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Bright Ideas

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Message from the Chair

Richard L. Ravin

From the category of learning when you teach, I relate this important piece of information about Internet usage, which also exemplifies why the Section's annual Fall Meeting is so worthwhile. While preparing to moderate a panel at our Section's Fall Meeting in October on the topic of identity theft, phishing, and spyware, I was forwarded a brand-new phishing scam e-mail which purported to be from amazon.com The forged message had a link which appeared to be a legitimate domain name, even to those familiar with phishing scams (*e.g.*, me), because when mousing-over the hyperlink "To confirm your identity with us click here," the following ULR was revealed: "https://secure.amazon.com.execacc-ro.com/signin.php?exec/[remainder of lengthy URL omitted]."

Although "amazon.com" does appear in the URL, because "execacc-ro.com" appears later in the string it is the controlling domain. The top-level domain (TLD) is ".com," and each label (separated by a period) to the left of the TLD specifies a subdivision or subdomain of the domain; thus "execacc-ro" is the second-level domain. Thus, if you were doing a look-up on the WHOIS database, you would look up the domain name by its TLD and second-level domain—"execacc-ro.com"—to determine the owner of the domain name registration. The portions of the URL "secure.amazon.com" are merely third-, fourth-, and fifth-level domains intended to fool the Internet user into thinking they are at the real amazon.com Web site.

The problem with subdomains came to my attention the evening before the program during a conversation I was having with Paul Fakler, Section Treasurer. We were catching up on our respective practices when our discussion turned to third- and fourth-level subdomains, which increasingly are

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becoming a problem. One of the issues with subdomains lower than the second-level is that they are not registered with ICANN as domain names because they are only associated with domain names and are not domain names themselves. They are created by the website host.

The most commonly used subdomain is "www," as in http://www.ravin.com. However, there is no requirement to insert "www" in front of the domain name. Similarly, the addresses of mail servers often use the term "mail" as the subdomain, as in mail.ravin.com. Because the subdomains are not registered, they arguably are not covered by the ICANN Uniform Dispute Resolution Policy or by those aspects of the federal Anticybersquatting Consumer Protection Act (section 43(d) of the Lanham Act) that require registration of the domain name.

By sheer coincidence, later that night I received the bogus e-mail referred to above and was alerted to look for the third- and fourth-level domain names, which were masquerading as what is commonly known as "the domain name." The next day at the conference, with the help of Paul, a free-flowing and interesting discussion about subdomains ensued.

The way I came to learn of the subdomain problem at the Fall Meeting and at the resulting discussion during the panel presentation on identity theft was exactly what was envisioned when the annual autumn meeting initially was set up by the Section 14 years ago. According to the oral history of our Section, the Fall Meeting at The Sagamore was conceived as a think tank, where Section members and speakers would spend the weekend together discussing cutting-edge topics and exchanging ideas and knowledge about the practice of intellectual property law. It was particularly satisfying to see the think-tank concept working so well at this past meeting with respect to identity theft and many other issues. Credit must be paid to our founding Chair, Rory J. Radding, and the other founding Section members for giving birth to this valuable tradition.

As usual, this year's Fall Meeting was held in early October at The Sagamore, which is magnificently perched on the shore of Lake George. Uncharacteristically, we were greeted with a heavy dose of rain instead of the usual beautiful colors and crisp autumn sun. However, nothing could dampen our enthusiasm for the exceptional conference, entitled "Games IP Lawyers Play: How IP Lawyers Win, Lose & Draw in IP Negotiations, Counseling & Litigation," which was a wonderfully enriching event for all attendees. We were thrilled to see so many first-time Fall Meeting attendees.

The program sessions included: Maintaining Relationships Between In-House and Outside Counsel; Maximizing Damage Awards in IP Litigation; Phishing, Spyware, Identity Theft, Database Protection and Cyberpiracy as They Pertain to Client IP Rights; Methods of Shutting Down Counterfeiters; Analysis of the Supreme Court's Decision in *Grokster* and the Second Circuit's Decision in *1-800-Contacts*; Review of Proposed and Newly Enacted IP Legislation, and Practical Experience with *Markman* in Patent Litigation. Although all the presentations were excellent, the undisputed highlight of the meeting was unquestionably the "Hasbro v. Ghettopoly" mock trial under U.S. and Canadian law, based on the notorious Ghettopoly board game, for its unique format and outstanding content and presentation.

Acting as a judge sitting simultaneously on the United States District Court for the Southern District of New York and on the Federal Court of Canada (which led to him being called "My Lord" by counsel, a title he surely enjoyed), attorney Jay Hulme guided counsel and the attendees, who acted as the jury in the proceedings. After hearing from counsel, the attendees rendered markedly different verdicts under U.S. and Canadian law on the issues of trademark infringement, fair use, and copyright infringement. Stephen Feingold represented Hasbro in the Southern District of New York action, and Mark Evans represented Hasbro in the Canadian action. Peter Rosenthal had the difficult task of representing Ghettopoly under both U.S. and Canadian law.

Perpetuating the game theme into the evening, Monopoly® boards and play money were strewn about the tables, and we had our first-ever Casino Night, which by all accounts was a resounding success. On Saturday night, we also tried something new—dinner featuring delicious tapas, while being entertained by Spanish guitarist Maria Zemantauski and Flamenco Dancer Lisa Martinez. Of course, no meeting would be complete without a boat ride around Lake George on The Morgan. Although the rain kept everyone in the cabin, we still enjoyed the ride, each other's company, and hors d'oeuvres on the lower deck. We all arrived back safe and sound.

Credit for this spectacular event must be given to Debra Resnick, our Vice-Chair, who outdid herself, once again, together with her program Co-Chair, Kelly Slavitt (Young Lawyers Division Co-Chair), and our very able staff at the NYSBA. Incredibly, this was Debra's third time as Co-Chair of the Fall Meeting. Debra hatched her plan to feature the Ghettopoly program and game motif and spent dozens of hours on the Gehettopoly mock trial alone. During the heart of the planning for the meeting, Debra made a career change—moving to FTI Consulting (litigation consultants and experts). Clearly, Debra runs circles around the rest of us, which is good training for her run around Manhattan as a recidivist NYC Marathoner.

We want to thank our sponsors, who greatly added to the success of the meeting, while significantly subtracting from the cost to registrants: Brandimensions, DLA Piper Rudnick Gray Cary UK, FTI Consulting, Genuone, King & Spalding, Morgan & Finnegan, Pitney Hardin LLP, Smart & Biggar, and Thompson CompuMark. Additionally, we are grateful for the help of the NYSBA staff, Patricia Stockli, Cathy Teeter, Naomi Pitts, and many others!

Our next major event is Tuesday, January 24, 2006, at the NYSBA Annual Meeting at the Marriott Marquis in New York City, which is being coordinated by Program Co-Chairs Thomas Curtin and Jonathan Matkowsky. The program will feature practical and interesting presentations on Emerging Issues in Cyberspace, Standard Bodies and Patent Pools, Ethical Issues in IP Transactions, and Electronic Evidence. A cocktail reception will follow the program. In the spring, the Section will co-host "The Copyright Office Comes To New York City," featuring top officials from the U.S. Copyright Office.

This past fall our Section presented its Bridging the Gap programs in several locations throughout the state. These seminars are meant for newly admitted attorneys and are an excellent source of information for any attorney interested in learning about basic intellectual property law. George McGuire is Overall Planning Chair for all locations. We are grateful for his efforts, as well as those of Jean Nelson, Associate Director of the NYSBA's CLE Department. For a list of dates and programs hosted by the Section and its Committees, including Roundtables and the Women in IP presentation, please consult the Section Calendar, available online at http://www.nysba/ipl and in the Section Directory.

I hope to see you at an upcoming Section event! Should you have any questions or comments, please contact me at rick@ravin.com.

Richard L. Ravin

Thank You

The Intellectual Property Law Section extends its gratitude to the following for their significant sponsorship over the past year:

- Bond, Schoeneck & King, PLLC
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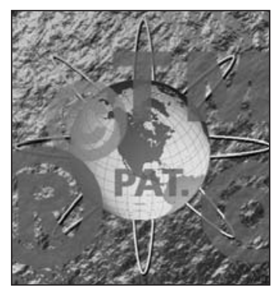
Young Lawyers Reception

On November 10, 2005 the Young Lawyers Committee hosted a cocktail and appetizer networking reception at Metro53 on the Upper East Side in Manhattan. Approximately fifty young lawyers admitted five years or less networked with other members of the Section and learned about programs and activities specifically geared towards

young lawyers from Kelly Slavitt, Chair of the Young Lawyers Committee, and from other Executive Committee members in attendance including Charles Weigell, Co-Chair of the Meetings and Membership Committee, and Joyce Creidy, Treasurer of the Section. In addition, because the Section has been chosen by the NYSBA to be part of the NYSBA's Pilot Mentoring Program, Seymour James spoke to attendees about the program and solicited feedback as to what more the NYSBA could do to meet the needs of its young lawyer base of members.

December 2005

Report of the Nominating Committee of the Intellectual Property Law Section



The Nominating Committee is pleased to report the following nominations for consideration by the Intellectual Property Law Section of the New York State Bar Association at the Annual Meeting to be held in New York City on January 24, 2006. The Committee nominates: Joyce L. Creidy for the office of Vice Chair; Paul Fakler for the office of Treasurer; and Kelly Slavitt for the office of Secretary. Terms for these offices will commence on June 1, 2006.

In accordance with the Bylaws of the Intellectual Property Law Section (Article III, Section 1), Debra Ivy Resnick shall become Chair of the Section on June 1, 2006.

Members-at-large will be announced by the Committee at a later date.

Respectfully submitted,

Nominating Committee
Richard L. Ravin, Chair
Debra Ivy Resnick, Vice Chair
Michael Chakansky, Former Chair
Marc Ari Lieberstein, Former Chair

Experience with *Markman* Proceedings in Patent Litigation

By Mark J. Abate

I. Introduction

Over ten years ago, the Federal Circuit handed down its decision in *Markman v. Westview Instruments, Inc.*[1] In a concurrence, one judge remarked that the majority opinion announced a "sea change" in the law relating to patent claim construction.[2] While that may be open to debate, what has been occurring in the district courts since *Markman* is nothing short of a "sea change" in the procedures by which patent cases are brought to trial. This article addresses how *Markman* has affected litigation of patent cases in the district courts. More specifically, it discusses the procedures, including so-called *Markman* hearings, that are being implemented by the district courts to insure the proper construction of patent claims.

There are three primary procedural issues created by *Markman* that trial counsel should consider in every patent case. First, whether to hold a *Markman* hearing. Second, when to hold the *Markman* proceeding. Third, what type of evidence should be admitted at the *Markman* proceeding. Even if there is no *Markman* hearing, the issues of when the patent claims should be construed and what type of evidence should be admitted for use in construing the claims must be considered.

In addition to those three primary issues, there are a number of secondary issues that deserve consideration by counsel. For example, the effect of a pretrial *Markman* ruling on trial, Seventh Amendment concerns over resolution of fact issues as part of the claim construction, and the timing and scope of appellate review of a *Markman* ruling. How trial counsel and the district court choose to deal with these issues will have a profound impact on the course of the litigation.[3]

II. Primary Procedural Issues Created by *Markman*

In *Markman*, the Federal Circuit held that the interpretation of a patent claim is a question of law.[4] Because patent claim construction is an issue of law, the district court is obliged to construe the patent claims and any claim terms in dispute.[5] The district court then must instruct the jury on the proper scope of the patent claims before giving the case to the jury for deliberation.[6]

A. Should a *Markman* Hearing Be Held?

While *Markman* requires that the district court construe the patent claims and instruct the jury accordingly, *Markman* did not dictate how the district court must go about construing the patent claims.[7] This raises the first issue: whether to have a *Markman* hearing at all.

There are a number of ways that claim construction may be presented to the district court. In *Markman*, the Federal Circuit indicated that claim construction can be accomplished "in the context of dispositive motions" or "by the court in framing its charge to the jury."[8] Thus, district courts may construe claims based on a documentary record, such as in response to a summary judgment motion of noninfringement or invalidity of the patent.[9] Alternatively, district courts may construe the claims after hearing all the evidence presented at trial and before instructing the jury, such as during the jury instruction conference.[10] It may even be acceptable for the district court to submit claim construction issues to the jury for an advisory opinion and defer its claim construction until post-trial motions.[11]

There are, however, some significant disadvantages to construing patent claims based either on a documentary record alone or at trial. Construction of the patent claims on a documentary record alone raises the concern that the district court will be interpreting the claims without the benefit of hearing all of the evidence that would be presented at trial. While there has been at least one case where a district court made its *Markman* claim construction ruling in response to a "motion for a claim construction,"[12] most district courts have expressed a preference for developing a clear understanding of the ramifications that a proposed claim construction will have on the outcome of the case.[13]

Construction of the patent claims at trial during the jury instruction conference raises the concern that the trial will be prolonged, complicated, and disrupted by evidence that may not prove necessary to the jury's deliberations. For example, the trial may be complicated by a party's presentation of evidence under alternative infringement theories, so that if unsuccessful on its primary claim construction argument, it will have an argument to make in closing. In addition, the district court's decision on claim construction also may prejudice the party that presented contrary evidence at trial. That is, if a party premises its case on a claim construction that is ultimately rejected, the jury may doubt the credibility of experts who have testified contrary to the judge's ultimate claim construction. Finally, the district court may not have adequate time to render a well-reasoned decision.

To alleviate these concerns, some district courts have conducted *Markman* hearings, pursuant to Fed. R. Civ. P. 42, before trial to interpret the patent claims.[14] A *Markman* hearing is simply a hearing before the district court to aid in its construction of the patent claims. *Markman* hearings have taken many forms. District courts have held *Markman* hearings to hear attorney argument and/or admit fact and expert testimony concerning the proper construction of the patent claims, as discussed in Section II.C. below.

However, there are also disadvantages to having a *Markman* hearing. A *Markman* hearing is an additional step in bringing a case to trial and requires pretrial-type activities, albeit with respect to claim construction alone, and may increase the total cost of the litigation. Even at a *Markman* hearing, the district court will be interpreting the patent claims without hearing all of the trial evidence. Depending on the timing of the *Markman* hearing and the evidence admitted, the district court may not fully understand the context of the arguments on claim construction. Despite these disadvantages, *Markman* hearings are scheduled in the vast majority of cases.[15]

B. When Should a *Markman* Proceeding Be Held?

Because *Markman* did not decide when the district court must construe the patent claims, a *Markman* proceeding can be held at any point in a case. For example, *Markman* proceedings have been held (1) before discovery; (2) in the midst of fact discovery; (3) after close of fact discovery but before expert discovery; (4) after close of expert discovery but before ruling on dispositive motions; (5) after close of expert discovery but before trial; and (6) at trial but before instruction of the jury. In addition to the concerns set forth above that bear on the timing of a *Markman* proceeding, there are a number of other issues relating to the appropriate time for a *Markman* proceeding. In most cases, *Markman* proceedings are scheduled to occur after discovery but before trial.[16]

Advantages associated with an early *Markman* hearing include reducing litigation costs by allowing for early resolution on summary judgment and narrowing the scope of relevant discovery.[17] However, if the technology is complex, the district court may be insufficiently informed at an early stage of the case to construe the claims. Also, the judge may unnecessarily perform an exhaustive claim construction where discovery might have revealed that one or only a few claims are dispositive.[18] A strategic consideration is that an early *Markman* proceeding may favor one party over another. For example, before the close of fact discovery a patentee may not have a thorough understanding of how the accused product operates and may be placed at a disadvantage by an early *Markman* proceeding. On the other hand, an accused infringer may not be aware of the best prior art, potential inventorship, best mode, or inequitable conduct defenses. An early *Markman* proceeding therefore may allow the patentee to argue a claim construction that would avoid some of the defenses unbeknownst to the accused infringer.

A later *Markman* proceeding provides advantages as well. A pretrial claim construction provides the district court with a basic technological background and the opportunity to dispose of the case quickly in the context of a summary judgment motion. Even where a summary judgment motion fails, the claim construction can facilitate settlement or at least narrow the scope of trial.[19] However, having a later *Markman* proceeding may have resulted in wasted time and effort in the pursuit of discovery towards an erroneous claim construction. Also, the cost of presenting arguments and evidence in a pretrial *Markman* hearing may be duplicated at trial where many of the same arguments might pertain to validity and infringement.[20] Additionally, a *Markman* proceeding occurring after the completion of expert discovery, when an expert has to take a position on the meaning of the claims, may render expert reports and depositions useless.

A *Markman* ruling also may create new issues of infringement or validity that require further discovery. In *Loral Fairchild Corp. v. Victor*, Judge Rader of the Federal Circuit, sitting as a district court judge by designation, articulated the potential for creating new issues, stating:

> Once the court resolves the meaning of the claims, this new pronouncement . . . may . . . generate more disputes. [T]he court has merely elaborated on the "normally terse" claim terms in an effort to resolve disputes. However, the skillful lawyer finds ambiguity even in attempted precision. Unchecked, the parties' new interpretations of the claim language in light of the court's legal meaning may begin the trial process, including discovery and depositions, anew.[21]

To address this concern, some courts have allowed a period for limited fact discovery after the *Markman* ruling directed to new issues created by the district court's claim construction.

C. What Type of Evidence Should Be Admitted as Part of the *Markman* Proceeding?

The third primary issue created by *Markman* concerns the type of evidence that should be admitted as part of the *Markman* proceeding. In *Markman*, the Federal Circuit stated that patent claims are to be construed in view of the claim language, specification, and prosecution history and that extrinsic evidence, including expert and inventor testimony, dictionaries, and learned treatises, may be helpful to explain the meanings of technical terms of art.[22] With respect to the use of extrinsic evidence, the court cautioned that (1) it cannot be used to vary and contradict the terms of the claims or to clarify ambiguity in the claim terminology, and (2) the district court cannot credit certain evidence over other evidence or make factual findings.[23]

Before *Markman*, district courts often gave claim construction disputes to the jury. As a result, litigants commonly would use expert testimony to attempt to influence the jury's resolution of disputed claim language. The Federal Circuit's holding in *Markman* stopped that practice. One basis for the Federal Circuit's holding in *Markman* was that competitors should be able to ascertain the scope of a patent from its text and the public record of the proceedings in the Patent Office.[24] On certiorari, the Supreme Court reiterated that rationale, noting that the limits of a patent must be known to encourage invention by others and avoid a "zone of uncertainty" that may be entered only at the risk of an accusation of infringement.[25]

In the next significant claim construction case after *Markman*, *Vitronics Corp. v. Conceptronics, Inc.*,[26] the Federal Circuit went even further to limit the use of expert testimony and other extrinsic evidence. The Federal Circuit stated that in construing the claims the district court should look first to the patent and prosecution history, what it called the intrinsic evidence and the most significant source of the meaning of the claims.[27] The Federal Circuit continued, stating that if intrinsic evidence alone will resolve an ambiguity in claim terminology, it is improper to rely on extrinsic evidence. Only if there is a genuine ambiguity in the claims after consideration of the intrinsic evidence should the court resort to extrinsic evidence.[28] With respect to use of experts, the Federal Circuit stated that expert testimony inconsistent with the patent and its prosecution history should be accorded no weight.[29]

More recently, the Federal Circuit embarked on a "plain language" approach to claim construction, elevating the weight accorded to ordinary dictionary definitions of the claim terminology. In *Texas Digital Sys. v. Telegenix, Inc.*,[30] the court noted that "[d]ictionaries, encyclopedias and treatises, publicly available at the time the patent is issued, are objective resources that serve as reliable sources of information on the established meanings that would have been attributed to the terms of the claims by those of skill in the art."[31] The court continued, "[i]ndeed, these materials may be the most meaningful sources of information to aid judges in better understanding both the technology and the terminology used by those skilled in the art to describe the technology."[32] The court refused to categorize dictionaries as "extrinsic evidence" or even a "special form of extrinsic evidence." However, the court stated where a dictionary definition is inconsistent with the intrinsic record, that definition must be rejected.[33]

In *Phillips v. AWH Corp.*,[34] the court sat *en banc* to resolve the conflict in its cases concerning the appropriate weight to be given to the various evidence relevant to claim construction. The court stated that "[t]he words of a claim 'are generally given their ordinary and customary meaning.'"[35] "The ordinary and customary meaning of a claim term is the meaning that the term would have to a person of ordinary skill in the art in question at the time of the invention, i.e., as of the effective filing date of the patent application."[36] The court also stated claims "must be read in view of the specification, of which they are a part" and their prosecution history.[37] While dictionaries and treatises can be useful tools in aiding courts to determine the definition of particular terms to those of skill in the art of the invention (they can help provide background information and explain how an invention works, etc.), they are less reliable than the patent itself and the prosecution history because

> [t]he patent applicant did not create the dictionary to describe the inventions. Thus, there may be a disconnect between the patentee's responsibility to describe and claim his invention, and the dictionary editors' objective of aggregating all possible definitions for particular words.[38]

Finally, the court remarked that, "[t]he sequence of steps used by the judge in consulting various sources is not important; what matters is for the court to attach the appropriate weight to be assigned to those sources in light of the statutes and policies that inform patent law."[39]

As stated in *Markman*, a district court can choose to rely on intrinsic evidence alone, *i.e.*, patent specification, patent claims, and patent prosecution history, including the prior art of record.[40] In addition, the district court can hear and rely on extrinsic evidence.[41] Extrinsic evidence may include: (1) dictionaries and learned treatises; (2) prior art not of record in the prosecution history; (3) technical expert testimony; (4) inventor testimony; (5) evidence relating to development of a product incorporating the patented invention; and (6) legal/patent expert testimony.[42]

III. Additional Issues Created by *Markman*

There are additional secondary issues created by *Markman*.

1. Who has the burden of proof on claim construction at a *Markman* hearing and what is the order of proof? The burden and order of proofs at a *Markman* hearing is unclear. While the patentee has the burden of proof of infringement, technically neither party has the burden of proof in a *Markman* hearing. With respect to the order of proof, the patentee, bearing the burden of proving infringement, usually goes first.

2. Do the rules of evidence govern admissibility of evidence at a *Markman* hearing? Some district courts have indicated that, during a *Markman* hearing, they may not be bound by the ordinary rules regarding the admissibility of evidence.[43]

3. The effect of a *Markman* claim construction ruling on conduct of the trial and motions in limine can be significant. For example, to defend against a charge of willful infringement, the accused infringer may want to present evidence of a contrary claim construction to support a good-faith belief of noninfringement. Once the district court makes its *Markman* ruling, should the introduction of evidence relating to alternative claim construction theories be precluded? Also should the district court preclude the introduction of evidence arguably inconsistent with the district court's claim construction? For example, should the district court permit evidence that the claims as construed are indefinite or not supported by an enabling disclosure? Some courts have permitted a party to make an offer of proof relating to evidence contrary to the court's claim construction which enables the party to preserve its rights on appeal.

4. Does a prior *Markman* ruling have collateral estoppel effect? Regional circuit law controls the issue of collateral estoppel in patent cases.[44] The elements for collateral estoppel vary from circuit to circuit, but the circuits generally require that the issue (1) is identical; (2) actually was litigated; (3) was necessary to the final judgment; and (4) that the party against whom estoppel is invoked was fully represented in the prior action. While a number of courts have considered this issue, there is no consensus concerning whether and in what circumstances a prior *Markman* ruling may estop the patentee.[45]

5. It is not clear how the district court should instruct the jury or what form the jury instructions should take, *i.e.*, what level of detail is required in the instructions relating to the court's claim construction. If the district court's instructions to the jury are general in nature, has the court fulfilled its obligation under *Markman* to construe the claims and instruct the jury accordingly? In *Sulzer Textil A.G. v. Picanol N.V.*,[46] the Federal Circuit offered some basic guidance on the requisite scope and form of jury instructions in patent infringement cases. The Federal Circuit acknowledged the broad discretion with which district courts may fashion jury instructions but insisted on a minimum requirement that courts clearly explain that claim construction is a matter of law for the court to decide:[47]

   > [T]he trial court in a patent case must at minimum take steps to assure that the jury understands that it is not free to consider its own meanings for disputed claim terms and that the district court's claim construction, determined as a matter of law, is adopted and applied by the jury in its deliberation of the facts. It is not enough that the testimony and argument at trial is consistent with the district court's construction of disputed claim terms. The jury must be told that the court has made a claim construction ruling that the jury must follow and cannot be left free to apply its own reading of disputed terms to the facts of the case.[48]

6. There may be Seventh Amendment concerns raised by the district court's consideration of fact issues reserved for the jury as part of its construction of the patent claims. For example, whether the claims, as construed, would be anticipated by the prior art is a fact issue for the jury that the district court may want to

consider as part of claim construction during a *Markman* hearing. Under *Elf Altochem N. Am. v. Libbey-Owens-Ford Co.*,[49] the district court would not look at a prior art patent in construing patent claims in order to preserve patentee's right to a jury trial on the issue of anticipation.

7. The timing and scope of the Federal Circuit appellate review raises additional issues. A claim construction ruling is not a "final decision" under 28 U.S.C. § 1295(a)(1) and therefore ordinarily is not immediately appealable to the Federal Circuit.[50] A party seeking an immediate review of the district court's claim construction may seek an interlocutory appeal pursuant to 28 U.S.C. § 1292(b), (c)(1); seek an entry of judgment pursuant to Rule 54(b); or concede that the claim construction is dispositive and that summary judgment should be granted.[51] The Federal Circuit has not accepted district court certifications of claim construction rulings for interlocutory appeal under 28 U.S.C. § 1292.[52] A Rule 54(b) partial final judgment, including a claim construction ruling, may allow an immediate appeal to the Federal Circuit.[53] Finally, claim construction rulings received in response to a motion for a preliminary injunction are appealable.[54] However, an appeal may not have the desired result because the claim construction rendered in response to a ruling on a preliminary injunction motion need not constitute the district court's final claim construction.[55]

Once on appeal, the Federal Circuit "review[s] the issue of claim interpretation independently without deference to the trial judge."[56] One extreme example of the effect of *de novo* review on appeal occurred in *Exxon Chemical Patents v. Lubrizol*,[57] where the Federal Circuit rejected the claim construction of the district court and the parties, arrived at its own claim construction, and reversed the judgment of infringement.

IV. Conclusion

There are three primary procedural issues created by *Markman* that trial counsel should consider in every patent case: whether to hold a *Markman* hearing, when to hold the proceeding, and what type of evidence should be admitted. Additionally, there are a number of secondary issues, including the effect of a *Markman* ruling on the trial, Seventh Amendment concerns, collateral estoppel effect of a prior *Markman* ruling and issues of appellate review. All deserve careful consideration by counsel. How trial counsel and the district court elect to deal with *Markman* undoubtedly will have a profound impact on the litigation.

Endnotes

1. 52 F.3d 967 (Fed. Cir. 1995) (*en banc*).
2. *Id.* at 989 (Mayer, J., concurring) ("Today the court jettisons more than two hundred years of jurisprudence and eviscerates the role of the jury preserved by the Seventh Amendment of the Constitution of the United States; it marks a sea change in the course of patent law that is nothing short of bizarre.").
3. The Northern District of California was the first court to adopt extensive local rules in patent cases which govern *Markman* proceedings, attempting to ensure consistency and predictability in the resolution of disputes involving claim construction. CAL. (N.D.) CIV. L.R. 16-7 - 16-11. Local rules in patent cases have also been adopted in the Western District of Pennsylvania, the District of Minnesota, the Northern District of Georgia and the Eastern District of Texas.
4. 52 F.3d at 970-71 ("we conclude that the interpretation and construction of patent claims . . . is a matter of law exclusively for the court."). The holding of *Markman* was confirmed in *Cybor Corp. v. Fas Techs., Inc.*, 138 F.3d 1448, 1456 (Fed. Cir. 1998) (*en banc*).
5. 52 F.3d at 979 ("[W]e therefore . . . hold that in a case tried to a jury, the court has the power and obligation to construe as a matter of law the meaning of language used in the patent claim.").
6. *Id.* at 981 ("When . . . the court finally arrives at an understanding of the language as used in the patent and prosecution history, the court must then pronounce as a matter of law the meaning of that language.").
7. *See Ballard Med. Prods. v. Allegiance Healthcare Corp.*, 268 F.3d 1352, 1358 (Fed. Cir. 2001) ("*Markman* does not require a district court to follow any particular procedure in conducting claim construction.").
8. 52 F.3d at 981.
9. *See, e.g.*, *Am. Bank Note Holographics, Inc. v. Upper Deck Co.*, 934 F. Supp 630, 638 (S.D.N.Y. 1996).
10. *See, e.g.*, *Vitronics Corp. v. Conceptronic, Inc.*, 90 F.3d 1576, 1579–80 (Fed. Cir. 1996); *York Prods., Inc. v. Cent. Tractor Farm & Family Ctr.*, 99 F.3d 1568, 1571 (Fed. Cir. 1996); *Johns Hopkins Univ. v. Cellpro*, 894 F. Supp. 819, 826 (D. Del. 1995).
11. *See, e.g.*, *Laitram Corp. v. NEC Corp.*, 62 F.3d 1388, 1394 (Fed. Cir. 1995) ("Because claim construction is a legal issue within the sole province of the court, this court will treat the jury's claim construction as an advisory determination."); *Rodime PLC v. Seagate Tech., Inc.*, 1997 WL 813016, *1 (C.D. Cal. 1997).
12. *Nova Biomedical Corp. v. i-Stat Corp.*, 980 F. Supp. 614, 615 (D. Mass. 1997).
13. *See, e.g.*, *Lucas Aerospace, Ltd. v. Unison Indus., L.P.*, 890 F. Supp. 329, 332 n.3 (D. Del. 1995).
14. *See, e.g.*, *Graco Children's Prods., Inc. v. Century Prods. Co., Inc.*, 1996 WL 421966, *3 (E.D. Pa. 1996); *Elf Atochem N. Am., Inc. v. Libbey-Owens-Ford Co., Inc.*, 894 F. Supp. 844, 850 (D. Del. 1995).
15. "The courts continued to schedule *Markman* hearings rather than decide them on the paper. In the 1999 Survey respondents reported the Court scheduled hearings 81.5% of the time and in the 2002 Survey the respondents reported hearings were scheduled 91% of the time." *American Bar Association Section of Intellectual Property Law Committee 601 Annual Report 2002-2003* at 5 (hereinafter "ABA Report").
16. "According to the Survey, most claim construction hearings (78%) occur after discovery but before trial, with some (16%) made prior to or during discovery and some taking place at trial (6%). Few are held before discovery begins (8%)." *ABA Report* at 2.

17. *See generally Markman* Subcommittee of the Patent Litigation Committee of AIPLA, *The Interpretation of Patent Claims*, 32 AIPLA Q. J. 1, 56-59 (2004) (hereinafter "AIPLA Report"); Federal Circuit Bar Association *Markman* Project, *Guidelines For Patent Claim Construction: The Basics Of A Markman Hearing*, 14 Fed. Cir. Bar J. 773–78 (2005) (hereinafter "FCBA Report").

18. *See AIPLA Report*, 32 AIPLA QJ at 56-59; *FCBA Report*, 14 Fed. Cir. Bar J. at 773–78.

19. *See id*.

20. *See id*.

21. 911 F. Supp. 76, 79 (E.D.N.Y. 1998); *Rambus, Inc. v. Infineon Techs. AG*, 145 F. Supp. 2d 721, 732 (E.D. Va. 2001).

22. 52 F.3d at 979–80.

23. *Id*. at 981.

24. *Id*. at 978–79 ("[Competitors] may understand what is the scope of the patent owner's rights by obtaining the patent and prosecution history—'the undisputed public record,' and applying establishing rules of construction to the language of the patent claim in the context of the patent.").

25. 517 U.S. 370, 390 (1996).

26. 90 F.3d 1576 (Fed. Cir. 1996).

27. *Id*. at 1582 (the patent "specification is always highly relevant to the claim construction analysis. Usually, it is dispositive; it is the single best guide to the meaning of a disputed term.").

28. *Id*. at 1583. In *Eastman Kodak v. Goodyear Tire & Rubber*, 114 F.3d 1547, 1555 (Fed. Cir. 1997), the Federal Circuit looked to extrinsic evidence to interpret the words in the claim as a person of ordinary skill in the art would understand them because the intrinsic evidence was not conclusive proof of the meaning of claim language.

29. 90 F.3d at 1584.

30. 308 F.3d 1193 (Fed. Cir. 2002).

31. *Id.* at 1202–03.

32. *Id.* at 1203.

33. *Id.* at 1204. *See CCS Fitness v. Brunswick Corp.*, 288 F.3d 1359, 1366 (Fed. Cir. 2002).

34. 415 F.3d 1303 (Fed. Cir. 2005) (*en banc*).

35. *Id.* at 1312 (*quoting Vitronics*, 90 F.3d at 1582).

36. *Id.* at 1313 (*quoting Innova/Pure Water, Inc. v. Safari Water Filtration Sys.*, 381 F.3d 1111, 1116 (Fed. Cir. 2004)).

37. *Id.* at 1315, 1317 (*quoting Markman*, 52 F.3d at 979).

38. *Id.* at 1321.

39. *Id.* at 1324 (*quoting Vitronics*, 90 F.3d at 1582).

40. 52 F.3d at 979–80.

41. *Id*. at 980.

42. *See id*. In *Vitronics*, the Federal Circuit noted: "A court in its discretion may admit and rely on prior art proffered by one of the parties, whether or not cited in the specification or the file history." 90 F.3d at 1584. With respect to inventor testimony, in *Hoechst Celanese v. BP Chem.*, 78 F.3d 1575, 1580 (Fed. Cir. 1996), the Federal Circuit stated, "*Markman* requires us to give no deference to the testimony of the inventor about the meaning of the claims." However, en route to claim construction rulings, some district courts have relied on admissions made by inventors and experts to resolve claim construction disputes against the patentee. *See*, *e.g.*, *Evans Med. Ltd. v. Am. Cyanamid Co.*, 1998 WL 312506, *11-12 (S.D.N.Y. 1998); *Alpex Computer Corp. v. Nintendo Co., Ltd.*, 102 F.3d 1214, 1220 (Fed. Cir. 1996). With respect to legal experts, in *Markman*, the Federal Circuit stated that the "legal opinion" of a patent attorney is entitled to "no deference." 52 F.3d at 983. *See generally AIPLA Report*, 32 AIPLA QJ at 24–45; *FCBA Report*, 14 Fed. Cir. Bar J. at 780–84.

43. *See*, *e.g.*, *Chad Indus., Inc. v. Automation Tooling Sys., Inc.*, 938 F. Supp. 601, 604 (C.D. Cal. 1996) (strict rules of evidence not applied during a *Markman* hearing).

44. *Bayer AG. v. Biovail Corp.*, 279 F.3d 1340, 1345 (Fed. Cir. 2002).

45. *See RF Delaware, Inc. v. Pac. Keystone Techs., Inc.*, 326 F.3d 1255, 1261–62 (Fed. Cir. 2003); *Dynacore Holdings Corp. v. U.S. Philips Corp.*, 363 F.3d 1263, 1274 (Fed. Cir. 2004); *TM Patents L.P. v. IBM Corp.*, 72 F. Supp. 2d 370 (S.D.N.Y. 1999) (construction of patent in an earlier lawsuit collaterally estopped patentee); *Graco Children's Prods. Inc. v. Regalo Int'l, LLC*, 77 F. Supp. 2d 660, 663–64 (E.D. Pa. 1999) (refused to apply collateral estoppel to a prior claim construction); *Abbott Lab. v. Dey, L.P.*, 110 F. Supp. 2d 667, 671 (N.D. Ill. E.D. 2000) (applied collateral estoppel to claim construction); *Edberg v. CPI-The Alternative Supplier, Inc.*, 156 F. Supp. 2d 190, 195–96 (D. Conn. 2001) (following *TM Patents* and distinguishing *Graco* on the grounds that Graco had won in its earlier litigation, making the claim construction not necessary to the final judgment); *Kollmorgen Corp. v. Yaskawa Elec. Corp.*, 147 F. Supp. 2d 464, 470 (W.D. Va. 2001) (refused to apply collateral estoppel to a prior claim construction).

46. 358 F.3d 1356 (Fed. Cir. 2004).

47. *Id.* at 1366 ("although the particular form and precise nature of jury instructions are matters within the sound discretion of the district court . . .").

48. *Id.*

49. 894 F. Supp. 844, 860 (D. Del. 1995) ("to preserve Atochem's right to a jury trial on the issue of anticipation, this court will not look to the EP '403 patent in construing the words in claim 1 of the '096 patent.").

50. *Nystrom v. Trex Co.*, 339 F.3d 1347, 1350 (Fed. Cir. 2003).

51. *See Nystrom*, 339 F.3d at 1350–51.

52. *See*, *e.g.*, *Flores v. Union Pac. R.R.*, 101 F.3d 715 (Fed. Cir. 1996) (the trial court certified an interlocutory judgment for appeal after conducting a *Markman* hearing, but the Federal Circuit refused to accept the appeal); *Cybor Corp. v. FAS Techs, Inc.*, 138 F.3d 1448, 1479 (Fed. Cir. 1998) (Newman, J., additional views) ("The Federal Circuit has thus far declined all such certified questions.").

53. 28 U.S.C. § 1292(c)(2). In *Trilogy Comm'ns., Inc. v. Times Fiber Comm'ns., Inc.*, 109 F.3d 739, 745–46 (Fed. Cir. 1997), the Federal Circuit affirmed the lower court's claim construction and the finality of its Rule 54(b) judgment of noninfringement. *But see Ultra-Precision Mfg. v. Ford Motor Co.*, 338 F.3d 1353, 1359–60 (Fed. Cir. 2003) (dismissing appeal because the district court's Rule 54(b) judgment was improper and not final).

54. 28 U.S.C. § 1292(c).

55. *Int'l Commc'n Materials, Inc. v. Ricoh Co., Ltd.*, 108 F.3d 316, 319 (Fed. Cir. 1997) ("We review on the district court's *tentative* claim construction and its resulting finding on the likelihood of successfully proving infringement, which form an adequate basis for our affirming its denial of the preliminary injunction.") (emphasis added).

56. *Cybor*, 138 F.3d at 1473.

57. 64 F.3d 1553, 1556 (Fed. Cir. 1995).

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Proving Patent Damages: What Is the Best Model for Your Client?

By Shelly Irvine and Juli Saitz

I. Introduction

Intellectual property infringement damages generally fall into three categories: (1) lost profits, (2) reasonable royalties, and (3) other damages. Depending on the factual situation, these "other damages" can include, but are not limited to, price erosion, increased costs, future lost sales, and prejudgment interest.

In the calculation of patent infringement damages, there is substantial guidance provided by case law and statutes. This article will provide an overview of some of the issues that may be considered in the development of damages in patent infringement litigation. The two most common means of recovery are lost profits and reasonable royalty, or some combination thereof. However, there are certain additional forms of recovery that may be appropriate remedies under certain circumstances.

Lost profits to the plaintiff (patent holder) typically are based on an analysis of the incremental amount of profits that the patent holder would have made but for the infringement. The patent holder focuses on analyzing whether it is reasonable to conclude, absent the infringement, that based on the facts and circumstances of the case and the marketplace and competition wherein the patented and infringing products are sold, it would (and could) have made the sales made by the infringer (or a portion of such sales).

If the analysis shows that the patent holder would (or could) not have made the infringer's sales, a reasonable royalty damages remedy would be employed to represent the amount that the two parties, as a willing licensee and willing licensor in a hypothetical negotiation, would have negotiated at the time the infringement began.

II. Damages Measures in the Form of Lost Profits

A. *Panduit* Factors

Panduit Corp. v. Stahlin Bros. Fibre Works, Inc.,[1] decided in 1978, provided an analytical structure for determining whether lost profits can be awarded. There are four *Panduit* factors that should be analyzed by the patent owner in order to provide a basis for a lost profits claim:

1. Demand for the patented product.
2. Absence of acceptable noninfringing substitutes.
3. Manufacturing, sales, and marketing capacity.
4. Amount of profit.

Lost profits may be appropriate if an analysis of the four *Panduit* factors results in the conclusion that the patentee would have been in a position to capture at least some of the infringer's sales. If the same analysis does not lead to this conclusion, then the appropriate remedy may be a reasonable royalty.

The first *Panduit* factor considers the demand for the patented invention. Depending on the facts and circumstances of the case, demand for the patented invention may be assessed by analyzing demand for the product that incorporates the patented invention. This type of analysis often considers analytics such as sales history, impact of the patented feature, price, qualitative customer and industry feedback, and market share. Common ways of demonstrating demand are showing a substantial volume of sales of products incorporating the patented invention; showing that products incorporating the patented invention sell at a higher volume or higher price than products that do not use the feature; demonstrating that products incorporating the patented feature achieved dominant market share; or using qualitative data to show that the patented invention used in the product and/or the product itself is demanded by customers. In certain circumstances it is not necessary for the patentee to sell a product which itself includes the patented invention in order to claim lost profits. For example, in the *Rite-Hite* case, during the period of infringement the patent owner sold a product that was not covered by the asserted patent but still competed for sales of the infringing product, and it was awarded lost profits.[2]

The second *Panduit* factor raises the issue of whether acceptable, noninfringing alternatives to the patented invention and/or the product that incorporates the patented invention were available during the time of infringement. In *Panduit*, a damages expert's infringement analysis largely involved analyzing noninfringing product alternatives available in the marketplace at the time of infringement. If there are such substitutes, the plaintiff would not be entitled to lost profits damages. The second *Panduit* factor has been modified over time to allow—depending on the marketplace dynamics—for recovery of lost profits even when there are noninfringing alternatives and/or substitutes in the marketplace. *State Industries, Inc. v. Mor-Flo Industries, Inc.*[3] weakened the need for complete absence of acceptable noninfringing alternatives. Instead, market share was used as a basis for lost profits by calculating the sales plaintiff would have made after removing the infringer from the marketplace. Further, in *Grain Processing Corp. v. American Maize Products Co.*,[4] the court found that even a new, noninfringing process that was not fully developed at the beginning of the infringement period could be considered a noninfringing alternative if appropriate materials were available, the technical process known, and the defendant had the necessary equipment, know-how, and experience to commercialize the noninfringing process in development. Consideration is given to actual alternatives available to the defendant at the time of infringement. The burden of proof lies with the infringer to demonstrate its ability to implement the substitute process.

Particularly with regard to this factor, damages experts should consider working in conjunction with technical experts to understand the products and features, and with company personnel, including marketing and sales personnel, to understand the dynamics of the market and competition. Often, this factor involves more time and effort than others to analyze adequately the relevant market segments, the products in that market, and the dynamics of those products.

The third *Panduit* factor focuses on whether the patent holder had the manufacturing, selling, distribution, and financing capacity to have made the infringer's sales. In order to substantiate a claim of lost profits on a particular sale, the patent holder typically analyzes whether it had sufficient capacity (or the ability to acquire additional capacity) to make the infringing sales. In the event that the patent holder is able to show it could have acquired additional capacity to accommodate an increase in demand (*e.g.*, through outsourcing or adding personnel and equipment), and an analysis of the steps the patentee would have taken in order to secure adequate capacity is performed (and is reasonable), lost profits may be recoverable. Any incremental costs related to those steps should appropriately be accounted for and deducted from lost profits, depending on the circumstances of the case. These could include costs such as financing costs if, for example, the patent holder would have borrowed to accommodate additional capacity. In addition, this factor should be analyzed carefully to consider issues such as whether the infringer and patent holder sell in similar geographic regions, whether similar sales channels are used by the infringer and patent holder, and whether the infringer and patent holder have similar customer segments or targets.

The fourth *Panduit* factor relates to the quantification of damages—specifically addressing whether damages are reasonably quantifiable. From a simplistic sense, in order to quantify damages two components are needed. The first is the level of sales (volume and price) that the patent holder would have made but for the infringer entering the market. The second is the incremental profitability that the patent holder attains through its sales of the patented product. An analysis/accounting of fixed and variable costs may be performed in order to account for the expense that the patentee would have incurred had it made the additional sales of the infringer.

III. Damages Measures in the Form of Reasonable Royalties

35 U.S.C. § 284 provides that a claimant should be awarded no "less than a reasonable royalty for the use of the invention by the infringer."[5] As discussed previously, the two most common means of recovery for patent infringement are lost profits and a reasonable royalty. If a patentee is unable to adequately establish entitlement to lost profits as a remedy, reasonable royalty damages typically are assessed. In this way, reasonable royalties often serve as a lower bound on patent damages. However, there are instances where reasonable royalty damages may exceed lost profits damages.

"Reasonable royalty" is defined by the case law. In general, the following cases indicate that a reasonable royalty is one that may be reached in the market, based upon an established royalty, or one that is adequate to compensate for the infringement:

- The sum allowed should be reasonable and that which would be accepted by a prudent licensee who wishes to obtain a license but was not so compelled and a prudent patentee, who wished to grant a license but was not so compelled (*Carrier Engineering Corporation v. Horvath*, 308 U.S. 636 (1939)).
- A reasonable royalty is the amount that a person, desiring to manufacture, use, and/or sell a patented article, as a business proposition, would be willing to pay as a royalty and yet be able to make, use, or sell the patented article in the market, at a reasonable profit (*Trans-World Mfg. Corp. v. Al Nyman & Sons, Inc.*, 750 F.2d 1552 (Fed. Cir. 1984)).

- The amount of the royalty should be that amount that adequately compensates for the infringement (*Stickle v. Heublein, Inc.*, 716 F.2d 1550, 1562 (Fed. Cir. 1983)).

For purposes of determining a reasonable royalty rate for patent infringement damages, a construct of a hypothetical negotiation is commonly employed. There are many factors to consider and analyses that can be performed which can be used as guidance in the determination of a reasonable royalty rate using a hypothetical negotiation construct. In particular, the factors delineated in *Georgia-Pacific Corp. v. United States Plywood Corp.*,[6] discussed below, provide a useful framework.

A. The *Georgia-Pacific* Factors

Georgia-Pacific states that a reasonable royalty is "the amount that a licensor (*e.g.*, a patentee) and a licensee (*e.g.*, the infringer) would have agreed upon (at the time the infringement began) if both had reasonably and voluntarily tried to reach an agreement."[7]

Georgia-Pacific can be used in the context of a hypothetical negotiation to help determine the royalty rate that a licensor and licensee would have agreed upon at the time infringement began, assuming the parties had voluntarily attempted to reach an agreement. *Georgia-Pacific* discusses fifteen factors to be considered in determining the outcome of such a hypothetical negotiation. *Georgia-Pacific* has become a widely accepted method for determining reasonable royalty damages. It provides a basis for approaching an analysis of factors that may impact the results of a hypothetical negotiation. Although courts have agreed with the use of *Georgia-Pacific* factors, they have not established the relative importance of the factors in relation to one another that is dictated by the facts and circumstances of each case.

The *Georgia-Pacific* factors are:

1. The royalties received by the patentee for the licensing of the patent in suit, proving or tending to prove an established royalty.
2. The rates paid by the licensee for the use of other patents comparable to the patent in suit.
3. The nature and scope of the license, as exclusive or non-exclusive or as restricted or non-restricted in terms of territory or with respect to which the manufactured product may be sold.
4. The licensor's established policy and marketing program to maintain its patent monopoly by not licensing others to use the invention or by granting licenses under special conditions designed to preserve that monopoly.
5. The commercial relationship between the licensor and licensee, such as whether they are competitors in the same territory in the same line of business or whether they are inventor and promoter.
6. The effect of selling the patented specialty in promoting sales of other products of the licensee; the existing value of the invention to the licensor as a generator of sales of his non-patented items; and the extent of such derivative or convoyed sales.
7. The duration of the patent and the term of the license.
8. The established profitability of the product made under the patent; its commercial success and current popularity.
9. The utility and advantages of the patent property over the old modes or devices, if any, that had been used for working out similar results.
10. The nature of the patented invention; the character of the commercial embodiment of it as owned and produced by the licensor; and the benefits to those who have used the invention.
11. The extent to which the infringer has made use of the invention and any evidence probative of the value of that use.
12. The portion of the profit or of the selling price that may be customary in the particular business or in comparable businesses to allow for the use of the invention or analogous inventions.
13. The portion of the realizable profit that should be credited to the invention as distinguished from non-patented elements, the manufacturing process, business risks, or significant features or improvements added by the infringer.
14. The opinion testimony of qualified experts.
15. The amount that a licensor (such as the patentee) and a licensee (such as the infringer) would have agreed upon (at the time the infringement began) if both had been reasonably and voluntarily trying to reach an agreement; that is, the amount which a prudent licensee—who desired, as a business proposition, to obtain a license to manufacture and sell a particular article embodying the patented invention—would have been willing to

pay as a royalty and yet be able to make a reasonable profit and which amount would have been acceptable to a prudent patentee who was willing to grant a license.

Within the *Georgia-Pacific* factors there are many considerations and analyses that may be explored. The following is a brief discussion of some of the factors and specific tools that can help guide a practitioner to a reasonable royalty.

Georgia-Pacific factor six considers whether the infringer has made sales of convoyed products—products sold for use with or complementary to the infringing product and/or ancillary or accessory products. Such convoyed product sales may not themselves use the patent in question, but they might have been lost due to the alleged infringement. Simple examples could include a razor and razor blade and printer and print cartridge. When assessing whether it is appropriate to claim lost profits on convoyed sales, one would evaluate whether the convoyed product has a functional relationship with the patented product and whether they are part of a single assembly, among other factors. As set forth in *Rite-Hite*[8] and affirmed in *Juicy Whip, Inc. v. Orange Bang, Inc.*,[9] if a functional relationship exists between patented and unpatented items, the patent holder may be able to claim lost profits on the unpatented items.

Georgia-Pacific factor seven looks at the duration of the patent and the term of the license. Patents issued since June 1995 generally have a term of twenty years, while patents issued prior to June 1995 generally have a term of seventeen years. However, terms of patents can vary depending on type. Utility patents, which are the majority of patents (machines, processes), typically follow the timetables listed. Design patents (ornamental features) typically last fourteen years, while plant patents typically last for eighteen years. The term of the license may be based on the licensor or licensee's practices (for example the licensor always enters into five-year agreements), or it could be based on the remaining term of the patent, depending on the product. When looking at the life of the product in terms of the duration of the license, it sometimes is relevant to consider that, in certain cases, products may have a useful life that is shorter than the life of the patent. This could occur in areas with rapid technological advancement.

Often discussed in factors twelve and/or thirteen and sometimes called the "Analytical Approach,"[10] is a technique that attempts to isolate the value of the patented invention with the following equation: Expected Profit Margin – Normal Profit Margin = Royalty Rate. The royalty rate is calculated as the difference between the profit margin the infringer expects to make on the sale of the infringing product and the normal profit margin for that type of product.

The Expected Profit Margin often is based on profit projections made by the infringer. Ideally, these projections should have been made at the time the infringement began, although evidence of the infringer's actual profits may be probative of its anticipated profits. Normal Profit Margin can be the standard industry profits for the products or similar products sold by the infringer/patentee which do not employ the patented invention. The difference between the "Expected" and "Normal" profit margins (or the "Excess" profit) may be one indicator of the value of the patented invention. The general concept of this analysis is that any profits in excess of those that are "typical" for that type of product would be one way to compensate the patent holder in the form of a royalty.

A similar analysis, sometimes called the "Premium Expected over NonInfringing Alternatives" method, is similar to the "Analytical Approach" in that it attempts to identify "excess" profits earned as a result of infringement over the profits that the infringer would have made but for the infringement. With this technique, a comparison is made between the profits of the infringer and the profits the infringer would have made had the infringer used a noninfringing alternative (if one is even available). For example, noninfringing alternatives may be a licensing agreement with a third party for a noninfringing technology or a patent design-around. *Grain Processing*,[11] wherein a reasonable royalty was determined using the defendant's next best alternative to the infringing product, illustrates this concept.

Another similar concept, a "Return on Investment (ROI) Comparison," compares the ROI of the infringing product to the ROI of noninfringing alternatives, with the "excess" being returned to the patent holder in the form of a reasonable royalty.

IV. "Other Damages" Measures

"Other damages" in this context could involve price erosion, increased costs, future lost sales, prejudgment interest, and trebled damages, among others.

A patent holder may be forced to lower its prices due directly to the competition created by an infringer selling its infringing product in the market. Damages from price erosion should be analyzed carefully, and a strong causal relationship between a diminishing price and the sales of the alleged infringer's product should be established. There are many other economic/market factors (*e.g.*, recession, entry of new competition for product, end of product life cycle) and company factors (*e.g.*, change in management, merger/acquisition, loss of major customer) that must be analyzed in constructing a defensible price erosion claim.

Increased costs occur in situations where the patent holder has incurred additional expenses due to the competition of the infringer. Those costs may be recovered, such as in the examples where advertising expenses or product modifications are made to compete with the infringer.

Prejudgment interest is based on the time value of money. Since having a dollar today is worth more than having a dollar one year from now, prejudgment interest represents the loss one suffers during the time between the lost sales and the actual trial and award dates. If the plaintiff had been able to make the sale back when the defendant did, the plaintiff would have had that money in yesterday's dollars. Prejudgment interest typically is applicable to compensatory damages but not to punitive damages and is awarded at the discretion of the court. Rates one might use for the calculation of prejudgment interest include, but are not limited to, WACC, Treasury bill or bond rate, or statutory rate.

A plaintiff could suffer future lost sales from a reduced sales base going forward. This could be relevant, for example, with a type of product where a consumer is likely to stay with a particular company as a result of becoming familiar with them (*e.g.*, replacement parts). In this case, even if a defendant is enjoined from selling the patented product any longer, it still may continue to receive the benefit, and the plaintiff may continue to be harmed, due to those customer losses. Another potential area of damage to a patent holder is lost design wins. This can be considered, for example, when an infringer secures a customer with a design win on an infringing part, and subsequent sales of next-generation parts, which may not be infringing, are made by the infringer and lost by the patent holder. If the patent holder can demonstrate that the infringer would not have made the sale of the subsequent generation part (without having the benefit of securing the customer initially with the infringing part), and also can demonstrate that it could have sold the infringing part, a case for future lost profits may be made. However, a claim for future lost profits must be supported carefully and can be subject to a higher level of scrutiny in court.

However, in circumstances where it reasonably can be demonstrated that the infringer may profit wrongfully beyond the life of the patent, those damages may be recoverable as well, as noted in the Accelerated Market Reentry Theory.[12] The Accelerated Market Reentry Theory describes a form of "future" lost profits in patent infringement based on the theory that the infringer has a head start by obtaining market share before the patent expires (*i.e.*, the infringer starts from a base of established sales instead of from a base of zero), and it is often most relevant if the patent is close to expiration or has expired.

V. Conclusion

It is extremely important to remember that the facts and circumstances of each damages analysis vary, and the applicability and appropriateness of the analyses described in this article vary equally with those same facts and circumstances. Therefore, appropriate consideration of the available financial, economic, and accounting information is the foundation of a well supported and reliable patent damages analysis.

Endnotes

1. *Panduit Corp. v. Stahlin Bros. Fibre Works, Inc.*, 575 F.2d 1152 (6th Cir. 1978).
2. *Rite-Hite Corp. v. Kelley Co.*, 56 F.3d 1538 (Fed. Cir. 1995).
3. 883 F.3d 1573 (Fed. Cir. 1989).
4. 185 F.3d 1341 (Fed. Cir. 1999).
5. 35 U.S.C. § 284.
6. *Georgia-Pacific Corp. v. U.S. Plywood-Champion Papers, Inc.*, 318 F. Supp. 1116, 1120 (1970).
7. *Id.*
8. 56 F.3d 1538 (Fed. Cir. 1995).
9. 72 U.S.P.Q.2d 1385 (Fed. Cir. 2004).
10. *TWN Mfg. Co., Inc. v. Dura Corp.*, 789 F.2d 895, 899 (Fed. Cir. 1986).
11. 185 F.3d 1341, 1350 (Fed. Cir. 1999).
12. *See Amsted Industries, Inc. v. National Castings, Inc.*, 16 U.S.P.Q. 2d 1737 (D.C. Ill. 1990).

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New York's Information Security Breach and Notification Act: A First Step in Protecting Individuals from Identity Theft

By Marc David Hiller

I. Introduction

In an effort to address identity theft, New York State has enacted the Information Security Breach and Notification Act (Chapter 442 of the Laws of 2005; as amended by Chapter 491 of the Laws of 2005) ("the Act") to "guarantee state residents the right to know what information was exposed during a breach, so that they can take the necessary steps to both prevent and repair any damage that may occur because of a public or private sector entity's failure to make proper notification."[1] The Act adds section 208 to the State Technology Law (STL) to address a breach of private information held by a public sector entity, and it adds article 39-F (§ 899-aa) to the General Business Law (GBL) to address a breach of private information held by a business or person. If a system's security is breached, state entities and businesses or persons that own or license personal information are obligated to notify the subject of the information that results in, or that they have reason to believe results in, an unauthorized person obtaining such information. The Act took effect on December 7, 2005.

The statutes are a step in the right direction to protect people from identity theft. However, while they address what to do in the event of a breach, they do not address how to prevent a breach. To this extent, the statutes assume the existence of internal controls for identifying, cataloging, and protecting personal and private information in computerized data. Without these controls, the efficacy of any notice is substantially compromised. For purposes of this article, it is assumed that such comprehensive internal controls do not exist.

As noted, the statutes discuss what actions a state entity or business is required to take in the event a system is breached, but they do not address how to secure the system. For state entities a number of these issues are addressed outside the scope of STL § 208: STL § 203[2] requires any state agency website to have a privacy policy, and the Office of Cyber Security and Critical Infrastructure Coordination's (OCSCIC) Information Policy (P03-002 V. 2.0 Apr. 4, 2005) (http://www.cscic.state.ny.us/policies.htm#cs) contains internal controls relating to identifying, cataloging, and securing computerized data. However, for businesses there are no comparable generic requirements at either the state or federal level. At the federal level there are industry-specific statutes such as Gramm-Leach-Bliley[3] for the financial industry and the Health Insurance Privacy and Portability Act[4] for the health care industry. Accordingly, for most businesses this is an unregulated area that devolves to individual businesses making risk assessments, to the extent that they are aware of the issues. Therefore, for the majority of businesses, recognizing and addressing these issues is in its infancy and probably will not be addressed unless—and until—the individual business, or a business sector collectively, sustains a financial loss as a result of a breach, either by means of legal action or loss of revenue.

II. Definitions

The following definitions are used in both STL § 208 and GBL § 899-a:

> **"Personal information"** shall mean any information concerning a natural person, which, because of name, number, personal mark, or other identifier, can be used to identify such natural person;
>
> **"Private information"** shall mean personal information consisting of any information in combination with any one or more of the following data elements, when either the personal information or the data element is not encrypted, or encrypted with an encryption key that has also been acquired:
>
> (1) social security number;
>
> (2) driver's license number or non-driver identification card number; or
>
> (3) account number, credit or debit card number, in combination with any required security

code, access code, or password that would permit access to an individual's financial account.

"Private information" does not include publicly available information which is lawfully made available to the general public from federal, state, or local government records.

"Breach of the security of the system" shall mean unauthorized acquisition or acquisition without valid authorization of computerized data that compromises the security, confidentiality, or integrity of personal information maintained by a business. Good faith acquisition of personal information by an employee or agent of the business for the purposes of the business is not a breach of the security of the system, provided that the private information is not used or subject to unauthorized disclosure.

In determining whether information has been acquired, or is reasonably believed to have been acquired, by an unauthorized person or a person without valid authorization, such business may consider the following factors, among others:

(1) indications that the information is in the physical possession and control of an unauthorized person, such as a lost or stolen computer or other device containing information; or

(2) indications that the information has been downloaded or copied; or

(3) indications that the information was used by an unauthorized person, such as fraudulent accounts opened or instances of identity theft reported.

"Consumer reporting agency" shall mean any person who, for monetary fees, dues, or on a cooperative nonprofit basis, regularly engages in whole or in part in the practice of assembling or evaluating consumer credit information or other information on consumers for the purpose of furnishing consumer reports to third parties, and who uses any means or facility of interstate commerce for the purpose of preparing or furnishing consumer reports. A list of consumer reporting agencies shall be compiled by the state attorney general and furnished upon request to any person or business required to make a notification under subdivision two of this section.

III. Applicability

STL § 208 applies to a "state entity," which is defined as "any state board, bureau, division, committee, commission, council, department, public authority, public benefit corporation, office or other governmental entity performing a governmental or proprietary function for the state."[5] STL § 208 does not apply to the judiciary or to "cities, counties, municipalities, villages, towns, and other local agencies."[6]

GBL § 899-aa applies to "any person or business which conducts business in New York State, and which owns or licenses computerized data which includes private information."[7] For jurisdictional purposes, the use of the phrase "conducts business in New York State" does not seem to require a physical presence in New York, either for the business transaction, or with respect to the location of the "computerized data."

IV. Breach of the Security of a System

The statutes are triggered by a breach of the security of a system that contains personal or private information. The definition of a breach employs a reasonableness standard as to whether personal or private information was acquired without authorization. The statute does not, however, define what constitutes a "system," and it assumes the existence of a security protocol for the system to enable the discovery of the breach. Under the definition, the determination as to the existence and scope of a breach is subjective. Moreover, the statutes are silent as to who is responsible for determining whether there has been a breach—the computer technician or a member of the executive staff. As discussed below, to ensure that a determination as to the existence and scope of a breach is an objective one that follows defined procedures requires developing, implementing, and monitoring internal controls.

V. Notification

The Act declares that state residents "deserve the right to know when they have been exposed to identity theft."[8] The mechanism for providing this right is notification to the individual in the event of a "breach of the security of the system." The statutes establish different notification requirements depending on whether the state entity or business "owns or licenses computerized data which includes private information"[9] or whether it "maintains computerized data which includes private information"[10] the state entity or business does not own.

A. Notification by the Owner/Licensor of the Computerized Data

If a breach of a system's security is discovered, the owner or licensor of the computerized data must notify all New York residents who may be affected.[11] The disclosure must be done quickly, in accordance with the legitimate needs of law enforcement[12] and "any measures necessary to determine the scope of the breach and restore the reasonable integrity of the system."[13]

The statutes employ a reasonableness standard for the discovery of the breach; however, the core issue is not the discovery of the breach, but, rather, how quickly the discovery is made. Time is the critical element in defeating the harm caused by identity theft; the more time an unauthorized individual has access to, and use of, someone's private information, the greater the potential harm. Because the statutes do not impose any performance standards on discovery of a breach, a discovery within a day, a week, a month, or a year of the actual breach all could be reasonable and, therefore, in compliance with the statutes. The statutes do not address the mechanism or means for discovering a breach, which are internal controls regarding the establishment and monitoring of a security system. Without these types of performance standards, the protection offered by the statutes is not as strong as it could and should be to protect against identity theft.

Both statutes provide that notifications "may be delayed if a law enforcement agency determines that such notification impedes a criminal investigation." But the notification "shall be made after such law enforcement agency determines that such notification does not compromise such investigation."[14] Section 899-aa does not require a person or business to notify law enforcement of a breach, but the statute seems to assume notification to law enforcement will occur when assessing the breach. In addition, state entities are required to consult with the OCSCIC to determine the scope of the breach and appropriate restoration measures.[15] However, it is not clear whether OCSCIC or the state entity is responsible for notifying law enforcement.

B. Notification by a State Entity of Business That Only Maintains the Computerized Data

Where the breach is discovered by a state entity or a business that only "maintains computerized data which includes private information,"[16] and the state entity or business does not own such computerized data, the state entity or business shall immediately notify the owner or licensee of the information[17] upon discovery of the breach if "the private information was, or is reasonably believed to have been acquired by a person without valid authorization."[18] The statutes list the following factors for a state entity or a business to evaluate in order to determine whether "the private information was, or is reasonably believed to have been acquired by a person without valid authorization":[19]

1. indications that the information is in the physical possession and control of an unauthorized person, such as a list or stolen computer or other device containing the information;
2. indications that the information has been downloaded or copied; or
3. indications that the information was used by an unauthorized person, such as fraudulent accounts opened or instances of identity theft being reported.[20]

C. Notification to Affected Individuals

The statutes contain identical provisions regarding the methods for providing notice. The notice must be provided by one of the following means:

1. written notification;
2. telephone notification; or
3. electronic notification.[21]

The notice may be provided telephonically only if the state entity or business keeps a log of such notification.[22] The notice may be provided by electronic means only if the person receiving the notice has expressly consented to receiving such notice, and a log of each such notification is kept.[23] The statutes prohibit, however, requiring consent to accept electronic notice "as a condition of establishing any business relationship or engaging in any transaction."[24]

A substitute method of providing notice may be used if the state entity or business demonstrates to the Attorney General that the cost of providing the notice would exceed $250,000; that the affected class of subject persons to be notified exceeds 500,000; or that the state entity or business does not have sufficient contact information.[25] If the Attorney General determines that the state entity or business has met the requirements for providing substitute notice, the Attorney General can authorize the state entity or business to provide substitute notice that consists of the following:

1. e-mail notice when the state entity or business has an e-mail address for the subject persons;
2. conspicuous posting of the notice on the state entity or businesses website page, if they have a website; and
3. notification to major statewide media.[26]

The statutes are silent as to whether major statewide media refers to print, broadcast or cable television, radio, or all three.

The existence of internal controls would provide information sufficient either to obviate the necessity of providing notice by a substitute method or to justify the necessity of providing notice by substitute method.

D. Contents of the Notice

The notice required by the statutes is the same regardless of the medium and must contain the following information:

1. contact information for the state entity or business making the notification; and
2. a description of the categories of information that were, or are reasonably believed to have been, acquired by a person without valid authorization, including specification of which of the elements of personal information and private information were, or are reasonably believed to have been, acquired.[27]

The statutes employ a reasonableness standard for determining the nature and extent of the personal and/or private information that was or may have been disclosed. The deployment of internal controls for cataloging the personal and/or private information that is retained not only raises the standard for the retention of the records but also ensures more complete discovery of the personal and/or private information that was disclosed. The requirement of internal controls thereby would raise the efficacy of the statutes.

E. Notice to the Attorney General, the Consumer Protection Board, and the Office of Cyber Security and Critical Infrastructure Coordination

If New York residents are to be notified, the statutes require that the Attorney General (AG), the Consumer Protection Board (CPB), and the Office of Cyber Security and Critical Infrastructure Coordination (OCSCIC) be notified as well. The notice to the above entities cannot delay the notice to the affected New York residents, and it must contain the following information regarding such notice: timing, content, and distribution of the notices, and the approximate number of affected persons.[28] The statutes do not address the coordination between or among these state entities or the coordination between these state entities and the state entity or business providing the required notification.

If more than 500,000 New York residents must be notified at one time, in addition to notifying the AG, CPB, and OCSCIC, the state entity or business issuing the notice must notify consumer reporting agencies in the same manner as the AG, CPB, and OCSCIC and without delaying the notice to the affected New York residents.[29]

The statutes do not specify what constitutes a delay in providing notice to the affected persons. Moreover, because the discovery of the breach is governed by a reasonableness standard, the imposition of these additional notice requirements without delaying the notice to affected persons appears incongruous. To require expediency in providing the notice but not in discovering the breach, which is the core issue in addressing the damage from identity theft, puts the focus on the cure and not on prevention. The deployment and monitoring of internal controls, by contrast, properly puts the emphasis on prevention.

VI. Applicability to Local Entities

At the same time that they are exempted from the requirements of STL § 208, “all cities, counties, municipalities, villages, towns, and other local agencies” (hereinafter “local entities”) are required to adopt a notification policy, or alternatively a local law, within 120 days of the effective date (December 7, 2005),[30] which is consistent with STL § 208.[31] To ensure that local entities adopt provisions consistent with STL § 208, GBL § 899-aa(9) provides that the provisions of GBL § 899-aa are “exclusive and shall preempt any provision of local law, ordinance or code, and no locality shall impose requirements that are inconsistent with or more restrictive than those set forth in this section.” Accordingly, despite specific language to the contrary in STL § 208, these two provisions effectively require local entities to comply with the provisions in STL § 208 and GBL § 899-aa. This raises the issue of whether they have sufficient internal controls in place, such as those required for state entities under the OCSCIC policy. It also raises the question of whether it is an unfunded mandate.

The Westchester County Board of Legislators has proposed a local law prohibiting commercial businesses within the county from providing public Internet access without installing a firewall to secure and prevent unauthorized access to all private information the commercial business may store, utilize, or otherwise maintain in the regular course of its business.[32] The definition of "private information" in the proposed local law is in sum and substance the same as the definition in GBL § 899-aa. The proposed local law does not, however, address the commercial businesses' responsibilities in the event of a breach of the firewall. The proposed local law highlights both the concern of multiple levels of government to address identity theft, as well as the potential for conflict between local laws and state statutes.

VII. Actions by the Attorney General Under GBL § 899-aa

GBL § 899-aa(6)[33] authorizes the Attorney General to bring an action to seek an injunction whenever the Attorney General believes that the article has been violated. In such an action, the court may award damages for actual costs or losses incurred by a person entitled to notice, including consequential financial losses. In addition to any other lawful remedy, if the court finds that the business knowingly or recklessly violated the article, the court can impose a civil penalty of the greater of $5,000 or up to $10 per instance of failed notification, provided that the latter amount shall not exceed $150,000. The statute of limitations for an action under GBL § 899-aa(6) is two years from the date of the act complained of or the date of discovery of the act.

In light of the reasonableness standard for discovery of a breach of the system, it is not clear what would constitute a violation of article 39-F of the GBL. However, if businesses were required to develop, implement, and monitor internal controls to prevent and identify a breach, establishing a violation would be substantially easier, being either a failure to establish or monitor the required internal controls. Requiring such internal controls would have enhanced the level of protection offered by the statute on both the front and the back end, and people would have been provided with better protection for the information by the business as well as by the AG in the event the business does not comply with article 39-F.

VIII. Recommendations

The statutes are a step in the right direction because providing notice of a breach can help fight identity theft. Unfortunately, notice only occurs after a breach; it is not designed to prevent a breach. The key to preventing a breach is identifying the proactive steps a state entity or business can take to secure its computerized data. The statutes assume the existence of the internal controls necessary to secure such information and determine the existence of a breach. Fundamentally, the efficacy of the statutes is a matter of internal controls, and assessing the internal controls requires addressing the following questions, among others:

1. Does the entity receive personal information?
2. Does that personal information contain private information?
3. Does it have a security policy?
4. If so, how does it monitor and ensure the effectiveness and compliance with its security policy?
5. Does it have the means to determine that there has been a breach, the extent of the breach, and the information that may have been compromised by the data?
6. Does it have a privacy policy?
7. If so, how does it monitor and ensure the effectiveness and compliance with its privacy policy?

To comply with the statues, a state entity or business must be able to determine if the triggering events under the statutes have occurred: that they have personal information that contains private information or that there has been, or may have been, a breach of the security of the system to an unauthorized individual. They also must determine to whom and how they need to provide the notification required by the statutes. A state entity or business also should ask these questions of any third party to whom they are entrusting their computerized data.

Developing, implementing, and complying with internal controls also may serve as a means by which a business can demonstrate that it did not act "recklessly" in the event the AG is evaluating whether to pursue an action under GBL § 899-aa(6).

IX. Pending Federal Legislation

There are a number of federal legislative efforts to address the issues of securing personal and private information and identity theft.[34] One such effort is S.1789, the "Personal Data Privacy and Security Act of 2005" (hereinafter the "Security Act"), sponsored by Senators Specter, Leahy, Feinstein, and Feingold to better protect the privacy of consumers' personal information. The Security Act establishes standards for business entities, data brokers, and government agencies to protect personally identifiable information. The Security Act also addresses methods for notifying individuals of a breach of the security system involving their personal information, as well as methods of enforcement by both the Attorney General and state attorneys general. The Security Act preempts state laws to the extent they are inconsistent with its provisions. Among the Security Act's findings is that "security breaches are a serious threat to consumer confidence, homeland security, e-commerce, and economic stability."[35]

Notification of security breaches is addressed in subtitle B of title IV of the Security Act. The Security Act defines a security breach as a "compromise of the security, confidentiality, or integrity of computerized data through misrepresentation or actions that result in, or there is a reasonable basis to conclude has resulted in, the unauthorized acquisition of and access to sensitive personally identifiable information."[36] As with the New York statutes, the Security Act addresses the right to the notice in section 421[37] (GBL § 899-aa(2); STL § 208(2)), the methods of notice in section 423[38] (GBL § 899-aa(5); STL § 208(5)), and the content of the notice in section 424[39] (GBL § 899-aa(7); STL § 208(6)).

Unlike the New York statutes the Security Act does not make an assumption about securing computerized data; it requires it. The Security Act, building off the experience of the Gramm-Leach-Bliley Act[40] and the Health Insurance Portability and Accountability Act of 1996 (HIPAA),[41] addresses internal controls, both their establishment and required testing.[42]

The Security Act will preempt any state law relating to notification of a security breach.[43] Therefore, if enacted, the Security Act would preempt GBL § 899-aa. The National Association of Attorneys General (NAAG), in a October 27, 2005, letter[44] signed by forty-seven state attorney generals addressed to Congressional leaders, called on Congress to enact a national security breach notification and urged Congress not to preempt the states from enacting and enforcing security breach laws because the states have been quicker to address concerns about privacy and identity theft than the federal government. The attorneys general requested that to the extent Congress seeks to preempt state laws, Congress narrowly tailor the preemption to only those laws that are inconsistent with the federal law and only to the extent of the inconsistency. The state attorneys general also asked that Congress enact a federal statute only if it could provide meaningful information to consumers; if not, the attorneys general asked that Congress leave the issue to the states because the states are responding strongly. Accordingly, it would appear that NAAG would oppose the blanket preemption contained in the Security Act as over-broad and as defeating the progressive efforts of the states to protect consumers.

New York is now among twenty-one states[45] to have adopted security breach notification statutes. The business community will argue that it is impractical, if not impossible, to comply with fifty different statues, and that the only way to help the individual in the event of a breach is federal legislation. The push for federal legislation in this area will continue to gain force; and it is quite probable that some form will pass in the next several sessions of Congress.

X. Conclusion

The New York information security breach statutes, while a step in the right direction, presume that state entities and businesses have created and comply with internal controls in the areas of privacy and security for computerized data. Notifying affected persons of a breach is only part of the solution to addressing identity theft. The core issue is examining how personal and private information is collected, stored, and protected, which requires developing, implementing, and monitoring internal controls. With respect to state entities, STL § 208 complements the requirement for privacy policies in article 2 of the State Technology Law, Internet and Security Privacy Act[46] and is more the ounce of prevention than the pound of cure. With respect to businesses, GBL § 899-aa is closer to the pound of cure than to the ounce of prevention because it does not address how the businesses identify and protect the personal information.

The issue and cost of identity theft, both to the individual and society, will continue to grow. The only way to prevent this is for individuals, as well as businesses, to establish internal controls as to whom and how they share personal information, whether their own or that of the customers, and the expectations of the businesses that retain this information. Businesses that take this next step, which is not required under GBL § 899-aa, not only put themselves in a better position to protect the personal information they presently have or license, but they also may be taking steps toward complying with potential federal requirements.

Endnotes

1. Section 2, Legislative Intent, of Chapter 442 of the Laws of 2005.
2. STL § 203.

Model Internet privacy policy.

1. The office shall adopt rules and regulations in conformity with the provisions of this article, and specify a model Internet privacy policy for state agencies that maintain state agency websites. Such model privacy policy shall include, but not be limited to, the following elements:

    1. a statement of any information, including personal information, the state agency website will collect with respect to the user and the use of the information;

    2. the circumstances under which information, including personal information, collected may be disclosed;

    3. whether any information collected will be retained by the state agency, and, if so, the period of time that such information will be retained;

    4. the procedures by which a user may gain access to the collected information pertaining to that user;

    5. the means by which information is collected and whether such collection occurs actively or passively;

    6. whether the collection of information is voluntary or required, and the consequences, if any, of a refusal to provide the required information; and

    7. the steps being taken by the state agency to protect the confidentiality and integrity of the information.

2. Each state agency that maintains a state agency website shall adopt an Internet privacy policy which shall, at a minimum, include the information required by the model Internet privacy policy. Each state agency shall post its Internet privacy policy on its website. Such posting shall include a conspicuous and direct link to such privacy policy.

3. The model Internet privacy policy specified by the office shall also be made available at no charge to other public and private entities.

3. Pub. L. No. 106–102 (1999).

4. Pub. L. No. 104–191 (1996).

5. STL § 208(c).

   "State entity" shall mean any state board, bureau, division, committee, commission, council, department, public authority, public benefit corporation, office or other governmental entity performing a governmental or proprietary function for the state of New York, except:

   (1) the judiciary; and

   (2) all cities, counties, municipalities, villages, towns, and other local agencies.

6. STL § 208(c)(1) and (2).

7. GBL § 899-aa(2).

   Any person or business which conducts business in New York state, and which owns or licenses computerized data which includes private information shall disclose any breach of the security of the system following discovery or notification of the breach in the security of the system to any resident of New York state whose private information was, or is reasonably believed to have been, acquired by a person without valid authorization. The disclosure shall be made in the most expedient time possible and without unreasonable delay, consistent with the legitimate needs of law enforcement, as provided in subdivision four of this section, or any measures necessary to determine the scope of the breach and restore the reasonable integrity of the system.

8. Section 2 of Chapter 442 of the Laws of 2005.

   Legislative Intent. The legislature finds that identity theft and security breaches have affected thousands statewide and millions of people nationwide. The legislature also finds that affected persons are hindered by a lack of information regarding breaches, and that the impact of exposing information that should be held private can be far-reaching. In addition, the legislature finds that state residents deserve a right to know when they have been exposed to identity theft.

   The legislature further finds that affected state residents deserve an advocate who can speak and take action on their behalf because recovering from identity theft can, and sometimes does, take many years.

   Therefore, the legislature enacts the information security breach and notification act which will guarantee state residents the right to know what information was exposed during a breach, so that they can take the necessary steps to both prevent and repair any damage they may incur because of a public or private sector entity's failure to make proper notification.

9. GBL § 899-aa(2).

10. GBL § 899-aa(3).

    Any person or business which maintains computerized data which includes private information which such person or business does not own shall notify the owner or licensee of the information of any breach of the security of the system immediately following discovery, if the private information was, or is reasonably believed to have been, acquired by a person without valid authorization.

11. GBL § 899-aa(2); STL § 208(2).

    Any state entity that owns or licenses computerized data that includes private information shall disclose any breach of the security of the system following discovery or notification of the breach in the security of the system to any resident of New York state whose private information was, or is reasonably believed to have been, acquired by a person without valid authorization. The disclosure shall be made in the most expedient time possible and without unreasonable delay, consistent with the legitimate needs of law enforcement, as provided in subdivision four of this section, or any measures necessary to determine the scope of the breach and restore the reasonable integrity of the data system.

    The state entity shall consult with the state office of cyber security and critical infrastructure coordination to determine the scope of the breach and restoration measures.

12. GBL § 899-aa(4) and STL § 208(4).

    The notification required by this section may be delayed if a law enforcement agency determines that such notification impedes a criminal investigation. The notification required by this section shall be made after such law enforcement agency determines that such notification does not compromise such investigation.

13. GBL § 899-aa(2); STL § 208(2).

    2. Any state entity that owns or licenses computerized data that includes private information shall disclose any breach of the security of the system following discovery or notification of the breach in the security of the system to any resident of New York state whose private information was, or is reasonably believed to have been, acquired by a person without valid authorization. The disclosure shall be made in the most expedient time possible and without unreasonable delay, consistent with the legitimate needs of law enforcement, as provided in subdivision four of this section, or any measures necessary to determine the scope of the breach and restore the reasonable integrity of the data system. The state entity shall consult with the state office of cyber security and critical infrastructure coordination to determine the scope of the breach and restoration measures.

14. GBL § 899-aa(4); STL § 208(4).

15. STL § 208(2).

16. GBL § 899-aa(3).

    Any person or business which maintains computerized data which includes private information which such person or business does not own shall notify the owner or licensee of the information of any breach of the security of the system immediately following discovery, if the private information was, or is reasonably believed to have been, acquired by a person without valid authorization.

    STL § 208(3). Any state entity that maintains computerized data that includes private information which such agency does not own shall notify the owner or licensee of the information of any breach of the security of the system immediately following discovery, if the private information was, or is reasonably believed to have been, acquired by a person without valid authorization.

17. GBL § 899-aa(3).

18. GBL § 899-aa(3); STL § 208(3).

19. STL § 208(3).

20. GBL § 899-aa(1).

    "Breach of the security of the system" shall mean unauthorized acquisition or acquisition without valid authorization of computerized data that compromises the security, confidentiality, or integrity of personal information maintained by a business. Good faith acquisition of personal information by an employee or agent of the business for the purposes of the business is not a breach of the security of the system, provided that the private information is not used or subject to unauthorized disclosure.

    In determining whether information has been acquired, or is reasonably believed to have been acquired, by an unauthorized person or a person without valid authorization, such business may consider the following factors, among others:

    (1) indications that the information is in the physical possession and control of an unauthorized person, such as a lost or stolen computer or other device containing information; or

    (2) indications that the information has been downloaded or copied; or

    (3) indications that the information was used by an unauthorized person, such as fraudulent accounts opened or instances of identity theft reported.

    STL § 208(1)(b).

    "Breach of the security of the system" shall mean unauthorized acquisition or acquisition without valid authorization of computerized data which compromises the security, confidentiality, or integrity of personal information maintained by a state entity. Good faith acquisition of personal information by an employee or agent of a state entity for the purposes of the agency is not a breach of the security of the system, provided that the private information is not used or subject to unauthorized disclosure.

    In determining whether information has been acquired, or is reasonably believed to have been acquired, by an unauthorized person or a person without valid authorization, such state entity may consider the following factors, among others:

    (1) indications that the information is in the physical possession and control of an unauthorized person, such as a lost or stolen computer or other device containing information; or

    (2) indications that the information has been downloaded or copied; or

    (3) indications that the information was used by an unauthorized person, such as fraudulent accounts opened or instances of identity theft reported.

21. GBL § 899-aa(5).

    The notice required by this section shall be directly provided to the affected persons by one of the following methods:

    (a) written notice;

    (b) electronic notice, provided that the person to whom notice is required has expressly consented to receiving said notice in electronic form and a log of each such notification is kept by the person or business who notifies affected persons in such form; provided further, however, that in no case shall any person or business require a person to consent to accepting said notice in said form as a condition of establishing any business relationship or engaging in any transaction.

    (c) telephone notification provided that a log of each such notification is kept by the person or business who notifies affected persons; or

    (d) Substitute notice, if a business demonstrates to the state attorney general that the cost of providing notice would exceed two hundred fifty thousand dollars, or that the affected class of subject persons to be notified exceeds five hundred thousand, or such business does not have sufficient contact information. Substitute notice shall consist of all of the following:

(1) e-mail notice when such business has an e-mail address for the subject persons;

(2) conspicuous posting of the notice on such business's web site page, if such business maintains one; and

(3) notification to major statewide media.

STL § 208(5).

The notice required by this section shall be directly provided to the affected persons by one of the following methods:

(a) written notice;

(b) electronic notice, provided that the person to whom notice is required has expressly consented to receiving said notice in electronic form and a log of each such notification is kept by the state entity who notifies affected persons in such form; provided further, however, that in no case shall any person or business require a person to consent to accepting said notice in said form as a condition of establishing any business relationship or engaging in any transaction;

(c) telephone notification provided that a log of each such notification is kept by the state entity who notifies affected persons; or

(d) Substitute notice, if a state entity demonstrates to the state attorney general that the cost of providing notice would exceed two hundred fifty thousand dollars, or that the affected class of subject persons to be notified exceeds five hundred thousand, or such agency does not have sufficient contact information. Substitute notice shall consist of all of the following:

(1) e-mail notice when such state entity has an e-mail address for the subject persons;

(2) conspicuous posting of the notice on such state entity's web site page, if such agency maintains one; and

(3) notification to major statewide media.

22. GBL § 899-aa(5)(c); STL § 208(5)(c).

23. GBL § 899-aa(5)(b); STL § 208(5)(b).

24. *Id.*

25. GBL § 899-aa(5)(d); STL § 208(5)(d).

26. *Id.*

27. GBL § 899-aa(7).

Regardless of the method by which notice is provided, such notice shall include contact information for the person or business making the notification and a description of the categories of information that were, or are reasonably believed to have been, acquired by a person without valid authorization, including specification of which of the elements of personal information and private information were, or are reasonably believed to have been, so acquired.

STL § 208(6).

Regardless of the method by which notice is provided, such notice shall include contact information for the state entity making the notification and a description of the categories of information that were, or are reasonably believed to have been, acquired by a person without valid authorization, including specification of which of the elements of personal information and private information were, or are reasonably believed to have been, so acquired.

28. GBL § 899-aa(8).

(a) In the event that any New York residents are to be notified, the person or business shall notify the state attorney general, the consumer protection board, and the state office of cyber security and critical infrastructure coordination as to the timing, content and distribution of the notices and approximate number of affected persons. Such notice shall be made without delaying notice to affected New York residents.

(b) In the event that more than five thousand New York residents are to be notified at one time, the person or business shall also notify consumer reporting agencies as to the timing, content and distribution of the notices and approximate number of affected persons. Such notice shall be made without delaying notice to affected New York residents.

STL § 208(8).

Any entity listed in subparagraph two of paragraph (c) of subdivision one of this section shall adopt a notification policy no more than one hundred twenty days after the effective date of this section. Such entity may develop a notification policy which is consistent with this section or alternatively shall adopt a local law which is consistent with this section.

29. GBL § 899-aa(8)(b); STL § 208(7) (b).

30. STL § 208(8).

31. STL § 208(8).

32. http://www.westchestergov.com/currentnews/2005pr/Wireless%20law.htm. Oct. 2005:

BOARD OF LEGISLATORS
COUNTY OF WESTCHESTER

Your Committee is in receipt of a communication from the County Executive urging the adoption of a Local Law adding Article XV to Chapter 863 of the Laws of Westchester County with respect to requiring all commercial businesses in Westchester County utilizing electronic means of maintaining personal information to have a secure network to protect the public from potential identity theft and other potential threats such as computer viruses and data corruption.

Your Committee notes that ever-evolving wireless communication technology has spawned various concerns with respect to the security of personal information such as Social Security numbers and credit card and bank accounts. One of the fastest growing areas in this regard is wireless fidelity or "Wi-Fi" which offers wireless Internet access to local area networks.

Your Committee also notes that Wi-Fi has traditionally been used in airports and hotels to assist business travelers. However, the trend has caught on and there are a growing number of commercial businesses using or offering Wi-Fi communication, colloquially known as "Internet cafes."

Your Committee is aware that the creation of these "hotspots" wherein Wi-Fi is provided offers an increased opportunity for identity thieves to prey on Internet users who might otherwise believe their personal information is secure. It is not only the Wi-Fi user who is at risk of identity theft. Identity theft may also occur where the business entity offering Wi-Fi utilizes the same network to conduct their day-to-day business. This practice could place a customer, who has made a credit card purchase with the business at risk for identity theft, computer viruses and data corruption from persons with rudimentary computer skills absent the appropriate security measures.

Your Committee is further aware that any entity which collects personal information could be vulnerable to threats of identity theft even if they do not offer Internet access to the public. A local retail store maintains personal information from your credit card and unless that store has taken the appropriate security measures such as installing a firewall, your personal information is at risk.

Your Committee is informed that while Wi-Fi communication offers opportunity for identity theft, so too does the use of traditional wired land area networks (LANs). Commercial entities that offer Internet connections through LANs expose themselves to electronic predators if such entities utilize the same LAN without appropriate security precautions.

Your Committee is also aware that while this Local Law is designed to help protect residents from certain cyber threats it does not provide a guarantee of such security. Therefore, the County will provide ongoing public education, through the distribution of pamphlets and postings on the County's website, outlining steps that residents should take to help protect themselves from the threat of identity theft through the use of computers and other electronic devices. The public education effort will track the latest technological advances in order to provide up-to-date and meaningful assistance.

Your Committee, in order to protect the residents of Westchester County and other users of wired and wireless networks from crimes such as identity theft and other consumer fraud, recommends adoption of this Local Law.

Dated: , 2005

RESOLUTION NO. - 2005

RESOLVED, that this Board hold a public hearing pursuant to Section 209.141(4) of the Laws of Westchester County on Local Law Intro. No. -2005 entitled "A Local Law amending the Laws of Westchester County requiring any entity offering or utilizing public Internet access to have a secure network to protect the public from potential identity theft and other risks related to computer use." The public hearing will be held at m. on the day of , 2005 in the Chambers of the Board of Legislators, 8th Floor, Michaelian Office Building, White Plains, New York. The Clerk of the Board shall cause notice of the time and date of such hearing to be published at least once in one or more newspapers published in the County of Westchester and selected by the Clerk of the Board for that purpose in the manner and time required by law.

LOCAL LAW 2005

A Local Law amending the Laws of Westchester County requiring any entity offering or utilizing public Internet access to have a secure network to protect the public from potential identity theft and other risks related to computer use.

BE IT ENACTED by the County Board of the County of Westchester as follows:

Section 1. A new Article XV shall be added to Chapter 863 of the Laws of Westchester County to read as follows:

ARTICLE XV. PUBLIC INTERNET PROTECTION ACT.

Sec. 863.1201. Definitions.

1. "Public Internet access" shall mean any commercial business that offers Internet access to the general public.
2. "Commercial business" shall mean any entity physically located in Westchester County that, for profit, offers goods or services for sale.
3. "Private information" shall mean personal information in combination with any one or more of the following data elements, when either the personal information or the data element is not encrypted (translated into private code) or encrypted with an encryption key that has also been acquired:
   (a) Social Security number;
   (b) driver's license number or non-driver identification card number; or
   (c) account number, credit card or debit card number, in combination with any required security code, access code, or password which would permit access to an individual's financial account.
4. "Firewall" shall mean a set of related programs or hardware, located at a network gateway server that protects the resources of a private network from users of other networks.

Sec. 863.1202. Security of Personal Information.

1. Public Internet access shall not be made available unless the commercial business providing such public access has installed a firewall to secure and prevent unauthorized access to all private information that such entity may store, utilize or otherwise maintain in the regular course of its business. Any commercial business providing public Internet access shall conspicuously post a sign stating:

   YOU ARE ACCESSING A NETWORK WHICH HAS BEEN SECURED WITH FIREWALL PROTECTION. SINCE SUCH PROTECTION DOES NOT GUARANTEE THE SECURITY OF YOUR PERSONAL INFORMATION, USE YOUR OWN DISCRETION.

2. Any commercial business that stores, utilizes or otherwise maintains private information electronically shall install a firewall to secure and prevent unauthorized access to all such information.

Sec. 863.1203. Notice of Compliance.

Any commercial business providing public Internet access shall, within 90 days of the enactment of this Local Law, file a notice of compliance with the provisions of this Article stating that such entity has installed a firewall as required by Section 863.1202 herein. Such notice of compliance shall be made available by the Westchester County Department of Weights and Measures.

Sec. 863.1204. Public education effort.

The Westchester County Department of Weights and Measures, in conjunction with the Westchester County Department of Information Technology, shall prepare and make available a pamphlet which shall inform and educate both the general public and the providers of public Internet access regarding the implications of this Local Law, including the need for network security measures in places of public accommodations. Such pamphlet shall also include information to assist the general public in protecting themselves from the potential of identity theft through the use of wireless Internet connections regardless of where such connections originate. Such information shall also be made available through the official Westchester County government web site at www.westchestergov.com.

Sec. 863.1205. Enforcement and Penalties.

1. The provisions of this article shall be enforced by the Westchester County Department of Weights and Measures.
2. A first violation for failure to file a notice of compliance shall result in a warning by the Westchester County Department of Weights and Measures which shall state that the offender has thirty (30) days to complete and file a notice of compliance. Failure to file a completed notice of compliance within the thirty day period shall constitute a first violation.
3. For a second violation of this Article, a civil penalty not exceeding two hundred and fifty hundred dollars ($250.00) shall be imposed. For the third and succeeding violations, a civil penalty not exceeding five hundred dollars ($500.00) shall be imposed for each single violation. No civil penalty shall be imposed as provided for herein unless the alleged violator has received notice of the charge against him or her and has had an opportunity to be heard.

Sec. 863.1206. Severability.

If any section, subsection, sentence, clause, phrase or other portion of this local law is, for any reason, declared unconstitutional or invalid, in whole or in part, by any court of competent jurisdiction such portion shall be deemed severable, and such unconstitutionality or invalidity shall not affect the validity of the remaining portions of this law, which remaining portions shall continue in full force and effect.

Section 2. This Local Law shall take effect one hundred and eighty (180) days following its enactment.

33. GBL § 899-aa(6) 6.

(a) whenever the attorney general shall believe from evidence satisfactory to him that there is a violation of this article he may bring an action in the name and on behalf of the people of the state of New York, in a court of justice having jurisdiction to issue an injunction, to enjoin and restrain the continuation of such violation.

In such action, preliminary relief may be granted under article sixty-three of the civil practice law and rules. In such action the court may award damages for actual costs or losses incurred by a person entitled to notice pursuant to this article, if notification was not provided to such person pursuant to this article, including consequential financial losses. Whenever the court shall determine in such action that a person or business violated this article knowingly or recklessly, the court may impose a civil penalty of the greater of five thousand dollars or up to ten dollars per instance of failed notification, provided that the latter amount shall not exceed one hundred fifty thousand dollars.

(b) the remedies provided by this section shall be in addition to any other lawful remedy available.

(c) no action may be brought under the provisions of this section unless such action is commenced within two years immediately after the date of the act complained of or the date of discovery of such act.

34. S.1408, A bill to strengthen data protection and safeguards, require data breach notification, and further prevent identity theft, http://thomas.loc.gov/cgi-bin/bdquery/?&Db=d109 &querybd=@FIELD(FLD003+@4((@1(Sen+Smith++ Gordon+H.))+01549))" [OR];

H.R.1745, To amend the Social Security Act to enhance Social Security account number privacy protections, to prevent fraudulent misuse of the Social Security account number, and to otherwise enhance protection against identity theft, and for other purposes; [FL-22]

35. S.1789, Sec. 2. FINDINGS.

Congress finds that:

(1) databases of personally identifiable information are increasingly prime targets of hackers, identity thieves, rogue employees, and other criminals, including organized and sophisticated criminal operations;

(2) identity theft is a serious threat to the nation's economic stability, homeland security, the development of e-commerce, and the privacy rights of Americans;

(3) over 9,300,000 individuals were victims of identity theft in America last year;

(4) security breaches are a serious threat to consumer confidence, homeland security, e-commerce, and economic stability;

(5) it is important for business entities that own, use, or license personally identifiable information to adopt reasonable procedures to ensure

the security, privacy, and confidentially of that personally identifiable information;

(6) individuals whose personal information has been compromised or who have been victims of identity theft should receive the necessary information and assistance to mitigate their damages and to restore the integrity of their personal information and identities;

(7) data brokers have assumed a significant role in providing identification, authentication, and screening services, and related data collection and analyses for commercial, nonprofit, and government operations;

(8) data misuse and use of inaccurate data have the potential to cause serious or irreparable harm to an individual's livelihood, privacy, and liberty and undermine efficient and effective business and government operations;

(9) there is a need to ensure that data brokers conduct their operations in a manner that prioritizes fairness, transparency, accuracy, and respect for the privacy of consumers;

(10) government access to commercial data can potentially improve safety, law enforcement, and national security; and

(11) because government use of commercial data containing personal information potentially affects individual privacy, and law enforcement and national security operations, there is a need for Congress to exercise oversight over government use of commercial data.

36. S.1785, Sec. 3(10).

SECURITY BREACH

(A) IN GENERAL—The term `security breach' means compromise of the security, confidentiality, or integrity of computerized data through misrepresentation or actions that result in, or there is a reasonable basis to conclude has resulted in, the unauthorized acquisition of and access to sensitive personally identifiable information.

(B) EXCLUSION—The term `security breach' does not include:

(i) a good faith acquisition of sensitive personally identifiable information by a business entity or agency, or an employee or agent of a business entity or agency, if the sensitive personally identifiable information is not subject to further unauthorized disclosure; or

(ii) the release of a public record not otherwise subject to confidentiality or nondisclosure requirements.

37. S.1789, Sec. 421.

NOTICE TO INDIVIDUALS

(a) In General—Any agency, or business entity engaged in interstate commerce, that uses, accesses, transmits, stores, disposes of or collects sensitive personally identifiable information shall, following the discovery of a security breach maintained by the agency or business entity that contains such information, notify any resident of the United States whose sensitive personally identifiable information was subject to the security breach.

(b) Obligation of Owner or Licensee

(1) NOTICE TO OWNER OR LICENSEE—Any agency, or business entity engaged in interstate commerce, that uses, accesses, transmits, stores, disposes of, or collects sensitive personally identifiable information that the agency or business entity does not own or license shall notify the owner or licensee of the information following the discovery of a security breach containing such information.

(2) NOTICE BY OWNER, LICENSEE OR OTHER DESIGNATED THIRD PARTY—Nothing in this subtitle shall prevent or abrogate an agreement between an agency or business entity required to give notice under this section and a designated third party, including an owner or licensee of the sensitive personally identifiable information subject to the security breach, to provide the notifications required under subsection (a).

(3) BUSINESS ENTITY RELIEVED FROM GIVING NOTICE—A business entity obligated to give notice under subsection (a) shall be relieved of such obligation if an owner or licensee of the sensitive personally identifiable information subject to the security breach, or other designated third party, provides such notification.

(c) Timeliness of Notification

(1) IN GENERAL—All notifications required under this section shall be made without unreasonable delay following:

(A) the discovery by the agency or business entity of a security breach; and

(B) any measures necessary to determine the scope of the breach, prevent further disclosures, and restore the reasonable integrity of the data system.

(2) BURDEN OF PROOF—The agency, business entity, owner, or licensee required to provide notification under this section shall have the burden of demonstrating that all notifications were made as required under this subtitle, including evidence demonstrating the necessity of any delay.

(d) Delay of Notification Authorized for Law Enforcement Purposes

(1) IN GENERAL—If a law enforcement agency determines that the notification required under this section would impede a criminal

investigation, such notification may be delayed upon the written request of the law enforcement agency.

(2) EXTENDED DELAY OF NOTIFICATION—If the notification required under subsection (a) is delayed pursuant to paragraph (1), an agency or business entity shall give notice 30 days after the day such law enforcement delay was invoked unless a law enforcement agency provides written notification that further delay is necessary.

38. S.1789, Sec. 423.

METHODS OF NOTICE.

An agency, or business entity shall be in compliance with section 421 if it provides:

(1) INDIVIDUAL NOTICE

(A) Written notification to the last known home mailing address of the individual in the records of the agency or business entity; or

(B) E-mail notice, if the individual has consented to receive such notice and the notice is consistent with the provisions permitting electronic transmission of notices under section 101 of the Electronic Signatures in Global and National Commerce Act (15 U.S.C. 7001).

(2) MEDIA NOTICE—If more than 5,000 residents of a State or jurisdiction are impacted, notice to major media outlets serving that State or jurisdiction.

39. S.1789, Sec. 424.

CONTENT OF NOTIFICATION.

(a) In General—Regardless of the method by which notice is provided to individuals under section 423, such notice shall include, to the extent possible:

(1) a description of the categories of sensitive personally identifiable information that was, or is reasonably believed to have been, acquired by an unauthorized person;

(2) a toll-free number

(A) that the individual may use to contact the agency or business entity, or the agent of the agency or business entity; and

(B) from which the individual may learn

(i) what types of sensitive personally identifiable information the agency or business entity maintained about that individual or about individuals in general; and

(ii) whether or not the agency or business entity maintained sensitive personally identifiable information about that individual; and

(3) the toll-free contact telephone numbers and addresses for the major credit reporting agencies.

(b) Additional Content—Notwithstanding section 429, a state may require that a notice under subsection (a) shall also include information regarding victim protection assistance provided for by that State.

40. Pub. L. No. 106–102 (1999).

41. Pub. L. No. 104–191 (1996).

42 S.1785, Sec. 401.

PURPOSE AND APPLICABILITY OF DATA PRIVACY AND SECURITY PROGRAM.

(a) Purpose—The purpose of this subtitle is to ensure standards for developing and implementing administrative, technical, and physical safeguards to protect the privacy, security, confidentiality, integrity, storage, and disposal of sensitive personally identifiable information.

(b) In General—A business entity engaging in interstate commerce that involves collecting, accessing, transmitting, using, storing, or disposing of sensitive personally identifiable information in electronic or digital form on 10,000 or more United States persons is subject to the requirements for a data privacy and security program under section 402 for protecting sensitive personally identifiable information.

(c) Limitations— Notwithstanding any other obligation under this subtitle, this subtitle does not apply to:

(1) financial institutions

(A) subject to the data security requirements and implementing regulations under the Gramm-Leach-Bliley Act (15 U.S.C. 6801 et seq.); and

(B) subject to

(i) examinations for compliance with the requirements of this Act by 1 or more federal or state functional regulators (as defined in section 509 of the Gramm-Leach-Bliley Act (15 U.S.C. 6809)); or

(ii) compliance with part 314 of title 16, Code of Federal Regulations; or

(2) "covered entities" subject to the Health Insurance Portability and Accountability Act of 1996 (42 U.S.C. 1301 et seq.), including the data security requirements and implementing regulations of that Act.

(d) Safe Harbor—A business entity shall be deemed in compliance with the privacy and security program requirements under section 402 if the business entity complies with or provides protection equal to industry standards, as identified by the Federal Trade Commission, that are applicable to the type of sensitive personally identifiable information involved in the ordinary course of business of such business entity.

Sec. 402.

REQUIREMENTS FOR A PERSONAL DATA PRIVACY AND SECURITY PROGRAM.

(a) Personal Data Privacy and Security Program—Unless otherwise limited under section 401(c), a business entity subject to this subtitle shall comply with the following safeguards and any others identified by the Federal Trade Commission in a rulemaking process pursuant to section 553 of title 5, United States Code, to protect the privacy and security of sensitive personally identifiable information:

(1) SCOPE—A business entity shall implement a comprehensive personal data privacy and security program that includes administrative, technical, and physical safeguards appropriate to the size and complexity of the business entity and the nature and scope of its activities.

(2) DESIGN—The personal data privacy and security program shall be designed to:

(A) ensure the privacy, security, and confidentiality of personal electronic records;

(B) protect against any anticipated vulnerabilities to the privacy, security, or integrity of personal electronic records; and

(C) protect against unauthorized access to use of personal electronic records that could result in substantial harm or inconvenience to any individual.

(3) RISK ASSESSMENT—A business entity shall:

(A) identify reasonably foreseeable internal and external vulnerabilities that could result in unauthorized access, disclosure, use, or alteration of sensitive personally identifiable information or systems containing sensitive personally identifiable information;

(B) assess the likelihood of and potential damage from unauthorized access, disclosure, use, or alteration of sensitive personally identifiable information; and

(C) assess the sufficiency of its policies, technologies, and safeguards in place to control and minimize risks from unauthorized access, disclosure, use, or alteration of sensitive personally identifiable information.

(4) RISK MANAGEMENT AND CONTROL—Each business entity shall:

(A) design its personal data privacy and security program to control the risks identified under paragraph (3); and

(B) adopt measures commensurate with the sensitivity of the data as well as the size, complexity, and scope of the activities of the business entity that:

(i) control access to systems and facilities containing sensitive personally identifiable information, including controls to authenticate and permit access only to authorized individuals;

(ii) detect actual and attempted fraudulent, unlawful, or unauthorized access, disclosure, use, or alteration of sensitive personally identifiable information, including by employees and other individuals otherwise authorized to have access; and

(iii) protect sensitive personally identifiable information during use, transmission, storage, and disposal by encryption or other reasonable means (including as directed for disposal of records under section 628 of the Fair Credit Reporting Act (15 U.S.C. 1681w) and the implementing regulations of such Act as set forth in section 682 of title 16, Code of Federal Regulations).

(b) Training—Each business entity subject to this subtitle shall take steps to ensure employee training and supervision for implementation of the data security program of the business entity.

(c) Vulnerability Testing

(1) IN GENERAL—Each business entity subject to this subtitle shall take steps to ensure regular testing of key controls, systems, and procedures of the personal data privacy and security program to detect, prevent, and respond to attacks or intrusions, or other system failures.

(2) FREQUENCY- The frequency and nature of the tests required under paragraph (1) shall be determined by the risk assessment of the business entity under subsection (a)(3).

(d) Relationship to Service Providers—In the event a business entity subject to this subtitle engages service providers not subject to this subtitle, such business entity shall:

(1) exercise appropriate due diligence in selecting those service providers for responsibilities related to sensitive personally identifiable information, and take reasonable steps to select and retain service providers that are capable of maintaining appropriate safeguards for the security, privacy, and integrity of the sensitive personally identifiable information at issue; and

(2) require those service providers by contract to implement and maintain appropriate measures designed to meet the objectives and requirements governing entities subject to this section, section 401, and subtitle B.

(e) Periodic Assessment and Personal Data Privacy and Security Modernization—Each business entity subject to this subtitle shall on a regular basis monitor, evaluate, and adjust, as appropriate, its data privacy and security program in light of any relevant changes in:

(1) technology;

(2) the sensitivity of personally identifiable information;

(3) internal or external threats to personally identifiable information; and

(4) the changing business arrangements of the business entity, such as:

(A) mergers and acquisitions;

(B) alliances and joint ventures;

(C) outsourcing arrangements;

(D) bankruptcy; and

(E) changes to sensitive personally identifiable information systems.

(f) Implementation Time Line—Not later than 1 year after the date of enactment of this Act, a business entity subject to the provisions of this subtitle shall implement a data privacy and security program pursuant to this subtitle.

43. S.1789, Sec. 429.

EFFECT ON FEDERAL AND STATE LAW. The provisions of this subtitle shall supersede any other provision of federal law or any provision of law of any state relating to notification of a security breach, except as provided in section 424(b).

44. http://www.naag.org/news/pdf/20051028-signon-InfoSecurityIDTheftLetter.pdf.

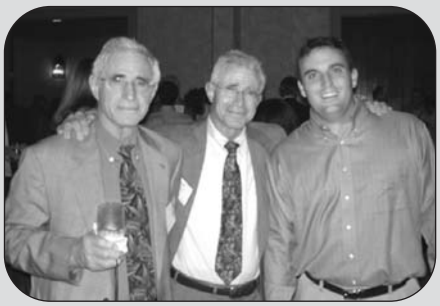
45. Arkansas, Connecticut, Delaware, Florida, Georgia, Illinois, Indiana, Louisiana, Maine, Minnesota, Montana, Nevada, New Jersey, New York, North Carolina, North Dakota, Ohio, Rhode Island, Tennessee, Texas, and Washington.

46. STL §§ 201–207.

Marc David Hiller is an Associate Attorney with the New York State Office for Technology. The opinions expressed herein are those of the author and not necessarily those of the New York State Office for Technology.

Scenes from the Intellectual Property Law Section





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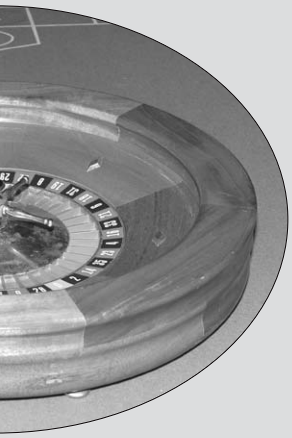















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Revenge of the Nerds in Japan: Examining the Employee-Inventor Revolt in Japan

By Thad McMurray

I. Introduction

Blue light-emitting diodes (LED) had been considered the holy grail for LED technology for over 30 years until a lone inventor, Shuji Nakamura, invented them in 1995 in the laboratory of a small Japanese chemical company.[1] If you own a PDA, cell phone, or other portable device, you can thank Mr. Nakamura every time you use it in the dark, because that blue backlighting so prevalent in those devices is provided by a gallium nitride LED that he created. That is only the tip of the iceberg for the uses of this technology. It is being heralded as the greatest invention since the light bulb, and it will revolutionize media storage, fax machines, printers, digital displays, DVD and CD players and writers, and every lighting system that currently is used.[2] And the reward bestowed on the inventor of this groundbreaking technology? A mere $180.

Disproportionately small rewards to employee-inventors, like that given to Shuji Nakamura, have been the focus of debate in Japan within the corporate sector and at every level of government for the past several years. Massive judgments in favor of employee-inventors in the last decade in Japan have spurred a vigorous debate there about appropriate compensation for employee-inventors that can be described as nothing short of a revolution.

The impact that inequitable award arrangements, which are typical of employee-inventor settings, can have on the patent system and on the progress of science has not grabbed much attention in the United States. Yet the *Nakamura* case is an opportune moment to assess the possible international ramifications of the employee-inventor revolt in Japan and to reassess the status quo in the United States; specifically, whether the courts and legislatures are striking the proper balance between the interests of the inventor and those of corporations, keeping an eye fixed on the ultimate goal of the patent system "to promote the progress of science and the useful arts."[3] In light of *Nakamura*, can that goal be achieved when the inventor becomes so disconnected from the primary incentive, the patent (and the associated potentially massive financial reward)? Absent a strong incentive for inventors, can science and technology be promoted as effectively and efficiently as possible? Japan is struggling with that question today, and the United States may be forced to address it in the very near future.

In Section II below, I summarize the evolution of the U.S. patent system with respect to ownership, control, and compensation for employee-inventor-generated inventions, the impact of the courts on employee-inventors, and the role business has taken to either foster, or, inadvertently, discourage invention. Section III examines the Japanese patent system with respect to employee-inventors, beginning with a historical overview of the patent statutes and the manner in which courts have interpreted section 35 of the Japanese Patent Law (JPL), and culminating with a review of several landmark cases in Japan that have established the precedent of providing large awards to employee-inventors to atone for historically incongruous employee-inventor compensation agreements. The focal point of Section III is the *Nakamura* case because of its notoriety and its cross-cultural and international repercussions. Section IV examines the possible impact of the recent interpretation of section 35 and briefly contrasts the U.S. and Japanese patent systems. The conclusion discusses the lessons that can be learned from the turmoil in Japan and suggests policy modifications that may be in order for the United States.

II. History of Employee-Inventors' in the United States

A. History of Inventor Enticement by Means of a Patent System

The control of intellectual property and the advantages that accompany that control have always been a primary concern in formulating incentives to entice "men from different places and most clever minds, capable of devising and inventing all manner of ingenious contrivances . . . [that] would be of no small benefit to [their] State."[4] The development of the first rudimentary patent laws, such as those proposed by the Venetian Council in the fifteenth century, were motivated by the desire to maintain and expand the technological advantage produced by inventive individuals, both citizens and foreigners.[5] From the dawn of patent law, nations have realized that they could acquire power, prestige, wealth, and other benefits for their people by providing incentives for inventors who created or brought innovations within their borders.

The inspiration for the creation and maintenance of patent laws has not changed in over 500 years since the Venetians took that bold step to create monopolies for individuals who pledged their inventions to the national intellectual property portfolio. In the United States, it was realized that without substantial protection and incentives for inventions, the drive that fueled development would all but evaporate. Lincoln coined the phrase, which now graces the stone portal of the U.S. Patent Office, "the fuel of incentive to the fire of genius."[6] That phrase captures the essence of early U.S. patent law that directed incentives to the individual inventor, just as antecedent patent laws had.[7] Initial romanticism for the heroic inventor toiling away in pursuit of the next great innovation, and the accompanying notion that he alone should profit from his creation, gradually eroded, however, as courts considered compensation for individual inventors merely a secondary factor.[8] Freedom of contract, and a policy of rewarding investment in technological development, has only served to worsen the position of individual inventors.

B. Invention Ownership and the "Shop Right"

In the United States judicially created rights have been fashioned to address ownership disputes concerning employee-inventions. One such right created by courts for employers was the "shop right." In *McClurg v. Kingsland*,[9] the Supreme Court affirmed a lower court finding that created an implied license for an employer to practice an invention of an employee although there was no contractual obligation creating such a right. The employee had improved a manufacturing process, which was incorporated into regular use at the factory. Although the employee received a pay increase, he sought and obtained a patent on the process improvement in his own name. Kingsland, the employer, was granted a license to continue to use the patented process even after the employee had ended his employment and sold his patent to another.

Cases after *McClurg v. Kingsland* further defined exactly when a "shop right" license is created and expanded upon the circumstances that implicate this principle. Commentary on *McClurg* suggests that the opinion stands for the rule that an implied license is implicated not whenever there is an employee-employer relationship, but rather when there is acquiescence to the use of an invention.[10] Regardless, the Supreme Court's decision and the context of the case implied that there must be a master-servant relationship as a predicate condition before a "shop right" is created; subsequent cases clearly made that point.[11]

Just establishing that an employment relationship existed was not enough to establish a "shop right"; the employer was required to make some contribution to the effort. The requisite contribution from the employer could be satisfied if in making the invention the employee made use of the employer's time, other employees, materials, or facilities.[12] The "shop right" has been interpreted in varying ways, but all courts have agreed that the license conferred on the employer does not transfer ownership.[13] The employee retains ownership until he decides to assign it to another.[14] Employers retain an implied license to use the patented invention even in the absence of any contract if the requisite contribution from the employer has been found or if there was some employer reliance established by the circumstances of the employee's hiring. In summary, a "shop right" "consists of a non-exclusive, nonassignable, royalty-free license to the employer to use the invention for the life of the patent."[15]

However, the implied license was not created as a tool to subjugate the employee-inventor to the employer, giving the employer the power to claim a "shop right" to all creations of the employee-inventor. Equity was the justification for the development of this implied license, since it is only fair that an employer that has contributed its resources to a patented invention should be protected from infringement actions that attempt to preclude it from using that patent.[16] While it is true that consent by the employee that grants the license is implied, the "shop right" doctrine does not shift ownership of the patent to the employer. The "shop right" has developed a balance between the need for an employer to capitalize on the risk assumed by maintaining a business and protecting the employee's right to be adequately compensated for contributing his intellectual property.[17] Courts seem to have developed the "shop right" to protect employers from being extorted by uncooperative employees, but they have tempered that protection by creating a "shop right [that gives] the employer only a license, not ownership of the patent."[18] An implied license for employee-inventions, or a "shop right," was an excellent compromise between the rights of the employer and employee-inventor.

C. Implied and Explicit Invention Assignment

Employer rights to employee-inventions expanded with a line of cases holding that ownership of such inventions could be shifted to the employer even absent an express assignment. In *Standard Parts Co. v. Peck,* Peck was hired under a written contract to "devote his time to the development of a process and machinery for the production of the front spring [that was] used on [a] product of the Ford Motor Company."[19] The employment contract did not specifically mention the assignment of patent rights, but it was apparent that the intention was to hire Peck to create a specific invention.[20] Peck finished his contractual obligation and filed a patent covering the machinery and refused to assign the patent to his employer.[21] Peck then charged Standard Parts, a successor in interest of the company that formerly had employed him, with patent infringement.[22]

Peck argued before the Supreme Court that the contract did not force him to assign his patent for two reasons: (1) employees are not obligated to assign patent rights absent an express contract to do so; and (2) no consideration was given to him that was specifically earmarked as compensation for the assignment.[23] The Court held that this was not a general employment contract, that the patent was the property of the employer "who engaged the service and paid for them, they being his inducement and compensation. . . ."[24] The Court looked at the nature and context of the contract and rejected the requirement that there be explicit language that imposed on the employee a duty to assign the patent.[25] *Standard Parts* was the first decision to infer that employees have a duty to assign any patents that are generated from work that they were specifically hired to perform. This was a dramatic shift in policy as the Court acknowledged; previously courts had required a specific written provision in the employment contract to assign the employee patent rights to the employer.[26] Courts now agree that "[w]hen an employee is hired to devote his efforts to a particular problem, to conduct experiments for a specifically assigned purpose, and an invention results from the performance of that work, it belongs to the employer."[27] While the default rule of "shop right" remains viable, it is necessary and applicable only in cases where the employee was not hired to invent or where there is no employment contract requiring assignment. This default rule is not evoked often in the modern era of employment contracts with unbending invention assignment provisions.

Courts have acknowledged that employment contracts that contain pre-invention assignment agreements have become routine practice in most businesses.[28] Companies seem to have developed this practice to eliminate any question regarding ownership and from their desire to protect resources that fuel research and development of patentable inventions. Initially, there was some hostility in the courts toward pre-invention assignment agreements that were oral or that seemed to capture inventions that were not clearly created during the term of the contract.[29] Some agreements were ruled unenforceable where they attempted to claim inventions not in the field of art in which the employee worked.[30] This trend soon reversed, and the courts' enforcement of assignment agreements steadily increased. The seminal case of *National Wire Bound Box Co. v. Healy*[31] was one of the cases that inspired the swing in how courts determined employee-invention ownership. Ironically, *National Wire* was handed down 13 years before *Standard Parts* and was based more on fiduciary duty and equity among partners in a common enterprise than on equity for employers and the massive investment that drives invention.[32]

D. Balancing the Rights and Incentives of Employee-Inventors and Employers

Recent cases echo the age-old notion that the "individual owns the patent rights to the subject matter of which he is the inventor," but a contract that gives ownership of the patent to the employee trumps this truism. Also, if the employee was hired to invent, then the employer most likely will own the patent.[33] The protectiveness that the courts showed at first toward employee-inventors has been replaced by the doctrine that "[c]ontract law allows individuals to freely structure their transactions and employee relationships [, and] an employee may thus freely consent by contract to assign all rights in inventive ideas to the employer."[34]

Policies that allow inventors to give up rights contractually to inventions before they are even conceived, and common practices in companies whereby executives or marketing and sales personnel are rewarded first while inventors are neglected and receive nothing more than an honorarium for their inventive efforts[35] could have troubling consequences. In the 1970s, legislators looking to increase the innovative edge of American corporations proposed legislation that would address the imbalance between employee-inventor compensation and corporate ownership of patented inventions.[36] Legislation proposed by Congressman John E. Moss attempted to balance the relationship between corporations and employee-inventors in order to increase America's competitive edge.[37] Unfortunately for American inventors, the bill never made it out of hearings.[38] If nothing else the Moss legislation raised awareness that factors such as employee-inventor motivation can be critical in driving innovation.

Case law favoring employee-inventors, although not very prevalent, is another indication that there are limits to the doctrine that grants employers exclusive invention ownership to the detriment of employee-inventors. In 1981, two inventors who worked for Lockheed Missiles and Space Co. were awarded $2,830,360 in damages by a California jury for infringement of a product they had developed called Super-Zip, which was utilized to separate rocket stages.[39] The jury found that Lockheed had acted in bad faith when it gave each inventor $1,260 after the invention had resulted in $400 million in sales.[40] Though cases such as this are rare, it illustrates that improper conduct on the part of an employer relating to an internal compensation program can lead to litigation.[41]

III. History of Employee-Inventors in Japan

To understand the Japanese business relationship with employee-inventors, a brief look at the Japanese employment model is in order. It often is assumed that the factors that inspired the distinctive employment style in Japan were a natural development of the cultural history of Japan, which changed and matured over centuries. However, Japan's employment style, the hallmark of which is lifetime employment, developed during the early twentieth century as Japan began its path toward industrialization.[42] Skilled workers were in high demand during this period of rapid technological advancement, and companies, realizing there was a shortage, started to train unskilled workers in-house.[43] Japanese companies created a dilemma for themselves because as "workers obtained the desired skills, they might raise the market's wage levels by moving on to other jobs with better pay, and to prevent this, wages based on seniority, along with a variety of facilities for the benefit of employees, were introduced."[44] Another factor that allowed employers to suppress employee demands for years was the high degree of loyalty on both sides of the employee-employer relationship.[45]

A. Japanese Statutes Governing Employee Inventions

Current statutory provisions in the Japanese patent system that address the compensation of employee-inventors are unique as compared with the U.S. patent system, which does not address the compensation of employee-inventors. The current Japanese patent system that has raised so much controversy was enacted in 1885 with the Patent Monopoly Act, which contained no mention of employee-inventor compensation.[46] It was not until the Patent Law of 1909 that inventions created by employees were first addressed substantively, and that body of law awarded full ownership to the employer if prior arrangements had not been made.[47] In 1921, patent laws concerning the treatment of employee-inventors were implemented that resembled the current patent system, but that does not mean that employee-inventors fared well.[48] While there is little statistical data, or judicial opinions, reflecting how these patent laws were interpreted and applied by courts, in light of the current upheaval caused by employees enforcing the employee-centric statutes, it would not be a stretch to presume that despite the 1921 statute change, Japan continued to be employer-focused in determining ownership of employee-created inventions.[49] When section 35 of the JPL was drafted in 1921, it was in response to the disparate bargaining position employees held in relation to their employers, and it was enacted to ensure employees were compensated for their inventions.[50] Circumstantial evidence supports the proposition that employee-inventors in Japan always have had an inferior and submissive position when it came to ownership and compensation for their inventions.

The complexity of the relationship between employee-inventors and their employers is evident as Japanese courts have sifted through section 35 of the JPL, contract law, and labor law, all in an effort to seek a balance that will serve the public interests in encouraging innovation. Before examining the compensation sections of the JPL, it is important to examine how the Japanese patent laws determine ownership of the intellectual property. Section 35 paragraph 1 stipulates that when an employee who "has obtained a patent for an invention which by reason of its nature falls within the scope of the business of the employer, and an act or acts resulting in the invention were part of the present or past duties of the employee, performed on behalf of the employer," such patent is referred to as an "employee's invention."[51] This distinction is important because paragraph 1 stipulates that employers will retain a non-exclusive royalty-free license to any invention that is designated as an "employee's invention."[52] Non-exclusive licenses are virtually worthless in industries that require a high degree of investment in research and development, such as pharmaceuticals and electronics.[53] Marketability of a non-exclusive license is low because the inventor retains an identical right, and the incentive created by patent monopolies is diluted.

The value of a patent system for businesses lies in exclusivity; without it the incentive to create or fund research is drastically reduced. In spite of the lack of marketing value in a non-exclusive license, employers have enjoyed a superior negotiating leverage over employee-inventors, which has allowed employers to pressure employees into assigning all rights to employee inventions for little in return. It might be presumed that employee-inventors could have shopped employee inventions among other employers or sought to license the invention, but given the historic loyalty among employees in Japan and the outstanding non-exclusive license held by the current employer, neither option was likely. Paragraph 1 and its "employee's invention" assignment provision is similar to the "shop right" courts in the United States have granted to businesses, which developed into a dramatic bargaining advantage for U.S. businesses.[54]

The potential detrimental effects of paragraph 1 on employee-inventors are rectified by paragraph 2, which disallows the pre-assignment of non-employee inventions.[55] Any attempt to lock up rights to inventions that were created outside of the employee's past or present duties, that were created outside of the employer's scope of business, or that were not created on behalf of the employer, are considered null and void.[56] Few inventions fall into these categories, but the legislature evidently was trying to protect the employee-inventor while still giving the employers the incentive to fund research.

With that as a backdrop, we will now examine paragraphs 3 and 4 of the JPL, which deal specifically with the compensation of employee-inventions. These two paragraphs have occupied the attention of the legal, business, and scientific communities in Japan for the past several years, in particular because there has been a fresh, extremely employee-friendly interpretation of the language of those paragraphs.[57] Paragraph 3 stipulates that employees have the right to "reasonable remuneration" when they have assigned either the right to obtain a patent or the patent itself with respect to an employee's invention; the obligation could be pursuant to a contract, employment policy, or other agreement.[58] Japanese legislators seem to comprehend the importance of adequately compensating employees for their inventions and considered the disadvantage employees faced in negotiating, given the traditional life-time employment and seniority systems. Despite this awareness, section 35 paragraph 3 has fallen short of its perceived goal because the "reasonable remuneration" language is vague and until recently was overlooked in favor of employers.

Paragraph 4 details the two criteria that should be considered in determining what is "reasonable remuneration."[59] Profits that the employer has derived from the invention should be referenced first. Then the contribution that the employer has made to the development of the invention can be used to determine what would be "reasonable remuneration."[60] There is no clear definition of profit and contribution in the statute, which makes the determination of "reasonable remuneration" malleable and imprecise. Those characteristics could increase predictability for businesses if its remuneration determinations were absolute, but in this climate courts have the final word on whether compensation was fair, and those determinations often trump internal compensation structures.[61] Previously, businesses had been left to their own devices to apply the statute, and until recently courts had no need to interpret the statute.[62] Since there are no clear guidelines, and because of the flexibility of the language of the statute, businesses have interpreted the statute to best meet their needs. This often has meant that little compensation is paid for inventions that are assigned irrespective of the success of the invention.[63]

B. The Employee-Inventor Revolt in Japan

Several decisions awarding huge damages to employee-inventors have stirred great controversy in Japan. Questions have been raised by commentators, patent experts, government ministries, and business leaders about the efficacy and efficiency of section 35 of the JPL.[64] Some executives at Japanese firms have described the situation as a "time bomb ticking away" that will only "foment conflict between employer and employee."[65] Some in the business world sympathize with the employers, wondering how smaller companies will survive some of the draconian awards that courts have been issuing.[66] Advocates for the employee-inventors support the high awards, arguing that researchers and engineers are the key players in developing the technology that allows Japan to compete in a global economy.[67] It is feared that without compensation that rivals that offered to inventors in other industrialized nations, Japan could be bogged down in an R&D malaise.[68] Researchers will begin to seek opportunities outside of Japan or will lose the incentive to create.[69]

For nearly a century the reasonable remuneration provision of section 35 went uninterpreted by the courts, but recently there has been a flurry of cases in which employee-inventors have challenged the employers' internal invention remuneration policies and procedures.[70] Employee-inventors have started to assert their right vigorously in courts, and courts have been willing to oblige their call for change by issuing large rewards in favor of the employee-inventor plaintiffs. Those in Japan's business world watching this phenomenon unfold worry that these hefty awards will weaken business' penchant for R&D and lead to a slowing of scientific and technological advancement.[71]

The Tokyo District Court has been extremely active in rectifying inequities in the internal employee-inventor compensation rules in place at most Japanese businesses. One of the first companies to bear the brunt of the court's judicial activism in this regard was Olympus. In 1999, a district court decision in *Tanaka v. Olympus Optical*[72] recognized the right of employee-inventors to claim reasonable remuneration above what the work rule[73] provides in exchange for the assignment of the right to obtain a patent.[74] Mr. Shumpei Tanaka sued Olympus, his former employer, claiming that the company had failed to compensate him adequately pursuant to section 35(3) and (4) of the JPL.[75] Tanaka's circumstances illustrate the dilemma that most employed inventors in Japan face. Starting with the company in 1969, he spent a five-year stint in the R&D division, which required him to sign an agreement to assign any right to obtain patents on his research.[76] His compensation was to be set according to company work rules, and this was where the dispute arose. The inventor was compensated 3,000 yen when the disputed patent was filed, 8,000 yen when the patent was issued, and 200,000 yen based on royalties earned from the invention.[77] This amounted to a total close to $1,900.[78] Tanaka claimed that his patent was an integral technology used in every CD player sold by Japanese companies and that Olympus had earned one percent of the over $6.25 billion in sales of CD players due to royalty revenue from licensing the technology.[79]

Besides rebutting the figures that Tanaka alleged, Olympus asserted two defenses. First, it argued that the remuneration established by the work rule preempted any attempt by the employee to claim additional compensation.[80] Olympus contended that the work rule was uncontestable and could not be overridden by section 35 of the JPL.[81] The court categorically rejected that proposition, stating that "the plaintiff did not have any reason to be bound by the work rule, because the work rule was stipulated by the employer one-sidedly."[82] Despite the failure of Olympus' defenses, it enjoyed a minor victory in that Tanaka received only a small portion of what he sought. The court noted Olympus' arguments that the patent was a minor component in the licensing agreements, that some licensees failed or refused to pay royalties, that the patent was not as widely used as Tanaka had claimed, and that the patent was vulnerable to invalidation in reducing the award to just over $20,000.[83] Nevertheless, Olympus appealed the District Court's judgment to the Tokyo High Court, where the decision was affirmed in its entirety. The High Court clarified the ruling on the validity of internal employment programs, holding that "reasonable remuneration" could not be set unilaterally by the programs in advance.[84] Olympus appealed to the Japanese Supreme Court, and the Court affirmed the lower courts' decisions and added further clarification, stating: "Statutory provisions do not prevent such internal policy from including the commitment, amount and timing of payment."[85] However, illegality is clear "if the amount of 'reasonable remuneration' is determined in final form well before an employee's invention is completed and before the detail and value of the right to a to-be-obtained patent becomes specific."[86]

The outcome in *Olympus* was not staggering in monetary terms, but in corporate policy and patent policy terms it was staggering. Olympus had dodged a bullet. The Court seemed to make an extraordinary effort to reduce the financial impact of its decision in this particular case, but it sent a strong message that interpretation of section 35 would no longer be a one-sided affair. "Reasonable remuneration" had taken on a new definition, which would no longer be a summary internal procedure that could not be contested. It was a shot across the bow of Japan's corporations, a warning that inequitable treatment of employee-inventors needed to change or the courts would step in.

Following that landmark case, several employee-inventors were emboldened to follow Tanaka's lead. Mr. Yonezawa filed suit against his former employer, Hitachi Ltd., after he retired, seeking further compensation for his inventions relating to light pickup units for compact disc players.[87] Several of his inventions led to patents both inside and outside Japan. In November 2002, the Tokyo District Court ordered Hitachi to pay $318,000 as remuneration to Yonezawa under section 35(3).[88] Yonezawa argued that foreign patent revenues should be included in the award, but the District Court declined to include those profits in the analysis.[89] Following the precedent set in the *Olympus* case, the court consulted the internal compensation policy of Hitachi but preempted the policy because it failed to "reasonably remunerate" Yonezawa for his assignment of the valuable patents.[90]

Yonezawa and Hitachi both appealed the decision of the District Court, which was affirmed in part and amended in part. The High Court accepted the lower court's interpretation of section 35(3) and (4), but it disagreed with the lower court's decision to limit the compensation determination to only profits derived in Japan.[91] The High Court ruled that since the employment agreement was between a Japanese corporation and a Japanese citizen, absent a contrary intention, Yonezawa had assigned the right to obtain patents worldwide, and that required Hitachi to calculate compensation on a worldwide basis. Including foreign patent rights in the reasonable remuneration calculation obviously increased Yonezawa's award. The High Court's decision, which was handed down on January 29, 2004, awarded Yonezawa $1,798,421.[92] This decision may have implications not only for Japanese employee-inventors working for Japanese companies but also for situations involving Japanese employees employed by foreign companies with Japanese subsidiaries and Japan-based research facilities or non-Japanese inventors employed in Japan by Japanese corporations.[93] This scenario has yet to be played out in the courts, but it will be interesting to see just how far courts are willing to push the envelope on employee-inventor rights.

Soon after the Yonezawa verdict was handed down, a much-anticipated decision from the Tokyo District Court was entered in favor of the inventor of the blue LED, Shuji Nakamura. In August 2001, Nakamura filed a suit against his former employer, Nichia Corp., seeking a declaration that the patents covering his work on blue LEDs remained his property because he had not assigned his rights to Nichia.[94] Alternatively, he sought $475 million as reasonable remuneration pursuant to section 35(3).[95] Nakamura had been compensated $180 in 1993, when he invented the blue LED, and Nichia subsequently had it patented.[96]

Nakamura began working for Nichia in 1979, and his quest to invent the blue LED started not long after.[97] As noted, blue LEDs had been the holy grail of many corporate giants for years, but every R&D effort by companies like GE, 3M, and RCA had failed.[98] But Nakamura persisted. He chose a path that traditional LED research and the president of Nichia advised against, namely using the semiconductor gallium nitride as the substrate.[99] Nakamura ignored his detractors and successfully developed the first blue LED, which made Nichia virtually the only manufacturer of blue LED and netted the company sales of close to $1.1 billion.[100]

Nakamura lost his bid for ownership of the blue LED patent, but the District Court awarded him $180 million as compensation for the patent rights.[101] It was the largest judgment ever for an employee-inventor and one of the most liberal applications to date of the reasonable remuneration provision of section 35(3) and (4). Following the District Court's decision a Nichia spokesperson declared the judgment an overestimation of the profits and claimed that the court had failed to consider other research necessary for blue LED production in calculating Nakamura's contribution.[102] Nichia appealed, and Nakamura eventually settled for $8.1 million.[103] It seems that globalization combined with judicial activism has transformed the once meek Japanese employee-inventor into a leviathan. Scientists who traditionally have been rather submissive to the company and team model are growing disgruntled. Employee-inventors are seeking favorable interpretations of section 35 of the JPL by the courts, and the courts have been responding sympathetically.[104]

Decisions such as *Tanaka v. Olympus* have encouraged employee-inventors in Japan to question business as usual. As employee-inventors become aware of their rights and begin to view corporate policies as exploitive, their sense of allegiance to their company has weakened. Another factor in reducing loyalty of employee-inventors to their employers is the vanishing tradition of lifetime employment.[105] The unspoken accord originally reached between employee-inventor and employer—uncontested invention assignment for lifetime employment—is no longer valid.[106] Movement in the workplace has given the employee-inventor leverage that was nonexistent in the past and has been a catalyst for change in the compensation structure for employee-inventors.

C. Response from Japan's Business Community

The warning shot launched by the *Olympus* case reverberated throughout Japanese industry. It set into motion a drastic increase in employee-inventor compensation and bonus programs.[107] Businesses heeded the warning and started to assess the fairness and efficacy of internal policies at motivating employee-inventors, but the courts have had their detractors. Criticism of the courts' interpretation of section 35 of the JPL has been heard from the business community and from professors who worry that these overly generous awards will sap the will of companies to invest in R&D.[108] Physicist Eichi Yamaguchi, a professor at Doshisha University, criticizes decisions that award large monetary awards to inventors like Nakamura because they overlook the decisions of executives to pour hundreds of millions of dollars into risky R&D projects.[109] Yamaguchi reasons that emphasizing the inventors' role in R&D to the extent that courts have recently distorts business practices and could paralyze R&D in Japan.[110] Corporate executives have expressed disappointment that the Supreme Court did not set specific guidelines for compensation for inventions, and to date the courts have only treated compensation questions on a case-by-case basis.[111]

Not all businesses have challenged decisions like *Nakamura* and *Olympus*. Some companies have realized that a fight to retain and attract the most talented and prolific inventors is under way and they have responded by offering significantly improved compensation systems for invention assignment. Sony, which previously offered bonuses only after the issuance of a patent, has started to pay bonuses upon filing an application.[112] Companies also have started to raise the upper limits of internal invention compensation programs in order to alleviate inventor discontentment and to entice inventors from competitors.[113] Shimadzu Corporation now guarantees compensation of nearly $100,000 (with no upper limit) for a patented product that generates sales over $100 million.[114] A Japanese pharmaceutical company, Eisai, has eliminated the upper limit on compensation and implemented a .05 percent royalty on sales of patented drugs.[115] Many other companies are following suit. Takeo Fukui, president of Honda Motor Co., offered a forward-looking evaluation of recent trends in the courts and stressed the importance of attracting capable researchers, commenting, "We don't think of it as a risk [for corporations]. It's a fantastic thing that researchers can conduct their work with such an opportunity."[116]

D. The Government Response

Japanese government officials shared the alarm regarding the courts' treatment of employee-inventors, and they are responding to the controversy. In February 2001, Japanese Prime Minister Junichiro Koizumi assembled the Strategic Council on Intellectual Property, which was made up of academics, attorneys, and scientists expert in intellectual property.[117] Five principal topics were addressed in a policy outline developed by the council: (1) promotion of the creation of intellectual property; (2) strengthening of the protection of intellectual property; (3) promotion of the exploitation of intellectual property; (4) development of human resources related to intellectual property; and (5) improvement of public awareness of intellectual property.[118] The policy outline was geared toward directing and facilitating a revival of the competitiveness of Japanese industries.[119]

Since the completion of the council's policy outline, similar councils and committees have been established under the auspices of the executive branch to examine particular segments of Japan's patent system. The Ministry of Economic, Trade and Industry (METI), the cabinet agency with responsibility over the patent system, has responded to the fervent debate about employee invention and organized a council to examine the impact of the current compensation policy and structure in Japan, including how it affects the incentive to create.[120] METI also convened the council to propose changes that would increase the motivation for invention among employee-inventors.[121] The Industrial Structure Council (ISC) issued the report in December 2003, and it noted problems with, and inadequacies of, the current law and called for sweeping changes.

The section of the patent law that deals with employee-inventions, section 35, has been around in virtually the same form since 1921, yet there has been no monitoring process to determine if it was functioning appropriately. Herein lies the problem. The recent judicial activism has been a wakeup call for METI and the Diet regarding the importance of assessing patent laws and adjusting them periodically. The ISC noted that historically employers have—without question or protest from employees—succeeded to the rights of employee-inventions.[122] That practice has allowed employers to smoothly transition these technologies into marketable products, and inventors seemed satisfied with their remuneration. But in the last decade changes in the employer/employee relationship has caused employees to seek recourse in the courts under section 35, and this led many to question the soundness of the statute.[123]

The ISC found two major problems inherent in the functioning of section 35. First, it increased the "uncertainty in research and development investment activities by companies."[124] Security in investment is contingent upon knowing what costs will be encountered in a research endeavor. Section 35(3) stipulates that employee-inventors shall be paid adequate remuneration for ceding their rights in inventions to their employer. The Supreme Court in *Olympus* held that employer compensation programs can be superseded by a court's determination that the compensation was inadequate.[125] Courts have thrown yet another variable into the already difficult businesses success calculus, which can only encumber efforts to attract venture capital for R&D. Employers are in a quandary without clear guidelines as to whether internal programs, that have been functioning for decades, are going to be sustained by the courts. Section 35(4) was intended to provide the desired guidelines, but the ISC believes that section 35(4) is too vague.[126] Nebulous guidelines have led to an "unpredictable remuneration situation [that] is causing obstacles to continuing investment in research and development."[127] Courts interpret the criteria contained in section 35(4), but there is no clear indication of how the categories are assessed and calculated.[128] The ISC stated that not enough of the employer's contributions, such as patent application costs, costs incurred in the exploitation of the invention, contributions to creation, and advertising, were being used by the courts in their compensation determinations.[129]

The second major problem with the current system is that the guidelines in place at most companies are imposed unilaterally by the employers, which raises employee doubt as to the accuracy and evenhandedness of the evaluations.[130] The ISC suggested that the one-sided rules should be eliminated and called for employment contracts that are negotiated in good faith. The ISC recommended that the current system be amended to allow for the independent determination of remuneration by the parties, which would mean that the employment contracts would be respected as the result of a binding negotiation. The ISC argued that this would bring predictability to the compensation system for companies and would allow for flexibility to account for the business environment.[131] There is not much distinction between company rules and an employment contract given the employer's strong bargaining position, but the ISC understood this and would require that employee concerns be reflected in the process.[132] Courts still will play a role in providing a forum in which employees can challenge the remuneration, but the ISC would like to limit those challenges to cases in which there was no internal provision in place or when the remuneration procedures are not transparent or detailed.[133] The ISC encourages employers to announce their compensation guidelines because it will promote a better research environment by attracting the brightest minds to the company and encouraging employers to have reasonable determinations.[134]

Prime Minister Koizumi is hoping the provisional legislation, Basic Law on Intellectual Property (Law No. 122 of 2002), will be enacted into law by the Diet promptly. It was drafted after the Strategic Council on IP produced its Policy Outline, and it was intended to address the issues brought up in that document. Article 8 of the Basic Law on IP addresses the business enterprise's responsibility to afford proper treatment to employee-inventors.[135] During the ordinary session of 2004, the section 35 revision bill was submitted to the Diet.[136] The bill adopted much of the content of the ISC report.[137]

IV. The Impact

Under the direction of Prime Minister Koizumi, Japan has embarked on a plan to revitalize its intellectual property resources and maintain and perhaps improve its position as a participant in the global intellectual property market. The many councils and committees assembled by the Prime Minister are focused on revitalizing Japan's industrial competitiveness and on securing inventor incentives "that will prevent capable researchers from 'draining' overseas and attract such personnel from overseas."[138] Japan's government is stepping in to prevent the migration of talented and innovative scientists like Shuji Nakamura. As Japan emerges into a new era, which is confronting the collapse of the lifetime employment system, it will need to adapt by creating a system that will address the new issues inherent in employee mobility. Businesses understand that government solutions are not a panacea, and they are reacting by rationalizing incentive programs to match employee contributions. Those companies that fail to adapt in this way will not be able to attract the brightest minds.

Shuji Nakamura, now a professor at the University of California at Santa Barbara, has been extremely outspoken about the shortcomings of the Japanese IP model. He charges that "Japan is sadly lacking in intellectual freedom, openness, and diversity, all vital for fostering innovative research."[139] Engrained in the psyche of much of the workforce is blind company loyalty that perpetuates the corporate sense that they are entitled to exploit its employees.[140] Nakamura cites shortcomings in the education system and business governance as the reasons for Japan's struggles in developing breakthrough technology.[141] Changes by the Japanese government to repair many of these problems related to the treatment and promotion of the employee-inventor in Japanese society have been initiated, but only time will tell to what extent they are successful.

One potential landmine that has been avoided by the current section 35 is the applicability of section 35 to foreign inventors working for Japanese companies or to Japanese inventors working for foreign companies in Japan.[142] European and U.S. companies that have research and development facilities in Japan may be hesitant to recruit and fund Japanese scientists if faced with the specter of "reasonable compensation" litigation awaiting any successful project. The international implications of the recent employee-inventor compensation suits in Japan are still not settled and may be the next stage in this struggle between employees and employee-inventors.

Some in the United States have expressed concern that the METI bill does not go far enough. The American Intellectual Property Law Association (AIPLA) recommended that more deference toward in-house compensation programs be shown in the legislation to discourage suits by employees.[143] AIPLA also suggested that examples of reasonable and unreasonable remuneration should be provided in the legislative history to give direction to the courts as to the proper interpretation.[144] Despite the shortcomings of the current version of the METI-proposed legislation, moves by Prime Minister Koizumi show that he and his cabinet are looking to adjust imbalances in the JPL in order to make Japan a more competitive player in the control and production of technology.

V. Conclusion

The U.S. patent system has struggled to balance employee-inventor rights against the practical need to give companies more control over inventions to promote predictability in R&D investment. Assurance that a company will not have complicated invention ownership disputes has led to steady investment in R&D and tremendous technology stimulation in the United States. Modern business dynamics require flexibility in compensation systems for inventions to allow companies to adapt efficiently to the rapidly changing economy. Inventors who produce profitable inventions can bargain for compensation that they deem sufficient in negotiation sessions at the onset of their employment contract. If these prized employee-inventors become unhappy with their compensation, they have the leverage to negotiate increases. Another counterbalance to the strong position that employers occupy is that the law "has long contained a quietly effective escape hatch, allowing creative employees to exit a firm before an inventive concept has taken on a concrete, tangible form."[145] Despite the absence of statutory compensation provisions in the United States, some commentators argue that legislatively imposed incentives are unnecessary or even counter-productive given the "widespread, and apparently growing, movement by firms to establish internal reward systems for their inventive employees. . . ."[146] Arguably, the "reward programs go at least part of the way toward providing more high-powered incentives for employees to engage in inventive work."[147] In light of these two factors, "employee-inventors appear much better off than the law of invention ownership alone might suggest."[148]

With 47 percent of patents issued in the United States originating from foreign applicants,[149] patent protection in the United States is no longer solely a national interest that can ignore foreign trends. Serious attention should be directed by U.S. officials towards the employee-inventor revolution that has been taking place in Japan, and an assessment of the impact the Japanese court decisions will have on U.S. interests in Japan should be conducted. It also is an opportunity to assess whether the incentive and compensation structure, as it stands in the United States, is calibrated to obtain the most efficient technology production from employee-inventors, the main source of patented technology in the United States.

Japanese corporations have been reeling as they adjust to the drastic changes that have been forced upon them by judges who side with employee-inventors. U.S. businesses should take heed and reassess their internal policies and determine whether the compensation structures being offered employee-inventors, particularly those employee-inventors currently living in Japan, are reasonable. Since the effort initiated by Congressman Moss in the 1970s to pass legislation that would regulate employee-inventor compensation,[150] interest in defining employee-inventor rights has percolated to the surface, but few efforts have been sustained. The IEEE-USA has been working on issues like pre-invention assignments since 1975 and has challenged the status quo, which treats "intellectual human capital as a disposable commodity instead of the nation's most valuable asset."[151] Although the United States will not see an upheaval of the magnitude occurring in Japan, the effects likely will reverberate throughout the United States and the international community. For that reason, the lessons taught by Japan's experience should persuade U.S. businesses and government officials to assess and adjust policies affecting employee-inventors to make certain that employee-inventors are properly motivated and compensated. Federal legislation has not been used to address employee-inventor/employer relations in the United States, but in light of the employee-inventor revolution in Japan, perhaps the time has come to eliminate the patchwork of state laws in favor of a uniform federal law as proposed by the IEEE-USA[152] to better ensure that the promotion of science in the United States is both efficient and vigorous.

Endnotes

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Trademark Law and Fair Use: The Tug of War Between Fair Use and Confusion in the Marketplace

By Stephen W. Feingold and Liza Negron

I. Introduction

Stephen W. Feingold

The courts, and even trademark practitioners, often confuse the meaning and role of trademark fair use. Fair use in trademark law has been used to identify a plethora of different uses: from the defendant who claims "My use is fair because no one is confused," to the defendant who seeks to invoke the statutory defense contained in section 33(b)(4) of the Lanham Act, which is known as the classic fair use defense. Thus, as used by some, fair use is a classic affirmative defense; as used by others, it is simply a useful way to identify a category of cases in which confusion may be less likely. The purpose of this article is to provide a better understanding of the many contexts in which the defense of trademark fair use arises.

Fair use in trademark law becomes easier to address when one distinguishes the five different types of fair use: classic fair use; nominative fair use; replacement parts/ingredients/repackaging; comparative fair use and advertisement; and parody.

A. Classic Fair Use

Section 33(b)(4) of the Lanham Act provides in pertinent part that it shall be a defense to a claim of infringement if:

> [T]he 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. . . .

As interpreted by the courts, a defendant invoking this defense has the burden of proving the following three elements:

1. The term was not used as a trademark;
2. The term was used "fairly" and in "good faith"; and
3. The term was used only to describe the defendant's goods or services and not the plaintiff's.

Under this doctrine, a print advertisement for CREST stating "the dentists' choice for fighting cavities" was held to be a fair use and not an infringement of the mark DENTIST'S CHOICE for toothbrushes.[1] The court applied the above-noted three-part test and found that (1) defendant's use was not a trademark use but rather a descriptive or explanatory use; (2) the use of the phrase "the dentists' choice" was a fair use made in good faith; and (3) the words were used in their primary sense to describe an attribute of the CREST product—that it is recommended by dentists.[2]

Few cases have turned on an evaluation of the second element.[3] This prong of the classic fair use defense sometimes is used to support the argument that a fair use can never be a confusing use. After all, according to this argument, if the use causes confusion, it can't be fair or made in good faith. As we shall see below, the Supreme Court's recent decision in *KP Permanent Make-Up v. Lasting Impression, Inc.*[4] was intended to answer the question of whether a defendant asserting a classic fair use defense has the burden to prove the absence of confusion in addition to proving each prong of the three-part test described above. In dicta, the Court suggested that a significant level of confusion may be relevant to the second factor.

The classic fair use defense is predicated on a clear bias against granting exclusive rights to descriptive marks. When the plaintiff chooses a mark with descriptive qualities, the fair use doctrine recognizes that he cannot altogether exclude some kinds of competing uses, particularly those that use words in good faith in their descriptive sense and not as a trademark.[5]

B. Nominative Fair Use

The nominative fair use defense is a judicially created doctrine recognized only by the Ninth Circuit and, to a limited extent, the Fifth Circuit. In contrast to the classic fair use defense, there is no statutory support for the nominative fair use defense.

To assert a nominative fair use defense, a commercial user must show:

> First, the product or service in question is one not readily identifiable without the use of the trademark; second, only so much of the mark or marks may be used as is reasonably necessary to identify the product or service; and third, the use must do nothing that would, in conjunction with the mark, suggest sponsorship or endorsement by the trademark owner.[6]

Judge Alex Kozinski of the Ninth Circuit first articulated this defense in *New Kids*, explaining that the doctrine was necessary to allow references to trademarked items. "For example," Judge Kozinski noted, "one might refer to the 'two time World Champions' or 'the professional basketball team from Chicago,' but it's far simpler (and more likely to be understood) to refer to the Chicago Bulls."[7] "[S]ometimes there is no descriptive substitute, and a problem closely related to genericity and descriptiveness is presented when many goods and services are effectively identifiable only by their trademarks."[8] This is not the case when equally informative non-trademark words describing the products are available, *e.g*., KLEENEX, SCOTCH TAPE, and JELL-O (facial tissue, cellophane tape, and gelatin).[9] When there is no easily allowable generic term, such usage is "fair" because it does not imply sponsorship or endorsement but is merely referential in nature.[10]

In subsequent cases, the nominative fair use defense has been clarified in several important ways. As initially formulated, the nominative fair use defense applied when the defendant used the plaintiff's mark to refer to or describe the plaintiff and not the defendant's own product. This defense was easily applied when a newspaper used the name NEW KIDS ON THE BLOCK as part of a telephone poll about the pop group. The term applied entirely to the mark owner and not to the defendant.

But in other cases, the defendant has used the plaintiff's mark in order to highlight something about the defendant's product, such as Franklin Mint's use of Princess Diana's name and likeness.[11] Does such use preclude application of the nominative fair use doctrine? No. In *Cairns*, the Ninth Circuit differentiated between a nominative fair use analysis and a classic fair use analysis when the Diana Princess of Wales Memorial Fund brought an action against Franklin Mint for marketing unauthorized Diana-related products. The court explained that the nominative fair use analysis is appropriate when a defendant has used the plaintiff's mark to describe the plaintiff's product, and, conversely, the classic fair use analysis is appropriate where a defendant has used the plaintiff's mark only to describe his own product.[12] The Court found that Franklin Mint's use of Princess Diana's name and likeness constituted nominative fair use.[13]

In *Cairns*, the Court went on to further clarify that "the distinction between classic and nominative fair use is important . . . [because] the classic fair use analysis only complements the likelihood of customer confusion analysis as set forth in *Sleekcraft*, whereas the nominative fair use analysis replaces the *Sleekcraft* analysis."[14] The Ninth Circuit expanded on this concept in *Playboy Enterprises, Inc. v. Welles*:[15]

> When a defendant uses a trademark nominally, the trademark will be identical to the plaintiff's mark, at least in terms of the words in question. Thus, application of the *Sleekcraft* test[16] which focuses on the similarity of the mark used by the plaintiff and the defendant, would lead to the incorrect conclusion that virtually all nominative uses are confusing.

Less than one year after *Welles*, a different panel of the Ninth Circuit explained:

> [T]he third requirement of the nominative fair use defense—the lack of anything that suggests sponsorship or endorsement—is merely the other side of the likelihood of confusion coin. . . . Therefore, whereas the plaintiff carries the burden of persuasion in a trademark infringement claim to show likelihood of confusion . . . the nominative fair use defense shifts to the defendant the burden of proving no likelihood of confusion.[17]

Taken together, these three cases instruct that when a purportedly nominative use is at issue, the nominative fair use test is a better predictor of whether there is a likelihood of confusion.[18] Confusion cannot coexist with a nominative fair use.

Is a different test necessary to evaluate nominative fair use? The *Polaroid* multi-factor test has been universally adopted with minimal variations by each circuit because its factors generally correlate to the presence of confusion. When two marks are identical and used for the same goods or services, typically the consumer viewing a defendant's mark will be confused.[19] The Third Circuit found that likelihood of confusion under these circumstances is "virtually inevitable."[20] For that reason, McCarthy characterizes such cases as "open and shut."[21]

The presumption that confusion is "virtually inevitable" is based on simple commercial reality rather than an arbitrary rule of law. This presumption still holds in the marketplace when the use is a nominative one. In addition, when a consumer is exposed to a potential nominative fair use, the consumer has no way to know in advance that the mark is being used in that manner. The consumer is simply seeing the plaintiff's mark used by the defendant to describe the plaintiff. Absent some cue indicating that the parties have no relationship, the consumer will assume there is some connection between the parties or that the use is authorized. Unless the defendant or the context provides that cue, there is no reason to conclude that such a use will not confuse consumers. By rejecting in *Welles* the applicability of the *Polaroid* factors in such cases and applying the nominative fair use analysis, the Ninth Circuit fell victim to a mechanical application of the multifactor test, forgetting that these factors have stood the test of time precisely because they correlate to commercial reality.

To state the matter from a different perspective: if a business decides to use another's trademark, it should scrutinize the use closely to ensure that the context (*e.g.*, direct comparative advertising) or some other cue counteracts the tendency of a consumer to assume that when one party uses the mark of another, they are affiliated or otherwise related. While the *Polaroid* factors (or their equivalent) should not be replaced by the nominative fair use test, that test is useful in evaluating the contested use. Specifically, it will ensure that the fact finder considers the entire context in which the mark has been used.

In *Jardine*, the use of the BEACH BOYS trademark by the defendant, an original group member, was held not to be a nominative fair use because his use of the trademark suggested sponsorship or endorsement by the trademark holder. *Jardine* should not be interpreted as literally shifting the burden of proof to the defendant to prove the absence of confusion; rather, in light of established commercial reality, the defendant asserting a nominative fair use defense should bear the burden of production, *i.e.*, identifying what factors or cues mitigate the likelihood of confusion.

Imposing this obligation on a defendant is perfectly consistent with long-standing trademark precedent. For years, courts have held that a junior user has a duty to avoid confusion.[22] When a defendant knowingly uses the plaintiff's mark without permission, common sense as well as a commitment to fair competition ought to compel the junior user to consider the ramifications in the marketplace.[23]

The *Jardine* burden of production is not particularly difficult to sustain. For instance, when a car repair shop, Value Auto Repair, lists in its yellow pages ad ten makes of cars it can fix, consumers know that a mechanic does not have to be authorized by the brand owner to fix that brand of car. The context of the use and the absence of any logo or stylized use of the mark provides the cue that the repair shop is independent and not sponsored by or affiliated with any of the ten brands listed in the ad. Conversely, if the shop is called Ford's Value Auto Repair Shop, the context and the cue changes and the consumer is likely to assume there is some connection between Ford Motors and the repair shop.[24]

The burden of proving no likelihood of confusion under *Jardine* would undoubtedly play out differently in these two examples. Value Auto Repair could satisfy its burden of proving no likelihood of confusion through several methods, *e.g.*, an affidavit showing common industry practice or a consumer survey. Ford's Value Auto Repair could not point to any industry custom and, absent a survey, could not sustain its burden. Thus, in the former scenario, the burden would fall back to the plaintiff to show why Value Auto Repair's use of the Ford mark in the ad was likely to cause confusion. The plaintiff would have to rebut Value's evidence or provide actual confusion evidence or survey evidence. The plaintiff should lose if it cannot meet this burden. Conversely, unless Ford Value Auto Repair could provide evidence explaining how the context or some other cue altered a consumer's expectation or survey evidence, the plaintiff trademark owner should prevail.

There are many other unsolved questions concerning the prongs of the nominative fair use defense. For instance, the first prong states the goods and services in question are not readily identifiable without use of the trademark. Which goods and services are "in question?" Is it the defendant's goods or services that cannot be described without reference to the plaintiff's marks or is it that the plaintiff's goods and services are not readily identifiable?

In *Playboy Enterprises, Inc. v. Netscape Communications Corp.*,[25] the Ninth Circuit held that the use of words PLAYBOY and PLAYMATE as triggers for certain Internet banner advertisements was not necessary because there were other words that could have achieved defendant's goal without implicating the plaintiff's mark.[26]

The second prong—taking no more than necessary—has typically been understood to mean that the defendant did not use the stylized or logo version of the plaintiff's mark.[27] In *Ty, Inc. v. Publications Int'l*,[28] the court found that by using different colors, font sizes and styles for the words Beanie Babies than for other words in its book's title, defendant exceeded the limits of nominative fair use.[29] In applying the *New Kids* test, the court denied defendant's summary judgment motion because the defendant used more of plaintiff's mark than it was entitled to use and thus failed to satisfy the second prong of the nominative fair use defense.[30] In *Welles*, analysis of this prong involved examining how frequently and/or prominently the plaintiff's mark appeared.[31] The *New Kids* test does not reference the need to avoid the trademark use or explicitly require that the plaintiff's mark be used fairly. Nevertheless, *Welles* suggests that these concerns may be considered under the second prong.

The nominative fair use defense has not been adopted in whole by any other circuit.[32] The Fifth Circuit in *Pebble Beach Co. v. Tour 18 I Ltd*.[33] adopted a modified version of the Ninth Circuit's test but specifically rejected characterizing nominative fair use as an affirmative defense. Instead, the court framed the defense as merely another way of claiming that there is no likelihood of confusion.[34]

Most notably in *WCVB-T v. Boston Athletic Ass'n*,[35] then-Judge (now Justice) Stephen Breyer held that a television station did not infringe the Boston Marathon mark by televising the race because there was little in the record (only the large size of the words on the screen) to suggest that the words "Boston Marathon" were used primarily as a mark, while there was much to show that the words were used primarily as a description (timing, meaning, contest, interest, and surrounding circumstances).[36]

The context of the use is critical in this analysis because it will allow us to anticipate how a consumer will respond to a particular use. A context-based approach makes clear that a nominative fair use cannot coexist with consumer confusion. This focus on context is—or ought to be—the primary focus in determining whether there is an infringement. Viewed in this manner, it makes sense that the nominative fair use defense has been applied to allow a defendant to use a trademarked term in a historical sense. For instance, in *Welles* the Ninth Circuit held that the defendant could identify that she was a former Playboy Playmate.[37] However, the use could not imply a continued affiliation.

The Third Circuit recently adopted a modified version of the *New Kids* nominative fair use defense. In *Century 21 Real Estate Corp. v. Lending Tree, Inc.*,[38] the Third Circuit reversed a preliminary injunction in favor of the trademark owner after applying a bifurcated approach for determining trademark infringement. Under the court's two-part analysis, a plaintiff first must prove likelihood of confusion by application of a modified multi-factor test that includes whether the goods are marketed through the same channels, whether the parties' sales efforts have similar targets, consumer sophistication, consumer expectations, the length of time the defendant has used the mark without evidence of actual confusion, the intent in adopting the mark, and any evidence of actual confusion.[39] The Third Circuit found that the strength of the plaintiff's mark and similarities between the marks should not be used in evaluating confusion in such cases.[40]

Once a likelihood of confusion has been established, the burden is on the defendant to prove that its use of the mark was within the bounds of nominative fair use. The Third Circuit modified the *New Kids* test to include slightly different considerations: Is the plaintiff's mark necessary to describe plaintiff's products or services and defendant's products or services? Is only so much of plaintiff's mark as is necessary used to describe plaintiff's products or services? Does defendant's language reflect the true and accurate relationship between plaintiff's and defendant's products or services? The rewording of the third prong of the Ninth Circuit nominative fair use test was intended to provide for a broader examination of the question of whether the defendant had done anything that might suggest affiliation or sponsorship.[41] After applying the two-pronged analysis, the Third Circuit reversed and remanded the case for application of its new test.[42]

C. Replacement Parts/Ingredients/Repackaging

In another line of cases sometimes characterized as implicating fair use, courts have held that using a mark to identify replacement parts or repackaged goods is a fair use. This particular fair use defense goes back to *Prestonettes Inc. v. Coty*.[43] In *Prestonettes*, Justice Holmes held that the use of a trademark in the repackaging of an original product to indicate that the goods came from the trademark owner was not an infringement as long as there was no deception. In this case, the defendant purchased plaintiff's perfume and rebottled it in smaller bottles. The defendant also used plaintiff's trademarked powders as one of the ingredients in its compact powders. The Court held that "a trademark only gives [the] right to prohibit the use of it so far as to protect the owner's good will against the sale of anther's product as his. . . . When a mark is used in a way that *does not deceive the public*, [the Court] sees no such sanctity in the word as to prevent its being used to tell the truth. It is not taboo."[44]

The line "It is not taboo" is used frequently when a court rules in favor of a defendant on a fair use defense. It is interesting to note, however, that when Justice Holmes wrote those words in 1924, trademark law did not protect against confusion as to affiliation or endorsement. Indeed, in the 1920s co-branding, endorsements, and sponsorship relationships were virtually nonexistent. Thus, consumers did not hold the same assumptions as to the possibility of endorsement or licensed use. Consequently, although courts continue to cite *Prestonettes* as good law, the amendment of the Lanham Act (on November 16, 1988) to recognize affiliation confusion may make the fair use defense in *Prestonettes* obsolete. But even if the change in the law does not overrule *Prestonettes*, the dramatic changes in the marketplace since 1924 have undercut its commercial foundation.

The procedural posture of *Prestonettes* is often overlooked. In that case, the Court held that the use of a disclaimer on packaging as required by the district court was sufficient to avoid any likelihood of confusion. It thereby reversed the Second Circuit, which had held that the disclaimer would not prevent confusion and therefore enjoined use of the plaintiff's mark. As discussed below, the Court's presumption in *Prestonettes* about disclaimers has questionable validity in light of recent precedent grounded in empirical research which shows that disclaimers generally are ineffective.

While these arguments may be compelling, for the moment they are academic. No court has ever questioned the continued validity of *Prestonettes*. In fact, the Supreme Court later applied its *Prestonettes* holding in *Champion Spark Plug Co. v. Sanders*,[45] where the Court upheld the refurbishing and selling of spark plugs under the CHAMPION trademark. The petitioner manufactured spark plugs and sold them under the CHAMPION trademark. The respondent collected the used plugs and repaired, reconditioned, and resold them while retaining the word CHAMPION. Citing *Prestonettes*, the Court held that a trademark only gives the right to prohibit its use to the extent necessary to protect the owner's good will.[46] It is permissible for a second-hand dealer to get some advantage from the trademark so long as the manufacturer is not identified with the inferior qualities of the product.[47] However, the Court went on to state that "cases may be imagined where the reconditioning or repair would be so extensive or so basic that it would be a misnomer to call the article by its original name, even though the words 'used' or 'repaired' were added."[48]

Champion is best understood as holding that the core quality of a refurbished spark plug continues to reflect the original manufacturer. In other words, the ordinary consumer would rather have a refurbished Cartier watch than a refurbished watch first sold for $9.99, even if both were refurbished by the same company.

More recently in *Nitro Leisure Prods. v. Acushmnet*,[49] the Federal Circuit affirmed the continued viability of *Champion* in a case involving refurbished golf balls. Plaintiff refurbished golf balls through a cosmetic treatment. The process included removing the base coat of paint, the clear coat layer, and the trademark markings and reaffixing the original manufacturer's trademark.[50] The refurbished balls were packaged in containers displaying a disclaimer. The disclaimer made it clear that the balls were refurbished and that "the products had NOT been endorsed or approved by the original manufacturer."[51] The Federal Circuit stated that used and repaired goods can be sold under the trademark of the original manufacturer, without deceiving the public, so long as the accused infringer had attempted to restore "so far as possible" the original condition of the goods and full disclosure is made about the true nature of the goods, for example, as "used" or "repaired."[52] The Lanham Act does not prevent the use of trademarks that do not confuse, even if such use results in the enrichment of others.[53]

The strongly worded dissent in *Nitro Leisure* distinguished the sale of refurbished goods from the resale of new goods with material alterations as prohibited by *Davidoff & Cie, S.A. v. PLD Int'l Corp.*[54] According to the dissent, under Federal Circuit precedent, the proper test was whether there had been a material alteration that would affect a consumer's decision in purchasing the product in question. The dissent concluded that the facts of *Nitro Leisure* were more closely analogous to the *Davidoff* line of cases than to *Champion*.

Related to the issue of refurbishing is the question of compatibility. Trademark law obviously cannot trump antitrust law, so it cannot be used to maintain a monopoly over a product. Therefore, trademark law should not prohibit reference to the fact that the defendant's product is compatible with another product. Nevertheless, compatibility does not create a license to confuse. In *Selchow Righter Co. v. Decipher*,[55] for instance, the defendant manufactured supplemental questions cards to be used with the board game TRIVIAL PURSUIT. While the defendant could state this fact on its packaging, the court found infringement because the defendant copied the game maker's trade dress and used the plaintiff's trademark to confuse prospective purchasers.[56]

In *Tyco Industries, Inc. v. Lego Sys. Inc.*,[57] the defendant copied the physical appearance of six basic Lego blocks, the copies differing only in that the feel of the copied blocks was altered.[58] Looking to *Prestonettes*, where the Supreme Court had observed that any confusion caused by the defendant's use of the plaintiff's mark would be minimized if the reference were not printed in different letters from the rest of the inscription, the Court held that Tyco's packaging did not comply with that requirement because the Lego mark appeared in the same size, color, type, and general distinctiveness as the surrounding text.[59] The Court found that the defendant's packaging created confusion because the references to Lego were not accompanied by a notation that Lego was a company unrelated to Tyco, and it entered an order directing Tyco henceforth to make the appropriate disclosure/disclaimer.[60]

While technically a victory for Lego, Tyco obtained the result it desired: the ability to continue indicating that its product was compatible with the plaintiff's. Similarly, it is often overlooked that the defendant in *Prestonettes* was found to have infringed; the only question was whether in the context of repackaging, a disclaimer was sufficient. *Prestonettes*, *Tyco*, and many other similar cases assume that disclaimers effectively prevent consumer confusion. Is this presumption valid?

In *Home Box Office, Inc. v. Showtime/Movie Channel, Inc.*,[61] the court held that a disclaimer is an adequate remedy only if the defendant establishes by a preponderance of the evidence that the disclaimer was sufficient to avoid the risk of consumer confusion. HBO sought an injunction to prevent defendant from using in its advertising the slogan "SHOWTIME & HBO. It's Not Either/Or Anymore," which informed consumers that while up until now they had to choose which cable networks they wanted when they selected their cable provider, it was now possible to get both networks at once. This can be seen as a variation on the compatibility cases. The record in *HBO* amply supported the finding that the aforementioned slogan and other related slogans created a likelihood of confusion.[62] Because the record was not sufficient to support a finding that the disclaimers proposed by defendant would be effective in substantially reducing consumer confusion, the case was remanded.[63]

HBO stands for the proposition that the party proposing to rely on a disclaimer has the burden of proving that the disclaimer eliminates confusion. Is there any reason why this burden should not fall to the defendant in a refurbishment or compatibility case as well? If the purpose of trademark law is to avoid consumer confusion, it is only logical to insist that before advertising that its product is better than the plaintiff's, the defendant must take steps to avoid confusion. Moreover, it is noteworthy that the *HBO* holding was based not on the subjective views of the court but on "a body of academic literature that questions the effectiveness of disclaimers in preventing consumer confusion as to the source of a product . . . especially those that employ brief negator words such as 'no' or 'not.'"[64] To the extent that *Prestonettes*, *Tyco*, and other cases were founded on a belief that disclaimers work, *HBO* provides further support for the proposition that such a belief is no longer sound.

D. Comparative Fair Use and Advertising

The objective of a company that uses another company's trademark in comparative advertising is to encourage comparison shopping or to persuade a consumer to consider the company's products or services as they are shopping. As stated by Justice Holmes in *Saxlehner*,[65] when using a trademark to identify a product that is being imitated, an imitator is "not trying to get the good will of the name, but the good will of the goods." Such a use is normally "fair" because it promotes product competition and product improvements.

The Ninth Circuit set the standard for comparative advertising in *Smith v. Chanel, Inc.*,[66] where it held that one who has copied an unpatented product sold under a trademark may use the trademark in his advertising to identify the product he has copied. The trademark at issue was Chanel N° 5. The defendant advertised a fragrance called "Second Chance" as a duplicate of plaintiff's Chanel N° 5 at a fraction of the latter's price. The court found that the use of another's mark to identify the trademark owner's product in comparative advertising is not prohibited absent misrepresentation regarding the products or confusion as to their source or sponsorship.[67]

Similarly, in *Calvin Klein Cosmetics Corp. v. Parfums de Coeur Ltd.*,[68] the court held that a manufacturer does not commit unfair competition merely because it refers to another's product by name in order to win customers interested in a lower cost of that product, as long as the reference is truthful and is not likely to confuse consumers into believing that the copy is from the same source as the original.

E. Parody

Parody cases are sometimes analyzed under a nominative fair use framework.[69] Other courts simply apply the standard *Polaroid* test or a modified version thereof.[70]

Parody is protected under section 107 of the Copyright Act as a form of fair use because of its critical nature, which furthers the ultimate goal of the Copyright Act.[71] However, it is considerably more difficult to apply a parody analysis to trademarks.

Parody is not synonymous with satire or comedy. "Parody appropriates commonly known elements of a prior work to make humorous or critical comment on that same work, whereas satire [appropriates] commonly known elements of a prior work to make humorous or critical comment on another subject."[72] Parody must make us reflect on a larger issue; it cannot just make us smile.

True parody is of such a quality that it would appear unlikely that the ordinary consumer would assume it came from the same source as the mark being parodied. Thus, as others have noted, a trademark parody must simultaneously achieve two contradictory goals: It must tell us that it is the parodied work (so we know the matter being parodied) and that it is not the parodied work (so there is no confusion).[73] If a parody is likely to cause confusion, it would appear inappropriate to grant any exemption. The First Amendment is not implicated by deceptive or confusing uses—issues that seldom arise in the copyright context.

Unfortunately, the case law in this area is highly inconsistent and appears to turn on whether the judge "got the joke." Whatever the parody, the outcome of such cases should not turn on the sense of humor of a particular judge.

F. *KP Permanent*

It is against this backdrop of the five different types of fair use that we now turn to the Supreme Court's recent fair use decision in *KP Permanent Make-Up*.[74] Lasting Impression (LI) and KP Permanent Make-Up (KP) are direct competitors in the permanent make-up business. LI registered the mark MICRO COLORS in a stylized logo format based on a priority date of April 1992. KP began using the term MICROCOLORS in 1990. KP's use was in the format MICROCOLOR: BLACK and limited to its bottles in a very unobtrusive descriptive manner. In 1999, KP began using the term MICROCOLORS in a new format that made it the dominant feature of an image within a brochure, as follows:

MICRO
COLORS

KP brought a declaratory judgment action, and both sides moved for summary judgment. The district court ruled in favor of KP, finding the term MICROCOLORS generic or descriptive and without secondary meaning. It also held that the use of the term was protected under section 33(b)(4) of the Lanham Act as a fair use. The court never inquired into whether there was a likelihood of confusion, finding it unnecessary to reach that question. The Ninth Circuit reversed, finding that because LI's mark was incontestable, KP could not argue that it was merely descriptive. The Ninth Circuit also found that the term was not generic. The priority of KP's use was not discussed, apparently because the Ninth Circuit found KP's more recent objectionable use to be totally distinct from its earlier descriptive use (MICROCOLOR: BLACK) despite its pre-dating LI's use.

Turning to the question of fair use, the Ninth Circuit held that there were a number of material facts in dispute as to whether there was a likelihood of confusion. Therefore, because the fair use defense requires the defendant to prove that there is no confusion, summary judgment was not appropriate.

The Supreme Court granted KP's petition for certiorari to decide "whether a party raising the *statutory affirmative defense of fair use* . . . has a burden to negate any likelihood [of confusion]."[75] Reversing the Ninth Circuit, the Supreme Court held that a "defendant has no independent burden to negate the likelihood of any confusion in raising the affirmative defense that a term is used descriptively, not as a mark, fairly, and in good faith."[76] The decision continues, however, to clarify that in light of this holding, "it follows . . . that some possibility of consumer confusion must be compatible with fair use."[77]

Nonetheless, the Supreme Court expressly refused to hold that consumer confusion cannot be a factor in determining whether a use is fair. *KP Permanent Make-Up*, therefore, "does not foreclose the relevance of the extent of any likely consumer confusion in assessing whether a defendant's use is objectively fair."[78] The Court also expressly rejected the notion that the term "used fairly" in section 33(b)(4) "demands only that the descriptive terms describe the goods accurately. . . . The Restatement raises possibilities like commercial justification and the strength of the plaintiff's mark. . . . As to them, it is enough to say that the case is not closed."[79]

On remand to the Ninth Circuit, that court again concluded that the district court had erred in granting summary judgment to the defendant based on a fair use defense. It specifically noted that the Supreme Court had not foreclosed the relevance of confusion in determining whether use is fair.[80] On review of the record, the court found that there were material disputed facts as to the likelihood of confusion and therefore as to whether the use was fair.[81]

If confusion remains relevant in a classic fair use case, it follows that in other "fair use" situations where there is no formal affirmative defense, confusion should trump those fair uses as well.

G. The Future

It is significant that when the Supreme Court granted certiorari in *KP Permanent Make-Up*, it had pending before it other cases from the Ninth Circuit that would have implicated both classic and nominative fair use.[82] Furthermore, these cases arose from Internet-based fact patterns. One might have thought that the Court would have decided to hear one of these cases because it would have allowed the Court to address many emerging issues in trademark law, *e.g.*, keyword advertising.

KP Permanent Make-Up, however, provided the Court with an opportunity to review the issue of classic fair use without the complicating factors that arise from on-line use[83] or the confusion over nominative fair use. Having set this "base line," though, it is likely that the Court will accept a case in the next few years that directly addresses nominative fair use in the context of the Internet. It is also likely that other circuits will now respond to the Third Circuit's holding in *Century 21 Real Estate Corp.* and the split between the Ninth and Third Circuits' formulations of the nominative fair use test.

Endnotes

1. *Wonder Labs Inc. v. Proctor & Gamble Co.*, 728 F. Supp. 1058 (S.D.N.Y. 1990).
2. *Id.* at 1064.
3. One example of a trademark case that deals with the issue of good faith/bad faith is *Coca-Cola Co. v. Purdy*, 382 F.3d 774, 782 (8th Cir. 2004). The case was brought under the Anticybersquatting Consumer Protection Act (ACPA) amendment to the Lanham Act rather than the classic fair use defense section of the Act, but the court's analysis still is informative in its application of the nine factors provided under the ACPA to determine whether a person has acted with bad faith intent. *Id.* at 785.
4. *KP Permanent Make-Up v. Lasting Impression, Inc*., 125 S. Ct. 542 (2004), *remanded to* 408 F.3d 596 (9th Cir. 2005).
5. *United States Shoe Corp. v. Brown Group, Inc.*, 740 F.Supp. 196, 198, *aff'd*, 923 F.2d 844 (2d Cir. 1990).
6. *New Kids on the Block v. New Am. Publ'g, Inc*., 971 F.2d 302, 308 (9th Cir. 1992).
7. *Id.* at 306.
8. *Id.*
9. *Id.*
10. *Id.* at 308.
11. *Cairns v. Franklin Mint Co.*, 292 F.3d 1139, 1152 (9th Cir. 2002).
12. *Id.* at 1151.
13. *Id.*
14. *Id.* at 1150.
15. *Playboy Enterprises, Inc. v. Welles*, 279 F.3d 796, 801 (9th Cir. 2002).
16. Sleekcraft is the Ninth Circuit's version of the *Polaroid Corp. v. Polarad Electronics Corp*., 287 F.2d 492 (2d Cir. 1961) multi-factor likelihood-of-confusion test. *See AMF, Inc. v. Sleekcraft Boats*, 599 F.2d 341 (9th Cir. 1979).
17. 318 F.3d 900, 909 n.5 (9th Cir. 2003).
18. *See Cairns*, 92 F.3d at 1051.
19. *Opticians Ass'n of Am. v. Independent Opticians of Am*., 920 F.2d 187, 195 (3d Cir. 1990).
20. *Cf. Beer Nuts v. Clover Club Foods Co*., 805 F.2d 920, 926 (10th Cir. 1986), where the court recognized "the possibility of confusion is greatest when products reach the public by the same retail outlets, and that confusing similarity is most likely when the products are themselves very similar."
21. 3 J. McCarthy, *McCarthy on Trademarks and Unfair Competition*, § 23.20, at 23–72 (2003) ("Cases where a defendant uses an identical mark on competitive goods hardly ever find their way into the appellate reports. Such cases are 'open and shut' and do not involve protracted litigation to determine liability for trademark infringement.").
22. *G.D. Searle & Co. v. Chas. Pfizer & Co., Inc.*, 265 F.2d 385, 387 (7th Cir. 1959); *Mobil Oil Corp. v. Pegasus Petroleum Corp*., 818 F.2d 254, 259 (2d Cir. 1987); *Harold F. Ritchie, Inc. v. Chesebrough-Pond's, Inc.*, 281 F.2d 755, 758 (2d Cir. 1960).
23. This obligation is most applicable when the defendant decides to enter a market by refurbishing or creating compatible products. If the purpose of trademark law is to avoid consumer confusion, it is only logical to insist that before advertising its comparable product, the defendant take steps to avoid confusion.
24. In *Stork Restaurant v. Sahati*, 166 F.2d 348 (9th Cir. 1948), the court recognized the piggy-backing of imitators on the goodwill of an established trademark. Citing to the Restatement of the Law on Torts, the court stated that where there is no direct competition, "confusion of source may be defined as a misleading of the public by the imitation of a . . . reputable trademark . . . for the purpose of securing for the imitator's goods some of the good-will, advertising and sales stimulation of the trademark or tradename." *Id.* at 356.
25. 354 F.3d 1020 (9th Cir. 2004).
26. *Id.* at 1030.
27. *See New Kids*, 971 F.2d at 308.
28. 2005 WL 464688, *9 (N.D. Ill. 2005).
29. *Id.*
30. *Id.* at *9.
31. 279 F.3d at 804.
32. In *Chambers v. Time Warner, Inc.*, 282 F.3d 147, 156 (2d Cir. 2002), the Second Circuit in dicta acknowledged the lower court's grant of summary judgment based in part on the Ninth Circuit's Nominative Fair Use defense. However, the circuit court remanded the case because the plaintiffs alleged enough facts to state a claim that was beyond the scope of the Nominative Fair Use defense. The court therefore avoided having to expressly approve or reject the Nominative Fair Use defense.
33. 155 F.3d 526 (5th Cir. 1998).
34. *Id.* at 545 n.12.
35. 926 F.2d 42 (1st Cir. 1991).
36. *Id.* at 46.

37. *Welles*, 279 F.3d at 806.
38. 2005 U.S. App. LEXIS 21942 (3d Cir. Oct. 11, 2005).
39. *Id.* at *36.
40. *Id.* at *33–*34.
41. *Century 21 Real Estate Corp.*, 2005 U.S. LEXIS 21942, at *52–*53.
42. As counsel for plaintiffs in this case, we limit our discussion to summarizing the holding and we refrain from any other comment except to note that plaintiffs have filed a petition for rehearing and *en banc* review. As of the date this article was submitted, the petition was still pending. See G.M. Filisko, *Trademark Ruling Creates Confusion—3rd Circuit Sets Two-Part Test in Nominative Fair Use Cases*, ABA Journal eReport, Oct. 21, 2005, *available at* http://www.abanet.org/journal/ereport/oc21tmark.html, for commentary on the Third Circuit opinion.
43. 264 U.S. 359 (1924).
44. *Id.* at 368 (emphasis added).
45. 331 U.S. 125 (1947).
46. *Id.* at 129.
47. *Id.* at 130.
48. *Id.*
49. 341 F.3d 1356 (Fed. Cir. 2003).
50. *Id.* at 1358.
51. *Id.*
52. *Id.* at 1361.
53. *Id.* at 1362.
54. 263 F.3d 1297, 1300 (11th Cir. 2001).
55. 598 F.Supp. 1489 (E.D. Va. 1984).
56. *Id.* at 1504.
57. 1987 U.S. Dist. LEXIS 13193 (D.N.J. 1987).
58. The blocks were altered by slightly reducing the dimensions of the tubes and studs so as to make the blocks feel looser and more easily detachable.
59. *Id.* at *82.
60. *Id.* at *87.
61. 832 F.2d 1311 (2d Cir. 1987).
62. *Id.* at 1314.
63. *Id.* at 1317.
64. *Id.* at 1315–16.
65. *Saxlehner v. Wagner,* 216 U.S. 375, 380–381 (1910).
66. 402 F.2d 562 (9th Cir. 1968).
67. *Id.* at 565–66.
68. 824 F.2d 665 (8th Cir. 1987).
69. *See Mattel, Inc. v. MCA Records*, 296 F.3d 894 (9th Cir. 2002); *Mattel, Inc. v. Walking Mountain Productions*, 353 F.3d 792 (9th Cir. 2003).
70. *See Mutual of Omaha Ins. Co. v. Novak*, 836 F.2d 397 (8th Cir. 1987).
71. *See*, *e.g., Campbell v. Acuff-Rose Music,* 510 U.S. 569, 579 (1994).
72. *Dr. Seuss Enterp, L.P. v. Penguin Book USA, Inc.*, 924 F. Supp. 1559, 1567 (S.D. Cal. 1996).
73. *Cliffnotes, Inc. v. Bantam Doubleday Dell Pub. Group, Inc.*, 886 F.2d 490, 494 (2d Cir. 1989).
74. *KP Permanent Make-Up v. Lasting Impression, Inc.*, 125 S. Ct. 542 (2004), *remanded to* 408 F.3d 596 (9th Cir. 2005).
75. 125 S. Ct. at 545–46 (emphasis added).
76. *Id.* at 551.
77. *Id.* at 550.
78. *Id.* at 550.
79. *Id.* at 551.
80. 408 F.3d at 607.
81. *Id.*
82. *Jardine v. Brother Records, Inc.*, 318 F.3d 900 (9th Cir.), cert. denied, 124 S. Ct. 155 (2003); *Garcia v. Horphag Research Ltd.*, 337 F.3d 1036 (9th Cir. 2003), *cert. denied*, 124 S. Ct. 1090 (2004).
83. Fair use cases involving the Internet can also implicate the Anticybersquatting Consumer Protection Act, 15 U.S.C. § 1125(d) (2005). *See Bosley Medical Institute Inc. v. Kremer*, 403 F.3d 672 (9th Cir. 2005).

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Correction

Due to an editing error, the article by John LaBarre, "Can the Software Patent Genie Be Put Back in Its Bottle?," which appeared in the Fall 2005 issue, stated incorrectly that a proposed European Union directive that would have removed the exclusion of software innovations from patent protection was approved in a July 6, 2005 vote in the European Parliament. In fact, the directive was decisively defeated in that vote. We regret the error.

Intellectual Property Law Section Annual Meeting

TUESDAY, JANUARY 24, 2006
New York Marriott Marquis
1535 Broadway, New York City

MORNING PROGRAM, 8:45 a.m.
Marquis Ballroom, 9th Floor

LUNCHEON, 12:45 p.m.
16th Floor Sky Lounge

AFTERNOON PROGRAM, 2:15 p.m.
Marquis Ballroom, 9th Floor

COCKTAIL RECEPTION, 5:00 p.m.
16th Floor Sky Lounge

IMPORTANT INFORMATION

Under New York's MCLE rule, this program has been approved for a total of up to 7 credit hours, consisting of 6 credit hours in practice management and/or areas of professional practice and one hour in ethics. **Except for the ethics portion, this course will not qualify for credit for newly admitted attorneys because it is not a basic practical skills program.**

Discounts and Scholarships: New York State Bar Association members may apply for a discount or scholarship to attend this program based on financial hardship. Under that policy, any member of our Association who has a genuine financial hardship may apply in writing not later than two working days prior to the program, explaining the basis of his/her hardship, and if approved, can receive a discount or scholarship, depending on the circumstances. For more details, please contact: Linda Castilla at: New York State Bar Association, One Elk Street, Albany, New York 12207.

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A Smart New Year's Resolution: Know Current Intellectual Property Law Trends and Practices

8:45 - 8:55 a.m. — **Welcoming Remarks - Richard L. Ravin, Esq.**, Section Chair

8:55 - 10:35 a.m. — ***EMERGING ISSUES IN CYBERSPACE: Blogging, Gripe Sites, Domain Parking and Keywords***
A panel of experts will discuss emerging issues from the world of cyberspace, from First Amendment and copyright issues raised by blogging and gripe sites to the new practice of "domain parking" and the increasing use of keywords in connection with online contextual marketing.

Speakers:
Daniel Dougherty, Esq.
Corporate Counsel, Yahoo! Inc., Sunnyvale, California
Professor Hugh Hansen
Fordham University School of Law, New York City
Martin Schwimmer, Esq.
Schwimmer Mitchell Law Firm (*The Trademark Blog)*, Mt. Kisco, New York

10:35 - 10:45 a.m. — **Break**

10:45 - 11:35 a.m. ***STANDARD BODIES AND PATENT POOLS***

Manufacturers will often lobby standards setting bodies to adopt standards incorporating their technologies before introducing new products that require compatible products of others. If they succeed, competitors who wish to enter the market must adhere to these standards. What happens when the patent rights necessary to practice the standards are owned by multiple third parties? Can the patent owners pool their patents to license each other and to license others who desire to make compatible products without running afoul of antitrust laws?

Speakers:
Christopher J. Kelly, Esq.
Mayer Brown Rowe & Maw, Washington, D.C.
Kenneth Rubenstein, Esq.
Proskauer Rose LLP, New York City

11:35 a.m. - 12:25 p.m. ***ETHICAL ISSUES IN IP TRANSACTIONS***

This lecture will review some of the most common ethical pitfalls that face lawyers in IP transactions, including out-of-state practice of law and communications with represented parties.

Speaker:
Eric A. Prager, Esq.
Darby & Darby P.C., Seattle, Washington

12:25 - 12:35 p.m. **Annual Law Student Writing Competition**

First Prize, $2,000, sponsored by Morrison & Foerster LLP
Second Prize, $1,000, sponsored by Sills Cummis Epstein & Gross, P.C.
The Section thanks these sponsors for their support of the Writing Contest.

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12:45 - 2:15 p.m. **Lunch** - 16th Floor Sky Lounge

The Intellectual Property Law Section would like to thank Darby & Darby P.C. for sponsoring lunch. Their support of the Section is greatly appreciated.

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2:15 - 3:55 p.m. ***ELECTRONIC EVIDENCE: DISCOVERY, SPOLIATION & ATTORNEY-CLIENT PRIVILEGE***

As the use of emails and electronic storage solutions have become more prevalent, replacing traditional paper correspondence and files, an increasing part of discovery is now in electronic format. The duties and obligations of litigants and their attorneys to protect, preserve and produce such electronic evidence is a growing concern to all members of the bar. Our panel of experts will discuss the most recent e-discovery developments including the forthcoming amendments to the Federal Rules of Civil Procedure, spoliation of electronically stored information and the problems in protecting the attorney-client privilege in the process. They will also offer practical solutions to applying common law principles to the electronic context.

Moderator:
Mr. David Remnitz
Senior Managing Director, FTI Consulting, New York City

Speakers:
Steven C. Bennett, Esq.
Jones Day, New York City

Professor Paul Rice
Washington College of Law, Washington, D.C.

Dan Hall Willoughby, Esq.
King & Spalding, Atlanta, Georgia

3:55 - 4:05 p.m. **Break**

4:05 - 4:55 p.m. ***REGISTERING COPYRIGHT IN THE 21st CENTURY***

What are the registration issues in the digital arena? How do you register updates to a database or website? How do you protect works from commercial exploitation while they are in preparation? What changes can you expect in registration practice as the Copyright Office prepares to go digital?

Speaker: **Robert W. Clarida, Esq.**
Cowan, Liebowitz & Latman, P.C., New York City

4:55 - 5:00 p.m. **Closing Remarks**

Thomas H. Curtin, Program Co-Chair
Lathrop & Gage L.C., New York City

Jonathan Matkowsky, Program Co-Chair
Darby & Darby P.C., New York City

5:00 - 6:30 p.m. **Cocktail Reception and Young Lawyers Introduction**
16th Floor Sky Lounge

Please join us for a Cocktail Reception sponsored by Thomson CompuMark following the program. The Section is most grateful to Thomson CompuMark for its continued support of the Section year after year!

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If you need assistance relating to a disability, please contact the NYSBA Meetings Department sufficiently in advance so that we can make every effort to provide reasonable accommodations.

For overnight room accommodations, please call the New York Marriott Marquis at 1-800-843-4898 and identify yourself as a member of the New York State Bar Association. Room rates are $235.00 for single/double occupancy. Reservations must be made by Friday, December 23, 2005

For questions about this specific program, please contact Linda Castilla at 518-487-5562 or lcastilla@nysba.org . For registration questions only, please call 518-487-5621.


ADVANCE YOUR CAREER.

NYSBA **Annual Meeting 2006**

Intellectual Property Law Section

Tuesday, January 24, 2006
New York Marriott Marquis
1535 Broadway, New York City

MORNING PROGRAM, 8:45 a.m.
Marquis Ballroom, 9th Floor

LUNCHEON, 12:45 p.m.
16th Floor Sky Lounge

AFTERNOON PROGRAM, 2:15 p.m.
Marquis Ballroom, 9th Floor

COCKTAIL RECEPTION, 5:00 p.m.
16th Floor Sky Lounge

ANNOUNCING THE

Intellectual Property Law Section's

ANNUAL LAW STUDENT WRITING CONTEST

To be presented at the **Annual Meeting of the Intellectual Property Law Section, January 24, 2006, New York, NY** to the authors of the best law review quality articles on subjects relating to the protection of intellectual property **not published elsewhere, scheduled for publication, or awarded another prize.**

First Prize: $2,000 Second Prize: $1,000

CONTEST RULES WERE AS FOLLOWS:

To be eligible for consideration, the paper must have been written solely by students in full-time attendance at a law school (day or evening program) located in New York State or by out-of-state students who are members of the Section. One hard copy of the paper and an electronic copy in Word format on a 3.5" H.D. disk must be submitted by mail, postmarked not later than **November 4, 2005**, to the person named below. As an alternative to sending the disk, the contestant may e-mail the electronic copies, provided that they are e-mailed before 5:00 p.m. EST, **November 4, 2005**.

Papers must meet the following criteria or points will be deducted: no longer than 35 pages, double-spaced, including footnotes; and one file with a cover page indicating the submitter's name, law school and expected year of graduation, mailing address, e-mail address, telephone number, and employment information, if applicable.

Reasonable expenses will be reimbursed to the author of the winning paper for attendance at the Annual Meeting to receive the Award.

Send entries by hard copy and e-mail to: Naomi Pitts, NYSBA, One Elk Street, Albany, NY (e-mail: npitts@nysba.org). Comments and/or questions may be directed to: Kelly M. Slavitt, Writing Contest Coordinator, ASPCA, 424 East 92nd Street, New York, NY 10128 (212) 876-7700, x4559 (e-mail: kellys@aspca.org)

Law Student Writing Contest Winners

2004

First Prize: Thad McMurray, SUNY Buffalo School of Law

Second Prize: Michele Gross, Cardozo School of Law

2003

First Prize: Christopher Barbaruolo, Hofstra School of Law

Second Prize: Anna Kingsbury, New York University School of Law

2002

First Prize: Deborah Salzberg, Fordham Law School

Second Prize: David V. Lampman, II, Albany Law School

2001

First Prize: Maryellen O'Brien, SUNY Buffalo School of Law

Second Prize: Safia A. Nurbhai, Brooklyn Law School

Third Prize: Stephen C. Giametta, St. John's University School of Law

2000

First Prize: Michael J. Kasdan, New York University School of Law

Second Prize: David R. Johnstone, SUNY Buffalo School of Law

Third Prize: Donna Furey, St. John's University School of Law

The Section reserves the right not to consider any papers submitted late or with incomplete information.

Trade Winds

Trade Winds offers Section members a way to keep up on the comings and goings of their colleagues and upcoming events of interest. Has there been a change in your practice? Any recent or forthcoming articles or lecture presentations? Won any awards recently? Please e-mail submissions to Jonathan Bloom at jonathan.bloom@weil.com.

Welcome New Members:

George Alexander
Michelle Almeida
Jeong-Hoon An
Albert E. Araneo
Alan Avorgbedor
Karen Jean Axt
Hong Oo Baak
Jacqueline Bardini
Gustavo Bastidas
Marsha L. Baum
Candace L. Bell
Jeffrey L. Benner
Dwayne L. Bentley
Dov Berger
Jason Berman
Jennifer Lynn BianRosa
Stephen H. Block
Lawrence Bluestone
Valerie J. Bluth
Steven Michael Bocknek
Karen G. Brand
Constance Rhee Brown
Eric Colin Bryant
Jesse R. Bucholtz
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Paul J. Burgo
Desa Calder
Louis J. Callea
Arnold B. Calmann
Baila H. Celedonia
Albert Wai Kit Chan
Justin Hsiang - Yu Chan
Eric Chang
Yih-Cheng Chang
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Lisa Carrie Cohen
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Jeffrey R. Colin
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Dennis Brian Danella
Mary Alice Davidson
Willem Fulps Christiaan De Weerd
Arkadia M. DeLay
Christy DeMelfi
Bruce D. DeRenzi
Elizabeth Anne Destro
Joanna A. Diakos
Jennifer Lynne Dohan
Frank Dolisi
Eugene Drozdetski
Louise P. Durante
Sherri Eisenpress
David A. Elia
John Eric Elliff
Eileene E. Falvey
Charles Z. Feldman
Tanya Fickenscher
Dyan M. Finguerra
Jim Fiorillo
Frank Walter Forman
Steven S. Fox
Emily Frangos
Jennifer Danielle Frank
Karl A. Fritton
Ralph N. Gaboury
James A. Gallagher
Jodi C. Gamma
Donald Andrew Gammon
Maria E. Garcia
Darren M. Geliebter
Harold Eli Gerber
Manjit S. Gill
Jerome Glasser
Peter John Glennon
Derek Gluckman
Louis M. Goldberg
Lisa Grant
Daniel F. Gray
Justin Grossman
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Rafael Jesus Guzman
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John Michael Lambros
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Inez Lee
Yoomi Lee
Laurie L. Levin
Aaron Michael Levine
Stanley Lewis
David G. Leyden
Jeffrey Lindenbaum
Justin Lubatkin
LeAura Luciano
Ana Luna
Joel E. Lutzker
Barry G. Magidoff
Michael Makarius
Andrew D. Manitsky
Laura N. Mankin
Amy Suzanne Manning
Paul A. Marchisotto
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I. David Parkoff
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Nicole S. Pence
Becky Anne Peratt
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Jee-yeon Yu
James B. Zane
Yiqin Zhang

MEMBERSHIP APPLICATION
New York State Bar Association:

INTELLECTUAL PROPERTY LAW SECTION

Membership in the New York State Bar Association's Intellectual Property Law Section is a valuable way to:

- enhance professional skills;
- keep up-to-date with important developments in the legal profession;
- join colleagues in exciting Section events.

OPPORTUNITIES FOR EDUCATION

The Intellectual Property Law Section offers both the experienced and novice practitioner excellent opportunities to enhance their practical and legal knowledge and expertise. Through Section activities, including conferences on intellectual property (an annual fall event), members may examine vital legal developments in intellectual property law. The Section's Web site provides current information regarding Section events and offers "members only" access to current issues of *Bright Ideas* and current Committee bulletins providing updates on intellectual property law. The Section plans to sponsor continuing legal education (CLE) credit-bearing programs for Section members at reduced rates. Recent programs offered by the Section related to computer software and biotechnology protection, conducting intellectual property audits, and practical considerations in trade secret law. The Section sponsors an annual Intellectual Property Law writing contest for New York State Law Students.

OPPORTUNITIES FOR PROFESSIONAL DEVELOPMENT

Intellectual Property Law Section committees address unique issues facing attorneys, the profession and the public. The Section offers opportunities to serve on committees such as Patent Law; Trademark Law; Copyright Law; Internet Law; Trade Secrets; Technology, Transfer and Licensing and Young Lawyers.

Committees allow you to network with other attorneys from across the state and give you the opportunity to research issues and influence the laws that can affect your practice. Committees are also an outstanding way to achieve professional development and recognition. Law students are automatically members of the Young Lawyers Committee. Section members may join more than one committee.

A VOICE IN THE ASSOCIATION

The Intellectual Property Law Section takes positions on major professional issues that affect practitioners and advocates those positions within the New York State Bar Association, the legislature, and the public.

See page 62 to become a member of the Intellectual Property Law Section

COMMITTEE ASSIGNMENT REQUEST

Please designate, from the list below, those committees in which you wish to participate. For a list of Committee Chairs and their e-mail addresses, please refer to page 63 of this issue.

___ Copyright Law (IPS1100)

___ Diversity Initiative (IPS2400)

___ International Intellectual Property Law (IPS2200)

___ Internet Law (IPS1800)

___ Legislative/Amicus (IPS2300)

___ Meetings and Membership (IPS1040)

___ Patent Law (IPS1300)

___ Technology, Transfer and Licensing (IPS1400)

___ Trademark Law (IPS1600)

___ Trade Secrets (IPS1500)

___ Young Lawyers (IPS1700)

Please e-mail your committee selection(s) to Naomi Pitts at: npitts@nysba.org

* * *

To be eligible for membership in the Intellectual Property Law Section, you first **must** be a member of the NYSBA.

❒ As a member of the NYSBA, I enclose my payment of $30 for Intellectual Property Law Section dues. (Law student rate: $15)

❒ I wish to become a member of the NYSBA and the Intellectual Property Law Section. I enclose both an Association and Section application with my payment.

❒ Please send me a NYSBA application. No payment is enclosed.

Name ____

Office ____

Office Address ____

Home Address ____

E-mail Address ____

Office Phone No. ____

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Please return payment and application to:

Membership Department
New York State Bar Association
One Elk Street
Albany, New York 12207
Telephone: 518/487-5577
FAX: 518/487-5579
http://www.nysba.org

Section Committees and Chairs

The Intellectual Property Law Section encourages members to participate in its programs and to contact the Section officers or Committee Chairs for information.

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Submission of Articles

Anyone wishing to submit an article, announcement, practice tip, etc., for publication in an upcoming issue of *Bright Ideas* is encouraged to do so. Articles should be works of original authorship on any topic relating to intellectual property. Submissions may be of any length.

Submissions should preferably be sent by e-mail to Jonathan Bloom, Editor-in-Chief, at the address indicated on this page. Submissions for the Spring/Summer 2006 issue must be received by March 1, 2006.

BRIGHT IDEAS

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