 1909 Act. At the same time, it added specific exemptions, including for Federal Communications Commission (FCC) licensed broadcast transmissions.

The FCC is an independent U.S. government agency, directly responsible to Congress. Established by the Communications Act of 1934, and charged with the regulation of interstate and international communications by radio, television, wire, satellite and cable, it is responsible for many of the rules and regulations radio stations must adhere to in its day-to-day operation.[8] One must be licensed under the FCC to own and operate a commercial radio station in the United States.

The technological revolution began soon after the passage of the Copyright Act of 1976. In 1977, Stephen Wozniak and Steve Jobs introduced the Apple II, a pre-assembled personal computer (PC) with a color monitor, sound, and graphics.[9] In the spring of 1983, compact discs sold for the first time in the US. By 1988 CD-recordable discs (CD-R) were brought into the market and by the beginning of the next decade, almost 300 million CDs were sold annually.[10] In 1991, the World Wide Web as we now know it was launched.[11] By 1992, both Intel and Tandy developed CD-ROMs for the PC at a cost of $400 apiece.[12]

With CD-ROMs, those working at their computers could use and play CDs on their PC. With copyable CDs, a place to use them on the computer, and a way to conveniently access the Internet, three out of the four necessary parts were in place for the widespread proliferation of free music. The only thing needed was a cheap program that could send music over the Internet from a master source to a PC.

Legislators never imagined the fourth part. Radio webcasting was in its infancy and those who streamed music over the Internet were few and far between. Congress tried to connect the dots as best they could but, as was brought up earlier, technology develops at a faster rate than the law can possibly handle.

In 1995, Congress passed the Digital Performance Right in Sound Recordings Act (DPRSRA) to amend the 1976 Copyright Act. The DPRSRA did not address "free over the

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air broadcast services."[13] Instead, webcasters offering subscription music services had to pay two licensing fees to both the publisher and record company. The payment was for the copyrighted musical work as well as the copyrighted sound recordings.[14] This became more commonly known as the double royalty fee.

The industry was divided into three groups with their own interests: recording, radio, and webcasting. Their separatism led to many legal struggles in the years to come.

The Recording Industry Association of America (RIAA) spearheaded the recording side of the debate. RIAA is the trade group that represents the U.S. recording industry. Its members are the record companies and the group as a whole creates, manufactures and distributes approximately 90 percent of all commercial sound recordings produced and sold in the United States.[15]

On the opposite end of the spectrum is the National Association of Broadcasters (NAB). NAB is a full-service trade association representing the interests of free, over-the-air radio and television broadcasters.[16]

Regular radio stations who played music terrestrially were unaffected by the DPRSRA. They need not pay royalties for sound recordings, though they were already paying performance royalties. RIAA blamed the powerful lobby of the NAB for this safe haven.[17] NAB, on the other hand, felt that it was purposely overlooked because historically the music industry has encouraged airplay as a way to increase sales for records, tapes, and now CDs.[18]

Indeed, the Senate said that it did not wish to "upset the long-standing business relationships among record producers and performers, music composers and publishers and broadcasters that have served all of these industries well for decades."[19] As a result, only webcasters were affected, which did not seem to bother the radio industry all that much as webcasting was both rare and expensive.

Late in 1995, RealNetworks, Inc. arrived on the scene. RealNetworks-based products and services enable organizations to use digital media by creating, sending, and receiving audio, video, and other multimedia over the Internet and corporate networks.[20] The products have the ability to take music that has been sent electronically from a master control and interpret it in the form of a sound file.

With the fourth piece now in place, suddenly everyone could stream music cheaply over the Internet. Amateur web-based radio stations set up across the country and professional ones could get off the ground fairly quickly. NAB and most of mainstream corporate radio dabbled in webcasting, but did not show a substantial interest in the technology just then.

As 1998 arrived with it came the Digital Millennium Copyright Act (DMCA). Webcasting was still not something done within mainstream commercial radio. It was partly because of this that Congress came down with as many new rules as it did.

RIAA lobbied Congress to change the rules regarding both royalties and webcasting in general. At the same time, it put pressure on the newly formed Digital Media Association (DiMA) by threatening legal action if it interfered. DiMA is in part an alliance of companies that develop technologies to promote and market music and video content on the World Wide Web. DiMA capitulated to RIAA's demands because NAB had all but ignored the issue, leaving DiMA to fend for itself. It had no capital so early in its formation to wage a legal battle against a giant like RIAA.

The DMCA passed through Congress and was signed into law on Oct 28, 1998.[21] Only webcasters who offered noninteractive (no request) programming would be allowed a statutory license.[22] Webcasters would not be allowed to play in any three-hour period more than three songs from a particular album. They were not allowed to announce ahead of time any artist or song that would be played, either.[23]

One reason for these rules is the proliferation of the technology. Taking music straight from the Internet and placing it on a CD meant any song played over the Internet can be illegally copied. Announcing what songs would be played ahead of time and keeping songs in heavy rotation, some would argue, allows those wishing to break the law easier access to do so.

The DMCA also stated that webcasters would pay sound recording royalties. The DMCA, however, did not stipulate to an amount. The act provided only that if the parties could not agree to a set rate, a Copyright Arbitration Royalty Panel (CARP) would be convened to set it.[24]

A CARP consists of three arbitrators selected by the Librarian of Congress. Two of the arbitrators come from a list provided by professional arbitration associations.[25] Those two arbitrators choose a third person from the same list to head the panel.[26] Together, CARP's goal is to determine the adjustment of reasonable copyright royalty rates as provided in Section 114.[27] Upon CARP's decision, royalties would then be payable at that rate, retroactive to October 1998.[28]

The DMCA eliminated two of the three exemptions to 17 U.S.C. § 106(6). In accordance with Section 106(6) the owner of copyright has the exclusive right to perform the copyrighted work publicly by means of digital audio transmission. This left only the Section 114(d)(1)(A) exemption for "a nonsubscription broadcast transmission."

What exactly is a nonsubscription broadcast transmission? When RIAA tried to find the answer to that question, it resulted in a legal battle that still rages on today. Before the courts came into the picture, though, the issue was submitted to the Copyright Office for its interpretation of the statute.

The Copyright Office

Not long after the DMCA became law, questions arose as to who exactly was exempt from the double royalty payment. NAB claimed its stations were "nonsubscription broadcast transmissions" and thus exempt from paying both performance and sound royalty fees. Many stations had just started developing their own terrestrial websites and simultaneous streaming of AM/FM radio over the Internet. They saw themselves and their acts as different from DiMA who had no terrestrial base and were solely located on the Internet. RIAA naturally disagreed.

RIAA filed a petition with the Copyright Office in 1999 asking them to make a determination on the issue, along with

any necessary statutory modifications.[29] In March 2000, the Copyright Office agreed to respond to the RIAA petition.

In April 2000, DiMA also filed a Petition for Rulemaking with the Copyright Office asking them to define what "interactive service" meant in 17 U.S.C. § 114(j)(7). It was first defined in the DPRSRA and later revised in the DMCA, but, according to DiMA, neither definition drew a bright line delineating just how much input a member of the public may have upon the basic programming of the service.[30] Consequently, DiMA sought clarification on this point and a regulation that would prohibit designating a service as interactive merely because it offers a consumer some degree of influence over the streamed programming.[31]

The Copyright Office still had not convened an arbitration panel to determine the retroactive licensing rates. This meant webcasters could do one of three things: negotiate independently with RIAA (an agreement that was kept secret so others who negotiated could not tell if they were getting a good deal); blindly file an intent to comply and just wait for the office's determination of rates, whatever they may be; or do nothing and worry about possible legal action somewhere down the road.[32]

By November 2000, a fourth group joined in the melee: music publishers. The record labels within RIAA now wanted to put music up on the Internet through a subscription service that would feature the works of their signed artists. This meant that they would now have to pay royalties to the publishers of that music, decreasing any profit margin of those labels. By the end of November, RIAA once again petitioned the Copyright Office, this time with a request for a rulemaking regarding fees payable to publishers for online subscription services.

Then, on December 11, 2000, the Copyright Office issued rulings for the questions that had been asked that year. It thought these rulings might have settled the matter, but the battle was just warming up.

The rulemaking of the Copyright Office considered whether an FCC-licensed AM or FM radio broadcaster, who was then exempt from paying royalties to record producers and recording artists when it broadcasted a recording in its FCC-licensed geographic area, remained exempt when the same broadcast was transmitted digitally over the Internet.[33]

The Copyright Office issued a final rule to clarify that the transmission of a sound recording as part of a retransmission of an AM/FM broadcast signal over a digital communications network, such as the Internet, is subject to the limited digital performance right provided by Section 106(6) of the Copyright Act, and is not exempt under Section 114(d)(1)(A)—the provision that specifically exempts a "nonsubscription broadcast transmission."[34] This meant that, according to the Copyright Office, radio stations were not exempt from paying a double royalty fee.

NAB filed a suit in early 2000 within the Southern District of New York that would have addressed the same issue decided by the Copyright Office.[35] The case *NAB v. RIAA* was later dismissed in 2001 through a motion by RIAA which, not coincidently, happened after the Copyright Office came out with its decision on RIAA's petition.

The office went on to deny DiMA's request for clarification. "The panel's responsibility is to establish the value of the performances and set appropriate rates, not to discern whether a particular service meets the eligibility requirements for using the license. In short, the Office does not believe that DiMA has presented a persuasive case that a rulemaking on this issue is necessary, desirable, or feasible."[36]

The music broadcasting industry was not very pleased with either of these decisions. The radio station broadcasters sought judicial review of the Copyright Office's administrative "final rule" early in 2001.

***Bonneville International Corp. v. Marybeth Peters,* 153 F. Supp. 2d (E.D. Pa. 2001).**

Marybeth Peters in her capacity as head of the Copyright Office defended the case against plaintiffs Bonneville International Corp., NAB, and a host of radio broadcasting corporations. At issue in *Bonneville* was the December 2000 Copyright Office decision reviewing both the definition of the "nonsubscription broadcast" exemption of 17 U.S.C § 114(d)(1)(A) as it related to rights granted by Section 106(6) and the general question of whether the Copyright Office had the authority to decide the question in the first place.[37]

Radio broadcasters argued that their practice of streaming AM/FM broadcasts over the Internet should be exempt from sound recording royalties, similar to the exemption enjoyed through traditional radio broadcasts. The Copyright Office, joined by RIAA, argued that webcasting did not qualify as ordinary AM/FM transmissions because webcasting involved transmission of signals over closed lines to specific computer addresses.[38] In other words, streaming sends information from one point directly to another point and is not broadcast openly like radio waves.

The plaintiffs contended that the key to resolving the controversy lay in determining the Act's definitions of "broadcast" (§114(j)(3)) and "transmit a performance" (§101).[39] A broadcast means "a transmission made by a terrestrial broadcast station licensed as such by the FCC."[40] The plaintiffs were quick to point out that the word "terrestrial" references the words "broadcast station" and not "transmission." It does not matter, they contend, how far-reaching the transmission is as long as it originated from a fixed broadcasting point.

Further, the word terrestrial is not defined in the statute. Even if the term terrestrial had been used in the statute to qualify the transmission rather than the transmitting entity, the term would still comfortably accommodate the Earth-wide potential of AM/FM streaming.[41] Basically, the plaintiffs argue, any transmission originating on Earth and traveling anywhere else on Earth can still be considered terrestrial.

The 150-mile limitation referred to in Section 114(d)(1)(B), the plaintiffs contended, applies only to retransmissions made by third parties and not simultaneous transmissions made directly in digital form over the Internet by original, FCC-licensed broadcasters.[42]

The plaintiffs also asserted that if Congress had intended to make a change in copyright policy by overturning over half a century of refusals to impose a financial burden to radio stations for sound recordings, they would have explicit-

ly done so in the 1995 or 1998 Acts.[43] Because they did not, the inference is clear.

Interestingly, the plaintiffs use this argument as an opportunity to further separate themselves from DiMA and the independent webcasters in the interest of winning the case. "It is," they argue "inconceivable that Congress intended Internet streaming of radio broadcast programming to be treated in the same manner as interactive and on-demand transmissions, the types of transmissions believed to create the greatest potential threat to the sale of sound recordings."[44]

Finally, plaintiffs argued the Copyright Office lacked the proper authority to determine the issue of royalties in this case. "The Register of Copyrights is authorized to establish regulations not inconsistent with law for the administration of the functions and duties made the responsibility of the Register under this title. All regulations established by the Register under this title are subject to the approval of the Librarian of Congress."[45] The powers and duties of the Copyright Office are outlined in 17 U.S.C. § 702, which grants to the office no authority to determine whether AM/FM radio streaming is exempt. In fact, the plaintiffs maintain the opposite. Because the Copyright Office participated substantially in the making of sound recording performance rights laws, the office is both biased and ill-suited in interpreting those same statutes.[46]

Decision

Despite these arguments, District Judge Berle Schiller handed down his ruling on August 1, 2001, denying the plaintiff's motions and granting the defendant's motion for summary judgment. With regard to the Copyright Office's authority, the court cited *Cablevision Systems Development Co. v. Motion Picture Ass'n of America, Inc* (1988). "Given Congress' awareness of the rapid changes taking place in the cable industry, we cannot believe that Congress intended that there be no administrative overseer of this scheme."[47]

Congress knew there needed to be an overseer for these royalty payments and knew that overseer would be the Copyright Office since 1995 and the passage of the DPRSRA.

The legislative history points toward a congressional intent to use the Office as an interpreter of copyright law. "Congress implicitly, if not explicitly, entrusted the Copyright Office with the task of determining which entities and means of transmission would be exempted by section 114 from the public performance rights of Section 106."[48]

With regard to the statutory exemption of Section 114(d)(1)(A), the court employed a two-part test established by the Supreme Court in *Chevron USA v. National Resources Defense Council*. First, the court is directed to ascertain whether Congress has directly addressed the precise issue before it. If Congress' intent is "unambiguously expressed," the court's evaluation ends as the court must defer to Congress' expressed wishes. If, however, the statute is silent or ambiguous with respect to the specific issue, the court must determine whether the agency's answer is a reasonable one based on a permissible construction of the statute.[49]

The court concluded that Congress did not express in any terms a need for an exemption of AM/FM streaming. "It is strange that Congress would choose not to exempt webcasting, but choose to exempt AM/FM streaming, an activity that shares many characteristics with webcasting," the judge stated. "Furthermore, if Congress did intend to have AM/FM streaming understood as a 'nonsubscription broadcast transmission' it is even more surprising that there is no mention of AM/FM streaming anywhere in the statute."[50]

That Congress intended FCC-licensed entities to be exempt while engaging in activities that Congress never referenced and the FCC does not regulate seemed unlikely.[51] Because the court concluded that the statute was either silent or ambiguous on the issue, it had to defer to the Copyright Office if its determination was reasonable.[52]

The court held that it was. Judge Schiller even took it one step further and stated that, had he the choice, he would have come to the same conclusion that the Office did.[53]

The Copyright Office, as noted previously, determined that AM/FM webcasters were not exempt and would therefore have to pay sound recording royalties for streaming over the Internet. It stated that the broadcasters' definition of "terrestrial" was inadequate because the area encompassing the entire planet was obviously not what Congress had in mind when it drafted the statutes. Also, that the same entity might own the antenna as well as the computer does not mean the webcast performed by a terrestrial station.[54] The computer is a separate entity from the radio station and subject to its own rules and regulations concerning broadcasts.[55]

Giving the AM/FM broadcasters the ability to webcast songs over the Internet without restrictions would give them an unfair advantage in the webcasting market.[56] It would go against Congress' wishes and it would strip the Copyright Office of their statutory power. For these reasons, Judge Schiller upheld the Office' determination, and granted the defendant's motion for summary judgment.

Discussion of *Bonneville*

To examine *Bonneville* accurately, one must look at the case on three different levels. First, did the court make the right decision in deferring to the Copyright Office in its interpretation of exemptions? Second, did the Copyright Office have the authority to make the ruling at all? Third, was the Copyright Office's ruling correct given the law and the legislative history?

It is unclear whether the *Chevron* standard needed to be used in this case. Case law is not dispositive as to whether a court should defer to an administrative "final rule" of the Copyright Office.[57] The Supreme Court, which created the *Chevron* analysis, sometimes gives *Chevron* powerful effect and sometimes ignores it altogether.[58]

United States v. Mead Corp., a 2001 Supreme Court case, reexamined the decision in *Chevron*. The Court held that the Chevron deference is available only where the statute has delegated to the agency the authority to make rules with the force of law and the agency has issued its interpretation in the exercise of that authority.[59]

This means that a judge must look at whether Congress specifically intended the agency to interpret a statute. If this is

the situation, the judge should then employ the two-part *Chevron* analysis. If it is not, the Supreme Court placed *Skidmore* as the new catch-all measure of deference for agency actions.[60]

Under the Supreme Court's decision in *Skidmore v. Swift & Co*. an agency's statutory interpretations are "not controlling upon the courts," and the weight accorded an agency interpretation "in a particular case will depend upon the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade."[61] In other words, the judge may consider the agency's decision as persuasive analysis, but not controlling on the final decision of that court.

The Court published *Mead* on June 18, 2001 while *Bonneville* was not ruled on for another month and a half. Mead's interpretation should have been applied to the Bonneville decision and yet it is given but a sentence's consideration and then dismissed.[62] Had it been, the *Chevron* analysis probably would not be applicable in the case. Nothing in the statutory text, nor in the legislative history, indicates that Congress wished to grant the Copyright Office the ability to interpret the law if and when a dispute arose.

But the court did use the *Chevron* analysis anyway. The first step is the determination of whether the Copyright Office had authority to make the ruling. Many commentators have found that both the Register (Peters) and the Librarian are legislative officers.[63] If this is the case, then Congress is creating legislation and sending it to its own branch to be interpreted. More than that, Congress is sending it to an agency that had a heavy hand in the negotiation and formation of the original law. This brings about serious concerns over a separation of powers issue.

In *Bowsher v. Synar*, the Supreme Court held that some of the powers vested in the Comptroller General violated the Constitution because Congress can play no direct role in the execution of the laws.[64] The court said that "[t]o permit the execution of the laws to be vested in an officer answerable only to Congress would, in practical terms, reserve in Congress control of the execution of the laws …The structure of the Constitution does not permit Congress to execute the laws; it follows that Congress cannot grant to an officer under its control what it does not possess." [65]

Under *Bowsher*, legislative officers may not execute the laws without offending the separation of powers doctrine. The Register is under the control of Congress because the Register and the Librarian each head legislative agencies within the legislative branch.[66] Further, the Register and the Librarian depend on Congress rather than the President for appropriations and policy support.[67] Therefore, the Register may not continue to issue interpretive rulings as a legislative officer.[68]

Marybeth Peters testified before Congress in 1995 that "[j]ustice requires that performers and producers of sound recordings be accorded a public performance right. As a world leader in the creation of sound recordings, the United States should no longer delay in giving its creators of sound recordings the minimum rights many countries give their performers and producers."[69]

Peters unequivocally declares in that statement that she believes the United States lags behind other countries in sound recording rights and the recording industry deserves protection. Five years later she's asked to weigh the evidence and decide an issue on that very subject. Is it any wonder the Office came out in favor of the recording industry?

Judge Schiller, perhaps seeing these problems, stated at least twice in his opinion that, had he the option, he would have ruled the same way as the Copyright Office. When the case is appealed (as of this writing motions have been filed), the appellate court may look at the judge's opinion and determine that while the Copyright Office overstepped its bounds the result would have been the same.

This would ignore *NAB v. RIAA*, discussed earlier, that was attempting to ascertain the answer to the same question as the Copyright Office. The case was dismissed after the Office handed down its final ruling and there's no way of knowing how the Southern District of New York would have decided the issue. The point here is that the Office's ruling, whether right or wrong, has irrevocably influenced court cases that should have been independent of the Office's decision.

So the Copyright Office might not have had the authority to decide the exemption status of AM/FM webcasters. Perhaps it overstepped its bounds when it handed down its ruling in December 2000. Or perhaps the Copyright Office was biased to begin with.

Still, ignoring everything else and deciding this issue in a vacuum, was the Copyright Office's ruling reasonable? More generally, if a court were to decide this issue, how should it rule? Is there an exemption under Section 114(d)(1)(A) for AM/FM webcasters?

It is reasonable to believe that Congress intended to carve out an exception for AM/FM Internet streaming. As discussed earlier, only webcasters who offered noninteractive programming would be allowed a statutory license.[70] Webcasters would not be allowed to play in any three-hour period more than three songs from a particular album. They could not announce ahead of time any artist or song that would be played.[71]

The problem is this is the exact format stations currently employ for broadcasting over radio waves. Radio stations take music requests all the time. They play block formats from artists or albums and they entice listeners to tune in through a commercial break by telling them what songs will be coming up next. Taking these options away if they wish to simultaneously stream over the Internet leaves the radio stations with two choices: have a separate broadcast for the Internet or substantially change how stations broadcast over the radio. The former would be monetarily unfeasible and would completely ignore the whole point of a simultaneous broadcast. The latter would do exactly what Congress wished not to happen: upset the long-standing business relationships among record producers and performers, music composers and publishers, and broadcasters that have served all of these industries well for decades.[72]

The defendants in *Bonneville* point out that Congress never explicitly mentioned AM/FM webcasting in the DMCA, the DPRSRA, or its legislative history.[73] This is incorrect.

While debating the DPRSRA, the Senate Committee on the Judiciary said "[t]he classic example of such an exempt transmission is a transmission to the general public by free over-the-air broadcast station, such as a traditional radio or television station, and the Committee intends that such transmissions be exempt *regardless of whether they are in a digital or nondigital format, in whole or in part*" (emphasis added).[74] Webcasting is a form of digital transmission. Congress is explicitly saying here that radio webcasting should be exempt from royalties.

Just as important as the legislative history is the reasonable interpretation of the exemption itself. How else can one explain the word "nonsubscription" as a classification? The word would be rendered superfluous because FCC-licensed over-the-air broadcasting has always been nonsubscription based. Only if the term "broadcast" encompassed some other form of digital transmission other than over- the-air transmissions would there have been a reason to qualify it with the word "nonsubscription."[75] No, one need not worry about the definition of "nonsubscription" as both sides capitulate to the fact that radio stations fall within that category.

Of more concern is the word "broadcast" as it refers to "terrestrial." Because there is not an official statutory definition, one must be logical in what the word most likely means. The defendants argue that terrestrial should be defined as a 150-mile radius from the broadcast point, like FCC regulations require for radio stations. The plaintiffs contend that terrestrial means just that: anywhere on Earth. This may seem both an extreme definition and one that is overly broad in scope, but transmissions received every day come from places outside Earth's surface. Satellites send copyrighted digital transmissions to Earth on a daily basis. Those are not covered under Section 114(d)(1)(A) and rightly so; AM/FM streamers should be because they meet the entire definition as a nonsubscription broadcast transmission. They transmit a noninteractive, nonsubscription-based terrestrial broadcast.

One last subject must be covered before moving on. That is the logical inconsistency of the rationale behind these rules and royalties payments. The driving force behind these payments is money. Money for sound recordings, yes. More importantly, though, is the money that needs to be made for the lost profits of copied music.

This is the reason why webcasters cannot announce songs or artists in advance. This is the reason why webcasters cannot play more than a certain number of songs by a particular artist in a given time period. Someone might take a blank CD, put it in the CD-ROM, use RealAudio and a CD burner to access music he or she did not pay for. "All … digital transmissions made by nonsubscription, noninteractive services are subject to the statutory license in order to compensate recording companies for the risk of lost sales due to the possibility that a listener may make a high quality unauthorized copy directly from the transmission."[76]

Now, one could argue that the webcaster should not be held responsible for the acts of the listener; however, that line of reasoning did not work for Napster when the court said it would "not impute the requisite level of knowledge to Napster merely because peer-to-peer file sharing technology may be used to infringe plaintiffs' copyrights."[77] The radio station provides the source for the illegal activity and might be held responsible even if it does nothing illegal itself.

A deeper examination of the meaning behind the definition of terrestrial broadcast reveals an alternate way of attacking the same problem; that is, the inconsistency behind the rules and their rationale.

Defendants assert that terrestrial means a 150-mile radius from the broadcast point and they do so knowing that the Internet is a worldwide phenomenon. What if it was not? What if it was possible to limit a streaming broadcast to Internet Protocol (IP) addresses within a 150-mile limit? Then radio stations theoretically would not have to pay the double royalties. But this is in conflict with the idea that royalties are being paid to offset illegal copying. Is one to assume that people living within a 150-mile radius of a broadcast are incapable of making a copy? Perhaps it's more likely that those people are not a substantial cause of the recording industry's lost profits.

What if every single radio station in the country streamed over the Internet and every radio station limited their coverage to IP addresses within a 150-mile radius? Then no station would have to pay double royalties and yet every listener would have the ability to make a copy directly from the broadcast. So the point of these statutes cannot be to subsidize the recording industry for lost profits due to illegal copying because there's a way to get around that without paying the RIAA anything.

This becomes all the more curious when considering royalty payments. As the opponents debate, promulgate, and litigate for their sides, no one seems to bring up this statutory "free zone" and how it affects payouts. Questioning the *Bonneville* decision fades slowly into the background. Now, the more important question shifts suddenly from, Can they even do this? to How much must we pay?

Who Owes What? CARP Regulations

A Copyright Arbitration Royalty Panel to determine the rates for royalty fess as discussed in 17 U.S.C. § 114(f)(1) commenced on July 30, 2000. The primary task of the Panel, and ultimately of the Librarian of Congress, was to determine what the marketplace rates were for the transmission of performances of sound recordings on the Internet.[78]

CARP would establish rates that most closely represented the fees that would have been negotiated in the marketplace between a willing buyer and a willing seller.[79] In determining these, CARP would base its decision on economic, competitive, and programming information presented by the parties including whether webcasting interfered with or enhanced the copyright's owner's revenue.[80] These fees would be retroactive to the passage of the DMCA in 1998.[81]

This worried NAB. Radio stations did not keep data on songs that long ago and there was no way to accurately reconstruct a list.[82] How could the station pay royalty fees with this necessary information missing?

It could be argued that the stations should have foreseen this because the statute explicitly states that royalty fees will be retroactive. Because NAB did not and still does not believe the double royalty payments apply to its broadcasters, there would be no reason to keep any records. A business cannot comply with every law merely because there is a possibility the law would someday be shown to pertain to that business.

So at the same time that the radio stations were appealing the legal decisions from the *Bonneville* case and others, they were also debating in front of the convened CARP to eliminate sound recording royalty payments for streaming.

CARP conducted hearings on the direct cases from July 20, 2001 through September 14, 2001. A total of forty-nine witnesses testified before the Panel representing webcasters, broadcasters, and the recording industry.[83] The Panel conducted an additional ten days of rebuttal hearings from October 15 through October 25, 2001.[84]

In these proceedings, RIAA outlined its proposed rates for DMCA-compliant webcasting services. For the basic business-to-consumer webcasting service, it offered a rate of either $.004 for each transmission of a sound recording to a single listener or 15 percent of the service's gross revenues.[85] This meant that for every listener that heard a streamed song, the webcaster would have to pay .4 cents in sound recording royalties. RIAA further proposed a minimum annual fee, subject to certain qualifications, of $5,000 per webcasting service. RIAA claimed its rates were based on fees it had previously negotiated with twenty-five individual webcasters.[86]

Under the DiMA plan, webcasters would pay $.0021 per listener-hour to cover performance right fees for use of sound recordings in online transmissions.[87] They calculated this fee through a fairly complex set of equations.

They first extrapolated from a significant portion of aggregate fees radio stations paid for performance royalties in 2000. Then they broke down that number to a per-song rate and multiplied that by 15, the number of songs webcasters average per hour. This came out to be $.003 per hour. Using other evidence presented, the webcasters reasoned that because at least 30 percent of record sales came from purchasers hearing that song on the radio, they reduced this figure by 30 percent, as is allowed statutorily by 17 U.S.C. §112(e)(4). This produced the figure of $.0021 per listener-hour.[88] They also proposed a fee of $250 per year for licensing rights.

Because the webcasters based their rates on an hourly basis and RIAA proposed a per song fee, it is somewhat difficult to compare the two. To understand better the differences between the two proposals, imagine a webcast streaming for an entire year (8,760 hours) with an average of 1,000 listeners and an average of fifteen songs per hour. Under RIAA's plan, the webcaster would be paying $4 per song or $530,600 per year in royalty rates, which incorporates $5,000 annual fee. To contrast, the webcaster's proposal using these same basic figures results in a payment of $2.10 per hour or $18,646 annually including the $250 licensing fee.

This wide discrepancy between the plans was not lost on experts in the field. Dave Rahn, co-president of SBR Media Outlet, said "Imagine walking onto car lot, seeing a car you like, and after doing your homework, offering the dealership $40,000 for the cherry ride. The salesman laughs and says, 'are you nuts? We're asking over a million dollars for that car!' Hard to believe, but that's how far apart the two sides are in this dispute."[89]

Still, the Panel needed to work out a compromise on the issue. Its job was not necessarily to make both parties happy but rather to determine what a willing buyer and a willing seller would have negotiated in a fair and open market.

On February 20, 2002, CARP's chairperson Eric Van Loon and its two arbitrators Jeffery Gulin and Curtis von Kann published their decision. CARP determined that the price at which a willing buyer and a willing seller would negotiate to for Internet-only webcasting was $.0014 per performance. The Panel applied the same methodology for radio station's simultaneous streaming in order to determine their rates, but also factored in the promotional effect radio broadcasts would have on record sales. It came up with a figure of $.0007 per listener.[90] These were based primarily on an earlier agreement between the RIAA and Yahoo!, a major webcaster and Internet retransmitter of radio broadcast signals.

Additionally, CARP imposed a fee of $500 per annum as a nonrefundable advance against any royalty payments that a webcaster or radio station paid during the year.[91] This was added to ensure that the agencies did not spend more money in the process of collecting fees than they gained in the actual fees collected. The Panel was fairly confident that, in an open market, RIAA would have bargained effectively for that clause to ensure they did not take a loss on collections.

In 17 U.S.C. § 802(f), the Librarian of Congress is granted the power to reject CARP's recommendation within ninety days of the report's delivery. On May 21, 2002, exactly ninety days after the report was published, the Librarian rejected CARP's recommendations. He claimed that significant portions of it were arbitrary or contrary to law. When this occurs, the Librarian may substitute his own judgment for that of the CARP, while still giving deference to those aspects of the report that were not contrary to law.[92]

The Librarian determined CARP's conclusion concerning the promotional values of songs heard over the radio or Internet was unsupported by the record. There was no evidence to show that listeners of webcasts were unaffected by music they heard but listeners of the radio significantly affected sales of records; thus, the two-tiered royalty structure was illogical.[93] Consequently, the Librarian did away with the Internet-only transmission rate and on July 8, 2002 ruled that there is a flat fee of $.0007 per song, per listener for any commercial webcast.

Discussion on CARP

The CARP report and the rules governing it are a bit disconcerting. CARP convened for forty-one days. It scheduled time for both initial debates and rebuttals. The arbitrators listened to seventy-five witness testimonies. They admitted over 230 exhibits into evidence for consideration. Yet, despite all this, the thing that influenced those three arbitrators the most

was a single deal between RIAA and Yahoo! that occurred before the proceedings even commenced.

CARP states that agreement is "the best evidence of what rates would have been negotiated in the marketplace between a willing buyer and a willing seller."[94] But how willing were they? Both RIAA and Yahoo! knew that the Panel would soon be meeting and would eventually come down with a rate proposal. The proverbial clock was ticking and neither party knew what would happen once it struck midnight.

Still, regardless of whether or not they were willing buyers or willing sellers, both corporations were looking out for their best interest. It's what a business does to remain in business. The deal between Yahoo! and RIAA involved both simultaneous radio/Internet webcasts and Internet-only webcasts. If a compromise was sought, Yahoo! had the option of working out a deal that might hurt its webcasting division but would help its company overall.

They can do this because they are looking out for the best interest of the corporation as a whole, not just its individual parts. The problem is that the individual parts of Yahoo! are the entire business of other companies. Internet- only streamers do not have the luxury of negotiating this way because there is no other part with which to bargain. The logic and rationale does not transfer to the majority of the situations at hand and yet the Panel blindly tried to squeeze in the square peg anyway.

The Librarian of Congress eventually overruled CARP's decision, but this raises its own problems. In a summation of his final ruling, the Librarian said he found the Panel's decision "to be arbitrary or contrary to law."[95] Statutorily, that is not his job.

In part, 17 U.S.C. §802(f) states: The Librarian shall adopt the determination of the arbitration panel unless the Librarian finds that the determination is arbitrary or contrary to the applicable provisions of *this title* (emphasis added). The statute refers to itself, not to anything larger and certainly not to the law as a whole. As convoluted as the logic of CARP may be, it did not violate the rules established in Section 802 and so the Librarian has no power withwhich to interfere.

Yet interfere he does. The voice of one Librarian overrules the opinion of three arbitrators. The Librarian does this without any appeal by either side. If it is determined that the Librarian did not overstep the powers granted by his office, one must ask what CARP's point is in the first place.

Why create a Panel at all when its decisions can be ignored so easily? Why grant the Librarian of Congress so much power to overturn five weeks' worth of hearings, hearings he did not participate in, without so much as a formal appeal by either side?

Briefs have already been filed with the U.S. Court of Appeals for the D.C. Circuit to appeal the Library of Congress' decision.[96] Those rulings would only answer the question of whether the Librarian was right or wrong; whether his decision was fair or unfair. It would not address the fundamental questions of whether he had the right to even overrule CARP's decision in the first place.

But whether one accepted either CARP's or the Librarian's decision, a decision had been made. The due date for the retroactive performance fee royalty payments was October 20, 2002. The webcasters scrambled to work out deals or payment plans with the recording industry in the hopes of beating the deadline.

Legislation to the rescue

As the due date neared, Congress also rushed to enact legislation that would delay the deadline. On September 26, Rep. Sensenbrenner introduced H.R. 5469 into the Committee on the Judiciary. The entire bill was one paragraph long and read as follows:

> The determination by the Librarian of Congress of July 8, 2002, of rates and terms for the digital performance of sound recordings and ephemeral recordings, pursuant to section 112 and section 114 of title 17, United States Code, shall not apply during the 6-month period beginning on October 20, 2002.[97]

Despite an expedited review, this bill did not pass by October 20. Nevertheless, SoundExchange, the RIAA agency mandated to recoup royalty payments from Web broadcasts, granted an eleventh-hour reprieve to the those webcasters that qualified under H.R. 5469. Small webcasters would only have to pay the minimum $500 per year, or $2,500 since 1998, and the rest could be sorted out when Congress eventually passed the bill.[98]

H.R. 5469 passed on December 4, 2002. Now known as The Small Webcaster Settlement Act of 2002, its final wording had a much greater reach than even Sensenbrenner originally envisioned.

Regarding webcasting fees for sound recordings, the Act referenced two groups of webcasters: small webcasters and noncommercial webcasters. Small webcasters would be granted a reprieve of eleven days (December 15) to work out with SoundExchange a payment plan, or else the Library of Congress' decision would govern.[99] Noncommercial webcasters had a greater time period in which to negotiate. Their deadline was May 31, 2003.[100]

Because the bill does not address large commercial webcasters or give a definition of what a small webcaster is, this could be the source of some legal clashes in the near future. Under earlier versions of the bill, eligible small commercial webcasters were those who did not have a total gross revenue exceeding $1 million from November 1, 1998 through June 30, 2002; however, as this is not in the final version of the bill, that definition is but merely a suggestion, not binding authority.

A second piece of legislation also could affect how webcasters do business. The Music Online Competition Act (MOCA), introduced by Rep. Chris Cannon, would expand performance exemptions for retail establishments and reorganize how royalty payments are made to artists.

A key issue for webcasters is Section 7 of the bill, which works to restructure the performance obligations of stations streaming songs over the Internet. It instructs the Copyright Office, in consultation with the Department of Commerce, to study and report to Congress on the impact of broadcast limitations on webcasters and then to make appropriate legislative recommendations.[101] It could mean the elimination of restrictions such as how many songs of the same artist can be played

in a particular time period and the ban on announcing songs in advance.

MOCA was introduced to Congress on August 2, 2001. It was referred to the Subcommittee on Courts, the Internet, and Intellectual Property on September 10, 2001. No congressional action on this bill has taken place since then.

Congress set May 31, 2002 as the date for nonprofit webcasters to work out a deal with the recording industry concerning retroactive royalty payments. The efficacy of this deadline remains in doubt. For "small webcasters," whatever the definition of that may be, the time for settlement has already come and gone. Those who have not made an agreement will no doubt attempt to continue to challenge the legality of royalty payments for their particular webcasting enterprise.

On January 22, 2003, Hilary Rosen announced her plans to resign by the end of the year. Rosen has been the chief executive of RIAA since 1998.[102] This could have a substantial effect on any pending legislation or legal battles as the new chief executive may have a different outlook on the entire scenario and a alternate method of dealing with the conflict.

The battle will continue to rage on regardless. Webcasters such as Entercom Communications, Susquehanna Radio Corp., and Clear Channel Communications have already filed appeals with the Third Circuit challenging the CARP ruling.[103] The Library of Congress responded with its own motion arguing that webcasters that did not participate in the CARP were not "an aggrieved party who would be bound by the determination" and thus should not be allowed to file an appeal in court against the decision.[104] No decision has yet been made on either activity.

Meanwhile, the outcome of *Bonneville* is also on appeal. The plaintiffs spend a good portion of their briefs discussing the *Mead* decision and how it influences the *Chevron* ruling. "*Chevron* deference is inappropriate absent a showing, based upon all relevant circumstances, that Congress expected the agency, and not the courts, to fill that gap or resolve that ambiguity,"[105] it states. "As *Mead* makes clear, there is no such default presumption of implicit authority."[106]

In response, the Copyright Office, joined by RIAA, amended their legal theory to include another act of Congress: the Communications Act of 1934. The plaintiffs filed an additional brief that stated "the Copyright Office should not be entitled to any deference with respect to a statutory interpretation that is ever-changing, let alone one that is founded on the Communications Act, a body of law administered by a different federal agency and as to which the Copyright Office can claim no special expertise." There is no word yet on whether the court of appeals will grant an appeal for this case.

Conclusion

The conclusion, unfortunately, is inconclusive. Three years of positioning, of marking one's line in the sand, followed by over four years of legal battles and yet no end appears in sight.

Four and a half years ago, President Clinton signed the DMCA into law. In that time, at least one court ruled in favor of the recording industry. CARP and later the Librarian of Congress have both stated exactly how much money is owed to the recording industry. Congress has given multiple extensions to arrange a form of payment.

It seems as if at every point along the way webcasters have repeatedly been informed of who owns what and who owes what. No decision thus far has favored those webcasters, yet the legal battles continue. Why?

One cannot overlook the obvious answer that money paid out is money lost. Businesses are protective of their self-interests and their profit margins. To delay payments as long as possible through continued legal battles with only a slim hope of victory could still be profitable in the long run.

More than just the issue of corporate greed is the basic issue that these webcasting rates dig too deeply into what a webcaster earns. If these royalty payments make it difficult for a start-up webcaster to remain in business, let alone a fifty-year-old established radio station, clearly something must be wrong with the amount paid to the recording industry.

But one need not attach such a materialistic rationale to the actions of the various webcasters. It may very well be that they truly believe the laws do not apply to them, that they are held to be statutorily exempt from the payments. A number of sound arguments support that contention. If this is the case, they should have the right to continue asserting their arguments in court.

One can always play the "what if" game. What if Congress had just expressed its wishes more clearly in the legislative history? What if the Revisor of Statutes had worded the law differently to avoid the entire conflict? What if NAB and DiMA had maintained a unified force through this battle and not tried to separate themselves ideologically at every opportunity?

Ultimately, the questions of past events are subordinate to the answers the future might bring. Without some form of mediation, there will be losers and winners in these conflicts. Either radio stations are exempt or they are not exempt. Either webcasters have to pay or they do not. One group will not come out of this smiling and the real concern is how that will affect all their future business dealings. After years of relentless headbutting, it might not be possible to settle this amicably and just let bygones be bygones. That alone should trouble music lovers everywhere.

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64. Zerounian, *supra* note 3, at 63.
65. Bowsher v. Synar, 478 U.S. 714, 715, (1986).
66. Id. Quoting from Cf. *INS v. Chadha,* 462 U.S. 919.
67. C. H. Dobal, *A proposal to amend the cable compulsory license provisions of the 1976 Copyright Act*, 61 S. CAL. L. REV. 699, 724 (1988).
68. *Id.* at 725.
69. *Id.*
70. S. Rep. No. 104-128, at 13 citing S. 227 at 25 (Mar. 9. 1995).
71. 17 U.S.C.A. § 114(a)(2)(A)(i).
72. 17 U.S.C.A. § 114(d)(2)(C)(iii).
73. S. Rep. No. 104-128, at 13 (1995).
74. "Furthermore, the legislative history is devoid of any mention of streaming of AM/FM broadcasts." *Bonneville*, 153 F. Supp.2d 763, 777.
75. S. Rep. No. 104-128 at 19 (1995).
76. Plaintiff's Brief at 18, *Bonneville* (No. 01-408)..
77. *Bonneville,* 153 F.Supp.2d 763, 784.
78. A&M Records, Inc. v. Napster, Inc., 239 F.3d 1004 (9 Cir. 2001).
79. www.copyright.gov/carp/webcasting_rates_final.html (Dec. 14, 2002).
80. 17 U.S.C.A. § 112(e)(4).
81. *Id.*
82. *Id.*
83. 24 Hastings at 13.
84. In the matter of rate setting for rate setting for digital performance right in sound recordings and ephemeral recordings, www.copyright.gov/carp/webcasting_rates.pdf at 14.
85. *Id.* at 15.
86. *Id.* at 27.
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88. *Id.*
89. www.copyright.gov/carp/webcasting_rates.pdf at 28–30.
90. www.customchannels.net/Subpages/Newsletters/ Webcasters%20Royalty%20Update.htm (accessed Dec. 15, 2002).
91. www.copyright.gov/carp/webcasting_rates.pdf at 77–78.
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93. www.copyright.gov/carp/webcasting_rates_final.html.
94. *Id.*
95. www.copyright.gov/carp/webcasting_rates.pdf at 77.
96. www.copyright.gov/carp/webcasting_rates_final.html.
97. www.Internetnews.com/bus-news/article.php/1473801 (accessed Dec. 15, 2002).
98. H.R. 5469 IH, 107th Cong (2002)
99. www.Internetnews.com/bus-news/article.php/1485741 (Dec. 15, 2002).
100. Pub.L. 107-321, 116 Stat. 2780 (codified at 17 U.S.C.A. § 114(f)(5)(D) (2002)).
101. *Id.*
102. Music Online Competition Act, H.R. 2724, 107th Cong. § 7 (2001).
103. www.cnn.com/2003/TECH/internet/01/22/rosen.resignation. ap/index.html (accessed Jan. 26, 2003).
104. Andrea E. Bates, *Dead Air Webcasters Face Retroactive Royalty Payments That May Push Them Out Of Business* The Recorder - Practice Center Law and Management Intellectual Property Law (San Francisco) (Oct. 2, 2002).
105. *Id.*
106. www.nab.org/Newsroom/PressRel/Filings/Stream071502. pdf (Plantiff's brief, 22, July 15, 2002), citing United States v. Mead Corp., 533 U.S. 218, 229 (2001).
107. *Id* at 28.

From the Editors

(continued from page 3)

shift to the results *Vornado* may trigger: Anarchy in patent law? Enhancement of patent law through the synthesis of many "voices,"or something in between? The jury is still out on those questions.

In the full year that has passed, a number of Federal Circuit matters have been transferred back to regional circuits. Circuit judges around the country are dusting off their libraries' copies of *Chism* and reacquainting themselves with patent law developments.

Yet there is no body of evidence from which to determine the degree of deference the regional appellate judges will pay to Federal Circuit precedent. The devil is often in the details, and here, the issue will be the case law that controls a particular situation—old regional circuit patent law, Federal Circuit law, or new regional patent law altogether. Let the forum shopping begin, albeit a tortuous process of filing nonpatent claims to trigger patent counterclaims in favorable jurisdictions; perhaps forum shopping is simply impractical on the present facts.

What is particularly interesting is that a pool of regional Circuit judges who have not decided a patent appeal in twenty years will be deciding cases this year in many regional circuits. Speaking at the ABA IPL Section's Summer IPL Conference in San Diego in June 2003, Ninth Circuit Judge Honorable M. Margaret McKeown remarked that until *Vornado*, "we didn't do windows, and we didn't do patents." While that may have been the case until recently, it is no longer true.

It is even more surprising that state court judges too may need to brush up on patent law. Based on the ruling in *Green v. Hendrickson Publishers, Inc.*,[13] it is quite possible that patent law counterclaims will be adjudicated in state court disputes concerning, for instance, trade secrets.

Our Roles as IP Lawyers

I want to explain the title of this article. Many students of patent jurisprudence espouse the view that the *Vornado* decision signals the beginning of a polyphonic judicial "voice" on patent issues and an erosion of the principles underlying the creation of the Federal Circuit—and worse yet, a return to forum shopping for preferential precedent on a geographic basis.[14]

To me, the *Vornado* decision certainly has the *potential* to trigger such a sea change. The harder and materially less predictable questions are: Will the regional circuit courts of appeals take up that challenge? Will activists among the regional circuit judiciary take the opportunity to affect patent jurisprudence? Do they care enough about the area? Or will the regional courts of appeals rely primarily on Federal Circuit precedent and adhere tightly to the vicissitudes of the folks on Lafayette Square? Will the Federal Circuit have to be more deferential in return, following nonpatent precedents of regional circuits with greater regularity and deference than at present?

In debating legislation at the IPL Section's business session last month, several section members argued that proposing legislation against the *Vornado* ruling would be futile because other sections will not allow such legislation to proceed beyond the ABA itself. Even assuming those facts, is it not our job as IP advocates to reach for the same uniformity in patent law that the Freund and Hruska commissions sought. Is the IPL debate over anti-*Vornado* legislation a "tempest in a teapot"?

I argue that it is not futile to continue to seek uniformity and predictability in the patent law. If allowed to travel unleashed, *Vornado* could trigger a sea change in the law. If the regional courts adhere tightly to Federal Circuit law over time, perhaps we will only experience sea spray. But for anyone who has spent much time by the shore, a little sea spray over many years will eat a hole in your car. It promises to be an interesting ride in any case.

Nick Setty

Endnotes

1. 122 S. Ct. 1889 (June 3, 2002).
2. Aerojet-General Corp. v. Machine Tool Works, 895 F.2d 736, 745 (Fed. Cir. 1990) (Markey, C.J., for unanimous *en banc* court) (reasoning that Federal Circuit had jurisdiction over matter in which counterclaim was only claim arising under patent law, but which was a "separate, nonfrivolous claim, having its own section 1338 jurisdictional basis independent of the jurisdictional basis of the complaint.").
3. *See generally* Comm'n on Revision of the Federal Court Appellate System¸ *Structure and Internal Procedures: Recommendation for Change*, 67 F.R.D. 195 (1975).
4. *See* United States Judicial Conference Committee on the Bicentennial of the Constitution of the Untied States, *United States Court of Appeals for the Federal Circuit: A History 1982–1990*, at 1 (1991); *see also* ABA Section of Antitrust Law*, Report on the United States Court of Appeals for the Federal Circuit* (July 2002).
5. *See supra,* n.3.
6. 67 F.R.D. at 220.
7. *See* Charles W. Adams, *The Court of Appeals for the Federal Circuit: More than a National Patent Court*, 49 MO. L. REV. 43, 60 (1984) (tracing Federal Circuit's conception, range and scope).
8. *See* The Judicial Improvement Act of 1979, S. 677, 96th Cong. (1979); S. 678, 96th Cong. (1979).
9. S. Rep. 97-275 at 4 (1981).
10. *Id.* at 34.
11. *See* Federal Courts Improvement Act of 1982.
12. *See* Debra D. Peterson, *Can This Brokered Marriage Be Saved? The Changing Relationship Between the Supreme Court and Federal Circuit in Patent Law Jurisprudence*, 2 J. MARSHALL REV. INTELL. PROP. L. 201 (2003).
13. 770 N.E.2d 784 (Ind. 2002) (reasoning that copyright counterclaim must be litigated in state court in view of *Vornado*).
14. *See* Janice M. Mueller, *"Interpretative Necromancy" or Prudent Patent Policy? The Supreme Court's "Arising Under" Blunder in* Holmes Group v. Vornado, 2 J. MARSHALL REV. INTELL. PROP. L. 57 (2002) (arguing that the Court's "literalistic" ruling was based on misplaced concerns regarding federalism).

Summer IPL Conference Recap

The 10th Annual Summer IPL Conference was held June 18–22 in San Diego. Nearly 300 attendees and their guests and families enjoyed excellent CLE programming and varied activities, such as a tour of the world-famous San Diego Zoo, trips to La Jolla, Birch Aquarium, the San Diego Wild Animal Park, and Foxploration—Fox Studios movie facility in Mexico. The always-popular Welcome Reception was held poolside at the Loews Coronado Bay Resort and included gondola rides in the adjacent canals of Coronado Island. Other popular social activities included an evening at Sea World and a San Diego Padres v. Seattle Mariners baseball game—won by the home team in an incredible finish.

The conference began with the Business Session, where Section members debated thirteen resolutions, prepared in committees. The IPL Section is one of the few ABA entities that provides members the opportunity to shape Section policy through debate.

CLE programs on Thursday afternoon and Friday included presentations regarding patent law issues and separate, simultaneous presentations regarding copyright and trademark issues. Thursday's highlights included a panel of Federal Court judges, academics and experienced practitioners discussing and debating developments in recent cases, as well as a copyright program covering regulation and content on the Internet, fair use, and the First Amendment and entertainment copyright law. Friday's program included informative presentations offering review of three recent Supreme Court cases involving intellectual property law and a program on patent issues and Biopharma.

The American Intellectual Property Law Education Foundation (AIPLEF) presented several scholarship awards to three outstanding scholars. AIPLEF was formed to increase the diversity of lawyers joining the IP bar. The Section, along with the Thurgood Marshall Scholarship Fund, the Minority Corporate Counsel Association, and the American Intellectual Property Law Association, created the foundation to provide a steady pipeline of high-quality IP lawyers for years to come.

The Sidney B. Williams, Jr. Scholarship Program was named in honor of Sidney B. Williams, Jr., a corporate and law firm intellectual property lawyer for more than thirty years. He obtained an undergraduate degree in chemical engineering and was the first African-American quarterback for a Big Ten School. Mr. Williams briefly played in the NFL for the New York Giants and in the Canadian Football League before going to law school and becoming a patent lawyer. He also was the first African-American to (1) chair a committee of AIPLA, (2) become a member of the AIPLA Board of Directors, (3) become Secretary of AIPLA, (4) chair the National Council of Intellectual Property Law Associations, and (5) serve as a Council member and Financial Officer of the American Bar Association Section of Intellectual Property Law. Mr. Williams also served as the first president of the National Inventors Hall of Fame.

During the Summer IPL Conference, two $10,000 Sidney B. Williams, Jr. Scholarships were awarded to:

- Lawrence Ilag: Lawrence has an undergraduate degree, summa cum laude, in biology from the University of the Philippines, a PhD in Molecular Biophysics and Biochemistry from Yale University and will graduate in June 2004 from Harvard Law School. Lawrence has worked as a research fellow at Massachusetts General Hospital; as a patent liaison at DuPont Agricultural Products; as a summer associate at Clark & Elbing, LLP in Boston; and is spending the summer of 2003 at Finnegan, Henderson, Farabow, Garrett & Dunner in Washington, D.C.
- Andre Segura: Andre has an undergraduate degree with honors in chemical engineering from the University of Texas at Austin. While at UT he actively contributed to the successful operation of a minority student-engineering program. He worked as a peer mentor, tutor and recruiter of prospective and current minority engineering students. Since graduation from UT in 2002, Andre has worked as a technical consultant for Moses, Patterson & Sheridan, LLP in Houston. Andre will begin his study of intellectual property law in the fall of 2003 at New York University School of Law.

Additionally, the Jan Jancin Award was presented to Nathan Mitchler, who attends American University, Washington College of Law in Washington, D.C. Nathan received the $5,000 scholarship that is presented by the ABA Section of Intellectual Property Law and the American Intellectual Property Law Association. The late Jan Jancin served not only as president of AIPLA, chair of the ABA/IPL Section, and chair of NCIPLA, but served with distinction in leadership roles in other intellectual property law associations, nationally and internationally. Students of intellectual property law and growth in quality intellectual property law education were keen interests of Mr. Jancin. Additionally, he was a persistent and perceptive observer of the legislative process as it related to all aspects of intellectual property law, and regularly reported to several intellectual property law associations on those activities. The ABA/IPL Section and AIPLA are pleased to continue the tradition of honoring an outstanding intellectual property law student each year in the name of Jan Jancin.

This year's conference was presented in cooperation with:

- San Diego Intellectual Property Law Association
- San Diego County Bar Association Intellectual Property Section
- Orange County Patent Law Association, and
- Intellectual Property and Entertainment Committee of the International Bar Association Section of Business Law

In addition, special events were co-sponsored by Townsend and Townsend and Crew, LLP; Christie, Parker & Hale, LLP; and Foley Hoag LLP; who provided tote bags for all conference attendees. Special thanks to all of the cosponsors and hosts of this year's Summer IPL Conference.

Be sure to mark your calendars for the 2004 Summer IPL Conference, to be held June 16–20, 2004 in Toronto, Ontario, Canada. There will be high-quality CLE programming, interesting tours, and the opportunity to network with both old and new friends in the IP industry. We look forward to seeing you there.

Corporate Counsel Column

Kenneth Massaroni

Mr. Kenneth Massaroni is vice president-law and deputy general counsel of Scientific Atlanta, a leading global provider of technologies directed to the cable television industry. Mr. Massaroni is responsible for all of Scientific Atlanta's intellectual property matters, including patent litigation, patent acquisition, and trademark and copyright issues. IPL Newsletter thanks Mr. Massaroni for agreeing to share his experiences and perspective in the interview that follows.

IPL: Mr. Massaroni, before we get started I wanted to get a quick description of Scientific Atlanta for our readers who are not familiar with the company. Would you please describe the company's goods and services at a high level?

Kenneth Massaroni: Scientific Atlanta is the premier manufacturer of end-to-end solutions in the broadband space—by that I mean the company designs, develops, implements and employs on behalf of its customers broadband solutions in the nature of equipment for the distribution of video, audio, and data to homes via cable. So, from the standpoint of what the average consumer knows about our products, it would probably be the set top box with cable modem that's in their home. But the reality is that it's a little bit like the water system. Most consumers know about the faucet that comes out of the wall. There is a lot of plumbing between the time the water is drawn out of the reservoir and the time it gets to your home. The same thing with Scientific Atlanta—between the time that the content leaves the reservoir at Disney, or whomever, and gets to your home, there is a lot of "plumbing" that is necessary to get the contents there, and Scientific Atlanta designs, builds, sells, and deploys that equipment.

IPL: Based on that description of your company's goods and services, what are the primary intellectual property issues that the company faces.

Massaroni: Certainly there are issues relating to the patents that we secure to protect technology that we develop. We're also mindful of patents regarding technologies developed by competing entities. Likewise there are standard copyright issues that go along with all the software that's in our products. We also have issues relating to trade secrets, trademarks, and the same IP issues as most companies. There are probably skewed a little more toward patents.

IPL: Given that focus, I will direct my questions to the patent aspects of your IP program. As a preliminary matter, however, as vice president of law and deputy general counsel for Scientific Atlanta, what is your role in the overall intellectual property efforts of the company?

Massaroni: Well, the deputy general counsel slot that I occupy also includes responsibility for all the company's intellectual property issues and matters, so another way to look at my job would be as chief IP counsel.

IPL: How many attorneys does the company have in-house focusing primarily on intellectual property issues?

Massaroni: Currently two. We traditionally have three IP attorneys in-house and a number of patent agents.

IPL: How does Scientific Atlanta use outside counsel in managing the acquisition of patents necessary to protect its technology?

Massaroni: We use outside counsel ideally on a project basis. We try to anticipate at the start of our year the number of applications that we think we're going to be filing during the course of the year and we match that up with the number of people and the amount of time we believe the in-house staff will have. So we can foresee the amount of effort that will be required and along the course of the year there are projects that come up that were unanticipated. These are spikes in activity and ideally we try to use outside counsel in the preparation and prosecution of our applications for the spikes. We group these spikes into projects so that we don't have outside counsel doing unrelated or random applications. Ideally, we find a project in which we see four, five or six, whatever the number is, related applications that we package. That way, it's easier for outside counsel to learn the related technologies, and we gain economy in terms of the learning curve.

IPL: In the current environment where cost containment is such a significant aspect of managing outside counsel, how does the company distinguish between core technologies on which it may spend additional money for protection and those that are more routine aspects of the company's technological development?

Massaroni: We have a pretty good relationship among the business units—the technology and engineering community and the legal community. We carefully review our invention disclosures with all three constituencies to make decisions: Is this a particular concept for which patent protection is sought or trade secret protection is sought or not; Do we simply perhaps file a publication on it? Having made that decision we then have a discussion about where the invention falls on the continuum between routine and core. Once we've had that discussion, we assign a relative position along that continuum; we then decide whether it is something of importance sufficient that we want to keep it in-house and let the in-house people work on it or something we want to send out. There are times in which, because of the crush of other work, it may be a very core technology and therefore something that needs to be prosecuted outside or it needs to be prosecuted quickly and therefore it needs to be prosecuted outside.

IPL: How does the company go about maximizing the value it garners from the intellectual property it has developed?

Massaroni: Well, I think that it's over the last couple of years more and more companies are recognizing that a patent unused is like having a machine on the assembly room floor that sits idle. That's an asset for which the company has given consideration and it is not generating revenue. It may be important to have that machine sitting there if the first machine breaks down and it's so important in your product manufacturing process that you need to have something that you can put into line right away. I think patents can be analogized to that notion. There are certain patents that are so important because they are the bedrock technology for the products that you're selling, that you might not necessarily mind whether it's being licensed outside the company. On the other hand, most companies are recognizing that you need to try and find ways to look for additional value for patents by finding other companies that are using your technology. Scientific Atlanta is no different in that regard in that we have active outlicensing programs where we take a look at the technologies we've developed, look at the fields where those technologies remain either inside or outside our direct industry, and we talk to companies about the advantages that our technology and that our patents bring to the products that they are manufacturing and talk to them about appropriately licensing that technology.

IPL: Would you consider the licensing process at Scientific Atlanta informal or formal?

Massaroni: I would call it an evolving process. By comparison to a lot of other companies that are far more evolved in terms of the licensing programs, we are trying to move along the path from a point where we were several years ago where it was an ad hoc effort to outlicense to one in which we look far more closely at the patents that we have, we match them up far more aggressively against industries outside Scientific Atlanta. In fact, by lining up industries and having a more formalized process for approaching those companies, we are taking small steps as compared to companies that have very well established outlicensing programs.

IPL: Are there any companies whose licensing programs Scientific Atlanta has used as a template or wished to emulate in developing its own program?

Massaroni: I think they're a lot of companies that we looked at and I'm not sure I would go into specifically naming names, but we have certainly looked at a lot of other companies and talked to those lawyers and law firms here in the Atlanta community and consultants from across the country that are active in this area to try and learn about best practices and to try and integrate those best practices into this evolving process that we are developing. We've gotten a lot of very good advice from outside law firms who helped us in this regard.

IPL: Now, you mentioned the second major aspect of your company's involvement with patents was becoming aware of or keeping apprised of patents developed by others. I'm going to take you directly to the patent litigation issue. I understand that the company has been involved in a number of pieces of large patent litigation over the last few years. Would you please describe your company's experience with that type of litigation?

Massaroni: Patent litigation is no surprise to anybody who's involved in it, exceedingly involved in it—it can be very costly as well. In the context of the litigation in which we've been involved in the last couple of years, it has been very intense. It included an ITC trial. The amount of time and effort that goes into the preparation, particularly of an ITC trial because of the compressed schedules, has demanded that we have a very close working relationship among the in-house attorneys and the outside attorneys as well. I think we've been very fortunate to work with teams of outside lawyers who have been very flexible and very willing to work in a team environment to bring about results that we've been pleased with thus far. We've also been very fortunate in that in this litigation we have been involved with co-defendants and co-respondents on the ITC case who have been outstanding to work with in that they too have shown flexibility in terms of trying to get work done among the parties.

IPL: What is the biggest lesson learned through that process?

Massaroni: Lots of lessons learned, the biggest lesson I suppose at a very flip level I would say—if you prefer to avoid litigation. I think the biggest lesson learned is that it is important not to bring egos into the room when you're discussing how strategy is going to be implemented, what the strategy is, how we're going to carry out. I certainly had the experience in other places that sometimes one becomes so enamored of a position, one becomes so zealous in advocating a position, that it is difficult to break away from that position to step back and take a look at the big picture. I think that we've been, again, very fortunate with the team that we have here that egos are left at the door and people are more than willing to roll up their sleeves and listen to other points of view and figure out how best to achieve the end goals.

IPL: Is there a particular aspect of your involvement in Scientific Atlanta's patent litigation efforts of which you are most proud?

Massaroni: I guess I would have to say the results. The major litigation that you referred to is one which we started as a declaratory judgment because we had very strong beliefs about the positions that we were taking. Seeing those positions bearing out thus far is very gratifying. In general, I think it's a fair statement that people would prefer to avoid litigation and when possible we do that. It is not the case that every time somebody suggests that a license to a patent is needed that we simply say there is the courthouse, go file. We look for the right kinds of opportunities to resolve these situations without litigation, but when litigation becomes necessary, one must engage in it.

IPL: Given the importance of Scientific Atlanta's use of outside counsel in its overall program, how does it go

about selecting outside counsel suitable for particular issues?

Massaroni: We have relationships that have been established over the years with several firms who have a very good knowledge of our industry. We have relationships established over the years with outside firms that have tremendous reputations in what they do best, litigation or what have you. We try to marry the best of the skills from various firms so that we can put on the field the best possible team, the best possible combination of patent professionals and litigators and trial preparation and appellate teams. So our view is that we look for the best that we can find and if they're not all on the same team, then we kind of create our own team and put all these people together. That is why it is so important to have outside counsel who can be flexible and work together because if they're coming from two or three different law firms, it's not impossible that rivalries develop. But having outside counsel who are as dedicated to reaching the conclusion that we all agree is desired and are willing to work toward that goal without having egos or bad feelings that it has to be their position that wins even among the internal discussion; that helps us all get there.

IPL: As an executive of Scientific Atlanta and deputy general counsel, what is the biggest reward that you have found in your work at the company?

Massaroni: I couldn't be more delighted to be at Scientific Atlanta. It's a tremendous, exciting place to work. I think the industry that we're in is really so critical on a going-forward basis to how information will ultimately be brought into the home, and I think that legal issues we face as a result of that are some of the most interesting, most complex issues in the IP space. I think that we're going to have a lot of issues relating to copyright on a going-forward basis. I'm not sure that they're our issues per se, but perhaps for our customers and content providers. Everyone is well aware of what happened with Napster. Well, I suspect that it's entirely possible that in years to come video could be treated much like audio was in the context of Napster and so, it's very interesting to see how the industry is already thinking about those issues and talking to the various constituencies that have concerns about these kinds of issues and how they're being dealt with. Very rewarding professionally and it's a great place to work. The engineering community is a tremendous group of folks who are working very hard on a lot of new technologies that I think consumers would be really taking advantage of in years to come.

IPL: I'm borrowing my final question from the previous interviewer from last issue's column.

Massaroni: I presume that that's an attribution and there is going to be no copyright issues, right?

IPL: That's right, so what is the single biggest challenge you face as in-house counsel?

Massaroni: Keeping up with all the change in the industry. Since I started practicing eighteen years ago, our profession has really come to the forefront. I mean the IP, the importance of IP has really come to the forefront in the legal profession over the last ten or fifteen years and that's been driven I think largely because the technology and the cycle time between generations of technology has compressed so dramatically. I'm no soothsayer, I don't know what's coming down the line here, but as I sit here right now I don't foresee that changing. That means our challenge as IP professionals would be to keep up with the changes that technology will mandate. I think that copyright law is going to be put to the test over the next several years as technology enables different kinds of models for how content is delivered to consumers, and I think we see pressure in that space already. We look at the content companies who are out there suing college students right now for copyright infringement and, I wish them all the best of luck in trying to resolve these issues, but I fear that their problem is going to get greater and not lesser. Our roles as IP attorneys in shaping policy and shaping legislation will be a huge challenge on a going-forward basis. I don't foresee an end and certainly not in the time span of careers for our age.

Recent Developments in Intellectual Property Law

BY JOHN C. GATZ, REPORTER

John C. Gatz

Patents

Case/Controversy under 35 U.S.C. § 271(e)(2)

Allergan Inc. v. Alcon Labs. Inc., 66 U.S.P.Q.2d 1225 (Fed. Cir. 2003). This appeal presents the question of whether the Drug Price Competition and Patent Term Restoration Act of 1984 (Hatch-Waxman Act) allows an action for induced infringement based on the filing of an Abbreviated New Drug Application (ANDA) in the following circumstances: (1) the patent claims a method of using a specified drug for a particular purpose that has not been approved by the Food and Drug Administration (FDA) based upon a New Drug Application (NDA); (2) the ANDA applicant seeks approval to produce a generic version of the drug for a use that is different from the method claimed in the patent; and (3) the generic drug that is the subject of the ANDA is effective for the method of use that is claimed in the patent.

Alcon and Bausch & Lomb (B&L) desired to market a generic version of Allergan's medication called Alphagan®. In 1996, Allergan obtained approval of its NDA for the drug, brimonidine, the chemical compound in Alphagan®, for reducing intraocular pressure (IOP). As a result, Allergan received a five-year period of market exclusivity for brimonidine plus a six-month extension for researching the health effects and safety of the drug in children. This exclusive term expired in March 2002. Brimonidine is not protected by a patent and is therefore in the public domain. During further investigation, Allergan's scientists discovered that brimonidine helps prevent neurodegeneration. Allergan filed and received the '415 and '741 patents directed to this use. The '415 and '741 patents do not claim the use of brimonidine for reducing IOP.

In October 2001, Alcon filed an ANDA for brimonidine, and in November 2001, B&L filed one as well. In their ANDAs, Alcon and B&L stated that they were seeking approval from the FDA to produce and sell a generic version of brimonidine for use in lowering IOP in patients with open-angle glaucoma or ocular hypertension. Neither Alcon nor B&L sought FDA approval for the methods of using brimonidine claimed in the '415 and '741 patents. Allergan filed suit under 35 U.S.C. § 271(e)(2), alleging that if the FDA approved Alcon's and B&L's ANDAs, they would induce doctors to infringe the '415 and '741 patents by prescribing brimonidine for neuroprotection and would induce patients to infringe by using brimonidine for neuroprotection. Alcon and B&L moved for summary judgment of noninfringement and argued that a claim of induced infringement is not cognizable under Section 271(e)(2) because the ANDA is for a drug use that is different from that claimed in the asserted patent.

The Federal Circuit, *per curium,* stated that Section 271(e)(2) is not a jurisdictional statute in the strict sense of the word. The Federal Circuit explained in *Glaxo* that Section 271(e)(2) "provide[s] patentees with a defined act of infringement sufficient to create case or controversy jurisdiction to enable a court to promptly resolve any dispute concerning infringement and validity." The critical question is whether Allergan's claim of induced infringement against Alcon and B&L is cognizable under Section 271(e)(2).

The Federal Circuit stated that the language of Section 271(e)(2) is not limited to direct infringement actions. Therefore, Section 271(e)(2) may support an action for induced infringement. In *Warner-Lambert,* the Federal Circuit held that, pursuant to Section 271(e)(2), a method of use patent holder may not sue an ANDA applicant for induced infringement of its patent, if the ANDA applicant is not seeking FDA approval for the use claimed in the patent and if the use claimed in the patent is not FDA-approved. On appeal, the *Warner-Lambert* court expressed concern that permitting a cause of action under Section 271(e)(2) for off-label method of use patents would "confer substantial additional rights on pioneer drug patent owners that Congress quite clearly did not intend to confer." The court also expressed concern about the threat of abuse by a patent holder attempting to extend its patent exclusion. Under *Warner-Lambert*, Allergan is precluded from suing Alcon and B&L under Section 271(e)(2) for inducing infringement of the '415 and '741 patents because Alcon and B&L are not seeking FDA approval for the uses claimed in the patents and because the uses claimed in the patents are not FDA-approved. Thus, the Federal Circuit affirmed the district court's decision granting summary judgment in favor of Alcon and B&L.

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Claim Construction

Apex Inc. v. Raritan Computer Inc., 66 U.S.P.Q.2d 1444 (Fed. Cir. 2003). It is well settled that a claim limitation that actually uses the word "means" invokes a rebuttable presumption that Section 112, ¶ 6 applies. Conversely, a claim term that does not use "means" will trigger a rebuttable presumption that Section 112, ¶ 6 does not apply. In this case, the presumption imposes a burden on the appellee to come forward with evidence to rebut the presumption, but does not shift to such party the burden of proof in the sense of the risk of nonpersuasion, which remains throughout the trial on the party on whom it was originally cast. The appellee can rebut the presumption if it demonstrates that the claim term fails to recite sufficiently definite structure for performing that function. This burden must be met by a preponderance of the evidence. If the party who must provide the evidence fails to proffer sufficient evidence to meet this burden, then the presumption, either for or against the application of Section 112, ¶ 6, prevails. The presumption can collapse when a limitation lacking the word "means" nonetheless relies on functional terms rather than structure or material to describe performance of the claimed function. To help determine if a claim term recites sufficient structure, the court examines whether it has an understood meaning in the art. The fact that a particular claim term is defined in functional terms is not sufficient to convert the claim limitation into a means for performing a specified function within the meaning of Section 112, ¶ 6. In this case, none of the claims asserted by the appellee contains the term "means." While the district court correctly stated that the limitations were presumed not to be means-plus-function limitations, it determined that all but two of the limitations were means-plus-function limitations. The district court erred as a matter of law by relying on a single word "circuit" as opposed to the limitation as a whole (e.g., "a first interface circuit for receiving keyboard and cursor control device signals from the workstation"). While the Federal Circuit did not find it necessary to hold that the term "circuit" by itself always connotes sufficient structure, the term "circuit" with an appropriate identifier, such as "interface," "programming," and "logic," identifies some structural meaning to one of ordinary skill in the art. The Federal Circuit found that the term "circuit" by itself connotes some structure, and in the absence of any more compelling evidence of the understanding of one of ordinary skill in the art, the presumption that Section 112, ¶ 6 does not apply is determinative.

Abbott Labs. v. Novopharm Ltd., 66 U.S.P.Q.2d 1200 (Fed. Cir. 2003). Although courts must presume that the terms in a claim mean what they say, and unless otherwise compelled, give full effect to the ordinary and accustomed meaning of the claim terms, the Federal Circuit previously has identified situations where a sufficient reason exists to require defining a claim term other than by its ordinary and accustomed meaning. One such situation is when the patentee has chosen to be his own lexicographer by clearly setting forth an explicit definition for a claim term. In this case, the district court found that, although the term "co-micronization" was not known in the art prior to the filing date, both "micronization" and the prefix "co-" had well known meanings as of that date, and one of ordinary skill in the art would have understood the meaning of "co-micronization." Had the term not been explicitly defined in the patent specification, the Federal Circuit might have agreed with the accused infringer that the term simply means "micronized with or together" and would not necessarily exclude the presence of ingredients not specifically recited in the claim. However, "co-micronization" is explicitly defined as "micronization of an intimate mixture of fenofibrate and a solid surfactant." Thus, the district court did not err in reading the patentee's definition from the specification into the claim where the patentee was his own lexicographer.

Storage Tech. Corp. v. Cisco Systems Inc., 66 U.S.P.Q.2d 1545 (Fed. Cir. 2003). Whether to treat a preamble as a claim limitation is determined by the facts of each case in light of the claims as a whole and the invention described in the patent. Here, a method claim included two steps: (1) determining an instance policy to be applied to related PDUs based on the contents of one PDU, and (2) caching policy identification information identifying that instance of network policy. The district courts interpreted the claim language to require not only caching of policy identification information, but also caching of an instance of network policy, which was based in part on the presence of the phrase "policy caching method" or "policy cache" in the preamble of every independent claim. In the written description of the patent, the terms "policy caching method" and "policy cache" consistently refer to the invention as a whole, not to the specific step of storing an instance of network policy or to the cache that stores the instance of network policy. Similarly, the Federal Circuit found that the term "policy caching method" and "policy cache" in the preamble of each claim serves as a convenient label for the invention as a whole. Thus, these preamble terms do not limit claim scope and simply refer to the invention set forth in the body of the claims.

Invitrogen Corp. v. Biocrest Mfg., L.P., 66 U.S.P.Q.2d 1631 (Fed. Cir. 2003). Claim language generally carries the ordinary meaning of the words in their normal usage in the field of the invention. The context supplied by the field of the invention, the prior art, and the understanding of skilled artisans generally is key to discerning the normal usage of words in any claim. While prosecution history estoppel does not apply to determining literal claim scope, statements to an examiner during prosecution before the USPTO may also illuminate the scope of the claims. An applicant can disclaim scope during prosecution. The applicant, however, must clearly and unambiguously express any such surrender of subject matter during prosecution. In response to a rejection during prosecution where the examiner stated that 18 degrees

Celsius to 32 degrees Celsius was essential to the invention, the applicants amended the claims to replace "less than 37 degrees Celsius" with "18 degrees Celsius to 32 degrees Celsius." On this basis, the district court construed a growing step to mean that "growth must be performed at a temperature within 18 degrees Celsius to 32 degrees Celsius inclusive, and that at no time prior to freezing can the temperature of the cells exceed 32 degrees Celsius." In other words, the district court's interpretation forecloses any growth other than growth in the claimed temperature range. In contrast, the Federal Circuit concluded that claim 1 does not address and therefore permits growth before the steps disclosed in the claim at temperatures outside the range of 18 degrees Celsius to 32 degrees Celsius. The claim language does not preclude growth in advance of the first step in the claim.

RF Deleware Inc. v. Pacific Keystone Tech. Inc., 66 U.S.P.Q.2d 1593 (Fed. Cir. 2003). It is well established that, generally, patent terms are given their plain, ordinary or accustomed meaning to one of ordinary skill in the relevant art. Under the doctrine of claim differentiation, each claim in a patent is presumptively different in scope. Although claim differentiation is not a hard and fast rule of construction, it is applicable where there is a dispute over whether a limitation found in a dependent claim should be read into an independent claim, and that limitation is the only meaningful difference between the two claims. Moreover, claims are not necessarily and not usually limited in scope simply to the preferred embodiment. In this case, the language of claim 1 is clear on its face that the claimed filter includes "a filter bed having a non-buoyant particulate media filter layer." The district court construed the term "filter bed" to encompass flocculation, transitional and filter layers. Finding that the term was not defined in claim 1, the district court turned to the claims to determine whether the term "filter bed" was further defined. The district court thus incorporated flocculation layer from claim 7 and transitional layer from claim 12. The Federal Circuit determined that to construe the "filter bed" of claim 1 to include a flocculation, a transitional and a filter layer conflicts directly with the claim language. Such construction also renders meaningless the limitations of claims 7 and 12. Such construction is not supported by the doctrine of claim differentiation, especially as the only meaningful difference between claims 7 and 12 is the limitation regarding a transitional layer, and a major difference between claim 1 and claim 7 is the addition of a flocculation layer. Furthermore, the Federal Circuit concluded that the district court also erred in reading the limitations of the specification incorporating the "most preferred embodiment" into the claim limitation "filter bed." A basic claim construction canon is that one may not read a limitation into a claim from the written description.

Claim Construction (Infringement)

Altiris Inc. v. Symantec Corp., 65 U.S.P.Q.2d 1865 (Fed. Cir. 2003). The Federal Circuit vacated the district court's decision and remanded the case after finding that the district court erred in the construction of six claim limitations that gave rise to the summary judgment decision. Specifically, the Federal Circuit concluded that the district court construed five of the disputed claim terms too narrowly, by limiting the order of the method claims and the meaning of disputed claim terms to the preferred embodiment. The Federal Circuit held that even though the preferred embodiment was the only embodiment described in the specification and referred to a specific order of steps, the method claims were not limited to the order of steps described in the specification. Also, even though the preamble of the claim referred to a particular order of steps because the body of the claim set forth the complete invention, the preamble was not limiting. The Federal Circuit held that in limiting the terms "boot selection flag" and "automated boot sequence data" to the description in the preferred embodiment, the district court construed them too narrowly. Instead, the Federal Circuit construed "boot selection flag" to encompass multiple flags to select the boot cycle and "automated boot sequence data" to be one or more bits of data or information in a boot selection flag that indicates that the computer should boot in automation mode. The Federal Circuit then determined whether the term "means of booting" was a "means plus function" clause. After determining that the term "commands" does not recite sufficient structure, the Federal Circuit identified the function as being the booting of the computer, and the structure corresponding to this structure as being two operating systems, a customized or normal MBR, communications software, and their equivalents. The Federal Circuit construed "means for connecting" as not being limited to NICs with boot ROMS.

Intel Corp. v. VIA Technologies, Inc., 65 U.S.P.Q.2d 1934 (Fed. Cir. 2003). The Federal Circuit upheld the district court's judgment of noninfringement. Intel promulgated a new industry standard and granted a royalty-free cross-license to all those who wish to comply with the new standard. The issue was whether the license agreement also included the subject of another patent owned by Intel, the "Fast Write protocol." The Federal Circuit stated that since the license so dictated, it should be interpreted under Delaware law. The patentee argued that the words "disclose in and required by" must be interpreted to include optional features or protocols. The alleged infringer argued that the "required by" language does not explicitly exclude the optional features and protocols, and that the license does not state that it only covers baseline features. The Federal Circuit held that both readings of the license agreement were reasonable and, thus, that the agreement was ambiguous. Under Delaware law, according to the Federal Circuit, an ambiguous agreement should be construed against the drafter who is solely responsible for its terms. Because there was no negotiation, the language should be construed against Intel.

The alleged infringer also filed a cross-appeal appealing the district court's stipulated final judgment against it on its counterclaim for a declaratory judgment of invalid-

ity. The Federal Circuit upheld the district court's findings. Specifically, the Federal Circuit found that the generic description of the core logic was not inadequate solely because no circuitry was disclosed. Modifying the core logic to perform the program on the circuitry level may be left to the knowledge of those skilled in the art and need not be described in the patent.

Phonometrics Inc. v. Westin Hotel Co., 65 U.S.P.Q.2d 1949 (Fed. Cir. 2003). The Federal Circuit upheld the district court's finding of noninfringement. Specifically, the Federal Circuit held that their claim construction in two prior cases involving the same patent were not in conflict. Phonometrics argued that a footnote in the prior Intellicall case held that the phrase "to the caller" cannot be part of the relevant claim construction. The Federal Circuit found Phonometric's argument as wholly lacking in merit. The Federal Circuit also held that it had previously held that the term "substantially instantaneous" means "during the call." In view of these arguments, and the fact that these same arguments had been litigated numerous times, the Federal Circuit also sanctioned Phonometrics for $3,000, to be paid to Westin. Phonometrics also argued that the district court judge should recuse himself on the basis of bias. The Federal Circuit held that, under Eleventh Circuit law, the test for recusal is whether an objective, disinterested lay observer would entertain a significant doubt about the judge's responsibility. The Federal Circuit found that holding a consistent interpretation throughout various trials or a pattern of adverse rulings are not, by themselves, evidence of bias against the losing parties.

Lacks Industries, Inc. v. McKechnie Vehicle Components, 66 U.S.P.Q.2d 1083 (Fed. Cir. 2003). The Federal Circuit found noninfringement of two patents (the '809 and '906 patents); the grant of summary judgment of invalidity of claims 1, 3, and 8 of a third patent (the '213 patent); the finding of infringement of claims 11–13, 20, and 24–25 of the '213 patent, and that these claims were not proven invalid from a pre-critical date public use or sale. As to the '809 and '906 patents, the Federal Circuit upheld the district court's claim construction that the term "axial peripheral lip" meant that the uncovered surface of the composite wheel goes up and over the top of the projecting rim lip, and ends where the outer side of the rim lip merges with the tire mounting surface of the wheel rim. The patentee's submitted dictionary definitions to support its construction, but the Federal Circuit found that these did not provide a plain meaning. Also, support for the district court's claim construction could be found in the specification and the claim language, which was not outweighed by arguments made by the patentee during the prosecution of the patent. Since the court found that the two patents were not infringed, they did not reach the issue of the two patents' validity.

Regarding claims 1, 3, and 8 of the '213 patent, the Federal Circuit also upheld the district court's findings that the publications of the patentee's foreign patent applications of the '809 and '906 patents created a statutory bar to the U.S. applications. The foreign patent applications were published more than one year before the U.S. applications were filed. According to the Federal Circuit, these three claims were anticipated by the publications of the '809 and '906 foreign patent applications. As to claims 11–13, 20, and 24–25 of the '213 patent, the Federal Circuit remanded and found that the special master used the wrong standard in assessing the evidence. The Federal Circuit found that the special master did not find the patentee's pre-patent activity to be a commercial offer for sale as defined by contract law. Also, the Federal Circuit stated that there was not enough evidence in the record to hold that the patentee's conduct amounted to a contractual offer for sale as would be understood in the automotive industry. Thus, the Federal Circuit remanded, stating that the district court may need to take additional evidence on the practice in the industry to determine if the patentee's activities amounted to offer for sale.

The alleged infringers also asserted that the '213 patent was invalid because of its activities, which amounted to public use and on-sale bars. The Federal Circuit, however, found that the alleged infringer's evidence was uncorroborated and that corroboration is required where the testimony is from an accused infringer concerning the sale of an invention more than one year before the filing date of the invention.

Bio-Technology Gen. Corp. v. Duramed Pharm. Inc., 66 U.S.P.Q.2d 1360 (Fed. Cir. 2003). The Federal Circuit reversed the district court's finding of noninfringement. The Federal Circuit held that claim 1 of the patent-in-suit required the administration of an estrogeneic compound during certain designated days early in the woman's menstrual cycle, which causes a menstrual shift. However, the Federal Circuit held that nothing in the claim limits the invention to a method practiced through using only a single package of pills. According to the patentee's expert, women who use the accused product experience such a menstrual shift and, thus, infringe claim 1. The Federal Circuit remanded for the district court to hear further evidence on this issue.

Regarding claim 18, which was directed to a "system constituted by at least 24 separate daily dosage units," the Federal Circuit held that district court's claim construction was unduly restrictive. The district court held that the system required that the product be a single package of at least twenty-four pills, in which the first pills contain unopposed estrogen and the remainder contain progestin. The Federal Circuit construed claim 18 to refer more generally to a system of at least twenty-four separate dosage units, which are to be taken in a specified order.

Northrop Grumman Corp. v. Intel Corp., 66 U.S.P.Q.2d 1341 (Fed. Cir. 2003). The Federal Circuit reversed and remanded the district court's claim construction of claims 1 and 13 as being unduly restrictive. Specifically, the Federal Circuit held that the "means for monitoring" was a means-plus-function clause. Under Section 112, ¶ 6, the structure in the specification can

only be corresponding structure if there is a clear link or association between the structure to the function in the claim. According to the Federal Circuit, input signals and control signals disclosed in the specification could not be part of the structure corresponding to the functions of the "means for monitoring" because they are the signals that are monitored by the means for monitoring. Furthermore, the Federal Circuit held that the "means for defining a functional state of the bus interface unit," was defined too broadly by the district court. The specification made clear that the structure corresponding to the defining function is the set of flip-flops, and nothing else. Finally, the Federal Circuit refused to limit the term "bus interface unit" to anything other than a unit for interfacing with a serial data bus. The Federal Circuit held that there was nothing in the specification that disavowed any embodiment other than one operating in a bus controller/remote terminal environment. While it is true that the patent teaches that a major object of the invention involved handling the protocols of a wide variety of flexible bus communication message formats and data transfer algorithms, it also teaches that other embodiments need not utilize that protocol.

Claim Construction (Preamble)

Eaton Corp. v. Rockwell Int'l Corp., 66 U.S.P.Q.2d 1271 (Fed. Cir. 2003). The parties disagreed on whether the preamble limits the claim. In general, a preamble limits the claimed invention if it recites essential structure or steps, or if it is "necessary to give life, meaning, and vitality" to the claim. Rockwell International Corp. and Arvin Meritor (collectively, Meritor) argued that the preamble of the claim is a limitation of the claim because many limitations in the claim body antecedent basis only in the preamble and, thus, the preamble is necessary to define the invention. Meritor also argued that the device described by the preamble must perform the "urging" step of the claim. Based on its claim construction, Meritor concluded that the claim is directed to an "automatic mechanical vehicle driveline system" in which the engagement and disengagement of the gears is performed automatically and does not require the manual intervention of the driver. The method steps of the claim require manipulating particular structures that are identified and described only by the preamble, during a particular sequence of events defined only by the preamble. The Federal Circuit concluded that the inventor chose to use both the preamble and the claim body to define the invention. Thus, the Federal Circuit reversed the judgement of infringement entered against Meritor.

Meritor alternatively argued that if the Federal Circuit rejected the district court's claim construction, then it was entitled to a new trial on the invalidity issues. The Federal Circuit in disagreeing stated that the mere fact that a new claim construction has been adopted on appeal is insufficient, in and of itself, to require a new trial. The Federal Circuit stated that Meritor failed to establish any prejudice because a narrower claim construction would not make it easier for Meritor, the accused infringer, to establish invalidity. The Federal Circuit affirmed the district court's denial of Meritor's motion for a new trial on the issue of invalidity. The Federal Circuit also affirmed the district court's judgment of no inequitable conduct.

Damage Computation (Interest)

Tronzo v. Biomet Inc., 65 U.S.P.Q.2d 1861 (Fed. Cir. 2003). The jury awarded Dr. Tronzo compensatory damages, enhanced damages, and punitive damages in 1996 (*Tronzo I*). On appeal in 1998, the patent was found to be invalid, but the verdict of liability on the tort claims was affirmed (*Tronzo II*). The punitive damages award was not appealed. In 1999, the district court reduced the compensatory and punitive damages to Dr. Tronzo (*Tronzo III*). Dr. Tronzo appealed, and the Federal Circuit in 2001 affirmed the reduced compensatory damages but reversed the reduction in punitive damages because the district court exceeded its mandate on remand (*Tronzo IV*). The pending issue was when interest calculation starts on the punitive damages.

The Federal Circuit's decision in *Tronzo IV* modified or reversed the district court's judgment in *Tronzo III*, because without such a decision the punitive damages were $52,000. Thus, Rule 37(b) should have been followed, and the *Tronzo* IV decision was flawed in its failure to instruct as to interest. A party "who conceives himself entitled to interest from a date other than the date of entry of judgment in accordance with the mandate should be entitled to seek recall of the mandate for determination of the question." Neither side, however, pointed out the Federal Circuit's oversight when it occurred or requested remedial action. The Federal Circuit looked to the regional circuit (Fifth Circuit) for guidance.

Because no motion was filed, the Federal Circuit vacated the award of post-judgment interest from 1996, and concluded that interest shall accrue from the date of the final judgment in *Tronzo IV,* which was 2001.

Doctrine of Equivalents

Boehringer Ingelheim Vetmedica Inc. v. Schering-Plough Corp., 65 U.S.P.Q.2d 1961 (Fed. Cir. 2003). Under the doctrine of equivalents, a claim limitation not literally met may be satisfied by an element of the accused device if the differences between the two are insubstantial. The insubstantial differences inquiry may be guided by determining whether the element in the accused device performs substantially the same function in substantially the same way to obtain the same result. The relevant analysis under the "function-way-result" test focuses on the role played by an element in the context of the specific patent claim, not whether the accused element is capable of performing different roles than the claim element in other contexts. In this case, what happens when the virus is administered to a pig is irrelevant to assessing whether the two strains are equivalent in the in vitro culture defined by the claim. The fact that in other contexts the virus can perform other functions in different ways to yield a different result is not relevant.

Fraud

Rambus Inc. v. Infineon Tech. AG, 65 U.S.P.Q.2d 1707 (Fed. Cir. 2003). Rambus attended meetings and joined the Joint Electron Devices Engineering Council (JEDEC). JEDEC is a standard-setting body in which member companies participate on various committees to develop standards for semiconductor technologies. During Rambus' membership on one of these committees, JEDEC adopted a standard for synchronous dynamic random access memory (SDRAM). After Rambus withdrew from JEDEC, JEDEC began work on a standard for double data rate-SDRAM (DDR-SDRAM), which incorporated technology discussed in general before Rambus' withdrawal. The jury found that Rambus committed actual fraud by not disclosing to JEDEC patents and patent applications related to the SDRAM and DDR-SDRAM standards. The district court denied JMOL on the SDRAM fraud verdict, but granted judgment as a matter of law (JMOL) of no fraud on the DDR-SDRAM, stating it did not have patents or applications related to the SDRAM standard while in JEDEC. Infineon cross-appealed the grant of JMOL of no fraud on the DDR-SDRAM verdict, arguing that the judge did not give proper deference to the jury.

To prove fraud in Virginia, a party must show by clear and convincing evidence: (1) a false representation (or an omission in the face of a duty to disclose), (2) of a material fact, (3) made intentionally and knowingly, (4) with the intent to mislead, (5) with reasonable reliance by the misled party, and (6) resulting in damage to the mislead party. Before determining whether Rambus withheld information on patents or applications in the face of a duty to disclose, the Federal Circuit must first ascertain what duty Rambus owed JEDEC. The Federal Circuit found that the language of the policy statements did not impose any direct duty on members. The Federal Circuit pointed out that while the policy language advises JDEC as a whole to avoid standards "calling for the use of a patent and the manual obligates the chairperson to remind members to inform the meeting of any patents or applications relevant to the work of the committee," it found no language in the membership application or manual excerpts expressly requiring members to disclose information. Nevertheless, because JEDEC members treated the language of Appendix E as imposing a disclosure duty, the Federal Circuit likewise treated this language as a disclosure duty. Appendix E prohibited standards that "call for use of a patented item or process" and encouraged disclosure of information "covered by the patent or pending patent." It was that language that the chairperson was instructed to show members to inform them of their duty. This language links the disclosure duty to patents or applications whose claims cover the proposed JEDEC standard. Further, the JEDEC policy permitted the adoption of a standard covered by a patent if the claimed technology was available under reasonable license terms. The Federal Circuit concluded that Rambus' duty to disclose extended only to claims in patents or applications that reasonably might be necessary to practice the standard.

The disclosure duty operates when a reasonable competitor would not expect to practice the standard without a license under the undisclosed claims. Stated another way, there must be some reasonable expectation that a license is needed to implement the standard. The disclosure duty does not arise for a claim that recites individual limitations directed to a feature of the JEDEC standard as long as that claim also includes limitations not needed to practice the standard. The Federal Circuit determined that despite its best efforts, Rambus did not obtain SDRAM claims in any of its undisclosed patents or applications. Because there is no expectation that the undisclosed claims are necessary to implement the standard, these claims did not trigger Rambus' disclosure duty. Thus, the Federal Circuit held that substantial evidence did not support the jury's verdict that Rambus breached its duties under the JEDEC policy. Similarly, with respect to the DDR-SDRAM verdict, the Federal Circuit found that the district court properly granted JMOL of no fraud in Rambus' favor on the DDR-SDRAM verdict because Infineon did not show that Rambus had a duty to disclose before the DDR-SDRAM standard-setting process formally began.

Inequitable Conduct

Hoffmann-La Roche Inc. v. Promega Corp., 66 U.S.P.Q.2d 1385 (Fed. Cir. 2003). A party seeking to have a patent declared unenforceable has a heavy burden to meet. Inequitable conduct requires a misrepresentation or omission of a material fact, together with an intent to deceive the PTO. Both of those distinct elements must be shown by clear and convincing evidence. Once the requisite level of materiality and intent are shown, the district court must determine if the equities warrant a conclusion of inequitable conduct. While it is difficult to prove inequitable conduct, a district court's ruling on inequitable conduct is reviewed deferentially. The court's findings of materiality and intent are reviewed for clear error and, thus, will not be reversed in the absence of a definite and firm conviction that a mistake has been made. The district court's assessment of the equities is reviewed for an abuse of discretion. In this case, the district court found that the inventors committed inequitable conduct by erroneously stating that they had performed a particular purification protocol and had obtained certain results. The portion of the specification describing the purification protocol and the results obtained is written in the past tense. The district court found that the purification protocol had not been performed as written, and in light of the testimony at trial, that finding cannot be held to be clearly erroneous. The inventors admitted that the experiment was never performed as described and, thus, the results were never obtained.

Misrepresentations by themselves are not enough to render a patent unenforceable. The misrepresentations must be intentional and material to patentability. The

inventors attested that all statements made in the patent application were true, but there was no suggestion that the use of the past tense was an oversight. There was no evidence presented to explain why the past tense was used to describe an experiment that was not performed. Accordingly, the district court did not clearly err in determining that the inventor's use of the past tense to describe the experiment was knowingly false. The district court's finding that the inventors had a good-faith belief in the novelty of their invention is not incompatible with a finding of deceptive intent. As to the materiality element, the appellant argued that because the patent did not have claims directed to purity, representations made about purity in an application cannot be material. The Federal Circuit, however, stated that materiality is not limited to matters recited in the claims of a patent. Rather, information is material when there is a substantial likelihood that a reasonable examiner would consider the information important in deciding whether to allow the application to issue. Moreover, affirmative misrepresentations, in contrast to misleading omissions, are more likely to be regarded as material. In this case, the inventors argued in an office action response that even if the claimed enzyme were not distinct compared to the prior art enzyme, applicants would still be entitled to a patent because the present preparations "are far more pure" than the prior art enzyme. Purity was therefore a prominent argument in favor of patentability. The fact that the examiner did not rely on the purity representations in issuing the patent is not inconsistent with a finding of materiality.

Infringement/Summary Judgment

Nikken USA Inc. v. Robinsons-May Inc., 65 U.S.P.Q.2d 1611 (Fed. Cir. 2003). Nikken USA Inc. (Nikken) owns two patents directed to therapeutic magnets and methods of using the same. Several retail defendants (collectively, HoMedics) sell (a) a wrap product with discrete hard magnets sewn into the material, and (b) shoe insoles with either straight or curved magnetization patterns.

The Federal Circuit construed the term "magnetizable flexible sheet" to be a flexible sheet that by itself is capable of being made a magnet. Because the only magnetizable portions of the flexible wraps made by HoMedics are the discrete magnets that are sewn into the wraps, those magnets are not part of the flexible sheets themselves. Reading the "magnetizable flexible sheet" limitation so broadly as to encompass the affixation of discrete magnets to a flexible sheet would make any flexible material "magnetizable" and would impermissibly vitiate the disputed limitation. Thus, the Federal Circuit stated that the wrap products with magnets sewn into the material cannot infringe the claim of the '111 patent.

The Federal Circuit stated that the construction of the phrase "first and second areas of alternating magnetic polarity" by the district court was flawed. Given the modified claim construction, the Federal Circuit agreed with Nikken that the district court erred in granting the judgment as a matter of law (JMOL) that the shoe insoles with curved magnetization patterns do not infringe the claim of the '111 patent. The district court's error in claim construction was harmless because the jury found infringement under the district court's narrower claim construction. Thus, the Federal Circuit reversed the district court's JMOL that the shoe insoles with curved magnetized patterns do not infringe the '111 patent, and reinstated the jury's finding of infringement. The Federal Circuit found that sufficient evidence supported the jury's finding that HoMedics' infringement of the '111 patent was willful, and remanded for the district court to determine whether enhanced damages are appropriate.

The Federal Circuit construed the phrase "attachable to the skin by a self adhesive plaster" of the '711 patent to mean that the term "attachable" requires that the magnetic sheet itself must be capable of attaching to the skin by a self-adhesive plaster. This phrase cannot be read so broadly to include any magnetic sheet that could somehow attach to the skin by adding some external means because everything would be attachable and this would render meaningless the "attachable" limitation. Furthermore, Nikken cannot assert a broader scope of the claim to include subject matter that was disclaimed during the prosecution history from prior art references with magnetic therapy devices that are not self-adhesive, but which self-adhesive plasters may be added. Thus, the Federal Circuit concluded that no reasonable jury could have found that the straight shoe insoles satisfy the limitations of the claims of the '711 patent. The Federal Circuit reversed the district court's denial of JMOL and concluded, as a matter of law, that the straight shoe insoles cannot infringe the '711 patent.

Obviousness

In re Berg, 65 U.S.P.Q.2d 2003 (Fed. Cir. 2003). Obviousness is a question of law supported by underlying fact. What the prior art teaches and whether it teaches away from the claimed invention are questions of fact. On appeal, the Board of Patent Appeals and Interferences' factual findings are reviewed for substantial evidence. As persons of scientific competence in the fields in which they work, examiners and administrative patent judges on the Board are responsible for making findings as to the meaning of prior art references to persons of ordinary skill in the art and the motivation that those references would provide to such persons. Absent legal error or contrary factual evidence, those findings can establish a prima facie case of obviousness. In this case, the appellants have not pointed to any legal error nor have they pointed to sufficient factual grounds to question the findings made by the examiner and the Board as to the teachings of the prior art and the motivation that the prior art would give to someone of skill in the art to make the claimed invention. Because the appellants did not show why the Board's conclusions regarding the disclosures in the prior art are not supported by substan-

tial evidence, the Federal Circuit agreed that a prima facie case of obviousness was established for the claims at issue. Because the appellants failed to present persuasive evidence or arguments in rebuttal, the Federal Circuit affirmed the Boards' decision to reject the claims at issue.

Duro-Last Inc. v. Custom Seal Inc., 65 U.S.P.Q.2d 1025 (Fed. Cir. 2003). Duro-Last, Inc. (Duro-Last), the patentee, sued Custom Seal Inc. (Custom Seal) for patent infringement. Duro-Last filed motions for judgment as a matter of law (JMOL) directed to inequitable conduct and the on-sale bar. A jury found that Custom Seal infringed both patents and also found both patents invalid for obviousness. After the district court entered judgment on the jury verdict, Duro-Last filed a motion for JMOL that the patents were not invalid for obviousness. Custom Seal objected to the motion because the issue was not properly raised in a JMOL motion at the close of evidence, as required by Rule 50. The district court, however, granted JMOL in Duro-Last's favor by holding that Custom Seal had failed to prove obviousness of either patent.

One issue addressed at the Federal Circuit was whether Duro-Last's pre-verdict JMOL motions, made at the close of evidence, raised the obviousness issue with enough specificity as required by Rule 50. Because this issue pertains uniquely to patent law, the Federal Circuit uses its own law. The JMOL motions of inequitable conduct and on-sale bar raise different elements of proof as compared to obviousness. Duro-Last was thus precluded from making a post-trial motion under Rule 50(b) for JMOL that its patents were not invalid for obviousness, and it was improper for the district court to rule on Duro-Last's motion challenging the sufficiency of Custom Seal's evidence on invalidity. Having concluded that Duro-Last waived its right to challenge the sufficiency of the evidence underlying the jury verdict of obviousness, the Federal Circuit determined whether and to what extent the verdict can be reviewed. When a party has preserved its right to appeal the jury verdict by filing a valid JMOL motion on obviousness, the Federal Circuit first reviews the underlying factual findings to ascertain whether they are supported by substantial evidence. In this case, Duro-Last waived its right to challenge any factual findings underlying the jury's obviousness verdict. Because the jury did not make explicit factual findings, the Federal Circuit presumed that the jury resolved the underlying factual disputes in Custom Seal's favor and that one of ordinary skill in the art would have been motivated to make the changes.

The Federal Circuit reversed the district court's grant of JMOL that the patents are not invalid for obviousness. The Federal Circuit affirmed the district court's judgment that one of the patents is not unenforceable due to inequitable conduct.

Ownership/Eleventh Amendment

Regents of the University of New Mexico v. Knight, 65 U.S.P.Q.2d 1001 (Fed. Cir. 2003). The Federal Circuit upheld the district court's decisions of summary judgment in favor of the University of New Mexico (UNM) with respect to ownership of the patent and breach of contract by Scallen and Knight. State law governs contractual obligations and transfers of property rights, including patents. Both Scallen and Knight were bound by the UNM patent policy. The UNM patent policy included the following provisions: "All staff members who make inventions or discoveries (i) in the course of research carried out under their direction and having all or any part of the cost paid from University funds …, or (ii) which are the direct result of their duties with the University, or (iii) which are made, in whole or in part, using University resources or facilities, shall disclose to the President all such inventions and discoveries …. [S]uch inventions and discoveries belong to the University [UNM]." The Federal Circuit agreed with UNM as to the contractual obligations that arose from the patent policy, the co-inventor agreement, and the joint assignments. Moreover, both Scallen and Knight acted as though they intended to be bound by the patent policy by assigning earlier unrelated inventions to UNM. It was not until a dispute arose concerning the prosecution of the patent applications that Scallen and Knight refused to cooperate with UNM.

Scallen and Knight argued that the district court erred in allowing UNM to withdraw its claims for money damages, which subsequently resulted in dismissal of their counterclaims. Scallen and Knight asserted that UNM waived its Eleventh Amendment immunity when it filed suit with claims for money damages. The Federal Circuit stated that the question of Eleventh Amendment waiver is a matter of Federal Circuit law. The Federal Circuit concluded that the district court erred in dismissing the counterclaims for money damages on the ground of the Eleventh Amendment. Because UNM consented to federal court jurisdiction when it filed suit against Scallen and Knight, the question is the extent to which UNM waived its Eleventh Amendment immunity.

The Federal Circuit reversed the district court's Eleventh Amendment dismissal of Knight's counterclaim for royalties because it was not unreasonable to view that UNM had anticipated and consented to such counterclaims. The Federal Circuit vacated the district court's dismissal of Scallen and Knight's counterclaims for money damages, and remanded for the district court to determine which, if any, of those counterclaims are compulsory with UNM's claims.

Patentability

Mazzari v. Rogan, 65 U.S.P.Q.2d 1049 (Fed. Cir. 2003). Mazzari and Sheedy (collectively, Mazzari) appealed the PTO Board of Appeals and Interferences' decision of unpatentability to the United States District Court for the District of Columbia, pursuant to 35 U.S.C. § 145. A Section 145 review is distinct from a Section 141 appeal in that it affords the applicant an opportunity to present additional evidence or argue the previous evidence afresh, either by simply relying on the record or by reintroducing the same evidence through alternative means such as live testimony.

In the Federal Circuit, Mazzari appealed the summary judgment decision from the district court that their application was not patentable. The PTO disagreed and presented several arguments before the district court. First, the PTO argued that the Kowalewski reference anticipates the pending claims. Mazzari did not deny that Kowalewski fully teaches the limitations of the claims. Rather, Mazzari argued Kowalewski is not prior art because it was not accessible to the public until 1992. But, the PTO submitted a declaration that established that Kowalewski was indexed, catalogued, and available to the public in 1991. Thus, Kowalewski was 35 U.S.C. § 102(b) prior art. Second, the PTO argued that the Breitig reference, which was available in 1965, also fully discloses all of the claim limitations. The argument by Mazzari that Breitig was written in German had absolutely no merit. Mazzari also could not overcome another prior art rejection based on obviousness by simply stating that there was no motivation to combine these references by a declarant who admitted that the device that he saw was not the reference device and that he was not one of ordinary skill in the art. Accordingly, the Federal Circuit affirmed the district court's summary judgment decision of the patent application not being patentable.

Personal Jurisdiction

Silent Drive Inc. v. Strong Industries Inc., 66 U.S.P.Q.2d 1602 (Fed. Cir. 2003). The Federal Circuit held that whether personal jurisdiction satisfies due process in a patent case depends on three factors: (1) whether the accused infringer "purposefully directed" its activities at residents of the forum, (2) whether the claim "arises out of or relates to" the patentee's with the forum, and (3) whether assertion of personal jurisdiction is "reasonable and fair." The Federal Circuit found that sending letters threatening infringement litigation is not sufficient to confer personal jurisdiction under the third factor. In this case, the patentees asked the Texas state court to enjoin the accused infringer from producing its products, and that the accused infringer was specifically named in the injunction, as was the location of its headquarters. The patentees allegedly sent letters to the accused infringer and its customers in which they detailed the serious consequences of disobeying the injunction. The accused infringer alleged that a real case or controversy exists between the accused infringer and the patentees over the effect of the state court injunction on the accused infringer. The accused infringer then requested that the district court order that the accused infringer is not bound by the state court injunction. The Federal Circuit found that the accused infringer has specifically pled that the patentees activities with respect to the enforcement of the Texas injunction were all "expressly aimed" at Iowa, and that the patentees "knew" the activities would have the potentially devastating effects of inhibiting the accused infringer from producing its products and its customers from buying them. In *Calder v. Jones*, 465 U.S. 783, 788 (1984), the Supreme Court held that personal jurisdiction over patentees who had never set foot in the forum was proper because the allegedly libelous "article was drawn from" sources within the forum state, and "the brunt of the harm … was suffered in" the forum. In sum, the forum is the focal point both of the story and of the harm suffered. The Federal Circuit held that the rationale of *Calder* applies to the circumstances of the patentees' attempted enforcement of the Texas injunction against the accused infringer in Iowa. The Federal Circuit has held repeatedly that the sending of infringement letters would satisfy the minimum contacts requirement of due process except for the policy considerations unique to the patent context. If infringement letters created jurisdiction, the patentee could be dragged into court anywhere the letters were sent. No such countervailing policy, however, exists with regard to state court injunctions, which are designed to operate primarily in the forum. Seeking to extend the injunction's effect beyond the boundaries of the forum is not an activity that merits special protection.

Summary Judgment/Claim Construction

Biogen v. Berlex Lab. Inc., 65 U.S.P.Q.2d 1809 (Fed. Cir. 2003). Berlex Laboratories Inc. (Berlex) owns the '567 and '779 patents directed to recombinant DNA technology and the production of human interferon. The claim construction issue in the '567 patent was whether the claims were limited to producing human interferon in Chinese hamster ovary cells using a single DNA construct that carried both the human interferon gene and the gene for the marker DHFR. The claims on their face did not specifically recite using a single DNA construct.

Berlex argued that the single construct was only a preferred embodiment and that it was incorrect to limit the claims to the preferred embodiment. The '567 patent specification only discussed the invention in terms of a single DNA construct. Berlex also argued that the '567 patent was a divisional application that was filed after another patent (the '843 patent) had issued that explicitly recited using a single DNA construct and, thus, the '567 and '843 patent claims are of a different scope. Berlex pointed to several isolated passages in the '567 patent that are not specifically limited to a single DNA construct. Biogen responded that these isolated statements are just a few general undeveloped sentences and the entire '567 patent specification is directed to a single DNA construct.

During the prosecution history of the '567 patent, Berlex stated that the claims were being pursued to cure an oversight in the '843 patent prosecution history. The oversight involved unnecessary language in the '843 patent claims concerning prokaryotic cell nucleotide sequences and selectable marker-related sequences.

In 1992, Berlex filed a terminal disclaimer in which the '567 patent claims would expire concurrently with the '843 patent. The PTO examiner found a technical flaw in the terminal disclaimer and issued an obviousness-type double-patenting rejection. In this rejection,

the examiner described the claims that issued as the '567 claims as not being patentably distinct from the '843 single DNA construct claims. The examiner stated that the '567 claims were simply a change to "functional language" and that this language limited the claims to the vector construct in the '843 patent. The '843 patent claims recite the DNA construct by listing each element of the vector construct.

Berlex, during the prosecution history of the '567 patent, also "clarified" the '843 patent record by stating that a prior art reference (Axel) did generically disclose linked genes, but the claims were allowable over Axel. The examiner in the '567 patent prosecution history stated in the reasons for allowance that the applicants' claims are directed to a DNA construct comprising a vector, an interferon gene, and a DHFR marker gene, and are similar to the '843 patent claims except that the '567 patent claims recite the marker gene to be DHFR, whereas the '843 patent claims do not. The claims were allowed after a terminal disclaimer was filed over the '843 patent claims.

Berlex responded to the examiner's reasons for allowance and stated that the '567 patent claims do not depend on any particular nucleic acid construct configuration. This response was not included in the certified prosecution record, and the district court erred by not giving it any weight because the public did not have access to it. The Federal Circuit stated that arguments made in a related application do not automatically apply to different claims in a separate application. The applicant's discovery that the Axel reference had been mischaracterized in the '843 patent prosecution history indeed necessitated a change to state the correct content of the reference. This correction, however, does not change the content of the specification or the description of the invention as using a single DNA construct for linked co-transformation. The applicant's statements to the examiner that the '567 patent claims "fall within the scope of subject matter already allowable over the prior art" weigh heavily against Berlex's now-proposed broad construction. The Federal Circuit stated that the specification defines the invention as using a single DNA construct to introduce the linked hamster ovary cell, and that the '567 patent claims are so limited.

In prosecuting a related application, the applicant is not barred from raising new arguments or correcting past errors. When the applicant is seeking different claims in a divisional application, estoppel generally does not arise from the prosecution of the parent. Thus, the '567 patentee, having in the '843 patent prosecution history argued that a single linked construct has advantages over multiple unlinked constructs, is not thereby estopped from asserting that a multiple construct infringes under the doctrine of equivalents. Thus, the Federal Circuit vacated the summary judgment of infringement of the '567 patent under the doctrine of equivalents. The Federal Circuit affirmed the decision of no literal infringement of the '567 patent and no infringement of the '779 patent.

Prima Tek II LLC v. Polypal S.A.R.L., 65 U.S.P.Q.2d 1818 (Fed. Cir. 2003). The first claim construction issue involved the term "floral holding material." The district court construed the term "floral holding material" to mean "a three-dimensional solid, semi-solid, or granular material capable of giving support to individual flowers when their stems are inserted into the material," and required that the flower stems be "inserted into and through" the floral holding material. Neither the phrase "inserted into" nor "inserted through" is recited in any of the asserted claims. Rather, the claims require that the floral holding material be made of material capable of receiving a portion of the floral grouping and supporting the floral grouping without potting.

The Federal Circuit found that the specification is at most ambiguous on whether "capability of receiving a portion of the floral grouping" requires insertion into and through the floral holding material. Polypap S.A.R.L. (Polypap), the accused infringer, argued that the specification supported the district court's claim construction. The Federal Circuit disagreed and stated that the specification only states that the floral holding material "may be" (not must be) the type of material commonly referred to as floral foam or soil. This makes it crystal clear that the open-ended examples of "floral holding material" are merely illustrative and, thus, do not limit the floral holding material in the claims to only these examples. Polypap also argued that the prosecution history supported the district court's claim construction. The Federal Circuit stated that drawing inferences of the meaning of claim terms from an examiner's silence is not proper when construing claims. Because it is also well established that broad claims supported in the specification should not be limited to a preferred embodiment, the term floral holding material should be given its ordinary meaning as recited in the claims.

The Federal Circuit agreed with the district court that the term "substantially bonded" should not be limited to requiring that the overlapping fold in the sheet of material be substantially bonded by an adhesive. Rather, the "substantially bonded" limitation requires that the overlapping fold in the sheet of material be gathered or crimped about the upper end of the floral holding material by a band or bonding material. The Federal Circuit could not determine with certainty whether there were any genuine issues of material fact regarding infringement by the accused product in view of the amended claim construction. Thus, the Federal Circuit vacated the district court's grant of summary judgment of noninfringement, and remanded for further proceedings consistent with the opinion.

Summary Judgment Doctrine of Equivalents

Lockheed Martin Corp. v. Space Systems/Loral Inc., 65 U.S.P.Q.2d 1282 (Fed. Cir. 2003).This case was remanded by the Supreme Court for reconsideration in light of the *Festo* decision. The Federal Circuit affirmed the decision of the district court that summary judgment of non-infringement was proper and that this case did

not implicate the Supreme Court's decision in *Festo*.

Lockheed Martin Corp. (Lockheed), the patentee, accused Space Systems/Loral Inc. (SSL) of infringing its patent. One of the claim construction issues involved the phrase "varies sinusoidally." The parties did not dispute the claim construction of the phrase "varies sinusoidally," but rather its application to the accused satellite. Lockheed conceded that there is no literal infringement because the SSL satellite L-Wheel rotates about a non-zero bias speed. An accused device, however, may infringe under the doctrine of equivalents if each element performs substantially the same function, in substantially the same way, to achieve substantially the same result. Under the all elements rule, there is no infringement under the doctrine of equivalents if even one limitation of a claim or its equivalent is not present in the accused device. Lockheed argued that the speed of the SSL satellite L-Wheel varies sinusoidally even though it always spins faster than a set bias speed. It is undisputed that the speed of the SSL satellite L-Wheel does not slow to zero, stop, and reverse direction twice during each orbit of its operation. Furthermore, this limitation requires the transverse wheel to vary in accordance with a "predetermined rate schedule." The SSL satellite does not utilize a predetermined rate schedule because the L-Wheel responds to actual real-time error sensed by the earth sensor. Therefore, the Federal Circuit affirmed the district court's grant of summary judgment of noninfringement in favor of SSL.

Summary Judgment/Prosecution History Estoppel

Spring Window Fashions LP v. Novo Indus. LP, 65 U.S.P.Q.2d 1826 (Fed. Cir. 2003).The patent relates to a method of trimming window blinds and includes the following claim limitation: "a cutting means, said cutting means including a first cutter for cutting said head rail and a separate second cutter for cutting at least said slats." The Federal Circuit relying on the prosecution history confirmed that the district court's interpretation of the term "separate" to mean capable of independent movement was correct.

In the prosecution history, the applicant amended the claim and distinguished the applied reference of Pluber by arguing that Pluber was not prior art because it post-dated the grandparent application. The applicant noted that extra effort is required to cut the head rail because of its steel construction and this is the reason for providing two entirely separate movement means; one for cutting the head rail and the other for cutting the bottom rail and the blind slats. The applicant replaced the term "a cutting means" with "a cutting means, said cutting means including a first cutter for cutting said head rail and a separate second cutter for cutting at least said slats."

The PTO examiner rejected applicant's argument that Pluber lacked two separate cutters, because each of the cutters are separately mounted to the plate. In response, the applicant argued that Pluber was not a prior art reference and stated that previous arguments that distinguished Pluber remain. Since Pluber's device and Novo's device have nearly identical arrangement of their cutting edges, the applicant clearly disclaimed coverage of Novo's device. It is not clear from the record why the examiner allowed the claims, but the examiner's remarks do not negate the effect of the applicant's disclaimer. The public notice function of a patent and its prosecution history requires that a patentee be held to what he declares during its prosecution history. A patentee may not state during prosecution that the claims do not cover a particular device and then change such a position by suing a party who makes that same device for infringement.

If the applicant mistakenly disclaimed coverage of the claimed invention, then the applicant should have amended the prosecution history file to reflect the error. The applicant, however, never retracted any of the statements distinguishing Pluber nor did the applicant acquiesce in the examiner's comments regarding the overlapping scope of Pluber. Since the accused device does not have two cutters that move independent of each other, the Federal Circuit upheld the district court's grant of summary judgment of noninfringement and denial of summary judgment of infringement. The Federal Circuit affirmed grant of summary judgment to the patentee on the accused infringer's counterclaims of tortious interference and disparagement.

Waiver

Pandrol USA LP v. Airboss Railway Products Inc., 65 U.S.P.Q.2d 1985 (Fed. Cir. 2003). When the patentees moved for summary judgment of infringement, they implicitly asserted ownership of the patent, which is a necessary prerequisite to winning a judgment of infringement. In opposing this motion it was incumbent upon the accused infringers to raise the issue of lack of patent ownership. As such, the district court correctly found that the failure to raise the ownership issue in opposing summary judgment of infringement constituted a waiver of that issue as a defense to the patentee's claim of infringement. However, the accused infringers' waiver of the defense of lack of patent ownership did not waive their ability to challenge the patentee's standing to sue under Article III of the Constitution. Under Article III, standing is jurisdictional and not subject to waiver. It is well established that any party, and even the court sua sponte can raise the issue of standing for the first time at any stage of the litigation, even on appeal.

Riverwood Int'l Corp. v. R.A. Jones & Co., 66 U.S.P.Q.2d 1331 (Fed. Cir. 2003). The Federal Circuit held that the district court erred as a matter of law that '789 and '361 patents were invalid. The district court held that a prior patent (the '806 patent) was prior art by admission. The Federal Circuit first found that the plaintiff did not waive its right to appeal the decision by its failure to object at trial. The Federal Circuit held that, since both parties fully briefed the issue of whether the '806 patent was prior art by admission prior to trial, and the district court issued a ruling that was adverse to the plaintiff,

it was futile for the plaintiff to object at trial. The Federal Circuit referred to the Eleventh Circuit's rule that there exists a futility exception to raising an objection when the basis for the objection is already known to the district court and the objection would be futile. The Federal Circuit recognized that a statement by an applicant during prosecution identifying certain matter as prior art is an admission that the matter is prior art. However, this doctrine does not apply to subject matter that is the inventor's own work. Furthermore, an application issued to the same inventive entity cannot be prior art under Section 102(e). According to the Federal Circuit, to determine the inventive entity, it is important to not only look at the inventors listed, but whether the portions of the reference relied on as prior art, and the subject matter of the claims in question, represent the work of a common inventive entity.

Because the Federal Circuit vacated the judgment of invalidity, the district court's construction of the term "flight bars" was reviewed. The term "flight bars" is used throughout the specification as a structure that intersects articles on a conveyor, forms groups, and moves the articles. Nothing limited this structure to being a unitary structure. Thus, the district court erred in construing the term to require a unitary structure.

Copyrights

Architectural Plans Not Published

John G. Danielson, Inc. v. Winchester-Conant Properties, Inc., (1st Cir. 2003). In 1987, the plaintiff architect prepared plans for a condominium development. Several plan drawings were submitted to the town for approval. As part of the submission to the town, the drawings were displayed at a televised town meeting. Videotapes of the broadcast were available at the town's public library. The submitted drawings did not bear a copyright notice, which was required for published works in 1987 under 17 U.S.C. § 401(a) (1982). Loss of copyright was the penalty for failure to mark.

A subsequent developer took over the project and copied the plaintiff's plans. The defendant countered the plaintiff's copyright claims by arguing that the plaintiff's non-marking forfeited its copyright protection in the published drawings. The First Circuit determined that there was not a "publication" that required marking. The First Circuit reasoned that some of the plaintiff's activities were protected under the doctrine of "limited publication" and other activities were merely a display under 17 U.S.C. § 101. Limited publication occurs when tangible copies of the work are distributed, but to a limited class of persons and for a limited purpose. It is well settled that the doctrine of limited publication is applicable to the submission of architectural plans to municipal authorities for approval.

Section 101 provides that a public display of the work does not of itself constitute a publication. The First Circuit indicated that the television broadcast and videotape were merely "displays" of the work. Thus, the plaintiff's non-marking did not bar its copyright claim.

Conversion of Software Source Code to Alternative Format Infringes Copyright

McRoberts Software Inc. v. Media 100 Inc., (7th Cir. 2003). The Seventh Circuit has determined that translation of software source code meant for the Macintosh operating system for compatibility with Microsoft Windows is copyright infringement, even in the face of questionable license language.

The plaintiff MSI developed character generation software for compatibility with Mac computers and licensed the software, Comet/CG, to Media 100 for use with Media 100's hardware. Media 100 submitted a copy of Media 100's proprietary source code to a third-party developer to convert the program for Windows compatibility. MSI sued Media 100 for copyright infringement and other counts. The district court ruled in favor of MSI on the copyright infringement count.

The Seventh Circuit deferred to the jury's finding that a license between MSI and Media 100 did not allow conversion of the software for use with Windows. Media 100 argued that the contract terms were ambiguous, allowing Media 100 to use executable versions of the software with "Media 100 hardware," not limiting it to use with Mac systems. Among other evidence, the jury considered the licensing fee paid by Media 100, the amount of which indicated that use with Mac formats alone was intended.

Copied Jellyfish Sculptures Not Fishy

Satava v. Lowry, 323 F.3d 805 (9th Cir. 2003). Plaintiff-artist Satava produced many lifelike glass-in-glass sculptures of jellyfish. Satava had registered several of his works with the Registrar of Copyrights. Defendant-artist Lowry—ostensibly inspired by Satava's works—also began making glass-in-glass jellyfish sculptures.

The Ninth Circuit established the rule "that a combination of patentable elements is eligible for copyright protection only if those elements are numerous enough and their selection and arrangement original enough that their combination constitutes an original work of authorship." The combination of unprotectable elements in Satava's sculpture(s) falls short of this standard because they combine several unprotectable ideas and standard elements. Thus, the Ninth Circuit reversed the district court's preliminary injunction grant because giving the plaintiff a copyright on this basic combination of elements would effectively give the plaintiff a monopoly on the idea of glass-in-glass single-vertical-jellyfish sculptures—all public-domain elements.

Photographs Entitled to Slim Protection

Ets-Hokin v. Skyy Spirits, Inc., 323 F.3d 763 (9th Cir. 2003). Plaintiff photographer brought a copyright infringement action against the vodka-producer defendant alleging that the vodka-producer's use of product photos—not the plaintiff's photographs—constituted copyright infringement. Earlier, the vodka-producer defendant had hired the plaintiff to take photographs of a vodka bottle for advertising purposes. Displeased with

the plaintiff's work, the defendant hired other photographers to take the photos and used these new photos for its advertising purposes.

The Ninth Circuit affirmed the district court's finding of noninfringement. The Ninth Circuit reasoned that the plaintiff's photographs had only thin copyright protection, which protects against only nearly identical copying, because the protectable expression is constrained by both the subject matter of the photograph and the conventions of the commercial product shot. Under the doctrines of merger and scene à faire, after subtracting out the unoriginal elements—the shared idea of photographing the bottle—the photographs do differ. Thus, the photographs used by the defendant did not interfere with the plaintiff's copyright in his photographs.

Registration of Compilation Protects Individual Underlying Works

Xoom, Inc. v. Imageline, Inc., 323 F.3d 279 (4th Cir. 2003). The Fourth Circuit held that registration of clip-art compilations were sufficient to protect the individual underlying works. Imageline obtained copyright registrations for two compilations of thousands of clip-art images. Imageline accused Xoom of infringing its copyrights by including in its own clip-art collection certain works from Imageline's compilations. The district court found that Imageline had no basis for litigating claims of infringement with respect to the individual images because its registrations were only in the compilations as a whole and not in the individual images. The Fourth Circuit reversed this finding, citing the fact that Imageline owned the copyrights both in the compilations and in each of the underlying works of art, and concluded that its registrations were sufficient to permit an infringement action on the underlying parts. However, the Fourth Circuit also concluded that Imageline was entitled to only one award of statutory damages per compilation, rather than one award for each underlying work allegedly infringed.

Substantial Similarity Test Must Focus on Work's Intended Audience

Kohus v. Mariol, 2003 Fed. App. 0150P (6th Cir. 2003). The Sixth Circuit held that the second step of its test for substantial similarity, requiring the trier of fact to evaluate similarity from the viewpoint of the ordinary observer, requires that the analysis be done from the standpoint of the intended audience of the work if "specialized expertise" is possessed by the intended audience.

KMI, co-owned by Louis Kohus, developed a two-step latch for a children's playyard. Kohus acquired ownership of all rights to the latch, including design drawings thereof, following a disagreement that led to litigation. In 1995, KMI co-owner John Mariol faxed a latch drawing to another children's furniture company, Kolcraft. Kohus filed a copyright infringement suit against Mariol and others in 1999, alleging that the faxed drawing and other drawings included in patent applications infringed Kohus's copyrights in the latch design drawings. The district court found in favor of the defendants, determining that no trier of fact would find the defendants' drawings and Kohus's design drawings substantially similar and refusing to consider conflicting expert testimony.

The Sixth Circuit applied a two-part test for determining substantial similarity. The first part allows analysis of expert evidence and the second part requires evaluation of similarity from an "ordinary observer" viewpoint. The Sixth Circuit identified this as a case in which expert knowledge was necessary to evaluate the similarity of the works and vacated the district court judgment. The Sixth Circuit acknowledged that "ordinarily" the lay public is the intended audience, but found that in this case "specialized expertise" was possessed by those to whom the latch drawings were directed.

Trademarks

Band Member Has No Rights Against Owner of Band's Trademark

Brother Records, Inc. v. Jardine, 65 U.S.P.Q.2d 1620 (9th Cir. 2003). In this case, the Ninth Circuit upheld the decision of the United States District Court for the Central District of California on a trademark infringement action brought by Brother Records, Inc. (BRI) against Alan Jardine (Jardine). Jardine was an original member of The Beach Boys band, which started in 1961. The band created BRI to handle the band's intellectual property rights. When Jardine decided to tour on his own, under the name "Beach Boys Family and Friends," BRI informed him that such use was trademark infringement. A license agreement was not reached between BRI and Jardine, though Jardine continued to tour and use the BEACH BOYS mark. His use often resulted in confusion by consumers as to which band or musicians would be performing.

BRI then filed its infringement claim, which Jardine answered with the defense of fair use, and counterclaimed for a declaratory judgment allowing him to tour using BEACH BOYS FAMILY AND FRIENDS. The district court granted summary judgment for BRI on Jardine's counterclaim.

The Ninth Circuit found that Jardine's defenses of classic and/or nominative fair use failed. Jardine used the BEACH BOYS mark for its secondary meaning (the musical band) and not for the mark's primary, descriptive meaning, so the fair use defense failed. The Ninth Circuit further found that the fair use defense, even if it could have applied, failed because of the actual confusion surrounding Jardine's use. Jardine met the first and second requirements for fair use, because the product (the Beach Boys band) is not identifiable without using the mark, and Jardine did not use any unnecessary means to identify the mark. However, Jardine failed the third aspect of the fair use test, as his use suggested sponsorship by the Beach Boys. He utilized the name for marquee value, and his use resulted in actual consumer confusion.

Exclusive Licenses Are Not Assignments

ICEE Distributors Inc. v. J&J Snack Foods Corp., 66 U.S.P.Q.2d 1161 (5th Cir. 2003). J&J Snack Foods Corp. (J&J), a distributor of ICEE semi-frozen beverage products, appealed a permanent injunction issued by the United States District Court for the District of Louisiana preventing it from selling ICEEs in squeeze-up tubes in ICEE Distributors, Inc.'s (Distributors) territory. Both Distributors and J&J traced their rights in the ICEE trademarks to ICEEQUIP, the owner of all ICEE trademarks. ICEEQUIP established regional licenses with various companies throughout the United States. Eventually, these licensees formed ICEE of America, (IOA). Through assignment, IOA received the trademark rights formerly held by ICEEQUIP. IOA's president was also the president of ICEE Co., a subsidiary of J&J and a distributor of ICEE products. IOA's president granted J&J a license to sell ICEEs in push-up tubes in Distributors' territory.

On appeal to the United States Court of Appeals for the Fifth Circuit, IOA contended that it was not subject to personal jurisdiction in Louisiana because it lacked significant contacts with the state. The Fifth Circuit agreed with Distributors' argument that IOA's assignment from ICEEQUIP resulted in IOA becoming a party to the pre-existing license agreements between ICEEQUIP and Distributors, which took place in Louisiana. The Fifth Circuit pointed out that an assignee steps into the shoes of an assignor and assumes the burdens as well as benefits of trademark ownership. The Fifth Circuit also agreed with the district court that the contract was ambiguous about whether or not it covered trademarks for ICEES in "push-up tubes" and hence submission of the issue to the jury was proper.

The district court based the permanent injunction on findings of both breach of contract and trademark dilution. The Fifth Circuit, however, reversed the finding of trademark dilution because Distributors were not owners of the trademarks and the FTDA only allows "owners" to bring suit. Distributors argued that because it was the exclusive distributor of ICEE products in its region for the lifetime of the trademarks, the license amounted to an assignment. The court disagreed and noted that IOA retained quality control over the products, had to give permission for any new use of the ICEE trademarks, and was responsible for policing the marks. Despite a finding that the district court erred by considering Distributors a *de facto* assignee, the Fifth Circuit did not reverse the injunction, because it remained a proper remedy for the breach of contract finding.

Likelihood of Confusion

Toro Co. v. GrassMasters Inc., 66 U.S.P.Q.2d 1032 (T.T.A.B. 2003). In this action, the United States Trademark Trial and Appeal Board (TTAB) dismissed an opposition by Toro Co. (Toro) to GrassMasters Inc.'s (GrassMasters) application to register the mark LAWN PUP for lawn mowers. Toro claimed ownership of the trademarks LAWN-BOY for "lawn mowers, lawn mower blades, grass catcher bags, and various attachments to lawn mowers" and SNOW PUP for "snow plows" (also called "snow throwers"), as well as related U.S. federal trademark registrations. Toro also asserted ownership of the unregistered mark SNOW PUP for "printed materials for snow throwers and snow plows such as owner's manuals and parts catalogs." Toro claimed that it had continuously used its LAWN-BOY mark through a predecessor in interest since 1933 and that sales of its LAWN-BOY mowers average around $50 million per year. Toro sold SNOW PUP snow plows from around 1964 through the late 1970s. Toro testified that it stopped selling SNOW PUP snow throwers by 1980 at the latest, but that many homeowners still own the snow throwers and that Toro continues to use the mark on owner's manuals and parts and service manuals. Toro admitted that it did not have exclusive rights to the elements "LAWN" and "PUP." GrassMasters began selling a small electric mower under the LAWN PUP mark in 1997, and has sold fewer than 100,000 mowers since 1997.

Finding there was no likelihood of confusion with respect to the marks LAWN-BOY and LAWN PUP, the TTAB stated that although the goods of the parties were to be considered identical, lawn mowers are expensive items and consumers would presumably exercise some care in making a purchase. Additionally, the marks LAWN PUP and LAWN-BOY are not similar in sound, appearance, and connotation or meaning, especially given the dilution of the element "LAWN" for mowers. Finally, there had been no instances of actual confusion despite the fact that the goods had been sold "virtually side-by-side" in some of the same stores.

With respect to the marks LAWN PUP and SNOW PUP, the T.T.A.B. noted that Toro stopped selling its SNOW PUP snow plows in 1980. Toro was prohibited from relying on its registration for the mark, as the registration was improperly renewed long after Toro had actually ceased use of the mark. The TTAB also found that GrassMasters' LAWN PUP mark was not confusingly similar to Toro's common law mark SNOW PUP for manuals and catalogs relating to snow plows as a result of the differences in the goods, the channels of trade for the goods, and because Toro sold or distributed fewer than fifty of the manuals or catalogs over a period of seven years.

Personal Jurisdiction Based on Internet Activity

Toys "R" Us Inc. v. Step Two S.A., 65 U.S.P.Q.2d 1628 (3d Cir. 2003). Toys "R" Us Inc. (Toys) operates the widely known toy store chain Toys "R" Us and a related chain of toy stores named Imaginarium. Step Two is a Spanish corporation that operates Imaginarium toy stores in Spain and several websites with "Imagniarium" as part of the domain name. Toys filed suit against Step Two in the United States District Court for the District of New Jersey for trademark infringement and cybersquatting in violation of the Lanham Act. The district court granted Step Two's motion to dismiss for lack of personal jurisdiction. The court also denied Toys' motion for

jurisdictional discovery and the United States Court of Appeals for the Third Circuit reversed.

Citing well-known Internet jurisdiction cases, the Third Circuit noted that a defendant must purposefully avail itself of minimum contacts with the forum state, and that in the case of Internet sites, this requires "something more" than merely being able to access the website in the forum. The Third Circuit approved of the idea that a plaintiff should be able to look for non-Internet contacts to help establish this "something more." Despite the fact that Step Two's websites were entirely in Spanish, were designed only to accept mailing addresses in Spain, and listed all prices in Euros or pesetas, the Third Circuit determined that jurisdictional discovery was needed to verify the extent of non-Internet contacts that were indicated in the record. These included contacts such as Step Two's president's business activities in the U.S. (including trade show appearances) and Step Two's relationship with vendors and suppliers in the U.S. The Third Circuit determined that Toys' allegations of the possibility of personal jurisdiction were asserted with reasonable particularity and therefore Toys should have been allowed to seek jurisdictional discovery from Step Two.

Senior User Enjoined

Patsy's Brand, Inc. v. I.O.B. Realty, Inc., 65 U.S.P.Q.2d 1442 (2d Cir. 2003). Defendant Patsy's Inc., I.O.B. Realty Inc. (I.O.B.) appealed the injunction and award of attorney's fees granted to plaintiff Patsy's Brand, Inc. (Patsy's Brand) by the United States District Court for the Southern District of New York. Both parties have operated pizzeria/Italian restaurants in New York City for more than fifty years. Patsy's Brand began marketing pasta sauce in 1993. In 1993, Patsy's Brand obtained a federal trademark registration for the mark PATSY'S PR SINCE 1944 for its sauce. Sometime after 1993, I.O.B. began marketing pasta sauce. I.O.B. received federal trademark registrations for the marks PATSY'S PIZZERIA and PATSY'S in 1995 and 1996, respectively, for restaurant services. The Southern District of New York canceled I.O.B.'s federal registrations and permanently enjoined I.O.B. from using its PATSY'S marks on sauce labels and for restaurant services. The court also granted attorneys fees to Patsy's Brand.

Affirming the decision of the Southern District of New York, the Second Circuit Court of Appeals concluded that the I.O.B.'s defense of priority over Patsy's first use of its marks was banned by laches. The Second Circuit reasoned that where the senior user has tolerated for decades the junior user's competition in the *same* market with a similar name, the justification for preserving the senior user's use of its name in a related field vanishes entirely.

Using the *Polaroid* factors, the Second Circuit found that the district court did not err in finding that I.O.B. infringed Patsy's Brand's marks. The Second Circuit disagreed with the district court's finding that I.O.B. adopted Patsy's mark in bad faith. While I.O.B.'s conduct at trial was illegal (such as submitting a fraudulent invoice for I.O.B.'s sauces), it went to protecting its marks. However, the Second Circuit found this behavior allowed Patsy's Brand to recover attorneys' fees. The Second Circuit also narrowed the scope of the permanent injunction. Because the establishments coexisted for decades, the Second Circuit allowed I.O.B. to continue to use its marks to identify its business, and allowed them to use the marks on sauce jars as a minor component of the labeling.

The U.S. Supreme Court Rules Actual Dilution Is the Test

Moseley v. V Secret Catalogue Inc., 65 U.S.P.Q.2d 1801 (U.S. 2003). In this case, the United States Supreme Court resolved a circuit split on whether the Federal Trademark Dilution Act (FTDA) requires actual dilution or only a likelihood of dilution. The Court ruled that a plaintiff who owns a famous mark must prove that the defendant's use has actually diluted the famous mark, rather than only showing that a defendant's use is likely to dilute the famous mark's distinctive quality.

The Victoria's Secret chain of women's lingerie stores brought suit against the operators of an adult gift and novelty shop in Elizabethtown, Kentucky, which used the names "Victor's Secret" and "Victor's Little Secret." The United States Court of Appeals for the Sixth Circuit found that the shop diluted the VICTORIA'S SECRET mark both by blurring and by tarnishment, given that items sold at the shop included adult videos and novelties, as well as lingerie.

In the Supreme Court opinion, Justice Stevens wrote that the plain language of the statute ("causes dilution") "unambiguously requires a showing of actual dilution, rather than a likelihood of dilution." That conclusion was bolstered by the FTDA's definition of dilution as "the lessening of the capacity of a famous mark to identify and distinguish goods or services." The Court noted, however, that consequences of dilution, such as actual loss of sales or profits, need not be proven. Furthermore, direct evidence of dilution, such as consumer surveys, are not necessary if actual dilution can be reliably proven through circumstantial evidence, such as where the marks at issue are identical. The Court also expressed some skepticism regarding the viability of a tarnishment cause of action under the FTDA, based on the language of the statute.

UDRP Proceedings Do Not Fall Under Federal Arbitration Act

Dluhos v. Strasberg, 65 U.S.P.Q.2d 1842 (3d Cir. 2003). Eric Dluhos registered the domain name www.leestrasberg.com. CMG Worldwide manages websites and Strasberg trademarks for the estate of Lee Strasberg, the famous acting coach, and his widow, Anna Strasberg (collectively, the Strasbergs). The Strasbergs began a Uniform Dispute Resolution Policy (UDRP) Proceeding with the National Arbitration Foundation (NAF). In response, Dluhos submitted a letter of limited appearance contesting NAF's jurisdiction over the matter and then filed suit, pro se, in the United States District Court for the District of New Jersey against the

Strasbergs. Dluhos challenged the constitutionality of the UDRP and brought claims for breach of contract, harassment, and violation of his First, Fifth, and Fourteenth Amendment rights. The district court granted the Strasbergs' motion to dismiss and then reviewed and upheld the NAF's decision to transfer the domain name to the Strasbergs. In its review, the district court applied the narrow review standards stated in the Federal Arbitration Act (FAA). On Dluhos' appeal to the United States Court of Appeals for the Third Circuit, the Third Circuit held that UDRP proceedings are not considered "arbitration" under the FAA. Thus, the district court erred in employing the narrow review standard contemplated by the FAA.

The Third Circuit reasoned that a dispute resolution mechanism falls under the FAA if, under reasonable commercial expectations, the dispute will be settled by the arbitration. This would be the case where litigation is stayed pending arbitration. UDRP proceedings, however, are explicitly designed to give way to litigation and were never intended to replace formal litigation as is the arbitration contemplated by the FAA. Also, UDRP proceedings readily provide a means of suspending a panel's decision by simply filing suit under the Anticybersquatting Consumer Protection Act ("ACPA"). Hence, UDRP proceedings are not "arbitration" as contemplated by the FAA. The Third Circuit liberally interpreted the complaint as pleading a cause of action under the ACPA and remanded the case to the district court with instructions to review the NAF determination *de novo* under the ACPA.

Websites Receive First Amendment Protection

Taubman Company v. Webfeats, 65 U.S.P.Q.2d 1834 (6th Cir. 2003). Defendant Henry Mishkoff, doing business as Webfeats (Mishkoff), created a website about the new mall opening in his neighborhood, "The Shops at Willow Bend" (Mall). The Mall is owned by the plaintiff Taubman Company (Taubman). Mishkoff registered the domain name "shopsatwillowbend.com" and created a fan site about the Mall, complete with maps, tenant information, prominent disclaimers regarding the official Mall site, and links to the official Mall site. His site also contained links to his "Webfeats" business and to his girlfriend's shirt business. Upon discovery of the site, Taubman filed a complaint for trademark infringement under the Lanham Act in the United States District Court for the Eastern District of Michigan, requesting a preliminary injunction and the surrender of Mishkoff's domain name. Mishkoff then registered five different versions of 'the mall sucks.com' sites. The district court granted the injunction requested by Taubman, preventing Mishkoff's use of all six domain names. Mishkoff appealed, claiming that Taubman failed to show a likelihood of success on the merits of its trademark infringement claim. The United States Court of Appeals for the Sixth Circuit agreed with Mishkoff's analysis of the likelihood of success, and reversed the decision of the Eastern District of Michigan.

The Sixth Circuit reasoned that Mishkoff's use of the domain name "shopsatwillowbend.com" warranted First Amendment protections, as the content was noncommercial and outside the scope of the Lanham Act. Mishkoff had removed the commercial links to his and his girlfriend's sites before the district court issued the injunction. Also, Mishkoff did not act as a cybersquatter. Mishkoff did not register the domain name in bad faith to sell the domain name to its genuine owner. Mishkoff only relinquished the site for $1,000 following an offer by Taubman. Moreover, even if his use was commercial, under the Lanham Act there can only be a violation if there is a likelihood of confusion among consumers regarding the different parties' goods and services. Mishkoff's conspicuous disclaimer greatly reduced that likelihood.

The Sixth Circuit also determined that the "sucks.com" sites contained noncommercial free speech that is not restricted by the Lanham Act. Even if the sites resulted in economic damage to the mall, the First Amendment allows Mishkoff to be critical of a business as long as there is no confusion as to the source. Taubman acknowledged in its brief, "Mishkoff is 'free to shout 'Taubman Sucks!' from the rooftops…." The Sixth Circuit recognized that the "rooftops of our past have evolved into the internet domain names of our present." Finally, the Sixth Circuit rejected Taubman's attempt to use the Safe Distance Rule as a way to prevent the use of the "sucks.com" sites. The rule, which predates the Lanham Act, essentially forces a business that has fraudulently utilized the good will of a competitor to keep a "safe distance" and put the public on notice that the two entities are unrelated. This claim failed due to Mishkoff's First Amendment protections for commentary and because there was no evidence of Michkoff being a proven infringer.

I²P Group News

BY SAMSON HELFGOTT, INTERNATIONAL ACTIVITIES COORDINATOR

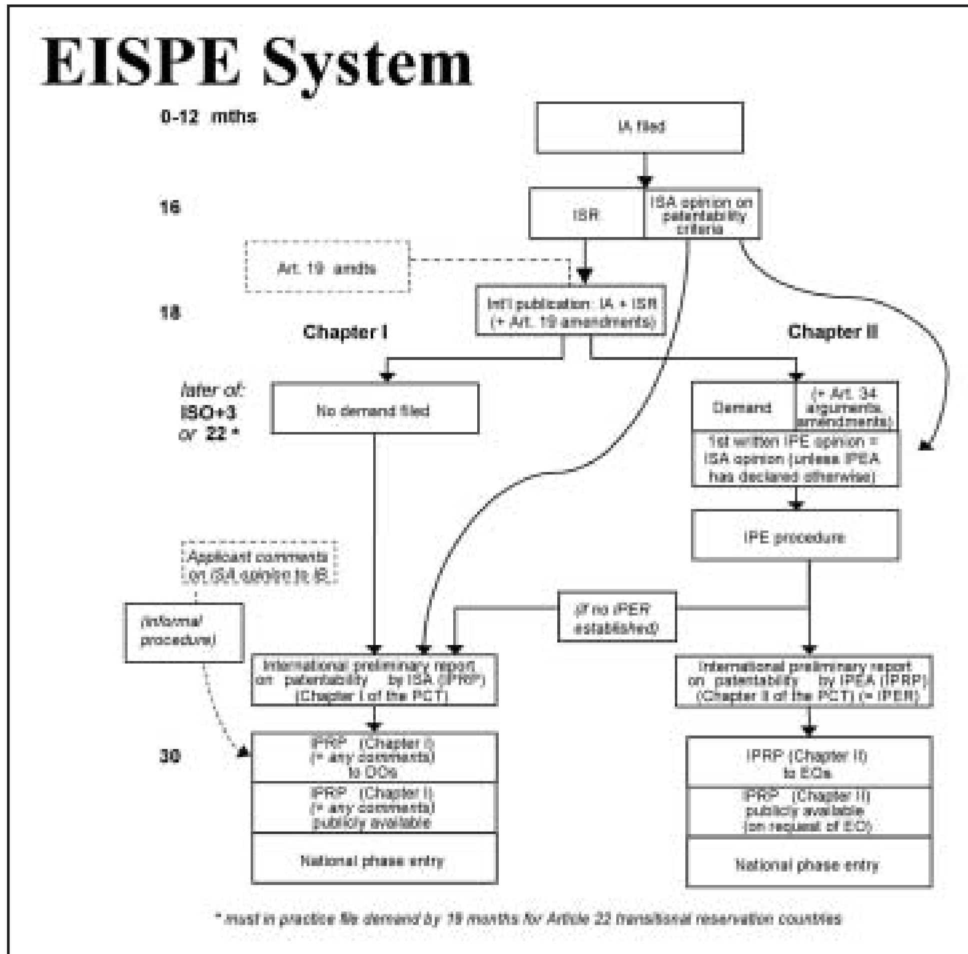
Samson Heffgott

A number of interesting items have come up with respect to the I²P Group (International Intellectual Property Group), which are of interest to the entire membership.

PCT Changes Going into Effect

Over the last few years a number of changes have been approved for modifying the PCT to make it more user friendly and lower cost. One of the first reform initiatives that was approved by the PCT Assembly was to extend the time limit for Chapter I of PCT from 20/21 months to 30/31 months. This would permit applicants to obtain an international search under Chapter I and avoid the necessity of paying for and obtaining an examination under Chapter II. Many applicants felt that the examination was not of significance because separate examinations would take place upon entry into national and regional offices following perfection of the PCT.

The ability to remain in Chapter I for the full 30/31 months went into effect on April 1, 2002. However, some countries required modifying their national laws to accommodate this change. Of the 120 contracting states, the only countries that still have not modified their laws to accept this change are Brazil, Norway, Singapore, Yugoslavia, and Tanzania. If an applicant intends to complete the national entry into any of these countries, it still will be necessary to utilize Chapter II until these other countries accept this modification. While there are other European and South African countries that have also not yet accepted the change, utilization of the European Patent Office for those European countries and the African Treaty ARIPO for those African countries, would permit entry into those other countries after the full 30/31 months from Chapter I.



The PCT Assembly also approved the concept of reinstating rights after failure to comply with the requirement for entering into the national phase within the applicable time. Specifically, failure to enter into the national phase at the end of the 20/21 month or the 30/31 month time limits will no longer result in the abandonment of the application. National/regional entry still will be permitted based upon showing that due care was taken under the circumstances. The national/regional offices have the ability of lowering that standard to one of unintentional failure to enter into the national phase. This restoration privilege has gone into effect as of January 1, 2003.

Further changes that have been accepted and which will go into effect on January 1, 2004 concern the new Enhanced International Search and Preliminary Examination (EISPE) System. Under this system, along with the International Search Report (ISR), which will be produced under Chapter I, there also will be an International Preliminary Report on Patentability (IPRP). This will be similar to the Written Opinion that is currently generated during the Chapter II examination phase. The

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IPRP will be sent to the applicant and will be retained in the file but will not be published at eighteen months; only the search report will be published. Should the applicant remain in Chapter I and never enter Chapter II, at the end of the 30/31 months the IPRP will be sent to the designated offices upon entry into the national/regional phase made publicly available. Should the applicant desire to have a dialog with the examiner and amend the claims, he can enter into Chapter II, as at present, and receive a Written Opinion which will generally be the same as the IPRP. He can then amend the claims and ultimately receive an International Preliminary Examination Report (IPER) as at the present time and that will then be sent to the elected countries upon entry into the national phase.

Other simplifications that also will be effective January 1, 2004, include an automatic and all inclusive designation system covering all of the countries that are member states of the PCT. There will also be a flat "international filing fee" for any filing. Designated offices will receive communications only upon their request, to reduce paper flow. Simplifications on signatures, powers of attorney and indications concerning applications also will go into effect at that time. Furthermore, from October 17, 2002, there has been a fee-reduction for electronic filing of applications into the PCT.

Additional reforms are still being discussed at the upcoming meetings of the Working Committee on PCT Reform. These include restoration of the failure to file an application within twelve months of the Paris Convention, as well as a new Framework for quality standards for search and examination by all of the International Search Authorities and International Examination Authorities. Other modifications of the PCT Regulations are being considered to place it in conformity with the Patent Law Treaty that was passed in recent years.

Revisions to Intellectual Property Laws in Japan

A bill to amend Japan's intellectual property laws was passed by the Diet in May 2003.

The more interesting aspects of these amendments are explained below. Further information concerning the amendments of the intellectual property laws are available in English on the JPO homepage (www.jpo.go.jp)

Amendment of intellectual property laws

A. Restructuring of patent fees

These changes are expected to take effect on April 1, 2004. However, some current fees will still apply to applications filed before this date.

1. The application fee will be reduced to 16,000 yen from 21,000 yen per application, irrespective of the number of claims.

2. The fee for the request for examination will be raised as follows:

Revised: 168,600 yen + 4,000 yen x number of claims

Current: 84,300 yen + 2,000 yen x number of claims

The fees for the request for examination for applications made by way of the PCT designating Japan and having an international search report will approximately double the current fees.

3. Annual fees will be reduced as follows.

Details of Fee Revisions

(Units in yen)	Current Fee		Revised Fee	
	Basic	Per claim	Basic	Per claim
Filing	21000	0	16000	0
Request for examination	84300	2000	168600	4000
1st-3rd annuities	13000	1100	2600	200
4th-6th annuities	20300	1600	8100	600
7th-9th annuities	40600	3200	24300	1900
10th-25th annuities	81200	6400	81200	6400

	Filing	Req. Exam.	Annuities	Total
Current Fee (old fee)	21000	99500	356200	476700
Revised Fee (new fee)	16000	199000	166600	381600

Comparison of new and old fees for an average application (calculated for an application having 7.6 claims, the average for filings in 2001, and maintained for nine years)

Provisions will be included to allow for the new fees to be reconsidered five years after enactment of the revisions.

4. Transition treatment of applications

Some of the current fees will continue to apply for applications filed before the fee revision comes into effect on April 1, 2004.

5. Half of the fee for the request for examination will be refunded upon request, if the application is abandoned or withdrawn before the first office action is issued by the JPO. However, this refund must be requested within six

months from the date of abandonment or withdrawal of the application.

B. Prompt, appropriate settlement of patent-related disputes (expected to take effect Jan. 1, 2004)

1. The current opposition system for patents will be abolished. However, the opposition system for trademarks will be maintained.

2. The invalidation trial system will be revised to contain both functions of the current opposition system and the current invalidation trial system.

Anyone will be able to demand an invalidation trial for a granted patent. However, interest will be required for violations related to joint applications and for misappropriation.

3. In order to encourage early settlement of proceedings before the JPO and the Tokyo High Court, the following change will be made.

Currently, while an opposition or invalidation trial is pending before the JPO, the patentee cannot demand a separate trial for correction of the patent. However, when an appeal against a JPO decision in an opposition or invalidation trial is filed at the Tokyo High Court, the patentee is free to file a trial for correction at the JPO at any time during the appeal.

Under the revised law, the opportunities for filing a trial for correction before the JPO when an appeal is proceeding at the Tokyo High Court will be reduced. For example, the patentee will have ninety days from the day on which an appeal is filed at the Tokyo High Court to demand a trial for correction at the JPO. The next opportunity to file a trial for correction will arise after the Tokyo High Court hands down a judgement.

4. To reduce interruptions before the JPO and the Tokyo High Court, the following change will be made: The Tokyo High court will be able to make a decision to remand a case to the JPO, if the patentee demands, or attempts to demand, a trial for correction before the JPO after filing a suit against a JPO decision which invalidates the patent.

C. Encouraging acquisition of foreign patents (expected to take effect January 1, 2004)

1. The provisions concerning unity of application will be revised to harmonize with global standards for unity of invention. It is hoped that this will reduce the burden on Japanese applicants wishing to file foreign patent applications. The revised articles of the Patent Law and Utility Model Law will follow Rule 13 of the PCT.

2. It will no longer be necessary to designate contracting states in a request for a PCT international application in response to amendment of Rule 4.9 of the PCT, which enters into force on January 1, 2004.

The Spanish Patent and Trademark Office Presented as a Preliminary Patent Examining Authority

The Spanish Patent and Trademark Office was presented as an International Preliminary Examining Authority for patent applications filed in Spanish, under the Patent Cooperation Treaty (PCT), last February 24 at a venue chaired by Science and Technology Minister Josep Pique.

Because the Spanish Patent and Trademark Office is an International Preliminary Examining Authority, applicants for patent in Spanish can have their application processed fully in that language.

The Spanish Patent and Trademark Office will start acting as an examining authority from June 1, 2003. The Office has been operating as a searching authority with full international recognition from the year 1995.

At present just six Spanish-speaking countries are PCT signatories (Colombia, Costa Rica, Cuba, Ecuador, Spain, and Mexico), but the possibility of processing in Spanish is expected to encourage other Spanish-speaking countries to join.

2002 Patent Applications in China

According to the preliminary statistics from SIPO, 2002 witnessed the continuous development of patent applications in China. SIPO received a total of 252,632 patent applications, an increase of 24 percent over 2001. Of this number, 80,233 were for inventions, 93,139 were for utility models, and 79,260 were for industrial designs. Of the total number of patent applications, 205,396 were domestic applications (an increase of 24 percent), while 47,236 were foreign applications (marking an increase of 25 percent).

The top ten foreign countries or territories filing patent applications in China, and percentage of increase, were Japan 18,275 (+33%); United States 10,012 (+11.3%); Germany 4,011 (+16.1%); Korea 3,626 (+45.2%); the Netherlands 2,148 (+53.8%); France 1,931 (+27%); Switzerland 1,110 (+8.8%); United Kingdom 1,023 (+12%); Sweden 952 (-1.6%); and Italy 627 (+26.7%).

Small/Large Entity Status Must Be Made at the Time of Filing in Canada

The Canadian Federal Court of Appeal has held in a unanimous decision that if an applicant for a patent qualified as a “small entity” at the time of application, that status must be made when the application is filed in Canada.

New Trademark Regime in Hong Kong

(continued from page 16)

tect their rights. If a proprietor has known for a continuous period of five years of the use of a registered mark that infringes their earlier rights, then no action can be taken to cancel that registration or oppose such use (unless there is evidence of bad faith).

- Parallel importation is now expressly permitted, removing the uncertainty under the previous law.
- Comparative advertising will not constitute infringement if the use of the other party's mark is honest.
- The period for revoking a registration on the grounds of nonuse of the registered mark in Hong Kong has been reduced from five years (calculated from the date of issue of the certificate of registration) to only three years. This will render registrations more vulnerable to cancellation. Where an application for registration is blocked by a citation based on an earlier registration then an applicant may find it easier to remove such a registration on the grounds of nonuse so that its application for registration may proceed. It is also easier to revoke registrations filed by trademark pirates. Conversely, registered owners should be aware of the increased vulnerability of their registrations to revocation by others.
- The initial validity period following registration is now ten years and the renewal period is also ten years.
- It is now simpler and substantially less expensive to record changes in ownership of trademarks or to record a trademark license or amendments in the name and address of an owner. In particular, recordal of a trademark assignment will usually now involve the simple completion of a form, and official fees for recording a change of name or address of an owner have been abolished.

All of these changes brought about by the new law are aimed at streamlining and simplifying trademark procedures in Hong Kong, as well as modernizing the rights conferred by registration in line with recent developments. Trademark owners and those acting on their behalf should be aware of the principal changes introduced by this new law and how this affects business operations in Hong Kong.