ideas on intellectual property law

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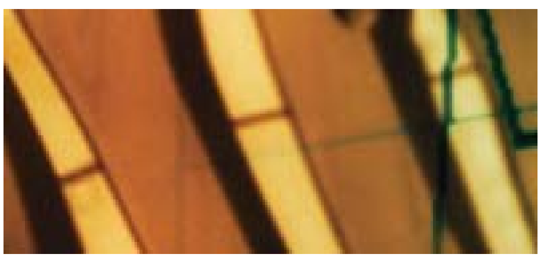

ROUTE TO

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When There Are No Good Guys

Choosing the Lesser Evil in a Trademark Case

In many cases, opposing parties may both have legitimate and appealing positions, and the court has the difficult job of choosing between them. But sometimes both sides evoke little sympathy, and the court must choose the lesser of two evils. In a recent trademark case, for example, the court had to choose a winner even though neither party was faultless.

ACT 1

CLM, a French corporation, manufactured and sold cosmetic products in Europe under its trademark, F&W. ICE, a New York company, bought, imported, sold and distributed cosmetic items, including the F&W line. The two companies agreed "to continue to develop, market and promote the F&W brand name in the United States."

The contract stated that CLM was the owner of the F&W trademark in Europe, and that ICE was "the owner and holder of all rights, title and interest in the mark F&W in the United States, Canada and Caribbean Islands." In return, the contract required ICE to sell $250,000 worth of F&W products for the first year and use its best efforts to increase sales by 20% annually over the next five years. But no provisions governed product purchase or manufacture.

So how could CLM authorize anyone else to sell F&W products in this country? That would infringe ICE's assigned trademark rights.

In the fall of 1999, ICE bought about $125,000 worth of F&W products from the French manufacturer. In early 2000, ICE applied to register the F&W mark with the U.S. Patent and Trademark Office.

ACT 2

Enter a third party: Gapardis, a Miami distributor, contracted with CLM in April 2000 to become the exclusive U.S. distributor for the French company's cosmetics bearing the F&W mark.

Whoa. What's going on here? CLM, the French company, no longer owned the U.S. rights to the F&W mark — it transferred those rights to ICE, remember? So how could CLM authorize anyone else to sell F&W products in this country? That would infringe ICE's assigned trademark rights.

Further, if CLM treats the third party as its exclusive U.S. distributor, it must cut off its sales of F&W trademarked products to ICE. So if ICE wants to continue selling F&W products, it must have someone other than CLM manufacture the products. Does the agreement between ICE and CLM permit the sale of F&W trademarked products in the United States that have no relation to the French company? Arguably, it does: If ICE is really the trademark owner, it can have whomever it pleases make the product.

Sure enough, CLM stopped providing ICE with F&W trademarked products in April of 2000. ICE then immediately procured substitute F&W products from a Spanish manufacturer, giving the Spanish manufacturer samples of the French-made F&W products and "the formula of its active ingredients." Thereafter, ICE distributed non-French-manufactured goods bearing the F&W mark in the United States.

ACT 3

Now comes a fourth party, Mr. McHeileh, a former associate of Gapardis. He too began receiving and selling products from other sources — which appeared to be counterfeit F&W products.

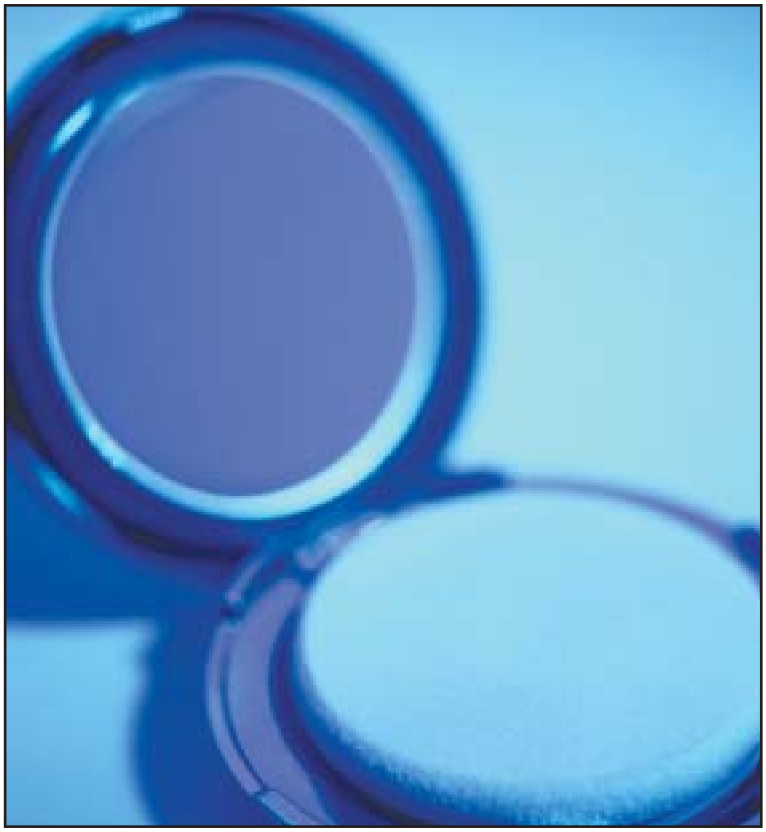
ICE, the U.S. trademark's record owner, sued Gapardis and CLM alleging trademark infringement and breach of contract. It asked for a preliminary injunction against their alleged infringement of its U.S. rights to the F&W mark.

But CLM and Gapardis apparently regarded themselves as the legitimate owner and licensee, respectively, of the U.S. trademark rights. They counterclaimed for infringement against ICE and sued the fourth party, McHeileh. Additionally, they moved for a preliminary injunction to prevent ICE and McHeileh from importing or selling counterfeit goods under the F&W mark.

THE GOOD, THE BAD AND THE UGLY

So, who are the good guys here? While none of the parties has a clear-cut right to the F&W trademark in the United States, each of them — except McHeileh, the fourth party counterfeiter — has a plausible claim to the F&W trademark in the United States. But none has demonstrated the highest business ethics.

The court first ruled that the contract between CLM and ICE was enforceable. CLM argued that if the agreement transferred the U.S. trademark rights apart from any connection to the original French manufacturer, it was invalid because a trademark isn't a separate commodity freely severable from the goodwill or the source it represents and therefore can't be assigned to someone else without that goodwill. Such an invalid assignment is referred to as an "assignment in gross."



But the court sided with ICE, the U.S. trademark assignee, on this issue. The contract clearly recognized ICE's previous efforts with F&W products. ICE had developed, distributed and marketed the F&W brand name in connection with those products in the United States and, as a result of its efforts, the F&W brand name had become known to U.S. retailers and consumers as a product of ICE, not CLM. The court held that, when the agreement was made, the assignment wasn't "in gross" because it continued the association of the

F&W trademark with ICE, the company that had created its reputation in this country.

The court also found that ICE was likely to win its breach-of-contract claim against the French company. The contract between the two companies was valid and ICE had complied with it. But CLM had failed to meet its obligation to supply ICE with F&W product, breaching the contract. In addition, CLM's contract with Gapardis violated its agreement with ICE, which had been granted exclusive U.S. ownership of the F&W mark.

THE WINNER?

It's not over yet. The court found that ICE also breached the contract when it sold F&W products not manufactured by CLM. ICE argued that it merely exercised ordinary trademark owner rights to procure substitute goods as "cover" for the product it could no longer obtain from the French company. But the court turned a deaf ear to this argument, because ICE hadn't told CLM it was going to secure F&W product from a different source or that CLM was in breach of the contract for refusing to ship the product.

The court interpreted the contract between ICE and CLM to mean that the "products" referred to in the agreement were exclusively those of the French company. So selling non-French-manufactured F&W trademarked products exceeded the contract's scope. When the French manufacturer breached the contract by not selling F&W product to ICE, the latter's remedy was to sue for breach of contract — not palm off a different product as genuine F&W merchandise.

ICE also maintained it was still the U.S. owner of the F&W mark. But the court noted that the contract's stated intent was to further the two companies' mutual objective of continuing to develop, market and promote the F&W brand name in the United States and to ensure the proper enforcement of the F&W mark and seizure of counterfeit products in the United States. The court held that ICE's ownership of the mark after the contract was terminated would undermine the contract and the rights sought to be protected by trademark law generally.

The court held that ICE's ownership of the mark after the contract was terminated would undermine the contract and the rights sought to be protected by trademark law generally.

Because ICE had no right to continue using the F&W mark after losing access to the trademarked product, it also had no right to prevent CLM from using the trademark in this country. Consequently, U.S. ownership rights to the F&W mark reverted to the French company.

THE FINISH LINE

From this it followed that both ICE and the fourth party McHeileh sold counterfeit F&W product, and were accordingly enjoined from such activity. So, despite its breach of contract, CLM and its second licensee, Gapardis, emerged the winners. You be the judge: Who are the good guys here, and did they win?

Profits Without Sales

Copyright Case Determines Profits

Copyright law protects architectural plans. Anyone who constructs a building using plans without the copyright owner's permission is an infringer. The copyright owner can stop the construction, if it hasn't progressed too far to make an injunction impractical. The owner may also obtain a monetary award, including the copyright owner's damages and the infringer's profits — assuming it's appropriate and these amounts aren't duplicative.

For example, the copyright owner's damages might be the fee that was, or should have been, paid to an architect for the use of the copyrighted architectural plans. If the infringer is a builder, profits might be the net gain from the sale of the building unlawfully constructed from the copyright plans. This amount could be awarded to the copyright owner to deter future infringements. But what if the infringer is not a builder, and doesn't sell the building? What role, if any, does a "profits" award play in that kind of case? A recent decision answered these questions.

HOME SWEET HOME

Associated Residential Design (ARD) prepared architectural drawings for Dan Deeter Homes. Deeter paid ARD about $8,200 for the drawings and built a home according to the plans and sold it to Mr. Boylan. Mr. and Mrs. Molotky apparently liked his home so much that, without ARD's authorization, they obtained a set of ARD's drawings. They unlawfully used them as a basis for designing their own home, which was later built in the same subdivision as the Boylan home. The Molotkys apparently are still living in the home, or at least they haven't sold it.

ARD sued the Molotkys for copyright infringement. It was too late for an injunction to be a practical remedy because the house was already finished and occupied. Instead ARD asked for a monetary award including damages and the Molotkys' profits. ARD's damages are easy: Deeter paid about $8,200 for the use of those same drawings in a real business context, so ARD could reasonably have expected to earn about the same from the Molotkys if they had negotiated a price. But how do you calculate a profit if the Molotkys haven't sold the house?

INDIRECT PROFITS

To the Molotkys it was easy: No sale equals no profit. Thus the profit portion of the monetary award is zero. But ARD had a different slant. It argued that copyright case law recognizes two kinds of profits: direct and indirect. Direct profits are made on sales directly resulting from the infringement while other kinds of gains are indirect results of the infringement.

For example, a brewing company used a copyrighted song without authorization in a television commercial. The copyright owner was awarded that part of the brewer's total profit that could reasonably be traced to the song's use. The court based this decision on a theory of indirect profits flowing from the infringement, but not derived from sale of the infringing item.

How do you calculate a profit if the Molotkys haven't sold the house?

Another example concerned a hotel that unlawfully used selections from a copyrighted musical in a revue. The court awarded the copyright owner direct profits derived from the use of the plaintiff's work, plus a percentage of the hotel's indirect profit traced to the infringement. These amounts were derived from the hotel's guest rooms, restaurants, cocktail lounges, movie theater, casinos, and other sources. The court reasoned that the copyrighted work helped draw customers to the hotel and increased the hotel's revenue from these other sources. So the court awarded indirect profits even though they weren't derived from the sale of an infringing item.

The court applied this reasoning to the present case. It found that, though the Molotkys still own their home, they could have "profited" from its construction because the home's value could now exceed the cost to build it. If so, the Molotkys may have earned an unrealized gain from the home's construction. And if ARD could prove this gain resulted from the infringing use of its architectural plans, it should recover the amount of this gain as indirect profits of the Molotkys, in addition to its loss of an architectural fee.

SHOW ME THE MONEY

Although monetary gain may not directly result from an infringing act, profits may result in other ways. Case law suggests that you can use the theory of indirect profits flowing from the infringement.

How a State Commits Patent Infringement

Patent law provides that "whoever actively induces infringement of a patent shall be liable as an infringer." Well-settled law holds that inducement of infringement coexists with direct infringement, so any inducement claim hinges on proof of direct infringement.

But the Supreme Court has held that a state cannot be a direct infringer. The question then arises: Can you sue a nonstate party for inducing a state or its agents to infringe a patent? Or are these lawsuits barred because the state or its agent cannot itself be subject to suit for direct infringement?

SOVEREIGN IMMUNITY

More than a century ago, the U.S. Supreme Court first held that, under the 11th Amendment, each state is a sovereign entity in the federal system, and states can't be sued without their consent. Further, the Court has held that this doctrine of "sovereign immunity" extends to a state's arm or agent, such as a state university.

More recently, Congress tried abolishing the states' sovereign immunity with respect to patent infringement suits. The Patent and Plant Variety Protection Remedy Clarification Act authorized

prove that UAB directly infringed the patent. But Oculus argued for dismissal of Syrrx's infringement inducement claim because UAB is an arm of the state of Alabama and, thus, couldn't directly infringe the patent, thereby negating the necessary prerequisite to an inducement claim. Syrrx contended that the states' sovereign immunity under the 11th Amendment doesn't extend to private parties who induce a state entity to infringe.

The court agreed with Syrrx, conceding that states can't be sued in federal court for patent infringement and Congress lacked the authority to abolish the states' 11th Amendment sovereign immunity. But the court ruled that that doesn't mean states can't infringe patents and can't be found to infringe patents in a federal lawsuit to which the state isn't a party. In effect, states can infringe patents, even though they can't be sued for it.

private parties to bring federal suit against states or their agents to enforce patent rights. But the U.S. Supreme Court struck down these provisions, holding that Congress lacked the constitutional authority to annul the states' sovereign immunity without their consent. Thus, the Constitution bars nonconsensual actions against states or their agents in federal court for direct patent infringement.

In effect, states can infringe patents, even though they can't be sued for it.

WHO IS THE PARTY?

Syrrx Inc., the exclusive licensee of a patent, filed suit under the patent laws alleging that Oculus Pharmaceuticals Inc. induced the University of Alabama at Birmingham (UAB) to infringe that patent. For Syrrx's inducement-of-infringement claim against Oculus to succeed, Syrrx first had to

Because states can infringe, nonstate entities can induce their infringement. And unlike states, these nonstate entities can be sued for their part in the transgression. Thus, a court may find the required direct infringement by a nonparty state or its agents on which to assert an inducement finding against a private party. Ultimately the court refused to dismiss the lawsuit.

ARE YOU IMMUNE?

The court held that the Constitution bars only patent infringement lawsuits against states in federal court, and has no effect on patent litigation between two private parties. Thus, under the 11th Amendment, sovereign immunity doesn't bar an inducement claim against a state or its agent.

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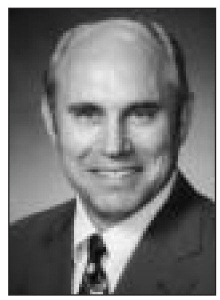

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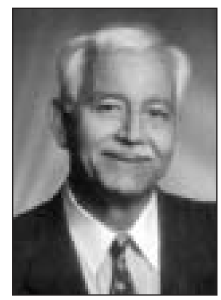

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