



FENWICK & WEST LLP



# Intellectual Property Bulletin

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Fenwick & West LLP — Winter 1998



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## Settling Patent Disputes: Licenses, Settlement and Lear Agreements

by [Charlene M. Morrow \(cmorrow@fenwick.com\)](mailto:cmorrow@fenwick.com)

An issue peculiar to the resolution of patent disputes is the extent to which a license or settlement agreement will ultimately resolve all disputes between the parties concerning validity of the asserted patents. The applicable rules have their roots in Federal Circuit decisions clarifying the application of the Supreme Court's decision in *Lear v. Adkins*, 395 U.S. 653 (1969).

The resulting rules provide that a party that takes a license in resolution of a patent dispute prior to any litigation is not foreclosed from later challenging the validity of the licensed patent(s) unless the party is the inventor of the patented technology or in privity with the inventor. However, a party who takes a license as part of a settlement of litigation can be prohibited from later challenging the validity of the licensed patent(s), but such a prohibition will be narrowly construed in subsequent litigation involving new products.

### ***Lear v. Adkins*: The Prohibition on Licensee Estoppel**

Under the *Lear* doctrine, public policy prohibits a licensee from being barred from later challenging the validity of the licensed patent(s). In *Lear*, the Supreme Court expressly reconsidered its prior rulings creating a doctrine of licensee estoppel. *Lear* involved a license that provided if "the U.S. Patent Office refuses to issue a patent or if such patent so issued is subsequently held invalid, then in any of such events *Lear* at its option shall have the right forthwith to terminate the specific license so affected or to terminate this entire Agreement" 395 U.S. at 657. In *Lear*, the Supreme Court held that where a license is taken *after* the issuance of a patent, the licensee is not barred from later asserting that the patent is invalid. 395 U.S. at 669-671. The Supreme Court held further that under the license before it, *Lear* had to pay royalties during the time the patent application was pending and prior to its challenge to the validity of the patent, but was not barred from asserting the invalidity of the patent or obligated to pay royalties during the time it was challenging the validity of the patent in court.

The continued vitality of *Lear* as applied to license agreements is shown by the Federal Circuit's 1997 decision in *Studiengesellschaft Kohle, m.b.H. v. Shell Oil Co.*, 112 F.3d 1561, 1568 (Fed. Cir. 1997), *cert. denied*, 66 U.S.L.W. 3385 (1997). *Studiengesellschaft* involved a license silent on the validity of the licensed patent. 112 F.3d at 1567. The Federal Circuit adopted the rule that where a licensee decides to challenge the validity of a patent it has licensed, it is not relieved of its duty to pay royalties under that license until it notifies the licensor it is doing so "because it has deemed the relevant claims to be invalid." 112 F.3d at 1568.

However, Federal Circuit decisions since *Lear* place a number of limitations on its application.

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### **The Assignor Exception to Lear**

The Federal Circuit has held that *Lear* does not apply where the party taking a license is the inventor of the patented technology, or is in privity with the inventor.

In *Diamond Scientific Co. v. Ambico, Inc.*, 848 F.2d 1220 (Fed. Cir.), *cert. dismissed*, 487 U.S. 1265 (1988), the Federal Circuit examined whether an employee inventor who had assigned his patent right to his prior employer was estopped along with his subsequently formed company from challenging the validity of the issued patents in subsequent infringement litigation. The Federal Circuit held that the public policy expressed in *Lear* did not apply to assignors. It stated, “The public policy favoring allowing a licensee to contest the validity of a patent is not present in the assignment situation. Unlike the licensee, who, without *Lear* might be forced to continue to pay for a potentially invalid patent, the assignor who would challenge the patent has already been fully paid for the patent rights.” 848 F.2d at 1224.

In *Sun Studs, Inc. v. ATA Equip. Leasing, Inc.*, 872 F.2d 978 (Fed. Cir. 1989), *vacated in part on other grounds*, 872 F.2d 994 (Fed. Cir. 1989), *overruled on other grounds*, *A.C. Aukerman Co. v. R.L. Chaides Constr. Co.*, 960 F.2d 1020 (Fed. Cir. 1992), the Federal Circuit extended its *Diamond* ruling to hold that a consulting firm that participated in developing a patented invention, which in its consulting agreement agreed to “assist in every lawful way in protecting or enforcing [the assignee’s rights in any subsequent patent], and in prosecuting and defending appeals, interferences, infringement suits, and controversies relating thereto” had not entered into an agreement that was against public policy, and that the consulting company’s breach of this provision by challenging the validity of the patents excused the assignee’s obligation to share royalties with the consulting firm.

Subsequently, in *Acoustical Design, Inc. v. Control Elec. Co.*, 932 F.2d 939, 943 (Fed. Cir. 1991), the Federal Circuit rejected the argument that the doctrine of assignor estoppel should not be applied where the assignor obtained a license-back of rights to practice the patented invention, holding that an assignor-licensee is in “a different situation from that of an ordinary licensee,” even where there is such a grant-back.

Accordingly, in resolving a patent dispute between an inventor and his prior employer, there is no public policy prohibition against prohibiting the inventor from later challenging the validity of the patent(s) issued to him or her.

### ***Lear* and Settlement of Litigation**

The Federal Circuit has also held that *Lear* does not apply where the license was entered into in settlement of litigation. In *Hemstreet v. Spiegel, Inc.*, 851 F.2d 348 (Fed. Cir. 1988), a settlement was reached during trial of the underlying litigation, which was memorialized in a “Settlement Order” that both the Court and the parties signed. The Order stated that the alleged infringer, REI, was taking a license that the patent holder agreed to accept “on condition that REI agrees to make said payments as they become due notwithstanding that

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said patents-in-suit may be held invalid and/or unenforceable in any other proceeding at a later date.” 851 F.2d at 349. The Federal Circuit held that REI could not avoid its obligation to make payments under the license agreement when the licensed patent was later held invalid in a separate suit. *Id.* at 350. Accordingly, as a general principle in settlement of litigation a party may agree not to later challenge the validity of a licensed patent or patents.

A later decision shed light on how such provisions will be construed in subsequent litigation on new products. In *Foster v. Hallco Mfg. Co.*, 947 F.2d 469 (Fed. Cir. 1991), the Federal Circuit examined the effect of a combination license agreement and consent judgment. The alleged infringer took a license to three patents. It also agreed to the entry of a consent judgment that provided that the asserted patents were “valid and enforceable in all respects.” When disagreement arose between the parties as to whether the defendant should be paying a royalty on later-introduced products, the defendant filed an action seeking a declaration that the patents were invalid and unenforceable and that they were not infringed by the new products. The Federal Circuit held that the public policies of encouraging settlements and the finality of judgments trumped the *Lear* policy against restricting attacks on patent validity. *Id.* at 474-75. In *Foster*, the Federal Circuit stated that it was adopting “the position that provisions in a consent judgment asserted to preclude litigation of the issue of validity in connection with a new claim must be narrowly construed.” *Id.* at 481. It reasoned that this would strike “a reasonable balance between the policy considerations enunciated in *Lear*, and those favoring voluntary settlement of litigation.” *Id.*

#### ***Lear* and Subsequent Litigation**

*Lear* is also an issue in subsequent litigation involving new products. In *Foster* the Federal Circuit first held that unless the new devices were “essentially the same” as those admitted to infringe in the original consent judgment, claim preclusion would not apply to bar the alleged infringer from litigating the validity of the patents in the subsequent suit.

Second, the Federal Circuit concluded (applying its *Lear* analysis) that the consent judgment, which stated that the asserted patents “are valid and enforceable in all respects” and that “[t]his consent judgment constitutes *res judicata* between the parties” did *not* bar litigation of validity or enforceability in a later action directed to different products, stating that these “clauses are slender reeds in themselves on which to rest its position that the parties *intended* to preclude particular issues namely validity and enforceability in future litigation of a different claim.” 947 F.2d at 481-482.

Accordingly, it is clear that to bar future litigation of patent validity in connection with disputes on new products, the consent judgment or other settlement documents must contain express provisions concerning such subsequent litigation.

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## Patent Protection for Internet Companies

by [Robert R. Sachs \(rsachs@fenwick.com\)](mailto:rsachs@fenwick.com)

Like most other high-technology companies, Internet companies seek to protect their products and ideas from their competitors. Patent protection is typically seen as the most powerful intellectual property protection available. Unlike other areas of technology, however, the global nature of the Internet presents a particularly complex environment for protecting inventions. This is because of the divergence between the trans-national nature of the Internet and the territorial rights granted by patents.

Internet-based systems can operate in multiple countries during a single transaction or information exchange. Therefore, patent claims for such systems must be written to cover the individual functional components of the system, apart from the overall system. Internet companies also have to be careful in promoting their technology to avoid the loss of potential patent rights in different countries, some of which bar patent protection for any technology that is publicly disclosed or used prior to filing for a patent.

### **Protecting Functionality**

Patent rights generally allow the patent holder to prevent others from making, using or selling a patented invention in the country granting the patent. For hardware technology, territorial patent protection is sufficient, since the infringing hardware is physically present in the country where the patent is granted.

Internet technologies are different from hardware technologies. An Internet company can provide products or services in three distinct modes: client programs, server programs or systems using both client and server components. Client programs are software that executes only on a user's machine. Server programs are software that executes at the company's Internet site (where the company is providing a service) or on the Internet site of a purchaser of the server. A particular client is not required, as the server can be accessed by any browser.

Client-server systems include both components, with a specific client program used to access the server. In these systems, the functionality, and hence value, of the system is provided by both components. Java, Shockwave and other technologies that send executable "applets" from the server to a compatible application may be characterized in this last category of client-server systems, since execution of the applets effectively makes the application a dedicated client. Since the trend in Internet applications is toward increased interactivity through Java or similar technologies, client-server systems present the greatest need for patent protection.

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On the Internet, use of a client-server system may involve components operating in multiple locations around the world. For example, a client program in the United States may access a server in Japan, which itself processes the transaction through a database in the Philippines. Proper patent protection of such a system requires a careful dissection of the invention into its components.

A fundamental rule of patent law is that every element of the claim must be present to infringe. Historically, client-server inventions would be covered by system claims that included both the client and server elements. As a result, such system claims are only infringed by the presence of both a client and a server together in the country where the patent is granted. These claims used to be sufficient, since a company would typically develop and sell the entire system, and a competitor would infringe by also making and selling a similar system. Either the manufacture, sale or use of the system would occur in a country covered by a patent.

But on the Internet, because either the client or the server may be outside of the country, system claims provide limited protection. Instead, inventions in client-server systems need claims directed to the individual components themselves. In these claims, it becomes essential to focus on the inventive aspects of the processing or structure of the particular client or server component. In both instances, the claims must describe the operations from the component's perspective. For example, in an online commerce system, client claims may include "transmitting a payment token" and "receiving a decryption key," whereas server claims would include "receiving a payment token" and "transmitting a decryption key." In this fashion, it becomes much easier to prove that all of the claim elements occur within the country covered by the patent.

The value of many Internet companies is in their ability to automatically synthesize specific information for a user. Whether it is finding, analyzing, compiling or otherwise manipulating information, the competitive advantage may reside in the idea of providing certain types of information or analysis, not in the technical implementation of how the information is assembled. For example, an Internet business may provide an online auction system, with real-time bidding and purchase of items, using simple bid-matching techniques. For such a company, broad claims would emphasize what is being done in the system management of auction bids from remote buyers instead of the underlying algorithms, which may be easily avoided.

Finally, the "clickflow" of a Web site is part of its functionality and supports the experience and utility of the site to the user. Clickflow is the user's perception of the behavior of the Web site, apart from the actual algorithms that the client and/or server execute in response to the user's actions. Protecting clickflow requires abstracting away from the specific Web pages to underlying structural and dynamic relationships in the information contained in the



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Web site. The claim perspective, as discussed above, should be from the component that provides the clickflow functionality, and not from the user's view.

Claims on user behavior are infringed only by users, not directly by a company copying the clickflow. The structural and dynamic relationships in the Web site, for example, should be claimed in a way that is specific to the type of information being presented, without limiting the claims to the particular implementation.

### **Publication and Use on the Internet**

In the U.S., a patent application must be filed within one year of public use of the invention or publication of a document describing the invention. In other countries, there is no such grace period and the patent application must be filed before any such public use or publication. However, some countries, such as Japan, do not consider a public use outside their borders as invalidating a later-filed patent application. Companies have traditionally relied on this distinction in order to preserve some foreign patent rights, and have marketed or demonstrated their products in the United States without fear of losing all foreign patent rights.

However, the Internet makes such conduct risky. Many Internet companies promote new products or services on their Web sites before filing for patents. For example, a company may offer a free trial version of its software or may simply give the software away in order to develop a customer base. For client or server software, use in a foreign country would certainly bar a patent. The harder question is whether merely accessing a server in the United States would bar patent protection on the server in Japan or a country having similar public use criteria. This question has yet to be addressed. In all cases, an infringer may have to demonstrate that the server was accessed or that the software was downloaded and used in the foreign country prior to the filing date of a patent application. While it may be difficult to prove such acts, it is not impossible. Similarly, a description, on a Web site, of a product incorporating an invention may be deemed a publication of the invention, and also bar the patent application.

Thus, the possible loss of patent rights anywhere in the world suggests that any software components that factor into the company's technology strategy and are used with its inventions should not be made available or used on the Internet until after the filing date of a patent. Filing a patent application in the United States will preserve most foreign patent rights. The technology can then be distributed, used or publicized on the Internet.

In sum, the Internet forces a rethinking of the basic issues in seeking patent protection: designing the claims to provide for enforceable protection for the invention using limited territorial patent rights, and managing pre-filing business activities to avoid loss of patent rights.

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## Quick Updates

### **ISP Not Directly Liable for Hosting Site Containing Copyright-Infringing Material**

In *Marobie-FL, Inc. v. National Association of Fire Equipment Distributors*, 45 U.S.P.Q. 2d (BNA) 1236 (N.D. Ill. 1997), a federal district court ruled that an internet service provider (“ISP”) that hosted a Web site containing infringing materials could not be held liable for direct copyright infringement. The court found that the ISP did not initiate the copying, and that its system was merely used by a third party to create a copy. The court thus concluded that the ISP was not liable for direct copyright infringement because its actions were “automatic and indiscriminate.” The court refused, however, to grant summary judgment in favor of the ISP on the issue of contributory copyright infringement (inducing or contributing to infringing conduct), stating that the degree to which the ISP knew, controlled or had the ability to monitor or control the contents of the infringing Web page was unclear and presented a disputed issue of material fact.

### **“No Electronic Theft Act” Signed into Law by President Clinton**

On December 16, 1997, President Clinton signed into law the “No Electronic Theft Act,” intended to address, among other things, electronic copyright piracy committed without a profit motive. The Act closes a loophole in the federal wire fraud statute as interpreted by *U.S. v. LaMacchia*, 871 F. Supp. 535 (D. Mass 1994). In *LaMacchia*, a computer bulletin board operator who provided bulletin board users with unauthorized copies of copyrighted software escaped prosecution under the wire fraud statute because his acts lacked the necessary element of commercial gain. The Act provides stiff criminal penalties for willful copyright infringement, and expands the statute of limitations for criminal copyright violations from three to five years.

### **NSI’s Domain Name Registration Does Not Constitute Trademark Infringement**

In *Lockheed Martin Corp. v. Network Solutions, Inc.*, 44 U.S.P.Q. 2d (BNA) 1865 (C.D. Cal. 1997), a federal district court granted summary judgment to Network Solutions, Inc. (“NSI”), finding that its services as the exclusive registrar of domain names could not subject the company to a trademark infringement claim by the owner of a registered trademark. Lockheed Martin argued that, in registering domain names that allegedly infringed Lockheed’s registered SKUNK WORKS mark, NSI had violated Lockheed Martin’s trademark rights. NSI argued that its registration of various “SKUNK WORKS” Internet domain names did not constitute trademark use of Lockheed’s mark and thus could not subject NSI to liability for infringement.

The court agreed with NSI, explaining that while domain names could serve a trademark function when identifying an Internet user offering goods or services on the Internet, NSI’s involvement with domain names did not reach this level. Rather, in registering domain names, NSI’s acceptance of the names served only to identify an address, *i.e.*, a set of computers on the Internet. Direct infringement, the court held, requires something more

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than simply registering a domain name. Nor could NSI be held liable as a contributory infringer, given NSI's limited involvement with the domain name. Unless NSI had "unequivocal knowledge" that a domain name was being used to infringe a trademark, the court reasoned, NSI could not contribute to ongoing trademark infringement.

#### **Advertising via Web Site Held Insufficient to Create Personal Jurisdiction**

In *Transcraft Corp. v. Doonan Trailer Corp.*, 45 U.S.P.Q. 2d (BNA) 1097 (N.D. Ill. 1997), a federal district court held that it had no personal jurisdiction over an out-of-state defendant where jurisdiction was based solely on the defendant's Internet Web site. Plaintiff sued defendant for trademark infringement, unfair competition and trademark dilution. Although defendant had no agents or offices in Illinois, it operated an Internet Web site that could be accessed by Illinois residents.

Likening defendant's Web site to a general advertisement to the whole world, the court explained that the Web site was not a specific invitation to Illinois residents to transact business. Unlike cable broadcasts, the Web site did not involve a defendant "purposefully serving a market in the forum state." For this reason, the court concluded, the Internet Web site could not alone create personal jurisdiction in Illinois.

#### **Parent Case Prosecution History May Not Apply to Subsequent Related Patents**

In *AbTox, Inc. v. Exitron Corp.*, 122 F.3d 1019 (Fed. Cir.), amended, 131 F.3d 1009 (Fed. Cir. 1997), defendant MDT Corporation alleged infringement by AbTox of two patents that originated from the same parent patent application. The Federal Circuit held that the prosecution history of the parent case must be considered in determining whether claim limitations could be read into the subsequent patents derived from that parent. Here, a claim limitation existed for RF technology in an apparatus and process in the parent case, but not for using microwave technology for the same apparatus and process. Thus, the Court held, the limitations from the parent case involving RF technology could not be imported into the subsequent patents which were directed to microwave technology. The Court stated that statements in the parent application must be confined to their proper context and properly acknowledge the distinctions between RF and microwave claims.

#### **Court Properly Used Extrinsic Evidence to Determine Meaning of Disputed Claim Term**

In *Fromson v. Anitec Printing Plates, Inc.*, 45 U.S.P.Q. 2d (BNA) 1269 (Fed. Cir. 1997), the Federal Circuit affirmed a district court's use of extrinsic evidence to narrow a disputed claim term beyond what appeared in the claim, specification and prosecution history. The appellate court reasoned that the narrowed term more accurately reflected the fundamental purpose of the claimed process. The plaintiff asserted that the district court improperly relied on expert testimony to change the meaning of the claim term. The court disagreed, however, reasoning that, "[b]ased on expert testimony, the [district] court concluded that not all electrolytically formed oxide coatings will protect the [aluminum sheet] as it moves into

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the contact cell a fundamental purpose of the Fromson patent. Extrinsic evidence may be particularly helpful to the court when a specific technical aspect that is potentially of dispositive weight was not discussed in the specification or explored during the patent prosecution.”

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