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Intellectual Property Litigation

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This Issue: The Future of IP Litigation

Copyright Issues Likely to Affect Business Models and Force Congressional Changes

By Brad R. Newberg

It is an axiom of the legal landscape that the law is always playing catch-up to technological changes. Legal challenges to new models often take years to get rulings, and Congress does not typically move until after such cases have been decided one way or the other—and the pace of that movement is notoriously glacial. By such time, a new technology is usually taking up the time and energy of both content owners and users.

It is therefore hard to play Nostradamus and decide what business developments and statutory changes will take place over the next year, never mind the next decade. However, given the flood of copyright decisions coming out of the district and circuit courts these past couple of years—combined with the Supreme Court's recent seeming reluctance to give definitive answers to copyright questions—now is as good of a time as any to look ahead and think about what might occur over the

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The Past, Present, and Future of Offer-to-Sell Infringement Jurisprudence and Damages

By Chantal Kuhn Rappi

What constitutes an infringing offer to sell? Does the location of the offer matter? What damages flow from an infringing offer? Should they be measured in the same way infringing sales damages are measured?

The patent statute provides that "whoever without authority makes, uses, *offers to sell*, or sells any patented invention within the United States . . . infringes the patent." 35 U.S.C. § 271(a) (2006) (emphasis added). Offer-to-sell infringement liability was added to the statute in April 1994 to comport with the Uruguay Round's Trade-Related Aspects of Intellectual Property Agreement (TRIPS) and was meant to harmonize U.S. patent law with that of other signatories. *See* Uruguay Round Agreements Act, Pub. L. No. 103-465, § 533(a)(1), 108 Stat. 4809, 4988 (1994); *Rotec Indus. v. Mitsubishi Corp.*,

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Message from the Chairs

The future of intellectual property litigation is a topic of interest to many people, as intellectual property impacts industry and spurs innovation in the United States and throughout the world. Both individuals and business enterprises rely on intellectual property laws to:

- Brand, market, and sell their products and/or services by relying on trademark and trade dress law for the opportunity to create unique ways for their consumers to identify their offerings;
- Protect ideas and inventions that are imperative to their success by relying on patent and trade secret law; and
- Establish ownership and maintain control of communications, literature, art, music, film, and television.

This issue explores the change to intellectual property law as we know it today and attempts to forecast the end result of the anticipated evolution of IP law. The articles that follow provide insight into potential revisions and additions to the copyright statutes by Congress and how businesses will take a new approach to protecting their copyrights. On the litigation front, we will review how the *Bell Atlantic Corp. v. Twombly* and *Ashcroft v. Iqbal* decisions may result in an amendment to Rule 8 of the Federal Rules of Civil Procedure to provide clearer guidance for patent litigation. We will explore patent infringement by offering to sell a patented device and the alternatives for proving damages for such an infringement theory. We will highlight a new approach to the prosecution of trade secret cases and discuss whether insurance coverage is available for the theft of a trade secret.

Our newsletter editors continue to work at a high level to provide our membership and the Section with meaningful and timely articles focused on highly relevant intellectual property issues. Our editors' work is consistent with the aim of our committee, which is, among other things, to deliver to you the intangibles to help you grow and maintain a thriving practice. Consistent with our goals, we are constantly updating our webpage with new articles regarding the practice of intellectual property litigation. We encourage you to visit on a regular basis, as we are constantly adding new content. If your time is limited, follow us on Twitter and get updates to your mobile device every time something new posts to the committee webpage. Just log on to Twitter and search for "ABAIPLCOMMITTEE."

The rest of our committee is hard at work trying to provide you with an ever-increasing range of member benefits, from roundtables to monthly conference calls with members of the bench, programs, and more. Don't forget to mark your calendar for the ABA Annual Conference in Toronto, Ontario, Canada, August 4–9, 2011. We expect to have several of our committee members in attendance and hope you will attend. We want to get to know you better and find out how we can better serve you and, if you like, get you more involved.

Don't hesitate to email any of us if you have any questions. Your feedback and comments are always welcome.

John P. Hutchins
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Form 18's Proper Place after *Twombly* and *Iqbal*

By Allison K. Levine

The Supreme Court's recent clarification—and effective revision—of the Rule 8 pleading standard in *Bell Atlantic Corp. v. Twombly* and *Ashcroft v. Iqbal* is a source of controversy in Congress (*see* Notice Pleading Restoration Act of 2009, S.1504, 111th Cong. (2009); Open Access to Courts Act of 2009, H.R. 4115, 111th Cong. (2009)) and uncertainty in the courts (*see* Jeremiah J. McCarthy and Matthew D. Yusick, "*Twombly* and *Iqbal*: Has the Court "Messed Up the Federal Rules?" 2010 *Fed. Cts. L. Rev.* 1, 8 (2010) ("The tension between Rule 84 and the Court's pronouncements in *Twombly* and *Iqbal* has created an unhappy state of affairs for the federal court pleader, not to mention the federal court judge.")). These decisions have created tension in patent-infringement cases by contradicting the standard embodied in Form 18. Courts have split as to how to reconcile Form 18 with *Twombly* and *Iqbal*, but an emerging approach likely to be tested by the Federal Circuit soon is to confine Form 18 to a narrow set of cases involving direct infringement of a simple device patent. For all other patent-infringement cases, Form 18 may fail to satisfy *Twombly* and *Iqbal*'s heightened standard.

Twombly and *Iqbal* vs. Form 18

Rule 8 of the Federal Rules of Civil Procedure provides that a complaint must contain a "short and plain statement of the claim showing that the pleader is entitled to relief." Under *Conley v. Gibson*, 355 U.S. 41, 47 (1957), the Supreme Court had long interpreted Rule 8 to require a plaintiff to merely "give the defendant fair notice of what the . . . claim is and the grounds upon which it rests." A complaint was not to be dismissed for failure to state a claim "unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief."

In *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007), and *Ashcroft v. Iqbal*, 129 S. Ct. 1937 (2009), the Supreme Court retired the "no set of facts" construction of the notice-pleading regime, deeming that phrase "best forgotten as an incomplete, negative gloss on an accepted pleading standard: once a claim has been stated adequately, it may be supported by showing any set of facts consistent with the allegations in the complaint." *Twombly*, 550 U.S. 544, 563 (2007). To adequately state a claim, the Court held, allegations must establish a *plausible* claim to relief, above the speculative level. *Id.* at 555–56; *Iqbal*, 129 S. Ct. 1937, 1949–50 (2009). The plaintiff's obligation to provide the "grounds of his entitlement to relief" requires "more than labels and conclusions," and "a formulaic recitation of the elements of a cause of action will not do." *Twombly*, 550 U.S. at 555; *Iqbal,* 129 S. Ct. at 1949.

In the aftermath of *Twombly* and *Iqbal*, courts have struggled to reconcile the heightened Rule 8 standard with the standard set forth in Rule 84, which references a set of model pleading forms in the Appendix and states that those forms "suffice under these rules and illustrate the simplicity and brevity that these rules contemplate." These forms are simple and largely conclusory and therefore inconsistent with the pleading standard recently articulated by the Supreme Court. *See* McCarthy, *supra* at 5–6 (2010) (discussing the conclusory nature of several Appendix Forms, including Form 12, 15, and 19).

This is particularly true with respect to a model pleading for patent infringement, represented by Form 18. Form 18's model pleading contains *only* the following:

> (1) statement of jurisdiction; (2) On <u>date</u>, United States Letters Patent No. ___ were issued to plaintiff for an invention in an <u>electric motor</u>. The plaintiff owned the patent throughout the period of defendant's infringing acts, and still owns the patent; (3) the defendant has infringed and is still infringing the Letters Patent by making, selling, and using <u>electric motors</u> that embody the patented invention, and the defendant will continue to do so unless enjoined by this court; (4) the plaintiff has complied with the statutory requirement of placing a notice of the Letters Patent on all <u>electric motors</u> it manufactures and sells and has given the defendant written notice of the infringement.

Young lawyers may be particularly interested in this article because they often deal with pleading standards.

This conclusory pleading would not survive the *Iqbal*-proscribed inquiry. Form 18 fails to state, for instance, which features of the accused device are alleged to infringe the limitations of those claims. Yet, according to Rule 84, the pleading suffices. Thus, as Justice Ginsburg has commented, "the *Iqbal* majority messed up the Federal Rules." Justice Ruth Bader Ginsburg, Remarks for Second Circuit Judicial Conference (June 12, 2009), available at www.supremecourt.gov/publicinfo/speeches/viewspeeches.aspx?Filename=sp_06-12-09.html. (According to the Rules Enabling Act, the Federal Rules may not be enacted or amended other than in compliance with the procedures established therein, adherence to which "is essential to maintaining the constitutional system of checks and balances among the branches of government." 1 James Wm. Moore et al., Moore's Federal Practice § 1.04[3][a] (3d ed. 2010). Thus, commentators have expressed concern over what is considered to be the Supreme Court's unilateral revision of Rule 8. *See* Erwin Chemerinsky, "Moving to the Right, Perhaps Sharply to the Right," 12 *Green Bag* 2d 413, 416 (2009) ("The Court's activism in this area is striking. There was no amendment to [Rule] 8. Congress did not pass a statute changing pleading standards. . . . Yet, on its own the Court has altered the very essence of the notice pleading system created by the Federal Rules.").) As a result, in the past few years, courts have divided over what patent plaintiffs must plead. *See* R. David Donoghue, "The Uneven Application of *Twombly* in Patent Cases: An Argument for Leveling the Playing Field," 8 *J. Marshall Rev. Intell. Prop. L.* 1, 9 (2008) ("Without strong Federal Circuit guidance, district courts have been scattered in their application of *Twombly* to patent cases.").

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One approach that courts have taken to harmonize Form 18 with modern patent law and pleading standards—that is likely the best approach—is to restrict Form 18 to *only* those claims involving direct infringement of a simple device patent.

Limiting Form 18 to Simple and Direct Claims

Since the Federal Rules of Civil Procedure were enacted in 1938, significant developments in patent law—including the 1952 Patent Act and the 1982 creation of the Federal Circuit—have altered the landscape of enforcing patent rights. *See* Jonathan L. Moore, "Particularizing Patent Pleading: Pleading Patent Infringement in a Post-*Twombly* World," 18 *Tex. Intell. Prop. L. J.* 451, 497–500 (2010). Moreover, patents have become far more complex than they were in 1938, based on the underlying technology and the number of claims per patent. Form 18 is therefore outdated for purposes of modern patent litigation.

Form 18 is also ill-suited to pleading any type of divided or indirect infringement, particularly after *Twombly* and *Iqbal*. For example, a claim of joint infringement requires a showing of direct infringement plus the additional element of "control or direction" by one of the parties over the entire process such that every step is attributable to the controlling party. *Friday Group v. Ticketmaster,* No. 4:08CV01203 JCH, 2008 U.S. Dist. LEXIS 100529 at *10 (E.D. Mo. Dec. 12, 2008); *Desenberg v. Google, Inc.*, 08 Civ. 10121 (GBD) (AJP), 2009 U.S. Dist. LEXIS 66122 at *20–23 (S.D.N.Y. July 30, 2009). These allegations are nowhere to be found in Form 18.

Similarly, claims of infringement by inducement require allegations that the defendant "knew or should have known his actions would induce actual infringement" and actively and knowingly aided and abetted another's direct infringement. *See MGM Studios, Inc. v. Grokster, Ltd.*, 545 U.S. 913, 936 (2005). And contributory infringement claims require allegations of knowledge and sales of components or materials without substantial noninfringing uses. *BMC Resources, Inc. v. Paymentech, L.P.*, 498 F.3d 1373, 1381 (Fed. Cir. 2008). Thus, as the court noted in *Elan Microelecs. Corp. v. Apple, Inc.*, "[b]oth types of indirect infringement include additional elements, none of which Form 18 even purports to address." *Elan Microelecs. Corp. v. Apple, Inc.*, No. C 09-01531 RS, 2009 WL 2972374, at *2 (N.D. Cal. Sept. 14, 2009). The court in *Elan Microelecs*. therefore held that Form 18 did not support "a conclusion that Apple had adequately pleaded its counterclaims," and that, instead, the court must "apply the teachings of *Twombly* and *Iqbal*."

Moreover, through the lens of *Twombly* and *Iqbal*, even many *direct* infringement claims may be inadequately pled by following Form 18. A claim based on the doctrine of equivalents—which is intensely technical and factual in nature—requires allegations that the defendant's product "performs substantially the same function in substantially the same way to obtain the same result." *Graver Tank & Mfg. Co. v. Linde Air Prods. Co.*, 339 U.S. 605, 608 (1950). These allegations are not found in Form 18. So, literal infringement of complex method patents may require more than Form 18 pleading. That is exactly what the court recently held in *Prestige Pet Prods., Inc. v. Pingyang Huaxing Leather & Plastic Co., Ltd*. 2:10-cv-13541-RHC-MAR (E.D. Mich. filed Sept. 7, 2010), Opinion and Order Granting Defendants' Motion to Dismiss, filed January 31, 2011.

In *Prestige Pet Prods.*, the plaintiff owned a patent for a "method of processing porkhide dog chews" that involved smoking the pork hide with gaseous smoke. The plaintiff's complaint tracked Form 18, stating ownership of the patent, identifying specific infringing product lines of seven different defendants, and asserting that "Defendants practice the patented methods of the '212 Patent and/or import, manufacture, use, market, distribute and/or sell pet chew products" "made by the patented methods of the '212 Patent."

On the defendants' motion, the court dismissed the complaint under Rule 12(b)(6) as inadequate under *Iqbal*, notwithstanding the plaintiff's reliance on Form 18 in its briefs and oral argument. The court first observed that a "process patent protects only the method of making a product as well as those products actually made using that method," and, therefore, to show direct infringement of its process patent, the plaintiff bore the burden of "proving that Defendants have performed or used each and every step or element" of the claimed process. The court further observed that the plaintiff had provided no facts, aside from the list of product lines allegedly produced using the patent. The court held that, "[a]lthough the assertion that products have been produced with a patented method in violation of U.S. patent law is not inherently implausible, neither is it sufficient to nudge the allegations beyond 'the mere possibility of misconduct" (citing *Iqbal*). An adequate claim, the court held, would require, at a minimum, "some articulated reason to suspect that the products were made in violation of the patent-in-suit."

The Federal Circuit appears to be coming around to this limiting approach as well, as it has expressed doubt as to Form 18's continued validity beyond the most basic of patent infringement claims. Following *Twombly* (but prior to *Iqbal*), a divided panel of the Federal Circuit in *McZeal v. Sprint Nextel Corp.*, 501 F.3d 1354 (Fed. Cir. 2007), deemed a pro se plaintiff's complaint that tracked Form 18 (then-Form 16) sufficient—but just barely—under *Twombly*, even though it asserted a theory based on the doctrine of equivalents (holding that the plaintiff had "met the low bar for pro se litigants to avoid dismissal" under Rule 12(b)(6), but noting that "by ruling in McZeal's favor, we do not condone his method of pleading."). In his dissent, Judge Dyk opined that Form 18 is not even adequate to provide sufficient notice to an accused infringer under a theory of literal infringement but noted that that defect would have to be cured through the rulemaking process. In the meantime, he argued, Form 18 should not be applied to a complex doctrine of equivalents claim, which is based on a doctrine articulated by the Supreme Court long after the forms became effective in 1938.

More recently, in *Colida v. Nokia, Inc.*, No. 2009-1326, 347 F. App'x 568 (Fed. Cir. Oct. 6, 2009), the Federal Circuit suggested in dicta that it may be inclined to embrace Judge Dyk's view by noting that "Form 18 is a sample pleading for patent infringement, but it was not tailored to design patents and was last updated before the Supreme Court's *Iqbal* decision."

Conclusion

In light of the present uncertainty in the law, the Federal Circuit is likely to take up this issue again in the near future, and it may endorse Judge Dyk's opinion in *McZeal* to restrict Form 18 to its limited utility—that is, as a model only for simple, direct infringement of product or device patents. Absent revision of Form 18 through the rulemaking procedure, such a limiting approach may be the only way Form 18 can coexist with Rule 8's pleading standard in the age of *Twombly* and *Iqbal*.

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Identifying Trade Secrets: A Condition Precedent for Trade Secret Litigation

By George F. Ritchie and Ned T. Himmelrich

If you are a plaintiff, time is of the essence in trade secret litigation. Consider the following two scenarios. In the first scenario, at 5 p.m. on a Friday, a high-level employee with access to your client's confidential customer lists and data informs your client that she has accepted a job with a competitor, effective immediately. Monday morning, the client's IT department discovers that over the weekend the employee transferred highly confidentiality trade secret information to a home computer before she left, and the client believes she will begin utilizing that information right away with her new employer. In the second scenario, a joint venture in which your client has shared technology and know-how falls apart on the eve of a new product launch, and your client believes its ex-venturer plans to move forward with the launch anyway, using your client's secrets.

As anyone who has litigated a trade secret case knows, when these situations arise, the first call you make is to your spouse, family, and friends. If you had plans for the weekend, you cancel them. If you had plans for a vacation, you cancel them. You spend the next several days or weeks scrambling to understand exactly what trade secrets are at risk. Where do you look? The answer obviously depends on the nature of your client's business, but unless your client had the foresight to conduct a trade secret audit, you look everywhere you can. The compromised information could include client information, computer source codes, standard operating procedures, patent applications, nondisclosure agreements, manufacturing data, and even board presentations. The list is lengthy. You gather facts in the time available, verify the accuracy of your information as best you can, file your complaint and motion for injunctive relief, and say a little prayer that you have all of the details right. Perhaps, in the back of your mind, you think that, even if the specifics are a little off, you can take some discovery of the defendant to hone your trade secrets claim.

While no good litigator would intentionally trade accuracy for speed, a number of recent trade secret decisions indicate the increasing importance of understanding (and articulating) at the outset of the litigation the precise nature of the trade secrets your client believes have been misappropriated. The days are on the wane when a plaintiff could file its trade secrets complaint and count on the discovery of a defendant before identifying the precise nature of the claims in dispute.

These recent decisions also demonstrate why tools to help clients gather and memorialize trade secrets—such as trade secret audits and related protocols—can be critical to success or failure in litigation. Quick actions by a company faced with trade secret misappropriation require that the company be able to identify its trade secrets. While this sounds self-evident, a surprising number of companies have not conducted adequate trade secret audits and have only vague ideas about the scope of their own trade secrets. Under the recent decisions described below, these companies will not be well-positioned to strike quickly to protect their core IP assets.

Perspectives on the Past

Unlike patents, copyrights, and trademarks, trade secrets are an amorphous type of intellectual property. The Restatement of Torts, Section 757, cmt. b (1934), which provided the original explication of trade secrets, defines a "trade secret" as follows:

> A trade secret may consist of any formula, pattern, device or compilation of information which is used in one's business, and which gives him an opportunity to obtain an advantage over competitors who do not know or use it. It may be a formula for a chemical compound, a process of manufacturing, treating or preserving materials, a pattern for a machine or other device, or a list of customers.

The Uniform Trade Secret Act, Section 1(4), which has been adopted by 44 states and the District of Columbia (the remaining six states—Massachusetts, New Jersey, New York, Pennsylvania, Texas, and Wyoming—protect trade secrets through common-law or state-specific statutes), provides a definition of equal breadth and opacity:

> [I]nformation, including a formula, pattern, compilation, device, method, technique or process, that: (i) derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use, and (ii) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.

The scope of a company's trade secrets may thus be extremely broad, encompassing everything from financial information to marketing plans, manufacturing techniques, and beyond. A company's trade secrets may just as often involve the processes or information the company does not practice or utilize, as well as those that it does. Trade secrets may also be "combination claims" that combine secret and nonsecret items together. The protean nature of trade secrets has led to a conundrum for some IP practitioners: How does one adequately define and protect a company's trade secrets without inadvertently excluding related combinations and extensions?

To a certain degree, trade secret litigation in the past solved this problem. Courts in earlier trade secret cases often allowed plaintiffs to resist precise identification of the trade secrets at issue in a case until very late in the litigation, sometimes upon completion of discovery or even on the eve of trial. These courts identified at least three policies justifying the approach, including a plaintiff's broad right to conduct discovery under the Federal Rules of Civil Procedure;

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the recognition that a trade secret plaintiff, particularly if the plaintiff has hundreds or thousands of trade secrets, may have no way of knowing what has been misappropriated until it receives discovery on the defendant's operations; and the catch-22 that might result in forcing a plaintiff to produce either a list of information that is too broad to qualify as trade secrets or too narrow to capture the defendant's misappropriation.

As commentators have rightfully noted, however, the practice of allowing plaintiffs to conduct discovery before identification can lead to litigation abuse. *See* Lee Ann Stevenson, "Can You Be More Specific?" *N.Y. L.J.*, Feb. 15, 2010; Charles Tait Graves and Brian D. Range, "Identification of Trade Secret Claims in Litigation: Solutions for a Ubiquitous Dispute," 5 *Nw. J. Tech. & Intell. Prop.* 68 (Fall 2006), at 78–81. Without a clear identification of the claims, defendants may be forced to defend a much broader set of trade secret issues than is justified. Plaintiffs, having looked into a defendant's bag of secret tricks, may be able to tailor their trade secret claims to fit the defendant's business practices. Finally, weak trade secret claims that might otherwise be appropriate for early dismissal survive longer than they should, at considerable expense to the parties.

The practice of allowing plaintiffs to conduct discovery before identification can lead to litigation abuse.

Guidelines for the Future

There have been scattered calls in the past by commentators and some courts for a uniform rule regarding the early identification of trade secrets. As of 1996, courts had attempted to resolve this issue through at least nine different approaches, including bifurcation of discovery so that the discovery of nonconfidential information would take place first, after which a plaintiff would have to demonstrate a factual basis for its claims to allow the discovery of confidential information. *See DeRubeis v. Witten Technologies, Inc.*, 244 F.R.D. 676, 680 (D.C. N.Ga. 2007).

Apropos of its position as one of the trade secret centers in the country, California has enacted a statutory requirement that requires a plaintiff in a trade secrets case "to identify the trade secret with reasonable particularity . . . before commencing discovery relating to the trade secret." California Code of Civil Procedure Section 2019.210. Courts in a number of other jurisdictions are beginning to follow suit and apply the California standard on their own.

In *DeRubeis*, the U.S. District Court for the Northern District of Georgia required a plaintiff to identify its trade secrets with "reasonable particularity" before allowing the plaintiff to take discovery. The court interpreted the reasonable particularity standard to require more than a description of areas to which the trade secrets relate; "reasonable particularity" means that the adversary is on notice of the nature of the claims and that the party can discern the relevancy of any requested discovery on its trade secrets. The *DeRubeis* court concluded that this requirement was appropriate for a number of reasons. The plaintiff already appeared reasonably aware of the trade secrets at issue and would not have to list thousands of trade secrets to ensure its claims were protected. The "reasonable particularity" standard would avoid the catch-22 of either over- or under-identifying the crucial IP. The standard would prevent the plaintiff from engaging in a "fishing expedition" into the defendant's business. The standard placed appropriate limits on discovery by excluding discovery into issues not identified by the plaintiff. Requiring the plaintiff to identify its trade secrets at this stage would allow the defendant to begin to mount a defense to the allegations.

Relying on *DeRubeis*, the U.S. District Court for the Eastern District of Michigan in *Dura Global, Tech, Inc. v. Magna Donnelly Corp.*, 2008 WL 2064516 (E.D.Mich.), stayed discovery until the plaintiffs provided the defendants with a list identifying the trade secrets alleged to have been misappropriated "with reasonable particularity." The *Dura Global* court also provided some insight into how stringently this standard can be applied. The court reviewed the plaintiff's initial list of trade secrets in connection with a motion to compel filed by the defendant and criticized the list as being "better described as a brief identifying areas as to which their trade secrets related . . . [the trade secrets] are described in general terms, such as 'business strategies and inside information,' interspersed with more specific information which identifies particular trade secrets."

The court concluded that the plaintiff's list was lacking and highlighted the dangers of over-designating the trade secrets at issue:

> *If Plaintiffs are claiming the misappropriation of each of these thousands of trade secrets, such a list is required by the reasonable particularity standard*, with the exception noted above regarding trade secrets which are compilations of secret and non-secret information for which the secret information need not be specifically identified. *However, the compilation must be identified with particularity*.

Id. (Emphasis added).

In a similar vein, the U.S. District Court for the Northern District of California in *Farhang v. Indian Institute of Techonology, Kharagpur*, 2010 WL 2228936 (N.D. Cal.), dismissed several of the plaintiff's claims for misappropriation of trade secrets due to insufficient early-stage identification. In *Farhang*, the plaintiff brought suit against the defendants alleging, among other things, misappropriation of the plaintiff's core technology as described in patent applications relating to wireless data technology and the plaintiff's "specific business models and implementations relating to this technology." While the court found that the patent applications sufficiently described trade secret information, it held that a description of the business models and implementation as "specifics regarding the actual implementation of . . . the project" was insufficient under the reasonable particularity standard. The court accordingly dismissed this aspect of the trade secret claim.

Not all courts applying the reasonable particularity standard have found

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plaintiffs' identification lacking. In a trade secret case concerning computer software, *Storagecraft Technology Corp. v. Symantec Corp.*, 2009 WL 361282 (D. Utah), the U.S. District Court for the District of Utah found that the plaintiff's description of its trade secrets as "all source code received under the License Agreement or derived or created from such code" met the reasonable particularity standard. The court specifically rejected the defendant's argument for a "bit by bit" identification of the source code and further found the defendant's attacks on the ultimate merits of the trade secret claim improper at that stage of the case. The *Storagecraft* court noted that "the reasonable particularity standard . . . is different from those standards used in determining whether a party is entitled to injunctive relief."

While Federal Rule of Civil Procedure 65(d) has always required specificity in orders granting injunctive relief, the Seventh Circuit's decision in *Patriot Homes, Inc. v. Forest River Housing, Inc.*, 512 F.3d 412 (7th Cir. 2008) may also be an indication of increased scrutiny of trade secret claims in the context of injunctive relief. And often, injunctive relief is the only remedy that can protect a client's ongoing market advantage. The plaintiff in *Patriot Homes* sought an injunction prohibiting the defendant from disclosing and using its trade secrets relating to modular home designs. In reversing the lower court's grant of the TRO, the Seventh Circuit wrote that:

> the preliminary injunction entered by the district court uses a collection of verbs to prohibit Sterling from engaging in certain conduct, but ultimately it fails to detail what the conduct is, i.e., the substance of the trade "secret" or "confidential information" to which the verbs refer.

The court went on to note that while the plaintiff contended that its trade secrets were contained in its "playbook" for modular home construction, it was not possible to tell how much of the information in the playbook was readily available through FOIA requests. The court concluded that a district court issuing injunctive relief in a trade secret case must "identify each and every element of . . . trade secret and [identify] specific proscribed acts."

The "takeaway" from these recent decisions is that potential trade secret plaintiffs must conduct greater due diligence before filing litigation. Plaintiffs will not be able to get away with vague allegations of trade secret misappropriation, hoping to sharpen their case after taking discovery of the defendants. If a plaintiff cannot identify with "reasonable particularity" the trade secrets at issue at the outset, the plaintiff may not get the opportunity to conduct discovery, and its claims will be dismissed.

Trade Secrets Audits and "Reasonable Particularity"

Let's turn back to the hypothetical litigation scenarios posed at the beginning of this article. After you have informed your loved ones that you will not be able to enjoy a weekend at the beach with them because your client's trade secrets have just walked out the door on a thumb drive, the second phone call you place should be to your client, asking it to begin identifying the exact nature of the trade secrets at issue. With luck, the first document your client will send to you will be its trade secret audit, updated within at least the last calendar year.

Much has been written recently about trade secret audits and the various forms they can take, depending on the size of the company, the nature of its business, and the amount of money the company is willing to invest in the project. *See, e.g.*, Scott F. Gibson, "Conducting a Trade Secret Audit," *For the Defense*, February 2011. In broad terms, a trade secret audit will identify a company's trade secrets and provide a comprehensive plan to protect them, including execution of employee nondisclosure agreements, confidential designations on trade secret material, and even physical barriers to prevent the dissemination of trade secrets.

From a litigator's point of view, these audits should have several basic features to provide value in assisting in the prosecution of trade secret claims. First, the audit should describe the trade secret in as much detail as possible. So, for example, if the client believes its customer information is a trade secret, the audit ought to identify the kinds of information kept on customers, including, for example, in the case of manufactured goods, orders, payment history, margin analysis, the specifications of custom products, marketing plans, and customer training programs. Providing this level of detail, rather than a generic designation of "customer files" or "sales history," will enable litigation counsel to identify the precise nature of the affected trade secrets quickly and describe the protected information to the court with reasonable particularity.

Second, a useful trade secret audit will identify the employees most knowledgeable on the particular topic, and this information will be updated on a regular basis with new employee departures and arrivals. This information will enable litigation counsel to identify efficiently those witnesses who will need to be interviewed in preparation for the lawsuit, as well as identify custodians whose electronic data will need to be mined for discovery.

Finally, a useful trade secret audit will identify the documents that comprise and/or relate to the trade secret. So, in the case of our manufacturing example, all manuals, recipes, standard operating procedures and written protocols/instructions should be identified next to the description of the confidential process. Such a list will aid in the process of efficient document and information gathering during those first few crucial weeks, when litigation counsel is working to understand and best present the initial salvo to the court. Of course, any company conducting a trade secret audit must bear in mind that the audit will likely be discoverable in litigation, and the audit should be thoroughly reviewed to ensure that it will be well-received by a court and/or jury.

Conclusion

While trade secrets remain a flexible form of intellectual property, the litigation procedures concerning misappropriation claims are tightening to require earlier, more specific identification of the trade secrets at issue. This development should be a spur for clients and practitioners to create specific trade secret audits and related protocols upon which litigation counsel can draw when the need for speed in pursuing would-be misappropriators arises.

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Copyright Termination Rights: Which Statutory Schemes Govern Gap Grants?

By Georgia Murray-Bonton

The 1976 amendments to the Copyright Act gave authors and their heirs the right to terminate prior grants of copyrights. 17 U.S.C. §§ 203–204. Congress added the termination rights to give the original copyright owners a second bite at the apple and an opportunity to negotiate more advantageous terms after one determined the true value of a work. Section 203 applies to copyrighted works created on or after January 1, 1978, and creates a termination right that extends for 40 years after the grant's date of execution. 17 U.S.C. § 203(a). Section 304 applies to works created before 1978 and creates a termination right that the original copyright owner can exercise 56 years after the grant's date of execution. 17 U.S.C. § 304(c).

The Copyright Act, however, is silent as to which section governs the termination of copyright grants entered into prior to January 1, 1978, for works created after January 1, 1978. This particular group of prospective grants does not fall neatly under one section or the other and have come to be termed "Gap Grants." In analyzing which statutory scheme applies to Gap Grants, the U.S. Copyright Office, legal scholars, and industry stakeholders have focused on the timing of the grant. The threshold legal question is whether the termination right attaches as of the execution date of the grant or the date on which the work comes into existence. As summarized by the Copyright Office, "Gap Grants raise a very technical question: Is it possible for an author to execute a grant prior to creating the work of authorship?" U.S. Copyright Office Analysis of Gap Grants, at 2 (December 7, 2010).

Copyright authors and industry stakeholders are now grappling with uncertainty over when and how the right to control and exploit Gap Grant copyrighted works will revert to the author or the author's heirs. In addition, authors who do not exercise termination (or who do not exercise it properly) within the statutory window lose the right to do so. Potentially thousands of compositions and musical performances created in the early 1970s are Gap Grants and are now subject to this ambiguity. For instance, standard music-industry contracts are for six to eight years, subjecting compositions recorded in the latter years to Gap Grant status. The book-publishing industry also has Gap Grants for books published in 1978 because most book contracts were signed more than one year before publication. Termination rights granted under section 203 began to expire on January 1, 2011 (35 years from the effective date of the 1976 act), and are continuing to expire on a rolling basis. It seems undisputed that one of the branches of government will have to clarify which statutory scheme applies to Gap Grant termination rights.

Clarification by the Courts

A review of the cases filed on the behalf of major stakeholders reveals that the courts have not decided which statutory section governs Gap Grant terminations. In addition, courts have heard very few cases concerning the validity of copyright-termination rights or Gap Grant terminations. The few cases that courts have decided address different, if not attendant, legal issues. In *Siegel v. Warner Bros. Entertainment, Inc.*, 690 F. Supp.2d 1048, 1093-95 (C.D. Cal., 2009), the issue was whether errors in termination notices were excused by the harmless error rule contained in 37 C.F.R. § 201.10(e)(1). The district court held that "the relevant omission was harmless error and the termination notice should be found to be effective even as to the omitted works." In *Korman v. HBC Florida*, 182 F.2d 1291, 1294 (11th Cir. 1999), the Eleventh Circuit held that section 203 of the Copyright Act applies to implied nonexclusive licenses as well as express licenses, but it does not dictate that when an implied license is for an indefinite duration, the grant can only be terminated *after* and not *before* the first 35 years of the copyright term.

Several of the cases filed under sections 203 or 304 address the issue of when and under what circumstances termination rights can be waived or extinguished. In *Marvel Characters, Inc v. Simon*, 310 F. 3d. 280, 292 (2d Cir. 2002), the Second Circuit found that to the extent that a 1969 settlement agreement was construed to extinguish the termination right long before vesting, it was void as an "agreement to the contrary" under § 304(c)(5), and the termination rights were not waived. Such was the case in *Penguin Group (USA) Inc. v. Steinbeck*, 537 F.3d 193 (2d Cir. 2008), where the Second Circuit declined to uphold the termination rights of John Steinbeck's heirs. In 1938, John Steinbeck entered into a publishing agreement with Viking Press whereby he licensed his copyrights to Viking. With respect to individual works under the agreement, there were several latter works to which Steinbeck granted rights prospectively. Specifically, these later created works were *Grapes of Wrath* (1939), *Cannery Row* (1945), *East of Eden* (1952), and *Travels with Charley* (1962). As a brief procedural history, Penguin Group USA appealed the district court's ruling that the termination of John Steinbeck's 1938 copyright grant was valid. On appeal, the Second Circuit held that the termination was ineffective because the 1938 agreement and grant had been superseded by a 1994 agreement. Again, this case is most often cited for precedence on when written agreements can void or nullify the termination rights granted authors and their heirs.

While these holdings can apply to Gap Grants, they do not resolve the threshold Gap Grant issue. These few cases are often cited to underscore the need for clarification. To date, the Supreme Court has not granted certiorari to any cases concerning Gap Grants.

Clarification Efforts of the U.S. Copyright Office

The Copyright Office recognized the need for clarity and has done its part to provide some clarification of Gap Grant terminations. Specifically, on March 29, 2010, the Copyright Office published its "Gap

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in Termination Provisions Request for Comments" as an inquiry into whether there was a need to clarify which section of the Copyright Act applied to Gap Grant terminations. Gap in Termination Provisions, 75 Fed Reg. 15390 (March 29, 2010). In response to comments received to its inquiry, the Copyright Office published a Notice of Proposed Rulemaking to amend its rules and regulations governing terminations under section 203 of the Copyright Act. Gap in Termination Provisions, 75 Fed. Reg. 72771 (Nov. 26, 2010). Comments to the inquiry were so numerous that the Copyright Office extended the period to submit comments until January 24, 2011. Gap in Termination Provisions, 75 Fed. Reg. 81952 (December 29, 2010).

After considerable review of the comments received, the Copyright Office arrived at the conclusion that Gap Grants are terminable under section 203 as currently codified because, as a matter of law, the date of execution of the grant will be on or after January 1, 1978. Until there is a work of authorship, there is no copyright interest, no transfer of that interest, and no author for whom exclusive rights (not to mention termination rights) can vest. 17 U.S.C. §§ 101, 102(a), 106, and 203.

The Copyright Office's position and analysis are supported by preeminent legal scholars, industry stakeholders, and practitioners, specifically, Jane C. Ginsburg of Columbia University Law School, Kenneth D. Freundlich of Freundlich Law, and Neil W. Netanel of UCLA Law School. Sharing the same analytical perspective are Bart Herbison of the National Songwriters Association and Randall D. Wixen of Wixen Music Publishing, Inc.

Clarification, however, is still required because the Copyright Office has not yet amended its rules and regulations. In addition, even with the Copyright Office's analysis, the applicability of section 203 to Gap Grants remains confusing. Section 203 requires the grant to have been executed on or after January 1, 1978, but it does not explain whether execution is the date the grant is signed or the date the copyrighted work is created. Notably, the Copyright Office recognized that the issues presented by Gap Grants are time-sensitive and called upon Congress to consider the issues as soon as possible. Gap Grant Analysis, at 3.

Legislative Action

In the past, when faced with the need to clarify the Copyright Act termination rights, Congress has taken legislative action. In 1976, Congress added the termination rights to the Copyright Act to assure that the extended copyright term did not deprive authors of the ability to gain a second bite at the apple. Even though a similar juncture has now been reached, the 112th Congress does not show any proposed bills or resolutions amending the Copyright Act to clarify Gap Grant terminations.

The Copyright Office's Gap Grant Analysis and many stakeholders make clear that it would be beneficial for Congress to clarify which statutory scheme governs Gap Grant terminations to ensure greater certainty in the marketplace for the benefit of authors and licensees with respect to the accuracy of copyright ownership.

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Does Insurance Cover IP Theft or Trade Secret Infringement?

By Peter S. Selvin

Neither IP theft nor trade secret infringement are typically identified as "offenses" in the advertising injury portion of a standard commercial general liability (CGL) policy. For this reason, efforts to find coverage in the context of IP theft or trade secret cases have tended to focus on fitting the allegations of the underlying complaint into one of the enumerated offenses to generate coverage. This is challenging because there is little resemblance between such commonly known offenses as "misappropriation of the style of doing business" and a claimed theft of IP assets or trade secrets having to do with, for example, manufacturing techniques or the chemical composition of a particular product.

Finding coverage in this context is even more difficult because of the requirement that both the triggering offense and the claimant's injury be causally related to the insured's advertising activities. *See, e.g.*, *Bank of the West v. Superior Court*, 2 Cal.4th 1254, 1277 (1992) (holding that this causal nexus requires that the insured's advertising activities have caused the claimant's injuries). In view of the requirement of this causal nexus, the majority view is that the mere misappropriation of a trade secret is not covered because the harm is caused by the misappropriation of the trade secret, not by the advertising itself. *See, e.g., Simply Fresh Fruit, Inc. v. Continental Ins. Co.*, 94 F.3d 1219 (9th Cir. 1996); *Hameid v. National Fire Ins. of Hartford*, 31 Cal.4th 16, 20 (2003) (noting that the lower court had found no duty to defend "because the underlying lawsuit claimed misappropriation of trade secrets, and not advertising injury"). *But see Sentex Systems, Inc. v. Hartford Accident & Indem. Co.*, 93 F.3d 578, 580 (9th Cir. 1996) (distinguishing *Simply Fresh* on the ground that the claims for the misappropriation of trade secrets related to marketing and sales and not to secrets relating to the manufacture and production of the underlying products).

PERSONAL INJURY COVERAGE

This article does not address in depth the coverage issues that are implicated under the personal injury section of a CGL policy. Typical formulations of this coverage part include two offenses that insureds have invoked to gain coverage in IP theft or trade secret actions: "oral or written publication of material that slanders or libels a person or organization or disparages a person's or organization's goods, products or services" and "oral or written publication of material that violates a person's right of privacy."

Although there is at least one decision finding coverage in a trade secrets case where the policyholder's actions fit within the definition of "libel," "slander," or "disparagement" (*Amquip Corp. v. Admiral Ins. Co.*, 2005 US Dist LEXIS 5462 (E.D. Pa. March 31, 2005)), these efforts appear to have been largely unsuccessful. *See, e.g., Microtech Research, Inc. v. National Mutual Insurance Co.*, 40 F.3d 968 (9th Cir. 1994) (no coverage for a trade secret action under "personal injury" coverage because the complaint did not allege libel, slander, or disparagement); *S.B.C.C., Inc. v. St. Paul Fire & Marine Insurance Co.*, 186 Cal.App.4th 383 (2010) (a "person's right to privacy" is not violated when a former employee took the former employer's confidential information because, under a literal reading of the policy, an "organization" is not a "person," and, as a matter of law, corporations do not enjoy privacy rights). On the latter point, the recent U.S. Supreme Court decision in *FCC v. AT&T, Inc.*, ___ US ___ (2011) (holding that corporations do not have "personal privacy" for purposes of an exemption in the Freedom of Information Act) may also be relevant.

Coverage under CGL Policies

There are two forms of coverage under a typical CGL policy that could potentially be triggered in respect to an IP theft or trade secret action: "advertising injury" coverage and "personal injury" coverage.

A typical advertising injury form provides for coverage for injuries arising out of one or more of the following offenses:

- The oral or written publication of material that slanders or libels a person or organization or disparages a person's or organization's goods, products, or services;
- The oral or written publication of material that violates a person's right of privacy;
- The misappropriation of advertising ideas or style of doing business; or
- The infringement of a copyright, a title, or a slogan.

Fitting a trade secret claim into one of these offenses is only the beginning of the battle. Under modern precedent, three separate prongs must be satisfied for coverage to apply: Does the claim fit within one of the enumerated offenses? Did the claim arise out of the insured's advertising activities? Is there a causal relationship between the claimant's injuries and the insured's advertising activities? *See Bank of the West v. Superior Court*, *supra*, 2 Cal.4th at 1276.

Because this three-part test is especially difficult to meet in IP theft or trade secret cases, decisions upholding coverage in such cases are rare.

In *The Merchants Co. v. American Motorists Insurance Co.*, 794 F.Supp. 611 (S.D. Miss. 1992), an insured under a CGL policy was sued for, among other claims, trade secret misappropriation. It

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was alleged in the underlying case that The Merchants Co. had wrongfully come into possession of a customer list of one of its competitors, AFD, and that it had used that customer list to contact AFD's customers.

Merchants tendered the action to its CGL carrier who denied the claim. In the coverage suit, however, the court granted Merchants' motion for partial summary judgment on the duty to defend. It held that the allegations of the underlying trade secrets lawsuit triggered two potential grounds for coverage under the advertising injury coverage form.

First, the court held that "insofar as AFD alleges in [the trade secret action] that Merchants improperly utilized [AFD's] customer list . . . the Court finds that [the trade secret action] may be said to involve an infringement of AFD's title to the customer list." In so reasoning, the court fitted the allegations of the trade secret action into one of the enumerated offenses ("infringement of copyright, title, or slogan") under the policy.

Second, the court found coverage under another one of the enumerated offenses—"misappropriation of advertising ideas or style of doing business." The court opined that although the term "advertising ideas" was not defined in the pertinent policy, "the Court is of the opinion that in the ordinary or popular sense, a customer list may be fairly said to be an 'advertising idea.'"

Finally, the court found that underlying claims arose out of the insured's "advertising activities," stating that

> it appears that part of the conduct alleged in the [trade secret] action relates to the use of AFD's customer list by Merchants to send a flyer to some of AFD's customers. This conduct is . . . conduct committed 'in the course of advertising' . . . . In short, where a direct competitor allegedly acquires and uses the customer list of another company in order to send direct mail solicitations for business to the competitor, this Court concludes that such conduct is within the definition of conduct committed within the course of advertising . . . .

The *Merchants* court's broad view of advertising activity is a distinctly minority view. In *S.B.C.C., Inc. v. St. Paul Fire & Marine Insurance Co.*, 186 Cal.App.4th 383 (2010), the court concluded that solicitation of a competitor's customers, even where enabled by a former employee's theft of confidential materials, did not rise to the level of advertising activities.

The pro-insured holding of the *Merchants* decision has been criticized by courts in the First (*RGP Dental, Inc. v. Charter Oak Fire Ins. Co.*, 2005 US Dist. LEXIS 28199 (D.R.I. Nov. 8, 2005)), Sixth (*Capital Specialty Ins. Corp. v. Indus. Elecs, LLC*, 2009 US Dist. LEXIS 95830 (W.D.Ky. Oct. 14, 2009)) and Ninth (*Precision Automation, Inc. v. West Am. Ins. Co.*, 1999 US App. LEXIS 31378 (9th Cir. Or. Nov. 24, 1999)) Circuits.

There is another pro-insured decision that is also noteworthy. In *Sentex Systems, Inc. v. Hartford Accident & Indemnity Co.*, 882 F.Supp. 930 (C.D.Cal. 1995), Sentex Systems, Inc., insured under a CGL policy, was sued by a competitor (ESSI) who alleged that a former employee (Colombo) went to work for Sentex in violation of a noncompetition agreement between it and Colombo. ESSI also alleged that Sentex, through Colombo, misappropriated ESSI's trade secrets and other confidential information, including customer lists, methods of bidding jobs, marketing techniques, and "other inside and confidential information."

Sentex tendered the case to its carrier (Hartford), who denied the claim. In the ensuing coverage litigation, the court granted Sentex's motion for summary judgment concerning Hartford's duty to defend, finding that the allegations of ESSI's suit triggered coverage under the advertising injury portion of the CGL policy.

At the threshold, the *Sentex* court found that the actions of ESSI's former employee (Colombo) constituted advertising activities within the meaning of the policy:

> There is no doubt that Sentex, through its employee Colombo, engaged in "advertising" activities when ESSI's alleged injury occurred. Colombo not only promoted and advertised Sentex's products throughout the Eastern United States but he also planned and delivered the presentations for the security entry systems to distributors, dealers, and, occasionally, to property managers, some of whom were customers of ESSI. Colombo also attended trade shows where he spoke to potential customers about the advantages of the entry system manufactured by Sentex over other systems, including the "shortcomings" of ESSI's Entreguard System. These advertising activities formed the basis of ESSI's complaint."

As noted above, appellate authority from last year (*S.B.C.C., Inc. v. St. Paul Fire & Marine Insurance Co.*, 186 Cal. App.4th 383 (2010)) takes the view that such activity does not rise to the level of advertising activity within the meaning of a CGL policy's advertising injury coverage. Moreover, the continued validity of this aspect of the *Sentex* decision may be in doubt in light of the California Supreme Court's subsequent decision in *Hameid v. National Fire Ins. of Hartford*, 31 Cal.4th 16 (2003) (the court finds that making telephone calls and sending mailers to names on the competitor's customer list did not constitute advertising within the meaning of the CGL policy). *See, e.g., Rombe Corp. v. Allied Ins. Co.*, 128 Cal. App.4th 482 (2005), which calls the continued validity of *Sentex* into question.

In terms of fitting the trade secret claim into the enumerated advertising injury offenses, the *Sentex* court, like the court in *Merchants*, found that at least two offenses were triggered by trade secret allegations—"misappropriation of advertising ideas or style of doing business" and "infringement of title." As to the misappropriation offense, the *Sentex* court noted that ESSI had alleged that Sentex, through its former employee, had misappropriated the "formula" and "trade secrets" of ESSI's business, including customer lists, marketing techniques, and the like. Importantly for the court, ESSI had alleged that Sentex had used these trade secrets to compete directly with ESSI by soliciting and marketing its products to ESSI customers.

Finally, the *Sentex* court suggested, in a sweeping bit of dicta, that the offense of "unfair competition" that had been included in pre-1986 CGL policies was "interchangeable" with the current misappropriation offense. "The fact that the 'unfair competition' offense in most policies suggests that these offenses may be interchangeable, or, at the very least that, so long as an 'advertising injury' is alleged,

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it is reasonable for an insured to continue to expect coverage for 'unfair competition' claims under the 'misappropriation' coverage of a policy." Suffice it to say that this theory—finding coverage for trade secret actions to be species of unfair competition and then conflating the now-defunct unfair competition offense with the current misappropriation offense—has never, to the author's knowledge, been judicially tested.

Merchants and *Sentex* have to be contrasted with those cases in which coverage for trade secret claims have been denied. As noted above, finding coverage for such claims is challenging principally because of the difficulty of fitting the insured's alleged activities into one of the enumerated offenses and the need to demonstrate that the insured's activities giving rise to the claim were advertising activities.

Cases denying coverage under the first prong (i.e., no activity fitting within one of the enumerated offenses) include *Imbrie v. State Farm Fire & Casualty Co.*, 2008 WL 4737950 (D. Or. 2008). In that case, the insured allegedly stole his former employer's customers and misappropriated his former employer's confidential, proprietary business forms, including its form representation agreement and purchase agreement. The court held that these allegations were insufficient to constitute either "misappropriation of advertising ideas or style of doing business" or "infringement of copyright." As noted in endnote three referenced above, the *S.B.C.C.* court also reached a similar conclusion on analogous facts.

Even if an insured demonstrates facts sufficient to constitute one of the enumerated offenses, however, the insured must still demonstrate that the trade secret claims arose from its advertising activities. In this regard, many cases hold that mere customer solicitation by a former employee of the plaintiff, who is also alleged to have taken the plaintiff's trade secrets, does not constitute advertising activity. *See, e.g., Microtech Research, Inc. v. Nationwide Mutual Ins. Co.*, 40 F.3d 968 (9th Cir. 1994); *Simply Fresh Fruit, Inc. v. Continental Insurance Co.*, 94 F.3d 1219 (9th Cir. 1996).

Finally, an insured seeking coverage under a CGL policy for an IP theft or trade secrets claim should also be aware that various exclusions might come into play to bar coverage. For example, CGL policies typically contain a breach-of-contract exclusion that bars coverage for personal or advertising injury "arising out of a breach of contract, except an implied contract to use another's advertising ideas." In those cases where a former employee is alleged to have breached a confidentiality agreement by sharing the former employer's trade secrets with his new employer, this breach of contract exclusion has been applied to bar coverage. *See, e.g., Capitol Specialty Insurance v. Industrial Electronics, LLC*, 2011 WL 96521 (6th Cir. Jan. 12, 2011); *Glenmark Pharmaceutical v. Franklin Mutual Ins. Co.*, 2008 WL 5194305 (NJ Super AD, Sept. 15, 2008).

Insureds seeking coverage for IP theft or trade secrets claims also need to be mindful of policy exclusions that purport to carve out from coverage claims asserting the infringement of IP rights. *See, e.g., S.B.C.C. v. St. Paul Fire & Marine Insurance Co., supra*, 186 Cal.App.4th at 396–97 (the policy's intellectual property exclusion barred coverage for a trade secrets claim); *Superperformance Int'l, Inc.*

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v. Hartford Cas. Ins. Co., 332 F.3d 215 (4th Cir. 2003) (an intellectual property exclusion relieved Hartford Insurance of the duty to defend claims of unfair competition based on trademark infringement).

Coverage under D&O Policies

Coverage for IP theft or trade secret infringement will be relatively easier to find under directors and officers (D&O) policies. This is because coverage under a D&O policy is triggered by the insured's commission of a "wrongful act." In this regard, a wrongful act is sufficiently broad to cover "a wide range of alleged or actual wrongdoing, whether negligent, reckless, or even intentional." *See, e.g., Soho Plaza Corp. v. Nationwide Mut. Ins. Co.*, 664 N.Y.S.2d 23 (1997). Thus, where the claim arises from negligent or nonnegligent actions allegedly committed by an officer or a director, the insurer is obligated to reimburse the corporation for amounts advanced by the corporation to defend the officer or director.

Two cases illustrate how the definition of a wrongful act has been applied to embrace claims for trade secret infringement.

In *Acacia Research Corp. v. National Union Fire Ins. Co. of Pittsburgh, Pa.*, 2008 WL 4179206 (C.D. Cal. 2008), the court addressed coverage for a trade secret claim under a D&O policy. In that case, Nanogen sued Combimatrix and its officer Montgomery based on the allegation that Montgomery, who was formerly employed with Nanogen, had stolen Nanogen's proprietary technology and was using it while employed by Combimatrix. Without directly addressing the scope of the term "wrongful act" under the pertinent D&O policy, the court determined that the D&O carrier was obligated to reimburse Combimatrix for the attorney fees it incurred in its and Montgomery's defense. The court also concluded that the settlement paid by Combimatrix to Nanogen to end the litigation was a "covered loss" under the policy and hence the obligation of the carrier.

In *MedAssets, Inc. v. Federal Ins. Co.*, 705 F.Supp.2d 1368 (ND Ga. 2010), MedAssets' subsidiary (Aspen) was sued by Guidant claiming that Aspen had induced some Guidant customers to share confidential pricing information that had been exchanged between Guidant and its customers. MedAssets' D&O carrier denied the claim, citing an exclusion in the policy for trade secret misappropriation.

The court, however, determined that there would be coverage under the D&O policy, notwithstanding the presence of the trade secrets exclusion. This was because Guidant alleged in its complaint, as alternative theories, that the pricing information rose to the level of a trade secret or was "confidential." In this regard, the court held that "[i]nformation can be confidential yet not rise to the level of being a trade secret." *See also Courtesy Temporary Serv., Inc. v. Camacho,* 222 Cal.App.3d 1278, 1291 (1990) (misappropriation of "confidential" information may be actionable, even if that information does not rise to the level of a trade secret).

The *MedAssets* decision is important not simply because it implicitly confirms that trade secret infringement will fit within the rubric of wrongful acts. The case also illustrates a way of overcoming an exclusion directed to trade secret infringement. Indeed, given the breadth of the duty of an insurer's duty to defend and the principle that the labels appended to a cause of action are not determinative of an insurer's duty to defend (*CNA Cas. v. Seabord Sur. Co.*, 176 Cal.App.3d 598, 609 (1986)), this case can be invoked in other contexts where the scope of an exclusion is also at issue.

Coverage under Crime or Employee Theft Policies

Because crime or employee theft policies are first-party policies, these policies are not triggered as a result of suits against the insured by third parties claiming trade secret infringement. Instead, these policies would be triggered in the event the insured discovered that one of its employees had sold its trade secrets to a third party.

This was the situation in *Avery Dennison Corp. v. Allendale Mutual Insurance Co.*, 310 F.3d 1114 (9th Cir. 2002). In that case, the insured submitted a claim to its crime carrier when it discovered that one of its employees had sold some of its trade secrets to a competitor. Coverage was denied because the policy covered the loss or damage to "Covered Property," which was defined as including money, securities, or "property other than money or securities."

The Ninth Circuit affirmed the district court ruling that there would be no coverage under the policy. Agreeing with the district court that, under the plain terms of the policy and the principles established by analogous cases, trade secrets are not tangible property, the court cited to the definition of "tangible property" as "things that can be touched, seen and smelled." *Kazi v. State Farm Fire & Cas. Co*., 24 Cal.4th 871, 880 (2001). Concluding that the "trade secrets for which Avery Dennison seeks to be compensated cannot be touched, seen, or smelled," the court affirmed the trial court's denial of coverage.

> **Coverage for IP theft or trade secret infringement will be easier to find under D&O policies because coverage under a D&O policy is triggered by the insured's commission of a "wrongful act."**

Conclusion

Claims for IP theft or trade secret infringement can easily become "bet the company" cases. While there are numerous challenges in finding insurance coverage for these kinds of cases, a creative practitioner can identify opportunities that are highlighted by the emerging case law. The key takeaways are to tender under all applicable policies—not just CGL policies, but D&O policies and potentially other forms of coverage as well. Given the breadth of the duty to defend in many jurisdictions, policyholders should take advantage of all opportunities for coverage in respect to these kinds of claims.

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Copyright Issues

Continued from page 1

next decade in reaction to those decisions. (This article does not address congressional changes or lobbying activities for congressional changes that are already underway or being heavily discussed, including certain anticounterfeiting laws and efforts to have terrestrial radio broadcasters pay sound recording owners for over-the-air transmissions.)

> ***Even if the user does not resell the product or give it away without authorization, any breach of the license agreement may void the license and subject the user to allegations of copyright infringement.***

Licenses, Licenses, Licenses

A rash of license-focused cases has come out of the Ninth Circuit in the last year, all essentially deciding that when consumers bring home copyrighted works—typically software—that contain an agreement that states the consumer is only being given a nontransferable license to use the product within certain restrictions, the consumer may not resell his copy of the copyrighted work. As the consumer is not buying a copy of the product, but merely a license, any resale of the work—or attempted transfer of the license—without permission violates the copyright owner's exclusive distribution right and is not subject to the "first-sale" exception in the Copyright Act. *See Vernor v. Autodesk, Inc.*, 621 F.3d 1102 (9th Cir. 2010).

Furthermore, even if the user of a product does not resell that product or give it away without authorization, *any* breach of the end-user license agreement may void the license and subject the user to allegations of copyright infringement. Whether such allegations will hold depends on whether the license term breached is deemed to be a "condition precedent" to the rights given—meaning an event or obligation that has to occur to have license rights at all or a term that limits a license's scope. This is as opposed to a contractual "covenant," such as payment terms or a promise not to act in a certain way unrelated to the copyright rights licensed, a breach of which may be actionable in contract, but does not completely take away license rights and make one liable for copyright infringement. *See MDY Indus., LLC v. Blizzard Entertainment, Inc.*, 629 F.3d 928 (9th Cir. 2010), *amended* 2011 WL 538748 (9th Cir. Feb. 17, 2011).

The Ninth Circuit did not expand such license doctrine to *every* transfer of product that purported to have restrictions on use or resale. For example, in *UMG Recordings, Inc. v. Augusto*, 628 F.3d 1175 (9th Cir. 2011), the court rejected an attempt to place the transfer/sale of free, promotional CDs outside the scope of the first-sale exception simply because the CD had a notice that it was not for resale. In *Augusto*, the court cited the Unordered Merchandise Statute, 39 U.S.C. § 3009, which stops companies from sending products to people who had not requested the items and then demanding payment unless the products are returned. The court likened the transfer of free CDs to transfers under that statute, giving the recipient ownership of the copy without any obligation to the sender. Furthermore, the restrictions on the CDs themselves were never specifically agreed to by the recipients, so the court held that no true contractual obligations were formed.

These three decisions significantly defined the landscape—at least where Ninth Circuit law is controlling—as to when transfers of product will be considered licenses as opposed to sales. Will every other circuit fall in line? Perhaps not. There could be either a public backlash against such decisions before too many other courts get a chance to review these issues or a set of facts that opens up slippery-slope arguments and turns courts in other circuits against this precedent. For example, what will happen if someone gets sued by a software manufacturer because he sold his computer on Craigslist without removing all the software?

Under the current state of the law, two business-model changes seem likely. First, software companies will use the license models of *Vernor* to make sure that customers are not purchasing copies of software, but licenses to use the software, and the same companies will use the lessons of *Blizzard* to make sure that their licenses are worded so as to tip the scales on a determination that just about any breach is a violation of a condition precedent and not a contractual covenant. Second, non-software content owners will follow the road maps of *Vernor*, *Blizzard*, and *Augusto* in an attempt to change much of what are currently considered "sales" into "licenses." If the main determinative factors in whether a transaction is a sale or a license are the method of the transaction and the language put on the product, then just about any content owner could, if it chose to do so, turn sales into licenses. We are all familiar with software that has an end-user license pop-up before one can use the program, requiring the user to check that he or she agrees with the terms. However, with the advancement of technology, it is not difficult to imagine a small, electronic chip on the packaging of a book or CD whose sole purpose is to receive and record (or transmit) the user's acceptance of similar terms before the product can be opened.

It is possible that the response to such business changes could be the alienation of consumers or a call for congressional action to expand the first-sale exception. It is also possible that in a few years, we will look at such procedures as simple industry standard. Given the uncertainty of some content markets, copyright owners may feel as if the benefits greatly outweigh the risks.

The DMCA "Access" Right

In addition to its license discussion and reiteration of *Vernor*, the *Blizzard* case had a second component. In *Blizzard*, the real

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defendant in interest, MDY, had created a "bot" that would play a video game for users even when the user was asleep or away so that upon his or her return, he or she would have accumulated points and experience in the game world.

Because no wrongful copies of the game were made and no other section 106 right was violated by users through use of the bot, the Ninth Circuit found that MDY was not liable for contributory copyright infringement. However, the court held that MDY was liable under the anti-circumvention provisions of the Digital Millennium Copyright Act (DMCA), 17 U.S.C. § 1201(a)(2), because the bot's anti-detection function circumvented a technological measure designed to eliminate any bot's "access" to the copyrighted software. Access is not a historical right included in the bundle of traditional copyright rights, but according to the Ninth Circuit, such a result must have been intended. Otherwise, it would be impossible to give each section of the DMCA meaning—a necessity of statutory construction. The court noted that section 1201(a)(2) has a blanket prohibition on the circumvention of technological measures used by a copyright owner to control access without any specificity on what one did with that access, while section 1201(b)(1)—which the court found was not violated by MDY's bot—concerns the circumvention of technological measures used to protect traditional copyright rights.

While the *Blizzard* decision was likely correct on a statutory construction basis, it was directly contrary to *The Chamberlain Group, Inc. v. Skylink Techs., Inc.*, 381 F.3d 1178 (Fed. Cir. 2004). In *Chamberlain*, the Federal Circuit stated that a proper access violation must be tied to the concept of obtaining wrongful access so that a section 106 copyright violation could occur. Under Federal Circuit precedent, *Blizzard* would have almost certainly gone the other way.

This Circuit split brings up a clear example of statutory construction results being at odds with policy results. The Ninth Circuit would say that the statute cannot be read any way other than to make unlawful the bypassing of a copyrighted work's access controls, no matter what the purpose might be. The Federal Circuit would say that because these sections are part of the Digital Millennium *Copyright* Act, policy would dictate that they be tied to the violation of standard section 106 copyright rights.

If the Federal Circuit is correct, Congress may need to take action because the Federal Circuit line of cases is not really based on what the statute says, but what the Federal Circuit believes it should say. It may be many years before this issue gets heard and decided by the Supreme Court, and having a circuit split of this magnitude is important, particularly because all patent appeals go to the Federal Circuit. There have already been murmurs regarding whether section 1201 defendants will attempt to add a patent claim any way they can to get the appeal heard in the Federal Circuit. When an issue has been decided by the original court's circuit, the Federal Circuit will use the law of the home Circuit instead of its own, so it is not as if Ninth Circuit defendants can avoid Ninth Circuit precedent. However, there are enough circuits that have not decided the access question that defendant forum shopping could become a real issue whenever patents have any chance at being involved.

Regardless of where a case might end up, based on the holding that the DMCA added an access right beyond the traditional copyright "bundle of sticks," content owners in the future are likely to change their products to add as many access restrictions as possible so that a third party—regardless of intent—cannot get access to the copyrighted work without authorization unless he or she violates the anti-circumvention provisions of section 1201. Such access protections may be added to virtually every type of product that uses software. It is possible that some businesses will use such protections to stop competitors and third parties from creating add-ons to or applications for the copyright owner's product or from servicing the copyright owner's product.

Dire Predictions of Overseas Manufacturing

In *Costco Wholesale Corp. v. Omega, S.A.*, 131 S. Ct. 565 (2010), the Supreme Court's 4–4 split left in place the Ninth Circuit's opinion (541 F.3d 982 (9th Cir. 2008)) that, when copyrighted works are made abroad, if they are then imported to the United States without authorization, that is a copyright violation not subject to the first-sale exception, despite the existence of a valid sale in a foreign country. In *Omega*, the watchmaker set up the case facts by placing a small copyrighted drawing on the back of its watches. It then sued when the Swiss-made watches, which were sold for far less in foreign markets, were resold into the United States. The court of appeals found for Omega, stating that the first-sale exception does not apply to works made outside the United States because those are not works "made lawfully under" the U.S. Copyright Act.

If Costco's predictions come true, Congress may be pressured into clarifying or changing the Copyright Act. Such large-scale business operation movements, however, are unlikely to be rapid.

As part of their arguments against this holding, Costco and other retailers predicted that such an outcome would send the majority of United States manufacturing overseas. If any manufacturer could move its operations abroad, put a small, meaningless, copyrighted work on a product, and then sue for copyright infringement whenever that product was resold into the United States, Costco argued, then every manufacturer would do so—something Congress could not have anticipated or wanted.

If Costco's predictions come true, Congress may be pressured into clarifying or changing the Copyright Act. Such large-scale business operation movements, however, are unlikely to be rapid, and this issue may not come to a head for many years. In the meantime, manufacturers who have had the most trouble with U.S. sales due to unwanted importation might

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make a slow but sure move overseas to maximize their rights and options. Perhaps 10 years down the road, most copyright lawsuits will concern small, inconspicuous, copyrighted works engraved on retail goods and pieces of machinery.

Registration or Application?

Section 411 of the Copyright Act states that no infringement action may be brought until the copyright in the work infringed has been registered (or a proper application has been denied by the Copyright Office). Courts have been unable to agree on whether section 411 requires merely that a copyright owner applies for a registration to bring his or her case or whether a registration actually has to issue from the Copyright Office. This court split has real-world ramifications, especially because the statute of limitations on copyright claims is three years, and the Copyright Office has such a backlog that it often takes more than a year for the office to act on applications; it sometimes takes more than a month even when one pays for expedited review.

It was hoped that the Supreme Court would speak to this dilemma when it took on *Reed Elsevier v. Muchnick*, 130 S. Ct. 1237 (2010), but it declined to do so, deciding that case on the narrow question of whether the requirement is jurisdictional. The Supreme Court found that section 411 is not jurisdictional, meaning that while registration is a pre-suit requirement, it is one that can be waived by a defendant—something that will have no practical significance for the vast majority of cases. The Court chose not to address the question of whether registration has to issue or if mere application satisfies section 411. On its face, the statute suggests that issuance is required, but is it correct or practical from a policy standpoint? If the Copyright Office backlog is not cured quickly by the office's new electronic system and the Supreme Court does not clarify which view is correct, look for Congress to eventually either change the statute on policy grounds or specify that issuance of a registration is indeed needed before an infringement action can be filed.

Red-Flag Infringement

The DMCA is clear that Internet service providers (ISPs) are not liable for copyright infringements placed by third-party users on their servers for storage purposes (and for certain other potentially infringing acts/materials) as long as the ISPs follow the safe-harbor rules. One of those rules is section 501(c)(1)(A), which states that even if the ISP does not have actual knowledge of specific infringing material residing on its servers, if it is "aware of facts or circumstances from which infringing activity is apparent," it must act "expeditiously to remove, or disable access to, the material." This awareness of infringing activity is known as "red-flag" infringement.

The DMCA is clear that ISPs are not liable for copyright infringements placed by third-party users on their servers for storage purposes as long as the ISPs follow the safe-harbor rules.

Until a few years ago, the prevailing wisdom was that consistent knowledge that infringements were occurring on an ISP's website could subject that ISP to liability, especially if the ISP was turning a blind eye to such infringement. However, a number of recent cases, including *UMG Recordings, Inc. v. Veoh Networks Inc.*, 665 F. Supp.2d 1099 (C.D. Cal. 2009) and especially *Viacom Int'l Inc. v. YouTube, Inc.*, 718 F. Supp.2d 514 (S.D.N.Y. 2010), have all but interpreted red-flag infringement out of the statute, holding that for an ISP to be held liable, the copyright owner must make the ISP aware of a specific infringement on its website, and the ISP must fail to take such specific infringements down. Thus, under these decisions, all the responsibility for policing copyright infringement falls squarely on the copyright holders.

Both cases are on appeal, and it would be somewhat surprising if the Second Circuit does not at least limit the holding of the *Viacom* case. But if the cases are upheld, the two circuits where a substantial portion of copyright cases are filed will have come out strongly against copyright owners on this issue. What will happen next remains a mystery. Copyright owners could give up, but it seems more likely that they will file cases in courts outside those circuits in hopes of getting better results and possibly forcing a circuit split to go in front of the Supreme Court. Also likely is a push for congressional action under the rationale that the courts have read an important provision out of the law and only statutory clarification will fix the problem. In any case, we can be fairly certain that the debate over the DMCA, what knowledge an ISP must have, and what actions it must take to retain safe-harbor protections will rage on for a substantial portion of the next decade.

Conclusion

There are many more copyright issues that may affect how businesses operate or may encourage statutory changes over the next decade. For instance, there is an ongoing conflict over whether the Uruguay Rounds Agreement should have been able to bring certain foreign works back from the dead (as opposed to leaving them in the public domain), and the Supreme Court has recently accepted certiorari on a case involving that issue. There is the debate over whether statutory damages must have a relationship to actual damages to satisfy due-process concerns. There is the possibility that we may see more subscription models for online content in an effort to protect that content from mass distribution and copying. There is the question regarding database rights, something protected in the European Union but not in the United States that some believe hurts U.S. companies abroad, especially given how important information has become as a commodity. When all is said and done, given how quickly technology advances, it is quite possible that the biggest change to occur in the next decade has not even raised its head yet.

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Offer-to-Sell Infringement

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215 F.3d 1246, 1253 (Fed. Cir. 2000). Although Congress expanded the statute to broaden the rights of patentees under § 271(a), it failed to explain the meaning of "offer to sell." *See Rotec Indus.*, 215 F.3d at 1253. In the absence of explicit guidance, the Federal Circuit determined that the phrase should be given its ordinary meaning.

Offer-to-sell infringement differs from the other bases of infringement liability in several key respects. First, the policy underpinning the provision is unique—preventing an infringer from generating interest in a potentially infringing product to the commercial detriment of the rightful patentee. *See 3D Sys., Inc. v. Aarotech Labs., Inc.*, 160 F.3d 1373, 1379 (Fed. Cir. 1998). Second, the infringement stands alone—offering an infringing product for sale is an act of infringement separate from an actual sale. *Transocean Offshore Deepwater Drilling, Inc. v. Maersk Contractors USA, Inc.*, 617 F.3d 1296, 1308 (Fed. Cir. 2010). Therefore, offering an infringing product for sale and later delivering a noninfringing alternative does not obviate the offer-to-sell infringement, even if the infringer may have avoided liability for an infringing sale. *Transocean*, 617 F.3d at 1310. Last, an infringing offer must be communicated to a third party for there to be an infringement (*see Rotec Indus.*, 215 F.3d at 1255), but need not be accepted to constitute an act of infringement. *Transocean*, 617 F.3d at 1308.

What Is an Infringing Offer to Sell?

The Federal Circuit first considered the question of what constitutes an infringing offer in *3D Systems*. *3D Sys., Inc.*, 160 F.3d at 1378. 3D filed a patent infringement suit alleging infringement of its stereolithography (rapid prototyping) equipment patents. The defendants engaged in a pattern of marketing behavior including sending price quotes, promotional materials, and emails to prospective customers; the defendants also maintained a website promoting and describing the infringing equipment. The Federal Circuit considered whether the price-quote letters were "offers" within the meaning of § 271(a) to determine whether the district court had properly dismissed the suit for lack of personal jurisdiction. Although the price-quote letters unequivocally stated that they were not offers to sell the infringing equipment, the Federal Circuit held that this was form over substance and that the letters were "offers." To hold otherwise would provide would-be infringers with a loophole to avoid liability.

Whether an offer has been made is determined by a traditional contract analysis and is interpreted in light of authorities like the Uniform Commercial Code, dictionaries, and the Restatement (Second) of Contracts. *Rotec Indus.*, 215 F.3d at 1254–55, 1257. The Federal Circuit held that an "offer" is the manifestation of a willingness to enter into a bargain, so made as to justify to another person in understanding that his assent to that bargain is invited and will conclude it and rejected approaches that would draw from state common-law principles or import the § 102(b) on-sale bar analysis into the offer-to-sell provision. *Rotec Indus.*, 215 F.3d at 1257.

Because this type of patent infringement can occur at an early stage in a potential sale, it might benefit sales forces to work closely with counsel to reduce the risk of offer-to-sell infringement.

Extraterritoriality and Offer-to-Sell Infringement

When is an offer an infringing act within the meaning of § 271(a) in the context of international business negotiations? The Federal Circuit first examined this issue in *Rotec Industries*. The plaintiff owned a patent related to construction machinery and accused the defendants of infringement when they offered to sell construction equipment as a part of a bid for a project in China. In preparing for the bid, the defendants undertook several activities in the United States, including designing and pricing the accused system and meeting with each other, but the third-party negotiations and the contract execution took place overseas. The Federal Circuit held that the defendants had not made an infringing offer in the United States because none of the defendants' activities that took place in the United States were communicated to any third parties and, thus, did not establish any commercial detriment to the patentee.

In the recent *Transocean* decision, the Federal Circuit examined whether overseas negotiations for domestic delivery of an infringing product constituted an infringing offer. Outside of the United States, American affiliates of Danish and Norwegian companies negotiated the delivery of an oil rig. They signed a contract in Norway that provided for the rig to operate in the U.S. Gulf of Mexico and other locations. Before it delivered the rig, the defendant modified the rig to design around Transocean's patent. The Federal Circuit held that an offer to sell an infringing product made overseas between two American companies for delivery and use in the United States is an "offer" within the meaning of § 271(a); the analysis should focus on the contemplated location of the future sale, not the location of the offer. However, negotiations between parties taking place in the United States to manufacture and deliver an infringing product abroad would not appear to be an infringing offer under *Transocean*. *See Ion, Inc. v. Sercel, Inc.*, No. 5:06-CV-236 (E.D. Tex. Sep. 16, 2010) (order granting-in-part motion for judgment as a matter of law on damages based on offers for foreign sales).

Patented Processes and Offer-to-Sell Infringement

Liability accruing from an offer to sell a product incorporating a patented process may not infringe an underlying process claim. In *Embrex Inc. v. Serv. Eng'g Corp.*, 216 F.3d 1343, 1349 (Fed. Cir. 2000), the Federal Circuit held that an offer to sell a machine cannot serve as the sole basis for finding infringement; that the sale of equipment to perform a process is not a "sale" of the process within the meaning of § 271(a).

Offer-to-Sell Infringement Damages

So what is the economic harm that results from an infringing offer? The patent statute provides for an injured party to be compensated in an amount "not less than a reasonable royalty" for the use of the invention but does not specifically address offer-to-sell infringement damages. *See* 35 U.S.C. § 284 (2006). Although the Federal Circuit has not often addressed this issue, it has recognized that damages resulting from an infringing offer "would likely be

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quite different from those calculated from an actual sale." *Transocean*, 617 F.3d at 1308. This observation makes sense in light of the unique policy goal behind the offer-to-sell provision—preventing an infringer from generating interest in a potentially infringing product to the commercial detriment of the patentee—and the unique economic circumstances surrounding the patentee and the infringer compared to those of parties to an infringing sales fact-pattern.

A patentee is entitled to price erosion damages if it can show that, but for the infringement, it would have been able to charge and receive a higher price for the patented product.

Damages can apply in two generic fact-patterns: active market patentee-competitors and other patentees. *See* Timothy R. Holbrook, "Liability for the 'Threat of a Sale': Assessing Patent Infringement for Offering to Sell an Invention and Implications for the On-Sale Patentability Bar and Other Forms of Infringement," 43 *Santa Clara L. Rev.* 751, 789–90 (2003).

Patentee Competing in the Market

Lost profits can be an appropriate measure of damages for offer-to-sell infringement if a patentee can establish a causal relationship between the infringement and its lost profits and but for the infringement, the patentee would have made the infringer's sales. *American Seating Co. v. USSC Group, Inc.*, 514 F.3d 1262, 1268 (Fed. Cir. 2008) (citing *BIC Leisure Prods. v. Windsurfing Int'l*, 1 F.3d 1214, 1218 (Fed. Cir. 1993)). A practitioner should bear in mind, though, that the crux of the patentee's damages theory is an amount of future sales the patentee believes it would have made; these can be speculative if not supported by sound economic models or adequate evidence. *See Shockley v. Arcan*, 248 F.3d 1349, 1362–64 (Fed. Cir. 2001).

The bait-and-switch offer. In *American Seating*, the Federal Circuit examined offer-to-sell infringement damages related to a "bait-and-switch" offer. The infringer sold two types of bus wheelchair restraints: an infringing version that it had initially offered to sell to a third party and a noninfringing substitute it ultimately delivered. The jury awarded lost profits as a result of the infringing offers and associated non-patented sales. The Federal Circuit held that the patentee had established consumer demand for the patented features embodied in the infringing restraints and that the infringer had offered the infringing restraints but filled the orders with noninfringing restraints. Although the noninfringing restraint was held to have been an unacceptable substitute, lost profits might still be available even if the infringer offered to sell an acceptable, noninfringing substitute (*see State Indus. v. Mor-Flo Indus.*, 883 F.2d 1573, 1578 (Fed. Cir. 1989)), or, at a minimum, the patentee would be entitled to a reasonable royalty. *See* 35 U.S.C. § 284. Practitioners who notify infringers of potential infringement may see this situation arise when an infringer ceases to offer an infringing product for sale.

Anticipated delivery of an infringing product. Damages can also arise in the case where an infringing product has been sold but not yet delivered. *See Vulcan Eng'g Co. v. Fata Aluminum, Inc.*, 278 F.3d 1366, 1381 (Fed. Cir. 2002) (Michel, C.J., dissenting) (although the majority held that the license defeated the infringement claim, C.J. Michel would have held that products that had been sold but not yet delivered infringed).

Price erosion. What if a patentee had to lower the price of its patented product to compete with the infringer's prices? What if the patentee had to lower its price in anticipation of an infringer entering the market who had been advertising a lower-priced infringing product? Even if the patentee ultimately made the sale, it is not necessarily precluded from seeking price erosion damages—i.e., the incremental portion of profits it lost but for the infringing offer—to make it whole. *See Brooktree Corp. v. Advanced Micro Devices, Inc.*, 977 F.2d 1555, 1580–81 (Fed. Cir. 1992); *Vulcan Eng'g Co.*, 278 F.3d at 1382–83 (Michel, C.J., dissenting) ("but-for" and price-erosion tests apply to determine offer-to-sell infringement damages); *but cf. Crystal Semiconductor Corp. v. Tritech Microelectronics Int'l, Inc.*, 246 F.3d 1336 at 1355, 1360 (Fed. Cir. 2001) (declining to evaluate price-erosion damages separately from a lost-profits claim).

A patentee is entitled to price erosion damages if it can show that, but for the infringement, it would have been able to charge and receive a higher price for the patented product (*Minco, Inc. v. Combustion Eng'g, Inc.*, 95 F.3d 1109, 1120 (Fed. Cir. 1996)) and that a supporting market reconstruction analysis accounts for the nature or definition of the market; the similarities between any benchmark market and the market in which price erosion is alleged; and the effect of the hypothetically increased price on the likely number of sales at that price in that market. *Crystal Semiconductor Corp.*, 246 F.3d 1336 at 1355, 1357. But the patentee need not know that the competitor-infringer's product infringes so long as the patentee had reduced its price to compete with an infringer. *Vulcan Eng'g Co.*, 278 F.3d at 1377. The presence of acceptable, non-infringing substitutes weakens the patentee's market share of the patented article (Holbrook, "Liability for the 'Threat of a Sale,'" *supra,* at 791–96), and may have a detrimental effect on a price-erosion claim.

Damages related to lost sales of unpatented articles. A patentee may recover lost profits on an unpatented product it tends to sell with a patented product if it can prove that, but for the infringement, it would have sold the unpatented product and that the patented and unpatented products together are components of a single assembly, parts of a complete machine, or together constitute a single functional unit (the combined use of which must be essential; they should not merely be sold together for convenience or business advantage). *American Seating Co.*, 514 F.3d at 1268. Claiming profits on lost sales of unpatented products has its own pitfalls.

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A claim for this category of damages may also be speculative unless well supported by evidence and economic models, and the strength of the claim will, of course, depend heavily on the circumstances of the infringement.

Other Patentees

Patentees who fail to establish a lost-profits claim are still entitled to a reasonable royalty as a damages floor, even if the harm resulting from infringement appears nominal. *Lucent Techs., Inc. v. Gateway Inc.*, 580 F.3d 1301, 1324 (Fed. Cir. 2008); *see* 35 U.S.C. § 284. A reasonable royalty in an actual infringing sale context is most commonly determined through a hypothetical negotiation analysis, which attempts to ascertain the royalty the litigants would have agreed to had they negotiated a license shortly before the first infringing act. *Lucent Techs. Inc.*, 580 F.3d at 1324 (citing *Georgia-Pacific Corp. v. U.S. Plywood Corp.*, 318 F. Supp. 1116 (S.D.N.Y. 1970)). However, not much jurisprudence exists to guide a reasonable royalty analysis in the case of an infringing offer. *See City of Aurora v. PS Sys., Inc.*, No. 07-CV-02371, 2010 U.S. Dist. LEXIS 75418 (D. Colo. June 25, 2010). This may very well be a result of the perceived nominal value of harm suffered by a patentee under these economic circumstances.

What is the harm to a patentee of an infringer's unaccepted offer to sell an infringing product if the patentee is not utilizing the patent? The patentee does not appear to have lost the opportunity to promote or license its patented technology. However, as one district court noted, there may be significant value to an infringer for merely being able to offer the patented technology, for example, to compete and win a large construction project bid. *City of Aurora,* 2010 U.S. Dist. LEXIS 75418 at *27–30.

How might one calculate the value of a limited license to offer the patented technology for sale? It is likely that insufficient evidence would exist to determine a royalty under a traditional hypothetical negotiation approach. For example, the infringer likely had not made much use of the invention beyond including it in its offer and advertising or much profit creditable to the patented technology, nor experienced any commercial success. *See Lucent Techs. Inc.*, 580 F.3d at 1324. And, because the infringer will have not made any actual infringing sales, a royalty sales base might not exist to which one could apply a running royalty.

We might turn to other intellectual property damages frameworks to inform a reasonable royalty damages approach that better fits the policy behind and economic circumstances surrounding offer-to-sell infringement. For example, trademark law, too, seeks to prevent an infringer from generating interest by infringing on a trademark to the commercial detriment of a trademark owner. *See* Terence P. Ross, Intellectual Property Law Damages and Remedies, § 4.01 (2000). Trademark damages analysis is versatile: The inquiry can focus on the harms to the trademark owner or the infringer's ill-gotten benefits. *Id.* § 4.03. Trademark owners can recover damages to compensate for the loss in value of the trademark and associated goodwill and for the cost of corrective advertising, in addition to lost profits, reasonable royalties, disgorgement of profits, and statutory remedies.

Thus, the value of this limited license might be derived indirectly from the value of the license to the infringer, taking into account the circumstances surrounding the intended use: the likelihood of the acceptance of the infringer's offer, the importance of the patented technology to the offeree, the infringer's anticipated sales and profits related to the patented technology, the anticipated sales and profitability of the infringer's functionally related unpatented items, and other relevant considerations.

Other Considerations

A patentee's commercial interests may have suffered in other ways due to the infringing conduct. By promoting the infringing product, the infringer may have harmed the reputation of the patent or patented products in the marketplace due to confusion about the exclusivity of the patented invention, or it may have otherwise harmed the patentee's trademarks and goodwill. *See* Rex W. Miller, "Note: Construing 'Offers to Sell' Patent Infringement: Why Economic Interests Rather Than Territoriality Should Guide the Construction," 70 *Ohio St. L.J.* 403, 446 (2009). Similarly, the patentee may have also lost his head start or competitive advantage in the market gained by exploiting his patent.

Because patent law does not provide for damages to redress these types of harms, *see Lucent Techs. Inc.*, 580 F.3d at 1324, the patentee might consider seeking to enjoin the infringer, arguing that these harms are irreparable. *See eBay v. MercExchange, LLC*, 547 U.S. 388 (2006). Furthermore, the patentee is not precluded from seeking to recover damages under other common-law, statutory, or business tort theories, including false advertising, counterfeiting, unfair competition, trademark infringement, or tortious interference theories, depending on the facts of the case.

The Future of Offer-to-Sell Infringement

Although neither the current House nor Senate versions of the patent-reform bill directly address offer-to-sell infringement, I offer the following predictions on what the future might hold for offer-to-sell infringement jurisprudence.

Because offer-to-sell infringement liability is relatively new to the patent statute compared to other kinds of infringing acts, the Federal Circuit will continue to explore the nature of this kind of infringement.

Our increasingly complex, global economy will force the courts to grapple with the subtleties of the mechanics of international business to determine whether an offer infringes in spite of the simple rule announced in *Transocean*. And, with more complex, international negotiations, more personal jurisdiction disputes are inevitable.

As for patent damages, cases will continue to test the boundaries of traditional patent-infringement damages principles because of the unique policy considerations and economic realities surrounding an infringing offer. For example, the hypothetical negotiation framework that is commonly applied in actual sale and use infringements does not appear to be well suited for evaluating a reasonable royalty resulting from an infringing offer. Perhaps the courts will look to analytical method, which emphasizes the infringer's expected profits, or draw from other intellectual property frameworks to find a better way to assess the harms suffered by the patentee.

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