



# ideas on intellectual property law



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# License to sue

## Supreme Court allows “pay and sue” suits by patent licensees

In an 8-1 ruling that stunned some in the intellectual property community, the U.S. Supreme Court cleared the way for patent licensees to challenge patents — while continuing to make their royalty payments. The so-called “pay-and-sue” strategy prevents a patentee-licensor from terminating the license or suing for breach of license. The *MedImmune v. Genentech* decision could dramatically alter the patent licensing playing field.

### PROTEST PAYMENTS

The patent at issue allegedly covered MedImmune’s respiratory drug Synagis, which has accounted for more than 80% of its revenue since 1999. MedImmune had licensed certain patents from Genentech in 1997. The license extended to an existing patent, as well as a pending patent that matured into the “Cabilly II” patent in 2001.

Shortly thereafter, Genentech demanded royalties from MedImmune based on its belief that Synagis

was covered by Cabilly II. MedImmune sought a declaratory judgment that the patent was invalid and not infringed, but it continued making royalty payments “under protest.” The company was concerned that Genentech would otherwise terminate the license and bring an infringement suit.

The district court dismissed MedImmune’s claim. On appeal, the Court of Appeals for the Federal Circuit affirmed the district court’s decision on the ground that there was no controversy because MedImmune was still making royalty payments. Undeterred, MedImmune filed an appeal with the U.S. Supreme Court.

### TEST DRIVES

The Supreme Court opinion discussed some earlier decisions related to the pay-and-sue strategy. In *Lear, Inc. v. Adkins*, the Supreme Court had rejected the argument that a repudiating licensee must comply with contractual obligations to pay royalties until its claim is vindicated in court. The ruling *allowed* licensees to halt payments but didn’t declare whether they *must* do so.

In *Gen-Probe, Inc. v. Vysis, Inc.*, the Court of Appeals for the Federal Circuit held that a licensee in good standing couldn’t file a declaratory judgment action over a patent because it failed the “case or controversy” jurisdiction test. The court reasoned that the license, “unless materially breached, obliterates any reasonable apprehension” of facing an infringement suit.

### SUPREME COURT TAKES A SPIN

The Supreme Court initially noted that, if MedImmune had ceased payments, it would have met the “case or controversy” standard. It then acknowledged that MedImmune’s own acts in continuing the royalties eliminated the imminent threat of harm. The question was whether this caused the dispute to no longer be a “case or controversy” within the meaning of Article III of the Constitution.



## Justice Thomas takes a detour

Only one Justice dissented from the decision in *MedImmune v. Genentech*. Justice Thomas' dissent focused on what he deemed MedImmune's improper use of the declaratory judgment procedure. He argued that the procedure cannot be used to obtain advance rulings on matters that would be addressed in future cases of actual controversy. Similarly, the procedure isn't available to obtain early rulings on potential defenses in a subsequent actual controversy.

Thomas said both principles apply in the patent licensing context. He pointed out that the declaratory judgment in *Altvater v. Freeman* was an affirmative defense to an infringement claim. And the Court in *Altvater* had reasoned that holding a patent valid if it isn't infringed is deciding a hypothetical case. Because MedImmune was a licensee in good standing, it brought its action without the threat of a lawsuit. Thus, according to Thomas, because neither MedImmune nor Genentech had a cause of action, MedImmune was seeking an advisory opinion about an affirmative defense it might use in some future litigation.

Thomas also criticized the Court's extension of prior case law involving governmental coercion to include coercion in the context of private contractual obligations. By holding that contractual obligations are sufficiently coercive to allow a party to bring a declaratory judgment action, the Court's decision gives patent licensees a cause of action and a free pass around Article III's requirements for challenging the validity of licensed patents.

Courts don't require a plaintiff to expose itself to liability before bringing a declaratory judgment suit to challenge a threatened governmental action. For example, while opting not to violate a law removes the threat of governmental prosecution, jurisdiction still exists to consider the law's constitutionality.

But what about the case where the plaintiff's self-avoidance of imminent injury is coerced by threatened enforcement from a private, nongovernmental party? The only Supreme Court decision, *Altvater v. Freeman*, held that a licensee's failure to stop royalty payments didn't render a dispute over the patent's validity nonjusticiable. The royalties there were paid under protest and an injunction order.

The fact that there was a compulsive injunction in the *Altvater* case, but not in the *MedImmune* case before the Court, made no difference. The Court found no support in Article III for a rule that a plaintiff must risk treble damages and the loss of 80% of its business before seeking a declaration of its actively contested legal rights.

### NO ALTERNATIVE ROUTES

The Supreme Court also dismissed Genentech's argument that the parties had effectively settled

the issue by entering the licensing agreement. Promising to pay royalties on patents that haven't been held invalid doesn't amount to a promise not to seek a holding of their invalidity.

Genentech further appealed to the common-law rule that a party to a contract cannot simultaneously challenge its validity and reap its benefits. The Court found the rule didn't apply because MedImmune wasn't repudiating the contract while continuing to reap its benefits. Rather, MedImmune asserted that the license didn't require royalties or prevent it from challenging the patents because the patents were invalid and didn't cover its products.

### TICKET TO RIDE

After the Court's decision in *MedImmune*, the U.S. Patent and Trademark Office rejected Genentech's Cabilly II patent when the examiner found the invention to be a variation of technology covered by earlier patents. But the Supreme Court's holding regarding the "pay-and-sue" strategy stands, and some in the intellectual property field believe the number of patent challenges will jump as a result. 

# Virtually liable

## *Audi drives away with trademark infringement claim*

Have you seen merchandise for sale that uses a domain name similar to an internationally known company's name and trademark? Well, you might see less of it after the Sixth Circuit Court of Appeals' ruling in *Audi AG v. D'Amato*. The court fully affirmed the trial court, which found that the Web site of one such entrepreneur infringed and diluted Audi's trademarks and also violated the Anticybersquatting Consumer Protection Act (ACPA).

### DOWNLOADING THE FACTS

Bob D'Amato registered "www.audisport.com" in February 1999. The Web site included text claiming it was a "cooperative" with Audi that provided the latest Audi products and information on "Audisport" North America.



According to D'Amato, a Florida Audi dealership employee contacted him via e-mail and inquired about developing the Web site jointly. Another dealership employee allegedly sent content to the Web site and gave D'Amato "verbal authorization" to display Audi trademarks. He never received written authorization. Further, an agreement between Audi and the Florida dealership specified that the dealer had no authority to grant permission to use Audi trademarks.

Beginning in April 2002, D'Amato agreed with one of the dealership employees to post links to another Web site, "www.audisportline.com," an "Audisport Boutique and Services" site. The site offered goods such as T-shirts and hats with "Audi Sport" logos and an e-mail subscription service with www.audisport.com addresses. D'Amato was to receive a portion of any revenue.

Before posting items for sale, D'Amato commissioned a graphic designer to create logos incorporating the Audi logo he displayed on his original site. After visiting Audi's own site, the designer raised questions as to whether D'Amato had licensing rights to use Audi logos. Critically, D'Amato did not.

The second Web site never generated any profit, and D'Amato eventually received three cease-and-desist letters from Audi. He claimed to remove all references to Audi, making the site noncommercial, but he continued to sell ad space on the site.

Audi brought suit against D'Amato in district court for numerous trademark claims, including claims under the ACPA. The district court found in favor of Audi and D'Amato appealed.

### LINKING TO INFRINGEMENT

The Sixth Circuit court began by clarifying that, contrary to D'Amato's assertion, equitable relief for trademark infringement under the Lanham Act requires only a likelihood of confusion. Actual confusion is necessary only to recover statutory damages. The court then assessed the likelihood of confusion by evaluating the eight relevant factors:

- 1. Strength of plaintiff's trademark.** The more distinct a trademark, the more likely confusion results from its infringement and thus the more protection due. The court called Audi's trademarks "world-famous."

**2. Relatedness of the goods.** Confusion is likely if the parties compete directly with their goods or services. D'Amato sold merchandise with the Audi trademark, along with the e-mail addresses and advertising space. The court concluded the goods sold by the parties were related because the way they were marketed and consumed would lead buyers to believe the merchandise came from the same or a connected source.

**3. Similarity of the trademarks.** The court expressly stated that the addition of characters or generic or common descriptive words to domain names doesn't eliminate the likelihood of confusion. Adding "sport" didn't distinguish the domain names; plus, D'Amato used Audi's actual trademarks on his goods and services.

**4. Evidence of actual confusion.** The court explained that the absence of actual confusion evidence is "inconsequential." Regardless, evidence showed the graphic designer was indeed confused about the relationship between the parties.

**5. Marketing channels used.** The court considered the predominant customers of each party and whether the parties used similar marketing approaches. The predominant customers would be the same for both parties' goods, and both parties used Internet marketing. And Internet surfers are more likely to be confused about ownership of an online outlet than customers of a brick-and-mortar store.

**6. Degree of purchaser care.** The goods and services on D'Amato's Web site bore the Audi trademark and were relatively inexpensive. The court found consumers unlikely to exercise a high degree of care when purchasing such goods and services.

**7. Defendant's intent in selecting the mark.** If the trademark was adopted with the intent of deriving benefit from the plaintiff's reputation, that fact alone may be sufficient to justify the inference of confusing similarity. Intent doesn't require direct evidence of intentional copying, but can be inferred from knowledge of the protected trademark or the

nature of the defendant's use. As to the nature of use, the court said using trademarks in domain names, repeating trademarks in watermarks, and mimicking distinctive scripts all indicate intent to convey an impression of affiliation. It found both factors supported an inference of D'Amato's intent to derive benefit from Audi's goodwill.

**8. Likelihood of expansion of product lines.** The court opted not to analyze this factor because the parties' product lines already overlapped.

## CLICKING TOWARD LIABILITY

Trademark infringement wasn't the only source of D'Amato's liability. He also faced claims for trademark dilution and cybersquatting.

To establish dilution, Audi needed to show its trademark is famous and distinctive and that D'Amato's use was in commerce, began after the mark became famous, and caused dilution of the mark's distinctive quality. The court found each element satisfied. Specifically, the dilution requirement was met because D'Amato used identical trademarks on his goods and services. Audi wasn't required to show D'Amato made actual sales or profited.

The court also found D'Amato liable under the ACPA. The statute imposes civil liability when an individual has a bad-faith intent to profit from another's trademark and "registers, traffics in, or uses a domain name that ... is identical or confusingly similar to or dilutive of that mark." The court considered nine nonexclusive factors related to bad faith and concluded D'Amato harbored bad intent. In particular, it noted that D'Amato's Web site "affirmatively misrepresented" his relationship with Audi. This inferred that he intended to divert customers from purchasing goods and services from Audi's legitimate Web site.

## BACK IT UP

In the end, the Sixth Circuit affirmed the lower court's decision. So in this case, the aspiring entrepreneur found that the Internet can be a superhighway of liability — with costly tolls. 💡

# Heavy lifting

## Federal Circuit weighs patent's "on sale bar"

The Federal Circuit Court of Appeals recently questioned the application of the "on sale bar" doctrine in a patent case involving software used to create interactive kiosks. The appeals court ultimately concluded in *Plumtree Software v. Datamize* that the district court erred in granting the plaintiff summary judgment based on the doctrine.

### PLAINTIFF HOISTS THE BAR

Plumtree brought a declaratory judgment action regarding two of Datamize's patents, which covered an "authoring tool" for creating software for kiosks. It moved for summary judgment on the ground that the patents were invalid under the on sale bar.

Under the bar, a patent claim is invalid if the invention was on sale before the "critical date," or more than one year before the patent application. The bar is intended to prevent attempts to profit from an invention's commercial use for more than a year before the application is filed. The critical date in *Plumtree* was Feb. 27, 1995.

The district court found the on sale bar was triggered by Datamize's agreement with the Ski Industry of America (SIA). Representatives from the two organizations met on Jan. 17, 1995, about an upcoming trade show. The authoring tool had been reduced to practice but not yet used to create a kiosk product. On Jan. 25, 1995, SIA sent Datamize a letter confirming that Datamize would participate as a sponsor at the show and display a computer kiosk, and SIA would waive the \$10,000 sponsorship fee. The show was held after the critical date and included a demonstration of a kiosk system created by the authoring tool. Programming and testing of the product weren't completed until the first day of the show.

The district court reasoned that the agreement embodied all of the patents' claims because the kiosk embodied all of the patents' claims. The

appellate court found the lower court's focus misplaced, because the invention was the process for creating a kiosk, not the kiosk itself.

### COURT PRESSES THE ISSUE

The Federal Circuit cited the two-part test for determining whether a sale or offer of sale occurred. The invention must have been:

1. The subject of a commercial sale or offer for sale, and
2. Ready for patenting.



Only the first prong was in question. The court explained that Plumtree could satisfy the prong by demonstrating one of two things occurred before the critical date:

1. **A commercial offer to perform the patented method was made.** The court noted that a commercial offer is one in which the offeror must be legally bound to perform the patented method if the offer is accepted. It found a pre-critical date offer by virtue of the SIA agreement. But the agreement didn't unambiguously require use of the patented method. The court held the agreement wasn't clear on whether it required the defendant just to provide the kiosk software or to perform the method.

2. The steps of the patented method were performed for such a promise. The court found that Plumtree hadn't established that the defendant had actually performed all of the patented steps before the critical date pursuant to the contract. The authoring tool was used to create the kiosk system, but the system wasn't completed until after the critical date. It was unclear whether the defendant had performed each of the

patented method steps before the critical date. Summary judgment, therefore, was inappropriate.

### BACK TO THE BENCH

The court sent the case back to the district court for further proceedings. Plumtree may still prevail if it can establish that the defendant performed all of the steps of the patented method before the critical date. 💡

## Copyright Office allows expanded DMCA circumvention

The U.S. Copyright Office recently announced three new exemptions to the Digital Millennium Copyright Act (DMCA). The DMCA generally prohibits people from circumventing a technological measure put in place by a copyright owner to control access to a protected work. But the exemptions allow users of certain types of works to circumvent such controls for non-infringing uses of a protected work.

### Real-world impact

The exemptions should result in the expanded use of some formerly limited materials, including the following:

**DVDs.** Circumvention is now sometimes allowed for audiovisual works included in the educational library of a college's or university's film or media studies department. This exemption is only for making compilations of snippets of protected works for educational use in the classroom. Previously, film and media professors couldn't legally break the copy-protection technology embedded in most DVDs.

**Cell phones.** Now exempted is circumvention for computer programs that enable cell phones to connect to a wireless telephone communication network, if the circumvention is for the sole purpose of lawfully connecting to a wireless network. Thus, cell-phone owners can break their phones' software locks to use the phones with providers other than their original providers.

**CDs.** Circumvention is now sometimes acceptable if a lawfully purchased sound recording distributed in CD format is safeguarded by technological protection measures that control access but create or exploit vulnerabilities that compromise the security of personal computers. Circumvention is approved only for good faith testing, investigating or correcting of such security flaws or vulnerabilities.

### The future

The Copyright Office also extended three previous exemptions, related to 1) obsolete software and games, 2) obsolete software dongles, and 3) e-books. But it eliminated a prior exemption related to lists of Internet locations blocked by filtering software, and it rejected some proposed exemptions, including an exemption allowing DVD owners to legally copy movies onto computers or portable players. The next round of exemptions is expected in 2009.

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