302 Managing IP Litigation

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Daphne Gronich is senior vice president, litigation and intellectual property of Fox Group, where she supervises the clearance, registration and enforcement of the intellectual property portfolio of all of the Fox companies on a worldwide basis, including Twentieth Century Fox and the Fox Television Group of companies (Fox Television Stations, the FOX Network, Fox Sports and the Fox Channels Group). Ms. Gronich provides general IP advice to the various divisions' executives and is involved in curtailing the activities of those making unauthorized uses of Fox's IP on the internet, including cybersquatters, supervising the company's audiovisual antipiracy activities and the protection of Fox's brands (FOX, FOX SPORTS, FOX KIDS) and licensed properties (e.g, *The Simpsons*, *Planet of the Apes)* against counterfeiters, and supervising litigation relating to issues impacting Fox's ability to exploit its properties.

Prior to her current position, Ms. Gronich was vice president of business and legal affairs for Fox Television Stations/Fox News/Fox Sports, vice president, business affairs for Twentieth Century Fox Film Corporation, vice president, business and legal affairs for FNM Films, and vice president and senior litigation counsel of Fox, Inc. Ms. Gronich started work in the IP area as an associate with Amster, Rothstein & Engelberg in New York.

Ms. Gronich received her LLM from New York University and her JD from Hofstra Law School.

Alan Ratliff

Alan Ratliff, CPA, is a shareholder and managing director of InteCap, Inc. in Houston. InteCap is a multinational litigation, economics, valuation, and strategic consulting firm with an emphasis on intellectual property with 12 offices in the United States and one London office.

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CORPORATE COUNSEL STRATEGIES IN HANDLING PATENT/TRADE SECRETS LITIGATION

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This article does not constitute legal advice and does not necessarily represent the views of Heller Ehrman White & McAuliffe LLP or its clients.

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The purpose of this outline is to identify issues and concerns that should be addressed in patent and trade secrets litigation. Corporate counsel may defer the decisions regarding many of the issues to litigation counsel. However, a general awareness of the issues will assist corporate counsel in monitoring and managing the litigation and in avoiding certain problems which are inherent in these types of cases. To a large extent, the outline focuses on the corporation as a defendant, but many of the items covered are equally relevant when corporate counsel is asked to initiate patent or trade secrets litigation. Due to the brief time available for the program, my remarks will cover only a few topics which are especially sensitive or pose unique problems for corporate counsel. Likewise, the outline provides legal analysis on those issues where corporate counsel's participation or judgment may be most necessary.

PATENT LITIGATION: Defense Perspective[2]

I. INTRODUCTION

- **Expense**: Patent litigation is one of the most expensive types of commercial litigation, with an average cost per suit of approximately $2 million. *See* American Intellectual Property Law Association, Report of Economic Survey 1999, at 72.

- **Disruption of Business**: Patent litigation can destroy an emerging technology business and can cause loss of clients and investments. In addition, patent litigation generally requires a substantial commitment of employee time and company resources. Accordingly, in addition to the cost, it can be very disruptive.

II. ABILITY TO SPREAD THE RISK

When confronted with patent litigation, corporate counsel should be sure to explore whether there is an insurance policy that might provide coverage for defense costs and monetary loss. In addition, consideration should be given to whether there are any contracts, such as license agreements, that might provide protection or indemnification for any potential loss.

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A. Insurance

B. Indemnification

C. Joint Defense Agreements

III. ALTERNATIVES TO LITIGATION

Before becoming involved in protracted litigation, counsel should evaluate whether there is an effective way to design around the patent and maintain market share. In the alternative, counsel should consider a commercial solution, such as the sale of the business or simply abandoning the product line.

A. Design Around

B. Sale Of Business

C. Drop The Product

IV. DEALING WITH CEASE AND DESIST LETTERS: FILING FOR A DECLARATORY JUDGMENT OF NONINFRINGEMENT/INVALIDITY

Often, before patent litigation is initiated, the patentee will send the alleged infringer a letter, putting it on notice of the patent. The letter may be as bland as asking the potential infringer to consider a patent, or the letter may offer a licensing arrangement. The most aggressive letter will demand that the company cease and desist from any infringement. Depending on the content of the letter, certain options may be available to the recipient, including seizing the initiative and striking first by filing a declaratory judgment ("DJ") action against the patentee.

See Cardinal Chemical Co. v. Morton Int'l, 508 U.S. 83, 94 (1993) (holding that a party threatened with an infringement suit can move for a Declaratory Judgment under 28 U.S.C. §2201 against the accuser for a declaration of noninfringement and/or invalidity of the patent(s) at issue to remove the cloud of uncertainty.)

A. "Case and Controversy" Requirement

An issue that frequently arises in a DJ action is whether at the time the action is filed by the accused infringer there is an existing "case and controversy," as required under Article III of the U.S. Constitution. For this requirement to be satisfied, the declaratory plaintiff must demonstrate that there is:

(1) an *explicit threat* or other action by the patentee, which creates a *reasonable apprehension* on the part of the declaratory plaintiff that it will face an infringement

> suit, and **(2)** present activity which could constitute infringement or concrete steps taken with the intent to conduct such activity.
>
> *See BP Chemicals Ltd. v. Union Carbide Corp.*, 4 F.3d 975, 978 (Fed. Cir. 1993).

"The element of threat or reasonable apprehension of suit turns on the conduct of the patentee, while the infringement element depends on the conduct of the asserted infringer." *BP Chemicals, id.*

B. Explicit Threat

A demand to stop alleged infringement in the form of a cease and desist letter qualifies as a threat, and, therefore, satisfies the first prong of the "case and controversy" test. *See GAF Building Materials Corp. v. ELK Corporation of Dallas*, 90 F.3d 479, 481 (Fed. Cir. 1996).

However, that threat has to involve an already issued, not a pending, patent of the accuser-patentee. *See GAF, id.* "A threat is not sufficient to create a case or controversy unless it is made with respect to a patent that has issued before a complaint is filed. The court cannot provide specific relief through a decree of a conclusive character, when there is no issued patent for the court to declare 'invalid' or 'not infringed.'" *Id.*

C. Reasonable Apprehension of a Suit

A threat of an infringement suit does not have to be explicit or even direct to satisfy the first prong. "Indirect threats or actions that place the declaratory plaintiff in reasonable apprehension of suit will meet the test for a declaratory judgment action." *BP Chemicals*, 4 F.3d at 979.

1. Objective test of Reasonable Apprehension

"The 'reasonable apprehension of suit' test requires more than the nervous state of mind of a possible infringer; it requires that the *objective* circumstances support such an apprehension." *Phillips Plastics Corp. v. Kato Hatsujou Kabushiki Kaisha*, 57 F.3d 1051, 1053-54 (Fed. Cir. 1995) (emphasis added).

a. Attempt at license negotiations alone insufficient**

An attempt at license negotiations is not considered to be a "threat" and does not objectively put a declaratory plaintiff in a reasonable apprehension of suit. *See, e.g., Phillips, id.* (holding that no reasonable apprehension existed where the patentee wrote to the declaratory plaintiff in an attempt to open license negotiations after its patent had reissued.) *See also EMC Corp. v. Norand Corp.*, 89 F.3d 807, 811 (Fed. Cir. 1996) ("A patentee's offer of a license, without more, is insufficient to establish the predicate for declaratory judgment jurisdiction.")

**Note, however, that an offer of a license has been found to constitute "actual notice" under 35 U.S.C. Section 287(a) for the purposes of calculating the date of accrual of patent infringement damages. *See SRI Int'l. v. Advanced Technology Labs.*, 127 F.3d 1462, 1470 (Fed. Cir. 1997) ("The actual notice requirement of §287(a) is satisfied when the recipient is informed of the identity of the patent and the activity that is believed to be an infringement, accompanied by a proposal to abate the infringement, whether by license or otherwise.")

b. Intimation of a legal recourse may be sufficient

When the patentee indicates that it would seek redress through the courts, "the alleged infringer is not required to wait for the patentee to decide when and where to sue, but can take the initiative and seek declaratory relief." *EMC*, at 811.

For example, in *EMC*, the patentee's counsel sent a letter to the alleged infringer's general counsel, referring to an "inclination to 'turn the matter over to' Norand's counsel 'for action,' and urged a 'preliminary business discussion,' 'perhaps avoiding this matter escalating into a continuous legal activity….' An objective reader of … [the] letter could only conclude that Norand had already decided EMC was infringing its patents and that Norand intended to file suit unless it could obtain satisfaction without having to sue." *Id.*, at 812.

See also Fina Research, S.A. v. Baroid Ltd., 141 F.3d 1479, 1483 (Fed. Cir. 1998): a patentee, in a letter to declaratory plaintiff, stated that it intended to vigorously protect and enforce its rights, including the filing of suit if necessary.

c. Refusal to Covenant not to Sue by Patentee Insufficient to Create Objective Apprehension

A refusal by the patentee to provide a covenant of non-suit does not create an objective reasonable apprehension, and does not constitute a charge of infringement or an indirect threat of suit. *See K-Lath, Division of Tree Island Wire v. Davis Wire Corp.*, 15 F.Supp.2d 952, 962 (C.D. Cal. 1998); *BP Chemicals*, 4 F.3d at 980.

2. No DJ against "quiescent patent owners"

The Federal Circuit adheres to a principle that "a declaratory judgment action should not be used to force unwanted litigation on 'quiescent patent owners.'" *See EMC*, at 812; *West Interactive Corp. v. First Data Resources, Inc.*, 972 F.2d 1295 (Fed. Cir. 1992) (holding that there was no reasonable apprehension of suit where patentee made no contact with declaratory judgment plaintiff, and sole source of plaintiff's apprehension was patentee's alleged statement to an unrelated party that plaintiff was infringing the patents at issue); *Hunter Douglas, Inc. v. Harmonic Design, Inc.*, 153 F.3d 1318, 1326 (Fed. Cir. 1998), *rev'd* on other grounds ("For an actual controversy more is required than the existence of an adversely held patent. We have maintained this requirement, for it protects quiescent patent owners against unwarranted litigation ….")

D. Present Infringing Activity or Present Intent to Infringe

"Plaintiff's conduct … must be such as to establish that plaintiff has a true interest to be protected by the declaratory judgment…. Plaintiff must be engaged in an actual making, selling, or using activity subject to an infringement charge or must have made meaningful preparation for such activity…. Whether a declaratory plaintiff's ability and definite intention to undertake a potentially infringing activity constitutes sufficient 'preparation' is a question of degree to be resolved on a case-by-case basis." *Arrowhead Industrial Water, Inc. v. Ecolocheim, Inc.*, 846 F.2d 731, 736 (Fed. Cir. 1988).

Where plaintiff's conduct is not alleged to be in the form of a direct infringement, but rather in the form of an inducement of infringement, that inducement, without prior direct infringement, could qualify as "preparation" within the meaning of the second prong. *See Fina Research*, at 1485 ("We decline, as the defendants would have us, to create a per se rule that an actual controversy predicated only on inducing infringement may exist only if direct infringement has already occurred. Instead, we confirm that, if only inducing infringement is at issue, whether a declaratory plaintiff's ability and definite intention to undertake a potentially infringing activity constitutes sufficient 'preparation' is a question of degree to be resolved on a case-by- case basis") (citations omitted).

V. OPINION OF COUNSEL: MINIMIZING THE RISK OF WILLFUL INFRINGEMENT LIABILITY

A. Introduction

In order to defeat a claim of willful infringement which could expose the alleged infringer to treble damages and attorney's fees, it is usually necessary to retain counsel to render an opinion of noninfringement and/or invalidity. The selection of opinion counsel and how to deal with that counsel are important and sometimes complicated issues. In selecting and dealing with opinion counsel, corporate counsel should keep in mind that the attorney-client privilege may be waived with respect to all communications relating to the opinion and all information upon which it is based. Accordingly, it is recommended that opinion counsel be selected from an outside firm that is <u>not</u> acting as litigation counsel.

B. Willfulness Generally

- <u>Test of willfulness:</u> The primary consideration is whether the infringer, acting in good faith and upon due inquiry, had sound reason to believe that it had the right to act in the manner that was found to be infringing. *SRI Int'l v. Advanced Tech. Labs*, 127 F.3d 1462, 1464 (Fed. Cir. 1997).

- <u>Affirmative Duty to Seek Legal Advice:</u> A potential infringer with actual notice of another's patent has an affirmative duty of care that usually requires the potential infringer to obtain competent legal advice before engaging in any activity that could infringe another's patent rights. *Comark Communs. Inc. v. Harris Corp.*, 156 F.3d 1182, 1191 (Fed. Cir. 1998).

- Reliance on Legal Opinion as a Defense:

  An important factor in determining whether willful infringement has been shown is whether or not the infringer obtained the opinion of counsel. *Comark*, at 1991.

  Those cases where willful infringement is found despite the presence of an opinion of counsel generally involved situations where opinion of counsel was either ignored or found to be incompetent. *Comark, id.*

- Totality of circumstances test: in reviewing or assessing willfulness, the court always looks at the totality of circumstances. *Comark*, at 1190.

- Enhanced damages: If willfulness is found, the court has discretion to increase the damages up to three times the amount found or assessed. 35 U.S.C. §284.

C. Legal Opinion Must Warrant a Reasonable Degree of Certainty that The Infringer Has the Legal Right to Conduct Infringing Activity

1. Opinion must be competent

Before the court considers the exculpatory value of an opinion of counsel, the legal advice contained therein must be found on the totality of circumstances to be competent, such that the client was reasonable in relying upon it. *Comark*, at 1991.

An opinion is competent if it is thorough enough, as combined with other factors, to instill a belief in the infringer that a court might reasonably hold the patent invalid, not infringed, or unenforceable. *John Hopkins Univ. v. CellPro, Inc.*, 152 F.3d 1342, 1364 (Fed. Cir. 1998).

2. Higher standard in evaluating competence for experienced corporate counsel

In *John Hopkins*, the court found that corporate counsel experienced in patent law would be held to a higher standard when requesting and evaluating patent validity, enforceability and infringement opinions prepared by outside counsel.

"Kiley, the CellPro representative who procured the opinion letters … was highly sophisticated in matters of patent law and in the involved technology. Kiley had worked as a patent examiner and later was a partner at the law firm of Lyon & Lyon, where he handled patent prosecution and patent litigation. It is therefore reasonable to conclude that Kiley should have been on notice concerning the opinions' obvious shortcomings and accordingly of the impropriety of CellPro's course of action." *John Hopkins*, at 1364.

The corporate counsel should consider the following factors in requesting/examining opinions, keeping in mind the higher degree of care required of experienced corporate counsel:

a. Opinion must be objective, preferably from outside counsel

The opinion should be objective. While there is no rule that it must be written by outside counsel, evidence that an opinion is independent supports a finding that it is reliable. *See Westvaco Corp. v. International Paper Co.,* 991 F.2d 735, 744-45 (Fed. Cir. 1993).

In addition, an opinion from an outside counsel could further evidence good faith. *See Underwater Devices Inc. v. Morrison-Knudsen Co.*, 717 F.2d 1380, 1389: "M-K knew or should have known that it proceeded without the type of competent legal advice upon which it could justifiably have relied. M-K knew that the attorney from whom it sought advice was its own in-house counsel. While this fact alone does not demonstrate M-K's lack of good faith, it is a fact to be weighed."

Accordingly, in virtually all cases outside counsel should be retained to prepare the opinion. As discussed below, opinion counsel should be from a law firm different from litigation counsel.

b. Opinions must be based on accurate and sufficient factual information from the client

"In order to provide such a prophylactic defense … counsel's opinion must be premised upon the best information known to the defendant. Otherwise, the opinion is likely to be inaccurate and will be ineffective to indicate the defendant's good faith intent. Whenever material information is intentionally withheld, or the best information is intentionally not made available to counsel during the preparation of the opinion, the opinion can no longer serve its prophylactic purpose of negating a finding of willful infringement." *Comark*, 156 F.3d at 1191.

In *SRI Int'l*, two different letters were each found to be insufficient to support a reasonable belief that defendant was not infringing a valid patent. 127 F.3d at 1466-67. The first opinion letter concluded that defendants' device did not infringe because it did not use the kind of filter claimed in the patent. At trial, however, it was undisputed that the facts assumed in the letter were wrong with respect the technology used in the accused device. Thus, the court found that the letter could not serve as an exculpatory opinion.

The second opinion letter considered in the *SRI* case stated that the defendant's product "might infringe" and that to determine infringement, more engineering information was needed concerning a specific limitation. No such information was ever provided to the lawyer preparing the opinion, however, and there was no follow-up opinion. The court found that the opinion was inadequate to support a good faith belief.

In *Minnesota Mining and Mfg. Co. v. Johnson & Johnson*, the Court affirmed a finding that the defendant's reliance on an opinion letter from its in-house counsel was not reasonable when the opinion was based on facts and a prior art references provided by a vendor who had an interest in the outcome of the analysis. 976 F.2d at 1580. The defendant had reason to know that the factual information on which the opinion was based was false and that the prior art reference relied upon did not teach what the vendor and the in-house attorney claimed it taught. *Id.*

c. Opinions must not be conclusory

The Federal Circuit has found noninfringement opinions "superficial and conclusory" when they included no analysis of specific claims, no interpretation of claim language, no discussion of means-plus-function claim limitations and no meaningful discussion of the prosecution history. *Critikon*, 120 F.3d at 1259.

In *SRI Int'l*, the Court upheld the finding of willfulness when one of the opinion letters was "conclusory and woefully incomplete, . . . lacking both legal and factual analysis." As such, it was insufficient to exculpate the infringer from the finding of willfulness.

In *Stryker*, the opinion of counsel concluded that a revised product did not infringe the claims of the asserted patent. Yet, the opinion went on to note that the plaintiff could assert infringement under the doctrine of equivalents, that the defendant therefore would violate any permanent injunction issued by the district court regarding the original device, and that the defendant could be held in contempt. It concluded that "the risk in selling the revised [device] is well within acceptable limits." On this record, the jury found willful infringement, the district court found contempt and the Court of Appeals affirmed. "Considering the conclusory nature of the opinion of counsel used by Davol to justify selling the revised device and the minor changes made to the original device, the court did not abuse its discretion in awarding treble the compensatory royalty damages, attorneys fees, and costs." *Stryker Corp. v. Davol Inc.*, 234 F.3d 1252, 1260 (Fed. Cir. 2000).

See also Jurgens v. CBK, Ltd., 80 F.3d 1566, 1572 (Fed. Cir. 1996) ("To reasonably rely on an opinion, it must be authoritative, not just conclusory, and objective.")

d. Opinions must address the file history, all claims, and all elements of the accused product or method

Courts will review an opinion letter for "its overall tone, its discussion of case law, its analysis of the particular facts and its reference to inequitable conduct…." *Ortho Pharmaceutical Corp. v. Smith*, 959 F.2d 936, 945 (Fed. Cir. 1992).

The opinion should contain a thorough review of the entire prosecution history and cited prior art. *See Jurgens*, at 1572. A review of additional prior art strengthens the foundation for the opinion. *See Westvaco*, 991 F.2d at 744. On the hand, an opinion of invalidity based solely on prior art considered by the examiner is suspect. The second opinion in *SRI Int'l* concluded that defendant's device might infringe but that the plaintiff's patent was invalid for obviousness and unenforceable for inequitable conduct. The basis for obviousness determination was a prior art patent which the patent examiner had considered during reexamination. The examiner had reconfirmed the patent over that reference, rejecting the same arguments put forth in the opinion letter. Thus, the court concluded that it was not reasonable for defendant to rely on the letter.

The claims of the patent should be addressed individually. *See Westvaco*, 991 F.2d at 744 (approving opinion in which claims are separately analyzed); *In re Hayes Microcomputer Prods., Inc. Patent Litig.*, 982 F.2d 1527, 1543 (Fed. Cir. 1992) (willfulness was supported where opinion letter "discusses concepts rather than analyzing the patent claims" and "there is no recitation of the specific claims whatsoever.")

In an opinion concerning infringement, the accused device should be analyzed in detail. *See Westvaco*, 991 F.2d at 744. At least one case holds that there is no hard and fast rule that it must consider infringement under the doctrine of equivalents in order to be competent. *See Ortho Pharmaceutical*, 959 F.2d at 944-45. Failure to address the doctrine may be considered, however, in evaluating the overall opinion. Thus, it is far better practice to address both literal infringement and infringement under the doctrine of equivalents.

e. Opinion must be timely

"Prudent behavior generally requires that competent legal advice was obtained before the commencement of the infringing activity." *SRI Int'l*, at 1468.

In *SRI Int'l*, a third opinion, written by an in-house legal department's Vice President, was based on a newly-discovered prior art reference. That opinion, however, came seven years after ATL began its infringing activity, and just two days before SRI filed its infringement suit. The Federal Circuit upheld the District Court's finding that the opinion came "too little, too late…." to "warrant a reasonable degree of certainty that the infringer had the legal right to conduct the infringing activity." *SRI Int'l*, 127 F.3d at 1467. The court noted that the opinion letter was produced as a "protective device in preparation for litigation, rather than as a genuine effort to determine before infringing whether the patent was invalid." *Id.*

The court expressly declined to decide whether willful infringement could ever be purged by subsequent legal advice. *Id*. Note, however, that there can be no willful infringement prior to a company's receiving notice of a patent, regardless of when a product was designed. *State Industries Inc. v. A.O. Smith Corp.* 751 F.2d 1226, 1236 (Fed. Cir. 1985).

f. Written opinions preferred over oral

"[Oral] opinions carry less weight, for example, because they have to be proven perhaps years after the event, based only on testimony which may be affected by faded memories and the forces of contemporaneous litigation." *See Minnesota Mining*, 975 F.2d at 1580.

g. Client must show *reliance* on the legal advice

A defendant arguing that it did not willfully infringe because it relied on advice of counsel must show conduct consistent with reliance on that opinion. *See Central Soya Co. v. Geo A. Hormel & Co.*, 723 F.2d 1573, 1577 (Fed. Cir. 1983): the opinion stated that Hormel would be "reasonably safe" if its product expanded less than 100% as a result of processing. Hormel, however, did not take measurements of its product to determine whether it infringed for two years after it obtained the legal opinion. *Id.*

Where opinions were conclusory and rendered after the defendant settled on the product designs, the jury could properly determine that reliance on the opinions was not reasonable. *Stryker Corp. v. Davol Inc.*, 234 F.3d 1252, 1259 (Fed. Cir. 2000).

D. Defense of Advice of Counsel Acts as a Waiver of the Attorney-Client and Work Product Privileges

When defendant asserts opinion of counsel as a defense to willful infringement, legal opinions become discoverable and attorney-client and work-product privileges are waived with respect to the opinions. *See, e.g.,* Northern California District Court Local Patent Rule 3-8 (party who will rely on an opinion of counsel as a defense to a claim of willful infringement is required to produce "any document(s) relating to the opinion(s) as to which that party agrees the attorney-client or work product protection has been waived…."); *Dunhall Pharmaceuticals, Inc. v. Discus Dental, Inc.*, 994 F.Supp. 1202 (C.D. Cal. 1998); *Solomon v. Kimberly-Clark Corp.*, 1999 WL 89570 (N.D. Ill. 1999) ("The assertion of an advice of counsel defense results in a waiver of the attorney-client privilege … [and] in a waiver of the attorney work product protection as well.")

The split between the courts focuses on the issue of the <u>scope</u> of these waivers:

Under one line of authority, often relied on by plaintiffs, the scope of the waivers is broad. In *Dunhall Pharmaceutical*, the court held that the waiver of the attorney-client privilege is a broad <u>subject-matter waiver</u>, and includes "any evidence relating to infringement, validity, and/or enforceability communicated between attorney and client, throughout the entire period of the alleged willful infringement." As to the work-product waiver, the court held it was narrower in scope, and includes "any evidence relating to the subject matter of the asserted defense, <u>whether or not communicated to the defendants</u>." *Dunhall Pharmaceuticals*, 994 F.Supp. at 1206. The work product waiver affects documents produced prior to litigation, however: "Once the lawsuit is filed, the waiver of work-product protection ends." *Id.*

Another line of authority allows for more circumscribed waivers. The attorney-client and work product waivers are limited to matters <u>communicated to the defendant</u>. "Because the appropriate focus is on relevance to the alleged infringer's state of mind, and not to counsel's state of mind, the bright-line distinction between what is and is not communicated to the alleged infringer is the optimal guiding principle." *See Solomon*, 1999 WL *3. *See also Beneficial Franchise Co. v. Bank One, N.A.*, 2001 WL 492479, *5 (N.D. Ill. 2001) ("the [work product] waiver … extends only to documents prepared by trial counsel which were communicated to the defendants, and which contained 'conclusions that contradict or cast doubt' on the disclosed opinions," *quoting Thermos Co. v. Starbucks Corp.*, 1998 WL 781120, *5 (N.D. Ill. 1998).

E. In-House Counsel as a Witness

If an in-house attorney renders an opinion about whether the patent-in-suit is valid or infringed by the corporate client, he/she is likely to be a witness if the infringer raises reliance on the opinion of counsel defense. The counsel who rendered the opinion should be bifurcated from litigation to avoid waiver of privilege as to litigation-related matters, or to avoid disqualification motions. *See, e.g., Bristol-Myers Squibb Co. v. Rhone-Poulenc Rorer, Inc.*, 2000 U.S. Dist. LEXIS 16015 (S.D. NY 2000).

VI. CONDUCT PRELIMINARY LITIGATION REVIEW

A. Assess the Plaintiff

1. Financial strength
2. Prior patent litigation
3. Other patents owned
4. Licensing practices
5. Acquisitions and other business activity

B. Assess the Court/Judge

1. Patent rules, esp. Markman practice
2. Prior patent decisions

C. Assess the Patent

1. Prosecution history, cited art
2. Continuations, divisions, CIP's
3. Reissues
4. Reexaminations
5. International counterparts
6. Prior litigation
7. Licenses granted

VII. IDENTIFY BEST DEFENSES AND COUNTERCLAIMS

A. Procedural Defenses

1. Subject Matter Jurisdiction
2. Personal Jurisdiction

3. Venue (improper, transfer)

4. More Definite Statement (e.g., fraud, accused products)

5. Arbitration Clause

6. Abstention/Stay

B. Non-Technical Defenses

1. Limitation on damages (marking, delay). *See* 35 U.S.C. §287

2. Exemptions under 35 U.S.C. §271(e)(1): It is not an infringement to make, use, offer to sell, or sell or import a patented invention (other than a new animal drug or veterinary biological product … which is primarily manufactured using recombinant DNA, recombinant RNA, hybridoma technology, or other processes involving site specific genetic manipulation techniques) solely for uses reasonably related to the development and submission of information under a Federal law which regulates the manufacture, use, or sale of drugs.

3. Intervening rights

4. Implied license

5. Accord/satisfaction

6. Estoppel

7. Misuse

C. Technical Defenses

1. Non-infringement

2. Section 102 (<u>lack of novelty</u>, such as, e.g., when the invention is already known or has been patented or described in a printed publication more than a year prior to the patent application; or the invention has been <u>abandoned</u>).

3. Section 103 (<u>obviousness</u>, when the differences between the subject matter of the patent application and the prior art are such that the subject matter as a whole would have been obvious at the time the invention was made to a person having ordinary skill in the art)

4. Section 112 (<u>failure to support claims by specification</u> – insufficient written description of the invention and of the manner and process of making and using it).

5. Unenforceability/Inequitable Conduct

D. Counterclaims

1. Patent infringement: Are there patents that your company can assert against the plaintiff?

2. Antitrust

3. Other

E. Reexamination

Amendments to 35 U.S.C. § 301 et seq. (2000) now permit third parties (defendants to a patent infringement suit) to request an *inter partes* reexamination. *See* 35 U.S.C. § 311 ("Any third party at any time may request an *inter partes* reexamination."). The basis for such a request, however, can *only* be the "*prior art* cited under the provisions of section 301" which consists of "patents and printed publications." *Id.*; 37 C.F.R. §1.915 (emphasis added). Thus, a request for reexamination on any other basis (lack of enablement, prior use or sale, inequitable conduct, etc.) cannot be raised by a third party in a request for reexamination. The examiner will review the request and cited prior art to determine whether a substantial new question of patentability has been raised. *See* 37 C.F.R. §1.925.

In addition, under the new statutory scheme, the requestor must now identify itself, and may not hide behind its attorney or a representative. *See* 35 U.S.C. §311(b)(1).

There are certain risks and benefits associated with the defendant's decision to request an *inter partes* reexamination. The benefit of going through the reexamination is that it can potentially save the defendant a lot of time and money by avoiding protracted patent litigation if, as a result of the reexamination, the plaintiff's patent is found to be invalid.

The risk is that requesters *and their privies* are estopped to file subsequent *inter partes* reexamination requests following a final determination in an *inter partes* reexamination. *See* 35 U.S.C. §§315, 317; 37 C.F.R. §1.907. Moreover, the requester is *estopped* from asserting in *any civil action* "the invalidity of any claim finally determined to be valid and patentable on any ground which the third-party requester raised *or could have raised* during the *inter partes* reexamination proceedings" *See* 35 U.S.C. §315(c) (emphasis added).

See generally M. Patricia Thayer *et al*, *Inter Partes Reexamination: The United States Joins Europe and Japan in Providing an Adversarial Administrative Procedure for Testing Patent Validity*, Patent World, May 2001 or at http://www.hewm.com/news/articles.asp.

VIII. EVALUATE POTENTIAL EXPOSURE

A. Likelihood of Success on the Merits

1. Claims

2. Counterclaims

B. Potential Extent of Recovery: Damages

One of the key questions from corporate counsel when faced with patent litigation is: what is our exposure? The threat of an injunction and the prospect of being banned from continuing business or selling product are perhaps the most immediate and compelling concerns. However, management will also want to know what is the monetary exposure, and, accordingly, understanding the nature and extent of potential damages is quite important.

<u>35 U.S.C. Sec. 284:</u>

> Upon finding for the claimant the court shall award the claimant damages adequate to compensate for the infringement, but in no event less than a reasonable royalty for the use made of the invention by the infringer, together with interest and costs as fixed by the court….

C. Core Damages

1. Lost Profits: actual damages

To recover lost profits, the patent owner must demonstrate with a "reasonable probability" that the infringer's actions caused it ("but for") to suffer the particular financial loss for which compensation is sought. *See State Industries v. Mor-Flo Industries*, 883 F.2d 1573 (Fed. Cir. 1989); *Rite-Hite Corp. v. Kelley Co.*, 56 F.3d 1538 (Fed. Cir. 1995) (en banc).

The following four factors ("*the Panduit test*"*)* are frequently, but not exclusively, used to evaluate lost profits:

(1) demand for patented product,

(2) absence of acceptable noninfringing substitutes (i.e., that the patentee would not have lost the sales to a noninfringing third party rather than to the infringer),

(3) manufacturing and marketing capability to exploit demand, and

(4) amount of profit it would have made; such showing permits court to reasonably infer that lost profits claimed were in fact caused by infringing sales, thus establishing patentee's prima facie case with respect to but for causation.

See Panduit Corp. v. Stahlin Bros. Fibre Works, Inc., 575 F.2d 1152, 197 U.S.P.Q. 726 (6th Cir. 1978); *Rite-Hite*, at 1544.

2. Reasonable Royalty: minimum damages recovery, regardless of proof of lost sales or any other damages

Where patent owner cannot prove lost profits, it utilizes "reasonable royalty" method for calculating damages. A comprehensive list of evidentiary factors for calculating reasonable royalties has been outlined in *Georgia-Pacific Corp. v. United States Plywood Corp.*, 318 F.Supp. 1116, 1120 (S.D.N.Y. 1970), modified 446 F.2d 295 (2d Cir. 1971). Courts and experts now widely utilize these factors in calculating reasonable royalties:

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 whom the manufactured product may be sold;

4. The licensor's established policy and marketing program to maintain his 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 its 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 of use of the invention;

11. Royalty based on the extent to which the infringer has made use of the invention; and any evidence probative of the value of that use. In the case of industrial machines, for example, the court may conclude that the royalty should be based not on the selling price of the machine, but on the machine's throughput. *See, e.g., Minco,* 95 F.3d 1109 (affirming an award of reasonable royalty damages based on sales of a commodity product made with an infringing machine);

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. Hypothetical Negotiation Approach: Often used when an established royalty rate cannot be arrived at. It is calculated based on the amount that a licensor (the patentee) and a licensee (the infringer) would have agreed upon at the time the infringement began if both had been reasonably and voluntarily trying to reach an agreement; or 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 by a prudent patentee who was willing to grant a license.

3. Combination of both reasonable royalty and lost profits

The court can also award damages based on a combination of lost profits and reasonable damages. *See, e.g., WMS Gaming, Inc. v. Int'l Game Technology*, 184 F.3d 1339, 1361 (Fed. Cir. 1999) (upholding district court's award of damages based on such a combination).

D. Non-Core Damages

1. **Convoyed sales:** Sales made simultaneously with the patented product. *See Carborundum Co. v. Molten Metal Equipment Innovations*, 72 F.3d 872, 882, fn. 8 (Fed. Cir. 1995).

2. **Derivative sales:** sales that would have been made but for the infringement, but not simultaneously with the patent product. *See Carborundum*, id.

3. **Entire market value:** Damages for unpatented components of the entire apparatus or process.

The "entire market value rule" permits recovery for lost sales of unpatented components when the unpatented components "function together with the patented component in some manner so as to produce a desired end product or result." *King Instruments Corp. v. Perego*, 65 F.3d 941 (Fed. Cir. 1995).

4. **Services:** Recovery of lost profits for services related to sales of the patented product.

5. **Unpatented products that compete with the infringing product:**

Patentee can also recover lost profits on sales of devices that compete with but are not covered by its patent. *See King Instruments v. Perego*, 65 F.3d 941, 951 (Patentee's sale of product which competes with competitor's infringing product but is not itself covered by patent may be basis for lost profits award against competitor, as market may dictate that exclusion of others from making, using or selling patented device is more profitable than marketing of device.)

6. **Price erosion:**

Price erosion occurs where patent owner may not have "lost sales," but may have been forced to offer its product at a discounted rate to meet competition from the infringer. The patent owner then can receive the price differential as damages, if the patent owner can prove that it would have sold at a higher price but for the infringement. *See Minco, Inc. v. Combustion Engineering, Inc.*, 95 F.3d 1109, 1120 (Fed. Cir. 1996) ("To prove price erosion damages, patentee must show that, but for infringement, it would have been able to charge higher prices.")

7. **Accelerated market reentry:** if reentry to market is accelerated by earlier infringement. These damages must be carefully distinguished from other evidence of lost profits.

8. **Increased expenses:**

The patent owner may be able to recover the increased costs that it incurred in competing with the infringer. For example, it may be possible to recover promotional expenses that the infringement forced the patent owner to incur. *See Lam, Inc. v. Johns-Manville, Corp.*, 718 F.2d 1056, 1065 (Fed. Cir. 1983).

IX. IDENTIFY POTENTIAL WITNESSES

A. Retention of Experts (retain early)

Obtaining the best expert or experts is often the key to winning a patent case. Expert testimony, at least with respect to validity and infringement, is critical. Often, the technical employees within the company are the best source of information concerning who may be qualified to serve as an expert. Accordingly, quite early in the litigation process, an inquiry should be made within the company to identify potential experts.

When selecting experts, technical qualifications are critical. However, appearance and the ability to communicate are quite important, as well as whether the potential expert has had prior experience testifying in deposition or trial.

An expert can help with:

1. All technical areas
2. Exemptions
3. Damages
4. Graphics
5. Trial Consultant

B. Fact Witnesses

1. Prior employees of the parties
2. Inventors
3. Licensees of plaintiff
4. Officers/directors of plaintiff
5. Other scientists employed by plaintiff
6. Government employees (PTO, FDA, SEC)
7. Defendant's employees

X. ADOPT DISCOVERY PLAN

A. **Interrogatories:** conception/reduction to practice; offers for sale and public disclosures; identification of accused products/services; witnesses.

B. **Documents:** lab notebooks; scientific articles; FDA/SEC/PTO filings; licenses; correspondence; litigation files; "commercial success" documents.

C. **Requests for Admission:** dates of sales; notices; prior art; level of skill; conception; reduction to practice.

D. **Contention Interrogatories:** literal infringement; equivalent; claim terms; non-obviousness; damages; notice.

E. **Prior Art Searching**

XI. PREPARE A SETTLEMENT POSITION

A. Cessation of Activity

B. Product Revision

C. License/Cross-License

D. Monetary Settlement

XII. ADR/MEDIATION POSSIBILITIES

"ADR can save time and money . . . where the volume of litigation is increasing and the complexity of disputes makes the costs of litigating especially high. For example, one study found that the median cost of patent litigation through the discovery phase is $498,000, and the median cost of a full trial is $752,000. Another commentator estimates that the costs of patent litigation routinely reach $1,000,000 per party, with cases frequently costing between two and five million dollars. In one particularly expensive case, *Polaroid Corp. v. Eastman Kodak Co.*, the parties spent a combined total of nearly $200,000,000.

By comparison, the median costs associated with alternative methods of resolving intellectual property disputes are quite modest: $50,000 for mediation; $78,000 for combined mediation and arbitration; $151,000 for binding arbitration. Most patent dispute arbitrations cost less than 85 percent of the cost of litigating the same case and arbitrations generally cost less than one-third of the cost of litigating the same case. With good case management and an experienced arbitrator, the costs can be further reduced. One study reported that sixty-one companies that used alternative dispute resolution saved a combined total of nearly $50,000,000, with an average savings of more than $800,000 per company in legal fees."

See Julia A. Martin, *Arbitrating in the Alps Rather than Litigating in Los Angeles,* 49 Stan. L. Rev. 917, 922 (1997).

In addition, ADR can save a lot of time to the litigants. "Using well-planned domestic U.S. arbitration, even in a fairly complex patent infringement suit, a party can almost uniformly get the final decision and a permanent injunction in place within 365 days. By comparison, it would take an average of more than six years for patent cases to make their way through the trial and appeal process…." *Id.*

Other benefits associated with an ADR or a Mediation proceeding include:

- Flexibility of rules
- Ability to bypass judicial backlog
- Avoidance of judge/jury confusion by employing an expert factfinder
- Conclusive settlement of a complicated dispute in a single action
- Simplicity of rules governing ADR proceedings, including simplified evidentiary rules
- Neutrality
- Quality of judgments
- Full confidentiality without showing "good cause"
- Preservation of business relationship because less adversarial than litigation

TRADE SECRETS[3]

I. INTRODUCTION

Trade secret cases can arise in many different contexts, but they often involve either a key technical employee leaving one company to assume the same technical position with a primary competitor, or a breakdown of a joint venture or joint development agreement with one of the participants exploiting the jointly developed technology. These, and other trade secret scenarios, usually provoke a strong reaction from management and a demand for immediate action. The immediate action often translates into a motion for a preliminary injunction. As a result, a trade secret case often involves expedited discovery, an early evidentiary hearing, and the prospect that the case may be essentially resolved within a relatively short period of time, from four to six months. Those four to six months, however, can place significant financial and logistic burdens on a company. Accordingly, an understanding of the dynamics of a trade secret case will assist corporate counsel in reaching a decision as to how and when to file trade secrets litigation or, in the alternative, how best to defend against and resolve a trade secrets claim.

II. ELEMENTS OF A TRADE SECRETS ACTION

The following outlines the requirements for a trade secrets action under the Uniform Trade Secrets Act ("UTSA"). The UTSA has been adopted (with some variation) by 43 states.

<u>Basic Elements:</u>

1. Information that is not generally known to the public, e.g.:

   - *Coca-Cola drink formula*: Coca-Cola's "secret formula" Merchandise 7X, which Coca-Cola has maintained as a trade secret since 1899, is a protectible trade secret. *See Coca-Cola Bottling Co. v. Coca-Cola Co.*, 107 F.R.D. 288, 289 (D.Del. 1985).

   - *Customer Lists*: *See, e.g., Galbe-Leigh, Inc. v. North American Miss*, 2001 WL521695 (C.D. Cal. 2001) ("A customer list can be found to have economic value because its disclosure would allow a competitor to direct its sales efforts to those customers who have already shown a willingness to use a unique type of service or product as opposed to a list of people who only might be interested. Its use enables the former employee to solicit both more selectively and more effectively"); *Cf. American Paper & Packaging Products, Inc. v. Kirgan*, 183 Cal. App. 3d 1318 (1986) (customer list not protectible as a trade secret because customers readily ascertainable to others in the shipping business).

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[3] By Alexander L. Brainerd and Olga Rodstein.

- *Computer Software*: *See, e.g., Computer Associates Int'l., Inc. v. Bryan et al.*, 784 F.Supp. 982, 1009 (E.D. NY 1992) (an internal financial software found to be a protectible trade secret) ("The particular combination of procedures used in plaintiff's computer system, and the particular features within the system are neither obvious nor easily duplicated. They constitute a trade secret").

- *Source Code*: *See, e.g., Beam System, Inc. v. Checkpoint Systems*, 1997 WL 364081, *2 (C.D. Cal. 1997) ("All or portions of the software and related materials may constitute trade secrets or other confidential commercial information, especially the source code form of the software and materials related to the software that explain its design and operation.")

2. Derives independent economic value (actual or potential)

3. Reasonable efforts have been made to maintain it secret (e.g., advising employees of the existence of a trade secret, liming access to the information to a 'need to know basis,' requiring employees to sign confidentiality agreements)

4. That is misappropriated (acquired or disclosed)

5. By "improper means" (e.g., theft, bribery, misrepresentation; breach of fiduciary duty, or espionage)

*See, generally, MAI Systems Corp. v. Peak Computer, Inc***.**, 991 F.2d 511 (9th Cir. 1993) (outlining elements of a trade secrets action under UTSA).

III. IMMEDIATE ISSUES WHEN FACED WITH A TRADE SECRETS CASE

A. Conduct Internal Investigation

B. Analysis of Alleged Trade Secrets

C. Document Control

IV. IDENTIFICATION OF TRADE SECRETS

A. A Hurdle for Plaintiff

Before plaintiff decides to file a trade secrets claim, it must be prepared to precisely identify its trade secrets. "'A plaintiff seeking relief for misappropriation of trade secrets must identify the trade secrets and carry the burden of showing that they exist'…. The plaintiff should describe the subject matter of the trade secret with sufficient particularity to separate it from matters of general knowledge of those persons … skilled in the trade. " *IMAX Corp. v. Cinema Technologies*, 152 F.3d 1161, 1164 (9th Cir. 1998) (upholding district court's grant of defendant's motion to compel identification of trade secrets and summary judgment) (citations omitted).

The burden of identifying trade secrets with particularity is not carried by a mere "catchall phrase," especially where trade secrets involve "sophisticated and highly complex system." *Id.*, at 1167. It must "clearly refer to tangible trade secret material." *Id.* For example, in *IMAX*, plaintiff's description of its trade secrets as including "dimensions and tolerances that defines or reflects the design" of a projector system was held not sufficiently precise, as it did not identify "which dimensions and tolerances were trade secrets." *Id.*

Failure to identify trade secrets with particularity carries serious repercussions for the plaintiff. It can result in the exclusion of such unidentified trade secrets from the evidence, and dismissal of the case on summary judgment for failure to identify the trade secrets. *Id.* at 1167, 1168-69.

B. A Weapon for Defendant

At the same time, the rule requiring precise identification of trade secrets can be a strong weapon in defendant's hands, as defendant can stall discovery until plaintiff complies with the request for identification. Defendant can eventually use plaintiff's failure to identify trade secrets to dispose of the action in its entirety. *See IMAX.*

V. PRELIMINARY INJUNCTION

One of the first things corporate counsel should consider before or immediately after filing a trade secrets suit is whether to file for a preliminary injunction. A speedy motion for a preliminary injunction can not only prevent the "loss" of a secret, it can also indicate to the court the seriousness of plaintiff's desire to protect its secrets. "Even though delay may not rise to the level of 'laches,' it may nonetheless indicate the absence of irreparable harm." *See Computer Associates*, 784 F.Supp. at 987 (holding that plaintiff did not unreasonably delay in bringing its motion, and therefore no laches defense applied).

However, preliminary injunctions usually involve expedited discovery which is intense, costly, and disruptive. In addition, the hearing on the preliminary injunction often results in a full trial on the merits and, for all intents and purposes, a final resolution of the matter. Accordingly, plaintiff must thoroughly prepare for the preliminary injunction process.

D. Legal standards for obtaining preliminary injunction

To prevail on a motion for a preliminary injunction (slight variation between federal and state courts, but difference insignificant), the moving party must demonstrate either:

> (1) a likelihood of success on the merits and the possibility of irreparable injury,
>
> <u>or</u>

> (2) the existence of serious questions going to the merits and that the balance of hardships tips sharply it its favor."
>
> *See Bayer Corp. v. Roche Molecular Systems, Inc.*, 72 F.Supp.2d 1111, 1116 (N.D. Cal. 1999).

The two tests represent "two points on a sliding scale in which the required degree of irreparable harm increases as the probability of success decreases." *Id.*

E. Burden of Proof

1. The existence of one or more trade secrets;

2. The trade secrets have substantial commercial value and are critical to the continued success of the endeavor or company;

3. Steps taken to preserve the confidentiality of trade secrets;

4. Actual or threatened use or disclosure of trade secrets (misappropriation);

5. Defendants use of trade secrets will cause irreparable harm to plaintiff.

F. Initial Considerations Before Filing for a Preliminary Injunction

1. Courts treat requests for preliminary injunction carefully and with some degree of skepticism.

2. Decision to file should and must be made contemporaneous with the preparation of the complaint and related initial pleadings.

3. Decision to go forward should be made after considering at least the following facts:

    - objectives (force early resolution of case; educate judge about the product; early discovery; protect property);
    - quality of proof (should have a strong case);
    - tactical considerations (such as revealing the entire case);
    - quality of the opposition and facts opponent can muster to defeat preliminary injunction motion (likelihood of success);
    - the judge;
    - costs (money; time; disruption of business)
    - bond (cost; exposure)

- the necessity of an injunction;
- possibility of debilitating the opponent;
- likelihood of obtaining tactical advantage;
- the scope of the injunction;
- risks (lose the injunction after revealing your entire case).

VI. Doctrine of Inevitable Disclosure

The doctrine of inevitable disclosure is currently one of the most controversial issues in trade secrets preliminary injunction litigation. The doctrine of inevitable disclosure provides a theory under which a court may enjoin a departing employee from working for a competitor in a job with similar responsibilities. The controversy surrounding the doctrine is fueled by a growing split between the courts on the doctrine's viability.

Courts that have adopted the inevitable disclosure theory have entered injunctions against departing employees out of concern that a departing employee is incapable of compartmentalizing sensitive information obtained at the former employer. Injunctions have been entered where (a) the employee has extensive and intimate knowledge of trade secrets from the previous employer; (b) the employee has been hired to perform work for the new employer substantially similar to the work performed for the former employer; (c) it would be impossible for the employee to compartmentalize the new employer either consciously or unconsciously; and (d) thus, the employee would inevitably rely on the trade secrets of his or her former employer if allowed to take the position with the new employer.

On the other side of the spectrum are the courts rejecting the doctrine because of the profound public policy implications. These courts, most vocally in California, have refused to grant injunctions against departing employees because doing so would undermine the policies of employee mobility and free competition.

The following are some examples of cases on all sides:

1. Courts adopting the doctrine

The doctrine of inevitable disclosure was first developed in the early 1980s in the Fifth Circuit. *See FMC Corp. v. Varco Intl., Inc.* 677 F.2d 500 (5th Cir. 1982); *Union Carbide Corp. v. UGI Corp.* 731 F.2d 1186 (5th Cir. 1984). It was not, however, included in the UTSA. The theory received its widest recognition in *PepsiCo v. Redmond*, 54 F.3d 1262, 1269071 (7th Cir. 1995):

- PepsiCo sought to preliminarily enjoin its former employee William Redmond and its competitor Quaker Oats to prevent him from working for Quaker. Redmond was a general manager at PepsiCo, having access to trade secrets and other confidential information.

PepsiCo alleged that Redmond's new position posed a threat of trade secrets misappropriation. The Seventh Circuit approved the grant of an injunction, finding that (1) Redmond possessed knowledge of specific PepsiCo trade secrets and not just "general skills and knowledge," (2) armed with this knowledge and because his responsibilities at Quaker would parallel those at PepsiCo, Redmond would be able to anticipate PepsiCo's business moves, and (3) Redmond's "lack of forthrightness … and out and out lies" demonstrated a "lack of candor … and a willingness to misuse [PepsiCo's] trade secrets." The court also said that "unless Redmond possessed an uncanny ability to compartmentalize information, he would necessarily be making decisions about Gatorade and Snapple by relying on his knowledge of [PepsiCo's] trade secrets." *Id.* at 1269.

· Courts following *PepsiCo* have used the following <u>factors</u> in evaluating whether a trade secret will be "inevitably" disclosed:

(1) Is the new employer a competitor?

(2) What is the scope of the defendant's new job?

(3) Has the employee been less than candid about his new position?

(4) Has plaintiff clearly identified the trade secrets which are at risk?

(5) Has actual trade secret misappropriation already occurred?

(6) Did the employee sign a nondisclosure and/or noncompetition agreement?

(7) Does the new employer have a policy against use of others' trade secrets?

(8) Is it possible to "sanitize" the employee's new position?

See D. Peter Harvey, *"Inevitable" Trade Secret Misappropriation After Pepsico, Inc. v. Redmond*, 537 PLI/Pat 199, 225 (1998).

2. Courts rejecting *Pepsico* and the theory of inevitable disclosure

· North Carolina courts have rejected the *Pepsico* decision and its rationale in *FMC Corp. v. Cyprus Foote Mineral Co.*, 899 F.Supp. 1477, 1482 (W.D.N.C. 1995), recognizing the danger of the inevitable disclosure theory and noting that "if the doctrine is applied as urged by FMC, then no employee could ever work for its former employer' competitor on the theory that disclosure of confidential information is inevitable."

· California courts have not adopted the inevitable disclosure doctrine, holding that it is contrary to public policy of employee freedom and mobility. California courts will not infer misappropriation from the mere fact that: (a) an employee worked for a company on a particular project; (b) that company has trade secrets relating to that project; and (c) the employee now works for a new employer on a similar project. *See Bayer Corp. v. Roche*

Molecular Systems, Inc. 72 F.Supp.2d 1111 (N.D. Cal. 1999) ("California trade-secrets law does not recognize the theory of inevitable disclosure; indeed, such a rule would run counter to the strong public policy in California favoring employee mobility.") *See also Danjag LLC v. Sony Corp.* 50 U.S.P.Q. 2d 1638, 1639-40 (C.D. Cal. 1999); *Universal Analytics, Inc. v. MacNeal-Schwendler Corp.*, 707 F.Supp. 1170, 1177-78 (C.D. Cal. 1989).

However, under California law, threatened misappropriation may be enjoined. Therefore, if there is evidence suggesting the former employee's intent to use or disclose the former employer's trade secrets, then a California court may issue an injunction:

> A trade-secrets plaintiff must show an actual use or an actual threat. Once a nontrivial violation is shown, however, a court may consider all of the factors considered by the jurisdictions allowing the theory in determining the possible extent of the irreparable injury. In other words, once the employee violates the trade-secrets law in a nontrivial way, the employee forfeits the benefit of the protective policy in California.

Bayer, 72 F. Supp. at 1120.

- The First Circuit rejected the inevitable disclosure doctrine in *Campbell Soup Co. v. Giles*, 47 F.3d 467 (1st Cir. 1995), case similar factually to Pepsico. Defendant, a sales manager, left for a similar job at Progresso. The court upheld the district court's ruling that public policy "counsels against unilateral conversion of non-disclosure agreements into non-competitive agreements. If Campbell wanted to protect itself against competition from former employees, it should have done so by contract. This court will not afford such protection after the fact…."

3. Alternative approach: Enjoining disclosure, not employment

In *Merck & Co. Inc. v. Lyon, 941 F.Supp. 1443* (M.D.N.C. 1996), the court granted a narrow injunction against disclosure rather than employment, holding that, under the inevitable disclosure theory, an injunction prohibiting employment cannot issue absent "some showing of bad faith, underhanded dealing, or employment by an entity so plainly lacking comparable technology that misappropriation can be inferred." *Id.* at 1458-59 (*quoting FMC,* 899 F.Supp. at 1483).

VII. ADR & SETTLEMENT

Due to the cost, disruption and risks associated with trade secret cases, they are excellent candidates for mediation and creative approaches to settlement. Because sophisticated technology is often involved, the selection of a mediator is a critical and sometimes difficult part of the process.

Creative settlement approaches may include:

- A neutral inspector and a regulated inspections process to insure that the defendant is not in fact using any of the trade secrets;

- Putting an employee on the shelf (essentially, a paid leave of absence) for some period of time so that the employee has no exposure to the new employer's technology;

- Requiring that the departing employee not work on sensitive technology for some extended period of time;

- Some business solution, such as a joint development agreement or a license.

THE ROLE OF IN-HOUSE COUNSEL IN THE PROTECTION OF INTELLECTUAL PROPERTY

Daphne Gronich

The views expressed herein are those of the author alone and do not necessarily represent the views of the author's employer.

THE ROLE OF IN-HOUSE COUNSEL IN THE PROTECTION OF IP

A. INTRODUCTION

With the development of digital technologies and the emergence of the Internet as a marketing and revenue-generating tool, there is an increased focus on intellectual property assets by management of for profit and non-profit entities alike. For in-house counsel, the overriding business consideration is to balance the value of IP, as a company asset to be protected, against the necessary costs associated with registering and otherwise protecting such assets. Not only is a strategy required for efficient IP enforcement programs, but the expenses associated therewith and with the maintenance of underlying IP rights (via patent, trademark, copyright and domain name registrations and renewals) need to be budgeted. These expenses often also need to be justified to financial managers with limited understanding of IP issues or of the need to protect such assets - such as in years when core assets may not be generating revenue. Nonetheless, without protection, such core assets could be lost.

It is imperative for in-house counsel to assist in maintaining, if not in generating or increasing, actual revenues associated with the IP assets of their company. Given that litigation is an inevitable facet of business, an effective and creative in-house IP litigator can contribute to the company in various legal, financial and non-financial ways. This article will provide an overview of the general role an in-house IP litigator can play and address issues unique to copyright and trademark litigation.

B. THE GENERAL ROLE OF IN-HOUSE IP COUNSEL

The variety and overall types of claims in copyright and trademark cases have not changed all that much over the years, notwithstanding the new problems that the Internet has spawned, particularly with regard to domain names and predatory cybersquatters (a new variation on trademark pirates). The basic question still remains: Did your client (the company) infringe another party's rights? OR Is someone infringing your client's IP rights?

The digital environment of the Internet has made it easier for greater numbers of people to create, promote, sell and distribute infringements of copyrighted works and trademarked properties on a worldwide basis, with little or no overhead costs. An effective IP strategy, therefore, is critical for legitimate businesses to remain viable; it will assist them in coming up with practical solutions and new approaches to the use of IP in the digital environment.

As a threshold matter, in-house IP counsel is in a unique position to both educate employees about IP, so that they do not inadvertently infringe the rights of others, and ensure that they follow certain basic procedures, like getting work-for-hire agreements signed. To the extent necessary, general IP usage guidelines can be prepared. If not, it is helpful for employees to be told whom they can contact to ask questions about IP or to report possible infringements that come to their attention.

In-house IP counsel can often achieve the cessation of infringing conduct by third parties via well-reasoned and crafted cease and desist letters. They can also resolve claims received by the company in the pre-litigation phase, all without the need to retain outside counsel. Tasks they routinely perform include: responding to and addressing IP infringement claims asserted in cease and desist letters, investigating the merits of a claim or cause of action, notifying the necessary executives of the assertion of a claim or filing of a lawsuit (including risk managers, if the subject matter is covered by "errors and omissions" insurance, and corporate communications personnel), tendering the defense of the matter and a demand for indemnification to a licensor, when appropriate, and coming up with settlement options that support their employer's business goals <u>and</u>

address both litigants' concerns. If business and IP protection goals can be achieved without "slash and burn" litigation tactics, everyone benefits.

In-house counsel should always anticipate potential media and public attention that may result from unpopular IP enforcement strategies. In this regard, the Internet has significantly increased public scrutiny and commentary about corporate and governmental IP policies. Therefore, it is important that in-house counsel work with their corporate communications officers to formulate responses to media inquiries related to the institution of litigation by or against the company and be prepared to assist management in defusing negative publicity that could affect the public's perception of the company.

On a related note, it is critical that the business executives whose areas are involved in or affected by pending litigation be kept informed. In-house counsel should alert them to developments and provide them with advance notice of upcoming hearings and an assessment of the potential for adverse rulings. Notwithstanding the fact that in-house counsel may believe that their company's legal position will ultimately be vindicated, they need to accept the fact that their business executives may sometimes prefer to negotiate a settlement, rather than risk an uncertain litigation outcome. Obviously, a settlement on terms the business executives find acceptable is always better than a bad decision for your client.

In litigation matters, once it is determined that additional assistance is needed, it is critical that in-house IP counsel not simply turn problems over to outside counsel for handling, with no further involvement therein. They can and should be working members of the litigation team, and should participate in setting litigation strategy and reviewing drafts of pleadings. To the extent feasible, it is also extremely helpful if they can also attend significant depositions and court hearings, so that they can get a sense of opposing counsel, the other parties and their counsel, not to mention the judge. In-house counsel often know more about the business issues than outside counsel, who are retained on a case-by-case basis. Together with their paralegal support staff, in-house counsel can streamline and manage document review and information-gathering more cost-effectively than outside counsel, such as in connection with tasks like interviewing employee witnesses and assembling factual information, compiling and reviewing documents responsive to discovery requests and preparing privilege logs.

In-house litigation counsel are aware of the positions the company has taken in similar cases in the past, and can ensure that no inconsistent legal and factual arguments are made in cases involving the same types of facts and circumstances. Additionally, in working with outside counsel to formulate litigation strategy, their "historical" perspective and corporate knowledge will enable them to make recommendations as to legal theories (including those successfully used in prior or similar cases), venue and jurisdictional options, as well as to provide substantive comments on the pleadings, all of which will benefit the case itself.

Of equal importance in effectively managing IP litigation, in-house counsel also really need to understand and be able to articulate the legal theories involved in IP cases. In other words, in-house counsel must really understand the law and stay abreast of current legal developments. While this may seem obvious, in a field like IP law, a true understanding of the nuances of the law, what practices are generally accepted, and how a judge may perceive them are key. To properly advise the company, in-house counsel should know, for example, how much of another party's IP rights can legally be used. They should also be able to counter the basic mistaken belief (whether expressed by their own colleagues or opposing parties) that because something is in a digital format or available on the Internet means that its owner can copy it freely.

IP rights are rarely, if ever, actually sold along with the physical object represented by the book, music CD, software, interactive game, DVD or other item of IP-laden merchandise. Nonetheless, infringing conduct is frequently defended as acceptable (if not also rationalized) under a variety of defenses, such as "fair use" under the copyright law, 1st Amendment free speech rights, as well as basic property principles. In-house IP specialists, therefore, need to be able to evaluate the strength of alleged defenses in various factual circumstances and find ways to protect, advance and enhance their company's assets, including via litigation, *if necessary*, and to defend them against spurious infringement claims by others. In-house IP counsel can and should also participate in reviewing and formulating new business strategies, corporate policies and legislative initiatives affecting their company's IP assets.

C. COPYRIGHT CLAIMS AND LITIGATION

1. General

The premise of any copyright claim or case stems from the violation of any one of several exclusive rights granted to copyright owners under Section 501 of the Copyright Act, such as the right to copy or to authorize others to copy the entire work or portions thereof, the right to create derivative works based on the copyrighted work, as well as the right to authorize public performances of the work. All too often, companies overlook the fact that copyright rights are varied and that liability can be based on infringement of just one of these exclusive rights.

Absent an admission or direct evidence of copying, to substantiate a claim of infringement, copyright owners need to prove access to the copyrighted work by the infringer and substantial similarity between the original and the copied works. In addition to being entitled to elect between statutory damages (if copyright registration of the work is made within 90 days of initial publication) and actual damages, copyright owners that can demonstrate wilful infringement can also recover increased damages and attorneys' fees. In defense to any of these claims, infringers can and do assert that their conduct is legal and permissible under the "fair use" doctrine, that the copyrighted work is not registered with the Copyright Office or in the public domain or that it does not constitute expression that is protectible under copyright. Even with a finding of infringement, if a defendant can successfully adduce evidence that it had a good faith belief in any one of these defenses, increased damages or attorneys' fees may not be awarded. Other defenses include that the claim is barred by estoppel, unclean hands, an implied license or statute of limitations. Counterclaims, such as copyright misuse or antitrust violations, are also not uncommon.

The Digital Millennium Copyright Act (DMCA) gives copyright owners additional rights and an entitlement to injunctive relief against those circumventing anti-copying technology or removing digital management information (DMI) placed on copyrighted works by their owners, as well as certain remedies against ISPs that disregard notices that websites served by them contain infringing content and/or whose conduct does not fall within specified "safe harbor" provisions.

2. Handling Infringement Issues

Where the company owns or has an exclusive interest in a registered, copyrighted work that is being infringed, and the activity is neither licensed nor legally permissible under a defense such as fair use, in-house IP counsel will need to decide whether to send a cease and desist letter to the infringer and, if so, what type of language to use in the letter to preclude the filing of a declaratory relief action, potentially in an unfriendly forum, by the infringer. If the business goal is to achieve a quick resolution of the claim and immediate cessation of the infringing conduct, damages and attorneys' fees may be less important and may warrant a more measured, settlement-inducing approach and pre-litigation letter.

On the opposite extreme, it may be critical to secure an immediate court-ordered cessation of infringement via a temporary restraining order to prevent business opportunities from being destroyed, if the impact of the infringement on such business is not capable of being quantified via a monetary damage award. In addition, it is sometimes important to set a precedent - both legal and practical - to deter infringement by third parties as well. Even in circumstances where a declaratory relief action is a possibility, demand letters are often sent, if only to bolster the possibility of establishing the infringer's wilfulness in the event infringement continues after receipt of the letter.

When a company is the recipient of a demand letter, its IP counsel will need to evaluate the merits of the claim, investigate the factual circumstances surrounding the alleged infringing exploitation of the copyrighted work, decide whether to recommend that the activity cease or that some alternate course be selected, included opting to secure a license in return for a nominal payment. On occasion, whether or not the claim is capable of being disposed of for a nominal sum, the company may have a policy of defending itself against and refusing to pay non-meritorious claims to ensure that it not be perceived as an easy target by would-be plaintiffs and claimants. If in-house IP counsel believes the conduct to be legal, a decision as to the tenor of the response letter and the desirability of filing a declaratory relief action seeking a declaration of non-infringement may also need to be evaluated, if no indemnification options are available.

Decisions on all these matters and the litigation strategy to be followed in any particular case will need to be made by in-house IP counsel based on their experience, knowledge and overall IP strategy, as well as in consultation with business executives and outside counsel, where additional expertise is required.

The 'Copyright Litigation' chapter that I co-authored in West Group's *Successful Partnering Between Inside and Outside Counsel* discusses the issues to be addressed in protecting copyright assets or in defending against infringement claims. The following '**Practice Checklist**' can be used as a reminder to ensure that key issues are considered. (For an in-depth discussion of each topic, you may want to refer to the chapter itself.)

Checklist of Typical Allegations

1. Jurisdiction.
2. Venue.
3. Description of the parties.
4. Lawsuit filed within the statute of limitations period.
5. Registration of the work with the Copyright Office.
6. Copyrightability of the work.
7. Plaintiff was the legal or beneficial owner of the copyright at the time of infringement.
8. Descriptions of licenses (if applicable).
9. Defendant was notified of claims prior to filing suite (if applicable).
10. Description of defendant's infringing acts.
11. Description of damage done to plaintiff by the infringement.

12 Request for relief.

13. Jury demand (if desired or permitted).

Checklist of Typical Defenses

1. Court Lacks Jurisdiction.
2. Plaintiff's copyright is invalid.
3. Plaintiff lacks standing.
4. Plaintiff abandoned any ownership in the copyright.
5. Plaintiff's claims are barred by laches.
6. Plaintiff's claims are barred by plaintiff's unclean hands.
7. Plaintiff's claims are barred by estoppel.
8. Plaintiff's claims are barred by implied license to use the copyrighted work.
9. Plaintiff's claims are barred by misuse of the copyrighted work.
10. Defendant independently created the work.
11. Defendant's use of the work was *de minimis*.
12. Defendant's use constitutes fair use of the copyrighted work.

13. Defendant is a licensee of or is otherwise authorized to use the copyrighted work and has not breached the terms and conditions of such license or authorization.

D. TRADEMARK CLAIMS AND LITIGATION

1. General Practice Issues

In the U.S., trademark claims are grounded in federal and state laws, as well as related common law and statutory unfair competition, dilution and related business tort causes of action, such as misappropriation. Given that principles of protection can be regional, state-wide or national, an in-house IP counsel needs to be cognizant of the existence of any preexisting third party rights by doing clearance searches before the adoption and use of a trademark by the company, to preclude avoidable litigation Once a new trademark is selected, it is increasingly important to also try to clear related domain names for use in connection with the marketing of the branded goods and services and to register said domain names before the new trademark brand is announced or launched, to preclude cybersquatters from doing so.

Once adopted, it is critical that third parties be placed on notice of the company's claimed rights via trademark notices, as well as the filing of applications for federal (or sometimes state) or international trademark registration. Obviously, maintenance of such registered trademarks and domain names via timely renewals is also important for preserving the company's IP position and maximizing the likelihood of success of its trademark enforcement strategy. The development of proper and consistent usage of trademarks in marketing materials for branded and related products and services, on websites, on packaging and hang tags associated with the goods, as well as quality control standards and approval processes for licensed marks (and the modification of existing logos and trademarks via uniform guidelines, to the extent feasible) are also critical for the establishment and maintenance of the company's rights.

To ensure protection of company trademarks, IP counsel often place their important marks "on watch" via third party monitoring services, which make them aware of newly-published conflicting marks, as well as alert them to the activities of trademark pirates in foreign jurisdictions who may seek to secure registrations before the company has expanded broadly outside the U.S.

The nature of trademark work, which may involve thousands of registrations in 200 different countries - all of which may have different dates for renewal or other key activity dates - underscores the need for a good record-keeping and calendaring system, as well as more informal mechanisms to track general information and data about usage of a particular mark.

2. Trademark Protection Theories

The most protectible marks are those known as arbitrary marks followed, in descending order of protectibility, by suggestive marks, descriptive marks (unless they have achieved a level of notoriety by way of secondary meaning which will make them more protectible) and generic marks. The easiest case of infringement is one where there is outright copying or even counterfeiting. This is covered by federal and state law.

Other types of conduct, such as an infringer's misrepresenting the source of origin of their goods are also prohibited under federal law (Section 43(a) of the Lanham Act) and state unfair competition statutes and common law. With the advent of the Federal (Anti-) Dilution Act (codified as Section 43(c) of the Lanham Act), no likelihood of confusion need be proven if the plaintiff owns a famous mark that would be diluted by the infringing mark. The Anti-Cybersquatting Protection Act (codified as Section 43(d) of the Lanham Act) also added provisions to assist trademark owners in protecting their rights against those who register domain names in bad faith, which is measured by a number of different factors set forth in the Act.

As with copyright, wilfulness in the adoption and use of an infringing mark (or registration by a defendant of a trademark owner's domain name with no legal basis to claim ownership therein) will play a large part in the remedies achievable by a plaintiff, including punitive damagaes and attorneys' fees. Again, there are various defenses that could be asserted, including that there is no likelihood of confusion between the 2 marks, that the plaintiff's mark is descriptive, that the alleged infringer has prior rights in a particular geographic area or that its rights are superior to the plaintiff's (who may be accused of reverse confusion or reverse passing off) or even that the alleged infringer has engaged in non-infringing, nominative (fair) use of the mark.

3. Handling Infringements

In the IP area, the Internet has made it necessary for in-house counsel to actively police the web and take steps to ensure the on-going protection of the company brands. As noted above, the in-house IP counsel's familiarity with the company's portfolio of rights will inevitably enhance the company's likelihood of success on the merits of its claims. Many activities that may previously have been overlooked before the advent of the Internet have allowed for newer types of infringements to be carried out on a far larger scale, requiring an in-house IP counsel to be far more aware of its company's websites, as well as with the company's customers activities on the web, such as on the now well-known <companyname>sucks.com sites, used to slam the company, its products, employees or sales policies.

How in-house IP counsel takes action against infringers, the types of letters that are written to cybersquatters, as well as the nature of a particular company's trademark enforcement strategy all become fair game and topics for discussion on the Internet. This can have unfortunate results for those who do not couch their demand letters with the expectation that correspondence relating to infringing activity on the Internet will likely be posted by recipients and could result in negative PR and the "spamming" of the company's e-mail system. At the same time, given the importance of the company's IP assets, it is important to ensure that trademarks are not misused and that steps are taken to get infringers to remove logos and company indicia from inappropriate sites, such as those fostering hate or promoting gambling and those selling or providing "adult only" material to minors. This will assist the company in preventing consumers from being misled into believing that the offensive content actually originates with the trademark owner, rather than the infringer.

CONCLUSION

In-house IP counsel need to set up effective systems to centralize, register and manage their company's IP assets, in addition to providing general counseling on IP issues, such as with regard to agreements covering the acquisition of rights or licensing of technology, or the drafting of services, work-for hire and other agreements. Just as importantly, they must try to learn about and understand all aspects of the company's business, interface with personnel in all areas, and be prepared to simultaneously handle various claims or pieces of litigation brought by or against the company. They also need to be ready to take action to address, if not deflect, possible public repercussions caused by a protective IP strategy.

Those who have broader business and legal perspectives to share with their non-legal colleagues (and non-IP legal co-workers), who work well under pressure and can work on multiple matters and different types of issues at the same time, who handle things as they come in and are able to re-prioritize their focus and efforts (and pitch in to help their colleagues) on short notice, will be perceived to be valued members of the management team.

Since IP assets are at the very core of many businesses, an in-house IP counsel's opinions will often be solicited on a broad range of issues. As a result, an involved and effective IP litigation counsel will permit the company to *maximize* (i) its potential for recoveries in any litigation filed by the company to protect its rights; (ii) its ability to defend itself successfully against infringement claims; (iii) its revenues from the exploitation of assets via new media and new business methods; (iv) its IP enforcement strategy's effectiveness.

CHAPTER 70
COPYRIGHT LITIGATION

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The following material is excerpted with permission from Chapter 70, "Copyright Litigation," in ***Successful Partnering Between Inside And Outside Counsel*** (Robert L. Haig ed.) (West Group & ACCA 2000) To order call West Group at 800 344-5009. There is a 30% discount to ACCA members.

Practice checklist

A. Checklist of Typical Allegations

1. *Jurisdiction*. Federal courts have exclusive jurisdiction over copyright claims. Thus, the plaintiff's claim must arise under the Copyright Act. 17 U.S.C.A. §§101, et seq., for jurisdiction to exist. (*See* § 70:54)

2. *Venue*. Venue for copyright infringement is governed by the special venue statute, 28 U.S.C.A. § 1400. Pursuant to the terms of that statute, there may be a number of possible venues, *i.e.*, venues in which personal jurisdiction over the defendant exists. Choosing among the possible venues should depend on a fine-tuned analysis of the law in the competing venues. (*See* § 70:8)

3. *Description of the parties*. This is a typical allegation in any federal complaint that, in the copyright infringement context, can serve to establish that venue is appropriate pursuant to 28 U.S.C.A. § 1400.

4. *Lawsuit filed within the statute of limitations period*. Claims for copyright infringement must be brought within three years from the date of the infringement. For continuing infringement, however, the statute begins to run from the date of the last act of infringement. (*See* § 70:56)

5. *Registration of the work with the Copyright Office*. Registration of a copyrighted work is a jurisdictional requirement. If registration has not occurred, an expedited application for registration should be made. (*See* §§ 70:9 and 70:52)

6. *Copyrightability of the work*. To prevail on a claim of infringement, the work at issue must be copyrightable, *i.e.*, original authorship, and fixation in a tangible medium of expression. (*See* §§ 70:33-70:34) A certificate of registration constitutes prima facie evidence that the work is copyrighted. (*See* § 70:52)

7. *Plaintiff was the legal or beneficial owner of the copyright at the time of infringement*. To have standing to bring a claim for copyright infringement, the plaintiff must be the legal copyright owner or the beneficial owner, *i.e.*, an assignee or exclusive licensee. (*See* §§ 70:48, 70:55)

8. *Description of licenses (if applicable)*. Where a licensee has gone beyond the scope of the uses permitted by the license, the licensee is in the same position as an infringer and thus can be sued for copyright infringement. (*See* § 70:48) Where the licensee's action, however, is merely a breach of covenant of a license agreement, a claim for copyright infringement will not lie. (*See* § 70:35)

9. *Defendant was notified of claims prior to filing suit (if applicable).* Notifying defendant of the infringement serves to establish willfulness of the infringement where the defendant continues to commit the infringing acts. (*See* § 70:13)

10. *Description of defendant's infringing acts.* "Infringement" can be a violation of any of the copyright owner's exclusive rights, though most frequently consists of reproduction of plaintiff's copyrighted work without authorization. (*See* §§ 70:39, 70:54)

11. *Description of damage done to plaintiff by the infringement.* Actual damage to the plaintiff may include diminution in the market value of the work, such as loss of licensing fees or sales or harm to licensing relationships. (*See* § 70:58)

12. *Request for Relief.* Relief for copyright infringement can include temporary restraints and/or preliminary and permanent injunctions, prohibiting further infringements and (if applicable) mandating recalls or destruction of infringing articles. Relief should also include actual and statutory damages and attorneys' fees. (*See* §§ 70:58, 70:61)

13. *Jury demand (if desired or permitted).* The right of a trial by jury is available for claims for copyright infringement where plaintiff seeks statutory or actual damages. There is no right to a trial by jury where only equitable relief is sought. (*See* § 70:58, note 7)

B. Checklist of Typical Defenses

1. *Court lacks jurisdiction.* Court can lack jurisdiction over a copyright infringement claim where the copyright is not registered or where the infringement action is merely a disguised action for breach of contract. (*See* §§ 70:9, 70:35)

2. *Plaintiff's copyright is invalid.* Plaintiff's work is not copyrightable subject matter, for instance, not an original work, not fixed in a tangible form of expression, is unprotectable subject matter such as *scenes á faire* or factual information, etc. (*See* § 70:34)

3. *Plaintiff lacks standing.* The plaintiff has no standing to bring on an infringement action if it is neither the legal owner nor beneficial owner and has failed to join either the legal or beneficial owner as an indispensable party. (*See* § 70:48)

4. *Plaintiff abandoned any ownership in the copyright.* A defendant may assert the defense of abandonment where the plaintiff intended to allow the copyrighted work to be freely copied by the public. (*See* § 70:56)

5. *Plaintiff's claims are barred by laches*. A defendant may raise the defense of laches where the plaintiff unreasonably delayed in asserting its rights and that such delay caused injury to the defendant. (*See* § 70:56)

6. *Plaintiff's claims are barred by plaintiff's unclean hands.* Defendant may raise the defense of "unclean hands" where a plaintiff's wrong-doing is substantial and is related to the subject matter of the infringement. (*See* § 70:56)

7. *Plaintiff's claims are barred by estoppel*. A defendant may raise the defense of estoppel where the plaintiff knew of defendant's allegedly infringing activities, that the plaintiff did not take any action that would lead defendant to believe that its conduct was infringing, and that defendant relied on plaintiff's conduct to its detriment. (*See* § 70:56)

8. *Plaintiff's claims are barred by implied license to use the copyrighted material.* Defendant may assert the defense of implied license where plaintiff has full knowledge of defendant's use and fails to object or otherwise, through conduct, implies that such use is permissible. (*See* § 70:56)

9. *Plaintiff claims are barred by misuse of the copyrighted work.* A defendant may raise the defense of misuse of copyright where the plaintiff has sought to use its copyright to extend its monopoly beyond protected expression to unprotected ideas, or to otherwise use it in an anti-competitive manner, such as a number of copyright owners acting in combination to obtain greater licensing fees or by an owner refusing to license one work unless it was tied in with licenses of less desirable works. (*See* § 70:56)

10. *Defendant independently created the work.* A defendant may rebut a prima facie case of access and substantial similarity where the defendant independently created the work. (*See* § 70:56)

11. *Defendant's use of the* copyrighted *work was de minimis.* Where the amount of the plaintiff's work that was copied by the defendant is minute in relation to the entirety of the plaintiff's work, the defendant may raise the defense of "de minimis" use. (*See* § 70:56)

12. *Defendant's use constitutes fair use of the copyrighted work.* Defendant may assert the defense of fair use where defendant's use constitutes criticism, comment, news reporting, teaching, scholarship or otherwise qualifies under four factors set out in 17 U.S.C.A. § 107. (*See* § 70:57)

13. Defendant is a licensee of or is otherwise authorized to use the copyrighted work and has not breached the terms and conditions of such license or authorization. Where a defendant is a licensee and the allegedly infringing action is permitted by a copyright license, i.e., is within the scope of the license, defendant can assert that its use is not infringement. (See § 70:1)

Increasing ShareholderValue in the New Economy:
How to Launch a Successful IP Management Strategy

By Ellen Rodgers and Alan Ratliff
November/December 2000 ACCA Docket

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When the Federal Circuit confirmed in State Street Bank & Trust Co. v. Signature Financial Group1 that business methods can be patented, shock waves went through corporate America. Although clients and counsel knew a seismic shift in the way markets valued corporations was under way, State Street formally signaled the arrival of a new era. In today's New Economy, intangible property has become the primary driver of stock values.

The fallout to the 1998 decision came quickly. Stories circulated about attorneys roaming the halls at major investment banks, asking employees what they had "created" that day and whether they had recorded extensive notes of their latest innovations. Corporate leadership expressed much concern over the possibility of competitors strategically filing business-method patent applications on methods or systems that were informally considered to be in the public domain. Indeed, filings of software, system, and business-method patent applications dramatically increased.2

The dispute in State Street centered on financial software developed by Signature Financial Group (Signature) that allowed it to compile data from its mutual funds into a central portfolio. State Street Bank & Trust Co. (State Street) negotiated with Signature to license this financial data system, but filed a declaratory judgment action when the companies' discussions stalled. Although the district court granted summary judgment for State Street on the theory that the system was a mathematical algorithm, and, therefore, not eligible for patent protection, the Federal Circuit reversed, concluding that the system generated a "useful, concrete, and tangible result."3

Case rulings like State Street have combined with the fast-changing reality of the World Wide Web to redefine the priorities of today's general counsel. Where once counsel focused on statutory intellectual property such as patents, trademarks, and copyrights, today they must turn their sights to broader "intangible property" initiatives. Successful companies will be those with comprehensive, integrated intangible property initiatives. While primary responsibility for many of these areas has traditionally been vested in the offices of the CXX (CEO, CFO, COO, and CIO) and with business development executives, today's successful companies will actively involve general counsel and will assemble multidisciplinary teams of professionals to lead and manage their initiatives.

Make no mistake: The "IP" of the New Economy is intangible, not just intellectual. The old IP has become a subset of the broader category of strategic intangible property, which encompasses assets such as people, processes, systems, goodwill, and know-how. Counsel will have to expand their thinking to embrace this major change.

This article begins with an overview of the justification, objectives, and organization of a comprehensive IP initiative. It then examines the two substantive phases of the initiative that management typically prioritizes: commercialization and protection, and concludes with a brief view toward the future. Throughout this article, references to IP are to the broader category of intangible property.

IP Is Key to Shareholder Value

During the past decade, traditional notions of shareholder value have changed radically. After World War II, the U.S. economy changed from being manufacturing centered to largely based on services. In the 1990s, the nation's economic focus shifted from the making physical assets to the meeting of needs through customization, speed, and flexibility. This change, however, was just the tip of an even bigger iceberg: in the vast New Economy, ideas, innovation, and other intangible assets have become the burning platforms.

Some telling statistics illustrate this trend and the broader economic transformation:

- Based on market studies and our own observations, approximately 75 percent of the current market capitalization of Standard & Poor's 500 companies consists of intangible asset value;4
- A number of companies, including IBM, Texas Instruments, and Proctor & Gamble, increased total licensing revenue from $3 billion in 1980 to more than $100 billion in 1997, after revamping R&D departments and creating IP holding companies to manage multimillion-, even billion-, dollar revenue generating IP businesses;5
- A resurgence in joint corporate/university research ventures and donation activities was reported in the financial press during 1999 involving for example, DuPont ($654 million), Eaton ($17 million), and P&G (40 patents), among others, resulting in millions of dollars in tax deductions;6
- U.S. patent, trademark, and copyright applications and registrations totaled about one million in 1999, continuing their 10-15 percent annual growth rate;7

- Intellectual property litigation climbed to 7700 new filings in 1999, a tripling of the cases filed in 1996;8 and
- IP-intensive IPO offerings grew to $40 billion in 1999, more than in the previous three years combined.9

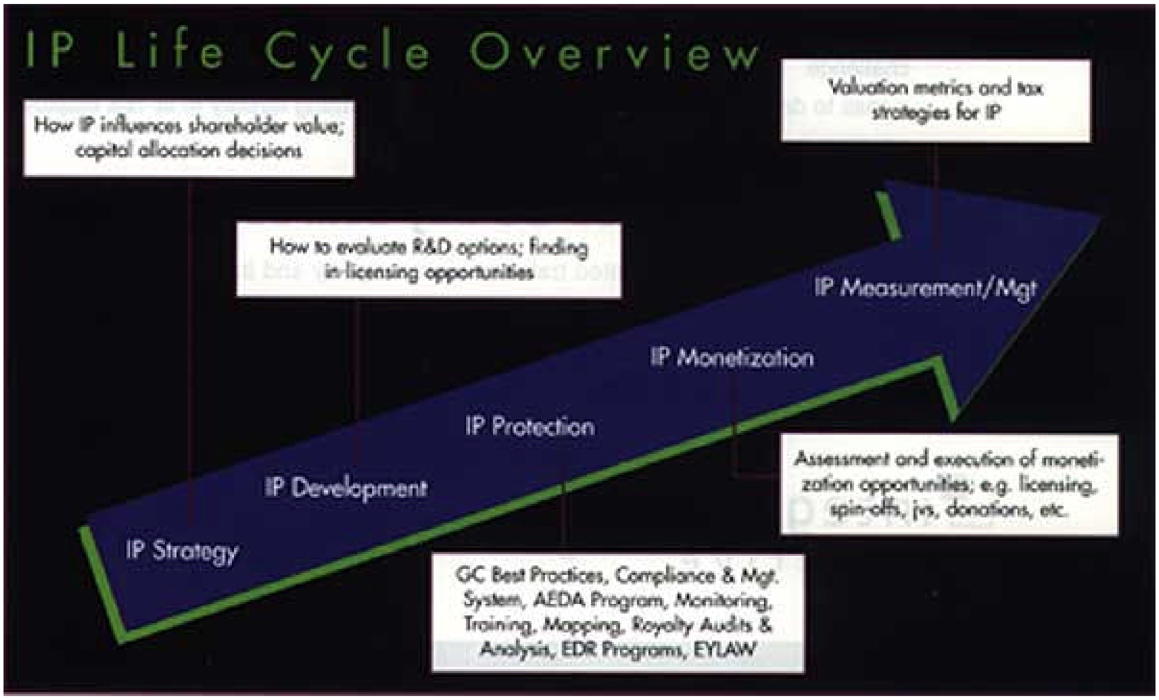
Furthermore, the British Technology Group estimates that less than four percent of the $3 trillion in worldwide intellectual property in 1998 was licensed.10

The increase in the number of U.S. patent, trademark, and copyright registrations, coupled with the expansion of business method and process patentability, has made it increasingly necessary for companies to protect their IP portfolios. Online Monitoring Services of Arlington, Virginia, estimates that more than 80 percent of Fortune 1000 companies lose money as a result of online intellectual property infringement.11 This problem is likely to get worse: by 2002, digital content may well account for 20 percent of the value of all goods and services offered over the internet, a market that Forrester Research expects to be worth $327 billion.12 Moreover, we need only look as far as the financial newspapers for word about litigation between companies related to job moves by valued employees with noncompete agreements, or strategic uses of patents to block competitors.

Every public company faces the significant risk of being sued in a securities class action lawsuit. The intellectual property case filings in 1999 set a record, and there is no end in sight. Given the large—even infinite—earnings multiples reflected by current market valuations of leading companies, it may not be long before underperforming and declining-price companies contend with class action litigation.

Any number of reasons can explain why stock prices underperform or drop. Class action lawsuits, however, often relate the decline to a company's mismanagement and its failure to disclose material facts, and could extend to a failure to exploit or preserve IP. The authors have even seen cases based on a company's alleged failure to effectively integrate another company acquired through a merger and to execute transactions in the way they were contemplated. Such seemingly marginal breach-of-fiduciary-duty lawsuits have survived.

The call to action is clear. Corporate managers who ignore the benefits of measuring and managing nonfinancial data may unwittingly be contributing to the under-valuation of their companies and courting a shareholder lawsuit. Moreover, they may be handicapping their company's ability to attract new investment capital, particularly if their competitors do measure and provide such data. Companies must be thinking about creating IP management strategies.



LAUNCHING AN IP MANAGEMENT STRATEGY

In light of the trends and factors just discussed, the case for implementation of a comprehensive IP management strategy has never been stronger. The launch of an IP strategy should start with appointing a management team that includes executives who represent a broad range of functions. Such diversity will help the team formulate a comprehensive view of the assets—how the company developed them and why, how the market views them, and what legal and economic risks exist—from which an effective strategy can be derived. Representatives from the general counsel's office, as well as from the R&D, business development, tax, marketing, finance, and operations departments, should be considered.

In devising a comprehensive IP strategy, team members will have to address the five stages of the IP Life Cycle.13 They are: initial strategy, development, protection, commercialization, and measurement. A brief summary of each stage follows.

Initial Strategy

A comprehensive IP strategy forces senior management to consider initially why IP is important to the business. There are many compelling cases for developing an IP strategy, but no one size fits all. Some companies prefer to protect their ideas as secrets as opposed to patenting them (for example, Coca-Cola), other companies may have more potential in branding strategies than out-licensing programs, and so forth. The initial strategy should be well thought out to ensure that the ultimate plan dovetails with the company's overall business goals.

Development

The IP development stage focuses on the build-or-buy decision, and on whether R&D investments are on target, given emerging trends. Often companies develop assets without giving due consideration to how they fit into the changing marketplace and then the assets sit on the shelf collecting dust. While companies certainly do not want to quash innovative ideas, they also need to ensure that R&D activities are on track and that financial resources are allocated and spent in a cost-effective manner. Given the rapid pace of advances in technology, it may make more economic sense for some companies to purchase IP rather than to build it internally, or, when justified by market changes, to terminate a project mid-stream and divert resources elsewhere.

Protection

IP protection is the function that has historically involved general counsel. But the game has changed in the New Economy. Among other things, protection now involves the identification of statutory and nonstatutory IP, evaluation of the protection to be sought, and development of uniform documentation. In addition, there are compliance, registration, and organization protocols and systems; prosecution and litigation activities; and assessment of the protection level of one's own IP, as well as the IP of others.

Commercialization

Developing an IP portfolio is an expensive process when costs of asset development, protection, maintenance, and marketing are factored in. To ensure a return on this substantial investment, companies should evaluate their commercial options, such as out-licensing, sale, or donation, to name a few, and many new resources and tools are available to assist in this process.

Measurement

The overall costs and benefits of the strategy must be quantified to gain a better understanding of success. An IP information system that uses appropriate metrics will provide data that can be fed back into the ongoing strategic management process, forming a continuous cycle and the basis for communicating value to the financial markets.

MONETIZATION OF THE IP PORTFOLIO

Although the IP strategy should address all five stages of the IP Life Cycle, the company's multidisciplinary IP team will undoubtedly be tasked to show results quickly. As long as the team keeps the overall objective in mind, there is no reason a company should not pursue low-hanging fruit to accumulate revenue as quickly as possible. Such an approach often convinces senior management to adopt and fund a comprehensive IP strategic plan. It also produces an initial source of funds for the broader, more comprehensive IP strategy that will generate revenue over a longer time horizon.

To facilitate the harvest of this low hanging fruit, the first step is to perform an IP portfolio review. In so doing, it will achieve the following benefits, among others:

- the categorization of IP into assets that are core and noncore to the business;
- the discovery of new and rediscovery of forgotten or overlooked IP;
- the development of a broad perspective of the trends affecting the IP portfolio;
- the reduction of costs through tax strategies or trimming deadwood patents; and
- revenue generation and maximization through more aggressive out-licensing or discovering alternative commercial uses.

We now summarize the steps in the review, which include IP identification, categorization, prioritization, and assessment.

Identification of IP

A thorough review of the portfolio is an integral part of leveraging its latent value. Corporate organization structures are often complex, so it is not surprising that many companies do not fully understand what assets they actually have. In the IP identification phase, the team compiles company-wide information on patents, trademarks, copyrights, and trade secrets, as well as other intangibles, such as systems or business processes, that may not be supported by legal document, but contribute toward shareholder value nonetheless. The team should identify and document business methods that are important to how the company runs its business internally, as well as to how it serves its customers.

During this process, the team should keep in mind wide-ranging considerations, for example: it should consider basic physical data about an asset—age, life, and location—but also factor in technical data about the patent and its role in products. The information compiled by the team can be recorded on something as simple as a spreadsheet. This may not be the best option, however, for large companies, especially multinational companies, because of problems of centralized control and access. There are commercial software systems that can handle this data collection, but each has its limitations. Many companies develop their own systems or combine commercial and proprietary systems. In any event, the system that the team chooses should be flexible enough to address the company's current and future needs.

Categorization of IP

Once the strategy team has a better understanding of the assets that are in the company's IP portfolio, it should categorize them. The team may consider classifying assets by:

Responsible Business Groups
This categorization assigns responsibility to a business group for both the maintenance costs of, and any incremental value generated from, the asset, and thus encourages accountability, competition, and a focus on profit.

Core vs. Noncore Status
This categorization assesses whether the asset is an integral part of the company's strategic business goals. Core assets are often too valuable from a competitive viewpoint to out-license, and noncore assets may be square pegs that don't fit into the business strategy, but have valuable applications elsewhere. A broader range of commercialization options can be applied to noncore assets than to core assets.

Technical Groups
This categorization facilitates groupings of assets into clusters that may generate more value than if the assets were commercialized separately.

Offensive vs. Defensive Strategy
This categorization takes into account the differences between companies that may have no intention of releasing information on their assets to potential competitors and those that may wish to license their products as a way to build market share and create a product standard. Many companies are motivated by the need to build an arsenal of assets to strengthen their position in cross-licensing negotiations.

These categories apply to the team's first round of organization, and may be adjusted as a result of further analysis of the portfolio.

Prioritization of IP
Prioritization enables the team to develop a better understanding of the inherent value of the IP. A cursory ranking that emerges from general discussions among IP team members can be useful, but a more comprehensive prioritization, made possible through the use of methodologies and tools, can speed up the process and reflect broader influences. Some of these analytical tools include the following.

Innovation Pipeline
The innovation pipeline approach is an analytical process that allows one to track an idea from its generation (the "Eureka" phase) to its legal documentation (for example, obtaining a patent) to its commercialization (for example, entering a licensing arrangement). This analysis helps put each asset into a context that reflects both current and future market trends.

Mapping

Three mapping processes aid in the evaluation of concepts as they move through the innovation pipeline. They are:

Science Mapping: One "maps" science by evaluating science journals for upcoming trends or scientific breakthroughs in a particular area of technology. This process is useful in identifying who is researching what, and how far the research has progressed. Knowing what is being developed before ideas are actually patented, and determining which competitors are funding the research, can help companies become better prepared for potential competing patents, for example. They may decide to scale down an existing R&D effort or to accelerate the out-licensing process to take advantage while it still exists.

Patent Mapping: One maps patents reviewing forward and backward citations in patent databases to assess the position of a company's patents relative to competing patents. The results of such a database search form a "landscape" of the patents in a specific area of technology. One can also create a geographical landscape to assess the breadth of coverage of competing patents or related patents around the world. Patent mapping can be used to evaluate potential licensing opportunities by focusing on the companies that have cited one's patents or have patents in the same space.

License Mapping: One maps public and proprietary license databases to evaluate the nature and extent of licensing of particular technologies, both within and across industries. Such databases may also be used to identify industry norms for royalty rates and standard terms and conditions. The data obtained can be analyzed using multivariate regression techniques to determine, among other things, the premium warranted from granting exclusivity rights.

IP mapping may be enhanced by in-depth discussions among various functional groups within the company. Discussions should involve those representing the core IP team, the general counsel, and others in strategy, business development, and R&D.

Assessment of IP

Once the IP team maps the assets and combines these results with knowledge gleaned from business discussions, it moves on to assessing potential commercial opportunities. At this juncture, the team should determine the monetization option that is most suitable for each company asset and the appropriate valuation of the asset for that purpose, given the results of the mapping process.

Monetization Options

Monetization options include out-licensing, sale or spin-off, joint ventures and alliances, charitable donation, and abandonment. A brief discussion of each of these options follows.

Out-licensing: Licensing the technology may be desirable when the asset is in demand by companies that do not wish or are not able to develop similar technology themselves. This occurs when the company lacks the economic means or runs into patent protection that prevents it from using the technology. Licensing arrangements can be mutually beneficial exchanges—revenue in return for access to the technology, for example. Or they can be the only option for users to ward off infringement litigation—users pay for legal access to the technology to avoid a lawsuit. Companies can also engage in cross-licensing by exchanging access to specified technologies within their respective portfolios. Cross-licensing often results when companies are trying to fend off infringement suits.

Sale or Spin-off: For those technologies that are not an integral part of the business, a company may wish to consider a sale or spin-off. Rather than licensing the IP to another company, the company could sell it or spin off the technology to generate a separate business entity.
Joint Venture or Alliance: If a company wishes to expand into a new market without facing the significant investment and/or risk of developing new operations from ground zero or losing control of the technology, it might consider a joint venture or alliance. In such a situation, two companies enter into an agreement involving the transfer of technology and/or technology licensing, and together, enlarge their current scope of business.

Charitable Donation: Donating patents or other forms of IP to a qualified charitable organization can yield a charitable contribution deduction equal to the fair market value of the donated IP. Often, the IP is worth more to the donee than to the donor because the donor may not be able to exploit the IP to its highest and best use. Thus, a key factor involved in evaluating the benefit of the deduction is the valuation of the IP for tax purposes.

Abandonment: Companies may consider abandoning assets that have become obsolete or were never commercially viable, to prevent additional expenses, for example, from maintenance (which can be significant), and obtain the tax benefit through deducting any remaining tax basis in the asset.

The Valuation Process

Once the IP team determines how it will commercialize the IP, it can value the asset according to traditional income, market, and cost approaches or use an emerging method of financial asset valuation called Real Options®, which works well with partially developed IP. Ideally, all of these approaches should be weighed in a comprehensive valuation analysis. But the nature of the IP and the availability of data may restrict the method that is ultimately used. Most standard valuation texts discuss the income, market, and cost methods in detail, so only brief definitions have been provided here.

The income method considers value based on the discounted cash flow stream expected from licensing. Under the market method, a company considers market license and sales data for comparable assets—much like a real estate appraisal of a house that factors in sales of other houses in the neighborhood. And, the cost method considers the investment—both cash and opportunity costs, and a reasonable rate of return—that would be necessary for the company to make the asset or a noninfringing alternative asset.

In contrast, the Real Options method values a business asset by analyzing the underlying drivers of value such as price, market size, or R&D success, together with their potential impact on the business plan and value proposition. By more fully accounting for these factors, a Real Options analysis may provide a dramatically different valuation from the traditional, and may drive important strategic insights. If the R&D team and the business development group know how certain external factors may influence investment in the development of a particular product, they can clarify the various options available and identify risks in the investment process.14

PROTECTING THE IP PORTFOLIO

Despite the natural tendency of management to focus on the opportunity for new revenues and tax benefits offered by monetization, failing to also implement an aggressive protection strategy could result in reduced and even short-lived benefits. For example, most licensees perceive the level of IP protection as the most significant factor in making the decision on how large of a royalty licensing rate they are willing to pay.15 So, to the extent that increased licensing revenues are a significant component of the overall IP management strategy, protection is key. It is also the stage of the IP life cycle with which counsel is most familiar and should be fundamentally involved.

Traditionally, protection has included registration, compliance, litigation, and licensing. These functions remain important, but, in the New Economy, new twists, new priorities, and new subfunctions have taken on a life of their own. The following discussion addresses counsel's most important strategic considerations in protection today.

Best Practices in Law Department Management

A discussion of strategic legal management necessarily begins with best practices. Best practices have developed within law department management in alternative dispute resolution, early case assessment, case management, document management, vendor and outside counsel management, billing and payment, planning, training, and knowledge management, among other areas.

Best practices may also encompass uniform systems or processes for transactions, including due diligence and corporate compliance. Moreover, in the electronic age, many best practices involve increased leveraging of technology where manual efforts and paperwork were the standards in the past. Given the many unique characteristics of legal practice and law office management, specialists in legal technology have emerged to serve the particular needs of this industry.

In the IP context, implementation of uniform, best practices programs in the areas of early case assessment, document management, training, and knowledge management, will be especially significant. For example, uniform licensing forms practices (document management) coupled with the use of historical licensing rate data and current licensing rate research (knowledge management) will ensure the most optimal revenue stream and effectively manage the risk.

Compliance Systems

With the dramatic increase in IP development and registration activity (some would say anticompetitive activity), as well as litigation, many of today's compliance processes are too outdated or inadequate to deal with the demand. The general counsel's office can significantly affect the value of the company's IP by working with the R&D and business development groups to create systems that enhance and preserve the value of IP sold or purchased. Many tools exist that are not only better than the methods used in the past but that improve compliance at the same time.

For example, numerous companies now use IP management technology systems that offer docket (prosecution and litigation), document, and knowledge management capabilities. These can be adapted, or custom modules can be added, to permit increased documentation and compliance in advance of (or in lieu of) formal registration activity.

Technological advancements have created capabilities that did not previously exist. Web-based document certification (for example, FirstUse™) creates an electronic "fingerprint" for date and time verification that can be used for any number of purposes in the documentation and compliance process. A growing number of web-based or web-accessible document repositories (for example, IntraLinks®) permit secure storage of all documentation relevant to the IP so that inside and outside counsel can access the needed information around the world and around the clock.

Further, many companies have interfaces from their IP management technology systems to mapping tools such as Aurigin™ and Map-It™, research tools such as Dow Jones Interactive, and licensing databases developed from the company's historical licensing experience, or from their proprietary equivalents.

Detailed documentation, comprehensive due diligence, and technology leveraging all help to enhance the compliance process through improved decision-making, greater uniformity, reduced risk, and increased value. For the compliance system to be effective, general counsel must lead these efforts.

Monitoring and Training

Through monitoring, companies can work proactively to detect third-party infringement of their IP. Through training, companies can work preventively to avoid third-party IP infringement by their own employees. The infringement equation works both ways, and counsel is integrally involved on each side.

So-called "cybersquatting" and internet/digital/electronic IP infringement have become hot legal topics. To preserve the value of their patents and trademarks, companies must actively police misuse and infringement by third parties. Among other options, they may increase website security, limit downloads through online watermarking, prevent direct "deep link" access, and send complaint notices to domain name registrars. Third-party services exist that will monitor misuses and infringements for the company.

While protecting their own IP, companies must be careful not to violate third-party IP rights. Monitoring can be employed to evaluate the company's risk of committing such an infringement. Tools such as patent and science mapping, as well as web-based clearinghouses, have proved useful in this regard. But the main emphasis in prevention is on training. Company personnel should receive training that explains the legal rules of the electronic road, thereby reducing the potential for IP infringement.

Licensing Practices

Best practices suggest that companies should have standard licensing form files and should accumulate knowledge on industries, markets, and historical company licensing activities to serve as a guideline for the future. Depending on the potential value of the licensing transaction, it may be appropriate for a company to perform public database research, to purchase third-party licensing data, or to commission a valuation study for use in negotiating the license.

Also, with the advent of online IP auctions such as the Patent & License Exchange (pl-x.com), Yet2.com, and others, additional tools and data to support the licensing process are becoming increasingly available. For example, as part of its goal to create an IP marketplace, the pl-x model offers third-party closing and escrow services, a market valuation tool, standardized agreements, and patent validity insurance.

One of the most important provisions of any licensing agreement is the licensor's right to audit the licensee to confirm compliance with the use and payment terms of the license. Issues concerning the royalty base, the timing of payment, minimum guaranteed payments, and the like often arise and are perceived differently by the licensor and licensee. Based on our experience, it is rare that a royalty audit does not pay for itself by yielding at least some adjustment.

Trade Secrets, Rights to Inventions, and Business Methods

The global accessibility of the internet, the mobility of the labor force, the .com start-up explosion, and recent caselaw have increased the importance of trade secrets, business-method patents, and IP rights. Much has been written about best practices concerning trade secrets. Among other things, their best practices should include noncompete and IP ownership provisions in key employee agreements, as well as active and strict enforcement of their policies and agreements.

The daily business journals are replete with news of lawsuits filed by one high tech company against another for "stealing" key employees who purportedly possess strategic knowledge that could benefit competitors. One recent example involved ReTrac, which successfully litigated an employment-related trade secret dispute in which an employee left to join a competitor, taking and sharing with the competitor ReTrac's trade secrets, resulting in a $15 million judgment.16 This is an area of increasing risk to IP value in which general counsel can play an important role.

The company's personnel and business policies should clearly define and protect corporate trade secrets, confidential information, and know-how. Education and training should be provided to employees. Key employees should have contracts that contain specific provisions addressing these matters.

In terms of business methods, after the detailed level IP inventory and assessment process is complete, the company will have a better handle on its strategic processes and know-how. At that, a framework can be developed to determine when such methods should be patented and when they will remain trade secrets. Counsel can positively effect this process through periodic reviews to determine whether the distinctions are being made and the appropriate actions are taken.

Litigation Trends, ADR, and Insurance

IP litigation has changed significantly in the past 20 years. Since the creation of the federal circuit in 1982, the trend in patent rulings has been exactly the opposite of what it was before. Previously, about 75 percent of patent claims were denied; now, about 72 percent of patent claims are upheld, and with substantially larger damage awards. Patent damage awards in the 1980s totaled $600 million, whereas awards in the 1990s exceeded $2.5 billion, with the average award nearly doubling.17 While reasonable royalty rates in litigation have historically hovered around 5 percent, since 1982 the median rate is closer to 10 percent, with two thirds of all U.S. reasonable royalty awards ranging from 5 to 20 percent.18 Similar trends have been observed in trademark litigation. In 1999, a jury awarded more than $100 million to Trovan Ltd. and its U.S. licensee, Electronic Identification Devices Ltd., for trademark infringement.19 Although a court subsequently reversed the verdict, the message is clear: It's not just about injunctions any more.20

The best way for general counsel to protect against IP litigation is to create an early dispute resolution (EDR) program that includes an early abbreviated damages assessment. A comprehensive assessment may incorporate mapping tools, preliminary valuations, alternative damage models (royalty, lost profits, and so on), and a critical self-assessment. The EDR program should also make active use of alternative dispute resolution techniques, such as multilevel mediation and arbitration.

Recently enacted federal statutes, including the Federal Trademark Dilution Act, the Digital Millennium Copyright Act, and the Anti-Cybersquatting Consumer Protection Act, as well as treaties with the Accredited Domain Name Registrars and World Intellectual Property Organization, mandate ADR in and should result in its widespread use. Effective ADR strategies frequently result in win-win situations for the parties involved. For example, rather than litigate, IBM and 3Com entered into cross-licensing agreements to resolve millions of dollars in potential patent disputes. Similarly, Hyundai and Texas Instruments settled their disputes with a long-term license worth more than $1 billion to TI. These were just the headline grabbers. There are many other such cases.

While standard advertising policies have long provided at least some coverage for trademark infringement damages, many national insurers are now offering specific IP coverages. Whether such policies make sense will vary depending on the scope of coverage, the company's level of R&D, patenting, and licensing activity, and the litigiousness of the relevant industry and competitors.

To address these trends and maximize the benefit of ADR and insurance, counsel should:

- develop a practice of evaluating offensive and defensive litigations to properly gauge the company's exposure;
- stay updated on trends in IP litigation and damages;
- be certain that standard licensing agreements contain ADR provisions; and
- periodically review insurance coverages to determine the appropriate type and level of protection.

CONCLUSION

Developing a successful IP management program and effectively communicating information about a company's intangible property values to the marketplace is not easy, but it has become necessary. In the New Economy, the key to shareholder value is the company's intangibles, as opposed to its physical assets, services, or statutory intellectual property, all of which remain important but are no longer alone sufficient.

IP permeates the organization and, as a result, a multidisciplinary team approach is necessary to the development and execution of an IP strategy. And, while companies should pick the low-hanging fruit, a comprehensive initiative focusing on strategy, development, protection, monetization, and measurement is necessary to assure long-term success.

Despite Wall Street's awareness of intangible value, the financial markets inconsistently and arbitrarily measure such values. In part, this is because companies' financial statements reflect very little information about the value of IP. This may be about to change, however, in light of the accounting standard proposed last year that would require companies to record the fair value of acquired, identifiable intangible assets that can be reliably measured in their financial statements.21 This differs from the current practice of assigning all such value to "goodwill."

A logical next step would be to require companies to furnish a market-based valuation for other IP where such IP is readily marketable through licensing, exchanges, or otherwise. This would ensure that not only IP resulting from a transaction, but IP created within the company, is valued consistently, uniformly, and accurately. This would aid investors and even the playing field for all.

But companies must not overlook their defensive strategies either. Every general counsel of a public company worries about class action securities litigation. With the increase in attention being paid by financial markets to IP, the expansion in patentable rights signaled by State Street ruling, and other trends, failure to exploit, communicate, or otherwise effectively manage IP could be asserted as a basis for a lawsuit. While we do not advocate this type of litigation, certainly similar theories based on other alleged forms of mismanagement have survived motions to dismiss.

IP management is the new game in town. It is competitive and it is important. Companies must develop and execute successful IP monetization and protection plans to stay in the game. Those that delay instituting an IP management program risk falling so far behind that they may never catch up.

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