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Inside

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Message from the Chair

Looking forward to our traditional CLE program on Ethics for October 26, 2012. Steven Nachimson is working hard to put the final touches on that program.

At the end of June in Cooperstown the House of Delegates approved our recommendation to allow in-house counsel, who have not been admitted to the New York bar but are registered in New York, to provide pro bono services while working for their employers. The recommendation would amend Part 522 of the Rule of the Court of Appeals for the Admission of Attorneys and Counselors at Law. Hopefully, when you read this, the rule will have been adopted by the courts.

Our Section took the top honor in the State Bar's President's Diversity Challenge in 2011 and we were recognized at the Section Leadership Conference in May 2012. The commitment to diversity continues for us. In my Spring/Summer message I anticipated six diverse law students in-house for the summer. However, we ended with nine students at nine different law schools in New York. On August 14, 2012 Alliance Bernstein hosted the 7th annual Kenneth G. Standard Diversity Internship Reception, which honors all of

Inside

Editors: Janice Handler and Allison B. Tomlinson

SPECIAL ISSUE: INTELLECTUAL PROPERTY

NYSBA

those who contribute to the success of this program. We launched a program mentoring our former interns. If you want to be a mentor in 2013 let us know. Our past interns are mentoring the class of 2012.

We welcomed three new liaisons from the Young Lawyers Section this year. As a past Young Lawyers Section liaison myself, it is an important relationship we must continue to cultivate as these members will be the future of our Section.

Our Technology and New Media Committee keeps adding content on our website for our members. Thus, check our Section's website at www.nysba.org/Corporate.

Please give us your feedback. The Section is always looking for volunteers, so please reach out if you have any interest in being more involved.

David S. Rothenberg

Inside *Inside*

Intellectual Property! As a young in-house marketing lawyer I thought this an exotic (and non-essential) legal specialty populated mostly by geeks with Ph.D.s—you know, the ones who chose science instead of English as their college majors. I learned quickly enough that marketing executives salivate over their trademarks and are very protective of their patents even when they have no clue what a patent is or does.

This issue has something for everyone—from the generalist in a small legal department who vaguely knows that the company has intellectual property but doesn't know what to do with it or how to protect it, to the patent experts who want to know how to use the newly enacted America Invents Act to strategic advantage.

We have articles that outline IP basics (such as "Intellectual Property: A Two-Edged Sword"; "How to Identify, Valuate, and Leverage Your Company's Intellectual Property "and "Protecting Your Intellectual Property by Staying Informed and Knowing Your Options"); articles that discuss recent developments in patent and copyright law (especially the AIA); and articles for the true IP connoisseur that discuss crowdsourcing, software as service deals, IP in the green economy, managing collaborative inventions, and using IP assets to ameliorate startup risks.

No corporate counsel can afford to be ignorant of IP issues—as one of our authors points out, the IP portfolio of a company can be more valuable than the products it manufactures. At the least, this issue will tell you what you don't know.

Enjoy!

Janice Handler

Janice Handler is co-editor of *Inside*, former General Counsel of Elizabeth Arden Cosmetics Co., and an adjunct professor of Corporate Counseling at Fordham Law School.

Intellectual Property: A Two-Edged Sword

By Cheryl L. Davis

No matter the nature of your Company's business, the odds are that as in-house counsel, you will have to address intellectual property issues with the Company's employees at some point. These issues will probably arise in one of two contexts (if not both): (i) advising employees on how to protect the Company's intellectual property, and (ii) cautioning them against becoming infringers themselves. The same laws that protect the Company's intellectual property can be turned on the Company just as easily if it infringes upon the intellectual property rights of others.

I. Protecting the Company's Intellectual Property

A. Legal Precautions

Before instructing employees on the business precautions they need to take to protect the Company's intellectual property, you should first make sure the necessary legal precautions have been taken. For example, where the Company has valuable copyrights, you want to make sure that they have been registered with the U.S. Copyright Office. While copyright arises upon creation, registration is necessary in order to be able to bring a suit in the event of infringement. In addition, if the copyright has been registered *before* the infringement takes place, statutory damages and attorneys' fees then become available.[1] Even if the Company doesn't end up actually bringing suit, the mere availability of increased damages may give you additional leverage when it comes to settlement negotiations.

You also want to make sure that there is adequate copyright notice on the Company's products (and/or their packaging), as well as on the Company's website and other materials entitled to copyright protection. By providing such notice, you can rebut the "innocent infringement" defense "that such infringer was not aware and had no reason to believe that his or her acts constituted an infringement of copyright."[2] The copyright law expressly provides that

> [i]f a notice of copyright in the form and position specified by this section appears on the published copy or copies to which a defendant in a copyright infringement suit had access, then no weight shall be given to such a defendant's interposition of a defense based on innocent infringement in mitigation of actual or statutory damages…[3]

As you can see, copyright notice still serves a practical purpose.

While copyright protection lasts for the life of the artist plus 70 years (or, in the case of a work made for hire, for 95 years from the year of its first publication or 120 years from the year of its creation),[4] patents only last for twenty years from the date of application.[5] While an initial trademark registration lasts for ten years, the registration can continue to be renewed for additional ten-year terms.[6]

With respect to protecting the Company's trademarks and patents, you want to make sure that (i) the necessary filings are being made to renew the registration (where trademarks are concerned) and (ii) again, that there is clear notice of the registrations. Designers and marketing personnel may occasionally protest that the notice will negatively affect the look of the logo or their design concept. But, if notice is absent, the Company must then prove that the infringer had actual notice of the registration, and therefore, of the infringement. The Company will then run the risk of losing at least some (if not all) of its potential damages—which, since they can potentially be trebled by the court, can end up being quite substantial.[7] You therefore should make sure that employees include the appropriate notices on the packaging and marketing materials for the Company's goods and services.

B. Educating Employees About Intellectual Property

Having ensured that the legal framework is in place, you should make sure that the employees are aware of the value of your Company's intellectual property, and that they know how (and how not) to treat it. While some basic information should be included in the Company's standard employee manual, it may also be helpful to have periodic seminars reminding employees about the Company's intellectual property practices and policies and to have regular meetings with any individual employees who deal with intellectual property issues on a regular basis.

1. Employee Work = Work for Hire

As a basic matter, the Company's employee manual should state that the employee's work will be deemed work-for-hire owned by the Company; that way, the employee will not mistakenly believe that s/he can transfer, license, or otherwise dispose of the property. Some departing employees may want to continue using projects they worked on while at the Company (and which belong to the Company) as examples of their own work product, to market their services and obtain future employment. The Company should have a clear policy stating whether such use is permissible.

2. Navigating Social Media

Employees should take care when using social media when referring to or circulating the Company's intellectual property. Certain sites and services, such as Twitpic, provide in their terms and conditions that "by submitting Content to Twitpic, you hereby grant Twitpic a worldwide, non-exclusive, royalty-free, sublicenseable and transferable license to use, reproduce, distribute, prepare derivative works of, display, and perform the Content in connection with the Service and Twitpic's (and its successors' and affiliates') business."[8] As you can see, by posting pictures containing the Company's intellectual property on Twitpic and similar websites, your employees might end up inadvertently granting licenses to the Company's intellectual property.

Some companies might issue a blanket prohibition against employees using social media for Company purposes. Your business, however, may be one that thrives on its social media presence and uses it to cultivate and maintain a passionate customer base. In that situation, it is important for the Company to issue clear guidelines for its employees—and its consumers—on how the Company's intellectual property should be used. For example, the Company's website should specify exactly how its trademarks should be used when reference is made to its goods and services, as well as clearly stating that the Company's trademarks should not be incorporated into the business name or trademark of any other entity without the Company's permission.

3. Taking Care When Protecting Intellectual Property

In today's world where seemingly minor disputes can go viral with the swipe of an iPhone®, it is ever more important to pick your intellectual property battles wisely. As a basic matter, employees should not issue (or threaten to issue) cease and desist letters without clearing them with counsel first. First of all, you face the question of whether the third-party's use is a "fair use" of the Company's intellectual property. The copyright law explicitly provides that certain types of use do not constitute copyright infringement:

> The fair use of a copyrighted work…for purposes such as criticism, comment, news reporting, teaching (including multiple copies for classroom use), scholarship, or research, is not an infringement of copyright. In determining whether the use made of a work in any particular case is a fair use the factors to be considered shall include—
>
> (1) the purpose and character of the use, including whether such use is of a commercial nature or is for nonprofit educational purposes;
>
> (2) the nature of the copyrighted work;
>
> (3) the amount and substantiality of the portion used in relation to the copyrighted work as a whole; and
>
> (4) the effect of the use upon the potential market for or value of the copyrighted work.[9]

The principle of fair use also applies to trademarks. The Lanham Act, like the Copyright Act, permits certain uses of a registered trademark. For example, it is a defense to a claim of trademark infringement that

> the use of the name, term, or device charged to be an infringement is a use, otherwise than as a mark, of the party's individual name in his own business, or of the individual name of anyone in privity with such party, or of a term or device which is descriptive of and used fairly and in good faith only to describe the goods or services of such party, or their geographic origin.[10]

In addition, the Company's trademarks may be used in connection with comparative advertising, as long as the third-party is not appropriating the Company's goodwill by misleading consumers.[11] In short, as much as the Company might wish it, there are some uses of its intellectual property the Company may not legally be able to prevent.

There are also some uses that the Company may not wish to prevent. If, as stated previously, the Company has a passionate consumer base, it may not wish to dissuade them from making (appropriate) use of the Company's trademarks and other intellectual property. Where such use is inappropriate, however, employees should be instructed to reach out to the (perhaps overly) passionate consumer, and ask him/her to follow the Company's rules (which should be clearly posted on the Company's website). Don't let your employees' desire to please the Company's customers lead the Company into an unwitting waiver of an infringement claim.

4. Departing Employees

Some in-house counsel may think "my Company doesn't have any intellectual property. Our business is manufacturing/real estate/sales, etc." But, at the very least, your Company has its own trademark, or trade name. Your Company may also have trade secrets, or other confidential information that it wants to protect from its competitors (and its consumers). Your employees should be aware of the need to protect the Company's information in its various forms. For example, in addition to notifying employees in the employee manual about the need to protect intellectual property, you will want to remind them of these procedures when they leave the Company's employ.

Many employees access Company files from their personal computers or print out hard copies of material for review at home. You don't want to risk these employees discarding the Company's intellectual property in a careless manner (such as by throwing out or recycling confidential documents, or by donating a used computer) just because they innocently forget the need for caution. A reminder to securely dispose of any intellectual property in his or her possession should be a part of any employee's exit interview.

II. Avoiding Infringing Upon the Intellectual Property of Others

It is quite likely that your Company uses third-party intellectual property in its ordinary course of doing business; most businesses license computer software, to name only one example. Your employees need to beware of engaging in even innocent infringement of such non-Company intellectual property.

With respect to software licenses, it is unfortunately easier than you might expect to end up being an infringer. Companies can lose track of how many licenses they've actually purchased. If the Company has a summer intern program, an intern may install a copy of his or her educational software on the Company's server, and if such educational software is used in a commercial context, the Company might end up violating the terms of use of the software. The best way to guard against such inadvertent infringement is to have periodic software licensing audits.

Virtually all companies have a website, and most of these websites have graphics or other images that may be subject to copyright protection. More people than you might think assume that "if it's on the internet that means it's in the public domain, right?" You want to nip these misapprehensions in the bud, before they sprout into an infringement. You will want to make sure that your marketing department (as well as your IT department and anyone else who has responsibility for your corporate website and image) gets the necessary permissions and licenses for any artwork or images that are not internally generated.

It is even possible that your employees might infringe upon intellectual property that your Company generated and then transferred to a third party. Where the transfer of intellectual property is part of your ordinary (or at least frequent) course of business (from architect to owner, for example), make sure that your employees know what they may and may not continue to use. Occasional lectures or other reminders may do the trick. Where such transfers of intellectual property are not common at your Company, you should bring them to the relevant employees' attention.

III. Conclusion

With proper guidance, the Company's employees can and should be your allies in protecting the Company's intellectual property against infringement and preventing the Company from becoming an infringer itself. The most important thing is to come up with a procedure for advising the employees about the Company's rights, and continue to keep them informed of their obligations in protecting them.

Endnotes

1. 17 U.S.C. §504.
2. 17 U.S.C. §401.
3. 17 U.S.C. §401(d). According to 17 U.S.C. §401(b), the form of notice shall include the symbol ©, the word "Copyright," or the abbreviation "Copr.," and the year of first publication of the work.
4. 17 U.S.C. §302.
5. 35 U.S.C. §154.
6. 15 U.S.C. §1059.
7. 15 U.S.C. §1111; 35 U.S.C. §287.
8. Twitpic Terms & Conditions, http://www.twitpic.com/terms.do.
9. 17 U.S.C. §107.
10. 15 U.S.C. §1115(b)(4).
11. *See, e.g., Merck & Co., Inc. v. Mediplan Health Consulting, Inc.*, 425 F. Supp.2d 402, 413 (S.D.N.Y. 2006) ("Courts permit defendants to use a trademarked name to convey to consumers what it is their product seeks to copy; in such cases, defendants are 'not trying to get the good will of the name, but the good will of the goods.'") (citation omitted).

Cheryl L. Davis is a litigator who concentrates in intellectual property matters (particularly copyright and trademark), employment, and real estate/construction related matters. She is a member of the firm of Menaker & Herrmann LLP, and one of the authors of the firm's book "Law for Architects: What You Need to Know." She would like to thank Erika J. Krystian and Jennie L. Sacks for their assistance in preparing this article.

How to Identify, Valuate, and Leverage Your Company's Intellectual Property

By Erica M. Hines

A majority of sophisticated and high-tech companies have long-appreciated the ever-increasing value of intangible assets, such as intellectual property (IP). More and more, small and medium-sized businesses have also come to appreciate the value that IP assets can contribute to the worth of an organization. Indeed, in market value determinations, it is not uncommon for companies' intangible assets to out-value tangible assets. This is in large part due to the considerable strategic advantages, both offensive and defensive, that IP assets can afford to companies of all sizes. Google's recent $12.5 billion acquisition of Motorola Mobility, driven largely by Motorola's enticing 17,000+ patents, is a case-in-point. The patents' defensive value in warding off lawsuits from Apple and Microsoft was of paramount import, and made Motorola a very attractive acquisition, notwithstanding its exorbitant price tag. Considering the significant role of IP, in order to provide the best legal advice, and maximize companies' competitive advantage in the marketplace, it is imperative that corporate and/or in-house counsel not only be familiar with IP basics, but also have a general understanding of how to identify, valuate, and leverage IP.

Identifying Your Company's Intellectual Property

Identifying your company's (or your client's) IP is a necessary first step before the IP can be assigned a value, and leveraged. There are four major categories of IP: patents, trademarks, copyrights, and trade secrets. The identification step should identify all IP falling within each category.

Patents protect new and non-obvious inventions, including products, compositions, and methods. Issued by the U.S. Patent and Trademark Office, they last twenty years from the filing date of a patent application and they allow patent owners to exclude others from using the patented technology. Because of this monopoly-like status, patents are generally the most valuable type of IP, but also the most expensive, time consuming, and complicated to procure.

Trademarks are words and/or designs that are used to associate products and services with a particular source. Trademarks can include a company's name, brands, product names, service names, logos, and slogans. While a company may have common law trademark rights stemming from the use of a mark, many companies using marks in interstate commerce wisely opt to federally register their marks with the U.S. Patent and Trademark Office. This registration has numerous benefits, including providing constructive notice of the trademark owner's claim, preventing others from registering a confusingly similar mark for use with their own goods and services, and providing for invocation of federal jurisdiction and the ability to bring a trademark infringement suit under the Lanham Act. It also allows companies to file their registrations with the Customs Service to prevent importation of infringing foreign goods, and may enable a trademark owner to collect statutory damages in the case of infringement.

Copyrights vest in the authors of original works of authorship, and give copyright owners certain exclusive rights including the right to control who can reproduce, alter, and distribute copyrighted material. Copyright assets may include a company's catalogues, brochures, website, manuals, product images, photographs, graphic designs, and software code. Copyrights can be federally registered with the U.S. Copyright Office, which creates a public record of the copyright and can allow copyright owners to recover statutory damages and attorney's fees in litigation.

Trade secrets refer to confidential and proprietary information that is valuable to a company if the information remains secret. Internal safeguards (including employee and independent contractor agreements with strict confidentiality provisions) are imperative to ensure the longevity of trade secrets and the competitive and economic advantages that they afford to a business.

After all IP assets have been identified, they should be properly documented in updatable form for company records. For example, IP assets may be listed in table form, along with relevant and helpful accompanying information, such as product life, extent of use, importance, and estimated value (from the IP valuation step discussed below). *See* Cockburn, Ian,"*IP Audit – A 'How to' Guide,*" World Intellectual Property Organization Website (available at http://www.wipo.int/sme/en/documents/ip_audit.htm) for a sample format.

Valuation of Your Company's Intellectual Property

There are numerous methods of IP valuation, and determining an appropriate method is highly dependent upon the IP being assessed, the purpose of the valuation, the circumstances involved, and the data available. Three basic approaches to IP valuation are the cost, market, and income approaches.

The cost approach is based on the principle of substitution. Essentially, this approach valuates IP based on the cost of re-creating/developing the IP (including R&D, prosecution costs, opportunity costs, and materials, labor, and overhead costs) as of the valuation date. Under the cost approach, IP can be valuated by determining the cost of reproducing the exact IP asset, or by determining the cost of replacing the IP asset with a similar asset. Under this approach, the value of an IP asset should at least equal what a buyer would pay to avoid starting from scratch in reproducing or replacing the asset. The cost approach can be useful at least in providing a bottom line value for many IP assets. However, a fundamental dilemma associated with the cost approach lies in its assumption that the cost of creating IP equals the value of the IP itself, which is often inaccurate. Among other shortfalls, the approach does not consider the profit potential of IP.

The market approach values IP assets by comparing them to similar assets recently exchanged under similar conditions. Under this approach, the price paid for similar assets is the value assigned to a company's comparable IP assets. The applicability of this approach is highly dependent upon the existence of a market for similar assets, and on the ability to obtain pricing information from the market. Because of the unique nature of many IP assets, it is often difficult to find an appropriate market benchmark.

The income approach is based on discounted cash flow theory. This approach assesses the expected financial value to be derived from the IP. An IP asset is assigned a value equal to the present value of the expected future economic benefits attributable to the IP asset over the course of the asset's economic life. The future profits attributable to the asset can be calculated by, for example, projecting a business's cash flow with and without the IP asset, or by calculating savings from not having to pay licensing fees for the required technology, due to the company's purchase of the asset (the "Relief from Royalty" method). After future profits have been estimated, the present value of the asset is calculated by discounting the aggregate projected future income stream (using one of a variety of different discount methods) to reflect risk associated with the projected income stream.

The valuation process is critical to developing a strong IP strategy, and is also important for internal decision making, including capital investment, R&D, and business and product development. In order to leverage a company's IP, it is imperative to know what IP assets a company has, and to have, at minimum, an idea of the value of those IP assets. Equipped with this knowledge, counsel can maximize their companies' or clients' competitive advantages by assisting with the leveraging of the IP assets.

Leveraging Your Company's Intellectual Property

In order for a company to extract maximum value from its IP, the company must develop and pursue a multifaceted intellectual property strategy that is much more complex than merely investing in, and acquiring IP assets. With an effective IP strategy, companies can achieve new opportunities and revenue streams from their existing IP assets, and they can develop or obtain access to new IP assets that open up new opportunities for their businesses. An effective IP strategy should include the efficient exploitation of the company's IP assets, as well as actively seeking, evaluating, and engaging in licensing, joint venture, and strategic alliance opportunities.

Due largely to ineffective IP management, companies actively use, on average, only 10-15% of their patent portfolios. While inactive IP assets may provide certain defensive advantages, companies can exploit these assets for financial gain by seeking out licensing partners, and actively licensing portfolio assets. Technology and brand licensing provide companies with a right to use IP assets without purchasing ownership rights in the IP assets. Licensing can be an incredibly valuable activity, and often is the centerpiece of a company's IP leveraging strategy. Technology licensing includes both in-licensing and out-licensing. In-licensing allows companies to expand their portfolios by licensing valuable technologies from other organizations. Companies can in-license complementary technologies to expand existing business and product lines, or platform technologies to expand into new areas and products. In-licensing can also enable companies to practice their own technologies without infringing problematic third party IP rights. Out-licensing allows companies to generate income by allowing others to use their technologies. Effective licensing requires companies to identify and target potential opportunities, negotiate the terms and conditions of license agreements, and manage post-deal arrangements and obligations.

Joint ventures and other types of partnership arrangements (e.g., strategic partnering, co-branding, cross-licensing, and strategic alliances and partnerships) can afford tactical advantages to participants in joint research, collaborative working relationships, and product promotion, distribution, and commercialization. By identifying and engaging in relationships with partners, companies can achieve mutually beneficial advantages, such as market intelligence, improved revenue streams attributable to enhanced R&D, licensing income, reputational clout, and the potential for mergers, acquisitions, divestitures, and collaborative arrangements.

To efficiently engage in licensing, joint ventures, and other strategic alliance opportunities, a company must be aware of the market for its IP assets, as well as comparable markets. In this respect, monitoring competitors' activities, engagements, and IP and product developments can be very helpful.

Whether bringing technology in, or licensing it out, companies must perform appropriate due diligence, including internal analyses, market research, and ascertaining whether IP is fully protected. It is often the responsibility of corporate counsel to spearhead these due diligence efforts.

Conclusion

The development of an IP strategy focused on leveraging IP assets is one of the most important strategic initiatives that a company can undertake. The first step of performing an audit to identify all company IP assets can lead to a better understanding of the breadth and nature of the assets in a company's IP portfolio.

It is often advantageous for corporate counsel to be involved in activities related to the generation of IP in order to ensure that all legal requirements are being satisfied in order to protect the IP (such as protecting confidential information, and avoiding activities that could preclude patent protection). Indeed, history is replete with horror stories involving forfeited IP rights, whose loss or conversion could have been avoided by early involvement of counsel in investment and R&D decisions, and in dealings with employees and third parties.

In-house counsel can help to protect and preserve IP rights by being involved in IP strategy development and maintenance, and by having at their disposal a toolkit of forms (e.g., NDAs, licenses, and employee and independent contractor agreements with IP assignment provisions and restrictive covenants) that can be quickly implemented to guard the integrity of their company's IP. Further, counsel should be apprised of, and should review, all IP legal documents being negotiated and entered into with third parties. Counsel should also ensure that employees who use and have access to confidential information are trained on how to use (and avoid misusing) the information, and how to properly protect the information. Taking these steps will help to secure the integrity and value of a company's IP assets, and will allow for the continued leveraging of those assets. Strategic partnering with outside counsel can also assist in securing and maintaining IP rights.

The valuation of IP assets is imperative to understanding the value of a company's IP portfolio. Generally, it is impossible for objective accounting standards to adequately represent the value of a company's intangible assets, so the value of IP assets is often inadequately represented on company books. In order to efficiently and effectively leverage IP assets, their value must be appreciated.

Following valuation of IP assets, leveraging initiatives can be reviewed and implemented. The success of any IP strategy depends, ultimately, on the effective leveraging of IP to create competitive advantages for a company. If a company has not already designated a team or individual to oversee its IP strategy and management activities, it is an important step to take to fully exploit the company's IP. Indeed, after creating a global director of intellectual asset and capital management position, Dow Chemical's intellectual property licensing revenue increased from $25 million to $125 million, and its intellectual property maintenance costs were reduced by $50 million.

By understanding the significant role of IP in a business, and advising their clients on the importance of developing and implementing a comprehensive IP strategy, corporate counsel can help to extract value from IP assets, and translate that value from intangible assets to company books.

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Protecting Your Intellectual Property by Staying Informed and Knowing Your Options

By Albert L. Jacobs, Jr., L. Donald Prutzman and Andrew Berger

Effective intellectual property use can often involve choices concerning where and how to protect intellectual property, in what forum to enforce a business's rights, or what intellectual property to use, or not use, to steer clear of infringement. Understanding the ramifications of various choices enables a business to make sound, informed decisions concerning intellectual property matters. We highlight three examples in this article, each concerning one of the three primary types of intellectual property—patents, trademarks and copyrights. Part A discusses making an informed choice of forum for enforcing a patent. Part B explains the complex network of choices for protecting trademarks in today's global economy. Part C highlights a recent Supreme Court decision upholding Congress' resurrection of numerous foreign works from the public domain and gives guidance concerning enforcement of rights in, and avoidance of infringement of, restored works.

A. The International Trade Commission ("ITC") or the Federal Court: Which Forum Is Best for Patent Owners?

The ITC—The International Trade Commission offers an administrative proceeding in which the sole remedy the Complainant (Plaintiff) can obtain is an Exclusionary Order, *i.e*. countrywide permanent injunction. The Exclusionary Order prevents importation of a patented product or a product made by patented process, even though the process was performed outside the United States. The ITC is an *in rem* proceeding and not an *in personam* proceeding so that it can reach foreign companies not otherwise subject to Federal Court jurisdiction. Its jurisdictional basis is 19 U.S. C. § 1337, or 337 proceeding in short. There are three additional distinct differences between an ITC proceeding and a Federal Court proceeding for patent infringement:

- The ITC is a three party proceeding:
  - i. The Complainant;
  - ii. The Respondent;
  - iii. The Office of Unfair Import Investigations ("OUII"), which looks after the public interest.
- The ITC can only prevent the importation of a product into the United States. If a product is made in the United States, the ITC has no jurisdiction.
- The patent owner must have a "domestic industry" in the subject matter of the patent in suit.

While the threshold for domestic industry is low, holding companies or non-practicing entities are not candidates for the ITC unless they license United States manufacturers who practice patents which are the subject of the 337 action.

United States Federal Courts—Patent actions are brought in the District Courts of the United States. Personal jurisdiction is required over the Defendant and venue must be properly laid for the action to be sustained. Under recent decisions interpreting the sufficiency of complaints, a prudent patent owner who sues in the Federal Court should not only allege ownership of the patent, but describe in some detail how the Defendant is infringing the patent and then ask for the desired relief. A patent owner who relies solely on Federal Form 18 to plead ownership of the patent and that the Defendant is engaged in infringing acts is likely to be subject to a Motion to Dismiss for Failure to State a Claim. The Federal Courts cannot reach a foreign Defendant, unless it is subject to the court's jurisdiction by virtue of doing business in the United States or is otherwise engaged in acts which subject it to the "Stream of Commerce" kind of cases.

Damages—Only the Federal Court can award damages for patent infringement. Thus, one reason to bring a Federal District Court proceeding is to seek damages rather than the Injunctive Relief the ITC offers. However, at the time the ITC complaint is filed, a parallel District Court proceeding may also be filed. Such a District Court action would, on application by the Respondent(s), be stayed pending the outcome of the ITC case. It is also possible to bring a later District Court action for damages after a successful ITC proceeding.

Domestic Industry—While the threshold to show a Domestic Industry in the subject matter of the patent is fairly minimal, there are some unsettled questions as to what constitutes a Domestic Industry. It is clear that if the patent owner is manufacturing product covered by the patent, there is a Domestic Industry. Difficulties arise when the patent owner has not manufactured, offered for sale or sold infringing product in the United States, but has begun substantial activities toward that end. Leasing land, building a plant and/or hiring executives as a prelude to sales have generally been found to satisfy the Domestic Industry requirement. There is some case law to the effect that significant litigation expenses directed toward forcing or assisting a licensing program may constitute a "Domestic Industry." There is also uncertainty about whether a Domestic Industry is established by a patent owner who has the components of the patented products manufactured outside the United States and merely assembles the finished product in the United States. The extent of the assemblage is a relevant factor as is the nature of the components. Surely, a patent owner would present a strong argument for "Domestic Industry" if the patented product was made up of a novel combination of readily available components so that it did not make economic sense for the patent owner to actually manufacture the components when they could be more readily and less expensively obtained from existing sources. If all the assemblage of the product took place in the United States, that activity will probably be sufficient to constitute a Domestic Industry.

Choosing Between the Two Forums—When weighing the pros and cons of an ITC 337 action versus a Federal District Court infringement suit, the overriding considerations are: 1) injunctive relief versus damages; 2) is the allegedly infringing product being imported into the United States as opposed to being domestically produced; and 3) does the patent owner have a domestic industry in the patented subject matter?

Since the ITC only grants Injunctive Relief by issuing an exclusionary order, the four-prong test (likelihood of success, irreparable injury, balancing the equities and the public interest) is not applied at the ITC. While the ITC cannot grant damages for patent infringement, the patent owner is not precluded from either bringing a parallel District Court action for patent infringement which would be stayed pending the ITC decision or bringing a subsequent District Court action, if successful at the ITC, to collect damages.

Types of Relief at ITC—The most common Order the ITC grants is a Limited Exclusionary Order, which precludes a Respondent from importing the infringing product. A General Exclusionary Order may be granted when the importation is shown to be so widespread that a Limited Exclusionary Order would be ineffective. The General Exclusionary Order precludes product which is alleged to infringe from importation, regardless of the source. A Cease and Desist Order is issued to a U.S. distributor or other party which has an inventory of infringing product. A Cease and Desist Order freezes the inventory and could, under appropriate circumstances, result in destruction of the inventory.

ITC Is a Rocket Docket—The ITC is a "rocket docket" type of proceeding, but of course one can find rocket dockets in a number of District Courts. Thus, the rapidity of the action can be an important strategic factor, but it is really the ability to get rapid Injunctive Relief that can be the overriding consideration in using the ITC, assuming that importation of the infringing product is occurring or likely to occur and that the patent owner has a domestic industry in the patented subject matter.

Additional ITC Advantages—While the new AIA legislation has created District Courts where presumably one can obtain a District Court judge experienced in patent matters, the Administrative Law Judges, ("ALJs") at the ITC are all patent savvy and present a better opportunity to ensure that your patent matter will be heard by a judge conversant with the technology or not afraid to learn it. At the ITC, delaying tactics are very difficult, so the patent owner can be sure of a fairly rapid conclusion, rarely more than 18 months. The ITC schedule is set in an initial conference among the parties and fixes a date for the ALJ to issue his Initial Determination ("ID"), as well as the date for the Commission to render its decision on an appeal from the ALJ's ID. While discovery, motions and other dates set between the institution of the proceeding and the trial may be adjusted slightly, the trial date and the date for issuance of the ID almost never move. In contrast in the District Courts, except for a few rocket dockets, dates are frequently moved and Defendants can engage in various delaying tactics which may not be in the best interest of the patent owner.

Summary—The ITC vs. the Federal District Courts requires balancing Injunctive Relief vs. Damages (which can be obtained later in a Federal Court Proceeding). But the ITC is only available as a forum when there is importation of a product (which is to be enjoined/precluded) and there is a "Domestic Industry" in the subject matter of the patent.

B. Protecting Trademarks in the Global Arena: An Array of Options for the U.S. Trademark Owner

Businesses planning to expand the global reach of distribution of their branded goods and services also need to plan for the expansion of international protection of their trademarks. There are several ways for U.S. trademark owners to secure international protection, each with its own advantages and drawbacks. Securing the best and most efficient protection in the jurisdictions where it is needed requires knowledge and consideration of all available methods and the pros and cons of each.

All international trademark protection is based on a "territorial" theory of international law under which a "trademark" only exists in jurisdictions where it is protected (either by registration or, in some cases, actual use) and that protection does not extend beyond the borders of those jurisdictions. There is a possible exception for "well-known" marks, which may be entitled to some protection in jurisdictions where they are famous under a widely subscribed multi-lateral treaty known as the "Paris Convention." However, most trademarks will not have sufficient "fame" to merit this protection.

Thus, initially, those guiding the international expansion of a brand need to be sure that protection is in place when and where it is needed. Ideally, that is before goods or services begin to flow to a new jurisdiction. A business should evaluate where it expects to be expanding over the next three to five years and begin the process of getting protection in place. Where popular brands with obvious expansion potential are involved it is advisable to look even farther into the future. Otherwise, a business may find that some enterprising, but unscrupulous, person has already registered its brand in one or more target jurisdictions in the hope of realizing a profit from sale of the mark to the "legitimate" trademark owner.

If possible, a business should seek international protection within six months of filing its U.S. trademark application. That is because the Paris Convention, referred to above, affords international applicants a six-month "priority" period. International applications filed within that period are deemed filed as of the U.S. filing date and will have priority over applications filed between that date and the actual foreign filing date. Having "priority" lessens the possibility that a prior filed application will interfere with the protection a business is trying to obtain.

Once a business decides where it wants protection, it must determine what method or combination of methods of securing international protection will best serve its needs. Three methods are potentially available:

- Individual country registrations filed with the trademark offices in each jurisdiction;
- An "International" registration filed with the U.S. Patent & Trademark Office and administered by the World Intellectual Property Organization ("WIPO") in Geneva; and
- "Supranational" registrations that afford protection in a group of countries through one registration.

Each has benefits and detriments, and the latter two methods are not available as alternatives for all jurisdictions. Accordingly, an international trademark protection program is likely to involve a well-considered combination of the three methods.

Individual Country Registrations—The one method of protection available in virtually all countries is registration with the country's trademark office. It is the only method currently available for some important countries, for example, Canada and most Latin American countries. The primary benefits of individual country registration are that only existing registrations in that country can potentially interfere with the registration sought, and that it is generally the fastest method of obtaining protection in a country. The drawbacks include the need for counsel in each country and the need to renew the registration in each country periodically.

International Registration—A multi-lateral treaty known as the "Madrid Protocol" provides for "International" registration of U.S. trademarks. Currently, 86 countries subscribe to the treaty. A U.S. trademark owner can file an "International" application with the U.S. Patent & Trademark Office, which forwards the application to the WIPO. The applicant can seek protection in any combination of jurisdictions that subscribe to the Madrid Protocol. The benefits of this method, where available, are the ability to have U.S. counsel make the application and avoid the expense of local counsel, and the ease of having only one registration to renew. However, each designated country's trademark office must review the application and determine, within 18 months, whether protection will be extended to that country. If there are problems in a particular country, local counsel will be required. In addition, if the U.S. registration fails for some reason, or is successfully attacked within five years, the "International" application disintegrates into a group of individual country applications with the attendant need to retain local counsel and renew individually.

There are two principal drawbacks to the "International" registration. First, its coverage is limited to the 86 signatory countries. Currently, there is no coverage in North America, very little coverage in Latin America or Africa, and spotty coverage in Asia. That problem is, however, beginning to change. Colombia has recently acceded to the Madrid Protocol, and Panama and Mexico are expected to do so soon. The U.S.'s trade policy of requiring accession to the Madrid Protocol as a condition of new free trade agreements should also increase the number of member countries.

The second problem with "International" registrations for U.S. trademark owners is that the description of goods and services in the "International" registration must mirror the U.S. application. The U.S. requires more specific descriptions than most other countries. This, in turn, leads to narrower coverage in foreign countries than might be available through individual country, or supranational, registrations. In certain situations, it may be advantageous to use one of the other alternatives to obtain a broader goods and services description in foreign registrations despite greater cost.

Supranational Registrations—A supranational registration grants protection in a particular group of countries that have agreed to offer group protection. The most important supranational registration is the Community Trademark ("CTM"), which offers protection in all EU countries through one registration. The primary benefits of the CTM are the broad coverage it offers, the requirement that the mark be used in only one EU country to support protection in all, and the availability of a pan-EU injunction in litigation. The main detriment is the cost, which exceeds $5,000, including filing fees. In general, if protection in three or fewer EU countries is the primary goal, then individual applications in those countries are more cost efficient.

Other drawbacks to the CTM include the requirement that each country's trademark office, in addition to the OHIM, examine and accept the application. If any country refuses registration, the entire CTM is disaggregated into a bundle of individual applications with the attendant drawbacks. In addition, the CTM does not include Norway or Switzerland, which are not part of the EU. Thus, depending on the circumstances, use of an "International" application, which permits a U.S. applicant to designate protection in Norway, Switzerland and the EU, as well as other countries, may be a better alternative.

Other supranational registrations are available for the Benelux countries and two groups of African nations. Each is somewhat different from the CTM, but the general considerations are similar.

In summary, obtaining the international trademark protection necessary in today's global economy requires advance planning and careful, informed choices among the international trademark protection options available.

C. *Golan v. Holder*: Copyright Restoration—Protecting and Avoiding Infringement of Former Public Domain Works

On January 18, 2012, the Supreme Court in *Golan v. Holder* upheld the constitutionality of § 514 of the Uruguay Round Agreements Act codified at 17 U.S.C. § 104A. That section restored copyright protection to millions of works coming from members of the Berne Union and the World Trade Organization ("WTO") that had fallen into the public domain in the U.S. for various technical reasons, such as failure to renew a registration, publication of the work without a copyright notice, or lack of copyright relations between the U.S. and the country of origin of the work. Congress enacted § 514 to comply with its obligations under the Berne Convention, which the U.S. joined effective March 1, 1989.

The restored works include Sergei Prokofiev's Peter and the Wolf, music by Stravinski, paintings by Picasso; and writings by George Orwell and J.R.R. Tolkien.

The *Golan* Case—The *Golan* petitioners, who had enjoyed free use of these works for years, challenged the restoration. They argued that § 514 exceeded Congress's authority under the Copyright Clause in Article I of the Constitution and therefore violated their First Amendment free speech rights. The Court, in a 6-2 majority opinion written by Justice Ruth Bader Ginsburg, rejected these arguments.

In summary, the Court, after examining the text of the Copyright Clause, historical practice and precedents, found no "barrier" to Congress' authority to enact § 514. The Court "declined to infer from the text of the Copyright Clause 'the command that'" a term of copyright, once set, becomes forever "fixed or inalterable."

Turning to the First Amendment, the Court stated there was no reason for heightened review because § 514 "leaves undisturbed" copyright's "built-in First Amendment accommodations," the fair use defense and the idea/expression distinction. Justice Ginsburg had, in *Eldred v. Ashcroft*, labeled these safeguards the traditional "contours of copyright." The Court added that works do not cease to serve the public interest when restored; they simply become subject to copyright and therefore must be licensed.

Golan thus makes clear that, if Congress amends copyright law in the future, the amendment will not face heightened scrutiny unless it alters the "First Amendment accommodations" of fair use or the idea/expression distinction.

Guidance Going Forward—Here is some guidance for dealing with restoration issues:

- The date of restoration is January 1, 1996 if the source country was a Berne or WTO member, or thereafter when a source country joins Berne;
- The copyright term for restored works subsists for the remainder of the term of copyright the work would have enjoyed in the U.S. if the work had never entered the public domain;
- Upon restoration a party who did not exploit the work when it was in public domain may not now do so without a license;
- If the restored work is in the public domain in the source country, the work does not gain copyright protection here;

- Title to the work vests in the author or initial rights holder of the restored work as determined by the law of the source country;
- A reliance party is one who exploited the work on an ongoing basis before it was restored and would have infringed the work if it had been protected by copyright;
- Owners of restored works can bring suit against a reliance party only after either filing with the Copyright Office within 24 months of restoration a notice of intent to enforce or serving a notice of intent to enforce on the reliance party;
- The reliance party, however, has a one-year grace period after receiving notice and before suit may be filed to sell off its version of the restored work or attempt to negotiate a license with the owner; and
- Owners of derivative works made from foreign restored works may continue to exploit the works for the remainder of the copyright term by paying a reasonable royalty.

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Clarifying Some Gray Areas of Copyright Law

By Lisa W. Rosaya and Michael J. Bales

I. Introduction

A company selling goods in both the U.S. and foreign markets will typically devote extensive research and consideration in determining how best to market, distribute, and price the goods in the selected markets. Despite the great care taken in these decisions, however, these companies are often unable to control the unauthorized re-importation of these goods back into the U.S. market, a practice known as "parallel importation." These genuine goods, which are intended for sale in foreign countries, but are resold in the U.S. without the authorization of the manufacturer, are commonly called "gray market goods," and they can create many problems for brand owners. Because goods intended for foreign markets are typically sold at a lower price than their U.S. counterparts, gray market goods can be resold in the U.S. for a lower price, effectively competing with the goods sold by authorized U.S. distributors. Additionally, parallel importation may negatively impact the public's perception of a product or brand. For example, when luxury items are offered in discount or big-box stores, this may contradict the brand's "elite" image. One analysis found that the gray market costs manufacturers up to $63 billion in sales per year.[1]

The Lanham Act has been the typical tool that brand owners have used to limit the sale and importation of gray market goods. Generally speaking, under the Lanham Act, a trademark owner can prevent the importation of genuine goods bearing the trademark if the goods in question did not undergo the same quality control procedures as the domestic goods, or if there are material differences between the foreign and domestic goods.[2] Where identical versions of trademarked goods are distributed in the U.S. and abroad, however, the Lanham Act does not provide protection. In these situations, some U.S. brand owners have turned to the U.S. Copyright Act, which provides the copyright owner a number of exclusive rights, including the exclusive rights to distribute or authorize the distribution of the copyrighted work, including importation into the U.S.[3]

While copyright has the potential to be a valuable tool to control the flow of gray market goods, some questions remain regarding the limiting effects of the first sale doctrine and the equitable defense of copyright misuse. Two pending cases will hopefully clear up this uncertainty, and give direction for brand owners concerned by gray market goods. Section II of this article will discuss how the first sale doctrine may frustrate efforts to use copyright to prevent the sale and importation of gray market goods. Section III will discuss the equitable defense of copyright misuse. Finally, Section IV will discuss the main takeaways from recent cases and provide tips for effective distribution and brand management strategies.

II. Reconciling the Copyright Owner's Importation Right with the First Sale Doctrine

As discussed above, the importation of a copyrighted work into the U.S. without authorization constitutes a violation of certain of the copyright owner's exclusive rights.[4] Accordingly, the copyright owner may bring an action for copyright infringement against the entities involved in the parallel importation of copyrighted works. Under Section 602(a)(1) of the Copyright Act, the unauthorized importation into the U.S. of a copyrighted work constitutes an infringement of the copyright holder's exclusive right of distribution provided by Section 106(3).[5] Parallel importers, who must first purchase the goods from authorized distributors, typically claim that their actions are lawful under the first sale doctrine, which is embodied in Section 109(a) of the Copyright Act.[6] This doctrine provides that the purchaser of a work "lawfully made" under the Copyright Act has the right to re-sell it without the permission of the copyright holder, effectively cutting off the copyright holder's ability to control the distribution of that particular work.[7] The interplay between the conflicting rights of the importer, under the first sale doctrine, and the copyright owner, under Sections 106(3) and 602(a)(1), is at the center of the two recent cases discussed herein: *Omega S.A. v. Costco Wholesale Corp.* and *John Wiley & Sons Inc. v. Kirtsaeng d/b/a Bluechristine99*.

The applicability of the first sale doctrine to imported goods was considered by the Supreme Court in the case of *Quality King Distributors, Inc. v. L'anza Research Int'l, Inc.*[8] This case addressed the unauthorized distribution of L'anza's hair care products (and accompanying copyrighted labels) by Quality King, which purchased the U.S.-manufactured goods abroad through an authorized distributor and then re-sold them in the U.S.[9] The Supreme Court held that, under the first sale doctrine, Quality King did not need L'anza's authorization to re-sell the products.[10] In a concurring opinion, however, Justice Ruth Bader Ginsburg noted that the facts of *Quality King* involve "a 'round trip' journey, travel of the copies in question from the United States to places abroad, then back again" and that the Court did not "resolve cases in which the allegedly infringing imports were manufactured abroad."[11] Justice Ginsburg reasoned that, due to the presumption that the Copyright Act does not apply extraterritorially unless expressly stated, the words "lawfully made under this title" in Section 109(a) must mean "lawfully made in the United States."[12] The ambiguity highlighted by this concurrence persists, and is evident in the cases of *Omega S.A. v. Costco Wholesale Corp.* and *John Wiley & Sons Inc. v. Kirtsaeng d/b/a Bluechristine99*.

A. First Sale in the Ninth Circuit: *Omega S.A. v. Costco Wholesale Corp.*

The case of *Omega S.A. v. Costco Wholesale Corp.* concerns the distribution of Omega's "Seamaster" watches.[13] These watches are made in Switzerland and, at the time the suit was brought, sold in the U.S. for a suggested retail price of $1,995. Costco, however, was able to secure a much better price from a foreign distributor, and imported the watches into the U.S., where it resold them for $1,299.

Omega could not sue Costco for trademark infringement as a result of this parallel importation, because the Seamaster watches that Costco imported and sold were identical to the watches sold by Omega's U.S. distributors and all of the watches in question were manufactured in Switzerland under the control of Omega. On the back of each Seamaster watch, however, Omega had engraved its "Omega Globe Design," for which it owns a U.S. copyright registration.[14]

Omega sued Costco for copyright infringement, alleging that by importing the copyrighted emblems affixed to the back of each Omega watch, without Omega's authorization, Costco violated Sections 106(3) and 602(a)(1) the Copyright Act.[15] The trial court, however, was persuaded that the first sale doctrine applied, and granted summary judgment to Costco on the basis that Omega's right to control the distribution of the watches was extinguished when they were first sold.[16] On appeal, the Ninth Circuit reversed, finding that the first sale doctrine is not a defense to an infringement claim for imported works that were made abroad.[17] Prior cases in the Ninth Circuit parsed the language of Section 109(a) of the Copyright Act, which limits the distribution rights as to works "lawfully made under this Title."[18] As suggested in Justice Ginsburg's *Quality King* concurrence, these cases found that a work that is manufactured and sold outside of the U.S. is not "lawfully made under this Title," and thus not subject to the limitations of the first sale doctrine unless first sold in the United States with the copyright owner's authority.[19] Accordingly, the Ninth Circuit held that Costco's unauthorized importation of the watches constituted a violation of Sections 602(a)(1) and 106 of the Copyright Act.[20]

Costco appealed to the U.S. Supreme Court, which granted certiorari, and it appeared that there would be a definitive ruling as to the applicability of the first sale doctrine to copyrighted works manufactured abroad. The Court, however, deadlocked at 4-4, which had the effect of upholding the Ninth Circuit's decision.[21] Since the appeal only dealt with Costco's defense under the first sale doctrine, the case was then remanded to the district court to address Costco's other defense, copyright misuse, which will be discussed in the next section.

B. In the Second Circuit: *John Wiley & Sons Inc. v. Kirtsaeng d/b/a Bluechristine99*

Fortunately, another chance for clarification from the Supreme Court presents itself in *John Wiley & Sons Inc. v. Kirtsaeng d/b/a Bluechristine99*.[22] In this case, the Second Circuit weighed the first sale doctrine against Sections 106(3) and 602(a)(1) of the Copyright Act, with similar results.[23] John Wiley & Sons is a textbook publisher that produces separate editions of its textbooks for distribution outside of the U.S., which are of a slightly lower quality, do not have all of the same features that are available with the U.S. editions, and are sold at a much lower price. A student from Thailand named Supap Kirtsaeng, attending college in the U.S., had friends purchase the foreign editions of the textbooks and ship them to him in the U.S. By reselling these books on eBay.com and similar sites under the username "Bluechristine99," Kirtsaeng realized a profit of approximately $37,000.

When John Wiley & Sons sued Kirtsaeng in the Southern District of New York for copyright infringement, the trial judge barred Kirtsaeng from raising the first sale doctrine as a defense, ruling that the doctrine does not apply to copies of works manufactured outside of the U.S.[24] The jury ruled in Wiley's favor, awarding statutory damages in the amount of $600,000.[25] On appeal, the Second Circuit affirmed the ruling.[26]

Kirtsaeng filed a petition for certiorari, which the Supreme Court granted on April 16, 2012.[27] A ruling by the Supreme Court on this issue has the potential to provide some much-needed clarity, and observers such as the American Intellectual Property Law Association, who filed an amicus brief, urge the Supreme Court to "clarify the scope of the first sale doctrine as it applies to copies made in a foreign country, as the resolution of this issue is of substantial importance to owners as well as purchasers of copies of copyrighted works."[28] Due to the widespread implications of the ruling, other interested parties include: museums, who frequently rely on the first sale doctrine to display art without first obtaining permission from the artist;[29] libraries, who may no longer be able to lend copyrighted works originating from outside the U.S. if the first sale doctrine does not apply to those works;[30] and drugstores, who under the Second Circuit's ruling may need to be cognizant of the place of manufacture for the goods it sells as well as how they were acquired.[31] These parties, along with brand owners, importers, retailers, scholars, and anyone else concerned about the impact of gray market goods all eagerly anticipate the Court's handling of this case during the October term.

III. Copyright Misuse—Another Potential Hurdle for Brand Owners

While copyright law may aid in the prevention of parallel importation and its accompanying challenges, copyright protection is not available for "useful articles," such as Omega's watches.[32] This is why Omega's copyright registration covers only the Omega Globe Design placed on the back of the watch, and not the design of the watch itself—as the latter would generally not be copyrightable. Costco argues that by using the copyrighted design to prevent the distribution of the watches, Omega is trying to improperly extend copyright protection to the watches as a whole. This is the idea behind the equitable defense of "copyright misuse": that a copyright owner is trying to use copyright law to obtain rights that copyright is not intended to confer.

The Central District of California granted Costco's motion for summary judgment, finding that Omega's use of the Omega Globe Design on its Seamaster watches constitutes copyright misuse.[33] In the order granting the motion, Judge Terry Hatter, Jr. states that:

> Omega concedes that a purpose of the copyrighted Omega globe design was to control the importation and sale of its watches containing the design, as the watches could not be copyrighted. Accordingly, Omega misused its copyright of the Omega Globe design by leveraging its limited monopoly in being able to control the importation of that design to control the importation of its Seamaster watches.[34]

Omega has appealed, arguing that it is merely using its copyright to control areas within its limited monopoly, *i.e.* to control the distribution of its copyrighted work. Thus, the case is again before the Ninth Circuit, and has drawn a lot of attention from stakeholders as well as scholars, including a group of 19 law professors who filed an amicus brief urging the Ninth Circuit to affirm the District Court's decision.[35]

Copyright misuse is not a concern for manufacturers of goods like the textbooks offered by John Wiley & Sons, as the product itself is the copyrightable expression. For manufacturers of goods that would be considered useful articles by copyright law, however, the outcome of this case will have a critical impact on the availability of copyright to combat parallel importation.

IV. Conclusion

In light of the current state of ambiguity on the applicability of the first sale doctrine to foreign-made goods, and the unclear contours of copyright misuse, there are several things that a brand owner should keep in mind when considering copyright law's potential to stemming the tide of gray goods being imported into and sold in the U.S.

First, bear in mind that a brand owner must obtain a copyright registration before bringing a suit for infringement. While this registration can be obtained at any time before filing suit, statutory damages and attorney's fees are only available to domestic copyright holders where the copyright was registered before the infringement in question. Due to these benefits, and the low cost and ease of obtaining a copyright registration, brand owners should not wait to obtain a copyright registration.

As demonstrated in the *Costco* and *Wiley* cases, the first sale doctrine may not apply where the work in question was created outside of the U.S., whereas it is settled law under *Quality King* that the first sale doctrine applies to goods that are manufactured in the U.S. and then sold abroad.[36] Accordingly, if a brand owner wishes to control the distribution of copyrighted works outside of the U.S., those works should also be manufactured outside of the U.S. in order to avoid the application of the first sale doctrine in the Second or Ninth Circuit. In the event that the Supreme Court affirms the Second Circuit's ruling in the *Wiley* case, this strategy will avoid the application of the doctrine in any circuit.[37]

It is important to remember that copyright is not available for useful articles, such as the watches in the *Costco* case. Manufacturers of useful articles should consider incorporating designs that are clearly separable from the utilitarian aspects of the product, and are thus copyrightable. The *Costco* case suggests, however, that this approach may be vulnerable to an allegation of copyright misuse if it appears that the real motivation is to obtain protection akin to trademark, or to protect goods which are not copyrightable. It may be easier to rebut such a claim if the copyrighted design is featured prominently enough that there is no question that the brand owner's primary intention is to protect the copyrightable work.

Finally, while copyright can potentially serve as a valuable tool in this regard, in light of current uncertainty, copyright should be considered only a supplemental form of protection, in addition to any supply chain and distribution controls already in place. Where available, utilizing the Lanham Act remains a key component to any strategy to combat gray market goods. Thus, brand owners should maintain high quality-control standards, and ensure that any goods distributed abroad are materially different from goods distributed in the U.S. under the same marks.

Anyone concerned about the impact of gray market goods is closely watching the *Costco* and *Wiley* cases, as the rulings in these cases will significantly impact a brand owner's ability to control gray market goods and the issues parallel imports raise in connection with brand image and loss of profits. Hopefully further clarification will be provided to this gray area of copyright law, aiding the development of more well-defined global distribution and enforcement plans.

Endnotes

1. Greg Stohr, *Discounted 'Gray Market' Goods Draw Top U.S. Court Review*, Bloomberg, Apr. 16, 2012, http://www.bloomberg.com/news/2012-04-16/discounted-gray-market-goods-draw-top-u-s-court-review.html.
2. *See e.g. Societe des Produits Nestle, S.A. v. Casa Helvetia, Inc.*, 982 F.2d 633 (1st Cir. 1992); *Zino Davidoff SA v. CVS Corporation*, 571 F.3d 238 (2d Cir. 2009).
3. 17 U.S.C. §§ 106(3), 602(a)(1).
4. *Id*.
5. *Id*.
6. 17 U.S.C. § 109(a).
7. *Id*.
8. *Quality King Distributors, Inc. v. L'anza Research Int'l, Inc.*, 523 U.S. 135 (1998).
9. *Id*.
10. *Id.* at 145.
11. *Id.* at 154 (Ginsburg, J., concurring).
12. *Id*.
13. *Omega S.A. v. Costco Wholesale Corp.*, 541 F.3d 982 (9th Cir. 2008).
14. *Id.* The Omega Globe Design is the subject of United States copyright registration number VAu 574-660.
15. *Id*.
16. *Id*.
17. *Id*.
18. *See, e.g., BMG Music v. Perez*, 952 F.2d 318 (9th Cir.1991), *Parfums Givenchy, Inc. v. Drug Emporium, Inc.*, 38 F.3d 477 (9th Cir. 1994), and *Denbicare U.S.A. Inc. v. Toys "R" Us, Inc.*, 84 F.3d 1143 (9th Cir. 1996).
19. *Id*.
20. *Omega S.A. v. Costco Wholesale Corp.*, 541 F.3d 982 (9th Cir. 2008).
21. *Costco Wholesale Corp. v. Omega S.A.*, 131 S. Ct. 565 (2010). Justice Elena Kagan recused herself from the case, due to her prior involvement in the case when she was Solicitor General, leaving a total of eight justices to decide on the case.
22. *John Wiley & Sons Inc. v. Kirtsaeng d/b/a Bluechristine99*, 654 F.3d 210 (2d Cir. 2011), *cert. granted*, 566 U.S. 2 (Apr. 16, 2012) (No. 11-697).
23. *Id*.
24. *Id*.
25. *Id*.
26. *John Wiley & Sons Inc. v. Kirtsaeng d/b/a Bluechristine99*, 654 F.3d 210 (2d Cir. 2011), *cert. granted*, 566 U.S. 2 (Apr. 16, 2012) (No. 11-697).
27. *Id*.
28. Brief for American Intellectual Property Law Association as Amici Curiae Supporting Neither Party, *Supap Kirtsaeng d/b/a Bluechristine99 v. John Wiley & Sons, Inc.*, 566 U.S. 2 (Apr. 16, 2012) (No. 11-697).
29. Brief of the Association of Art Museum Directors, et al. as Amici Curiae in Support of Petitioner, *Supap Kirtsaeng d/b/a Bluechristine99 v. John Wiley & Sons, Inc.*, 566 U.S. 2 (Jul. 9, 2012) (No. 11-697). This group of museums notes in its brief that Section 104 of the Copyright Act "makes the full range of U.S. copyright protections and limitations applicable to all eligible works, and it makes no distinction based on where a work or a copy of it was manufactured." *Id.* at 17. Additionally, they argue that the Second Circuit's ruling will force museums to seek licenses from copyright owners, which would be difficult and expensive. *Id.* at 3.
30. Brief of Amici Curiae of the American Library Association, et al. in support of Petitioner, *Supap Kirtsaeng d/b/a Bluechristine99 v. John Wiley & Sons, Inc.*, 566 U.S. 2 (Jul. 3, 2012) (No. 11-697). The library associations also urged that, if the Second Circuit's ruling is upheld, the Supreme Court should lessen the impact on libraries by 1) allowing parties to raise the first-sale defense in copyright cases involving foreign-manufactured copies so long as a lawful domestic sale had occurred; 2) holding that the the library exception in 17 U.S.C. § 602(a)(3)(C) applies to lending as well as importing; and 3) holding that library lending constitutes a fair use under 17 U.S.C. § 107. *Id.* at 5.
31. Brief of the Retail Litigation Center, Inc., et al. as Amici Curiae in Support of Petitioner, *Supap Kirtsaeng d/b/a Bluechristine99 v. John Wiley & Sons, Inc.*, 566 U.S. 2 (Jul. 9, 2012) (No. 11-697). This group of retailers, which includes Quality King Distributors, Inc., contend that the rulings in both the *John Wiley* and *Costco* cases are inconsistent with the Supreme Court's ruling in *Quality King*, and "cause undue disruption and uncertainty for retailers and distributors, who confront the risks of selling virtually any imported product that could have a copyrightable label, logo or insert." *Id.* at 24.
32. 17 U.S.C. § 101. Useful articles are defined as articles "having an intrinsic utilitarian function that is not merely to portray the appearance of the article or to convey information." *Id.*
33. *Omega S.A. v. Costco Wholesale Corp.*, No. 04-05443, slip op. at 4 (C.D. Cal. Nov. 9, 2011).
34. *Id*.
35. Brief of Intellectual Property Law Professors as Amici Curiae in Support of Defendant-Appellee and Affirmance, *Omega S.A. v. Costco Wholesale Corp*., case number 11-57137 (July 25, 2012). These professors argue that the "redistribution of the incidental copyrighted insignia on the useful articles" is fair use under copyright law, and that Omega is attempting to circumvent trademark law and create a "mutant form of copyright law." *Id.* at 28.
36. *Omega S.A. v. Costco Wholesale Corp*., 541 F.3d 982 (9th Cir. 2008), *John Wiley & Sons Inc. v. Kirtsaeng d/b/a Bluechristine99*, 654 F.3d 210 (2d Cir. 2011), *cert. granted*, 566 U.S. 2 (Apr. 16, 2012) (No. 11-697), *Quality King Distributors, Inc. v. L'anza Research Int'l, Inc.*, 523 U.S. 135 (1998).
37. Obviously, if the Supreme Court rules that the first sale doctrine applies to foreign-manufactured works, then copyright law will provide no protection against gray market goods.

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Intellectual Property Issues Relevant to the "Green" Economy

By Gaston Kroub

The sustainability revolution in goods and services continues on a global scale. From startups to established multi-national corporations, a global innovation boom in the area of "clean" or "green" technology continues. This boom is being fueled by various funding sources, including venture capital, government support, and corporate investment. As a result of these developments—and the resultant commercial importance of sustainable products and services—it is absolutely essential that companies of all sizes gain an awareness of the relevant intellectual property legal landscape. This landscape includes specific considerations relating to green patents/trade secrets, branding, and advertising. Those considerations are discussed separately below.

1. "Green" Patents and Trade Secrets

Imagine that you are in-house counsel for a large consumer products company and your R&D department has come up with an improvement to one of your companies' flagship products. Assume that this improvement results in significant savings of production materials, for example. Or that you are employed by a smaller company, perhaps even a cleantech-sector startup, where the technology you are attempting to commercialize is the literal lifeblood of your company. Either way, it is likely that your company will be interested in procuring patents to protect the new sustainable technology. And when it comes to patenting sustainable technologies, an understanding of the various "accelerated examination" schemes employed by patent offices worldwide is critical. For patents, and the licensing revenue they can generate, remain an important linchpin of any intellectual property strategy for the global economy.

At a minimum, both you and outside counsel should consider, as part of your patent strategy, whether there will be a global market for the new green technology. If so, you will want to consider which countries to focus on with respect to your patent applications. And if you are filing in countries like the UK, Japan, Israel, or Australia (among others) for example, you will also want to consider whether expediting your patent applications in those jurisdictions is desirable. More sophisticated strategies, such as targeting certain expedited patent programs in conjunction with patent reciprocity agreements, can be utilized for "mission critical" technologies.

For those whose patent energies are more focused domestically, it is important to be aware that while the USPTO has ended its nascent "Green Technology Pilot Program," there is still an option for expedited patent examination (technology-agnostic) available. Of course, faster examination is not always ideal, considering the earlier publication (and potential earlier disclosure of the new technology to an interested competitor) of the application(s) that usually results, either through earlier issuance or as part of an expedited program's requirements. There can also be more front-loaded costs involved with expedited examination, a reality that can pose difficulty for smaller companies or departments forced to adhere to stricter budgets.

At bottom, when it comes to green patents, awareness of the various expedited examination programs available worldwide, together with an understanding of their respective requirements is the key.[1] It is important to remember that some of these programs have very liberal standards when it comes to classifying a particular technology as "green," and thus qualified for expedited examination. And in the USPTO, the only barrier for entry is cost. Considering the commercial opportunities currently available for sustainable products and services, and the importance of strong patent protection to guard and perhaps further monetize the technology, it is likely that more companies will choose expedited examination in the USPTO for key green technologies. If that happens, companies will need to be even more diligent in tracking the patenting efforts of competitors, because of the increased risk of infringement allegations or being otherwise crowded out of potentially valuable technologies. At the same time, of course, companies will need to focus more carefully on their own patent strategies, particularly as they look to garner as much a return as possible on their investment into the innovation of "green" or sustainable technologies.

Of course, not every technology is best served from a protection perspective by patents. Just as a beverage company might want to keep the formulation of a top-selling product a secret, so might a cleantech-focused startup keep some of its proprietary technology under wraps for at least some amount of time. Whether the motivation for secrecy is to secure additional funding to later finance patent filings, continuing development work on the core technology, or any other reason, the ability to maintain technological insights as a trade secret will always be a valuable option for some companies. And because of the proliferation of cleantech-focused startups, some of which are no more than an as yet unfunded "good idea," there will always be a need to consider trade secret protection as an alternative to patenting. Likewise, sophisticated companies, particularly those with competitors attuned to their patent filings, will also consider maintaining secrecy regarding at least some aspects of their technology. Ultimately, it is up to in-house and outside counsel to explore the various options regarding trade secrets in the "green" context, and make sure that this potentially valuable alternative to patenting is not ignored in the rush to build a robust portfolio.

Finally, it is important to be aware of the increasing risk of litigation due to the increasing global levels of "green" patent and trade secret activity. Technology is expensive and time-consuming to develop, and companies that have made the necessary investments to develop innovative technologies will not hesitate to defend their legal rights. And at least in the United States, there is an entire cottage industry built on monetizing patents (usually on a contingency basis) through litigation. There is a good chance, particularly as the marketplace dictates which cleantech companies succeed or fail, that many of the issued and currently issuing "green" patents will one day become available for sale, whether through bankruptcy proceedings or in "fire sales" by companies on the verge of dissolution. Once sold, it would be realistic to think that the purchasers would want to maximize their return on investment; contingency litigation against established entities is thus likely. Of course, the same holds true for competing companies targeting innovation of sustainable goods and services in a shared market sector. In fact, the largest current "green" patent cases involve competitors trying to exercise their "right to exclude" in the form of patents to capture market share and royalties. All these considerations suggest "green" patent litigation is an imminent risk for many companies, and steps should be taken to ensure that this reality is not being ignored.[2] As with all things, the current "green" patent landscape provides risks and opportunities for companies, and both legal departments and outside counsel need to work together to make sure that their respective companies and clients play the "green" patent game smartly.

2. "Green" Branding

Effective branding drives success in the marketplace. And effective branding can help capture the customer's "mind" when thinking about a particular good or service, thereby making it harder on the competition. Companies, large and small, marketing sustainable goods and services are very aware of the importance of branding. So they are increasingly filing for trademark protection, and otherwise looking for ways to differentiate their "green" offerings through branding techniques. Driving these approaches is the increasing commercial importance of "green" or sustainable elements in product or service offerings. Customers concerned about conservation or climate change have, time and again, shown a willingness to spend extra on sustainable products and services, so companies are doing their best to attract their attention. As a result, trademark applications for "green" marks have soared over the last few years, as indicated by a large spike in filings including such terms as "Green," "Eco," and "Clean" amongst others. One good example of an industry aggressively pursuing "green" marks is the automotive industry. Most, if not all, of the major automotive manufacturers have come up with "green" marks to describe their sustainable technologies. Examples such as Mercedes-Benz's BLUETEC, or Mazda's SkyActiv Technology, abound. In some cases, these marks are literally branded (or badged as it were) on the manufactured cars themselves, underscoring their importance to the automakers as a means of engaging current and prospective customers.

Because of this "green" branding rush to the USPTO, it has become harder for most companies to register variations of descriptive terms such as "Eco" and "Green." That said, companies continue to file marks using these terms, and frequently will do their best to argue that these terms, when used in combination with the other elements of the applied-for mark, are suggestive (and thus registrable) rather than descriptive. Alternatively, companies are looking at the Supplemental Register as a hopefully temporary staging ground for their "green" marks. Either way, companies continue to realize the value of an association with sustainability, and both legal departments and outside counsel need to be flexible and creative in pursuing trademark protection for the "green" goods and services their companies and clients create.

3. "Green" False Advertising—or "Greenwashing"

It is not surprising that the most active component of "green" intellectual property law right now involves counseling clients on "green" false advertising issues, commonly referred to "greenwashing."[3] As discussed above, "green" innovation and branding efforts are well under way in most sectors of the global economy, and it is only natural that companies are keen to advertise the sustainable goods and services they have invested in developing and bringing to market. Because so many of the past and present attempts at "green" advertising have been irresponsible at best and deceptive at worst, there has unfortunately arisen a "presumption of greenwashing" regarding most advertising efforts supporting "green" products and services. In some respects, it is the good-natured sensibilities of the target customer for those "green" products and services, and their demonstrated willingness to spend more in support of those sensibilities, that makes the temptation to "greenwash" very difficult for even reputable companies to avoid.

Fortunately, there is some guidance for companies and their counsel to rely on with respect to avoiding "greenwashing" and by doing so practice responsible "green" marketing. The two most important resources in this regard are the Federal Trade Commission's "Green Guides" and TerraChoice's reports regarding the "Sins of Greenwashing."[4] This is not the place for an in-depth discussion of these resources, but it is well worth developing at least a superficial familiarity with their guidance if you have a role in advising on "green" marketing issues at your company. What is critical to keep in mind with respect to the "greenwashing" issue is that there is a large and varied "police force" ready and willing to expose and sometimes punish "greenwashing" activities. Government agencies (such as the FTC), state attorney general's offices, international and domestic environmental action groups, and even consumers have demonstrated a willingness to take action against "greenwashing."

One of the consequences of the existence of the loosely connected network of anti-"greenwashing" entities is that even responsible "green" marketing can come under criticism and even attack. In those situations, companies need to seriously consider fighting back, and not allow commercial goodwill to dissipate in a storm of extremist criticism. In order to be able to do so, companies should make sure that any "green" marketing they are engaged in is done responsibly by at minimum making sure that any environmental claims are targeted and demonstrably accurate. Both corporate counsel, and when appropriate outside counsel, need to be willing to rein in well-meaning but improper attempts by marketing departments to zealously tout skimpily supported environmental benefits. By doing so, they will increase the likelihood that the environmentally-conscious customer will respond positively to their offerings, while making sure that they are not exposing their companies to enforcement actions or other undesirable "greenwashing" consequences.

Conclusion

Corporate counsel should be aware of the various opportunities and risks involved with "going green" from an intellectual property perspective. As "Cleantech" innovation continues, and more sustainable products and services become a part of our daily lives, the importance of "green" intellectual property awareness will continue to grow for companies and their legal departments.

Endnotes

1. The author recommends the "Green Patent Blog," available at www.greenpatentblog, as a resource for those interested in learning more about the expedited examination programs, and for discussion of other issues relating to green patents. The offerings on the blog include some contributions by this author as a guest poster. This recommendation, though, is made notwithstanding that fact, as the blog continues to provide the most comprehensive coverage of green patent issues around.
2. For example, this author has on occasion engaged in conversation at "green" conferences with senior executives, e.g. Chief Sustainability Officers, at large corporations. While they are typically excellent ambassadors for their companies with respect to the worthy initiatives they are charged with overseeing, there is also a dangerous tendency on their part to ignore the intellectual property risks inherent in implementing those initiatives. For example, after hearing a long presentation on a major investment a large retailer was making in new "green" lighting fixtures for their stores, I asked whether or not anyone had consulted with intellectual property counsel regarding either patentability or possible infringement issues. The answer was no, and as a result the company may have lost out on a potential asset while also increasing its risk of being sued for infringement. Not an ideal situation, but easily remedied by making sure that the Legal and Sustainability departments at your company are in communication regarding IP issues.
3. Greenwashing is usually broadly defined along the lines of "making misleading claims regarding the environmental benefits of services or products."
4. Available at http://ftc.gov/bcp/grnrule/guides980427.htm and http://sinsofgreenwashing.org/ respectively.

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Recent Changes to U.S. Patent Law

By Gerard F. Diebner

I. Introduction

On September 16, 2011, President Obama signed into law the Leah-Smith America Invents Act ("AIA"). The AIA enacts sweeping changes to the patent statute, 35 U.S.C., such as converting to a first inventor to file system, new post-issuance procedures before the Patent and Trademark Office ("PTO"), and litigation reforms. Some of these changes took effect immediately while others are to be phased in over time. This article summarizes some of the more important changes enacted by this legislation.

II. Timing of Changes

The changes enacted by the AIA became effective upon the date the AIA was enacted (September 16, 2011), one year after the date of enactment and eighteen months after the date of enactment. The effective dates can be summarized as follows:

- Immediately (September 16, 2011)—Litigation reforms.
- One year (September 16, 2012)—New procedures before the PTO.
- Eighteen months (March 16, 2013)—First to file rule.

III. Changes Enacted by the AIA

A. First to File

One of the most profound changes enacted by the AIA is to convert the U.S. patent system from a first to invent system to a first to file. These changes are set forth in Section 3. Under these provisions, the determination of what constitutes prior art against an application depends upon the earliest effective filing date of the application, not the date of invention.

Under the old rules, which will remain in effect until March 16, 2012, a patent applicant could "swear behind" prior art with a date earlier than the patent applications filing date by establishing that the invention was made prior to the date of the prior art. As of March 16, 2013, applicants will no longer be able to "swear behind" prior art.

Interestingly, and unlike most other countries, the AIA maintains a one-year grace period, albeit in a limited form, for filing a patent application. Under this limited grace period, an applicant's own public disclosure of the invention, or a disclosure by another who obtained the disclosed subject matter directly or indirectly from an inventor, would not constitute prior art if the disclosure was made less than one year before the earliest effective filing date of the invention.

Another exception to what constitutes prior art relates to disclosures made in patent applications or patents. If the subject matter disclosed was obtained from an inventor or a joint inventor, or if there is a common ownership or a joint research agreement, the disclosure does not constitute prior art under 35 U.S.C. §102(a)(2).

In most other countries, the prior publication of an invention bars patentability, and it does not matter who made the publication.

The change to a first to file rule will occur on March 16, 2013. Any patent applications with an effective filing date before March 16, 2013 will be controlled by the first to invent rule. Therefore, for example, interference practice will still apply to these applications. For applications with an effective filing date on or after March 16, 2013, the first to invent rule, as well as interference practice, will not apply.

B. Inventor's Oath and Assignee Signing

Section 4 of the AIA makes certain changes to 35 U.S.C. §§115 and 118. For example, the Oath or Declaration is only required to state that an inventor believes himself or herself to be an "original inventor" not a "first and original" inventor. Second, an application can be filed by an assignee, although an Oath or Declaration must still be filed before the patent issues.

C. Prior Commercial Use

Previously, a prior use defense only applied to certain business method patents. Now, under Section 5 of the AIA, 35 U.S.C. §273 has been amended so that the prior use defense applies to "subject matter consisting of a process, or consisting of a machine, manufacture, or composition of matter used in a manufacturing or other commercial process." The prior use must be a commercial use in the United States occurring at least one year before the invention was disclosed to the public in a manner which qualifies as an exemption from the prior art pursuant to 35 U.S.C. §102(b). The prior use defense is not available to a party who derived the invention from the inventor or if the prior use was abandoned. These new provisions apply to any patent issued on or after September 16, 2011, the date the AIA was enacted.

D. Post-Grant Review Proceedings

Section 6 of the AIA substantially increases the post-grant review of patents. There are two types of post grant review proceedings, an inter-partes review and a post-grant review.

1. Inter-Partes Review

In an inter-partes review, any third party can request cancellation of one or more patent claims as anticipated or obvious, but only on the basis of prior art patents or publications. This type of review must be filed after the later of 9 months after the grant of a patent, reissue or the conclusion of any post-grant review.

Although an inter-partes review is limited to anticipation or obviousness over patents or publications, a petitioner can submit expert affidavits or declarations to support the petitioner's invalidity contentions.

An inter-partes review will invoke an estoppel. A petitioner, real party in interest or privy cannot request a proceeding before the PTO on any ground it did or reasonably could have raised in the petition. Also, a petitioner, real party in interest or privy cannot assert, in a civil action or ITC proceedings, any ground it raised or reasonably could have raised in the petition.

Inter-partes review will be available as of September 16, 2012, or one year after the enactment of the AIA, and shall apply to any patent issued before, on or after that date.

2. Post-Grant Review

Another procedure available under the AIA is the post-grant review. This type of review can be requested by any third party for any ground of invalidity (except "best mode"). A petition for post-grant review, however, can only be filed no later than 9 months after the grant of a patent or reissue patent. As is the case with an inter partes review, a post-grant requester can submit expert declarations and affidavits.

Many of the regulations governing a post-grant review are substantially the same as those governing an inter-partes review, including estoppel. Beware, however, that because a requester in a post-grant review proceeding can challenge a patent on virtually any ground, the scope of estoppel can be much greater.

E. Tax Strategy Patents Banned

Section 14 of the AIA bans patents on "any strategy for reducing, avoiding or deferring tax liability," whether or not the strategy was previously known. These provisions took effect on September 16, 2011.

F. Best Mode Requirement

The best mode requirement, under Section 15 of the AIA, can no longer be raised as a defense in patent litigation. It is still an issue during patent prosecution. This provision took effect on September 16, 2011.

G. Patent Marking

Patent marking has been substantially amended by Section 16 of the AIA and suits for false marking have been substantially curbed. First, virtual marking will be allowed. Here, a patent owner can provide an Internet address listing the patents which cover the article. Second, for suits alleging false marking, the party alleging false marking must also show competitive injury, and damages are limited to compensate for actual injury. Third, marking an article with an expired patent will no longer constitute a violation.

The provisions of Section 16 took effect on September 16, 2011 and apply to all cases pending on or commenced after that date.

H. Advice of Counsel

Under Section 17 of the AIA, 35 U.S.C. §298 is added which relates to advice of counsel. Under this provision, the failure of an accused infringer to obtain the advice of counsel or to present such advice to a court or jury cannot be used to prove willful infringement or inducement to infringe.

I. Joinder of Parties

Section 19 of the AIA also contains a provision concerning joinder of parties. Under this Section, which adds 35 U.S.C. §299, accused infringers can be joined in one action only if any right to relief is asserted against the accused infringers jointly, severally, or in the alternative with respect to or arising out of the same transaction, occurrence or series of transactions or occurrences relating to the making, using, selling, offering to sell or importing into the United States the same accused process or product; and questions of fact common to all accused infringers will arise in the action.

IV. Conclusion

As the provisions of the AIA are phased in, they will have a profound effect on U.S. patent practice. Careful coordination with patent counsel is recommended to avoid potential problems. For example, once the first to file rule takes effect, it will become more important to file patent applications sooner rather than later.

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A Supreme Court Milestone in the Evolving Right of Judicial Recourse from Administrative-Agency Decisions in the Wake of the America Invents Act

By Charles E. Miller

I. Introduction

On April 18, 2012 the U.S. Supreme Court in *Kappos v. Hyatt*[1] unanimously affirmed the Federal Circuit's November 8, 2010 en banc decision,[2] which held that in a civil action in district court under the Federal Rules of Civil Procedure for de novo review[3] of the Patent and Trademark Office's (PTO's or Agency's) refusal to grant a patent application, there are no restrictions beyond those spelled out in the Federal Rules of Evidence on the ability of the applicant to introduce evidence relevant to the Agency's administrative fact-findings. Upon such proffer, the court must determine the facts de novo, taking into account as a whole said evidence together with the evidence already in the administrative record, with no deference to the PTO's fact-findings. In advocating the exclusion of evidence that could have been presented during the administrative (examination) stage, the PTO would diminish the unfettered right to challenge the PTO's adverse decisions[4]—in this case the Board's affirmance of an examiner's rejection of the claims in a patent application.

II. Background Law and Proceedings

A. Operative Principles

Since as early as 1839,[5] PTO decisions[6] rejecting claims in patent applications have been subject to judicial recourse and oversight which continues to this day under the Patent Act of 1952 (title 35, U.S.C.)[7] and will continue under the recently enacted Leahy-Smith America Invents Act (AIA).[8]

1. Appellate Review of PTO Decisions

When faced with an adverse PTO decision in an administrative appeal from an examiner's rejection of an application, the applicant has two, mutually exclusive options for seeking judicial recourse.[9] One option is a direct *appeal* to the Federal Circuit[10] which reviews de novo (i.e., without deference to) the Board's conclusion(s) on the issue(s) of law, viz., the patentability of the applicant's invention. In doing so, the Federal Circuit, being a court of appellate jurisdiction, cannot disturb (i.e., it must defer to) the Board's underlying findings of fact. To accord such deference the court must initially determine whether the Board's fact-findings are based on *substantial evidence*[11] *in the record of the administrative proceeding* as prescribed by statute.[12] Such findings must be set forth thoroughly enough in the Board's written decision to enable the court to do so.[13]

2. De Novo Review

The other option, which is the one the applicant in *Hyatt* chose to pursue, is to seek de novo judicial review of ***both*** the *conclusions of law* ***and*** the underlying *findings of fact* that informed the Board's decision. Such fully non-deferential or "hard look" review[14] is obtained by *suing the PTO* in federal district court for a *full adjudication and bench trial*[15] on *both* the evidence in the administrative record *and* additional proofs submitted by either *party.* This is consistent with the Administrative Procedure Act (APA)[16] and is enabled by 35 U.S.C. § 145 which, as amended by the AIA, states as follows:[17]

> § 145. Civil action to obtain patent.
>
> An applicant dissatisfied with the decision of the ~~Board of Patent Appeals and Interferences~~ >Patent Trial and Appeal Board< in an appeal under section 134(a) of this title may, unless appeal has been taken to the United States Court of Appeals for the Federal Circuit, ***have remedy by civil action*** against the Director in the United States District Court for the ~~District of Columbia~~ >Eastern District of Virginia< if commenced within such time after such decision, not less than sixty days, as the Director appoints. The court may ***adjudge*** that such applicant is entitled to receive a patent for his invention, as specified in any of his claims involved in the decision of the ~~Board of Patent Appeals and Interferences~~ >Patent Trial and Appeal Board<, ***as the facts in the case may appear*** and such ***adjudication*** shall authorize the Director to issue such patent on compliance with the requirements of law. ***All the expenses of the proceedings shall be paid by the applicant***. (Emphasis added.)[18]

The provisions of Section 145, quoted above, operate as a statutory waiver of the federal government's sovereign immunity from suit against a specific cabinet (Commerce Department) agency (the PTO), in a specific type of case (rejected patent applications), within a specified jurisdiction (the U.S. district court), and in an exclusive venue (E.D. Va.). Such provisions are a *sui generis* subset of those in the general waiver statute of the APA.[19] Because the plaintiff-applicant must make the financial commitment to pay all the expenses of the proceeding—including those of the PTO (which can be significant)—a Section 145 civil action is not to be entered into without exceptional forethought.

B. The Proceedings in the PTO

On June 6, 1995, just prior to the effective date of the 20-year-from-filing patent term provisions of the Uruguay Round Agreements Act (URAA) pursuant to the Trade-Related Aspects of Intellectual Property (TRIPS) section of the General Agreement on Tariffs and Trade (GATT),[20] an electrical engineer, businessman, and registered patent agent named Gilbert P. Hyatt applied for a U.S. patent as the sole designated inventor of a computer system for processing and displaying visual image information.

1. Before the Examiner

The PTO examiner rejected many of Hyatt's 117 claims for lack of descriptive support in the specification as required by 35 U.S.C. § 112, ¶ 1. Hyatt, prosecuting his application pro se, responded by submitting a tabulation of the individual words in the claim limitations together with representative pages and line numbers of the specification where those words appeared—but without pointing out the substance of the limitations themselves.

Hyatt's reply failed to persuade the examiner to withdraw the rejection, whereupon Hyatt appealed to the Board in September 1998.

2. At the Board of Patent Appeals and Interferences

In an unpublished decision issued July 30, 2002, the Board affirmed the examiner's rejection of Hyatt's application grounded on the conclusion of law that there was a lack of an adequate description in the specification of his invention based on the factual finding that Hyatt's response to the examiner's Section 112 rejection was insufficient.

In his request for a rehearing, Hyatt offered new, claim-by-claim arguments as proof in further support of his traversal of the rejection. The Board denied the request since, under the PTO's rules, Hyatt had waived his right to present them because they could and should have been made to the examiner and in Hyatt's initial, administrative appeal brief.

C. Proceedings in the District Court; *Hyatt v. Dudas* (D.D.C. 2005)

On April 16, 2003, Hyatt, now represented by counsel, sued the PTO in the U.S. District Court for the District of Columbia under 35 U.S.C. § 145 seeking an adjudication of the Board's decision. Hyatt's election to pursue a civil action in district court presumably was motivated by the need to buttress his case with the additional proofs that the Board had refused to consider. This would not have been possible in a direct appeal to the Federal Circuit since the evidentiary and factual predicates of that court's decision would have been confined to the contents of the administrative record in the PTO. Also, the filing of a continuing application in order to adduce the required additional evidence was contraindicated since doing so would have forfeited Hyatt's right to a patent term of 17 years from issuance in the event his application were ultimately granted.[21]

The defendant PTO moved for summary judgment under Fed. R. Civ. P. 56, on the assertion that the Board's affirmance of the examiner's written-description rejection was already supported by the requisite "substantial evidence" in the administrative record which therefore sufficed to justify the district court's deference to the PTO's fact-findings and consequent affirmance of the Agency's decision. *Hyatt replied on January 28, 2004 by submitting a written declaration setting forth the information he had presented for the first time in his unsuccessful petition for a Board rehearing, and which he contended established the requisite bases for the claims in the specification "as purported evidence supporting his opposition" to the PTO's summary judgment motion.*

The district court, in its September 30, 2005 unpublished memorandum opinion,[22] granted summary judgment after sustaining the PTO's objection to Hyatt's evidentiary declaration *as being inexcusably late because it was available and could have been presented during the prosecution of the application, and Hyatt's failure to explain why he did not do so was deemed indicative of his* ***negligence*** *which justified the exclusion.*

D. Proceedings in the Federal Circuit

Following the district court's denial of his motion for reconsideration, Hyatt appealed to the Federal Circuit.

1. Panel Decision; *Hyatt v. Doll* (Fed. Cir. 2009)

On August 11, 2009, in a split decision by a three-judge panel (Judges Michel, Dyk, and Moore), the Federal Circuit affirmed the district court's summary judgment.[23]

The majority opinion held that (i) the district court did not abuse its discretion in excluding Hyatt's declaration evidence because it was deemed *willfully* withheld from the PTO[24] (as opposed to *negligently* withheld as the district court had found) and (ii) the evidence of record in the PTO was in and of itself substantial and therefore enough to justify summary judgment as a matter of law.

The opinion noted that "the court had never squarely addressed the issue of exactly what standard governs district courts in ruling on the admissibility of evidence withheld during examination in the PTO.[25] It thus went on to observe that although in some circumstances new evidence could be submitted, it does not necessarily mean this right is unfettered, and that there are situations in which new evidence could be excluded.[26]

The court concluded that Hyatt's inadequate response to the examiner's rejection was not mere negligence, as the lower court had found, but rather, a willful refusal to cooperate in consequences of which:

> the district court's exclusion of Hyatt's new evidence must be affirmed.… [I]t is clear from the *record* that Hyatt willfully refused to provide evidence in his possession in response to a valid action by the examiner. Such a refusal to provide evidence…was [sufficient] grounds to exclude the withheld evidence. Similarly, we hold that in light of Hyatt's willful non-cooperation here, the district court did not abuse its discretion by excluding the Hyatt declaration.[27]

2. En Banc Decision on Rehearing: *Hyatt v. Kappos* (Fed. Cir. 2010)

Following the granting of Hyatt's "Combined Petition for Panel Rehearing or Rehearing En Banc" filed November 30, 2009, the Federal Circuit on November 8, 2010 issued a 7-2 decision vacating the summary judgment and remanding the case to the district court.[28]

The majority ruled[29] that the district court erred by exceeding its authority in applying the wrong standard for admitting evidence, and in so doing abused its discretion in determining that Hyatt's "negligence affected admissibility."[30] In doing so, the majority ***held*** that 35 U.S.C. § 145 requires the entry of any relevant (competent) evidence otherwise admissible under the Federal Rules of Evidence regardless of why it was not presented during the administrative stage. The court went on to note that its holding is consistent with dicta in *Dickinson v. Zurko*,[31]and the holding in *Mazzari v. Rogan*,[32] that "[i]f the parties to a § 145 action do not introduce any new evidence before the district court, the court reviews the case on the same record presented to the agency and the reviewing court must apply the APA's substantial evidence standard to Patent Office fact findings,"[33] but that the "substantial evidence" standard of judicial review does not apply when new evidence is introduced. "'The presence of such new or different evidence makes a factfinder of the district judge,'"[34] and "the district court…must make de novo fact findings with respect to factual issues to which the newly submitted evidence relates."[35]

III. The Supreme Court Decision

In reaction to the Federal Circuit's en banc decision, the Government petitioned for certiorari which the Supreme Court granted on June 27, 2011. The Court's merits decision was handed down on April 18, 2012.

A. Issues and Contentions

The specific issues certified for decision by the Court were informed by two questions set forth in the PTO's petition for certiorari as follows:

1. *Whether the plaintiff in a Section 145 action may introduce new evidence that could have been presented to the agency in the first instance.*
2. *Whether, when new evidence is introduced under Section 145, the district court may decide de novo the factual questions to which the evidence pertains, without giving deference to the prior decision of the PTO.*

The PTO argued that Hyatt's newly presented "evidence,"[36] albeit relevant and hence admissible, was properly *excluded at the court's discretion* because Hyatt's failure to present it at the administrative stage was either *willful or negligent*. Hyatt countered that Section 145 imposes no special, heightened standard of admissibility that would justify such exclusion.

B. The Court's Holdings

The Court, in a 9-0 opinion, decided both questions in the affirmative and held that:

a. Further to prior dicta that a patent applicant may present new evidence to the district court that was not presented to the PTO,[37] "there are no evidentiary restrictions [on a patent applicant's ability to introduce new evidence in a Section 145 district court civil action] beyond those already imposed by the Federal Rules of Evidence and the Federal Rules of Civil Procedure."[38]

b. Regarding "what standard of review the district court should apply when considering new evidence…the district court must make a de novo finding when new evidence is presented on a disputed question of fact," as "it makes little sense for the district court to apply a deferential standard of review to PTO factual findings that are contradicted by the new evidence. The PTO, no matter how great its authority or expertise, cannot account for evidence that it has never seen. Consequently, the district court must make its own findings de novo and does not act as the 'reviewing court' envisioned by the APA. See 5 U.S.C. § 706."[39] "Though the PTO has special expertise in evaluating patent applications, the district court cannot meaningfully defer to the PTO's factual findings if the PTO considered a different set of facts. Id. at 1697; cf. Microsoft Corp. v. i4i Ltd. Partnership, 564 U.S.__, __, 131 S. Ct. 2238, 2251…(2011) (noting that 'if the PTO did not have all material facts before it, its considered judgment may lose significant force'). For this reason, we conclude that the proper means for the district court to accord respect to decisions of the PTO is through the court's broad discretion over the weight to be given to evidence newly adduced in the § 145 proceedings."[40]

c. "In deciding what weight to afford that evidence, the district court may, however, consider whether the applicant had an opportunity to present the evidence to the PTO." (Emphasis added).[41]

d. "[T]he principles of administrative exhaustion do not apply in a § 145 proceeding. [The PTO's rationale based on] 'the avoidance of premature interruption of the administrative process'…does not apply here because, by the time a § 145 proceeding occurs, the PTO's process is complete…[and] Section 145, moreover, does not provide for remand to the PTO to consider new evidence, and there is no pressing need for [remand] because a district court, unlike a court of appeals, has the ability and the competence to receive new evidence and to act as a factfinder."[42]

IV. Why *Hyatt* Is Important to the Well-Being of the U.S. Patent System

Fortunately for the patent community, the Supreme Court did not accede to the PTO's argument that would have required judges to decide whether to exclude relevant evidence that was not, but could have been, presented at the Agency level—rather than admitting the evidence and then weighing it in arriving at the court's fact-findings and conclusions of law. The result sought by the PTO and rejected by the Supreme Court would have hamstrung the business community's ability to rely on the judicial process by foreclosing the unfettered right to proffer evidence beyond the administrative record when necessary to refute the factual bases for adverse decisions of the Agency.

Lawyers for the business, scientific, and engineering communities hailed the Supreme Court's reasons for affirming the Federal Circuit's en banc holding in *Hyatt*. When an inventor, assignee, or licensee finds itself in the position of having to proffer additional evidence in order to challenge adverse Board rulings, a plenary civil action in district court under the Federal Rules of Civil Procedure provides the long-established means for doing so. The admission of (as opposed to the weight ultimately given to) such evidence will not depend on whether it could have been presented at the administrative stage. There are sound reasons for this:

- The limited scope of judicial review afforded by a direct appeal to the Federal Circuit makes it highly unlikely that Board decisions based on erroneous fact-findings can be overcome when such findings are supported by substantial evidence.[43]
- Admitting new evidence and then weighing its probative value makes for a full evidentiary record in the district court for subsequent appeal to the Federal Circuit, thereby optimizing the ultimate prospect of a just result by promoting comprehensive appellate review.[44]
- The filing of a continuing application, a request for continued examination (RCE), or a stay of prosecution in lieu of a civil action in order to introduce additional evidence places an applicant at an unfair disadvantage when the evidence required, e.g., oral (lay or expert) testimony, cannot be entertained or considered by the PTO, or can only be compelled from third parties for which subpoenas are not available in non-contested cases.[45]
- The loss of accrued patent term adjustment (PTA) when a continuing application is filed, and the loss of PTA (for "three year delay") accrued prior to appealing to the Board or filing an RCE, would unfairly penalize patent applicants in situations where time is required to obtain and process additional evidence needed to refute examiners' rejections. By contrast, a civil action affords the applicant as plaintiff the opportunity to adduce the requisite evidence while retaining all PTA accrued prior to Board appeal, and adds additional PTA for the entire period between the administrative appeal and a (favorable) court decision.[46] Of course, a Section 145 action comes at a steep price to the applicant who must pay for the entire case,[47] thereby discouraging such recourse when direct appeal to the Federal Circuit would suffice.
- *Hyatt* provides the much-needed certainty that new evidence submitted in Section 145 actions will not be excluded so long as it is relevant and non-cumulative. As a result, IP portfolio managers and patent practitioners can exercise sound judgment in making prudent decisions affecting the timing, cost, and extent of generating and presenting evidence in support of the patentability of inventions and the allowability of patent applications. This can be done without fearing the potentially disastrous consequences of being limited in district court for all intents and purposes to Federal Circuit-type deference to the factual bases of adverse PTO decisions.[48]

In non-contested (ex parte) administrative proceedings, the PTO has long been averse to allowing those aggrieved by its actions to have recourse in district court. That aversion was manifested nine years ago when the

Agency, by its own rulemaking, sought to eliminate district court jurisdiction of administrative decisions in ex parte patent reexaminations requested post-November 28, 1999.[49] The rule in question, 37 C.F.R. § 1.303(d), was criticized[50] as having been prescribed without statutory authority or power under the 1952 Patent Act[51] and hence is ultra vires and therefore invalid. The PTO's attitude unfortunately has resurfaced, this time in the AIA. In particular, SEC. 6(h)(2)(A) and SEC. 7(c)(1) of the AIA amend 35 U.S.C. § 141 and § 306 to bestow immunity from suit upon the PTO *nunc pro tunc* in patent reexaminations in Chapter 30 of title 35, U.S.C., irrespective of when the request for reexamination was filed. Patent owners are thereby stripped of their long-standing, fundamental, statutory right of civil action to challenge adverse patent reexamination decisions of the Agency.[52]

Likewise, with respect to contested (inter partes) administrative proceedings, the AIA has established two patent claim invalidation procedures, namely, "inter partes review" under SEC. 6(a) (revising Chapter 31 of title 35, U.S.C.) and "post-grant review" under SEC. 6(d) (adding new Chapter 32 of title 35, U.S.C.). Revised Section 319 in Chapter 31 and Section 329 in new Chapter 32, together with 35 U.S.C. § 141 as revised by SEC. 7(c)(1), preclude district court jurisdiction of PTO decisions in those cases as well.[53] A third type of contested case called "derivation proceeding," introduced by the AIA, replaces patent interferences, reflecting the transition from the historic "first-to-invent" system of patent entitlement to a "first-inventor-to-file" paradigm. Curiously, the right of de novo judicial recourse from PTO decisions in interferences has been carried over to derivation proceedings. It would seem incongruous to preserve the right of civil action in one type of contested case (derivation proceedings) while depriving PTO stakeholders the same right(s) in the other two types of contested cases (inter partes reviews and post-grant reviews).

Also troubling is the possibility of problems stemming from the concurring opinion of Justice Sotomayor (joined by Justice Breyer), *Hyatt*, 132 S. Ct. at 1701-02 which reads in pertinent part as follows (emphasis added):

> Because there is no suggestion here that [Hyatt's] failure to present the evidence in question to the PTO was anything other than the product of negligence or a lack of foresight, I agree that [Hyatt] was entitled to present his additional evidence to the District Court. *But I do not understand today's decision to foreclose a district court's authority, consistent with "'the ordinary course of equity practice and procedure,'" ante, at 1700 (quoting Butterworth, 112 U.S. at 61, 5 S. Ct. at 25), to exclude evidence "deliberately suppressed" from the PTO or otherwise withheld in bad faith.* For the reasons set out by the Court, see *ante*, at 1700-1701, an applicant has little to gain by such tactics; such cases will therefore be rare. *In keeping with longstanding historical practice, however, I understand courts to retain their ordinary authority to exclude evidence from a § 145 proceeding when its admission would be inconsistent with regular equity practice and procedure.*

When would the admission of new evidence in a Section 145 proceeding be regarded as "inconsistent with regular equity practice and procedure"? It would not be an unreasonable stretch of the imagination to suppose that the PTO will try to exploit the above-quoted dicta by asking during the prosecution stage of a patent application whether all of the evidence available to the applicant that supports the traversal of a rejection has been submitted to the Agency. Could the failure to respond, or to identify or produce evidence available or which could have been obtained (although perhaps at great expense, e.g., by retaining experts to conduct tests and submit affidavits) be used to estop the applicant from presenting such evidence in subsequent prosecution (including a Section 145 action) or in litigation, based on the inference that it had been "deliberately suppressed" or "otherwise withheld from the PTO in bad faith" rather than for cost savings? To suppose that a patent applicant appearing before the PTO would, for no good reason, engage in "deliberate suppression" of, or "withhold in bad faith," existing or procurable evidence supportive of patentability is too farfetched to warrant serious concern. Even in a situation like Hyatt's, whose patent, if granted, might benefit from the prolongation of its pendency, such behavior would be unlikely given the loss of royalties not to mention the likelihood of obsolescence of the invention by the time the patent is granted.

Nevertheless, such a speculative scenario, despite its virtual impossibility, creates a tension between the PTO's goal in limiting the bases for justifying Section 145 civil actions on the one hand, and the exercise of sound professional judgment on the part of patent practitioners in foregoing evidentiary "data dumps" in the PTO that would lard their clients' patent prosecution histories with proofs of patentability[54] beyond what is necessary and prudent to make the point and to avoid supplying unnecessary fodder for imaginative assertions by adversaries in future litigation. In such circumstances, when responding to the PTO's inquiry one might be well-advised to note for the record that, in the opinion of the applicant's representative, the evidence presented is considered sufficient to address the rejection, and that the applicant reserves the right to present additional supporting evidence as may be appropriate in the event a subsequent de novo judicial review proceeding becomes necessary. It remains to be seen whether the PTO, emboldened by the perception of indifference on the subject within the patent community,[55] could thwart the benefit of such a response through rule-making authorized by some future "technical" amendment of the AIA, or by persuading Congress to statutorily limit the evidentiary scope of Section 145, or even abrogate the section entirely, thereby achieving a devastating inroad toward the total abrogation of the right of de novo judicial review of all its decisions.

V. Conclusion

So, what is the take-away from *Hyatt*? In sum, the Supreme Court rejected an argument by the PTO that, if accepted, would have harmed the legitimate interests of the inventive and business communities and been antithetical to the constitutional purpose of the patent system which is and always has been "to promote the Progress of… the useful Arts."[56] For many years, the PTO has sought to preclude patent applicants and their assignees and licensees from fully exercising, when needed, their historic statutory right to a square deal in seeking plenary, district court adjudication of adverse PTO decisions perceived to be erroneous in refusing to grant patent protection for eligible inventions that are properly set forth and claimed in patent specifications. Fortunately, the Supreme Court's endorsement of the long-standing principle of full de novo judicial review of PTO decisions by civil action remains intact—at least for now. But the victory achieved in *Hyatt* could be undone by the PTO through future legislation and rulemaking. Indeed, this has already occurred in the context of administrative post-grant review procedures under the AIA. The patent community will rue the day it allowed this to happen.[57]

Endnotes

1. 566 U.S. __, 132 S. Ct. 1690 (2012) (Thomas, J.) (concurring opinion by Sotomayor and Breyer, JJ.).
2. *Hyatt v. Kappos*, 625 F.3d 1320 (Fed. Cir. 2010) (en banc).
3. "De novo review"—as opposed to appellate review—is defined in Black's Law Dictionary, 9th ed. p. 924 (West Group 2009) as "[a] court's nondeferential review of an administrative decision, usually through a review of the administrative record plus any additional evidence the parties present." The phrase is a convenient shorthand but somewhat of an oxymoron, inasmuch as a court does not "review'" an administrative tribunal's decision on an evidentiary record after the record has been supplemented by new evidence. It thus suggests a tension between "review" and the prefatory words "de novo." At the risk of putting too fine a point on it, one might consider thinking in terms of "judicial adjudication of an administrative decision." Thus, the de novo judicial review sought in *Hyatt* was by litigation aimed at a trial in district court, in contrast to direct recourse to the Federal Circuit which would have entailed an appellate review requiring deference to the Agency's fact-findings (if based on "substantial evidence—*see infra* note 12) on a record fixed at the administrative stage, with no opportunity to introduce rebuttal evidence aimed at refuting those findings.
4. Although other types of civil actions against the PTO were not specifically addressed in *Hyatt*, the Court's holding in the case applies in contexts other than patent applications, namely, administrative decisions under 35 U.S.C. § 32 (disciplinary proceedings), 35 U.S.C. § 154(b)(4)(A) (patent term adjustments), 35 U.S.C. § 156 (patent term extensions), and 15 U.S.C. § 1071(b)(3) (trademark registration applications).
5. Act of Mar. 3, 1839, ch. 88, § 10, 5 Stat. 353, 354.
6. With the amendment of 35 U.S.C. § 6 by the American Inventors Protection Act of 1999 (AIPA), Pub. L. No. 106-113, Div. B, § 1000(a)(9), 113 Stat. 1536 (Nov. 29, 1999), the highest administrative tribunal of the PTO became known as the "Board of Patent Appeals and Interferences" (BPAI). On September 16, 2012, pursuant to SEC. 7(a) of the Leahy-Smith America Invents Act (AIA), Pub. L. No. 112-29, 125 Stat. 284 (Sep. 16, 2011), the BPAI will become the Patent Trial and Appeal Board (PTAB). The transition from the BPAI to the PTAB—both of which are referred to herein as the "Board"—coincides with the effective date of provisions of the AIA enabling inter partes review (SEC. 6(c)(2)(A)) and post-grant review (SEC. 6(e)), and conferring administrative trial jurisdiction of such proceedings on the PTAB.
7. 66 Stat. 815, c. 950 (Jul. 19, 1952); *Hyatt*, 132 S. Ct. at 1697-98.
8. *See supra* note 6.
9. Logically, the PTO *qua* administrative agency has no right of judicial recourse from Board rulings because they are in effect decisions of the Agency itself. *In re Alappat,* 33 F.3d 1526, 1535 (Fed. Cir. 1994) (en banc).
10. 35 U.S.C. § 141(a)/28 U.S.C. § 1295(a)(4)(A).
11. "Substantial evidence" has been judicially defined as "more than a scintilla. It means such relevant evidence as a reasonable mind might accept as adequate to support a conclusion." *See,* e.g. *, In re Gartside,* 203 F.3d 1305, 1312 (Fed. Cir. 2000), citing *Consolidated Edison Co. v. NLRB*, 305 U.S. 197, 229-30 (1938). For practical implications of the "substantial evidence" standard of appellate judicial review in administrative patent cases, *see infra* note 43.
12. *See* 35 U.S.C. § 144 which requires the Federal Circuit to decide the appeal on the basis of operative facts set forth exclusively in the administrative record.
13. *See Gechter v. Davidson*, 116 F.3d 1454 (Fed. Cir. 1997) (PTO Board fact-findings must meet the standard of Fed. R. Civ. P. 52(a)).
14. Matthew C. Stephenson*, A Costly Signaling Theory of "Hard Look" Judicial Review,* 58 Admin. L. Rev. 753, 754 (ABA 2006).
15. Civil actions for de novo review of decisions of government agencies in general and of the PTO in particular, being bills in equity, are not subject to the Article VII right to trial by jury. *See* Gregory C. Sisk, *Litigation with the Federal Government – Cases and Materials*, 2d ed., 78-84, 529-36 (Foundation Press 2008).
16. 5 U.S.C. § 706 states: "The reviewing court shall…(2) hold unlawful and set aside agency actions, findings and conclusions found to be (A) arbitrary, capricious, an abuse of discretion or otherwise not in accordance with law;…(E) unsupported by substantial evidence in a case…reviewed on the record of an agency hearing provided by statute; or (F) *unwarranted by the facts to the extent that the facts are subject to trial de novo by a reviewing court*." (Emphasis added). Note that the "arbitrary, capricious," etc. standard of court review of agency actions, findings, and conclusions pertains to the characteristics of the administrative fact-finding process itself as reflected in the state of mind of the tribunal whose decision is being reviewed rather than to the

objective sufficiency of the underlying evidence. Thus, a finding of fact can be arbitrary and/or capricious regardless of whether the evidentiary record is "substantial" or not. Albeit erroneous, a finding of fact presumptively grounded on substantial record evidence will not be set aside unless such finding is arbitrary or capricious.

17. The Supreme Court noted that its concern was "only with § 145 proceedings in which new evidence has been presented to the District Court," *Hyatt*, 132 S. Ct. at 1699, and that "[n]either party contends that the [AIA] has any effect on the questions before us," *id.* at 1694 n.1. However, there appears to be no reason why the Court's holding would not apply equally to civil actions under the Lanham Act counterpart in 15 U.S.C. § 1071(b). Also, with regard to the Court's latter observation and its converse, *see infra* Part V.

18. *See supra* note 6. Also, under SEC. 9(a) of the AIA, venue in all civil actions against the PTO has been relocated from the District of Columbia to the Eastern District of Virginia. Because the latter forum is noted for its uniformly robust "rocket docket" handling of cases, one can expect trial of such actions within time frames comparable to if not shorter than the PTO's handling of continuing applications or requests for continued examination (RCEs).

19. 5 U.S.C. § 702. *See also* 28 U.S.C. § 1338(a) confirming the district court's original civil action/bench trial jurisdiction of Board decisions. For a comprehensive treatment of federal sovereign immunity from suit and its waiver in the context of civil actions against government agencies, *see* Sisk, *supra* note 15 at 104-589.

20. Under the URAA, Pub. L. No. 103-465, Dec. 8, 1994, amending 35 U.S.C. §§ 104, 111, 154, and 271, U.S. patents issued on applications filed before June 8, 1995 have terms of 17 years from their grant date without regard to the filing date of any antecedent application. Patents issuing on applications filed thereafter have terms of 20 years from the filing date of the earliest pre-URAA U.S. non-provisional application to which priority has been claimed under 35 U.S.C. § 120. *See* U.S.C. § 154(a)(2). Had *Hyatt* filed a continuing application instead of instituting the civil action, then under the facts of the case, he would have forfeited his right to a 17-year patent term measured from the grant date.

21. *Id*.

22. 2005 WL 5569633 (Sept. 30. 2005).

23. 576 F.3d 1246 (Fed. Cir. 2009).

24. *Id.* at 1275.

25. *Id*. at 1253.

26. *Id*. at 1261.

27. *Id*. at 1278 (footnotes and citations omitted).

28. 625 F.3d 1320 (Fed. Cir. 2009).

29. *Id.* at 1322-38.

30. *Id*. at 1338.

31. 527 U.S. 150 (1999).

32. 323 F.3d 1000 (Fed. Cir. 2003).

33. *Hyatt*, 625 F.3d at 1336.

34. *Id*. at 1333 (quoting *Zurko*, 527 U.S. at 164).

35. *See supra* note 33.

36. 2011 WL 1343566 (June 27, 2011).

37. *Dickinson v. Zurko*, 527 U.S. at 164 (1999).

38. *Hyatt*, 132 S. Ct. at 1694. In particular, *see* Fed. R. Evid. 403.

39. *Id.* at 1694, 1696.

40. *Id*. at 1700.

41. *Id*. at 1694.

42. *Id*. at 1696-97 (citing *McKart v. United States*, 395 U.S. 185, 193-94 (1969)).

43. It is difficult—and often quite futile—to advocate Federal Circuit reversal of PTO decisions by attacking the Agency's fact findings when they are supported by substantial evidence in the administrative record which cannot be altered or supplemented at the appellate review stage. This is illustrated time and time again in the case law, most recently, for example, in *In re Hyon*, __ F.3d __, 102 U.S.P.Q. 2d 1889, 2012 WL 1871780 (Fed. Cir. 2012), and *In re Breiner*, 2012 WL 1631021 (Fed. Cir. 2012) (nonprecedential).

44. *See supra* Part III.B.c; 28 U.S.C. § 1295(a)(1) and (4)(C).

45. By characterizing a particular administrative proceeding as contested or non-contested, can the PTO, through its own rulemaking, determine or limit the availability of an Article III court's 35 U.S.C. § 24 subpoena power and other discovery devices under 35 U.S.C. § 23? *See Dome Patent L.P. v. Doll*, No. 07-1695 (PLF), slip op. at 6 n.5 (D.D.C. Mar. 30, 2009) ("the availability of discovery under the Federal Rules of Civil Procedure is a significant incentive for parties challenging PTO actions to file suit in United States district courts rather than appeals in the Federal Circuit") (available on PACER). Given that 35 U.S.C. §§ 23 and 24 remain unchanged by the AIA, and that the ability or inability to obtain discovery affects a party's right to adduce evidence in support of the merits of its case, the PTO has thus acquired a subtle form of *substantive* rulemaking authority which Congress did not intend the Agency to have. *See Cordis Corp. v. Kappos*, Civil Action No. 1:12-cv-75 filed Jan. 26, 2012 (E.D.Va.).

46. 35 U.S.C. § 154(b)(1)(C)(iii).

47. 35 U.S.C. § 145, last sentence.

48. *Mazzari v. Rogan*, 323 F.3d 1000 (Fed. Cir. 2003).

49. 37 C.F.R. § 1.303(d) (2003) ("For an ex parte reexamination proceeding filed on or after November 29, 1999… no remedy by civil action under 35 U.S.C. § 145 is available."). The rule when prescribed was (in the present author's opinion) ultra vires and hence invalid. *See* Charles E. Miller & Daniel P. Archibald, *Interpretive Agency-Rulemaking vs. Statutory District Court Review-Jurisdiction In Ex Parte Patent Reexaminations*, 92 J. Pat. & Trademark Off. Soc'y 498, 502 n.7 (2010). In a case of first impression, *Teles A.G. v. Kappos*, 2012 WL 695610 (D.D.C. 2012) (Howell, J.), the district court addressed the question as to whether 35 U.S.C. § 306 confers pre-AIA district-court jurisdiction under 35 U.S.C. § 145 of PTO decisions in post-November 28, 1999 ex parte reexaminations (thereby providing discovery mechanisms under the Federal Rules of Civil Procedure that are not available in direct appellate review in the Federal Circuit). *See supra* note 10. The court did not address the validity vel non of 37 C.F.R. § 1.303(d), *Teles*, slip op. at 13 n.8, notwithstanding that the rule flies in the face of the express language of 35 U.S.C. § 306 in effect at the time ("The patent owner involved in a[n ex parte] reexamination proceeding…may seek court review under the provisions of sections 141-145 of this title, with respect to any decision [of the Board] adverse to the patentability of an…claim of the patent."). *Teles*, slip op. at 3-4 (emphasis added). An appeal of the district court's March 5, 2012 ruling was filed in the Federal Circuit on April 3, 2012.

50. *Id*.

51. Prior to the AIA, the PTO's rulemaking authority was strictly limited as to the powers set forth in 35 U.S.C. § 2(b)(2). *Tafas v. Dudas*, 541 F. Supp. 2d 805 (E.D. Va. 2008), *aff'd in part and vacated in part sub nom*. *Tafas v. Doll*, 559 F.3d 1345 (Fed. Cir.), *vacated en banc*, 328 F. App'x 658, 91 U.S.P.Q.2d 1153 (Fed. Cir.), *appeal dismissed sub nom*. *Tafas v. Kappos*, 586 F.3d 1369. *See* Charles E. Miller & Daniel P. Archibald, *supra* note 49 at 501 n.3.

52. A more detailed treatment of this aspect of the AIA is contained in a soon-to-be-published article by Charles E. Miller & Daniel P. Archibald, tentatively titled *Beware the Suppression of District-Court Jurisdiction of Administrative Patent-Validity Determinations Under the America Invents Act: A Critical Analysis of a Legislative Black Swan in an Age of Preconceived Notions and Special-Interest Lobbying*. Preprints are available from the present author upon request.

53. *Id*.

54. Such an attitude is not inconsistent with the ratio decidendi of the holding in *Therasense, Inc. v. Becton, Dickinson & Co.*, 649 F.3d 1276 (Fed. Cir. 2011) (en banc). A patent applicant's behavior in withholding evidence *supportive* of patentability in order to avoid unduly burdening the application record would be of no relevance to the duty of disclosure under 37 C.F.R. § 1.56 because it could not be a basis for imputing to the applicant the *mens rea* required to prove inequitable conduct.

55. Some have posited that the filing of only a few hundred Section 145 civil actions since the 1952 Patent Act came into effect, and of numerous such suits under the predecessor statutes, evinces a degree of desuetude relative to direct appeals to the Federal Circuit. From this they argued that such de novo judicial review of PTO decisions no longer serves its purpose, thereby warranting the abolition of Section 145 (not to mention the trademark (Lanham Act) counterpart, 15 U.S.C. § 1071(b)). Such an attitude gives one pause, to say the least. On that basis, why not abolish the sections of other titles of the United States Code that are supposedly underutilized?

56. U.S. Const. art. I, § 8, cl. 8.

57. *See supra* note 43.

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Taking the Contracting Mystery Out of Software as a Service Deals

By Mark Grossman

Enterprises are increasingly willing to rely on data storage in the cloud and software as a service ("SaaS") solutions. These are significant changes from the traditional software model where you store your data locally and your enterprise licenses the software it uses. This article will discuss some unique contract considerations in SaaS deals and how SaaS deals differ from traditional software licenses.

Some Definitions

Before the non-techie readers zone out, this article will turn to some fundamental definitions. They are neither mysterious nor complex.

It all starts with what is cloud computing and where is the cloud? You need to understand this as a prerequisite to understanding SaaS. Cloud computing for the purposes of this article is simply the delivery of computing and storage services over the Internet. If you have ever stored your music collection with Apple using iTunes or your photos with Flickr, you have personally used the cloud. Of course, enterprises use the cloud too.

The cloud physically lives in data centers around the world. Amazon is a well-known example of a cloud services provider since it sells access and use of its data centers to other enterprises for their business needs. So to visualize the cloud, do not look to the sky. Instead, you should think more mundanely of racks of computers gorging on the power grid in a cool room with lots of ventilation so that they do not fry. That is the cloud.

SaaS is the delivery of software from the cloud to your computer. If you use Gmail or Yahoo mail, you have used a SaaS solution. Gmail is run by complex email software, but you do not have the software installed on your computer. Rather, you access this complex software using your browser. This is as compared to the traditional software licensing model that has email software like Outlook installed on your PC's hard drive.

Negotiating Agreements

Your company's ability to negotiate an agreement for SaaS and cloud computing services is no different from its ability to negotiate any other type of tech deal. While service providers may argue that they cannot agree to custom agreements with individual customers because of the shared infrastructure inherent in cloud and SaaS solutions, this writer's experience says that while the refrain is common, it is simply not true.

What is true is that your company's ability to negotiate the poorly written form agreements service providers foist upon you as non-negotiable PDFs is directly proportional to things like the size of your spend, the length of the agreement, and your company's size. If this sounds no different from the calculus of your negotiating power in almost any other type of deal, that is because it is not.

SaaS Is Not a License

The starting point in negotiating any SaaS deal is for you to understand that SaaS is not a software licensing deal. It is a complete paradigm shift from licensing software to providing it as a service. Thus, if the service provider sends you a form agreement with licensing language like "Buyer hereby licenses the software installed on Seller's server," you have already learned that the service provider's lawyers are living proof that even the bottom of the law school class can find a job too.

On a more serious note, I will not try to redline a SaaS agreement that feels like a license. The document is simply a throwaway and I am quick to tell the other side the bad news. If I can, I will use this as an opportunity to send them my SaaS agreement, which has a tilt toward my client. (He who drafts sets the agenda.) Sometimes service providers will buy into this because of their hope (as cynically interpreted by this writer) that they can use my agreement as the starting point for the future redo of their form.

Smarter service providers will not let me get away with my form as the starting point for the discussion, but of course, the smarter ones do not send SaaS agreements that read like licenses. Either way, this conversation about the agreement being completely inappropriate creates some interesting discussion. If there is any good news here, it is that over time this writer is seeing fewer licenses purporting to be SaaS agreements.

A correctly written SaaS agreement is a service agreement without a license to use anything.[1] By analogy, think of the plain old telephone service ("Pots") your company buys for landlines from Verizon, AT&T, or whomever. Your company gets a dial tone that you instinctually know has lots of software behind it. Nonetheless, your company does not license any software as a part of the

Pots deal. All your company is buying is a service. What the telephone company does, and the technology it uses to provide the dial tone is its problem.

With SaaS, it is the same thing. Your company does not license the software underlying the service. It simply buys a service that may happen to have software behind the curtains to make the service work. Everything about your agreement with your service provider must reflect this reality underlying SaaS.

Some Key Contract Considerations

In all SaaS contracts, you will have the negotiations regarding the usual provisions like limitations of liability and exclusions from the limits, indemnity, and all the other usual suspects. However, this article will focus on a few examples of considerations and provisions that are unique to SaaS deals.

Service Level Agreements

Probably the most important part of any SaaS deal is the negotiation of the Service Level Agreement ("SLA"). Since your service provider runs and delivers the service to your enterprise in a SaaS arrangement, it is essential that you have clear and objective provisions regarding things like uptime requirements, speed, responsiveness, and the like. Typically, SLAs will provide for credits against the next month's fees if your service provider does not meet the requirements of one or more of the specific services levels. Also typical are provisions that limit the total of all credits to between 10% and 20% of the fee in any given month.

While it is tempting to write a long SLA with many specific metrics, this writer finds it more effective to push my own client to focus on the metrics that are truly important to it and focus the negotiation on just those. Otherwise, it is easy to get lost in minutia.

Moreover, do not—I repeat—do not get lost in demanding service levels beyond what your company needs. Some downtime and occasionally deficient service are often reasonable risks depending on what the service does and the enterprise cost associated with problems.

You may have heard terms bandied about like "five nines" and "four nines" uptime. In English, this translates to 99.999% uptime and 99.99% uptime respectively. With a 99.999% (five nines) uptime SLA, the service provider promises that the system will be down no more than about six seconds per week. With 99.99% (four nines), the promise is downtime not to exceed about one minute per week. If the system uptime does not meet the standard required by the SLA, the contract would typically award a credit that would be applied to the next month's bill.

The point of this numbers exercise is to make the point that four and five nines are rigorous standards that come with a cost. If your enterprise wants and needs five nines, your service provider may have to throw lots of redundancy at the promise and that redundancy comes at a cost to the buyer. For example, five nines might require using two different data centers that are geographically remote from one another to help accomplish the SLA's requirements just in case of a power or weather-related problem in one particular geographic area. This type of redundancy is not free.

So, if your operation is tolerant enough to accept 99% uptime (two nines in the lingo) or about 7.2 hours per month of downtime, go for the lower price that probably comes with that lesser SLA.

You may remember all the controversy about cloud and SaaS services that followed storm related outages at companies like Netflix and Salesforce.com in June 2012. Many of the articles at the time spoke about the reliability issues inherent with cloud and SaaS services. Ridiculous.

Even if your own IT department ran its own data center, no sane CIO would ever promise 100% uptime. Even an attempt at five nines uptime would require your CIO to demand increased funding for redundant hardware and a redundant location. This does not come cheaply.

And this brings you back full-circle to the importance of SLAs. If you need a certain level of service, your agreement should reflect that. Careful and thoughtful contracting can help your company accomplish what it needs in the cloud with SaaS. Moreover, since SaaS fees are usually in the nature of monthly recurring service charges, your company could avoid the large capital expenditures required to run its own data center and local software installations.

Chronic Downtime

An area of legitimate concern with SaaS deals is the mediocre service provider whose failures never quite reach the level of a breach of contract, but rather are more in the nature of every month it misses one or more service level in ways that are annoying and disruptive. This is a problem your agreement could address using what some commentators refer to as a "chronics provision."

With this type of provision, you might say something like a failure to meet the SLA required metric on three or more individual items in three consecutive months or four of any consecutive six months would be considered a material breach of the agreement.

The buyer of the service would want a provision that says that the credits provided by the SLA for failures would not be the exclusive remedy for "chronics" and that the buyer could seek all damages permitted by law. Obviously, the service provider would want "damages" capped by the credits permitted by the SLA. Many factors would determine how this plays out, including the relative negotiating power of the parties and the cost of the service.

Ownership of Data and Risk of Loss

Since your company's SaaS provider will often store data as a part of a SaaS deal, it is important to have express provisions that appropriately deal with the issues of data ownership and risk of loss if data is lost, damaged, or compromised.

Data ownership is the easier one. The contract must have an express statement that the customer owns its data and then continue with appropriate authorizations for the service provider to use the data solely for the purposes of providing the services pursuant to the SaaS agreement. No ambiguity should ever be acceptable in this area.

Lost, damaged, or compromised data is the tougher one to negotiate if for no other reason that it is like any negotiation over risk of loss. The SaaS provider's rhetoric includes things like, "We are not charging you enough to bear this risk" and "We are not an insurance company."

The customer's pushbacks typically include, "You must bear responsibility for your actions" and "Your reticence to accept responsibility is causing us to wonder about your own confidence in your own abilities."

Norms Are Lacking

People are often in search of the ever-elusive norms in the industry. Using the example of risk of loss provisions, this writer must conclude from his extensive experience in doing these deals that there are few "norms" and that every deal stands on its own relative merits.

If there is a norm, it is that sophisticated enterprise level SaaS deals are complex exercises in negotiation and contracting and that they usually require many weeks of discussions before the parties can conclude a deal. The examples of important provisions discussed in this article and basic negotiation tactics like pushing back hard, asking for more than you really need, and not buying into the vendor's form are the foundational concepts to effectively negotiating a SaaS deal.

Endnote

1. Sometimes a SaaS solution requires special software and not just any browser to access the software being delivered as a service. In that case, there may be a license limited to that special software that may be installed on each PC or handheld device that accesses the services. However, the generalization that SaaS is not a licensing arrangement remains true.

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Crowdsourcing: Understanding the Risks

By Marc A. Lieberstein, Ashford Tucker and Andrea K. Yankovsky

I. Introduction

In today's information-based economy, crowdsourcing is becoming an ever-increasing reality for organizations, no matter what space they inhabit. Havas, a major French holding company, recently bought a majority stake in crowdsourcing agency Victors & Spoils, whose clients have included Coca-Cola, Converse, Discovery Channel, Harley-Davidson, and Levis.[1] The Pentagon recently revealed its sponsorship of a $4 million crowdsourced prize contest for designing an amphibious vehicle for the Marines.[2] When official sources for information about the Fukushima Daiichi nuclear reactor failure were lacking, hacker group Safecast used crowdsourced data to measure and map radiation contamination around Japan.[3] At the cutting edge of innovation, the crowdsourcing environment presents challenging legal issues. The question is, when crowdsourcing arrives at your front door, usually from your internal marketing or R&D people, what do you tell your clients?

Below we provide a brief introduction to crowdsourcing, with some real world examples and discussions of potential risks, followed by a discussion of specific risks associated with intellectual property and idea submissions in the crowdsourcing context.

II. What Is Crowdsourcing? A Basic Overview

A. Four Categories of Crowdsourcing

> Crowdsourcing is the act of taking a job traditionally performed by a designated agent (usually an employee) and outsourcing it to an undefined, generally large group of people in the form of an open call.[4]

Also referred to as "open innovation" or as a subset of "user-generated content," crowdsourcing can be divided into four general categories: crowd voting, crowd creation, crowd wisdom, and crowd funding.[5] If you have ever tuned into *American Idol* or chosen a restaurant based on Yelp.com reviews, you have experienced *crowd voting*—a type of crowdsourcing where end users or computer algorithms assess the popularity of a given object.

With *crowd creation*, people are asked to do something, often solving a problem or working on a system. The Linux operating system is a classic example. Toyota utilized crowd creation in its logo re-design, as did Pepsi with its refresh campaign.[6] Snack food maker Doritos relies on the public's creativity for its successful user-submission-based "Crash the Super Bowl" television commercial campaign.[7]

Crowd wisdom involves capitalizing on the diverse knowledge of a group to solve problems, predict future outcomes, or guide corporate strategy. For example, the Iowa Electronic Markets ("IEMs") are small-scale online futures markets where contract payoffs depend on economic and political events such as elections. Developed and used as a research tool by the University of Iowa, the IEMs provide an "unparalleled laboratory in which we can study individual trading behavior as well as market level performance."[8] In another fascinating example of crowd wisdom, last year, over the course of just three weeks, online video gamers created an accurate three-dimensional map of a monomeric protease enzyme, solving a puzzle that had stumped AIDS research scientists for more than a decade.[9]

Bypassing corporate lenders, *crowd funding* provides financing to individuals or groups. Kiva.org is a non-profit organization that uses a crowd funding model to finance microloans to individuals and small businesses in developing nations.[10] People can lend as little as twenty-five dollars, which gets pooled together with contributions from other individuals to fund a given project. Since its founding in 2005, Kiva has made over $326 million in loans. Kickstarter and Indiegogo are two other established crowd funding websites, offering their separate respective platforms to individuals and organizations seeking funding for a variety of artistic, musical, charitable, and commercial projects.[11]

B. Benefits and Risks of Crowdsourcing

Exemplified by the success of organizations across these four categories, the upside to crowdsourcing can be quite high. Tapping into the intelligence of a crowd provides a vast, yet inexpensive, resource and mechanism for acquiring new ideas, solutions, funding, and information. Crowdsourcing can also result in consumers becoming more invested in a product, service, or activity and its ultimate success. The Doritos "Crash the Super Bowl" campaign is one of the most successful crowdsourcing projects in recent memory. Since 2006, this contest has offered the public the opportunity to submit television commercials for consideration, with finalists aired during the Super Bowl and a million dollar prize to the winner. According to social media news source *Mashable*, the Doritos campaign has generated thousands of submissions resulting in millions of votes cast and an estimated one billion impressions.[12] And the positive publicity generated from this campaign has driven up sales.[13]

Additionally, organizations often use crowdsourcing as way of giving back to consumers and to the community, generating goodwill. For example, Skechers recently launched a crowdsourced customer rewards program.[14] Rewards program members can earn points towards future purchases when they publish product reviews on Skechers' website or answer questions posted by other customers.

While crowdsourcing offers potentially spectacular benefits, it nonetheless involves some risk, and indeed high-profile risk in some cases. For example, popular video content delivery service Netflix created a significant public relations buzz when it offered a million dollar prize called the Netflix Prize to the team of mathematicians who created the best algorithm for improving the company's movie suggestions to consumers. Netflix awarded the prize to the winning team, but Netflix ultimately never used the winning algorithm due to engineering logistics.[15] Although it achieved a high level of notoriety by hosting the crowdsourced competition, Netflix ultimately scrapped the sequel to the Netflix Prize the following year after being approached by the Federal Trade Commission and separately sued by consumers over the use of consumer data—which allegedly could be made less than anonymous through certain methods—in connection with the sequel.[16]

Accordingly, the Netflix Prize provides a good example of the potential risks and rewards associated with crowdsourcing. A high-profile crowdsourcing project can energize consumers and, if innovative and exciting, create its own news story, potentially raising a brand's profile. But a company hosting a crowdsourcing project should fully analyze all associated legal issues to gauge the acceptable level of risk.

Companies face several intellectual property and confidentiality risks when conducting a crowdsourced project. Because crowdsourcing draws from the general public, the statistical reality is that a crowdsourced project easily could and very well may receive submissions that contain infringing or unauthorized material. In view of the high cost and difficulty in verifying whether submissions are non-infringing or sufficiently authorized, the company's exposure to infringement liability and other damages increases, and, as a practical matter, the company has no legitimate indemnification against such claims because chances are that the crowdsourced submitter lacks assets or resources to indemnify the company.

Adding to the infringement risks are the increased contractual obligations and insurance coverage issues. Indeed, if a company launches a crowdsourcing campaign, the contractual language for submissions, usage, compensation, and credit can be extensive. And while insurance costs should not rise in connection with such campaigns, if your insurance company views a particular campaign as risky, there could be circumstances where additional premiums are charged or riders required before launching any such campaign.

As noted above, uses of consumer data in crowdsourcing projects can raise issues pertaining to the consumer's right of privacy under state law, if for example consumers are surprised to learn that their personally identifiable data has been used or shared. Similarly, issues can arise when a company's online privacy policy and otherwise applicable terms do not conspicuously and expressly address the uses to be made of consumer data or obtain necessary consent from consumers. In addition, some states recognize a right of publicity that grants an individual a right to monetize his or her name and likeness, and this right can create similar issues if a company crowdsources, for example, uncleared images or recordings of individuals.

And of course, any crowdsourced competition likely abuts regulations pertaining to sweepstakes or gaming, another area of the law that must be considered by the organizer of such projects.

Despite the aforementioned risks, companies have implemented very successful crowdsourcing campaigns, saved their companies lots of money, and enabled their companies to connect with the consuming public in ways they never could before. So, how can you deal with these risks, and make better informed choices about whether and how to implement crowdsourcing in your organization?

One of the most important steps to take is the creation of written terms governing the relationship between the parties involved in a crowdsourcing project. Below we focus on how to address some of the intellectual property risks associated with such projects.

III. Evaluating Intellectual Property Risks of Crowdsourcing

A. The Source Risk Continuum

Whenever companies source work product protected by intellectual property law, the level of risk associated with exploiting the work product falls along a continuum based on the source of the work product. Whether dealing with copyright, patent, or trademark law, this risk continuum generally applies throughout intellectual property law, because the burdens of clearing potential infringement and obtaining rights in the work product generally are similar.

For example, take a project that sources a design for a logo. Because of the ability of the company to control the internal design process, an internally sourced design (one created by an employee of the company) generally falls on the low risk end of the continuum, while a crowdsourced design falls in the high risk zone. A design sourced from a reputable creative agency occupies the middle area.

1. Internally Sourced Designs

Internally sourced designs occupy the lowest risk area of the design source continuum and theoretically have the lowest clearance risk of the three categories discussed, due to the element of control a company has over its employees. Additionally, the issue of ownership is substantially less complicated where the employee works within the scope of employment, because works created by employees within the scope of employment qualify as works made for hire.[17] With a work made for hire, neither assignment nor termination of transfer issues exist because copyright vests in the employer.[18] In this situation, indemnification and insurance are not additional concerns because the company is merely conducting business in the normal course. But while internal sourcing may offer the lowest risk, practically speaking, companies often look to external sources for increased expertise and potential rewards.

2. Crowdsourced Designs

Of all sources for design, crowdsourced designs involve the highest risk of infringement because of the large number and anonymous nature of contributors and the consequent difficulties associated with clearance. Even if warranties or indemnification concerning the non-infringing origins of the work can be obtained, they may be worthless. Importantly, a company must obtain complete written assignment of rights. Further, companies using crowdsourcing need to address the use of designer's name and likeness.

If your company is concerned with owning the result of the crowdsourcing project, as it often would be, crowdsourced designs protected by copyright involve additional challenges because crowdsourced works might not qualify as works made for hire. Because contributors likely are not considered employees under U.S. copyright law,[19] the only way a crowdsourced work can be eligible for work for hire status is if the work falls within one of the statutorily enumerated categories and the parties expressly agree the work is for hire.[20] If a work is not considered a work made for hire, termination of transfer issues can crop up, allowing the original creator of the work to reclaim ownership of the work after a statutory period of time, despite having assigned the work to you.[21]

Adding another wrinkle, crowdsourced contributor contracts may be in the form of electronic click-through agreements because much of crowdsourcing happens over the Internet. While courts generally uphold these agreements, courts have yet to address the validity of such contracts within the context of crowdsourcing.[22] Also, with crowdsourced projects, insurance may not cover liability or the full extent of damages.

3. Agency Sourced Designs

Agency sourced designs fall within the medium risk zone of the design source continuum. Lower clearance risk exists if the agency is obligated to clear the works. Likewise, warranties or indemnification may be of some value if you are dealing with a reputable, established agency. As with any independent contractor arrangement, the hiring party must obtain a complete written assignment of the rights. For agreements concerning copyrighted material, including both an assignment and a work-for-hire provision is a good idea, because the latter may avoid copyright termination issues if you can establish that the work falls within one of the statutorily enumerated categories. As with crowdsourced design, insurance may not cover liability or the extent of damages.

B. An Example of Risk Associated with Idea Submissions

While the following case law examples are not true crowdsourcing situations, we present them to provide you with an understanding of risks associated with accepting ideas submitted by the public. Ultimately, the issues of payment and confidentiality are important to address in any idea-submission agreement, and when operating in the crowdsourced space such terms are equally important.

In *Desney v. Wilder*, the California Supreme Court set the precedent for the eponymous "*Desney* claim" in holding that an idea submission can be construed as an implied in fact contract. [23] In *Desney*, the plaintiff pitched a television program to an executive at Paramount Studios. The court explained that if the idea purveyor clearly conditioned the conveyance with the expectation of compensation and the recipient voluntarily accepted the disclosure, then an implied in fact contract would be found, despite the work's ineligibility for protection under copyright law.

In *Larry Montz v. Pilgrim Film and Television*, the court expanded on *Desney* and held that copyright law does not preempt a "*Desney* claim" where the plaintiff alleges a bilateral expectation that he would be compensated for use of the idea.[24] Likewise, in *Riggs v. Myspace, Inc.*, the court reversed dismissal where the plaintiff alleged that she offered to sell her ideas to MySpace before disclosing them to MySpace.[25]

New York courts have also found implied in fact contracts in idea submissions. In *Forest Park Pictures v. Universal Television Network, Inc.*, television show developers brought an action against a network, alleging breach of an implied contract term to pay reasonable compensation if the network used the embodied concept in a television show.[26] The court held that the network knew or should have known of the implied condition for payment and that, while the developers' treatment fell within the subject matter of copyright, the breach of the implied contract term precluded a finding of Copyright Act preemption.

Nondisclosure agreements also may protect the purveyor's idea submission. In *Apfel v. Prudential-Bache Securities Inc.*, an intermediate New York state court held that nondisclosure agreements are enforceable where there is a showing of sufficient consideration.[27] The *Apfel* court reasoned that the agreement to purchase plaintiffs' idea for issuing and selling municipal bonds sufficed in that it was novel to or otherwise of value to the buyer.[28]

Plaintiffs can also bring a misappropriation of property claim under New York law; however, such claims require proof of originality, or general novelty; novelty to the buyer alone is insufficient.[29] In some cases, the submitted idea may be so unoriginal or lacking in novelty that knowledge of the idea will be imputed to the buyer and the claims dismissed. For instance, in *Nadel v. Play-By-Play Toys & Novelties, Inc.*, the Second Circuit reversed the lower court's dismissal and remanded the case to determine whether "an upright, sound-emitting, spinning plush toy" was either novel or original.[30]

The bottom line is that—bearing in mind the case law discussed herein—payment and confidentiality terms governing idea submissions should be clearly stated to avoid potential implied contract claims under state law. Any agreement governing a crowdsourcing project where the company does not intend to (i) pay for submissions or (ii) keep submissions confidential should state these terms expressly.

IV. Minimizing Crowdsourcing Risks

Crowdsourcing is here to stay. And while one cannot avoid the risks associated with using crowdsourcing, informed lawyers can work to mitigate those risks by taking the following steps in drafting terms and agreements governing crowdsourcing projects:

- If you want your company to be the owner of the submitted work product, take care to explicitly assign all intellectual property to the company. Whether the project involves patents, copyrights, or trademarks, under these circumstances a company should make sure to obtain a full grant of rights, including the right to sue for infringement. When dealing with copyrights, designate the work as made for hire whenever possible.
- Alternatively, if ownership of crowdsourced work product is less of a concern, your company may consider taking a broad license from the submitter in some circumstances.
- Obtain releases to use a contributors' name, image, likeness, and personally identifying information.
- Even though it ultimately may not hold significant weight in the event of an infringement action, require contributors to provide a warranty or representation of originality and non-infringement for their contributions. Similarly, require an indemnity covering infringement and misappropriation damages.
- Make provisions clear that you do not accept confidential submissions, or those containing proprietary information belonging to a third party.
- Detail logistics for submissions and draft clear provisions on the matter of payment, prizes, and awards for submissions, or lack thereof.
- Also be sure to include appropriate provisions for the selected crowdsourcing method. For example, sweepstakes law, employment law, and privacy law often apply to crowdsourced projects.
- Always determine whether third-party website terms of use apply to the company's selected crowdsourcing method. Websites such as Facebook and Twitter have policies regarding how companies can use the sites to interact with contributors.[31]

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How to Manage Collaborative Inventions

By Timothy Howe, Ph.D., Esq., Deborah L. Lu, Ph.D., Esq., Thomas J. Kowalski, Esq. and Smitha B. Uthaman, Ph.D.

One of the main goals of university technology transfer offices is to outlicense technology to industry. Patent portfolios provide attractive incentives for industries to license technology from universities; however, a decision to license technology is only the first move in a rather interesting, question-filled relationship between academia and industry.

An initial question is whether work is to be conducted by both parties, in accordance with a work plan laid out with agreed objectives. A typical model involves research to be conducted by a principal scientist in academia, with such work to be sponsored and/or funded by industry. A work plan, and associated budget, is developed and agreed upon. The parties then meet periodically to review the progress of the research. These project reviews may reveal inventions made during the course of the research program.

An industry perspective may view intellectual property as a strategic asset, but the stage of the technology dictates the value of the asset. In other words, a question is whether the technology is only at a basic research stage and likely to incur further costs of development or is it already at a mature stage and primed for commercialization. A further question is whether the industry will fund the further development of the technology and the procurement of intellectual property rights. In particular, the industry may obtain outright ownership of the intellectual property, an exclusive license or an option to obtain a license at a later date.

The academic perspective may be quite different. Partnering with industry is a source of research funds and it is important for a university to maximize the opportunity. Hence, promising technologies in their early stages of development may be considered more valuable in this light. Furthermore, the university may prefer that ownership stays with the academic institution to ensure continued development of the technology.

Unfortunately, there are some patent procurement issues that are diametrically opposed. From an industry perspective, limits on publications to protect patent rights may be preferred. On the other hand, academia subscribes to the publish or perish tenet, a position often expressed in terms of academic freedom. Both industry and the university may wish to take the lead in patent procurement and/or enforcement. Such decisions should be in the resultant agreement, as well as choice of counsel. It should also be clear as to whom the counsel represents—the university, the industry or both—as long as appropriate waivers are obtained.

One or both parties may identify inventions during the course of their respective research, and this may happen independently of the standing project reviews. In either case, the collaboration agreement will typically contain language that requires that any party that identifies an invention notify the other party as to such a development. This gives the parties the opportunity to share their respective views as to the nature of the invention, whether it may be patentable, and if so, whether patent filings should be made at this time, or if they should await development of additional data that would reasonably be expected to lend support to the patent application or broaden its scope.

A preliminary determination of inventorship may be performed at this stage. Under U.S. case law, an inventor is one who conceives of an invention, and not merely one who assists in its reduction to practice.[1] As such, an individual or individuals may be deemed an inventor even though such individual performed no experiments or "wet work." Generally, conception is "the complete performance of the mental part of the inventive act," and "the formation in the mind of the inventor of a definite and permanent idea of the complete and operative invention as it is thereafter to be applied in practice."[2]

And, an individual may be deemed a co-inventor even though he or she did not work in the same laboratory as the other inventor, did not make its contribution to the invention contemporaneously as the other inventor, etc.[3] It is a requirement for patentability that the inventors of a patent be identified in the patent application.[4] Failure to name an inventor is known as non-joinder, whereas naming an individual who did not contribute inventively to a patent constitutes mis-joinder.[5]

Under U.S. law an issued U.S. patent may be deemed invalid or unenforceable for failure to comply with the rule that the true inventors be named.[6] However, the America Invents Act (AIA) has proposed changes to simplify correction of inventorship.[7] In particular, the proposed rules simplify the methods for correcting inventorship. For example, proposed rule 37 C.F.R. § 3.31(h) would permit the use of an assignment to meet the oath or declaration requirements.[8] In other words, an inventor would only need to sign one document to satisfy the oath and declaration requirements of an inventor as well as assign his or her rights to an assignee. Furthermore, as amended by the AIA, 35 U.S.C. § 256(b)[9] recites"[t]he error of omitting inventors or naming persons who are not inventors shall not invalidate the patent in which such error occurred if it can be corrected as provided in this section." This amended language contemplates the invalidation of patents that fail to name the proper inventors; however, correcting inventorship has been simplified under the AIA and there is no reason why a patent should be unenforceable for improper inventorship.

There is no such rule in other jurisdictions, where, e.g., applications may be filed in the name of the company in which the research was conducted, or in the name of the head of the laboratory, and select others, where the research was performed. In other words, in other jurisdictions inventorship may be treated in a manner analogous to authorship. U.S. patent practitioners should be aware of this difference in rules and standard practice when preparing the U.S. counterpart of a foreign application.

Since inventorship is determined on a claim-by-claim basis, and as certain individuals may be deemed to have contributed to the invention described by some, but not all, of the claims in a patent application, a final review and correction of inventorship should be undertaken by the patent practitioner prosecuting the patent application at the time the Notice of Allowance is received.

Aside from compliance with the law, inventorship is often associated with ownership of patents which arise under a collaboration. Many collaboration agreements recite that "ownership of patents arising under the collaboration will follow inventorship, with inventorship determined in accordance with U.S. law." Under U.S. law, and absent any contractual agreement to the contrary, co-inventors each enjoy a complete, undivided interest in such patents.[10] Such patents are deemed to be jointly owned, and each party is free to exploit all or part of such patent, and license others to so exploit, without the consent of, and without accounting to, the other party.[11] Naturally, neither co-owner can license any aspect of a jointly owned patent on an exclusive basis. In the U.S., patent ownership rights are transferred contractually through a patent assignment agreement.[12]

Note that this situation is handled differently in other jurisdictions. In France, for example, a party to a jointly-owned patent may practice such patent directly, but cannot license its rights to a third party without the express consent of the other owner. This can result in a striking asymmetry between the parties insofar as one party, e.g., the commercial entity, may have the wherewithal to undertake development, registration and commercialization whereas the other party, e.g., the academic, could realize no value in the absence of outlicensing, something he or she could not do without the consent of the other owner.

Generally, academia has a limited budget for patent expenses, and looks to the industry partner to pay for preparation and prosecution. From the university's standpoint, this can give rise to a "moral hazard" insofar as, from the university's perspective, it would be best if the industry partner were to file, and vigorously prosecute, in each and every country of the world. It is highly unusual for any company to file patent applications in countries other than those where they may expect to make, use or sell products covered by the patent in question. Most companies have a standard list of countries where they routinely file, and may elect, on a case-by-case basis, to file in additional countries if a particular patent has potential relevance to countries not on the standard list.

The university may take the position that, notwithstanding the interest of the industry partner, and standard language of the contract referring to the territory as "worldwide," the industry partner may be deemed to have forfeited rights in countries where patent applications have not been filed. From the university's point of view, any country for which patent protection is not sought represents a country where otherwise infringing acts may occur, thereby depriving the university of royalty revenue to which it would be otherwise entitled. Generally, the parties agree that the industry party is obligated to file in those countries where it customarily files, and no more. Sometimes the university partner insists on a list of such countries at the outset, and that becomes part of the negotiation, and the contract itself.

Differences in patent enforcement issues also exist from industry and academic perspectives. From an industry perspective, litigation protects a competitive position as a patent has value with respect to its enforcement. However, an important question is whether the industry partner has standing to sue. Furthermore, if the patent deals with pharmaceutical drugs and their therapeutic equivalents and is to be listed in the Orange Book, such a listing requires exclusive rights. On the other hand, a university tends to be risk-averse and may be displeased about the role the inventors are expected to play in a litigation.

Another question is who decides what to do in case a jointly owned patent is being infringed. Because joint owners are considered indispensable parties to an infringement suit, if a joint inventor wants to sue an alleged infringer, it cannot do so unless all co-inventors voluntarily join in the suit.[13] The interests of the parties may not always be aligned. One party may be practicing the patented invention, and/or relying on the patent to exclude competitors from practicing such invention, and may not be willing to put the patent at risk by filing an infringement suit. The alleged infringer will likely develop arguments designed to persuade the court that the patent at issue is invalid or unenforceable, and such a holding will apply to all parties, not simply the alleged infringer.

For this reason, and based on its individual, subjective assessment of the "strength" of a given patent, a party may prefer to ignore infringement so as to avoid putting the patent "in play." The other party may only be collecting royalties, and may complain that unchecked infringement deprives it of royalties for which it would otherwise be entitled (such hypothetical lost royalties could be associated with lost sales of licensed product that would have been realized "but for" the infringing alternative). Or, such party may feel that the other party should sublicense the alleged infringer rather than allow the infringement to continue unabated. Because of these predictable divergences of interest the disposition of alleged infringement must be agreed in advance.

Assuming the parties agree, or the party that was contractually vested with the right to initiate an infringement suit does so, the question is what happens next? The lead party may require the cooperation of the other party, its inventor(s), witnesses, etc. The other party may need to be joined to the suit. Beyond that, other questions are where to file the suit, what outside counsel to engage, which party pays, who decides matters of strategy and who decides whether and when to settle.

Assuming the parties prevail, and provided monetary damages are awarded, the next question is, how are such damages to be divided? One way to approach this last point is to reimburse each party for its costs and expenses associated with the litigation, then divide the remainder in proportion to the amount of money each had invested in the suit. More commonly, damages are treated as comparable to "Net Sales," and the licensor is paid a royalty at the agreed rate.

There are many conflicting interests between academia and industry that must be identified and managed effectively from the outset. For example, ownership and rights to the invention may be retained by academia, granted to the industry partner or joint ownership between the two. Ownership of inventions arising from joint research projects may also present a conflict. The publication of results is also at issue—generally industry prefers less disclosure while academia encourages publishing. The availability of inventions to promote development is another conflicting issue. Also, the availability of inventors and the demands on their time for enforcement of the patent is another issue that most universities do not desire. Furthermore, a reversion of rights in initial and any jointly owned inventions to the university in the event there is no commercialization is yet another issue to consider.

Despite the issues in collaborative inventions between industry and academia, the rewards may outweigh the conflicts. For example, suppose a university develops a basic, real-world technology, an appeal to patent examiners that the university needs a patent to get a licensee and further develop the technology may be successful. Suppose the same university obtains an industry partner and develops lead compound X. An appeal to patent examiners that the university has a licensee and both the university and licensee need a patent because the product is in clinical trials may likely be successful as examiners often appreciate real-world scenarios. Often, if a perspective is maintained and balanced for both academic and university interests, a collaborative invention tends to be beneficial for both parties.

Endnotes

1. Morse v. Porter, 155 USPQ 280, 283 (Bd. Pat. Inter. 1965).
2. Townsend v. Smith, 36 F.2d 292, 295, 4 USPQ 269, 271 (CCPA 1930).
3. 35 U.S.C. § 116.
4. Stark v. Advanced Magnetics, 119 F.3d 1551, 1553, 1556 (Fed. Cir. 1997); 35 U.S.C. § 102(f).
5. 35 U.S.C. § 256.
6. Stark v. Advanced Magnetics, 119 F.3d 1551, 1552 (Fed. Cir. 1997).
7. Federal Register/Vol. 77, No. 4/Friday, January 6, 2012/Proposed Rules.
8. 37 C.F.R. § 3.31(h).
9. 35 U.S.C. § 256(b).
10. MPEP § 301.
11. 35 U.S.C. § 262.
12. 35 U.S.C. § 261.
13. Ethicon, Inc. v. United States Surgical Corp., 135 F.3d 1456, 1468 (Fed. Cir. 1998); Bendix Aviation Corp. v. Cury, 88 F. Supp. 243, 247-48 (E.D.N.Y. 1950).

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Using IP Assets to Weather the Startup Storm

By Jason Kreps and Tom Lemmo

Introduction

With the recent Facebook IPO making international headlines, the focus on startups and their potential to distribute great wealth to their members has never been more intense. This exit, and the recent exits of other notable startups (e.g., Linked-In, Zynga, Groupon, etc.) has created a veritable gold rush among investors who are clamoring to find any opportunity to make a profit in the still struggling investment world. This interest in the tech industry has bestowed a select few with unimaginable wealth and drawn tens of thousands of entrepreneurial workers into its web.

For those looking to form their own startups, the incentives are clear: no corporate bureaucracy, little dependence on others, heaps of optimism, and the possibility of unrivaled wealth. But as is the case with any entrepreneurial venture, the likelihood of realizing a sizable return is remote. As such, the savvy entrepreneur should always plan for multiple exit options. And in the world of startups, these exits will invariably involve the sale of intellectual property assets.

Intellectual property can be an elusive concept to grasp, especially for founders who are positioning their ventures to depend on it as a value-generating mechanism. For one, it is intangible and the founders will, for the most part, never hold the asset in their hands. Additionally, it is difficult for founders to feel secure in their ownership of intellectual property when it almost exclusively exists on paper.

This article begins with an overview of intellectual property rights, their various quirks, and their applicability to startups. Then, various methods of monetizing a startup's intellectual property investments will be explored from the perspective of entrepreneurs captaining distressed or failing startups through difficult, and sometimes deadly, market conditions.

Intellectual Property

Patents

The essence of the patent system is rooted in Article I of the U.S. Constitution: "Congress shall have Power...To promote the Progress of Science...by securing for limited Times...to Inventors the exclusive Right to their...Discoveries."[1] Correspondingly, under the Patent Act, a patent holder is granted the exclusionary right to stop others from making, using, selling, offering to sell, or importing the claimed technology for a period of twenty years.[2] The quid pro quo for this government-granted monopoly is the requirement that a patent holder disclose the invention for the public's benefit.[3] Progress is promoted and innovation is accomplished as the public learns from and builds upon this new technology.

Patents are inherently complex legal documents that present numerous challenges to anyone seeking to extract value from them. For one, a patent does not grant its owner an affirmative right to *do* anything. In this way, the exclusionary right granted by a patent can also be understood as a negative right to preclude others from "practicing" the claimed technology. This ability to exclude is important for startups to consider, because all of the energy and resources that are poured into an idea can be encapsulated in a patent in order to retain value in the future. Simply stated, a patent is like an innovation battery—it stores all of the energy and resources poured into it by the startup, and saves them for future use.

Copyrights and Trade Secrets[4]

Copyrights

For startups creating software code, copyrights can afford more cost-effective and unburdened protection than patents. Most software purchased or licensed by consumers today is copyrighted for this reason.

Copyrights are derived from Article 1 of the Constitution as well, but they differ from patents in important respects. For one, copyrights attach to creative works immediately upon their creation and do not have to be granted by the government.[5] Additionally, copyright protection can extend for 70 to 120 years, depending on the circumstances surrounding authorship.[6] It is important to note, however, that copyright protection only covers the literal work, the specific computer code as it is written line for line, and stops short of protecting the operation of the code.[7] A patent is required to achieve this secondary, more powerful level of protection for a literal work's method of operation. This can present problems when a startup seeks to monetize its copyrights, in that willing competitors can work around the copyright quite easily.

Trade Secrets

Trade secrets are by far the most prevalent form of intellectual property protection utilized in the United States today, existing by virtue of diligence. A company seeking trade secret protection must fastidiously protect its secrets through the use of confidentiality agreements and procedures developed to protect valuable proprietary information from misappropriation. Through the use of the appropriate agreements, this form of intellectual property can be created rather cheaply and effectively, hence its widespread use.[8] However, trade secrets often present a problem for startups. The culture of startup fundraising is one of disclosure, and as anyone who has courted a venture capitalist knows, potential investors are rarely willing to sign any form of non-disclosure or confidentiality agreement.[9]

For the above reasons, and others, the focus of this article falls squarely on the use of patents as the preferable method of protecting a firm's intellectual property rights. In doing so we recognize that we are limiting our analysis to what many would refer to as "high-tech" startups. This is purposeful: high-tech startups are more likely to have assets worthy of saving or reincarnating, and they are becoming increasing prevalent in New York.[10]

Formation and Maintenance of Intellectual Property Rights

Beginning at their inception, new companies should be diligent in securing any and all intellectual property rights. For the cash-strapped startup, priority should be placed on securing intellectual property above most other legal formalities. In fact, the first documentation that many venture capitalists and financiers will request from startups is proof of ownership for their intellectual property assets, an interest that further emphasizes the potential value of these assets.

Practitioners and owners alike should ensure that all employees, consultants, and contractors of a company sign strong invention assignment agreements, thereby securing a company's ownership rights in all intellectual property assets. While these agreements operate as a formal transfer of rights, it is also important to inform those who are party to these assignment agreements of their obligations under them, thereby helping to avoid future challenges.

One of the most important obligations that employees must comply with is an agreement to not utilize prior inventions in their work for the company. When they do, it is critical that the company execute a perpetual free license with the employee to use the prior work in current innovations. If the company's invention assignment agreements do not address these points well enough, its claims to intellectual property may be severely undermined.

Throughout the lifespan of a company, it is imperative that invention assignment agreements are routinely used and updated. In tandem, companies should keep track of the development of their inventions and consult with counsel about the appropriate time to file for rights, if necessary. This advice should especially be heeded with regards to patents, which require a lengthy application process and robust evidentiary disclosures.

Commercialization

Traditionally, the monetization of patent assets has been accomplished through commercialization, where an innovator patents a technology, develops that technology into a product or service, then takes it to market and earns revenue through sales. A successful commercialization strategy can open the door to lucrative future exits for entrepreneurs, like acquisitions, mergers, or IPOs. However, the journey from an idea's inception to acquiring a profitable market share is unpredictable and frequently ends in failure. Accordingly, entrepreneurs must be aware of the options their intellectual property can provide when the going gets tough, and how they can preserve future opportunities to monetize their patent investments.

Execution of sophisticated commercialization strategies is a daunting task for any entrepreneur, especially in light of startup firm failure rates.[11] In the startup space, commercialization can depend less on the quality of a new company's innovation than converting a high-potential innovation into a stream of economic returns; the failure of a startup to successfully bring an innovation to market is often a product of the inherent ineffectiveness of the startup mode of commercialization.[12] This primary management challenge persists despite the availability of abundant venture capital funding, as well as the management and marketing resources that accompany such relationships.

In developing and executing an effective commercialization strategy, it is critical for a startup to understand the economics of its space, particularly the distribution of ownership of complementary assets.[13] Complementary assets—technology and/or infrastructure required to bring an innovation into commercial existence—can be in the form of existing platforms necessary for the operation of an innovation, convergent technology necessary for integrating an innovation with product applications, or downstream technology necessary to bring an innovation to market.[14] When the nature of a startup's innovation requires the assets of other technology owners within a market, the successful in-licensing, out-licensing, and cross-licensing of complementary assets can help companies cooperate in commercialization while maintaining organizational independence.[15]

However, "for many startup innovators, those firms that control key complementary assets are precisely those that are the most likely and/or most effective potential product imitators."[16] Even though patent protection can strengthen an innovation's appropriability—a patent increases the likelihood of appropriating returns from an innovation by granting a monopoly to the owner while also decreasing the likelihood of imitation by competitors—this risk still exists. A patent cannot always block a competitor's commercialization of a similar technology, because competitors can always attempt a "design-around" strategy in an effort to introduce their own product into a competitive space while avoiding liability for infringement.[17]

From a patent law perspective, simple changes can be made to a technology so it can exist in a market without infringing on similar products and still achieve the same functionality as those products.[18] However, the preclusive nature of a patent will vary according to the type of technology it embodies, so the threat of design-around is enhanced in some spaces more than others.[19] In the software space, where the advantage of patent protection is constantly debated, the risk of design-around imitations is amplified: many variations of code can be written to execute similar program functions (the added patent protection for methods of operation notwithstanding). In the pharmaceutical space, by contrast, a chemical embodiment described in a patent will have unique properties and functions that similar compounds cannot replicate without infringing on the original patented chemical.[20]

Startups can struggle with the commercialization of their innovations not because their technology is inadequate, but because of competitive pressures in a space. In these circumstances, access to more time and more capital can become difficult, but entrepreneurs can avail themselves of alternative means of extracting value from their intellectual property, thereby either extending their lifespan or arranging for a cost-effective dissolution.

Alternatives

As a threshold matter to the discussion that follows, it is important to note that accurately valuing a patent is arguably the most difficult and important step in any monetization strategy. Combine the inherent complexity of patents as legal documents with the sophistication of rapid-growth cutting-edge technology, and one can see how identifying the seminal qualities of a claimed invention—a patent's metes and bounds—is a challenging endeavor. Startups looking to use innovative means to monetize their intellectual property must gather and evaluate an extremely broad range of information, or look to a third party who possesses the rich and integrated knowledge set required to do so. Patents have been transformed into one of the driving engines of high-technology firms of all sizes, and this transformation has inspired legal, finance, and technical professionals to pioneer innovative business models and techniques that view intellectual property, particularly patents, as transactional assets ripe for monetization.

Debt as VC

When facing competitive pressures with bringing an innovation to market, sometimes a startup just needs more time. But extending the "runway" between rounds of venture capital financing requires more money. Another monetization option for cash-strapped startups is patent collateralization, a form of debt financing that uses a patent as collateral for a secured lending transaction. Traditionally, startups have a low likelihood of utilizing external debt in the company's financial structure, due to their assets (mostly intangible in the form of intellectual property and human capital) having low collateral value and high specificity.[21] It's no surprise that traditional lenders prefer to avoid the uncertainty of loan repayment that accompanies investments in early-stage startups with no track record, no positive cash flows, and no tangible assets.

However, if entrepreneurs look beyond traditional banks they can find "venture lenders," or banking institutions, and public and private firms that specialize in providing loans to fund startups.[22] This "venture debt" can be thought of as a non-convertible bridge loan between rounds of venture capital financing, but one that involves the encumbrance of patent assets and an equity piece comprised of warrants in the startup.[23] However, the involvement of venture lenders in a startup is predicated upon the presence of venture capital financing and patent ownership already in the mix. From the lender's perspective, venture capital investment and patent collateral are substitutes for traditional loan eligibility criteria (e.g., the presence of cash flow and tangible assets).[24]

From an equity perspective there are benefits, too, which is why some venture capital funds are willing to participate in a third party financing source that encumbers their investment's intangible assets. For example, venture debt helps entrepreneurs, angels, and venture capitalists avoid dilution by extending the time period between a startup's equity rounds. A longer runway provides a startup more time to develop, market, and achieve milestones. Venture debt makes this possible without having to issue additional equity, which in turn allows investors to extract a higher valuation when more equity is eventually sold. As less of the startup is sold to raise funds, existing shareholder value is preserved. Moreover, from a venture capital fund's perspective, delaying and/or reducing the amount of capital it is forced to draw down from fund investors improves the fund's internal rate of return.[25]

As stated, venture lenders will look to a startup's intellectual property as collateral for securing the lending transaction. Article 9 of the Uniform Commercial Code (UCC) governs the creation of security interests in and relating to patent collateral, and presents its own unique obstacles. Particularly, Article 9 is notoriously ambiguous and unpredictable with respect to patent collateralization, and the potential pitfalls accompanying this particular finance technique can be costly.[26]

Licensing

In the event a startup has been unable to successfully commercialize its patented technology, entrepreneurs still have options. Although the economics of the patent licensing environment can sometimes prove discouraging, a growing patent intermediary market has allowed a greater number of patent owners, both big and small, to procure and benefit from equitable licensing agreements. A multitude of monikers have surfaced in an attempt to describe and differentiate the various business models operating within this market: non-practicing entity, patent aggregator, patent dealer, patent enforcement specialist, patent licensing firm, and many others.[27] Entities operating in this intermediary market can open up the possibility of out-licensing unused or uncommercialized technology, thereby providing a viable exit for entrepreneurs dealing with a failing startup.

As discussed, startups often fail not because of the inadequacy of their technology, but because of competitive pressures in their market sector. The failure of a startup will most likely take place in a concentrated industry containing larger, more established incumbents that possess the necessary complementary assets to develop and market technology efficiently and cost-effectively.[28] Licensing a technology can allow a startup to capitalize on the profits of more established, better positioned companies.

However, the patent licensing playing field is notorious for operating to the benefit of these incumbents, a disparity that can be explained by the substantial market bargaining power provided by their ample capital and more robust patent portfolios. Patent intermediary firms can help a startup combat this imbalance in two ways. First, they can supply the capital necessary to create a legitimate threat of litigation, which in turn provides startups with the leverage required to execute equitable licensing agreements with larger entities.[29] Second, the intermediary can be useful in increasing the liquidity of a startup's patents assets by taking them to a centralized market where information asymmetries are reduced and patent rights can be sold for cash capital.[30] This latter avenue is a more rapid means of unlocking value wrapped-up in a startup's patent assets prior to the outright sale or dissolution of the firm. Entrepreneurs looking for an exit can utilize a patent intermediary firm to help level the playing field, lower the costs of patent licensing transactions, and ameliorate some of the illiquidity issues of intellectual property.

Finally, entrepreneurs with patent assets should avoid shortchanging the value their intellectual property might have to third parties. Patent acquirers can be attracted to patents for many reasons, including defensive patent pooling, offensive purposes, leverage in cross-licensing negotiations, nuisance-value settlements, preemptive strategies, and auctioning and brokering.

Bankruptcy

Among developed companies, bankruptcy is frequently utilized to distribute assets and settle outstanding liabilities. While the unique legal framework of bankruptcy proceedings supplies a much needed structure for troubled companies, it is not a panacea for all companies looking to restructure or dissolve.[31] The need for judicial oversight and sophisticated counsel often makes bankruptcy an expensive option. Additionally, bankruptcy's use of a trustee to distribute the assets of a company can often make it an inefficient mechanism when dealing with intellectual property.[32] For these reasons, and the ones discussed below, entrepreneurs should be aware of this important process and the alternatives available.

Entrepreneurs, and the practitioners who represent them, may want to avoid a discussion about bankruptcy in the hopes of never having to seriously contemplate it. But the reality is that the life of a startup up may end more abruptly than anticipated. Therefore, understanding the processes available for managing the closure or restructuring of a firm can provide a startup with useful insight.

As discussed above, there are two primary reasons why startups may want to avoid bankruptcy proceedings: costs and inefficiencies. Since the court oversees bankruptcy proceedings, the legal fees associated with the process are typically high. In addition to the company's own counsel, the entity will also have to pay for a trustee to oversee the proceedings. The trustee may hire its own counsel and associate other professionals in order to carry out its obligations, further compounding the costs.[33]

Aside from costs, trustee competency is another important factor to take into consideration when contemplating bankruptcy. Startups operate in a fairly intricate space that focuses on the value of specialized intellectual assets. The technologies associated with these assets are often hard to value and require sophisticated parties to properly handle. Given these considerations, it is important to have a trustee in charge of asset distribution who is familiar with the technology and the importance of transferring assets in coordination with inventors. This a crucial point, considering bankruptcy often requires that employees be terminated before assets are addressed.[34] For some technologies, especially those dependent upon and/or composed of software, the original development team must remain intimately involved with the technology in order for it to retain its value.[35] Due to the immense amount of effort required to become familiar with some technologies on even a basic level, potential acquirers may be less likely to acquire a technology without its inventors in tow.

Accordingly, many startups, and especially those operating in California, have utilized a process known as an assignment for the benefit of creditors (ABCs), which helps to avoid the aforementioned issues. As Professor Mann at the University of Texas notes, utilizing an assignment in lieu of bankruptcy can produce better results for the disappearing company at a lower cost and in a more expedient manner.[36] The success of ABCs hinge on mating the company with a suitable assignee that can extract the most value from the intellectual property that is being disposed of. As Mann describes, the fertile environment existing in Silicon Valley is ripe for these kinds of transactions, and ABCs have made a sizable dent in the number of bankruptcies filed by startups in the state.[37] New York's statutes appear to impose considerably more onerous restrictions on companies looking to avail themselves of an ABC. However, as the tech community continues to mature in the state of New York, these transactions can and should be embraced by practitioners.[38]

Conclusion

Staying competitive in the new idea economy requires an understanding and appreciation of the intricacies and legal constructs of the evolving IP-as-assets perspective, as well as the monetization potential of these assets. In order to always preserve opportunities for accessing intellectual capital—especially in times of need or in the event of dissolution—it is vital that entrepreneurs are mindful of their IP management strategies, as well as the emerging patent intermediary market, at the inception of their startup and throughout its lifespan.

Endnotes

1. *See* U.S. Const. art. I. § 8 cl. 8.
2. *See* 35 U.S.C. § 271 (2008).
3. *See Brenner v. Manson*, 383 U.S. 519, 534 (1966); 35 U.S.C. § 122(b)(1) (2000).
4. Trademarks, while of course valuable, do not play an important role in our analysis. Failed startups typically have not infused their mark with significant value by the time it becomes necessary to close up shop. The marks also do not protect the technical assets of the entity, which are the focal point of this piece. For more information on the monetization of trademarks, *see* Xuan-Thao Nguyen, "Collateralizing Intellectual Property," 42 Ga. L. Rev. 1 (2007).
5. *See* 17 U.S.C. § 302 (1976).
6. *Id.*
7. The extent of protection offered by software copyrights was tested in the landmark case *Lotus Dev. Corp. v. Borland Int'l, Inc.*, 516 U.S. 233 (1996), in which the United States Court of Appeals for the First Circuit ruled that copyright protection does not extend to the "method of operation" of the software.
8. *See* Mark A. Lemley, "The Surprising Virtues of Treating Trade Secrets as IP Rights," 61 Stan. L. Rev. 312 (2008).
9. *See* Guy Kawasaki, "The No-Bull-Shiitake Investor Wishlist," American Express Open Forum, December 9, 2008, *available at*: http://www.openforum.com/idea-hub/topics/the-world/article/the-no-bull-shiitake-investor-wishlist.
10. A great example of New York's emerging focus on high-tech companies can be seen in Cornell's plan to build CornellNYC Tech, a tech campus solely focused on the pursuit of learning revolving around cutting edge technologies: http://now.cornell.edu/nyctech/.
11. Carmen Nobel, "Why Companies Fail—and How Their Founders Can Bounce Back," Harvard Business School: Working Knowledge, March 7, 2011, *available at*: http://hbswk.hbs.edu/item/6591.html.
12. *See* John E. Dubiansky, "An Analysis for the Valuation of Venture Capital-Funded Startup Firm Patents," 12 B.U. J. Sci. & Tech. L. 170, 186 (2006).
13. *See* Joshua S. Gans & Scott Stern, "The product market and the market for "ideas": commercialization strategies for technology entrepreneurs," 32 Research Policy 333, 334 (2003).
14. *See* Dubiansky, supra note 12, at 188.
15. *See* Gans & Stern, supra note 13, at 337.
16. *Id*. at 334.
17. *See* Hung H. Bui, "Practical Strategies to Develop an IP Portfolio and Avoid Mistakes Pertaining to IP for High-Tech Startups and Small Technology Companies," The Sixth VACETs Technical International Conference, June 4, 2005, at 18.
18. Stuart J.H. Graham & Ted Sichelman, "Why Do Startups Patent?" 23 Berkeley Tech. L.J. 1063, 1084 (2008).
19. *See* Dubiansky, supra note 12, at 187.
20. *See id*.
21. Catherine L. Mann & Paroma Sanyal, "The Financial Structure of Startup Firms: The Role of Assets, Information, and Entrepreneur Characteristics," FRB of Boston Working Paper no. 10-17, at 2, *available at* SSRN: http://ssrn.com/abstract=1768099.
22. See Darian M. Ibrahim, "Debt as Venture Capital," 2010 U. Ill. L. Rev. 1169, 1169-1170 (2010) (Estimates $1-5 billion per year in venture loans).
23. The typical term of a venture loan can range from twenty-four and thrity-six months, and warrant coverage typically ranges from 5-15% of the loan amount. *See id.* at 1179-80.
24. *See id*. at 1173.
25. *See id.*
26. For a more in-depth look at these transactions, *see* Jason Kreps & Thomas Lemmo, "Patent-backed Securitization and Collateralization: The Pitfalls of Article 9," J. of Taxation and Regulation of Financial Institutions, Vol. 25, No. 03 (January/February 2012).
27. *See* Raymond Millien & Ron Laurie, "A Survey of Established and Evolving IP Monetization Models," 984 PLI/Pat 1033, 1038-1054 (2007).

28. *See* Dubiansky, supra note 12, at 189.
29. *See* James F. McDonough III, "The Myth of the Patent Troll: An Alternative View of the Function of Patent Dealers in an Idea Economy," 56 Emory L.J. 189, 212 (2006).
30. *See* Sannu K. Shrestha, Trolls or Market-Makers? "An Empirical Analysis of Nonpracticing Entities," 110 Colum. L. Rev. 114, 130 (2010).
31. *See* Ronald J. Mann, "An Empirical Investigation of Liquidation choices of Failed High-Tech Firms," 82 Wash. U. L.Q. 1375, 1390 (2005).
32. *See id*. at 1390-1392.
33. *See id*. at 1393.
34. *See id*. at 1392.
35. *See* Michael Arrington, "What To Do With Failed Startup IP?" TechCrunch, May 6, 2008, *available at* http://techcrunch.com/2008/05/06/what-to-do-with-failed-startup-ip/.
36. *See* supra note 31.
37. *See* supra note 31, at 1415.
38. *See* supra note 31, at 1405.

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2012 President's Section Diversity Challenge

The New York State Bar Association President's Section Diversity Challenge: In 2011, NYSBA President Vincent E. Doyle III challenged NYSBA Sections to develop and execute initiatives to increase the diversity of their membership, leadership and programs, and to evaluate the results. The Committees on Membership and Diversity and Inclusion were tasked with coordinating the initiative. The Challenge began in June 2011 and concluded in March 2012.

Corporate Counsel Section Awarded 1st Place—Section Diversity Leaders

Working Together, Everything Fits

Right to Practice Reform: Registered In-House Counsel and Pro Bono Service

By David S. Rothenberg, Cynthia Beagles, Greg Hoffman, Jeffrey P. Laner, Randal S. Milch, Thomas A. Reed and John Frantz, with the assistance of Eve Runyon

Summary

The crisis in access to justice "has reached a breaking point."[1] The gap between unmet legal needs and available legal resources has widened to an unprecedented degree, demanding that no resource be left untapped. This includes the efforts of in-house attorneys, who are a growing force in pro bono assistance. Yet, hundreds of registered in-house attorneys in New York are unable to fulfill their ethical obligations and serve as valuable resources, due to a lapse in New York's practice rules.

Fortunately, there is an easy solution. To empower in-house counsel, provide them the opportunity to satisfy their ethical obligations, and grant them the authority to efficiently provide pro bono assistance to New Yorkers and nonprofit organizations in need, New York should amend its practice rules to permit registered in-house counsel to provide pro bono services in addition to working for their employer. In-house counsel should be freed in most representations[2] from cumbersome requirements mandating that registered in-house counsel be supervised by locally licensed attorneys or work with an approved organization. Such limitations are unnecessary due to requirements and protections provided for in the New York Rules of Professional Conduct.

For these reasons, which are further detailed in this report, New York should amend Part 522 of the Rules of the Court of Appeals for the Admission of Attorneys and Counselors at Law to include the following provision:

> §522.8 Pro bono services
>
> An attorney registered as in-house counsel under this Part may also provide pro bono legal services in this State, and in the provision of such pro bono legal services the registered in-house counsel may:
>
> > (a) make appearances in this State before a tribunal, as that term is defined in Rule 1.0[w] of the New York Rules of Professional Conduct (22 NYCRR 1200.0), or engage in any activity for which pro hac vice admission would be required, only after having sought and obtained permission to make such appearances or engage in such activities in the same manner required of an attorney not admitted to the practice of law in this State; and
> >
> > (b) not hold oneself out as an attorney admitted to practice in this State except on letterhead with a limiting designation.
>
> The provisions of §522.4 shall not apply to the provision of such pro bono legal services.

Report

Effective April 20, 2011, New York implemented "Rules for the Registration of In-House Counsel" that permit in-house counsel who are licensed to practice in another jurisdiction but not in New York to work for their company in New York.[3] This rule does not include language permitting those lawyers to also engage in pro bono work.[4]

This report proposes that New York amend its rule and grant registered in-house counsel the authority to engage in pro bono services. It suggests language that would enable registered in-house counsel to provide pro bono support free from unnecessary restrictions but subject to the same ethical and disciplinary rules that apply to attorneys licensed to practice in New York as well as, until further study is completed, the *pro hac vice* admission rules that apply to attorneys not licensed to practice in the State.

The State of Legal Needs in New York

Legal services in the United States and New York are in crisis. According to the national Comprehensive Legal Needs Study of the American Bar Association, 80 percent of the legal needs of low-income people go unmet.[5] This number has been reaffirmed in legal needs studies across the nation.[6] In addition, the Legal Services Corporation (LSC) found in 2005 that there is only one legal services attorney for every 6,861 low-income persons.[7] Coupled with the recent cuts in legal aid resources, including Interest on Lawyer Account Funds (IOLA) and the $56 million decrease in basic field funding for LSC for Fiscal Year 2012, the situation for low-income individuals, the lawyers who assist them, and court systems around the nation is devastating. Providing essential legal assistance to persons in need and the organizations that support them helps stabilize communities and ensures the viability of public trust in the justice system.

In New York, the situation is equally dire. Charged by the courts to assess the degree of unmet legal needs, the Task Force to Expand Access to Civil Legal Services in New York (Task Force) issued a report to the Chief Judge in 2010 that reveals that more than 2.3 million people in New York attempt to navigate the legal system without the assistance of counsel.[8] Most of these people are low-income New Yorkers and are unrepresented not by choice but due to financial limitations.

This report also states that annually nearly 3 million low-income New Yorkers are faced with a civil legal problem and 1.2 million face three or more legal problems.[9] Yet, IOLA funded legal services organizations handle only about 260,000 matters a year, creating a tremendous gap in the provision of legal services to those in need. Providers in New York are serving, at best, only 20 percent of the need.[10]

Just as, nationally, there are not enough legal service lawyers to assist the number of low-income individuals in need, in New York, legal service providers reported that, in 2009, they turned away 50 percent of eligible low-income New Yorkers due to lack of resources.[11] In 2010, as the weight of the recession continued to impact the most vulnerable, legal aid organizations reported a substantial increase in the number of individuals turned away.[12] Importantly, this increase does not include or reflect the number of low-income people who are unaware of their rights or who do not seek assistance from legal service organizations.

New York's charitable organizations face a similar dilemma in obtaining necessary legal services. According to Charity Corps, a joint initiative of the New York State Bar Association and the New York Attorney General's office, New York State is home to approximately 80,000 charities that enrich communities and provide crucial services to residents across the state. However, most New York State charities are comparatively small in size. An estimated 80 percent of New York nonprofits do not have access to legal counsel to properly address organizational legal needs such as employment law issues, contract reviews, real estate matters, and board governance/fiduciary responsibilities—important issues that when properly addressed, help ensure that charitable assets are being efficiently used, and that legal matters are properly identified and addressed before they become problems.[13]

Despite the increase in demand, funding for legal service organizations has decreased dramatically. New York State IOLA revenues for civil legal services, a critical source of legal services funding, fell from $32 million in 2008 to $6.5 million in 2010 and 2011.[14] More than 57 percent of legal service organizations report staffing reductions because of decreased resources, increasing the number of low-income individuals the organizations are unable to serve.[15]

This gap between the need for legal services and the services available for low-income individuals and organizations that support them has a tremendous impact on the judicial system in New York.[16] The Task Force reports that judges in New York found that valid court claims are lost because unrepresented parties do not present evidence or understand the law.[17] Courts must spend tens of thousands of hours trying to assist the unrepresented, becoming less efficient and impairing the quality of justice for all New Yorkers, even those with representation.[18]

The Need for Pro Bono Service

While pro bono assistance alone cannot fill the widening gap between legal needs and available assistance, the Task Force continues to emphasize leveraging resources through pro bono work. In its most recent report, the Task Force lists "increasing the available pro bono assistance by private lawyers" as one of its "significant non-monetary recommendations."[19] With additional pro bono resources, there is potential to increase representation and expand the work of legal service organizations. Currently in New York, the private bar contributes over 2 million hours of pro bono service to low-income individuals and communities, and the nonprofits that serve them.[20] However, there still remains a significant untapped resource.

Growing Willingness and Capacity of In-House Pro Bono

There are more than 9,500 in-house counsel practicing in New York, and, to date, more than 350 of them have registered as in-house counsel under the new rule. A large number of in-house lawyers work at legal departments where supporting low-income communities through pro bono assistance to individuals and to nonprofit organizations is a core value.

Over the past five years, in-house pro bono has grown tremendously. According to Corporate Pro Bono (CPBO), a partnership project of the Pro Bono Institute and the Association of Corporate Counsel (ACC), many of the Fortune 500 companies and a majority of the Fortune 100 companies have either set up or are moving to establish formal pro bono programs for the lawyers in their legal departments. This list includes Aetna Inc., Caterpillar Inc., The Coca-Cola Company, Ford Motor Company, The Gap, Inc., General Electric Company, Hewlett-Packard Company, Merck & Co., Inc., Microsoft Corporation, Shell Oil Company, Wal-Mart Stores, Inc., and a host of others. In addition, lawyers in smaller companies and legal departments engage in pro bono legal services through opportunities organized by CPBO, local bar associations, and ACC Chapters.

This trend is especially true in New York. Companies such as American International Group, Inc., American Express Company, Citigroup Inc., Deloitte and Touche, Federal Reserve Bank of New York, The Goldman Sachs

Group, Inc., International Business Machines Corporation, JPMorgan Chase & Co., MasterCard Corporation, MetLife, Inc., News Corporation, New York Life, PepsiCo, Inc., Philip Morris International Inc., Pfizer Inc., Time Warner Inc., Verizon Communications Inc., Viacom Inc. and others have not only expressed an interest in pro bono, they have begun to set up or have set up formal pro bono programs within their legal departments. The Pro Bono Partnership, Inc., a Westchester County- based nonprofit, 501(c)(3) legal services provider, has as a core mission to engage in-house attorneys on transactional and corporate pro bono matters for charitable organizations in New York, New Jersey and Connecticut. Since its start in 1997, it has successfully worked with most of these and other legal departments. In addition, the New York ACC Chapters and the New York State Bar Association highlight pro bono opportunities for in-house counsel to its members.

The Need to Create a Simple Process

Rule 6.1 of the New York Rules of Professional Responsibility provides that "Lawyers are strongly encouraged to provide pro bono legal services to benefit poor persons. (a) Every lawyer should aspire to (1) provide at least 20 hours of pro bono legal services each year to poor persons…." (The Rule also applies to pro bono services provided to charitable, religious, civic and educational organizations.) Rule 6.1 makes no distinction between locally licensed and registered in-house counsel.

To ensure that the private bar is fully supporting the role it can play in addressing the crisis in legal services, and to afford in-house counsel the opportunity to efficiently provide pro bono assistance to communities in need, New York should amend its rule to grant in-house counsel the ability to easily comply with Rule 6.1, satisfy their ethical obligations, and provide pro bono representation to underserved individuals and nonprofit organizations.

In order for the amended rule to most benefit New York, its citizens, and its courts, it should be drafted so that it will: (1) add to the number of lawyers able to assist low-income communities; (2) broaden the reach of services legal aid providers are able to give; (3) minimize the burden overtaxed legal service providers already bear; (4) expand the number of low-income individuals and communities served; (5) reduce the burden on the courts; (6) bring efficiencies to the justice system; and (7) ensure that pro bono counsel provide competent and diligent assistance, subject to the rules of New York.

The language proposed below, as §522.8 Pro bono services, achieves these goals. However, some states have adopted rules counter to these objectives.

Unnecessary Obstacles to Pro Bono Practice

Several jurisdictions have adopted practice rules that, while allowing in-house counsel to perform pro bono work, unduly restrict the ability of registered in-house counsel to provide pro bono services to indigent communities. These limitations are unnecessary and serve to decrease the number of competent lawyers able to provide assistance to those in desperate need and reduce the number of clients served.

Under the Supervision of a Locally Licensed Lawyer

Some states have adopted requirements that in-house counsel licensed to practice in another jurisdiction provide pro bono assistance under the supervision of a lawyer licensed to practice in-state. This is an unnecessary restriction that limits the amount of time competent lawyers are able to provide direct assistance to clients and reduces the number of clients served.

First, it requires that lawyers licensed in-state dedicate time and resources to act as supervisors to lawyers who are already licensed to practice and are in good standing in another jurisdiction, constraining the ability of licensed lawyers to serve clients directly. Second, it hampers the ability of qualified in-house counsel to provide advice and services to communities in need by insisting that they only do so under close supervision. Third, it mandates that two lawyers provide services to one client regardless of whether the matter requires such staffing.

New York rules already require lawyers, including registered in-house counsel, to competently represent their clients and to acquire "the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation." Rule 1.1 of the New York Rules of Professional Conduct. Further, the new in-house counsel rule already requires registered in-house counsel to "abide by all of the laws and rules that govern attorneys admitted to the practice of law in this State," except as specifically limited in the new rule. Part 522.3(d) of the Rules of the Court of Appeals for the Registration of In-House Counsel. To mandate that, in addition, these lawyers must work under the supervision of another is an unnecessary limit on services that are in desperate need.

In Association with an Approved Legal Aid Organization

Other states require that registered in-house counsel provide pro bono services in association with an approved legal aid or similar organization. Many in-house legal departments and corporate counsel already work with legal aid organizations in New York and will continue to do so. However, restricting registered in-house counsel from working with other organizations that serve low-income communities, including law firms, courts, social service agencies, and community groups, prevents in-house counsel from serving the breadth of low-income families and organizations in need.

Legal aid organizations are already exhausting their resources; they can only assist volunteer attorneys so much. In a number of communities, local legal service programs have reduced staff or have closed offices. This limits the ability of volunteers to provide services through those organizations.

In addition, legal aid organizations only serve a small segment of low-income households in need. Many legal aid organizations narrow the focus of their work, excluding certain types of clients or certain types of matters, like foreclosures and divorce. Furthermore, only a small percentage of low-income households in New York seek assistance from legal aid organizations.[21]

The need to identify diverse avenues through which low-income communities can be served is tremendous. Mandating that registered in-house counsel can only provide services in partnership with an approved legal service provider or similar organization unnecessarily hand-cuffs what these lawyers can do and who they can help.

Further Study of the Continued Applicability of the Pro Hac Vice *Rules*

The proposed language maintains the applicability of the current *pro hac vice* admission rules to in-house counsel, limiting their ability to appear before tribunals without the assistance of fully barred New York attorneys. Although maintaining these rules will diminish the benefits that in-house counsel can bring to those in need of representation in New York, some study is required to better understand whether applying these rules is necessary to protect clients in need. This study should be undertaken expeditiously.

Proposed Language

The underlined and italicized language below has been drafted to empower New York registered in-house counsel to provide pro bono services, without unnecessary restrictions, but subject to the New York Rules of Professional Conduct.

§522.4 Scope of Legal Services

An attorney registered as in-house counsel under this Part shall:

(a) provide legal services in this State only to the single employer entity or its organizational affiliates, including entities that control, are controlled by, or are under common control with the employer entity, and to employees, officers and directors of such entities, but only on matters directly related to the attorney's work for the employer entity, and to the extent consistent with the New York Rules of Professional Conduct;

(b) not make appearances in this State before a tribunal, as that term is defined in the New York Rules of Professional Conduct (22 NYCRR 1200.0 Rule 1.0[w]) or engage in any activity for which *pro hac vice* admission would be required if engaged in by an attorney who is not admitted to the practice of law in this State;

(c) not provide personal or individual legal services to any customers, shareholders, owners, partners, officers, employees or agents of the identified employer; and

(d) not hold oneself out as an attorney admitted to practice in this State except on the employer's letterhead with a limiting designation.

§522.8 Pro Bono Services

§522.8 Pro bono services
An attorney registered as in-house counsel under this Part may also provide pro bono legal services in this State, and in the provision of such pro bono legal services the registered in-house counsel may:

(a) make appearances in this State before a tribunal, as that term is defined in Rule 1.0[w] of the New York Rules of Professional Conduct (22 NYCRR 1200.0), or engage in any activity for which pro hac vice admission would be required, only after having sought and obtained permission to make such appearances or engage in such activities in the same manner required of an attorney not admitted to the practice of law in this State; and

(b) not hold oneself out as an attorney admitted to practice in this State except on letterhead with a limiting designation.

The provisions of §522.4 shall not apply to the provision of such pro bono legal services.

Endnotes

1. The Task Force to Expand Access to Civil Legal Service in New York. *Report to the Chief Judge of the State of New York* at 1 (Nov. 2010), available at http://www.courts.state.ny.us/ip/access-civil-legal-services/PDF/CLS-TaskForceREPORT.pdf (Report 2010).
2. The proposed amendment at subsection (a) leaves in place a requirement that in-house counsel remain subject to the current rules requiring pro hac vice admission for "foreign" lawyers to practice before New York tribunals. This requirement should be reconsidered after appropriate study to determine if its maintenance for pro bono activities is necessary to protect pro bono clients.
3. Part 522 of the Rules of the Court of Appeals for the Registration of In-House Counsel, relating to the registration of in-house counsel in New York.
4. To date, more than 350 in-house counsel have registered to practice in New York.
5. American Bar Association, *Legal Needs and Civil Justice: A Survey of Americans. Major Findings from the Comprehensive Legal Needs Study* (1994), available at http://www.abanet.org/legalservices/downloads/sclaid/legalneedstudy.pdf.
6. In 2004, nine state studies found that less than 20 percent of the legal needs of low-income people were being met. *See* Legal

Services Corporation, *Documenting the Justice Gap in America, The Current Unmet Civil Legal Needs of Low-Income Americans, Overview* at 2 (2005), available at http://www.lsc.gov/pdfs/JusticeGapReportOverview120105.pdf.

7. Legal Services Corporation, *Documenting the Justice Gap in America: The Current Unmet Civil Legal Needs of Low-Income Americans* at 15 (2005), available at http://www.lsc.gov/justicegap.pdf.
8. Report 2010 at 12.
9. *Id.* at 11.
10. The Task Force to Expand Access to Civil Legal Service in New York. *Report to the Chief Judge of the State of New York* at 1 (Nov. 2011), available at http://www.nycourts.gov/ip/access-civil-legal-services/PDF/CLS-2011TaskForceREPORT_web.pdf (Report 2011).
11. Report 2010 at 4.
12. *Id.*
13. See "Charity Corps: NYSBA & NYAG Joint Initiative to Secure Pro Bono Legal Services for Unrepresented Charities in New York," available at http://www.nysba.org/Content/NavigationMenu/ForAttorneys/CharityCorpsResources/Full_Program_Descrip.htm.
14. Report 2011 at 1.
15. Report 2010 at 13.
16. Report 2011 at 3.
17. Report 2010 at 1.
18. *Id.*
19. Report 2011 at 1.
20. Report 2010 at 4.
21. Only seven percent of low-income households in New York who experienced a civil legal problem in the past year sought help from legal aid organizations. *See* Findings of Lake Research Partners on Civil Legal Needs Among Low Income New York State Residents, Appendix 17 to The Task Force to Expand Access to Civil Legal Service in New York. *Report to the Chief Judge of the State of New York* at 58 (Nov. 2010), available at http://www.courts.state.ny.us/ip/access-civil-legal-services/PDF/CLS-TaskForceREPORT.pdf.

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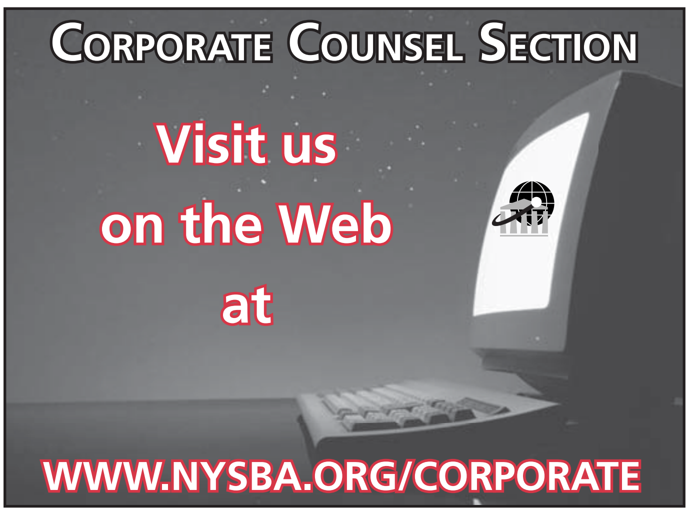

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Inside

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