FENWICK & WEST LLP

Intellectual Property Bulletin

Fenwick & West LLP — Summer 1998

FENWICK & WEST LLP

About The Firm

Fenwick & West LLP provides comprehensive legal services to high technology and life sciences clients of national and international prominence. We have over 280 attorneys and a network of correspondent firms in many major cities throughout the world. We have offices in Mountain View and San Francisco, California and Washington, D.C.

Fenwick is committed to providing excellent, cost-effective and practical legal services and solutions that focus on global high technology industries and issues. We believe that technology will continue to drive our national and global economies, and look forward to partnering with our clients to create the products and services that will help build great companies. We differentiate ourselves by having greater depth in our understanding of our clients' technologies, industry environment and business needs than is typically expected of lawyers.

Fenwick is a full service law firm with "best of breed" practice groups covering:

- Corporate (emerging growth, financings, securities, mergers and acquisitions)
- Intellectual Property (patent, copyright, licensing, trademark)
- Government Contracts and Technology Transfer
- Litigation (commercial and IP litigation)
- Tax

Our Offices

Silicon Valley Center
801 California Street
Mountain View, CA 94041
Tel: 650.988.8500
Fax: 650.938.5200

Suite 200
815 Connecticut Avenue NW
Washington, DC 20006
Tel: 202.261.0400
Fax: 202.463.6520

Embarcadero Center West
275 Battery Street
San Francisco, CA 94111
Tel: 415.875.2300
Fax: 415.281.1350

For more information about Fenwick & West LLP, please visit our Website at: www.fenwick.com.

FENWICK & WEST LLP

Intellectual Property Bulletin

Summer 1998

Table of Contents

Copyright Misuse and Its Effect on the Enforceability of a Copyright

by Mitchell H. Zimmerman (mzimmerman@fenwick.com) and Steven D. Young

A Ninth Circuit Court of Appeals decision last year has raised questions as to the enforceability of certain licensed copyrights. The existence of certain types of restrictions in any license agreement regarding a copyright can render the copyright unenforceable, even against those who were never parties to the agreement. Because some of these restrictions are fairly common, many copyrights may have become, unknown to the copyright owner, unenforceable. Fortunately for those copyright owners, it appears that this unenforceability can be cured.

Copyright misuse can be a defense to a claim of copyright infringement, and is useful only to one who would otherwise be found liable for copyright infringement. By showing that a copyright owner has attempted to impermissibly extend the scope of a copyright, a defendant can render a copyright temporarily unenforceable. Copyright misuse might also constitute a defense to a breach-of-contract action where a contract involves a copyright that has been misused. This is a potentially grave situation for companies that rely on copyright protection and copyright-based royalties.

In *Practice Management Information Corp. v. American Medical Association*, 121 F.3d 516 (9th Cir. 1997), the American Medical Association ("AMA") was barred from enforcing its copyright on the "Current Procedural Terminology" (CPT) coding system. The coding system had been licensed by the AMA to the Health Care Financing Administration of the federal government ("HCFA") for use on Medicaid and Medicare forms. The CPT license agreement contained a provision that prohibited HCFA from using any other coding system. The Ninth Circuit found that the restriction constituted copyright misuse, since it was an attempt to extend the monopoly granted by the copyright. Even though HCFA expressed no reservation with regard to the restriction, and the plaintiff, a publisher of medical books, was not a party to the license agreement, the Ninth Circuit declared the plaintiff free to make copies of the coding system.

The result in *Practice Management* is not without precedent. Although the doctrine of copyright misuse is an emerging one, courts have applied it in other jurisdictions. In *Lasercomb America, Inc. v. Reynolds*, 911 F.2d 970 (4th Cir. 1990), the Fourth Circuit Court of Appeals found copyright misuse in a software license that prohibited a licensee from independently developing software similar to that being licensed. In *DSC Communications Corp. v. DGI Technologies, Inc.*, 81 F.3d 597 (5th Cir. 1996), the Fifth Circuit Court of Appeals adopted the *Lasercomb* position, finding copyright misuse where the owner of a copyright on an operating system attempted to use the copyright to prevent others from designing hardware to be compatible with that operating system.

The defense generally extends to copyrights covered by license agreements that include an attempt to leverage a copyright monopoly into a larger monopoly or exclusive right. Typical situations where misuse can arise include:

- licenses that prohibit a licensee from using a competing product or service;
- licenses that require a licensee to license or purchase other property of the licensor;
- licenses that prohibit a licensee from inde- pendently developing products or works that compete with products or works of the licensor;
- licenses that seek to extend the temporal or territorial scope of copyright protection.

While these kinds of restrictions are suggestive of antitrust issues, the courts have made it clear that a license provision does not need to rise to the level of an antitrust violation in order to constitute copyright misuse. Because this is still an emerging area, it is not clear what other situations may give rise to copyright misuse. Some have suggested that standard software license provisions prohibiting reverse engineering constitute copyright misuse. David A. Rice, *Public Goods, Private Contract and Public Policy: Federal Preemption of Software License Prohibitions Against Reverse Engineering*, 53 U. Pitt. L. Rev. 543, 550-551 (1992).

In fashioning the copyright misuse doctrine, the courts have expressly relied on analogies to patent law, which has recognized a patent misuse defense since 1942. As a cure to copyright misuse, the courts appear to have adopted the notion of "purging" from the law of patent misuse. As is the case with patent misuse, copyright misuse renders a copyright unenforceable, but it does not extinguish the copyright. The copyright misuse can be purged, after which the copyright is once again enforceable. Although the particular requirements for the purging of copyright misuse have not been explicitly laid out by any court, it is likely that the accepted means for purging patent misuse would suffice in the copyright context. Assuming this is true, the misuse of a copyright is purged after the copyright owner strikes any offending provision from any license that is based on the copyright. The purge is effective when the effects of the misuse have "fully dissipated." At that point, the copyright should once again be enforceable. The copyright owner cannot, however, recover for acts of infringement that occurred during a period of misuse. For this reason, it is advisable for companies to expedite the process of purging any misuse that may be lingering in current license agreements.

Statutory Damages for Copyright Infringement

by David W. Johnson

In a copyright infringement lawsuit, a plaintiff may elect to pursue either actual damages and lost profits, or statutory damages as defined by the copyright statute. 17 USC §504(c)(1). Statutory damages range from $500 to $20,000 per discrete infringed work. These damages can increase to a maximum of $100,000 per infringed work if the infringement is found to be willful. Whether willful or not, these damages have traditionally been assessed by the federal judge, even where the issue of infringement was decided by a jury.

A recent decision by the Supreme Court has fundamentally altered the landscape for the assessment of damages in copyright infringement actions. The Supreme Court ruled that the parties, either the copyright owner or the infringement defendant, have a right to a trial by jury on the amount of statutory damages recoverable in an action against an infringer. *Feltner v. Columbia Pictures Television, Inc.*, 140 L.Ed. 2d 438 (1998). This holding drastically alters the landscape in copyright litigation.

The relevant federal statute states that “the copyright owner may elect, at any time before final judgment is rendered, to recover, instead of actual damages and profits, an award of statutory damages for all infringements involved in the action, with respect to any one work . . . of not less than $500 or more than $20,000 *as the court considers just* .” 17 USC §504(c)(1) (emphasis added).

The statute continues, “In a case where the copyright owner sustains the burden of proving, and *the court finds* , that infringement was committed willfully, *the court in its discretion* may increase the award of statutory damages to a sum of not more than $100,000.” 504(c)(2) (emphasis added).

The issue is whether the term “court” as used in the statute means a judge or a jury. The Supreme Court, relying on deep historical precedent specific to copyright law, held that both questions—willfulness and per-infringement damages—are questions for the jury.

The effect is that statutory damages will, in many contexts, become the plaintiff’s primary tool for maximizing recovery for alleged infringement. Where a case involves infringement of several works, a multiplier effect takes hold. In *Feltner* , by way of example, the trial judge found 440 separate acts of infringement—one for each airing by Feltner of a syndicated television episode for which license fees to Columbia went unpaid. The judge also found the infringements willful, but assessed only $20,000 per infringement, resulting in an award to Columbia of $8.8 million (plus attorney’s fees).

Under the new *Feltner* rule, a jury could have awarded upwards of $44 million. Where this multiplier effect is capable of generating damage numbers approaching, if not exceeding, the value of the works themselves, one can argue that the *Feltner* rule contains an embedded punitive damages component where none previously existed (and is expressly disallowed). Because such numbers can far exceed actual damages, and because willfulness will likely be easier to prove to a jury than to a judge, *Feltner* now requires all copyright litigants to assess even more carefully, at the beginning of any potential litigation, the significance of having a jury decide these questions.

Copyright Protection and Gray Markets

by John J. Steele, Hanna Bui-Eve and Kelly Smith

The Business Problem

Here is the problem: A company has a network of "authorized" distributors and resellers who are required to sell its product with pre-sale and post-sale customer support and other added value. Unfortunately, a number of unauthorized resellers, sometimes called "gray marketers," are selling the company's product without appropriate support. The company's authorized resellers are furious, demanding to know why they should spend so much time and money supporting the company's product when the gray marketers are getting a "free ride" from their efforts. Meanwhile, customers are calling the company, angry that they have been sold the wrong equipment, or that the retailer won't service it or even that the materials in the box are written in a foreign language.

This article explores some of the legal tools that enable the company to go on the offensive, sending an unmistakably clear message to the unauthorized resellers that it will not tolerate the gray marketing of its products.

What Can Be Done About Gray Marketing?

Depending on the facts presented by the individual instance of gray marketing, a variety of causes of action are available to the company including those based upon section 602(a) of the Copyright Act, Section 1797.8 *et seq*. of the California Civil Code, and the common law tort of inducing breach of contract.

If a company suspects that a gray marketer is importing the company's goods into the U.S., Section 602(a) of the Copyright Act is a possible basis for litigation. Section 602(a) gives the copyright owner the right to prohibit the unauthorized importation of copies. Although the recent Supreme Court opinion in *Quality King Distributors, Inc. v. L' Anza Research International, Inc.*, 140 L.Ed. 2d 254 (1998) limited the scope of this section by holding that 602(a) was limited by the first sale doctrine of section 109(a), section 602(a) will still prohibit the unauthorized importation of the company's product if that product was made overseas. In addition, if the company has licensed, not sold, its copyrighted goods to its authorized resellers (*i.e.*, licensing the operating system within sold computer hardware), the first sale doctrine will not limit the force of section 602(a).

In some circumstances, section 1797.8 *et seq*. of the California Civil Code dictates that the gray marketer must make numerous disclosures at the point of sale and in advertising, including notice that the item is not covered by an express warranty and not eligible for a manufacturer's rebate. The gray marketer's failure to abide by these disclosures is unfair competition under California law.

The company can also allege that the gray marketer, by buying products from authorized resellers with the knowledge that those resellers are contractually prohibited from selling for resale, is inducing a breach of contract between the company and its authorized resellers. To determine the source of the company's products being sold in the gray market, the company can make targeted "buys" from suspected gray marketers and trace the product's serial number back to an authorized reseller. Further, the company can establish notice of the contractual provision at issue by writing a letter to suspected gray marketers.

The Long-Term Solution

Even if, by utilizing some or all of the above causes of action, the company is successful at diminishing gray market sales of its goods, the company should establish a long-term plan for preventing the gray market from resurfacing.

For example, the company should audit its distribution contracts to ensure that the contracts set forth appropriate restrictions. If the company's product includes a software component, the contracts must state that such software is licensed and not sold in order to avoid the application of the first sale doctrine. As a further protection against unauthorized importation, the contracts should have a provision restricting the territory in which the authorized reseller may distribute the product, coupled with a prohibition against the sales of the product to anyone who will, directly or indirectly, export it. Additionally, the contracts need to specify that the authorized resellers may only sell the product to end users and other authorized resellers, and may not sell it to anyone outside this channel. This prohibition against transshipping will prevent the authorized resellers from selling the products to another reseller who is not under a contractual obligation to provide services of the quality that the company requires its authorized resellers to provide to the customers.

Additionally, the company will need to discipline the authorized resellers identified as selling to the gray market. Some things to consider are whether the client can afford to terminate the particular reseller and whether such termination would be legal under any applicable foreign law.

Finally, the company should continue to communicate with the channel to identify new gray marketers. Once these are identified, the company can continue to give notice of its contracts with authorized resellers and, if necessary, use the above causes of action to inhibit or preclude future unauthorized sales of its product.

Quick Updates

Copyright Licensee May Exploit Work Through New Uses Reasonably Within Medium Described

In *Boosey & Hawkes Music Publishers Ltd. v. Walt Disney Co.*, the Second Circuit Court of Appeals recently held that a copyright licensee may exploit a licensed work through new and later developed technologies if the new uses fall within the medium described in the license. The court found that Walt Disney's license to use Igor Stravinsky's "The Rite of Spring" in the movie Fantasia extends to videotape format distribution. The license conveyed the right to record the composition "in any manner, medium or form" for use in a motion picture. While acknowledging that its approach deprives the author/licensor of participation in the profits of new and unforeseen channels of distribution, the court found this result to be more fair and sensible than depriving a contracting party of a right reasonably found in the terms of the contract.

Use of Another's Trademarks as a Metatag Can Constitute Nonactionable Fair Use

A federal court has held that use of another's trademark as a metatag, aimed at directing customers to a defendant's Web site, can constitute a fair use.

In *Playboy Enterprises Inc. v. Welles* , No. 98-CV-0413-K (S.D. Cal.4/22/98) defendant created a Web site featuring a heading and link page that advertised her career as a former "Playmate of the Year." In building the Web site, defendant used several of plaintiff's trademarks as metatags, markers invisible to the public but used to allow search engines to help Web surfers find Web sites.

The court denied plaintiff's request for a preliminary injunction against defendant, finding fair use based on defendant's accurate, and minimal, use of plaintiff's marks to promote her career, a practice that the court concluded plaintiff typically encouraged. The court also ruled that defendant's use of plaintiff's marks as meta- tags constituted a nonactionable fair use of plaintiff's trademarks, explaining that the use of the term "Playboy" in messages referenced only defendant's identity as a Playmate of the Year and also referenced legitimate editorial uses of the term as used visibly on defendant's Web site.

Use of Another's Trademark Likely to Confuse Where Original Work Not Parodied

Further examining the relationship between parody and trademark infringement, the Fifth Circuit reversed a lower court denial of a preliminary injunction based on parody, holding that in order for parody to weigh against a likelihood of confusion, the parody must target the original work for comment or ridicule. *Elvis Presley Enterprises, Inc. v. Capece*, 5th Cir., No. 9720096, 5/7/98.

In *Elvis*, plaintiff sued defendant, owner of the Velvet Elvis lounge club, for trademark, copyright and right of publicity infringement. The lower court found no infringement, citing defendant's parodic use of plaintiff's marks. The appellate court reversed, holding that because defendant did not intend to parody the original work, parody, in this instance, did not weigh against a likelihood of confusion. The Fifth Circuit found that the defendant intended to parody "a time or concept from the sixties" rather than the late entertainer *per se*, and thus, could have accomplished its goal without using plaintiff's name or mark. The court thus remanded the case and directed the district court to enjoin defendant's use of the plantiff's mark.

Federal Circuit Clarifies Test for Determining Whether Inventions Implementing Mathematical Algorithms are Patentable

In *State Street Bank & Trust Co. v. Signature Financial Group, Inc.*, No. 96-1327 (Fed Cir. 1998), the Federal Circuit held that a data processing system for managing financial portfolios, such as mutual funds, is patentable subject matter despite the fact that the purpose of the system is to produce numbers by using a mathematical algorithm representing portfolio price, cost, profit, loss, etc. The court held that the *Freeman-Walter-Abele* test, which requires that an algorithm be applied to physical elements or process steps, is no longer applicable to determining the presence of patentable subject matter. Instead, an invention implementing a mathematical algorithm is patentable if it is a "practical application" that produces a "useful, concrete and tangible result." The Federal Circuit also eliminated the judicially created "business method exception" doctrine, which excludes methods of doing business from the definition of patentable subject matter.

Ed. Note: A full-length article discussing this important new case in detail will appear in the next issue of the IP Bulletin.

Factual Findings Relating to Claim Construction are Reviewed De Novo on Appeal

In *Cybor Corp. v. FAS Technologies Inc.*, 46 USPQ2d 1169 (Fed. Cir. 1998), the Federal Circuit, *in banc*, held that factual findings related to claim construction are to be reviewedde novo on appeal. The court admitted that some recent Federal Circuit cases had applied a clearly erroneous standard to factual findings related to claim construction, but disavowed language in such cases that is contrary to its present ruling on this issue.

Intellectual Property Bulletin Editorial Staff

Summer 1998

Editor
Stuart P. Meyer

Assistant Editors
David C. McIntyre
John T. McNelis

Article Contributors
Mitchell H. Zimmerman
Steven D. Young
David W. Johnson
John J. Steele
Hanna Bui-Eve
Kelly Smith

Update Contributors
William P. Fitzpatrick
Christine L. Hoang
Tina M. Lessani