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# FOREWORD

By *Cathy E. Cretsinger*<sup>†</sup> & *Peter S. Menell*<sup>‡</sup>

Now in its fourth year, the *Annual Review of Law & Technology* (“*Annual Review*”) provides practitioners, judges, policymakers, and scholars with timely summaries and analyses of leading developments in technology law, including the fields of intellectual property, antitrust, constitutional law, telecommunications, business law, and international law. This year’s volume contains detailed analyses of twenty-two important developments during the period September 1, 1999 through August 30, 2000 as well as shorter summaries of thirty-nine other cases and other developments through February 2001.

During the past year, the Internet and digital technology continued to take center stage in the evolution of copyright, trademark, antitrust, telecommunications, and business law. The year will be remembered for the epic battle between music copyright owners and new online music services, the implementation of new legal regimes—domestic and international—to protect the rights of trademark owners in cyberspace, and the finding that Microsoft Corporation violated antitrust law through its licensing practices. In addition, federal and state legislatures made strides in developing a new commercial law for the Internet Age.

## I. INTELLECTUAL PROPERTY LAW

### A. Copyright

All three of this year’s copyright Notes present cases that arose from the use of computer technology. These cases reflect the courts’ continuing struggle to protect the rights of creators of digital information without unduly interfering with public access to and use of that content.

Two cases highlighted this year apply traditional copyright law to the digital world. In *Tasini v. New York Times Co.*,<sup>1</sup> the Second Circuit ruled

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We would like to thank this year’s student authors and advisors, as well as the senior editorial staff of the *Berkeley Technology Law Journal*, for their exceptional efforts in bringing this year’s issue of the *Annual Review* to fruition.

that publishers of magazines, newspapers, and other collective works lack authority to place contributions from freelance writers into conventional electronic databases. While recognizing that § 201(c) authorizes the owners of collective works to revise such works, the Second Circuit held that this limited privilege did not extend to breaking the collective work into its component contributions and archiving the content independently of the collective work. This decision threatens the availability of comprehensive archives of news stories and other works because of the high transaction costs of acquiring requisite permissions from freelance authors. The Supreme Court recently heard arguments on this case, so we can expect to revisit this issue in next year's *Annual Review*.

In *Sony Computer Entertainment v. Connectix Corp.*,<sup>2</sup> the Ninth Circuit ruled that reverse engineering a video-game console's operating-system software in order to produce a competing product (an emulator) was fair use. The court emphasized that the competitor, Connectix, was entitled to study and understand the functional aspects of Sony's software and that reverse engineering was the only available means for such study. The court accorded much less importance to the potential effect of Connectix's competing product on the market for Sony's PlayStation. In so doing, the court added further support for the view that copyright protection does not extend to network features of computer technology.<sup>3</sup>

This year's *Annual Review* analyzes the first two cases to apply the Digital Millennium Copyright Act's ("DMCA") anti-circumvention provisions, *RealNetworks, Inc. v. Streambox Inc.*<sup>4</sup> and *Universal City Studios, Inc. v. Reimerdes*.<sup>5</sup> In *RealNetworks*, the developer of RealMedia technology that enables content owners to stream (in a non-downloadable form) content over the Internet sued the developer of Streambox VCR, a product that overrides the RealMedia encrypted security measures so as to enable users to download streamed content. The court held that the Streambox VCR violated the DMCA's anti-circumvention provisions, rejecting the argument that such technology was permissible under the *Sony* stan-

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1. 206 F.3d 161 (2d Cir. 2000), *cert. granted*, 121 S. Ct. 425 (2000).

2. 203 F.3d 597 (9th Cir. 2000)

3. See Peter S. Menell, *An Epitaph for Traditional Copyright Protection of Network Features of Computer Software*, 43 ANTITRUST BULLETIN 651 (Fall-Winter 1998); Julie E. Cohen, *Reverse Engineering and the Rise of Electronic Vigilantism: Intellectual Property Implications of 'Lock-Out' Programs*, 68 S. CAL. L. REV. 1091 (1995).

4. No. C99-2070P, 2000 U.S. Dist. LEXIS 1889 (W.D. Wash. Jan. 18, 2000).

5. 111 F. Supp. 2d 294 (S.D.N.Y. 2000).

dard<sup>6</sup>—that the product had substantial noninfringing uses. In *Reimerdes*, the major movie studios obtained an injunction against publication of “DeCSS” software, which decrypts encrypted movies on DVD. DeCSS enables users to watch DVD movies on Linux-based computers; it also enables users to create and distribute unlimited numbers of digital copies of the movies. This case is currently on appeal in the Second Circuit.

In addition to these cases, the litigation over Napster’s online music-swapping service attracted substantial attention throughout the year. At the urging of major record labels and other music copyright owners,<sup>7</sup> the Northern District of California issued a preliminary injunction enjoining the service in August 2000,<sup>8</sup> which the Ninth Circuit stayed pending its consideration of the matter. The Ninth Circuit’s decision, which issued in February 2001,<sup>9</sup> substantially upheld the lower court’s legal analysis but remanded for narrowing of the injunction. This decision was handed down too late for full treatment in this year’s *Annual Review*, but will be featured in next year’s issue.

## B. Patent

With the general questions of the patentability of software and business methods apparently settled,<sup>10</sup> the Federal Circuit focused on more traditional questions of patent law in the prior year. This year’s *Annual Review* highlights a number of cases addressing the construction of means-plus-function claims,<sup>11</sup> the application of the doctrine of equivalents,<sup>12</sup> licensee standing,<sup>13</sup> and the best mode requirement.<sup>14</sup>

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6. *Sony Corp. of Am. v. Universal City Studios, Inc.*, 464 U.S. 417 (1984) (holding that private home viewing of TV programs on copies made by videotape recorders is fair use).

7. *E.g.*, *A&M Records v. Napster, Inc.*, 114 F. Supp. 2d 896 (N.D. Cal. 2000); *Young v. Napster, Inc.*, No. 00-04366 (C.D. Cal. filed Apr. 25, 2000); *Metallica v. Napster, Inc.*, No. 00-0391 (C.D. Cal. filed Apr. 13, 2000) (filing copyright infringement and racketeering claims against Napster and three universities).

8. *A & M Records*, 114 F. Supp. 2d at 927 (2000).

9. *A&M Records v. Napster, Inc.*, Nos. 00-16401 & 00-16403, 2001 U.S. App. LEXIS 1941 (9th Cir. Feb. 12, 2001).

10. Software and Internet patents continue to pose challenges to the Federal Circuit. *See, e.g.*, *Interactive Gift Express, Inc. v. CompuServe, Inc.*, 231 F.3d 859 (Fed. Cir. 2000) (holding that the district court construed the claims in a software patent too narrowly); *Amazon.com v. Barnesandnoble.com*, No. 00-1109, 2001 U.S. App. LEXIS 2163 (Fed. Cir. Feb. 14, 2001).

11. *IMS Tech., Inc. v. Haas Automation, Inc.*, 206 F.3d 1422 (Fed. Cir. 2000); *Kemco Sales, Inc. v. Control Papers Co.*, 208 F.3d 1352 (Fed. Cir. 2000).

In November, the Federal Circuit released its long-anticipated en banc decision in *Festo Corp. v. Shoketsu Kinzoku Kogyo Kabushiki Co.*,<sup>15</sup> addressing the range of equivalents available for a claim element amended during prosecution. In a decision that will undoubtedly place greater emphasis upon the patent prosecution process, the court ruled that an amendment to a claim restriction for any reason related to patentability bars application of the doctrine of equivalents to that claim limitation. In resolving the tension between ensuring patentees' protection against insubstantial imitation and affording the public notice of the scope of patent claims, the majority came down squarely on the side of public notice in those circumstances where the patentee narrows a claim restriction. Because the decision came so late in the year, *Festo* will receive full coverage in next year's *Annual Review*.

As the initial map of the human genome reached completion, the patenting of sequence data received substantial attention. The Patent and Trademark Office issued new utility guidelines aimed at raising the standards patent applicants must meet in order to patent genetic data. Meanwhile, in an effort to preempt the patenting of human genetic code, the Wellcome Trust embarked on a new institution for disclosing gene sequence data into publicly accessible databases. While this will prevent companies from securing rights to the raw sequence data, participants hope that the lure of proprietary rights in new gene-based diagnostic and therapeutic tools will encourage exploitation of genome data.

### C. Trademark

The Internet dominated new developments in trademark law as two new tools became available to trademark owners in the battle against cybersquatting. First, the Anticybersquatting Consumer Protection Act of 1999 took effect, providing mark owners with a more effective and better targeted means of addressing cybersquatting than the Federal Trademark Dilution Act. The Second Circuit was the first court to apply these new standards.<sup>16</sup> In a parallel development of potentially greater importance, the Internet Corporation for Assigned Names and Numbers ("ICANN")

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12. *Vehicular Techs. Corp. v. Titan Wheel Int'l, Inc.*, 212 F.3d 1377 (Fed. Cir. May 22, 2000); *Zodiac Pool Care, Inc. v. Hoffinger Indus. Inc.*, 206 F.3d 1408 (Fed. Cir. 2000); *Optical Disc Corp. v. Del Mar Avionics*, 208 F.3d 1324 (Fed. Cir. 2000).

13. *Speedplay, Inc. v. Bebob, Inc.*, 211 F.3d 1245 (Fed. Cir. 2000); *Prima Tek II, L.L.C. v. A-Roo Co.*, 222 F.3d 1372 (Fed. Cir. 2000).

14. *Northern Telecom Ltd. v. Samsung Electronics Co.*, 215 F.3d 1281 (Fed. Cir. 2000).

15. 234 F.3d 558 (Fed. Cir. 2000) (en banc).

16. *Sporty's Farm L.L.C. v. Sportman's Market, Inc.*, 202 F.3d 489 (2d Cir. 2000).

implemented its Uniform Domain Name Dispute Resolution Policy (“UDRP”).<sup>17</sup> This alternative dispute resolution institution provides fast and inexpensive resolution of the multitude of disputes relating to the use of trademarks in domain names. In its first year of operation, the ICANN UDRP process resolved well over 1,000 domain name disputes.

This past year also witnessed important developments in more traditional areas of trademark law. In *Wal-Mart Stores, Inc. v. Samara Bros.*,<sup>18</sup> the Supreme Court ruled that although product packaging may be inherently distinctive trade dress, product design cannot acquire trade dress protection without having acquired secondary meaning. While the Court resolved the circuit split over the distinctiveness of product design, lower courts will no doubt spend several years wrestling with the problem of distinguishing product packaging from product design.

In *Comedy III Productions, Inc. v. New Line Cinema*,<sup>19</sup> a case dealing with the overlap between different intellectual property regimes, the Ninth Circuit ruled that trademark law could not be used to substitute for an expired copyright. The court rejected the plaintiff’s claim that the use of a thirty-second clip from a Three Stooges film that had fallen into the public domain violated any rights to the name, likeness, or act of The Three Stooges.

#### D. Trade Secret

With its capacity to provide inexpensive, instantaneous, and widespread distribution of vast amounts of information to anyone with a website, the Internet poses a substantial threat to trade secret owners. *Ford Motor Co. v. Lane*<sup>20</sup> demonstrated the complex balancing required to protect trade secrets in this promiscuous environment. The Eastern District of Michigan, citing First Amendment concerns, refused to enjoin defendant Lane from posting misappropriated trade secrets on his website. The court held that in the absence of a confidentiality or fiduciary agreement between the parties, Ford’s commercial interest in its trade secrets and Lane’s misappropriation did not outweigh the First Amendment interest in avoiding prior restraints on speech.

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17. ICANN, Uniform Domain Name Dispute Resolution Policy, at <http://www.icann.org/udrp/udrp-policy-24oct99.htm> (Oct. 24, 1999).

18. 529 U.S. 205 (2000).

19. 200 F.3d 593 (9th Cir. 2000).

20. 67 F. Supp. 2d 745 (E.D. Mich. 1999).

## II. ANTITRUST

The past year saw the trial court resolution of a historic antitrust case: *United States v. Microsoft Corp.*<sup>21</sup> Unlike the IBM antitrust litigation that dragged on for more than a decade without resolution,<sup>22</sup> the comparably complex Microsoft case proceeded on a fast track and resulted in a strongly worded decision that Microsoft violated section 1 of the Sherman Act through its bundling of Internet Explorer with Microsoft Windows in an attempt to leverage its operating-system monopoly into a monopoly in web browser software. As a remedy, the court ordered a break-up of the corporation into an operation system company and a software applications business. The case is currently on appeal in the District of Columbia Circuit. Regardless of the outcome, the decision has already reverberated through the digital technology industries.

In another important antitrust development, the Federal Circuit came out strongly in favor of patent and copyright owners' right to exclude in *In re Independent Service Organizations Antitrust Litigation*.<sup>23</sup> The court ruled that it was not an antitrust violation for Xerox Corp. to refuse to sell the patented parts for its copiers or the copyrighted service manuals to independent service providers. With respect to patents, the Federal Circuit held that a patentee has the right to exclude unless the antitrust plaintiff can prove illegal tying, fraud on the Patent Office, or that the patentee is engaged in sham litigation. With respect to copyrights, the court held that the antitrust plaintiff must overcome the presumption that a desire to exclude others from access to a copyrighted work is a sound business justification for a refusal to sell or license the work.

## III. CONSTITUTIONAL LAW

The Supreme Court expanded First Amendment protection for cable broadcasters in *United States v. Playboy Entertainment Group*.<sup>24</sup> The Court struck down a provision of the 1996 Telecommunications Act requiring cable operators either to completely block adult-channel signals from nonsubscribers or to show adult programming only during hours when children were unlikely to watch. Significantly, the Court subjected the provision to strict scrutiny, the first time a law restricting broadcasters'

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21. 84 F. Supp. 2d 9 (D.D.C. 1999) (findings of fact); 87 F. Supp. 2d 30 (D.D.C. 2000) (conclusions of law); 97 F. Supp. 2d 59 (D.D.C. 2000) (remedy).

22. See FRANKLIN M. FISHER ET AL., FOLDED, SPINDLED, AND MUTILATED: ECONOMIC ANALYSIS AND U.S. V. I.B.M. (1983).

23. 203 F.3d 1322 (Fed. Cir. 2000).

24. 529 U.S. 803 (2000).

speech was subjected to this high standard. Equally significantly, the Court pointed to advances in technology to establish that a less restrictive alternative existed.

#### IV. TELECOMMUNICATIONS LAW

The rise of the Internet and of Internet Service Providers (“ISPs”)—largely unforeseen when the Telecommunications Act of 1996 opened up competition in local telephone markets—has also affected telecommunications law. As local telephone markets have been opened to competition, incumbent carriers (“ILECs”) and their new competitors (“CLECs”) have negotiated reciprocal compensation agreements, in which each carrier compensates others for the cost of terminating calls originating from the carrier’s subscribers. Many CLECs have signed up ISPs as subscribers and profited from the reciprocal compensation agreements, as ISPs make few calls but receive many. To avoid paying the high fees, the ILECs sought and won a ruling from the FCC exempting ISP-bound local traffic from reciprocal compensation agreements. The D.C. Circuit, however, vacated this ruling in *Bell Atlantic Telephone Cos. v. FCC*,<sup>25</sup> with language strongly suggesting that ISP-bound traffic must be included in reciprocal compensation.

#### V. BUSINESS LAW

The past year brought various developments regarding the adaptation of commercial law to the new realities of the Internet Age. The Electronic Signatures in Global and National Commerce Act,<sup>26</sup> signed June 30, 2000, affords electronic signatures the same legal force as those executed in ink. The law mandates a technologically-neutral approach in deciding what form of electronic signatures are binding. Thus, everything from private-key encryption systems to a simple click on an “I Agree” box can be legally binding. While this approach avoids the danger of requiring contracting parties to use a technology that may become obsolete or easily forged, it raises concerns about consumer protection and the allocation of the risk of a falsified electronic signature.

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25. *Bell Atlantic Tel. Co. v. FCC*, 206 F.3d 1 (D.C. Cir. 2000).

26. Pub. L. No. 106-229, 114 Stat. 464 (codified at 15 U.S.C.A. §§ 7001-7006 (West Supp. 2001)).

Efforts by the 106th Congress to extend the moratorium on Internet taxes<sup>27</sup> led to a number of bills,<sup>28</sup> but no new laws. The bills reflect efforts to retain traditional state sovereignty over sales taxes without burdening the emerging Internet economy with a multitude of conflicting tax provisions or the possibility of incurring tax liability in multiple jurisdictions for the same transaction. With the current moratorium set to expire later this year, the 107th Congress is likely take up the issue soon.

At the state level, efforts to regulate unsolicited e-mail came under constitutional attack. In recent years, many states have sought to regulate senders of bulk e-mail, requiring flags in subject lines, accurate identification of the sender, and opt-out mechanisms. This year, two state trial courts struck down anti-spam laws as violating the dormant Commerce Clause.<sup>29</sup> If these decisions stand, numerous existing state spam laws may be invalid as well. Federal regulation may be the only answer to the increasing burdens on ISPs and individual recipients of unsolicited e-mail. Indeed, the 106th Congress considered an Unsolicited Commercial E-Mail Act ("UCEMA"), but did not adopt it.

As part of the continuing effort to adapt contract law to the age of software licensing, several state legislatures began debating the Uniform Computer Information Transactions Act ("UCITA") in 2000. Two states, Virginia and Maryland, adopted UCITA, albeit with various modifications. A third state, Iowa, took the opposite approach by passing a "bomb-shelter" provision that invalidates choice-of-law provisions in consumer contracts if the state selected in the provision would apply UCITA.

## VI. FOREIGN & INTERNATIONAL LAW

As noted above, the ICANN implemented an international dispute resolution mechanism for domain names. In another important international development, U.S. copyright law came under scrutiny at the WTO in 2000.<sup>30</sup> On a complaint brought by the European Union, a dispute reso-

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27. Internet Tax Freedom Act, Pub. L. No. 105-277, Div. C, Title XI, §§ 1100-1104, 112 Stat. 2681, 2681-719 (1998), available at <http://www.house.gov/chriscox/nettax/law.html> (last visited Nov. 5, 2000).

28. *E.g.*, H.R. 3709, 106th Cong. (2000); H.R. 4460, 106th Cong. (2000); S. 2775, 106th Cong. (2000); H.R. 4462, 106th Cong. (2000); H.R. 4267 106th Cong. (2000).

29. Order on Civil Motion Granting Defendant's Summary Judgment, *Washington v. Heckel*, No. 98-2-25480-7SEA (Wash. Super. Mar. 10, 2000) (Washington state law); Order Sustaining Defendants' Demurrer without Leave to Amend, *Ferguson v. Friendfinder, Inc.*, No. 307309 (Cal. Super. June 2, 2000) (California state law).

30. WTO Dispute Panel Report on Section 110(5) of the U.S. Copyright Act, WT/DS160/R (June 15, 2000), at <http://www.wto.org/wto/ddf/ed/public>.

lution panel of the WTO considered two provisions of the Copyright Act that allowed bars, restaurants, and stores to play music on radios and televisions without obtaining licenses if certain conditions were met.<sup>31</sup> The panel ruled that one of the provisions created too broad an exception to the general rule that authors control the distribution and broadcasting of their works and that that provision violated the TRIPS Agreement and the Berne Convention. The United States has agreed to amend the provision.

The rapid pace of developments at the intersection of law and technology presages new developments for the coming year. The debate over digital music and digital rights management, the appeal of the *Microsoft* antitrust case, and further development of the legal infrastructure for electronic commerce are just a few of the salient issues already on next year's agenda for the *Annual Review*. The *Berkeley Technology Law Journal* and the Berkeley Center for Law & Technology remain committed to providing this reliable, up-to-date resource for lawyers, judges, policymakers, and the academic community interested in following this fast-moving field of law now and in years to come.

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31. 17 U.S.C. § 110(5). The conditions involve the type of equipment and number of speakers used; the particulars depend on the type and size of the business establishment.



**BERKELEY TECHNOLOGY LAW JOURNAL**  
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**INTELLECTUAL PROPERTY**



## TASINI V. NEW YORK TIMES CO.

By Josh J. May

In the early 1980s, companies began compiling periodical articles in electronic databases.<sup>1</sup> These companies licensed newspaper and magazine articles from publishers and marketed the articles to the public. Database owners gradually archived enormous collections of articles spanning many years from hundreds of different periodicals.<sup>2</sup>

Electronic databases flourished because computers could instantaneously sift through a huge amount of data to find targeted information.<sup>3</sup> Users typed in a search and technology delivered dozens of relevant articles. The Internet skyrocketed the availability of, movement of, and access to information.<sup>4</sup> Databases experienced a corresponding increase in value and market size.<sup>5</sup>

Most periodical articles are written by employees of the magazine or newspaper,<sup>6</sup> and copyright in these articles vests in the periodical publisher.<sup>7</sup> Sometimes, though, a publisher hires a freelance writer to pen a

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1. See *Tasini v. N.Y. Times Co.*, 972 F. Supp. 804, 807 (S.D.N.Y. 1997), *reconsideration denied*, 981 F. Supp. 841 (S.D.N.Y. 1997), *rev'd en banc*, 206 F.3d 161, 164 (2d Cir. 2000), *cert. granted*, 121 S. Ct. 425 (2000). For the original Second Circuit opinion, which was withdrawn, see *Tasini v. N.Y. Times Co.*, 192 F.3d 356 (2d Cir. 1999).

2. See *Tasini*, 206 F.3d 161, 164 (2d Cir. 2000).

3. See *id.* at 164 (NEXIS subscribers can “access an almost infinite combination of articles from one or more publishers using the database’s advanced search engine.”).

4. See, e.g., Robert Meitus, *Interpreting the Copyright Act’s Section 201(c) Revision Privilege with Respect to Electronic Media*, 52 FED. COMM. L.J. 749, 750 (2000) (“[T]he United States is in the midst of unprecedented technological change in which our capacity to produce, transmit, and receive information increase daily.”).

5. See Matthew Hoff, *Tasini v. The New York Times: What the Second Circuit Didn’t Say*, 10 ALB. L.J. SCI. & TECH. 125, 163-04 (1999) (“Today, any personal computer user can gain instant access to archives through commercial databases or the Internet.”).

6. See *Tasini*, 972 F. Supp. at 806-07.

7. If the writer of the article is employed as a writer by the publication at the time the article was written, then copyright vests initially in the publication. See 17 U.S.C. §§ 101, 201(b) (1994); see also *Community for Creative Non-Violence v. Reid*, 490 U.S. 730 (1989) (distinguishing employees from independent contractors).

story.<sup>8</sup> Absent a written agreement to the contrary, in such situations the freelance writer retains the copyright in the article.<sup>9</sup>

The process for hiring a freelance writer used to be straightforward:<sup>10</sup> an editor telephoned a freelance writer and verbally contracted for an article;<sup>11</sup> the writer wrote the piece and delivered it to the editor, who published it in the periodical. Publishers sold their newspapers and magazines at newsstands and to subscribers.<sup>12</sup>

Periodical publishers traditionally bargained only for first publication rights because the value in publishing lay almost entirely in being the first to print.<sup>13</sup> The Internet turned that principle on its head by allowing publishers to publish cheaply online, where content remains readily available.<sup>14</sup> Electronic publishing rights suddenly became a valuable commodity. For authors, electronic publication heralded a new and long-lived revenue source.<sup>15</sup> Publishers also sought to exploit this new medium; the right to distribute a freelance writer's copyrighted article as part of the bundle of articles already owned by the publisher lowered transaction costs and increased the efficiency of the licensing process.

*Tasini v. New York Times Co.*, now pending before the United States Supreme Court, is the first case to interpret the electronic distribution rights of freelance writers who publish in newspapers and magazines.<sup>16</sup> This Note contends that the Second Circuit correctly applied the relevant provisions of the Copyright Act in determining that freelancers retain the electronic distribution rights in their articles. Moreover, giving the rights to the freelancers does not necessarily lead to inefficiency because collective rights organizations can manage negotiations for secondary publication rights.

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8. See *Tasini*, 972 F. Supp. at 807.

9. Articles written by freelance writers are not considered works for hire and therefore copyright ownership vests initially in the freelance writer. See 17 U.S.C. §§ 103(b), 201(c) (1994).

10. See Rod Dixon, *Profits in Cyberspace: Should Newspaper and Magazine Publishers Pay Freelance Writers for Digital Content?*, 4 MICH. TELECOMM. & TECH. L. REV. 127, 150 (1998).

11. See *Tasini v. N.Y. Times Co.*, 206 F.3d 161, 164 (2d Cir. 2000) ("Publishers' general practice was to negotiate due-dates, word counts, subject matter and price; no express transfer of rights under the Author's copyright was sought.").

12. Hoff, *supra* note 5, at 162; *Tasini*, 972 F. Supp. at 807-08.

13. Hoff, *supra* note 5, at 162.

14. See *id.*

15. See *Tasini*, 972 F. Supp. at 812.

16. *Id.*

## I. BACKGROUND

The U.S. copyright system promotes the creation of original works of authorship for the benefit of the public.<sup>17</sup> The system for achieving this goal is two-fold: grant ownership rights to the authors and afford the public access to the works.<sup>18</sup> Awarding overly expansive property rights to copyright owners may curb access to copyrighted works.<sup>19</sup> On the other hand, granting inadequate property rights results in a lack of motivation for authors to create new works or circulate existing works.<sup>20</sup>

In the case of works composed of contributions by a number of authors, Congress attempted to resolve the competing intellectual property rights of publishers and freelance writers by distinguishing copyright in a collective work from copyright in a contribution to that work.<sup>21</sup> The Copyright Act defines “collective work” as “a work, such as a periodical issue, anthology, or encyclopedia, in which a number of contributions, constituting separate and independent works in themselves, are assembled into a collective whole. . . . The term ‘compilation’ includes collective works.”<sup>22</sup> The copyright in a collective work extends only to the material contributed by the collective work author, and does not imply any exclusive right in the underlying contributions.<sup>23</sup>

Section 201(c) permits a collective work publisher to reproduce and distribute an underlying contribution as part of that particular collective work, a revision of that collective work, or a later collective work in the same series.<sup>24</sup> This section only applies when the collective work publisher does not also own the copyright in an underlying article. Publishers, therefore, can contract around the default rule by obtaining a freelance

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17. See generally Jessica D. Litman, *Copyright, Compromise, and Legislative History*, 72 CORNELL L. REV. 857 (1987); Peter S. Menell, *Intellectual Property: General Theories*, in 2 ENCYCLOPEDIA OF LAW AND ECONOMICS 129 (Boudewijn Bouckaert and Gerrit De Geest, eds., 1999).

18. See U.S. CONST. art. I, § 8, cl. 8 (giving Congress the power “[t]o promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries”).

19. See Menell, *supra* note 17, at 130-34.

20. See Mary Maureen Brown, Robert M. Bryan & John M. Conley, *Database Protection in a Digital World*, 6 RICH. J.L. & TECH. 2, 8 (1999); Hoff, *supra* note 5, at 131. But see *Feist Publ'ns, Inc. v. Rural Tel. Serv. Co.*, 499 U.S. 340, 349 (1991) (the “primary objective of copyright is not to reward the labor of authors”); John Perry Barlow, *The Next Economy of Ideas*, WIRED, Oct. 2000, at 238 (authors of original works will continue to create regardless of monetary incentive).

21. 17 U.S.C. § 201(c) (1994).

22. *Id.* § 101.

23. *Id.* § 103(b).

24. *Id.* § 201(c).

writer's copyright.<sup>25</sup> Any transfer of copyright ownership, other than by operation of law, must be in writing.<sup>26</sup> Otherwise, a nonexclusive license to use the copyrighted work may be granted orally or implied from the conduct of the parties.<sup>27</sup>

## II. CASE SUMMARY

Tasini<sup>28</sup> and five other freelance writers published articles in *The New York Times*, *Newsday*, and *Sports Illustrated*.<sup>29</sup> Each writer registered a copyright in his or her article, and none of the periodical publishers obtained any express transfer of copyright.<sup>30</sup> After publishing the periodical editions containing the writers' articles, the publishers licensed the contents of their periodicals to at least two electronic database owners per existing agreements.<sup>31</sup> The database owners incorporated the writers' articles

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25. See *infra* Part III.C; see also *Tasini v. N.Y. Times Co.*, 206 F.3d 161, 164 n.1 (2d Cir. 2000) (reporting that the *New York Times* now requires an express transfer of copyright from a freelance writer before accepting a freelance article for publication); Kia L. Freeman, *Tasini v. New York Times: Wrong Issue, Wrong Presumption*, 32 LOY. L.A. L. REV. 841, 876 (1999) (stating that the periodical publishing industry now widely requires express transfers of copyright from freelance writers).

26. 17 U.S.C. § 204(a) (1994).

27. *Graham v. James*, 144 F.3d 229, 235 (2d Cir. 1998) (citing 3 MELVILLE B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT § 10.03[A][7], at 10-43); see also Hoff, *supra* note 5, at 139 (citing *Effects Assoc., Inc. v. Cohen*, 908 F.2d 555, 558 (9th Cir. 1990)).

28. Jonathan Tasini is President of the National Writers Union ("NWU"). See NWU Directory, at <http://www.nwu.org/directry.htm> (last modified Oct. 19, 2000). For more on the NWU, see *infra* Part III.C.

29. The six plaintiffs claim that defendants infringed their copyrights in a total of 21 articles sold for publication between 1990 and 1993. Twelve of these articles, written by plaintiffs Tasini, Mifflin, and Blakely, appeared in *The New York Times*. Another eight of the articles, by plaintiffs Tasini, Garson, Whitford, and Robbins, were featured in *Newsday*. The remaining article . . . appeared in an issue of *Sports Illustrated*. All of the plaintiffs wrote their articles on a freelance basis, and not as employees of the defendant publishers.

*Tasini v. N.Y. Times Co.*, 972 F. Supp. 804, 806. (S.D.N.Y. 1997)

30. *Newsday* attempted to acquire electronic distribution rights from the writers by a notice on the writers' paychecks. However, the district court found the writing ineffective and *Newsday* did not appeal. One of the writers, Whitford, had a contract with *Sports Illustrated* that expressly addressed republication rights. The Court of Appeals analyzed his case separately and granted his motion for summary judgment. *Tasini*, 206 F.3d at 163-64.

31. *Tasini*, 972 F. Supp. at 807.

into their databases and made the articles available to the public for purchase.<sup>32</sup>

One of the database owners, Mead Data Central Corporation (“Mead”), owned NEXIS, an online database containing the full texts of articles appearing in a large number of periodicals.<sup>33</sup> Mead tags each article in its database with the author’s name, the name of the publication, and the page on which the article originally appeared.<sup>34</sup> Articles on NEXIS, however, appear differently than they do in print; “such things as photographs, advertisements, and the column format of the newspapers are lost.”<sup>35</sup> NEXIS users can “access an almost infinite combination of articles from one or more publishers using the database’s advanced search engine.”<sup>36</sup>

The second database owner, University Microfilms International (“UMI”), produced CD-ROMs. Its NY Times OnDisc CD-ROM (“NYTO”) contains the full texts of *New York Times* articles from a limited time period.<sup>37</sup> NYTO articles are formatted and retrieved exactly like NEXIS articles.<sup>38</sup> Another UMI CD-ROM, General Periodicals OnDisc (“GPO”), contains selected articles from various periodicals.<sup>39</sup> UMI scans the printed periodical page directly onto an image-based file, which is abstracted and placed on the CD-ROM.<sup>40</sup> GPO articles appear just as they do in print, complete with “photographs, captions, and advertisements.”<sup>41</sup>

The writers filed suit against the publishers and database owners, alleging copyright infringement.<sup>42</sup> The defendants acknowledged the validity of the writers’ copyrights in their individual articles but countered that § 201(c) permitted the publishers, as owners of the copyright in the collec-

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32. *Tasini*, 206 F.3d at 164.

33. *Id.*; About Nexis.com, at <http://www.lexis-nexis.com/business/about.htm> (last visited Jan. 30, 2001) (NEXIS maintains “2.8 billion searchable documents [from] 30,000 news, business, and legal information sources.”).

34. *Tasini*, 972 F. Supp. at 808.

35. *Id.*

36. *Tasini*, 206 F.3d at 164 (“[A]lthough articles are reviewed individually, it is possible for a user to input a search that will generate all of the articles—and only those articles—appearing in a particular periodical on a particular day.”).

37. *Tasini*, 972 F. Supp. at 808.

38. *Id.* (“Indeed, at the end of each month, pursuant to a three-way agreement among *The New York Times*, NEXIS and UMI, NEXIS provides UMI with magnetic tapes containing this information.”).

39. *Id.*

40. *Id.* at 808-09.

41. *Id.*

42. *Id.* at 809.

tive works, to create electronic reproductions of the authors' articles and license the collective works to databases.<sup>43</sup>

### A. The District Court Decision

The District Court for the Southern District of New York issued three important rulings.<sup>44</sup> The court first held that a publisher of a collective work could use its revision privilege to transfer a collective work from one format to another without infringing a freelance writer's copyright in an underlying article.<sup>45</sup> The court then ruled that the revision privileges were transferable because § 201(c) transmits to publishers some exclusive rights in a freelance writer's copyrighted contribution.<sup>46</sup> Lastly, the court found that NEXIS, NYTO, and GPO qualified as revisions of the collective work.<sup>47</sup>

The writers argued that § 201(c) places a media restriction on the revision privilege, prohibiting the shifting of a collective work from one medium to another. The court, however, determined that the Copyright Act does not limit copyright protection to existing technologies or exclude new media.<sup>48</sup> This holding affirmed the right of the copyright holder in a collective work to produce an electronic version of a printed collective work, for example.

The court then held that when a freelance writer contributes an article to a collective work without a written contract, the publisher acquires not merely a nonexclusive license or nontransferable privilege to use the article, but also some exclusive rights under the copyright.<sup>49</sup> Since exclusive rights are transferable, the publishers could license the writers' copyrighted articles to the database owners as part of the contents of their periodicals.<sup>50</sup>

The court then turned to whether NEXIS, NYTO, or GPO qualified as a revision of a collective work. The court determined that a database could

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43. *Id.* at 806-09.

44. The presiding judge, Sonia Sotomayor, was elevated to the Second Circuit Court of Appeals on November 6, 1998. *See* U.S. Court of Appeals: Second Circuit, at <http://www.tourolaw.edu/2ndcircuit/Info/Sotomayor.htm> (last visited Jan. 30, 2001).

45. *Tasini*, 972 F. Supp. at 817-18.

46. *Id.* at 815.

47. *Id.* at 824-26.

48. *Id.* at 817-18; 3 MELVILLE B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT § 10.10[b], at 10-11 (stating that the trend in the Second Circuit is to permit licensees to "pursue any uses that may reasonably be said to fall within the medium as described in the license").

49. *Tasini*, 972 F. Supp. at 815.

50. *Id.*

be a revision as long as it preserved the characteristics of the collective work that initially earned the work protectable status under copyright law.<sup>51</sup> The selection, coordination, and arrangement of previously existing material qualify a collective work as an original work of authorship.<sup>52</sup> Applying a substantial similarity test, however, the court ruled that a database qualified as a revision if it merely maintained the same selection of articles as the collective work.<sup>53</sup> The court found that each database met this standard.<sup>54</sup> In light of these three rulings, the district court granted summary judgment for the publishers and database owners.<sup>55</sup>

In a motion for reconsideration, the writers disputed the court's factual finding that the electronic databases were similar enough to the original collective works to qualify for the revision privilege.<sup>56</sup> The court upheld its substantial similarity analysis and responded that "where it is apparent that an entire original selection of materials has been copied into a subsequent work, that work shares a substantial similarity with the work that preceded it, even if the subsequent work includes numerous additional materials, as well."<sup>57</sup> The court denied the motion for reconsideration<sup>58</sup> and the writers appealed.

## B. The Second Circuit Decision

The Second Circuit reversed and remanded the case with instructions to enter summary judgment for the writers.<sup>59</sup> The court stressed that the § 201(c) privileges are exceptions to the general rule that copyright vests initially in the author of the individual contribution to a collective work.<sup>60</sup>

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51. *Id.* at 824-25.

52. 17 U.S.C. § 101 (1994); H.R. REP. NO. 94-1476, at 122 (1976), *reprinted in* 1976 U.S.C.C.A.N. 5737.

53. *Tasini*, 972 F. Supp. at 821-25.

54. *Id.* at 817, 824-26 ("[S]o long as defendants are operating within the scope of their privilege to 'reproduce' and 'distribute' [the writers'] articles in 'revised' versions of defendants' collective works, any incidental display of those individual contributions is permissible.").

55. *Id.* at 804.

56. *Tasini v. N.Y. Times Co.*, 981 F. Supp. 841 (S.D.N.Y. 1997).

57. *Id.* at 849 (citing *CCC Info. Servs., Inc. v. Maclean Hunter Mkt. Reports, Inc.*, 44 F.3d 61 (2d Cir. 1994)).

58. *Id.* at 841; *Tasini v. N.Y. Times Co.*, 206 F.3d 161, 164 (2d Cir. 2000).

59. *Tasini*, 206 F.3d at 166 ("Publishers of collective works are not permitted to include individually copyrighted articles [in the bundle of articles licensed to electronic databases] without receiving a license or other express transfer of rights from the author.").

60. *Id.* at 168.

The district court recognized that its interpretation of the revision privilege would “cause the exception to swallow the rule.”<sup>61</sup>

Noting that it was undisputed that an electronic database was “neither the original collective work . . . nor a later collective work in the same series,”<sup>62</sup> the court rejected the remaining argument that any of the defendant databases constituted a revision of a particular collective work.<sup>63</sup> If an electronic database like NEXIS was merely a revision of a collective work, reasoned the court, then the third § 201(c) privilege—“reproduc[ing] and distribut[ing] an author’s copyrighted article in . . . a later collective work in the same series”—would be superfluous.<sup>64</sup> Under ordinary principles of statutory construction, the second clause must be read in the context of the first and third clauses.<sup>65</sup> However, no court would ever need to reach the third privilege because any possible revision would be covered under the first and second privileges. This would violate a basic rule of statutory construction requiring that “significance and effect shall, if possible, be accorded to every word.”<sup>66</sup>

In placing the contents of a periodical issue on NEXIS, some of the content and most of the arrangement of the original collective work are lost.<sup>67</sup> Like NEXIS, GPO includes articles from many periodicals, but GPO uses scanned photo-images instead of text-based files, rendering a nearly identical copy of the collective work.<sup>68</sup> NYTO only features articles from one periodical, but utilizes the same article configuration as NEXIS.<sup>69</sup> In language that could apply to each database, the court characterized NYTO as “at best a new anthology of innumerable editions of [the periodical], and at worst a new anthology of innumerable articles from these editions”; in any case, “it cannot be said to be a ‘revision’ of any (or all) particular editions or to be ‘a later collective work in the same se-

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61. *Id.*

62. *Id.* at 166.

63. *Id.* (“The most natural reading of the ‘revision’ of ‘that collective work’ clause is that [s]ection 201(c) protects only later editions of a particular issue of a periodical, such as the final edition of a newspaper.”); *id.* at 168 (“[T]here is no feature peculiar to the databases at issue in this appeal that would cause us to view them as [section 201(c)] ‘revisions.’”).

64. *Id.* at 167.

65. *See id.* at 166 (citing *General Elec. Co. v. Occupational Safety & Health Review Comm’n*, 583 F.2d 61, 64-65 (2d Cir. 1978)).

66. *Id.* at 167 (citation omitted).

67. *See id.* at 169 (“Even if a NEXIS user so desired, he or she would have a hard time recapturing much of the material contributed by the [publisher] of such [collective] work.”).

68. *Id.*

69. *Id.*

ries.”<sup>70</sup> Therefore, the court held that no defendant database retained enough of the features of the original publication to qualify as a revision.

Since this holding allowed the court to rule against the defendants, it refused to decide whether the revision privileges were transferable.<sup>71</sup> The court did note, however, that § 201(c) “grants collective works authors ‘only’ a ‘privilege,’ rather than a ‘right.’ Each of these terms connotes specialized legal meanings, and they were juxtaposed by Congress in the same sentence of [s]ection 201(c).”<sup>72</sup> The publishers appealed, and the United States Supreme Court granted certiorari on November 6, 2000.<sup>73</sup>

### III. DISCUSSION

This Note analyzes the relative rights of freelance authors and publishers of collective works. Part III.A discusses whether inclusion in a database is a revision under the Copyright Act. Part III.B then analyzes the transferability of a publisher’s revision privilege. Finally, Part III.C describes the role collective rights organizations can play in lowering the transaction costs involved in licensing individual authors’ works to electronic databases.

#### A. 17 U.S.C. § 201(c)—Contributions to Collective Works

The Copyright Act provides that “[c]opyright in each separate contribution to a collective work is distinct from copyright in the collective work as a whole, and vests initially in the author of the contribution.”<sup>74</sup> When an author grants permission to a publisher to include an article in a collective work, absent an express transfer of copyright, the publisher acquires “only the privilege of reproducing and distributing the contribution as part of that collective work, any revision of that collective work, and any later collective work in the same series.”<sup>75</sup>

The first clause of the privilege affirms the essential right of the publisher to use the contribution in “that collective work.” The House Report offered examples of permissible and impermissible applications of the final two clauses:

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70. *Id.*; see also H.R. REP. NO. 94-1476, at 122-123 (1976), reprinted in 1976 U.S.C.C.A.N. 5737 (declaring that if the republication is in a “new anthology” or “entirely different collective work,” it is not within § 201(c)).

71. *Tasini*, 206 F.3d at 165 (“We need not, and do not, reach the question whether this privilege is transferable under section 201(d).”).

72. *Id.* at 168 n.3.

73. *Tasini v. N.Y. Times Co.*, 121 S. Ct. 425 (2000).

74. 17 U.S.C. § 201(c) (1994).

75. *Id.*

[Section 201(c)], under which the privilege of republishing the contribution under certain limited circumstances would be presumed, is an essential counterpart of the basic presumption [that absent an express grant, the author retains copyright]. Under the language of this clause a publishing company could reprint an article from a 1980 edition of an encyclopedia in a 1990 revision of it; the publisher could not revise the contribution itself or include it in a new anthology or an entirely different magazine or collective work.<sup>76</sup>

The district court, attempting to determine the scope of the revision privilege, utilized the copyright concept of substantial similarity.<sup>77</sup> Substantial similarity is a term of art courts use to determine whether one work infringes the copyright in another work.<sup>78</sup> Though neither § 201(c) nor the House Report refer to substantial similarity as a test for determining whether a publication is a revision of a collective work, the district court held that

where a [collective work] possesses both an original arrangement and an original selection, a substantial similarity persists even where the original arrangement is sacrificed. Thus, because the electronic data bases [sic] preserve defendants' original selection of articles, those data bases [sic] are 'substantially similar,' as a matter of law, to defendants' periodicals.<sup>79</sup>

Under this standard, collective work publishers and database owners would meet § 201(c) criteria even if they abandon the coordination and arrangement of a collective work. The Second Circuit rejected the district court's application of the substantial similarity test, terming the test "inapposite."<sup>80</sup>

The House Report states that § 201(c) forbids a revision from appearing in an "entirely different magazine or collective work."<sup>81</sup> This is true regardless of whether the new work is substantially similar to the original collective work.<sup>82</sup> Suppose, for instance, that the Legal Eagle Publishing Company solicited an article from a professor on a freelance basis for in-

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76. H.R. REP. NO. 94-1476, at 122-123 (1976), *reprinted in* 1976 U.S.C.C.A.N. 5737 (alteration in original).

77. *Tasini v. N.Y. Times Co.*, 972 F. Supp. 804, 825 (S.D.N.Y. 1997).

78. *See Freeman*, *supra* note 25, at 867-69.

79. *Tasini*, 972 F. Supp. at 825 (citations omitted).

80. *Tasini v. N.Y. Times Co.*, 206 F.3d 161, 169 n.4 (2d Cir. 2000).

81. H.R. REP. NO. 94-1476, at 122-123 (1976), *reprinted in* 1976 U.S.C.C.A.N. 5737.

82. *Tasini*, 206 F.3d at 169 n.4.

clusion in a collective work titled *California Criminal Procedure*. The professor retains the copyright in the article, limiting the publisher to the § 201(c) privileges. The Legal Eagle Publishing Company then includes the entire content of *California Criminal Procedure*, including the professor's article, in two of its other collective works, *United States Criminal Law* and *Criminal Law for Dummies*. Both collective works would be substantially similar to *California Criminal Procedure* because they incorporate all of the content of *California Criminal Procedure*. They would also be entirely different collective works because the selection and arrangement of articles is different. Section 201(c) does not give Legal Eagle Publishing the right to reuse the professor's article in this way. A new collective work such as a database, thus, needs more than to pass the substantial similarity test to qualify as a revision.

A collective work consists of a number of copyrighted individual works set in a copyrighted collective work. A collective work is "copyrightable only to the extent that it features an original selection, coordination, or arrangement."<sup>83</sup> When one strips away the coordination and arrangement in the collective work, only the selection of the previously existing articles remains.

Electronic databases are convenient archives containing possibly millions of articles from thousands of periodicals. Most databases make it impossible to view a collective work in its collective, copyrightable form at all.<sup>84</sup> Consumers pay for the privilege of searching a large number of periodical articles for information on a specific topic, not for the ability to browse a particular periodical issue.<sup>85</sup>

Merely transferring a collective work to digital format is a legitimate exercise of the revision privilege as long as the publisher transfers the copyrightable aspects of the collective work along with the articles. A noninfringing database must present the whole collective work, not merely the dismantled parts of the whole. The Second Circuit declared:

[Section 201(c)] would not permit a Publisher to sell a hard copy of an Author's article to the public even if the Publisher also offered for individual sale all of the other articles from the particular edition. We see nothing in the revision provision that would

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83. *Feist Publ'ns, Inc. v. Rural Tel. Serv. Co.*, 499 U.S. 340, 360 (1991); *see also* 17 U.S.C. § 103(b) (1994).

84. *See* Michael A. Forhan, *Tasini v. New York Times: The Write Stuff for Copyright Law?*, 27 *CAP. U. L. REV.* 863, 877 (1999).

85. *See* Hoff, *supra* note 5, at 164.

allow Publishers to achieve the same goal indirectly through NEXIS.<sup>86</sup>

In other words, a publisher does not truly license its collective work to a database; it licenses the underlying, pre-existing material in that collective work.

The question remains whether a database like GPO should be considered a revision. GPO displays a replica of the collective work in its original format.<sup>87</sup> GPO, however, reproduces periodical pages from several different periodicals, thereby creating a new, separately copyrightable collective work.<sup>88</sup> The House Report states that a collective work publisher "could not revise the contribution itself or include it in a new anthology or an entirely different magazine or collective work."<sup>89</sup>

A court could find, however, that a database like GPO is not "entirely different" from any of the original collective works. The nature of the GPO database bolsters this interpretation. GPO users must browse the contents of the CD-ROM by abstracts of articles,<sup>90</sup> reducing the chances that a user is more interested in the individual contributions than she is in the nature of the collective work. Thus, GPO more closely resembles a revision of the original collective work than does NYTO or NEXIS.

## B. Transferability

The Second Circuit interpreted § 201(c) much more narrowly than the district court, finding that the revision privilege gives collective work publishers, at most, a nonexclusive license.<sup>91</sup> A nonexclusive license to use a copyrighted work may be granted orally or implied from the conduct of the parties.<sup>92</sup> This occurs when the licensee requests the creation of a work, the licensor creates the work and delivers it to the licensee who asked for it, and the licensor intends that the licensee copy and distribute the work.<sup>93</sup> In copyright law, a nonexclusive license is nontransferable.<sup>94</sup>

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86. *Tasini*, 206 F.3d at 168.

87. *Tasini v. N.Y. Times Co.*, 972 F. Supp. 804, 808-09 (S.D.N.Y. 1997).

88. *Tasini*, 206 F.3d at 169.

89. H.R. REP. NO. 94-1476, at 122-123 (1976), *reprinted in* 1976 U.S.C.C.A.N. 5737.

90. *Tasini*, 972 F. Supp. at 809 (stating that GPO "does not employ Boolean searching").

91. *Tasini*, 206 F.3d at 168.

92. *Graham v. James*, 144 F.3d 229, 235 (2d Cir. 1998) (citing 3 MELVILLE B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT § 10.03[A][7], at 10-43); *see also* Hoff, *supra* note 5, at 139 (citing *Effects Assoc., Inc. v. Cohen*, 908 F.2d 555, 558 (9th Cir. 1990)).

93. *Id.*

The district court ruled that publishers of collective works received some exclusive rights under the freelance writer's copyright by operation of law.<sup>95</sup> This, reasoned the court, is permissible under § 201(d)(1), which allows the transfer of copyright "in whole or in part by any means of conveyance or by operation of law."<sup>96</sup> Next, the court looked to § 201(d)(2), which declares that a transfer may consist of "any of the exclusive rights comprised in a copyright, including any subdivision of any of the [five exclusive rights]."<sup>97</sup> Thus, the district court concluded that § 201(c) transfers to collective work publishers full authority over the "subdivision" of "privileges" enumerated in the section.<sup>98</sup>

Since the exclusive rights supposedly conveyed to collective work publishers would be transferable, the publishers could license the freelance writers' articles to third party databases.<sup>99</sup> Even without a nominative transfer of some exclusive rights under a copyright, the district court believed that "to the extent that the electronic reproductions qualify as revisions under [s]ection 201(c), the defendant publishers were entitled to authorize the [database owners] to create those revisions."<sup>100</sup>

Courts look to § 201(c) in the absence of an express transfer of copyright in order to give a collective work publisher some minimal privileges, not to give a publisher exclusive rights under a copyright for which it did not bargain. The only other case to interpret § 201(c), *Ryan v. Carl Corp.*,<sup>101</sup> determined that

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94. 17 U.S.C. § 101 (1994); H.R. REP. NO. 94-1476, at 122-123 (1976), *reprinted in* 1976 U.S.C.C.A.N. 5737 ("The term 'transfer of copyright ownership' is defined in section 101 . . . to cover any 'conveyance, alienation, or hypothecation,' including assignments, mortgages, and exclusive licenses, but not including nonexclusive licenses.").

95. *Tasini*, 972 F. Supp. at 815-16.

96. *Id.*; 17 U.S.C. § 201(d)(1) (1994).

97. *Tasini*, 972 F. Supp. at 815-16; *see also* 17 U.S.C. § 106 (1994).

98. *Tasini*, 972 F. Supp. at 815-16.

99. *See Hoff, supra* note 5, at 127-28; *see also* 17 U.S.C. § 201(d)(2) (1994) (stating that the owner of any part of an exclusive right in the copyright is entitled "to all of the protections and remedies accorded to the copyright owner").

100. *Tasini*, 972 F. Supp. at 816.

101. 23 F. Supp. 2d 1146 (N.D. Cal. 1998). This decision was issued before the appellate court opinion in *Tasini*. In *Ryan*, four freelance writers sued UnCover, a company that maintained an Internet database with the titles of more than eight million articles from seventeen thousand periodicals. *Id.* When a customer requested an article, UnCover copied the article from a library and sent a copy to the customer and a copyright payment to the periodical publisher. As long as the publisher did not complain, UnCover continued to copy articles printed by that publisher. UnCover never contacted or compensated the individual authors of the articles, even if the author owned the copyright in the article. *Id.*

[Congress enacted the section] in response to the doctrine of copyright indivisibility . . . to enlarge the rights of authors . . . Both the language and the legislative history of section 201(c) suggest that when in doubt, courts should construe the rights of publishers narrowly rather than broadly in relation to those of authors.<sup>102</sup>

The Second Circuit rightly characterized the § 201(c) privileges as more closely resembling nonexclusive licenses than broad, transferable rights: “Were the permissible uses under [s]ection 201(c) as broad and as transferable as appellees contend, it is not clear that the rights retained by the Authors could be considered ‘exclusive’ in any meaningful sense.”<sup>103</sup>

### C. Collective Rights Organizations

The defendants argued that, regardless of the court’s § 201(c) analysis, they were the best party to further the policy goal of providing public access to the copyrighted articles in their periodicals.<sup>104</sup> They claimed that the burden of obtaining permission from every freelance writer before including their articles in electronic databases would force database owners to drop the articles from their databases.<sup>105</sup> The district court echoed these fears, worrying that not allowing publishers to electronically distribute writers’ copyrighted articles would undermine the policy goal of “ensuring that collective works be marketed and distributed to the public.”<sup>106</sup>

From the standpoint of societal efficiency, it makes sense to allocate the right of electronic distribution to publishers.<sup>107</sup> The efficiency argument, however, failed to persuade the Second Circuit. The *Ryan* court also made it clear that a court “is not free to construe statutes in the manner most efficient. Instead, it must follow the intent of Congress as expressed in the terms of the statute.”<sup>108</sup>

The possibility exists, however, that authors can control the electronic distribution of their articles and maintain an efficient licensing scheme to distribute the articles to the public, via a collective rights organization (“CRO”). Commercial copyright transactions require negotiation, monitoring, and enforcement that can be prohibitively costly for individuals but

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102. *Id.* at 1150.

103. *Tasini v. N.Y. Times Co.*, 206 F.3d 161, 168 (2d Cir. 2000).

104. *See Meitus, supra* note 4, at 772.

105. *Id.* at 772-73.

106. *Tasini v. N.Y. Times Co.*, 972 F. Supp. 804, 815-16 (S.D.N.Y. 1997).

107. *Id.*; *Meitus, supra* note 4, at 772.

108. *Ryan v. Carl Corp.*, 23 F. Supp. 2d 1146, 1151 (N.D. Cal. 1998).

feasible for a CRO.<sup>109</sup> CROs, which flourish in the presence of new forms of media, devise general rules that replicate contracting terms between two parties and substantially lower transaction costs.<sup>110</sup> The transactional bottleneck that would likely occur between publishers and individual freelance writers could be alleviated by a CRO.<sup>111</sup>

The fledgling Publication Rights Clearinghouse (“PRC”) is a CRO designed to license and enforce the copyrights of freelance writers.<sup>112</sup> The PRC was created by the National Writers Union (“NWU”)<sup>113</sup> and the Copyright Clearance Center (“CCC”).<sup>114</sup> Although, as ASCAP and BMI manage the licensing and royalty business for composers, songwriters, lyricists, and music publishers,<sup>115</sup> the PRC plans to administer the licensing business for freelance writers. Writers assign the PRC the right to act

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109. See generally Robert P. Merges, *Contracting Into Liability Rules: Intellectual Property Rights and Collective Rights Organizations*, 84 CALIF. L. REV. 1293 (1996).

110. See *id.* at 1296, 1327, and 1334 (reporting that the rise of earlier CROs paralleled the growth of radio and television).

111. See *id.* at 1295.

112. See National Writers Union, *Welcome to the Publication Rights Clearinghouse*, at <http://www.nwu.org/prc/prchome.htm> (last modified Jan. 20, 2000).

113. The NWU is the trade union for freelance writers who work for American publishers. The NWU has approximately 6500 members in seventeen local chapters and is affiliated with the United Automobile Workers and, through them, the AFL-CIO. See National Writers Union, *About the National Writers Union*, at <http://www.nwu.org/nwuinf1.htm> (last modified Sept. 11, 2000).

114. The CCC, the largest licensor of text reproduction rights in the world, was formed in 1978 to facilitate compliance with U.S. copyright law. The CCC provides licensing systems for the reproduction and distribution of copyrighted materials in print and electronic formats throughout the world. See Copyright Clearance Center, *Creating Copyright Solutions*, at <http://www.copyright.com/About/default.html> (last visited Jan. 30, 2001); see also National Writers Union, *PRC and Copyright Clearance Center*, at <http://www.nwu.org/prc/prccc.htm> (last modified July 29, 1999).

115. Merges, *supra* note 109, at 1329.

ASCAP, the American Society of Composers, Authors, and Publishers, which was formed in 1914, is one of the largest performing rights societies. Like the other institutions of its kind, ASCAP acts as a central depository that allows members to control public performances of their works. ASCAP issues “blanket licenses” covering the relevant copyrights of all members of the Society to radio and television stations and other entertainment outlets. It then monitors the songs played and divides up the total receipts among all members on the basis of a complex pro rata formula. Monitoring and enforcement activities with respect to licensees and infringers are also an important part of ASCAP’s function. A rival organization, Broadcast Music Incorporated (BMI), which was founded in 1941 expressly to compete with ASCAP, operates similarly.

*Id.* (citations omitted).

as their agent in licensing the nonexclusive secondary rights to their previously published copyrighted articles.<sup>116</sup> The PRC offers publishers and databases the nonexclusive right to use the work of PRC members in exchange for a licensing fee.<sup>117</sup> When the PRC licenses an author's work to a database or other secondary user, it collects the copyright fees from that user and distributes the royalties to the author.<sup>118</sup> PRC enrollees get from 75 percent to 90 percent of the fees.<sup>119</sup>

The PRC has the potential to efficiently allocate royalties to freelance writers while keeping databases operational.<sup>120</sup> In order to succeed, the PRC must enroll as many freelance writers as possible and persuade publishers and databases to comply with its licensing scheme. Many potential CRO members join "because they realize that without joint action no compensation would be forthcoming at all."<sup>121</sup> The PRC has already signed a deal with one large online database, Contentville.<sup>122</sup> Whether other purveyors of copyrighted material will abide by the PRC licensing scheme largely depends upon how the Supreme Court rules in *Tasini*.

Unfortunately for freelance writers, publishers can circumvent § 201(c) by acquiring the freelance writer's copyright. Because the section only applies to collective work publishers that do not also hold the copyright in an underlying contribution, publishers can contract around the default rule by insisting that freelance writers transfer their copyright as a condition of publication.<sup>123</sup> If publishers succeed in inducing freelance writers to relinquish their copyrights, publishers will be able to avoid having to obtain permission from and compensate freelance writers for the electronic distribution of their articles, and *Tasini* will have little practical effect on future contributions to collective works. Several commentators have concluded that future freelance writers will be unable to retain their

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116. See National Writers Union, *About the Publication Rights Clearinghouse*, at <http://www.nwu.org/prc/prcabout.htm> (last modified July 29, 1999).

117. See National Writers Union, *Frequently Asked Questions About PRC*, at <http://www.nwu.org/prc/prcfaq.htm> (last modified July 29, 1999).

118. *Id.*

119. *Id.*

120. See Meitus, *supra* note 4, at 774-76.

121. Merges, *supra* note 109, at 1338.

122. National Writers Union, *NWU Seals Landmark Agreement with Brill*, at <http://www.nwu.org/prc/cv1.htm> (last modified Aug. 7, 2000); Contentville, at <http://www.contentville.com> (last visited Jan. 30, 2001) (offering material ranging from doctoral dissertations to speeches to screenplays).

123. Freeman, *supra* note 25, at 876 (reporting that the periodical publishing industry now widely requires express transfers of copyright from freelance writers).

electronic distribution rights due to the lopsided power dynamic between authors and publishers.<sup>124</sup>

While collective work publishers may succeed in acquiring the copyright from many freelance writers, writers with enough clout and legal savvy should be able to continue to publish in collective works without surrendering their copyrights. Electronic distribution profits represent a far greater proportion of potential income for freelance writers than for publishers, and freelance writers may be willing to give up some initial income in exchange for electronic distribution royalties. In addition, the NWU may be able to collectively bargain on behalf of freelance writers to preserve their electronic distribution rights.<sup>125</sup>

#### IV. CONCLUSION

The free flow of information and tremendous distribution power, hallmarks of the digital economy, “challenge some of the foundational premises of intellectual property protection” and complicate a determination of the appropriate scope of intellectual property rights.<sup>126</sup> The advent of electronic media has altered the publishing landscape by creating a lasting, lucrative online market for periodical articles.<sup>127</sup> Periodical publishers own the copyright in the majority of articles they publish, entitling them to the

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124. See, e.g., Dixon, *supra* note 10, at 154-55; Hoff, *supra* note 5, at 165; Meitus, *supra* note 4, at 752; Forhan, *supra* note 84, at 884 (“[M]ost writers will ‘bargain’ away their rights out of necessity in order to be published.”); see also Freeman, *supra* note 25, at 876 (citing *Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 445, 449 (D.C. Cir. 1965) (stating that unequal bargaining power between parties can result in unconscionable contracts and contracts of adhesion)).

125. This depends largely upon the bargaining strength of the NWU, which is untested. Note, however, that the Screen Actors Guild (“SAG”) and the American Federation of Television and Radio Artists (“AFTRA”) recently bargained successfully for individual actors to retain residual payments from television commercials. See Screen Actors Guild, *SAG and AFTRA Members Approve New Commercials Contract*, at <http://www.sag.org/pressreleases/pr-la001201.html> (last visited Jan. 30, 2001).

126. Brown, Bryan & Conley, *supra* note 20, at 4.

127. *Tasini v. N.Y. Times Co.*, 972 F. Supp. 804, 827 (S.D.N.Y. 1997) (reporting that Congress could not have foreseen this change).

profits of electronic distribution,<sup>128</sup> except where a freelance writer has retained the copyright in her article.<sup>129</sup>

*Tasini v. New York Times Co.* is the first case to resolve the competing rights of collective work publishers and freelance writers who publish in collective works. A collective work is "copyrightable only to the extent that it features an original selection, coordination, or arrangement."<sup>130</sup> If a database destroys the elements that make a collective work an original work of authorship, only the previously existing articles remain. Such a database operates merely as an electronic delivery system for individually copyrighted articles.

In the absence of an express transfer of copyright, § 201(c) gives the collective work copyright owner the privilege of reproducing and distributing a contribution to the work as part of that particular collective work, a revision of that collective work, or a later collective work in the same series.<sup>131</sup> Any revision of a collective work should necessarily maintain a similar selection, coordination, and arrangement of preexisting material. The revision privilege allows a collective work publisher to electronically publish its collective work or beam it to wireless devices or email it to subscribers only so long as the publisher includes the copyrightable aspects of its collective work along with the underlying articles. This is a narrow but important distinction, and one intended by Congress.<sup>132</sup>

The Copyright Act does not transfer to a collective work publisher any exclusive rights in the underlying material.<sup>133</sup> Copyright in each separate contribution to a collective work is distinct from copyright in the collective work itself.<sup>134</sup> Copyright in the collective work "does not imply any exclusive right in the preexisting material."<sup>135</sup> Congress intended to en-

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128. If the writer of the article is employed as a writer by the publication at the time the article was written, then copyright vests initially in the publication. *See* 17 U.S.C. § 101 (1994); 17 U.S.C. § 201(b) (1994); *see also* *Community for Creative Non-Violence v. Reid*, 490 U.S. 730 (1989) (distinguishing employees from independent contractors).

129. Articles written by freelance writers are not considered works for hire and copyright ownership vests initially in the freelance writer. *See* 17 U.S.C. §§ 103(b), 201(c) (1994).

130. *See* *Feist Publ'ns, Inc. v. Rural Tel. Serv. Co.*, 499 U.S. 340, 360 (1991); *see also* 17 U.S.C. § 103(b) (1994).

131. 17 U.S.C. § 201(c) (1994).

132. *See* H.R. REP. NO. 94-1476, at 122-123 (1976), *reprinted in* 1976 U.S.C.C.A.N. 5737.

133. 17 U.S.C. § 103 (1994) ("The copyright in [a collective work] is independent of, and does not affect or enlarge the scope, duration, ownership, or subsistence of, any copyright protection in the preexisting material."); 17 U.S.C. 201(c) (1994).

134. 17 U.S.C. § 201(c) (1994).

135. 17 U.S.C. § 103(b) (1994).

courage authors to contribute articles to collective works by ensuring that authors could retain the exclusive copyright in their articles: “one of the most significant aims of [section 201(c)] is to clarify and improve the present confused and frequently unfair legal situation with respect to rights in contributions.”<sup>136</sup> As the Second Circuit recognized, § 201(c) does not grant collective work publishers any exclusive rights under a copyright for which they did not bargain.

When a collective work publisher does not hold the copyright in an underlying contribution, § 201(c) grants the publisher only three minimal, nontransferable privileges.<sup>137</sup> These privileges should not allow a collective work publisher to license a freelance writer’s copyrighted article to an electronic database without the writer’s permission.

If the Supreme Court rules in favor of collective work publishers, they will be able to exclude freelance writers from reaping the profits of the electronic distribution of their articles. If freelance writers prevail, collective work publishers and database owners will need permission from freelance writers to include their articles in databases, and freelance writers will profit from the sale of their articles to the public.

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136. H.R. REP. NO. 94-1476, at 122-123 (1976), *reprinted in* 1976 U.S.C.C.A.N. 5737.

137. 17 U.S.C. § 201(c) (1994).



## SONY COMPUTER ENTERTAINMENT, INC. V. CONNECTIX CORP.

By Stan Karas

Software is a utilitarian article.<sup>1</sup> Copyright law, on the other hand, is commonly associated with protecting creative expression in such fields as music, literature, and film.<sup>2</sup> Yet, software is protected under the law of copyright.<sup>3</sup> Reconciling software's utilitarian nature with its copyrightability has presented unique challenges for the courts.<sup>4</sup> One of the most interesting challenges has been ensuring public access to software's uncopyrightable functional<sup>5</sup> elements. Culminating in the Ninth Circuit's recent decision in *Sony Computer Entertainment, Inc. v. Connectix Corp.*,<sup>6</sup> a line of cases has held that reverse engineering of software to gain access to its functional elements is fair use.

In *Sony v. Connectix*, the Ninth Circuit concluded that Connectix's reverse engineering<sup>7</sup> of the an operating system program extracted from a

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1. "Software" is a collective term for "computer programs and applications . . . that can be run on a particular computer system." MICROSOFT ENCARTA WORLD ENGLISH DICTIONARY (Kathy Rooney et al. eds. 1999), available at <http://dictionary.msn.com/find/entry.asp?search=software> (last visited Feb. 7, 2001). "Computer software" thus includes operating systems, compilers, interpreters, and application programs.

2. "The overarching object of copyright law in the United States is to encourage the widest possible production and dissemination of literary, musical, and artistic works." PAUL GOLDSTEIN, COPYRIGHT: PRINCIPLES, LAW, AND PRACTICE § 1.1 (1989).

3. The 1980 amendment to the Copyright Act amended 17 U.S.C. § 117 to provide that "it is not an infringement for the owner of a copy of a computer program to make or authorize the making of another copy or adaptation of that computer program." 17 U.S.C. § 117 (1994); see also H.R. REP. NO. 94-1476, at 54 (1976) (explaining that § 102(a)'s reference to "literary works" "includes . . . computer programs"); *Apple Computer, Inc. v. Franklin Computer Corp.*, 714 F.2d 1240, 1249 (3d Cir. 1983) (programs in machine-readable form are appropriate subject matter for copyright).

4. See *Sega Enters. v. Accolade, Inc.*, 977 F.2d 1510, 1524 (9th Cir. 1992) ("Computer programs pose unique problems for the application of the 'idea/expression distinction' that determines the extent of copyright protection.").

5. Copyright law does not protect ideas contained in a work. See Part II. A *infra*. As used in this Note, the term "functional element" refers to such uncopyrightable material.

6. 203 F.3d 596 (9th Cir. 2000), *cert. denied*, 2000 U.S. LEXIS 5843 (2000).

7. As used in this Note, unless otherwise noted, the term "reverse engineering" refers only to reverse engineering of software.

Sony PlayStation console was protected fair use.<sup>8</sup> Connectix's repeated copying of copyrighted elements of Sony's software did not constitute infringement because it was necessary to access the software's functional elements.<sup>9</sup> This Note explains that while the court's application of the fair use doctrine is consistent with precedent, the decision is significant because it permits reverse engineering of software in the process of creating a product that will compete directly with the original. This outcome conflicts with the "effect on potential market" factor of the fair use test. The Note will also discuss the possible consequences of *Sony v. Connectix*, including software manufacturers' greater reliance on software patents and shrinkwrap licenses, as well as significant changes in business and marketing practices of software manufacturers.

## I. BACKGROUND

### A. Copyright Law and the Fair Use Doctrine

The Constitution grants Congress the power to enact copyright legislation.<sup>10</sup> Copyright law confers on the copyrighted work's author a limited statutory monopoly through the grant of certain exclusive rights.<sup>11</sup> The copyright owner's exclusive rights are limited in a number of ways, including by the fair use limitation.<sup>12</sup> The fair use doctrine permits the courts to avoid finding copyright infringement when doing so "would stifle the

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8. *Connectix*, 203 F.3d at 599.

9. *Id.*

10. U.S. CONST. art. I, § 8, cl. 8 ("The Congress shall have the power . . . to promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries; . . .").

11. The copyright owner has the exclusive rights to do and to authorize any of the following:

(1) to reproduce the copyrighted work in copies or phonorecords; (2) to prepare derivative works based upon the copyrighted work; (3) to distribute copies or phonorecords of the copyrighted work to the public; (4) to perform the copyrighted work publicly; (5) to display the copyrighted work publicly; and (6) in the case of sound recordings, to perform the copyrighted work publicly by means of a digital audio transmission.

17 U.S.C. § 106 (1994 & Supp. 1996). This Note's focus is on the first of these rights—reproduction of the copyrighted work in copies.

12. 17 U.S.C. § 107 (1994). See, e.g., Dane S. Ciolino, *Rethinking the Compatibility of Moral Rights and Fair Use*, 54 WASH. & LEE L. REV. 33, 56 ("An integral part of the Copyright Act, fair use limits copyright's protection of intangible intellectual works of authorship.").

very creativity which that law is designed to foster.”<sup>13</sup> Under section 107 of the Copyright Act, fair use analysis includes the following factors:

- (1) the purpose and character of the use, including whether the use is of a commercial nature;
- (2) the nature of the copyrighted work;
- (3) the amount and substantiality of the portion used in relation to the copyrighted work as a whole; and
- (4) the effect of the use upon the potential market for or value of the copyrighted work.<sup>14</sup>

These factors are weighed together in determining whether copying is protected by fair use.<sup>15</sup> Additionally, to encourage creativity and the free exchange of ideas, copyright protection does not extend to the ideas embodied in a work, but only to the work’s expression.<sup>16</sup>

## B. Principles of Reverse Engineering

Reverse engineering is the process of disassembling a finished product to uncover its functional components. In the context of trade secret law, the Supreme Court has endorsed reverse engineering as a “fair and honest means [of] . . . starting with the known product and working backward to divine the process which aided in its development or manufacture.”<sup>17</sup> With regard to software, reverse engineering involves decompiling the object code in which software is distributed and translating it into source code,

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13. See *Campbell v. Acuff-Rose Music, Inc.*, 510 U.S. 569, 577 (1994).

14. 17 U.S.C. § 107 (1994).

15. *Campbell*, 510 U.S. at 578.

16. See 17 U.S.C. § 102(b) (1994) (The Act does not protect “any idea, procedure, process, system, method of operation, [or] concept . . .”).

Because it contains both functional and protectable elements, software is markedly different from such conventional subjects of copyright protection as literary works. This unique position of computer code within the range of copyrightable material requires a unique approach to the determination of infringement. In *Computer Associates International v. Altai, Inc.*, 982 F.2d 693 (2d Cir. 1992), the Second Circuit adopted a three step test for determining copyright infringement of non-literal elements of a computer program. First, a court should apply an “abstraction test” by “dissect[ing] the allegedly copied program’s structure and [isolating] each level of abstraction contained within it.” *Id.* at 707. Second, a court should apply a “filtration test” by examining the structural components at each level of abstraction to “determine whether their particular inclusion at that level was ‘idea’ or was dictated by considerations of efficiency,” which would make it merely incidental to that idea; “required by factors external to the program itself; or taken from the public domain.” *Id.* Finally, the court should compare the allegedly infringing work with the “protectable expression” found in the filtration step. *Id.* at 710-11.

17. *Kewanee Oil Co. v. Bicron Corp.*, 416 U.S. 470, 476 (1974).

which programmers can then use to understand the functional elements of the program.<sup>18</sup>

Reverse engineering of software may take several forms: (1) reading about the program; (2) observing "the program in operation by using it on a computer;" (3) performing a "static examination of the individual computer instructions contained within the program;" and (4) performing a "dynamic examination of the individual computer instructions as the program is being run on a computer."<sup>19</sup> The first method is often ineffective because information available about a program may be scarce and the existing manuals may misdescribe a program.<sup>20</sup> The remaining methods require that the copyrighted program be copied into the computer's random access memory ("RAM").<sup>21</sup> Such copying, if unauthorized, has been found to be actionable under the Copyright Act.<sup>22</sup> The crucial issue is whether copying for the purpose of deciphering functional elements of the program falls within the fair use defense.

### C. Application of Fair Use Defense in Software Copyright Infringement Actions

When confronting copyright infringement stemming from reverse engineering of software, most courts have held that such copying constitutes fair use. For example, in *Atari Games Corp. v. Nintendo of America, Inc.*,<sup>23</sup> the Federal Circuit excused such copying as fair use when it was necessary to obtain access to the software's functional elements.<sup>24</sup> This case involved Nintendo's 10NES software, which contained a security mechanism requiring the console to detect a coded message on the video game cartridge in order to function. Atari, a video game manufacturer, used a copy of Nintendo's program to correct errors in its reverse engineering efforts and subsequently created its own software, the "Rabbit

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18. Greg Weiner, *Reverse Engineering as a Method of Achieving Compatibility in the Computer Industry*, 6 U. BAL. INTELL. PROP. J. 1, 2 (1997).

19. *Sony Computer Entm't, Inc. v. Connectix Corp.*, 203 F.3d 596, 599 (9th Cir. 2000) (citing Andrew Johnson-Laird, *Software Reverse Engineering in the Real World*, 19 U. DAYTON L. REV. 843, 846 (1994)).

20. *Connectix*, 203 F.3d at 600.

21. *Id.*

22. Merely loading software into the RAM of a computer has been held to create a copy within the meaning of the Copyright Act. *See, e.g., MAI Sys. Corp. v. Peak Computer, Inc.*, 991 F.2d 511, 519 (9th Cir. 1993).

23. 975 F.2d 832 (Fed. Cir. 1992).

24. This extension of the fair use doctrine was dicta; the Federal Circuit upheld the lower court's preliminary injunction against Atari, on the grounds that Atari acquired an unauthorized reproduction of source code from the Copyright Office, which negated any finding that Atari's reverse engineering was fair use. *Id.* at 841-42.

Program,” to unlock the 10NES system. The result was “to render the Atari Games’ chip functionally indistinguishable from the Nintendo chip, thus precluding Nintendo from altering its future base units in a manner that would selectively exclude Atari Games’ cartridges.”<sup>25</sup> In other words, the program allowed Atari to produce video games that were not licensed by Nintendo but could still be played on the Nintendo game system. Atari’s final code differed on a line-by-line basis from that of Nintendo.<sup>26</sup> The court held that Atari’s reverse engineering was fair use as long as Atari did not copy beyond the point necessary to understand the unprotected ideas and processes embedded in 10NES software or commercially exploit Nintendo’s protected expression.<sup>27</sup> Even though the court ruled against Atari on other grounds, *Atari* established fair use as a valid defense in reverse engineering copyright suits.

Central to the *Connectix* court’s analysis was *Sega Enterprises v. Accolade, Inc.*,<sup>28</sup> which was decided only months after *Atari*. In *Sega*, during the process of creating video games to be played on Sega’s console, Accolade copied and disassembled some of Sega’s copyrighted software.<sup>29</sup> Accolade then printed and studied the disassembled code in order to produce Sega-compatible games.<sup>30</sup> The Ninth Circuit held that creation of object code through disassembly constituted infringement but concluded that intermediate copying, such as Accolade’s, was fair use.<sup>31</sup>

The court admitted that Accolade’s purpose in copying was purely commercial.<sup>32</sup> Nevertheless, the copying was fair use because it occurred at an intermediate stage of software development, and therefore Accolade’s commercial exploitation of Sega’s work was indirect.<sup>33</sup> Furthermore, Accolade’s purpose was nonexploitative, since it disassembled Sega’s code merely to study its functional requirements.<sup>34</sup>

The court also observed that Accolade’s games would not displace Sega’s games in the market and that limiting the market for Sega-compatible games only to those produced or licensed by Sega would run counter to the goal of promoting creative expression embodied in copy-

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25. *Atari Games Corp. v. Nintendo of America, Inc.*, 18 U.S.P.Q.2d (BNA) 1935, 1939 (N.D. Cal. 1991).

26. *See Atari Games*, 975 F. 2d at 836.

27. *See id.* at 843.

28. 977 F.2d 1510 (9th Cir. 1993).

29. *Id.* at 1514.

30. *Id.* at 1514-15.

31. *See id.* at 1514.

32. *Id.* at 1522-23.

33. *Id.*

34. *Id.* at 1523.

right law.<sup>35</sup> Ultimately, the court held that “[w]here there is good reason for studying or examining the unprotected aspects of a copyrighted computer program, disassembly for purposes of such study or examination constitutes a fair use.”<sup>36</sup>

Accordingly, prior reverse engineering cases establish these principles: (1) the defendant may only copy the minimum amount necessary to understand the product; (2) the defendant must have a legitimate reason to reverse engineer the software; (3) the defendant must lawfully obtain the copy of the plaintiff’s work; and (4) disassembly must be the only reasonable way to gain access to the ideas contained in the software.

## II. CASE SUMMARY

In 1992, Sony Computer Entertainment, Inc. (“Sony”) began the development of the Sony PlayStation, a video game system. The development and marketing of the PlayStation cost Sony over \$600 million and took more than three years.<sup>37</sup> Introduced in 1995, the PlayStation became a success, selling over 20 million copies worldwide and establishing Sony as a leader in the video game console industry.<sup>38</sup>

In July 1998, Connectix, Inc., a software manufacturer, decided to emulate PlayStation’s hardware so that PlayStation games could be played on personal computers.<sup>39</sup> To develop its system, Connectix needed to emulate the PlayStation operating system—the basic input-output software (“BIOS”).<sup>40</sup> Sony had registered a copyright in its BIOS and disallowed copying or distribution for any purpose.<sup>41</sup> To accurately emulate the PlayStation’s BIOS, Connectix purchased a PlayStation, removed the chip containing the BIOS, and downloaded the contents of that chip onto a disk.<sup>42</sup> Over the several months spent developing a functional PlayStation emulator,<sup>43</sup> Connectix engineers repeatedly copied Sony’s BIOS into the

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35. *See id.* at 1523-24.

36. *Id.* at 1520.

37. *See Sony Computer Entm’t, Inc. v. Connectix Corp.*, 48 F. Supp. 2d 1212, 1214 (N.D. Cal. 1999).

38. *Id.*

39. *Id.* at 1215.

40. *Id.*

41. *Id.*

42. *See id.* at 1216.

43. An emulator is hardware or software that permits a computer system to run programs written for and process data originating from a different type of computer system. MICROSOFT ENCARTA WORLD ENGLISH DICTIONARY (Kathy Rooney et al. eds. 1999), available at <http://dictionary.msn.com/find/entry.asp?search=emulator> (last visited Feb.

RAM of their personal computers during the process of reverse engineering.<sup>44</sup> This copying was intermediate; it was done solely to understand the functioning of the PlayStation. Ultimately, none of Sony's copyrighted computer code appeared in Connectix's emulator program.<sup>45</sup>

In January 1999, after spending about \$150,000 on its development, Connectix introduced the Virtual Game System ("VGS") at the MacWorld Expo in San Francisco.<sup>46</sup> Sony promptly sued Connectix in the District Court for the Northern District of California, alleging copyright infringement as well as other causes of action.<sup>47</sup>

### A. District Court Decision

In its April 1999 decision, the district court granted a preliminary injunction prohibiting Connectix from marketing its program. The court held that Connectix had likely infringed the copyrighted code contained within the PlayStation BIOS.<sup>48</sup> As a result, it ordered Connectix to pull the Virtual Game Station from the market and halt all moves towards preparing its future retail release.<sup>49</sup>

The court rejected Connectix's fair use defense. The court stated that even though the VGS did not contain any infringing code, it was, and had been marketed as, a substitute for the PlayStation.<sup>50</sup> The fact that Connectix's product allowed PlayStation games to be played on a computer monitor as opposed to a television screen did not amount to transformative use.<sup>51</sup> According to the court, since the VGS was merely a substitute product, marketing it would harm Sony's sales of its PlayStation console.<sup>52</sup> Accordingly, the district court issued a preliminary injunction against Connectix.

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7, 2001). In other words, emulator products are designed to enable one computer system to imitate another, so that they can function in the same way and achieve the same results.

44. Sony's Appellate Brief at 10, *Sony Computer Entm't, Inc. v. Connectix Corp.*, 203 F.3d 596 (9th Cir. 2000) (No. 99-15852).

45. *Connectix*, 203 F.3d at 600.

46. *Id.* at 601.

47. *Id.* Sony also alleged circumvention of technological protection measures, and trademark dilution. *Sony Computer Entm't, Inc. v. Connectix Corp.*, 48 F. Supp. 2d 1212, 1214 (N.D. Cal. 1999).

48. The court also found that the Connectix product had the potential of tarnishing the Sony PlayStation trademark. *Id.* at 1223.

49. *See id.* at 1224.

50. *See id.* at 1219.

51. *See id.* ("The VGS does not do anything new, anything different, or anything unique from the PlayStation.").

52. *Id.* at 1221.

## B. Ninth Circuit Decision

On appeal, the Ninth Circuit ruled that copying by Connectix constituted fair use and dissolved the lower court's injunction.<sup>53</sup> The court based its decision primarily on *Sega Enterprises v. Accolade, Inc.*,<sup>54</sup> which held that disassembly is fair use as a matter of law where it is necessary to gain access to the ideas contained within a copyrighted program.<sup>55</sup> Taking this as a starting point for its analysis, the court found that a fair use analysis favored Connectix.<sup>56</sup>

With respect to the nature of the copyrighted work, the first fair use factor, the court found that because Sony's BIOS program contains unprotectable aspects it did not belong to the core of intended copyright protection as, for example, would a literary work. Under this lower standard of protection, to establish fair use Connectix only had to demonstrate that its copying was "necessary." The court found that this showing had been made. Sony's BIOS contained functional elements that could not be accessed without copying the program during the process of reverse engineering.<sup>57</sup> The court rejected Sony's argument that Connectix's copying was infringing because it "used" rather than merely "studied" the copyrighted code, as creating an "artificial" distinction.<sup>58</sup>

Responding to Sony's claim that it was not necessary for Connectix to copy the BIOS repeatedly, the court held that the number of times that the program is disassembled is irrelevant to a finding of fair use.<sup>59</sup> The court noted that given the technical realities of reverse engineering, limiting the number of times the code can be copied leads to inefficiency.<sup>60</sup> Erecting

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53. *Sony Computer Entm't, Inc. v. Connectix Corp.*, 203 F.3d 596, 608-09 (9th Cir. 2000). The court also rejected Sony's trademark dilution claims, finding that "the evidence on the record did not support a finding of misattribution." *Id.* at 609. Furthermore, the court could not find any evidence that "Sony's mark or product was regarded or was likely to be regarded negatively because of its performance on Connectix's Virtual Game Station." *Id.*

54. 977 F.2d 1510 (9th Cir. 1992).

55. *See id.* at 1518.

56. *Connectix*, 203 F.3d at 608. The only fair use factor weighing in favor of Sony was the amount and substantiality of portion of the copyrighted material used. *Id.* at 606. Connectix admitted to copying Sony's BIOS multiple times in order to reverse engineer it. *Id.* The court, however, noted that this factor of the test is of little weight when the final product does not contain infringing material. *Id.* at 605.

57. *See id.* at 603.

58. *Id.* at 604.

59. *See id.*

60. *Id.*

artificial hurdles to the public's access to the ideas contained within copyrighted works contravenes the goals of copyright law.<sup>61</sup>

Further, since Connectix developed entirely new object code, the court held that its use of copyrighted material was transformative under the "purpose and character of the use" prong of the fair use test.<sup>62</sup> Accordingly, the court was "at a loss" to see just how Connectix's development efforts, which resulted in a noninfringing product, violated any PlayStation copyrights.<sup>63</sup> Even though the PlayStation and the VGS are similar in both function and screen output, the court found that the VGS, as a "wholly new product," was "modestly transformative."<sup>64</sup>

Finally, the court found that the fair use factor concerning the effect of the use on the potential market favored Connectix. While acknowledging that Connectix products may cause a loss of PlayStation sales, the court held that this made Connectix a legitimate competitor and not an infringing party.<sup>65</sup> Since the VGS is a transformative product, endowed with original expressive qualities, it is less likely to cause a substantial adverse effect on the market for the original.<sup>66</sup> According to the court, Sony's potential economic losses result from legitimate competition and not Connectix's supplanting or superseding the market for the PlayStation.<sup>67</sup> Consequently, the Ninth Circuit reversed the district court's ruling.

### III. DISCUSSION

Although the Ninth Circuit's decision in *Sony v. Connectix* was mandated by precedent, the court did not devote sufficient attention to the fair use factor concerning the effect of use on the market for the original work. Consequently, the court for the first time found production of an emulator that is functionally identical to the original to be fair use. This holding is likely to encourage greater reliance by software manufacturers on software patents and shrinkwrap licenses prohibiting reverse engineering, and result in improved quality of software and greater market choice for consumers.

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61. *Id.*

62. The fact that copying was done for a commercial purpose does not weigh against Connectix, since the purpose in copying the BIOS was legitimate and the commercial use of copyrighted material was only intermediate.

63. *Id.* at 606-07.

64. *Id.*

65. *See id.* at 607

66. *See id.*

67. *See id.*

### A. Reverse Engineering and Emphasis on Software's Functional Nature

The *Connectix* court's fair use analysis is predicated on its approach to the "nature of the work" factor. By setting out that the PlayStation BIOS as a software program was entitled to "a lower degree of protection than more traditional literary works,"<sup>68</sup> the court ruled that in order to be fair use, *Connectix's* copying of Sony's copyrighted code need only be "necessary." Although this approach permits extensive copying of copyrighted code, it is a pragmatic and fair method of facilitating access to software's functional elements.

This permissive approach to reverse engineering is firmly based in precedent. In *Vault Corp. v. Quaid Software Ltd.*,<sup>69</sup> the Fifth Circuit rejected the plaintiff's argument that reverse engineering a computer program was contrary to the Copyright Act because it was not for the "intended purpose" of executing the program. The court reasoned that such a narrow reading of the Copyright Act was contrary to the Act's language.<sup>70</sup> Similarly, in *Atari* the Federal Circuit emphasized that reverse engineering is justified because individuals have a right to "undertake necessary efforts to understand the [copyrighted] work's ideas, processes, and methods of operation."<sup>71</sup> Since software is usually distributed to the public only as object code, which is unintelligible to most humans, the holder of the copyright cannot prevent the public from attempting to access the ideas contained within that code via reverse engineering.<sup>72</sup> The *Atari* court expressly linked the right to reverse engineer software with the weak level of copyright protection afforded to computer code. "When the nature of a work requires intermediate copying to understand the ideas and processes in a copyrighted work, that nature supports a fair use for intermediate copying."<sup>73</sup>

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68. *Id.* (quoting *Sega Enters. v. Accolade, Inc.*, 977 F.2d 1510, 1526 (9th Cir. 1992)).

69. 847 F.2d 255 (5th Cir. 1988).

70. *Id.* at 261.

71. *Atari Games Corp. v. Nintendo of America, Inc.*, 975 F.2d 832, 842 (Fed. Cir. 1992).

72. *See id.* ("An author cannot acquire patent-like protection by putting an idea, process, or method of operation in an unintelligible format and asserting copyright infringement against those who try to understand that idea, process, or method of operation. The Copyright Act permits an individual in rightful possession of a copy of a work to undertake necessary efforts to understand the work's ideas, processes, and methods of operation." (citations omitted)).

73. *Id.* at 843.

The *Sega* decision reinforced judicial endorsement of reverse engineering as a legitimate method of getting to the functional elements contained in computer object code. The court emphasized that “computer programs are, in essence, utilitarian articles—articles that accomplish tasks.”<sup>74</sup> Where the copyrighted work contains little creative expression, copyright protection is thin.<sup>75</sup> The amount of creative expression in software is limited by its functional purpose; even if programming decisions are idiosyncratic and original, they still serve a functional purpose. Accordingly, the court explained that given the unique nature of software in the copyright regime, copying of an entire program is permissible if it is “the only means of gaining access to . . . unprotected aspects of the program.”<sup>76</sup>

### B. Rejection of the Strict Necessity Test

The *Connectix* decision expands *Sega*’s principle of necessity. In *Connectix*, the court rejected Sony’s contention that *Sega* limited fair use for copying code to the number of instances strictly necessary to access its functional elements.<sup>77</sup> The *Connectix* court specified that once the necessity of the defendant’s method of accessing software’s functional elements is established, the number of times that method is applied is irrelevant.<sup>78</sup> In other words, as long as Connectix necessarily had to make one copy of the BIOS code in order to study it, it could make and use hundreds of subsequent copies to expedite its reverse engineering.<sup>79</sup>

Although the court maintained that *Sega* mandates this result, that case is factually distinguishable from *Connectix*. Unlike Connectix, Accolade did not spend months copying and running tests on the copyrighted software in order to produce an emulator.<sup>80</sup> In both cases, decompilation was necessary to access the ideas contained within the software, but only Connectix continued with the copying until the emulator was completed. In

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74. *Sega Enters. v. Accolade, Inc.*, 977 F.2d 1510, 1524 (9th Cir. 1992).

75. *See id.* (citing *Feist Publ’ns, Inc. v. Rural Tel. Serv. Co.*, 499 U.S. 340, 349 (1991)).

76. *Sega*, 977 F.2d at 1520. The court specifically noted the lack of evidence of a viable alternative to reverse engineering as a factor weighing in favor of finding fair use. *See id.* at 1525-26.

77. *See Sony Computer Entm’t, Inc. v. Connectix Corp.* 203 F.3d 596, 604 (9th Cir. 2000).

78. *See id.* at 605.

79. David Goldberg & Robert J. Bernstein, *Computers and Intermediate Copying*, N.Y. L.J., July 21, 2000, at 3.

80. In *Sega*, Accolade disassembled the code, then printed it out and studied its functional elements to produce Genesis-compatible videogames.

*Connectix*, the Ninth Circuit rejected the opportunity to limit the frequency of copying of copyrighted code to what was necessary to divine the workings of the program, choosing instead a much broader “necessity of method” standard. This is a pragmatic and justifiable choice.

Sony urged the court to consider the frequency of copying as relevant to the issue of whether the conduct was reasonably necessary. Cognizant of the difficulty of applying established legal standards to evolving technologies, the Ninth Circuit refused to “supervise the engineering solutions of software companies in minute detail. . . .”<sup>81</sup> The court’s refusal to create a stricter test for fair use in reverse engineering cases reflects its caution in assessing complex technologies as well as its recognition of the judiciary’s inability to create lasting legal tests for rapidly developing industries.<sup>82</sup>

Indeed, limiting the extent of permissible copying to what is reasonably necessary would have caused confusion in the lower courts. If a “strict necessity” standard were adopted, trial judges in subsequent cases would have to face battles of experts on whether a particular instance of intermediate copying was necessary to access a program’s functional elements. Given the inherent subjectivity at this level of inquiry, further refinement of the strict necessity standard would have introduced substantial uncertainty into this area of the law. Embracing a strict necessity standard would require the courts to issue highly arbitrary and potentially uneducated decisions. This arbitrariness would impede creativity by evoking the specter of costly litigation at the early stages of the reverse engineering process.

The lower level of copyright protection afforded to software permits any unauthorized copying of software necessary to access the ideas contained therein. All reverse-engineering-related copying is necessary per se because object code is not readable by humans. Instead of expanding the legal test of necessity by considering the frequency of copying, the court pragmatically chose to permit any amount of intermediate copying so long as the other factors of the fair use test are satisfied. This decision is within the spirit of precedent, reflects the technical and market realities of software engineering, and comports with the institutional competence of the courts.

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81. *Connectix*, 203 F.3d at 605.

82. As the *Sega* court noted, the courts have not been able to develop even a rudimentary test standard distinguishing between functional and expressive elements in software. The court observed that “thus far, many of the decisions in this area reflect the courts’ attempt to fit the proverbial square peg in a round hole.” *Sega Enters. v. Accolade, Inc.*, 977 F.2d 1510, 1524 (9th Cir. 1992) (quoting *Computer Assocs. Int’l, Inc. v. Altai, Inc.* 982 F.2d 693, 712 (2d Cir. 1992)).

### C. Emulators and the Fourth Fair Use Factor

*Sony v. Connectix* further extends *Sega* and other reverse engineering cases by finding the development of an emulator through reverse engineering to be fair use. Although the court's decision that the "nature of the work" factor of the fair use test favored Connectix is justifiable, its finding in favor of Connectix on the "effect of use upon the potential market" factor is questionable. The Ninth Circuit's decision encourages production of emulator products through reverse engineering,<sup>83</sup> which will have a deleterious effect on the market for the originals. This result conflicts with the court's analysis of the "effect of use" factor.

The Ninth Circuit was faced with an issue of first impression: Is an emulator whose code does not infringe the original but that performs the same functions protectable under the fair use defense? In *Atari*, the "Rabbit Program" did not serve as a market substitute for Nintendo Entertainment System; it simply gave Atari a way to unlock Nintendo's software so that Atari could produce Nintendo-compatible games. In *Sega*, Accolade created original video games to be played on Sega's console. The court found that although Accolade's games may affect the market for Sega's or Sega-licensed video games, there is no proximate link between the new product and a reduction of sales of the original.<sup>84</sup> Accolade's games did not supplant Sega's; they added to the marketplace. No other case has dealt with emulator products.<sup>85</sup>

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83. As one booster for the emulation scene put it: "There's no more questioning the legality of emulation. *Sony v. Connectix* finally settles that issue once and for all. Both developing and using an emulator are protected under the 'fair use' statute of copyright law." David Lloyd, *Y2K Addendum: The Effects Sony v. Connectix - Analysis and Implications*, at [http://www.eidolons-inn.de/emufaq2000/EmuFAQ\\_Y2KAddendum1.htm](http://www.eidolons-inn.de/emufaq2000/EmuFAQ_Y2KAddendum1.htm) (Mar. 16, 2000).

84. By facilitating the entry of a new competitor, the first lawful one that is not a Sega licensee, Accolade's disassembly of Sega's software undoubtedly "affected" the market for Genesis-compatible games in an indirect fashion. We note, however, that . . . video game users typically purchase more than one game. There is no basis for assuming that Accolade's "Ishido" has significantly affected the market for Sega's "Altered Beast," since a consumer might easily purchase both; nor does it seem unlikely that a consumer particularly interested in sports might purchase both Accolade's "Mike Ditka Power Football" and Sega's "Joe Montana Football," particularly if the games are, as Accolade contends, not substantially similar.

*Sega*, 977 F.2d at 1523.

85. See, e.g., *DSC Communications Corp. v. DGI Techs., Inc.*, 81 F.3d 597, 601 (5th Cir. 1996); *Bateman v. Mnemonics, Inc.*, 79 F.3d 1532, 1539 n.18 (11th Cir. 1996);

Emulation presents novel legal challenges that the *Connectix* court skirted over. The Ninth Circuit dispensed with the “effect of use on potential market” factor in three terse paragraphs.<sup>86</sup> The court’s analysis of the factor hinged on its earlier finding that the VGS was a transformative work.<sup>87</sup> The court assumed that because the VGS was transformative, it was less likely to adversely affect the market for the PlayStation.<sup>88</sup> The transformative nature of the VGS also made it a “legitimate competitor in the market for platforms on which Sony and Sony-licensed games can be played.”<sup>89</sup> Consequently, “some economic loss by Sony as result of this competition does not compel a finding of no fair use.”<sup>90</sup>

Yet, the finding of “modest” transformativeness does not compel a finding of fair use under the fourth factor. As the court itself noted, although a transformative work is less likely to cause a substantially adverse impact on the potential market for the original, it may still do so.<sup>91</sup> Where the allegedly infringing product is used for the same intrinsic purpose as the original, that fact cuts against a finding of fair use.<sup>92</sup> This is the case here, and the court should have addressed the functional identity of the PlayStation and the VGS.

The VGS performs the same function as the PlayStation: providing a console for running PlayStation games. Emulators are by definition a replacement for the original product, not a “supplement” as the court saw it. The Ninth Circuit recognized that the VGS would cause Sony to lose console sales and profits.<sup>93</sup> The district court was blunter: “Sony is being harmed by the sales of the *Connectix* emulator. To the extent an individual

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Lotus Dev. Corp. v. Borland Int’l, Inc. 49 F.3d 807, 817-18 (1st Cir. 1995) (Boudin, J., concurring); Vault Corp. v. Quaid Software Ltd., 847 F.2d 255, 270 (5th Cir. 1988).

86. *Connectix*, 203 F.3d at 607-08.

87. “Merely stating that the final work was transformative was all the proof the *Connectix* court needed to hold that [the ‘effect of the use’] factor was in favor of *Connectix*.” Morgan Malino, *Focus on Copyright*, THE NATIONAL LAW JOURNAL, Oct. 16, 2000, at C11.

88. *See Connectix*, 203 F.3d at 607.

89. *Id.*

90. *Id.*

91. *See id.*

92. *See Am. Geophysical Union v. Texaco, Inc.*, 60 F.3d 913, 922 (2d Cir. 1994) (The court rejected the fair use defense where copyrighted works were being photocopied without paying for a license and noted that “courts will not sustain a claimed defense of fair use when the secondary use can fairly be characterized as a form of ‘commercial exploitation,’ i.e., when the copier directly and exclusively acquires conspicuous financial rewards from its use of the copyrighted material.”); *see also Marcus v. Rowley*, 695 F.2d 1171, 1175 (9th Cir., 1983).

93. *Connectix*, 203 F. 3d at 607.

purchases a VGS to play PlayStation games, those consumers [sic] will be less likely to buy PlayStation consoles.”<sup>94</sup> Indeed, the only reason for purchasing both consoles would be to play PlayStation video games on both a personal computer (“PC”) and a television. Given the high prices of consoles, such a duplicative purchase is unlikely. Consequently, since the VGS is used for the same intrinsic purpose as the PlayStation, it is at best only mildly transformative.<sup>95</sup>

Even if we assume that the VGS is entirely transformative, the detrimental effect on Sony’s market for its product may be extensive. The VGS reduces Sony’s prospects of expanding its product line by creating a PC-based PlayStation or licensing its BIOS to another company for that purpose.<sup>96</sup> More generally, the *Connectix* decision makes long-term product development or licensing planning by the copyright holders extremely difficult. For example, at any point during licensing negotiations a competitor may unexpectedly come out with an emulator and render moot a potentially lucrative agreement. The effect on the potential market for the original is substantial and harmful.

Also, there is the possibility of Connectix patenting its product to preclude Sony from entering the market for PC-based PlayStation emulators. Although Sony has valid patents on its BIOS, another company in a similar situation may not. As the following section explains, this situation may lead to greater reliance on software patents by copyright holders.

#### D. Possible Consequences of *Sony v. Connectix*

It is hard to predict how a single court decision will affect an industry as complex and as rapidly developing as software manufacturing. It is, however, possible to perceive several probable effects of *Sony v. Connectix*.

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94. *Sony Computer Entm’t, Inc. v. Connectix Corp.*, 48 F. Supp. 2d 1212, 1221 (N.D. Cal 1999).

95. Admittedly, on a line-by-line basis the VGS’s code is different from the PlayStation’s. As seen in *Atari* and *Sega*, this often compels a finding of fair use. Transformative use entails adding something new or original to the existing work. *Campbell v Acuff-Rose Music, Inc.*, 510 U.S. 569, 579 (1994). *Connectix* reworked Sony’s software so that PlayStation games could be played on a new platform. As a result, the VGS adds to the marketplace by expanding the number of platforms for PlayStation games. This is, however, undercut by the functional identity of the two products.

96. There is also no suggestion on the record that Sony was not already working on a PC-compatible version of the PlayStation when the VGS hit the market.

### 1. *Greater Use of Software Patents*

One likely outcome of the Ninth Circuit decision is increased reliance by software manufacturers on software patents.<sup>97</sup> Since Sony did not sue Connectix for patent infringement, the *Connectix* court noted that its decision did not affect patent claims.<sup>98</sup> Less than a week after the Ninth Circuit announced its decision in *Connectix*, Sony filed a new suit against Connectix alleging patent infringement.<sup>99</sup> Similarly, Sony filed a patent suit against Bleem, Inc., another emulator manufacturer, after losing a copyright infringement suit against that company over Bleem's use of screen shots from Sony's video games in advertisements for its emulator.<sup>100</sup> Therefore, software manufacturers' attempt to protect their products from reverse engineering by relying on software patents is not an abstract possibility but a reality.<sup>101</sup>

As opposed to copyright law, under patent law reverse engineering of patented software likely constitutes infringement.<sup>102</sup> Therefore, the public is unable to access the ideas contained within patented software by reverse engineering it. Furthermore, the public may be unable to gain that information from published patents since the Federal Circuit does not require would-be patentees to disclose their inventions' source code.<sup>103</sup> Software manufacturers may also try to counteract reverse engineering by patenting a small portion of a program, such as a lock-out device, and enforcing that patent.

In sum, although *Connectix* removes copyright liability for reverse engineering, this decision ironically may diminish reverse engineering by encouraging software companies to patent their software and then sue emulator-makers for patent infringement. It is possible that such patent

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97. Software patents present many complicated legal issues. The merits of software patents are beyond the scope of this Note.

98. See *Connectix*, 203 F.3d at 598.

99. See *Sony Continues Battle Against Bleem and Connectix*, CONSUMER MULTIMEDIA REP., May 29, 2000.

100. See *id.*; *Sony Computer Entm't America, Inc. v. Bleem LLC*, 214 F.3d 1022 (9th Cir. 2000).

101. After years of equivocation, the Federal Circuit in *In re Alappat* endorsed patentability of software without qualification. 33 F.3d 1526, 1543 (Fed. Cir. 1994). "Close to one hundred thousand software or software-related patents are now in force in the United States . . ." Julie E. Cohen & Mark A. Lemley, *Patent Scope and Innovation in the Software Industry*, 89 CALIF. L. REV. 1, 11 (2001).

102. "The patent statute includes no express provision allowing reverse engineering, nor is there any judicially-developed exception akin to copyright's fair use doctrine that might permit it." *Id.* at 18.

103. See *id.* at 24 n.87.

infringement claims may be barred by the first sale doctrine<sup>104</sup> or may leave plaintiffs vulnerable to patent misuse counterclaims<sup>105</sup> or antitrust suits.<sup>106</sup> Yet, for now, software manufacturers will increasingly rely on software patents to curb competition from the emulator-makers.

## 2. *Greater Use of Shrinkwrap Licenses*

Greater use of shrinkwrap licenses in the software industry is another strategy available to software manufacturers seeking to protect their products from reverse engineering.<sup>107</sup> Generally, a shrinkwrap license is a standardized, unsigned agreement between the purchaser of a software program and the software manufacturer.<sup>108</sup> It defines the terms of the transaction and places contractual conditions on the purchaser's use of the software.<sup>109</sup> These shrinkwrap licenses could potentially restrict reverse engineering of software, arguably bypassing copyright law by relying on contract law. The courts have affirmed the validity of shrinkwrap licenses,<sup>110</sup> and they are widely used in connection with the sales of computer products.<sup>111</sup> In the future, these licenses are likely to be governed by

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104. See Cohen & Lemley, *supra* note 101, at 30-35. The first sale doctrine states that patentees who have introduced their invention to the marketplace are estopped from claiming patent infringement against anyone obtaining the invention from the original purchaser. Mark J. Rozman, *Intel v. ULSI System Technology, Inc.*, 1 J. INTELL. PROP. L. 373, 379 (1994).

105. See *id.* The patent misuse doctrine allows the courts to deny remedy for patent infringement to patent owners who used their patent in an improper manner, for example, by violating the antitrust laws or extending the patent beyond its lawful scope. Note, *Is the Patent Misuse Doctrine Obsolete?*, 110 HARV. L. REV. 1922, 1923 (1997).

106. "Patent misuse is frequently . . . coextensive with conduct that violates the anti-trust laws." Cohen & Lemley, *supra* note 101, at 35.

107. See Page M. Kaufman, *The Enforceability of State "Shrink-wrap" License Statutes In Light Of Vault Corp. v. Quaid Software, Ltd.*, 74 CORNELL L. REV. 222, 224 (1988) (stating that software developers often attempt to use "shrink-wrap" license agreements to broaden the protection offered under the Copyright Act).

In this section, I am making two assumptions: (1) that software manufacturers either will not be able to use their software patents to prevent reverse engineering or will choose to rely on enforcement of shrinkwrap licenses instead, and (2) that although shrinkwrap licenses are already widely used in connection with software sales, after *Connectix* their use and enforcement will become even more widespread.

108. Darren C. Baker, *ProCD v. Zeidenberg: Commercial Reality, Flexibility in Contract Formation, and Notions of Manifested Assent in the Arena of Shrinkwrap Licenses*, 92 NW. U. L. REV. 379, 389 (1997).

109. *Id.*

110. See, e.g., *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996).

111. Most commercial software is made available pursuant to a shrinkwrap license that typically includes a provision prohibiting the licensee from engaging in any reverse engineering of the software. See Nicholas Groombridge, *Reverse Engineering Copy-*

the Uniform Computer Information Transaction Act ("UCITA"), a model contract law statute.<sup>112</sup>

UCITA's purported aim is to promote freedom of contract.<sup>113</sup> By purchasing and opening a product, a consumer can bind himself to an agreement to refrain from reverse engineering any software contained therein. In the mass-market software context, the licensees are devoid of any real bargaining power.<sup>114</sup> Agreeing to the provisions of the shrinkwrap license is the unavoidable prerequisite to obtaining a software program. Thus, a consumer may not be able to obtain the software whose functional elements he would like to study without preemptively "agreeing" to the provision prohibiting any kind of reverse engineering whatsoever.

Legal issues raised by shrinkwrap licenses in general, and UCITA in particular, are beyond the scope of this Note.<sup>115</sup> It bears noting, however, that *Sony v. Connectix* brings these issues to the forefront more than ever because of the greater reliance on shrinkwrap licenses that is to be expected as result of this decision.

### 3. Greater Consumer Choice and Improved Product Quality

*Sony v. Connectix* could have some positive consequences for consumers as well. Consumer choice could be broadened through the creation of new products, including higher-quality emulator software. Legal implications of its actions aside, by creating the VGS, Connectix added to the video game console market by providing video game players with a new platform for the games. Consumers certainly benefit from a wider choice

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*righted Software?; Ninth Circuit's Recent Ruling Clarifies Law, Resolves Long-Standing Questions*, N.Y. L.J., Oct. 16, 2000, at S3.

112. UCITA allows enforceability of shrinkwrap licenses only if three requirements are met. First, the buyer must have reason to expect that additional contract terms will be proposed after the purchase. UNIF. COMPUTER INFO. TRANS. ACT § 208(2), at 119, available at <http://www.law.upenn.edu/bll/ulc/ucita/ucitaFinal00.pdf> (Sep. 29, 2000). Second, the buyer must be able to return the product at the licensor's cost. *Id.* § 209(b), at 122. Finally, the buyer must be able to recover damages for the alterations to his system if it has been altered by the installation of license terms for review. *Id.*

113. *Id.* at 1 (prefatory note) ("UCITA . . . [is] based upon the principle of freedom of contract . . .").

114. See, e.g., Pratik A. Shah, Note, *The Uniform Computer Information Transactions Act*, 15 BERKELEY TECH. L.J. 85, 93 (2000) ("[G]iven the bargaining power of most licensors over licensees in the mass-market shrinkwrap context, where adhesion contracts are the norm, this apparent efficiency could come at the licensee's expense.").

115. See *id.*; see also Brian D. McDonald, Note, *The Uniform Computer Information Transactions Act*, 16 BERKELEY TECH. L.J. 461 (2001) (discussing the prospects for widespread adoption of UCITA).

of video game consoles.<sup>116</sup> Given the emulator industry-friendly decision in *Connectix*, other small software companies will be encouraged to exploit larger companies' reluctance to enter new markets by creating and marketing emulator software. Reverse engineering of software is inexpensive, at least relative to its creation. In creating the VGS, Connectix spent less than 0.01% of Sony's research and development and marketing budgets for the PlayStation.<sup>117</sup> Small start-up companies also lack larger companies' inherent bureaucratic resistance to quick production and marketing of new emulator products.

Alternatively, to compete with the emulator industry, large software manufacturers might expand their product lines, consequently expanding consumer choice. Instead of preparing a single version of their product, large companies could be driven to create a number of versions compatible with different platforms in order to preempt competing emulator software. Creation of several versions of products by large companies may improve the quality of emulator products. Connectix's VGS was flawed and "buggy,"<sup>118</sup> but a company like Sony with its superior resources would be able to create high quality emulators. Also, manufacturers of the original software would not have to engage in the time-consuming and imperfect process of reverse engineering. With full access to both source and object code of the original, original developers can improve the quality of emulator products.

#### IV. CONCLUSION

Copyright law has to adapt its traditional principles to a continually expanding field of subject matter. The courts faced a particularly difficult challenge when software, a utilitarian article, was granted copyright protection in 1980. *Sony v. Connectix* reinforces the rule that was established by such cases as *Atari v. Nintendo* and *Sega v. Accolade*—reverse engineering of copyrighted code performed for the purpose of accessing the

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116. See, e.g., Sam Pettus, *Emulation: Right or Wrong?*, at [http://www.emuhq.com/emufaq/mod3\\_pt1.htm](http://www.emuhq.com/emufaq/mod3_pt1.htm) (Oct. 1, 1999) ("[E]mulation actually allows users to enjoy programs outside of their intended platform. Mark Asher, writing for C|NET GameCenter, puts it this way: 'What this denial of injunction [for Sony] means for gamers is simple: freedom of choice.' Howard Wen, writing for Salon, calls it "'tearing down the barriers for code among proprietary formats.' . . .").

117. See *Sony Computer Entm't, Inc. v. Connectix Corp.*, 48 F. Supp. 2d 1212, 1214 (N.D. Cal 1999) (stating that Sony spent over \$600 million developing the PlayStation); see also *Sony Computer Entm't, Inc. v. Connectix Corp.* 203 F.3d 596, 601 (9th Cir. 2000) (stating that Connectix spent approximately \$150,000 developing the VGS).

118. *Connectix* at 596.

work's functional elements is fair use. *Connectix* also helps to clarify the holding of *Sega* by specifying that when the necessity of reverse engineering to get to the ideas contained within software is established, the frequency of copying of protected material is irrelevant to the fair use analysis. The Ninth Circuit established that the functional identity between the original and the new work is immaterial when considering the "effect on the market" factor of the fair use test in reverse engineering cases. This holding allows for creation of software whose functions substantially overlap with those of the work from which it was reverse engineered.

*Sony v. Connectix*, for the first time, establishes the applicability of the fair use defense to the production of emulator products through reverse engineering. Although the court's analysis of the fourth fair use factor is flawed, the software industry will likely be able to counteract the effect of *Connectix* by enforcing software patents, relying on shrinkwrap licenses that prohibit reverse engineering, and preemptively producing emulator products.

## REALNETWORKS, INC. V. STREAMBOX, INC. & UNIVERSAL CITY STUDIOS, INC. V. REIMERDES

By Eddan Elizafon Katz

The encoding of any type of expression in digital form preserves perfect quality in every subsequent copy, even when duplicated and distributed many times. When content is stored in digital form, technological barriers have to be imposed in order to create an artificial scarcity that would prevent the otherwise unobstructed propagation of information and art.<sup>1</sup> The copyright industries—music, film, television, and publishing—perceive the Internet and digital technology in general as a threat to their exclusive right to distribute and make copies of the copyrighted works they own. As a precondition for the release of their copyrighted works onto the Internet, these companies insist on a legal framework that supports the technological protection systems they have developed. Information technology companies, educational institutions, and consumer advocates are concerned that the implementation of these technological protection systems may result in an imbalance between the protections afforded to copyright owners and society's access to information. They argue for a flexible legal framework that encourages access to information implied by the open infrastructure of the Internet.

The Digital Millennium Copyright Act of 1998 (“DMCA”)<sup>2</sup> sought to balance these interests. The anti-circumvention provisions in section 1201 of the DMCA prohibit the access and duplication of copyrighted works through circumvention of technological protections imposed by the copyright owner. *RealNetworks, Inc. v. Streambox, Inc.*<sup>3</sup> and *Universal City Studios, Inc. v. Reimerdes*<sup>4</sup> are the first cases to test these anti-circumvention provisions. Both raise urgent questions regarding legitimate uses of technology permitted to innovators, researchers, and the general public. The rulings in both district courts broadly interpreted the ban on circumvention and narrowly applied the various exemptions and limitations within the statute. The unfortunate result of these rulings may be the establishment of an asymmetrical copyright system that grants unchecked

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1. See generally John Perry Barlow, *The Economy of Ideas*, WIRED, Mar. 1994, available at [http://www.wired.com/wired/archive/2.03/economy.ideas\\_pr.html](http://www.wired.com/wired/archive/2.03/economy.ideas_pr.html).

2. 17 U.S.C. § 1201 (Supp. IV 1998).

3. No. C99-2070P, 2000 U.S. Dist. LEXIS 1889 (W.D. Wash. Jan. 18, 2000).

4. 111 F. Supp. 2d 294 (S.D.N.Y. 2000).

authority over the use of digital works to copyright owners. The cases demonstrate that such a strict understanding of the DMCA may lead to overprotection for copyright owners at the expense of public access to art and information.

## I. BACKGROUND

### A. DMCA Anti-circumvention Provisions

The DMCA contains three main provisions: (1) an act-of-circumvention ban;<sup>5</sup> (2) an access control circumvention device ban (sometimes called the “trafficking” ban);<sup>6</sup> and (3) a copyright protection circumvention device ban.<sup>7</sup> The first provision prohibits the *act* of circumventing technological protection systems, while the other two ban technological *devices* that facilitate the circumvention of access control or protection of the rights of the copyright owner. The three provisions are also distinguishable in that the first two provisions focus on technological protections that provide access control to the copyright owner, while the third provision prohibits circumvention of technological protections against unauthorized duplication and other copyright infringing activities.<sup>8</sup>

The act-of-circumvention behavior ban in section 1201(a)(1)(A) prohibits “circumvent[ing] a technological measure that effectively controls access to a work.”<sup>9</sup> According to the statute, “to ‘circumvent a technological measure’ means to descramble a scrambled work, to decrypt an encrypted work, or otherwise to avoid, bypass, remove, deactivate, or impair a technological measure, without the authority of the copyright owner.”<sup>10</sup> A technological protection that effectively controls access to a work is a measure which “in the ordinary course of its operation, requires the application of information, or a process or a treatment, with the authority of the copyright owner, to gain access to the work.”<sup>11</sup>

The second provision mandates that “[n]o person shall manufacture, import, offer to the public, provide, or otherwise traffic in any technology, product, service, device, component, or part thereof” that is primarily used

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5. 17 U.S.C. § 1201(a)(1)(A) (Supp. IV 1998).

6. *Id.* § 1201(a)(2).

7. *Id.* § 1201(b).

8. See David Nimmer, *A Riff on Fair Use in the Digital Millennium Copyright Act*, 148 U. PA. L. REV. 673, 690-91 (2000); see also *supra* notes 5-7.

9. 17 U.S.C. § 1201(a)(1)(A) (Supp. IV 1998).

10. *Id.* § 1201(a)(3)(A).

11. *Id.* § 1201(a)(3)(B).

for circumvention.<sup>12</sup> Congress intended this provision to be analogous to existing laws prohibiting the manufacture or distribution of “black boxes” whose function is to descramble cable television and satellite cable services.<sup>13</sup> What constitutes “trafficking” is defined by three clauses prohibiting circumvention devices that (1) are “primarily designed . . . for the purpose of circumventing,” (2) have “only limited commercially significant purpose or use other than to circumvent,” or (3) are marketed for use in circumventing a technological measure.”<sup>14</sup> As with the act-of-circumvention ban, this provision prohibits accessing a copyrighted work without authorization but does not regulate the activity of users once they have access.<sup>15</sup>

The third provision prohibits “circumventing protection afforded by a technological measure that effectively protects a right of a copyright owner.”<sup>16</sup> This provision regulates devices that enable copyright protection to be circumvented, whether or not gaining access was necessary or required authorization of the copyright owner. In contrast with the other provisions, the copyright protection circumvention device ban has no equivalent provision for circumvention activity in section 1201 of the DMCA. Rather, the provision serves as a buttress to the already prohibited uses of a work, extensively covered by traditional copyright law, once it is lawfully accessed.<sup>17</sup>

## B. Exemptions and Limitations in Section 1201

In response to the warnings from information technology industry advocates that strict anti-circumvention controls would damage innovation and competition in the burgeoning digital economy, Congress included several explicit limitations to the three anti-circumvention provisions.<sup>18</sup>

One important limitation is the reverse engineering exemption,<sup>19</sup> which is most relevant to the development of software products. This exemption contains three significant subsections. The first subsection allows programmers to circumvent a technological measure “for the sole purpose of identifying and analyzing those elements of the program that are necessary to achieve interoperability of an independently created computer pro-

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12. *Id.* § 1201(a)(2).

13. *See* H.R. REP. NO. 105-551, pt. 2, at 38 n.2 (1998).

14. 17 U.S.C. §§ 1201(a)(2)(A)-(C) (Supp. IV 1998).

15. Nimmer, *supra* note 8, at 686.

16. 17 U.S.C. § 1201(b)(1)(A) (Supp. IV 1998).

17. Nimmer, *supra* note 8, at 691.

18. *See* H.R. REP. NO. 105-551, pt.2, at 25-26 (1998).

19. 17 U.S.C. § 1201(f) (Supp. IV 1998).

gram.”<sup>20</sup> The other two subsections allow the development of circumvention devices “for the purpose of enabling interoperability of an independently created computer program with other programs.”<sup>21</sup> The third subsection takes into account the collaborative work involved in reverse engineering by exempting engineers from the “trafficking ban” if they permit the device to be made available to other persons for the purpose of interoperability, and not for gaining access to protected works for infringing purposes.<sup>22</sup>

The most controversial limitation attempts to preserve the defenses traditionally available under copyright law, including fair use.<sup>23</sup> It is unclear from the language of the provision whether or not fair use defenses can be applied to liability under the anti-circumvention provisions.<sup>24</sup>

Congress also recognized that the market behavior of copyright owners on the Internet, bolstered by a flat prohibition against circumvention of technological protection measures, could unduly hinder the public’s access to information.<sup>25</sup> In order to alleviate these concerns, Congress established a two year delay for the act-of-circumvention ban after the enactment of the DMCA. This left open the possibility of incorporating any findings of the Copyright Office on the subject of noninfringing uses of circumvention.<sup>26</sup> After hearings, comments, and statements from diverse groups (including parties involved in *RealNetworks* and *Universal*),<sup>27</sup> the Copyright Office issued its Final Rule with two narrow exemptions, neither of which would have affected the outcome of either case.<sup>28</sup>

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20. *Id.* § 1201(f)(1).

21. *Id.* § 1201(f)(2).

22. *Id.* § 1201(f)(3).

23. *Id.* § 1201(c)(1) (“Nothing in this section shall affect rights, remedies, limitations, or defenses to copyright infringement, including fair use.”).

24. *See infra* text accompanying notes 51, 105-07.

25. H.R. REP. NO. 105-551, pt.2, at 36 (1998).

26. *Id.*

27. *See* U.S. Copyright Office, Statements from Anticircumvention Hearings, at <http://www.loc.gov/copyright/1201/hearings/index.html> (last visited Feb 7, 2001) (listing participants and providing links to testimony).

28. *See* Exemption to Prohibition on Circumvention of Copyright Protection Systems for Access Control Technologies, 65 Fed. Reg. 64,556 (Oct. 27, 2000) (to be codified at 37 C.F.R. pt. 201). The first exemption is for compilations of lists of websites blocked by filtering software. The second exempts literary works protected by access control mechanisms that are broken.

## II. CASE SUMMARIES

### A. *RealNetworks, Inc. v. Streambox, Inc.*

The RealNetworks “RealPlayer” is a software application predominantly used to access “on demand” audio and video content over the Internet.<sup>29</sup> Through a “streaming” method of broadcast, the audiovisual information from originating servers can be viewed and listened to on an end-user’s computer without transferring the file.<sup>30</sup> Once the content is encoded in the “RealMedia” format, it can be hosted on any web server and contains security measures that prevent the downloading of the file onto the end-user’s computer.<sup>31</sup> This protection against copying is achieved by first using a “secret handshake” that authenticates the destination of the file as a RealPlayer, then activating a “copy switch” that prevents the download of the streamed content. If the content owner chooses to employ the copy switch with the streaming broadcast, the data will “evaporate” from the user’s computer once it finishes playing.<sup>32</sup>

Streambox made a suite of software products that facilitated different uses of content transmitted from RealServers. The Streambox “VCR” allows end-users to download RealMedia files by mimicking the authentication procedure of the secret handshake and then ignoring the copy switch.<sup>33</sup> Rather than only accessing the streamed content while connected to a RealServer, the Streambox VCR allows end-users to download the RealMedia files and store them on their computers.<sup>34</sup> The Streambox “Ripper” allows files to be converted from the RealMedia format to other music or video file formats utilized by other software programs.<sup>35</sup> The Streambox “Ferret” is a plug-in application that allows the end-user to switch from the default search engine of RealMedia to a search engine operated by Streambox.<sup>36</sup>

RealNetworks brought suit against Streambox to enjoin Streambox’s suite of products on the ground that they violated the trafficking provision in section 1201(b).<sup>37</sup> RealNetworks also alleged contributory copyright

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29. See *RealNetworks, Inc. v. Streambox, Inc.*, No. C99-2070P, 2000 U.S. Dist. LEXIS 1889, at \*5 (W.D. Wash. Jan. 18, 2000).

30. *Id.* at \*4-5.

31. *Id.* at \*5-6.

32. *Id.* at \*6.

33. *Id.* at \*10-11.

34. *Id.* at \*10-11.

35. *Id.* at \*14.

36. *Id.* at \*15.

37. Complaint for Violation of The Digital Millenium Copyright Act, Contributory, Vicarious and Direct Copyright Infringement, Tortious Interference with Contract, and

infringement and interference with contract.<sup>38</sup> RealNetworks claimed that the Streambox VCR circumvented both security features of the RealPlayer upon which content owners rely for protection against the unauthorized duplication and distribution of their copyrighted works,<sup>39</sup> thereby violating both the access control and copyright protection circumvention device provisions of the DMCA. RealNetworks also claimed that the Streambox Ripper facilitated copyright infringement by creating “unauthorized derivatives” of copyrighted works in formats other than RealMedia files.<sup>40</sup> Finally, RealNetworks claimed that the Ferret’s addition of the Streambox search engine threatened the exclusive licensing relationship between RealNetworks and Snap, the provider of RealNetworks’ search engine.<sup>41</sup>

The District Court for the Western District of Washington issued a preliminary injunction against the Streambox VCR and Ferret and denied injunctive relief against the Streambox Ripper.<sup>42</sup> The court held that the Streambox VCR (1) circumvents an access control measure by mimicking the secret handshake to gain access to the RealMedia files and (2) circumvents a copy protection measure by ignoring the copy switch.<sup>43</sup> The Streambox Ferret was enjoined on a theory of contributory copyright infringement due to its altering of the user interface of the RealPlayer.<sup>44</sup> Finally, the court found that the Streambox Ripper did not violate the DMCA because the conversion feature was distinct from copying and, in fact, potentially served beneficial uses for the copyright owner.<sup>45</sup>

RealNetworks emphasized two concerns. First, content owners would lose significant advertising revenue from decreased website traffic as a result of users viewing their downloaded copies rather than streaming the content from the copyright owner’s website each time they wanted to view it.<sup>46</sup> Second, the downloaded files would be easy fodder for piracy. As the court observed, “[o]nce an unauthorized, digital copy of a RealMedia file is created it can be redistributed to others at the touch of a button.”<sup>47</sup>

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Lanham Act Violations at ¶¶ 31-46, *RealNetworks* (No. C99-2070P), available at [http://www.realnetworks.com/company/pressroom/pr/99/rnwk\\_complaint.html](http://www.realnetworks.com/company/pressroom/pr/99/rnwk_complaint.html).

38. *Id.* at ¶¶ 47-60.

39. *RealNetworks*, 2000 U.S. Dist. LEXIS 1889 at \*7.

40. *See id.* at \*27-29.

41. *See id.* at \*33-34.

42. *Id.* at \*2-3.

43. *See id.* at \*18-19.

44. *See id.* at \*33. Since the claim was not brought under the anti-circumvention provisions, this Note will not discuss the court’s analysis of the Ferret.

45. *Id.* at \*27-30.

46. *Id.* at \*7-8.

47. *Id.* at \*13.

Streambox argued that there were substantial noninfringing uses of the Streambox products, analogizing to the foundational fair use case of *Sony Corporation of America v. Universal City Studios, Inc.*<sup>48</sup> The court, however, held that the *Sony* doctrine did not apply to the circumvention device bans of section 1201 of the DMCA.<sup>49</sup> The court reasoned that the user's conduct was irrelevant to the circumvention device ban, since "Congress specifically prohibited the distribution of the tools by which such circumvention could be accomplished."<sup>50</sup> The court cited *Nimmer on Copyright* for the proposition that manufacturers of consumer products with substantial noninfringing uses that would otherwise immunize them from liability under the *Sony* doctrine are nonetheless subject to prohibition by section 1201.<sup>51</sup>

Streambox also asserted that it was not required to manufacture its VCR with features responding to the copy switch because of the no-mandate provision of the DMCA.<sup>52</sup> The court did not rule on the validity of this defense, concluding instead that the circumvention of the secret handshake access control measure was sufficient to warrant the injunction against the Streambox VCR.

#### **B. *Universal City Studios, Inc. v. Reimerdes***

The prospect of unauthorized parties distributing motion pictures in digital format for sale on the home market led the movie studios to develop an encryption system for Digital Video Disks ("DVDs") that would prevent the piracy of their movies.<sup>53</sup> Though DVDs allow movies to be presented in a higher quality and longer-lasting format than videotape, the movie studios, who collectively own a large fraction of all copyrighted motion pictures, were concerned that DVDs also facilitate making limitless copies of movies without a reduction in quality.<sup>54</sup> CSS, or Content Scrambling System, is an encryption-based system that embeds the digital sound and graphics files on a DVD in an encryption algorithm.<sup>55</sup> A DVD

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48. 464 U.S. 417 (1984) (holding that the private home viewing of TV programs on copies made by videotape recorders is considered "fair use" and that manufacturers of those recorders cannot not be held liable for vicarious or contributory infringement).

49. *RealNetworks*, 2000 U.S. Dist. LEXIS 1889 at \*22.

50. *Id.*

51. *Id.* (citing 1 MELVILLE B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT §12A.18[B] (1999 Supp.)).

52. *Id.* at \*24-25.

53. *See Universal City Studios, Inc. v. Reimerdes*, 111 F. Supp. 2d. 294, 309-10 (S.D.N.Y. 2000).

54. *Id.* at 309.

55. *Id.* at 309-10.

that contains CSS “can be decrypted by an appropriate decryption algorithm that employs a series of keys stored on the DVD and the DVD player.”<sup>56</sup> The DVD Copy Control Association (“DVD-CCA”), a group made up of consumer electronics manufacturers and movie studios, licenses the technology that contains the key to decrypt CSS so that the content can be viewed.<sup>57</sup>

Jon Johansen, a Norwegian teenager, reverse-engineered a licensed DVD player, discovered the CSS encryption algorithm, and developed a program that was capable of performing the decryption.<sup>58</sup> He then posted the program, named DeCSS, on his website, and informed software developers for Linux, who needed the decryption of CSS for the development of a Linux-compatible DVD player.<sup>59</sup>

In late 1999, defendant Eric Corley, who publishes the magazine *2600: A Hacker Quarterly*, posted the source and object code of DeCSS on the 2600.com website as part of a story on the hacking of the DVD encryption system.<sup>60</sup> In addition to making DeCSS available for download, 2600.com included links to other locations on the Internet where DeCSS was available.<sup>61</sup> Upon learning of the existence of DeCSS, the major movie studios<sup>62</sup> sent cease and desist letters to website operators that had the program on their website and eventually filed suit against 2600 Enterprises and two other defendants.<sup>63</sup> Since Eric Corley was not the actual developer of DeCSS and since there was no act of circumvention involved in posting or linking to the code, the movie studios filed a motion for a preliminary injunction charging that making the program available for download was in violation of the “trafficking” ban on circumvention devices.<sup>64</sup> The U.S. District Court for Southern District of New York granted the injunction

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56. *Id.* at 310.

57. *Id.* at 310 & nn.60 & 63.

58. *Id.* at 311. Jon Johansen worked on the project with two other unnamed individuals.

59. *Id.* Johansen posted the program to the LiViD mailing list, an Internet community of software developers working on creating a Linux DVD player.

60. *Id.* at 308-09.

61. *Id.* at 312.

62. Universal City Studios, Inc.; Paramount Pictures Corp.; Metro-Goldwyn-Mayer Studios Inc.; TriStar Pictures, Inc.; Columbia Pictures Industries, Inc.; Time Warner Entertainment Co.; Disney Enterprises, Inc.; and Twentieth Century Fox Film Corp.

63. *Universal*, 111 F. Supp. 2d. at 309-10.

64. Complaint for Violation of Provisions Governing Circumvention of Copyright Protection Systems, 17 U.S.C. §§ 1201 et seq., *Universal* (No. 00 Civ. 0277 (LAK)), available at [http://www.eff.org/IP/MPAA\\_DVD\\_cases/20000114\\_ny\\_mpaacomplaint.html](http://www.eff.org/IP/MPAA_DVD_cases/20000114_ny_mpaacomplaint.html).

and barred the defendants from posting DeCSS.<sup>65</sup> While all three defendants removed the DeCSS program and source code from their websites, Eric Corley continued to maintain a list of over 500 external links to locations where DeCSS was available on the Internet as an act of “electronic civil disobedience.”<sup>66</sup> The movie studios subsequently amended their complaint seeking to expand the preliminary injunction to include linking to websites which contained DeCSS.<sup>67</sup>

Due to the decrypting function of DeCSS, the court held that DeCSS was clearly “a means of circumventing a technological access control measure.”<sup>68</sup> The court explained that DeCSS was prohibited under the statute since “[o]ne cannot lawfully gain access to the keys [embedded in CSS] except by entering into a license with the DVD-CCA under authority granted by the copyright owners or by purchasing a DVD player or drive containing the keys pursuant to such a license.”<sup>69</sup> The court then noted that offering DeCSS on the 2600.com website therefore violated the trafficking ban of the anti-circumvention provisions unless one of the “statutory exceptions applie[d] to their actions.”<sup>70</sup>

The movie studios argued that their copyrighted works were vulnerable to piracy over the Internet as long as DeCSS was readily available and that Eric Corley was encouraging the theft of their intellectual property. Defendants argued that DeCSS was not designed to facilitate piracy, but rather was created as part of a project to develop a DVD player for Linux.<sup>71</sup> However, the court held that “whether the development of a Linux DVD player motivated those who wrote DeCSS is immaterial to the question whether the defendants . . . violated the anti-trafficking provision of the DMCA.”<sup>72</sup> The court interpreted the anti-trafficking provision as indifferent to the actual use of the technology or the context in which it developed, concluding that whether 2600 Enterprises made DeCSS available “in order to infringe, or to permit or encourage others to infringe, copyrighted works . . . simply does not matter for purposes of Section 1201(a)(2).”<sup>73</sup> The fact that DeCSS circumvented the protection measure in DVDs, reasoned the court, was sufficient for violation of the anti-

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65. *Universal*, 111 F. Supp. 2d. at 312.

66. *Id.* at 312-13.

67. *Id.* at 324.

68. *Id.* at 317.

69. *Id.* at 317-18.

70. *Id.* at 317.

71. *Id.* at 319.

72. *Id.*

73. *Id.*

trafficking provision, "except to whatever extent motive may be germane to determining whether their conduct falls within one of the statutory exceptions."<sup>74</sup> The court noted that defendants' claim that DeCSS was created as part of an effort to create a Linux DVD player was not credible since they were aware of the program's utility in facilitating the copying of movies.<sup>75</sup>

The defendants further argued that embedding CSS in DVDs prevented some of the legitimate uses that one can make of a DVD.<sup>76</sup> The court acknowledged that "technological means of controlling access to works create a risk, depending upon future technological and commercial developments, of limiting access to works that are not protected by copyright."<sup>77</sup> The court concluded that Congress considered this impact and decided nonetheless that protection of copyright against device circumvention trumped "fair use."<sup>78</sup> The inclusion of statutory exemptions and the Copyright Office's rulemaking proceedings on exempted classes of works circumscribe the legitimate uses that can be made of works protected by technological measures.<sup>79</sup>

Defendants also defended their actions under the reverse engineering exemption in section 1201(f) since "DeCSS is necessary to achieve interoperability between computers running the Linux operating system and DVDs."<sup>80</sup> The court dismissed this claim as irrelevant because Eric Corley was not the person who reverse-engineered the DVD player.<sup>81</sup> Even if Corley had originally obtained the information, the court reasoned that the exemption does not allow for the public dissemination of a software developer's work, but rather permits him only to share that information with individuals collaborating on the interoperability project.<sup>82</sup>

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74. *Id.*

75. *Id.* at 320.

76. *See id.* at 322 (using the example of "the preparation by a film studies professor of a single CD-ROM or tape containing two scenes from different movies in order to illustrate a point in a lecture on cinematography").

77. *Id.* at 322 n.159.

78. *See id.* at 304.

79. *Id.* at 323.

80. *Id.* at 320.

81. *Id.*

82. *Id.*

### III. DISCUSSION

#### A. The Priority of Public Access in the Copyright Balance

As highlighted by the Supreme Court in the *Sony v. Universal*<sup>83</sup> decision, “[t]he monopoly privileges that Congress may authorize are neither unlimited nor primarily designed to provide a special private benefit. Rather, the limited grant is a means by which an important public purpose may be achieved.”<sup>84</sup> The Court emphasized the appropriate prioritization of this balance of interests, declaring that Congress “has been assigned the task of defining the scope of the limited monopoly that should be granted to authors or inventors *in order to* give the public appropriate access to their work product.”<sup>85</sup> These principles are inconsistent with the district courts’ interpretation of the anti-circumvention provisions of the DMCA. Holding that legitimate noninfringing uses of the Streambox VCR and DeCSS were rendered irrelevant by the use of technological measures endangers the balance that was sought in the Copyright Clause.<sup>86</sup>

The anti-circumvention provisions of the DMCA reserve broad authority over access for copyright owners utilizing technological protection systems on their copyrighted works. As is evident from the statutory definitions of a “technological measure” and “circumvention” of such a measure, the boundaries of access control are the authority of the copyright owner.<sup>87</sup> Congress introduced these legal protections for access control systems in order to “make digital networks safe places to disseminate and exploit copyrighted material.”<sup>88</sup> Yet, without meaningful exemptions to the anti-circumvention provisions, the limited monopoly over use of and access to copyrighted works ensured by copyright law would be transformed into absolute control by copyright owners.<sup>89</sup>

The district courts in *RealNetworks v. Streambox* and *Universal v. Reimerdes* were the first to interpret this structurally complex act. In both cases, the courts interpreted the various exemptions to the exclusive right to authorize access as being separate from the circumvention device ban.<sup>90</sup>

83. *Sony Corp. of Am. v. Universal City Studios, Inc.*, 464 U.S. 417, 429 (1984).

84. *Id.*

85. *Id.* (emphasis added).

86. See Pamela Samuelson, *Intellectual Property and the Digital Economy: Why the Anti-circumvention Regulations Need to be Revised*, 14 BERKELEY TECH L.J. 519, 545-46 (1999).

87. 17 U.S.C. § 1201(a)(1), (3) (Supp. IV 1998); see also *supra* text accompanying notes 10-11.

88. S. REP. NO. 105-190, at 2 (1998).

89. Nimmer, *supra* note 8, at 720-21.

90. See *supra* text accompanying notes 49-52, 73-75, 77-78.

Disconnecting inquiry into the uses of circumvention from prohibitions on circumvention devices can extend a copyright owner's authority over use to cover access as well when the technological systems are designed to protect both. In light of this, Congress explained that copyright law "historically advanced th[e] constitutional objective" of the Copyright Clause of the Constitution by "regulating the use of information—not the devices or means by which the information is delivered or used by information consumers—and by ensuring an appropriate balance between the interests of copyright owners and information users."<sup>91</sup> Unfortunately, the potential noninfringing uses of the Streambox VCR and DeCSS were essentially ignored by the district courts.

### B. Legitimate Uses of the Streambox VCR

The *Streambox* court's ruling that the *Sony* doctrine is irrelevant to the anti-circumvention prohibitions is inconsistent with the provision preserving the traditional defense of "fair use" in copyright infringement analysis.<sup>92</sup> As a technology that can record broadcast media and store that information on a user's local device, the Streambox VCR is the Internet equivalent of the Betamax video tape recorder. In *Sony*, the Supreme Court determined that the Betamax was capable of noninfringing uses of television broadcasts because it facilitated the "private, noncommercial time-shifting in the home."<sup>93</sup> The biggest difference between the legitimate uses of the Betamax and the Streambox VCR stems from the difference between broadcast television and the Internet. Since streamed programming is available on demand whenever a user is connected to the Internet, the convenience of "time-shifting" is rendered unnecessary. The convenience afforded by the Streambox VCR, as suggested in Streambox's advertising, is that Internet users can "'download RealAudio and RealMedia files as [they] . . . would any other file, then reap the benefits of clean, unclogged streams straight from [their] hard drive."<sup>94</sup> The majority of users do not have a fast Internet connection that is always on, and the streaming "RealMedia" clips are susceptible to skipping during times of heavy Internet traffic and can also get interrupted due to software mal-

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91. H.R. REP. NO. 105-551, pt.2, at 24 (1998).

92. *See supra* text accompanying note 51.

93. *Sony Corp. of Am. v. Universal City Studios, Inc.*, 464 U.S. 417, 442 (1984).

94. *RealNetworks, Inc. v. Streambox, Inc.*, No. C99-2070P, 2000 U.S. Dist. LEXIS 1889, at \*13 (W.D. Wash. 2000).

function.<sup>95</sup> The Streambox VCR therefore provides the useful service of “space-shifting” the RealMedia files so that they can be viewed without the limitations of Internet connection speeds and unstable streaming transmissions.

RealNetworks insisted that the downloading of files enabled by the Streambox VCR subverts the access and copy protection features that “empower the copyright owner to determine how to distribute the content and how to obtain remuneration for it.”<sup>96</sup> The court was persuaded by the primacy of the copyright owners’ authority, distinguishing the case from *Sony* because “copyright owners have specifically chosen to prevent the copying enabled by the Streambox VCR by putting their content on RealServers and leaving the copy switch off.”<sup>97</sup> RealNetworks argued that “by circumventing protections for copyright holders, Streambox’s VCR and Ripper enable the widespread infringement of works that were not supposed to be copied or modified by end-users.”<sup>98</sup> Regarding the legitimate uses individuals may have for the Streambox VCR, RealNetworks argued that the fair use exceptions available to defendants in copyright infringement cases do not apply to violations of the anti-circumvention provisions of the DMCA.<sup>99</sup>

RealNetworks responded to Streambox’s claim that the VCR allows end-users to access otherwise unobtainable files by declaring that those “files are unobtainable because the content owners want it that way.”<sup>100</sup> It is unclear whether or not the proprietary aspect of the secret handshake allows RealNetworks to have the exclusive authority for granting access to all RealMedia files. Regulating the Streambox VCR’s access to RealMedia files that are in the public domain is certainly outside the authority of copyright owners.<sup>101</sup> For example, most audio and video clips of court-

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95. See RealPlayer Plus 5.0 FAQs, available at <http://pluszone.real.com/pp5backnew.html#traffic> and <http://pluszone.real.com/pp5general.html#multiple> (last visited Feb. 5, 2001).

96. Plaintiff’s Reply Brief in Support of Preliminary Injunction at § I(B), *RealNetworks* (No. C99-2070P) available at [http://www.realnetworks.com/company/pressroom/pr/99/m\\_replybrief.html](http://www.realnetworks.com/company/pressroom/pr/99/m_replybrief.html). [hereinafter RealNetworks Reply Brief].

97. *RealNetworks*, 2000 U.S. Dist. LEXIS 1889, at \*22.

98. RealNetworks Reply Brief, *supra* note 96, at § III.

99. See *id.* at § I(B).

100. *Id.* at § I(A).

101. See generally Yochai Benkler, *Free As The Air To Common Use: First Amendment Constraints On Enclosure Of The Public Domain*, 74 N.Y.U. L. REV. 354 (1999). (arguing that laws which conceive of information as an owned commodity remove uses of information from the public domain and place them under the copyright owner’s exclusive control).

room proceedings or congressional hearings remain on the CSPAN website for only a few days.<sup>102</sup> After they are removed, users cannot have access to them without having downloaded them with the Streambox VCR. As this example shows, the exclusive right to authorize access for all works encrypted behind technical protection systems is overreaching if not limited by exemptions allowing for circumvention according to the principles of fair use.<sup>103</sup>

### C. Fair Use Exemptions

At the heart of the debate over the interpretation of the DMCA is the survival of fair use as a defense against liability under the anti-circumvention provisions. Section 1201(c)(1) explicitly states that “[n]othing in this section shall affect rights, remedies, limitations, or defenses to copyright infringement, including fair use.”<sup>104</sup> The tension over the interpretation of this exemption is whether the defenses can be applied to violations of the anti-circumvention provisions or whether they only apply in cases of copyright infringement. If the anti-circumvention prohibitions are distinct from copyright infringement, defendants can be held liable for circumventing an access control measure even if the uses made of the work are held not to infringe on the rights of the copyright owner.<sup>105</sup> Professor Pamela Samuelson, though, urges courts to “distinguish between circumvention aimed at getting unauthorized access to a work and circumvention aimed at making noninfringing uses of a lawfully obtained copy.”<sup>106</sup> Professor Jane Ginsburg points out that the comma before the clause “including fair use” may indicate that fair use is applicable not only to copyright infringement claims but also to all provisions under Title 17.<sup>107</sup>

The *Streambox* court did not even mention section 1201(c)(1) in its decision. Rather, the court relied on *Nimmer on Copyright* to support the inapplicability of fair use to manufacturers or distributors of circumvention devices.<sup>108</sup> The *Universal* court also distinguished the application of

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102. See <http://www.cspan.org> (stating that “[m]ost events will remain in the archive for 15 days or less” when one searches for an old event in the Search the Program Archives feature).

103. See Samuelson, *supra* note 86, at 543.

104. 17 U.S.C. § 1201(c)(1) (Supp. IV 1998).

105. Cf. Samuelson, *supra* note 86, at 539 n.108.

106. *Id.* at 539.

107. Jane C. Ginsburg, From Having Copies to Experiencing Works: the Development of an Access Right in U.S. Copyright Law, 15 (Public Law & Legal Theory Working Paper Group 2000), available at [http://papers.ssrn.com/paper.taf?abstract\\_id=222493](http://papers.ssrn.com/paper.taf?abstract_id=222493).

108. See *supra* text accompanying note 51.

fair use to circumvention violations from copyright infringement claims, stating that “[i]f Congress had meant the fair use defense to apply to such actions, it would have said so.”<sup>109</sup>

Congress did in fact establish a forum for reviewing the fair use implications of the anti-circumvention provisions in the biennial rule-making proceedings established in section 1201(a)(1)(C).<sup>110</sup> The statute provides that exemptions created by the rule-making process apply only to the act-of-circumvention ban and explicitly states that such exemptions may not be “used as a defense in any action to enforce any provision of this title other than this paragraph.”<sup>111</sup> Nevertheless, in the discussion of DVDs as a possible class for exemption in the first rulemaking decision, the Copyright Office recognized that the uses of a copyrighted work are in fact implicated by the restriction of access but deferred the question back to Congress.<sup>112</sup> The Copyright Office noted that it “would be helpful if Congress were to clarify its intent,” since Congress “did create a distinction between the conduct of circumvention of access controls and the conduct of circumvention of use controls by prohibiting the former while permitting the latter.”<sup>113</sup> Technological protections adopted by copyright owners that merge these two types of controls “would undermine Congress’ decision to offer disparate treatment for access controls and use controls.”<sup>114</sup>

#### D. The Threat to Interoperability

Copyright law has traditionally allowed reverse engineering of products in the open market. Reverse engineering promotes the production of improved products and enhances competition. Of particular importance to the information technology industry is the ability to make products that are interoperable with industry standards. For example, software applications require interoperability with software platforms so they can run smoothly together.<sup>115</sup> In apparent accordance with this tradition, the DMCA allows

109. *Universal City Studios, Inc. v. Reimerdes*, 111 F. Supp. 2d 294, 322 (S.D.N.Y. 2000).

110. 17 U.S.C. § 1201(a)(1)(C) (Supp. IV 1998). *See supra* text accompanying notes 25-27.

111. 17 U.S.C. § 1201(a)(1)(E) (Supp. IV 1998).

112. *Exemption to Prohibition on Circumvention of Copyright Protection Systems for Access Control Technologies*, 65 Fed. Reg. 64,556, 64,568 (Oct. 27, 2000) (to be codified at 37 C.F.R. pt. 201).

113. *Id.*

114. *Id.*

115. *See* American Committee for Interoperable Systems (“ACIS”), *Comments on “Intellectual Property and the National Information Infrastructure,”* at 2-3 (Sept. 1, 1994), available at <http://www.interop.org/greenComments.html> [hereinafter ACIS Comments].

circumvention of technological protection measures in order to achieve interoperability.<sup>116</sup>

Unfortunately, the DMCA's reverse engineering exemption was interpreted too narrowly by the *Universal* court. The court ruled that the manner in which Jon Johansen shared his reverse engineering results was outside the scope of legitimate collaboration and instead was a "public dissemination of means of circumvention."<sup>117</sup> The ruling affects the development structure of open source software, which is organized to facilitate collaborative projects within a particular community but is open to all Internet users.<sup>118</sup> This type of product development has been an integral element in the success of Linux in the computer industry. The further acceptance of Linux in the consumer market as a practicable operating system alternative to Windows depends on the ability of users to utilize the same mainstream applications, including the ability to view DVD movies. The court doubted the credibility of the developers of DeCSS, finding that the developers of DeCSS were aware "that DeCSS could be used to decrypt and play DVD movies on Windows as well as Linux machines."<sup>119</sup> The court noted that the piracy of copyrighted works was therefore facilitated by DeCSS since "the decrypted files could be copied like any other unprotected computer file."<sup>120</sup> Nevertheless, the court's interpretation of the reverse engineering exemption disadvantages open source software developers, whose collaborative nature does not allow for the same degree of secrecy as traditional product development.<sup>121</sup>

The exemption undermines its own purpose when it is interpreted so that copyright owners maintain control over the authorization to reverse-engineer beyond the point when the work is lawfully acquired. While the various provisions of section 1201(f) exempt software developers from the act-of-circumvention ban and the circumvention device ban, they do not exempt reverse engineering from violations of the copyright protection circumvention device provision.<sup>122</sup> Since the development of software through the use of reverse engineering necessitates the creation of an intermediate copy of the work, the programmer risks copyright infringement

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116. 17 U.S.C. § 1201(f) (Supp. IV 1998).

117. *Universal City Studios, Inc. v. Reimerdes*, 111 F. Supp. 2d. 294, 320 (S.D.N.Y. 2000).

118. A message posted to an Internet discussion list that contains information about technological protection systems can be considered dissemination of a circumvention device since the information is potentially available to all Internet users.

119. *Universal*, 111 F. Supp. 2d at 320.

120. *Id.*

121. See *supra* text accompanying note 75.

122. *Nimmer, supra* note 8, at 701.

in the very act of reverse engineering.<sup>123</sup> The fact that copyright law considers backup copying a privileged activity would not be helpful to the programmer's dilemma if the work was protected behind a technological copy protection measure.<sup>124</sup> The reverse engineering exemption would therefore be rendered meaningless if the copyright owner employed technological measures that control both access to and use of the copyrighted work.<sup>125</sup> A more appropriate construction of the provisions would focus "on the uses to which those devices are put rather than the devices themselves."<sup>126</sup>

#### IV. CONCLUSION

The Digital Millennium Copyright Act marks a significant departure from copyright law's traditional focus on the infringing acts of violators to the prohibition of devices and services that facilitate circumvention. The provisions upset the balance between copyright protection and public access by assigning absolute rights to the copyright owner while creating only narrow exemptions for technology innovators, academic researchers, and the general public. In the first two cases tried under the new anti-circumvention provisions, the court's rulings exacerbated the imbalance between the protection of copyright in the digital age and the limitations on that right for the sake of public access. The fate of a thriving electronic marketplace, where consumers can enjoy their art and information in ways appropriate to their needs, now rests in the hands of higher courts.

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123. Terril Lewis, *Reverse Engineering of Software: An Assessment of the Legality of Intermediate Copying*, 20 LOY. L.A. ENT. L. REV. 561, 564 (2000).

124. See Samuelson, *supra* note 86, at 550-51.

125. See *supra* text accompanying notes 112-114.

126. ACIS Comments, *supra* note 115, at 7.



## IMS TECHNOLOGY, INC. V. HAAS AUTOMATION, INC. & KEMCO SALES, INC. V. CONTROL PAPERS Co.

By Eva M. Ogielska

The complexity of patent claim interpretation reflects the delicate balance of interests between the public and the inventor. Interpreting claims too narrowly may unfairly deprive the inventor of his property rights, while overly broad interpretation may negatively affect the public by discouraging technological innovation.<sup>1</sup> The difficulties of claim interpretation are particularly apparent in the judicial construction of means-plus-function claims.<sup>2</sup> Two recent decisions in the Federal Circuit, *IMS Technology, Inc. v. Haas Automation, Inc.*<sup>3</sup> and *Kemco Sales, Inc. v. Control Papers Co.*,<sup>4</sup> exemplify the unsystematic approach of the Federal Circuit in interpreting means-plus-function claims.

Partly due to the scarcity of legislative guidance, judicial constructions of means-plus-function claims have not been uniform or equitable to the patentee. The resulting ambiguity renders impossible a prospective evaluation of the scope and validity of individual means-plus-function claims. In addition, the present system is inequitable to the patentee as the infringement determination ultimately hinges on the particular standard of construction employed by the court. To insure that patentees are granted the appropriate scope of protection, the courts must implement a uniform set of criteria for construing means-plus-function claims.

This Note advocates the approach taken in *IMS* where the Federal Circuit considered the relative importance of a structure claimed in means-plus-function language to the invention as a whole. More specifically, this Note contends that such a contextual approach would result in a more equitable literal infringement determination since it would simultaneously

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1. See *Hilton Davis Chem. Co. v. Warner-Jenkinson Co.*, 62 F.3d 1512, 1531-32. (Fed. Cir. 1995) (Newman, J., concurring).

2. 35 U.S.C. § 112, ¶ 6 (1994). See, e.g., *Dawn Equip. Co. v. Kentucky Farms, Inc.* 140 F.3d 1009 (Fed. Cir. 1998); *Chiuminatta Concrete Concepts, Inc., v. Cardinal Indus., Inc.*, 145 F.3d 1303 (Fed. Cir. 1998); *Valmont Indus., Inc., v. Reinke Mfg. Co.*, 983 F.2d 1039 (Fed. Cir. 1993).

3. 206 F.3d 1422 (Fed. Cir. 2000).

4. 208 F.3d 1352 (Fed. Cir. 2000).

provide more certainty and be sufficiently flexible to protect the property rights of patentees adequately.

## I. BACKGROUND

Patent claims delineate the legal bounds of the invention and place competitors on notice regarding potential infringement liability.<sup>5</sup> The Patent Act does not dictate a particular claim format, unless a patentee elects to utilize "means-plus-function" claims defined in 35 U.S.C. § 112, paragraph 6.<sup>6</sup> Since certain combination inventions do not readily lend themselves to a structural description, § 112, paragraph 6 provides that the patentee may claim the invention using functional language.<sup>7</sup>

More precisely, means-plus-function claims allow the drafter to claim an element of a combination "as a means or step for performing a specific function without the recital of structure, material, or acts in support thereof."<sup>8</sup> By allowing the patentee to claim his invention in functional language, means-plus-function claims are intended to "grant the [patentee] . . . a fair scope that is not dependent on a catalogue of alternative embodiments in the specification."<sup>9</sup> The statute provides that such a claim does not cover every possible means of accomplishing a particular function.<sup>10</sup> Rather, the scope of the claim is limited to the "corresponding structure, material, or acts described in the specification and equivalents

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5. Full disclosure requires that a patent applicant "particularly point[] out and distinctly claim[] the subject matter which the applicant regards as his invention." 35 U.S.C. § 112, ¶ 2 (1994). In exchange for full disclosure, the inventor obtains the right to prohibit others from making, using, selling, offering for sale, or importing a patented invention for a period of twenty years from the date the patent is filed. *Id.* § 271(a).

6. An element in a claim for a combination may be expressed as a means or step for performing a specified function without the recital of structure, material, or acts in support thereof, and such claim shall be construed to cover the corresponding structure, material, or acts described in the specification and equivalents thereof.

*Id.* § 112, ¶ 6.

7. Congress enacted § 112, paragraph 6 in 1952 to overrule an earlier Supreme Court decision in *Halliburton Oil Well Cementing Co. v. Walker*, 329 U.S. 1 (1946) (invalidating means-plus-function claims because of the worry that coverage would be overbroad).

8. 35 U.S.C. § 112, ¶ 6 (1994). As an example, a patentee may claim "a means for toasting bread," rather than limiting himself to claiming a toaster.

9. *Texas Instruments, Inc. v. U.S. Int'l Trade Comm'n*, 805 F.2d 1558, 1562 (Fed. Cir. 1986).

10. *See Valmont Indus., Inc. v. Reinke Mfg. Co.*, 983 F.2d 1039, 1042 (Fed. Cir. 1993).

thereof.”<sup>11</sup> Lack of corresponding structure in the specification renders the claim indefinite under § 112, paragraph 2.<sup>12</sup>

Because § 112, paragraph 6 includes the phrase, “and its equivalents,” means-plus-function claim elements are construed differently from claims that recite structure. Literal infringement of a structural claim requires that the accused device embody all of elements recited in the patent claim.<sup>13</sup> In the case of structural claims, all equivalence determinations are reserved for an analysis of nonliteral infringement under the doctrine of equivalents.<sup>14</sup> Literal infringement of a means-plus-function claim requires identity between the function recited in the claim and the function performed by the accused device.<sup>15</sup> Furthermore, the accused structure must be identical or equivalent to the corresponding structure disclosed in the specification.<sup>16</sup> The two structures are equivalent if the differences between the disclosed structure and the structure in the accused device are insubstantial<sup>17</sup> and add “nothing of significance to the structure, material, or acts disclosed in the patent specification.”<sup>18</sup> The examination of equivalence under § 112, paragraph 6 involves the “application of the doctrine of equivalents . . . in a restrictive role.”<sup>19</sup>

Although seemingly innocuous, judicial interpretations of § 112, paragraph 6 are fraught with confusion even though its purpose “was to provide clear parameters within which means-plus-function claims could be drawn and sensibly construed.”<sup>20</sup> A determination of infringement may arise under § 112, paragraph 6 *or* the doctrine of equivalents,<sup>21</sup> although

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11. 35 U.S.C. § 112, ¶ 6. *See generally* Greenberg v. Ethicon Endo-Surgery, Inc., 91 F.3d 1580, 1582 (Fed. Cir. 1996).

12. *See In re Donaldson Co.*, 16 F.3d 1189, 1195 (Fed. Cir. 1994) (en banc).

13. ROBERT P. MERGES, ET AL., *INTELLECTUAL PROPERTY IN THE NEW TECHNOLOGICAL AGE* 255 (2d Ed. 2000).

14. *See, e.g.*, Graver Tank & Mfg. Co. v. Linde Air Products Co. 339 U.S. 605 (1950).

15. *See Al-Site Corp. v. VSI Int'l, Inc.*, 174 F.3d 1308, 1320 (Fed. Cir. 1999); *Valmont Indus., Inc. v. Reinke Mfg. Co.*, 983 F.2d 1039, 1042 (Fed. Cir. 1993); *Pennwalt Corp. v. Durand-Wayland, Inc.*, 833 F.2d 931, 934 (Fed. Cir. 1987) (en banc).

16. *See Al-Site Corp.*, 174 F.3d at 1320; *Valmont Indus.*, 983 F.2d at 1042; *Pennwalt Corp.*, 833 F.2d at 934.

17. *See Chiuminatta Concrete Concepts, Inc., v. Cardinal Indus., Inc.*, 145 F.3d 1303, 1309 (Fed. Cir. 1998).

18. *Valmont Indus.*, 983 F.2d at 1043.

19. *Warner-Jenkinson Co. v. Hilton Davis Chem. Co.* 520 U.S. 17, 28 (1997).

20. *Dawn Equip. Co. v. Kentucky Farms, Inc.*, 140 F.3d 1009, 1021 (Fed. Cir. 1998).

21. Whereas § 112, paragraph 6 is a statutory determination that forms the basis of literal infringement, the doctrine of equivalents is an equitable doctrine which was judi-

the doctrine of equivalents may only be invoked once there is a finding of no literal infringement.<sup>22</sup> The goal of the doctrine of equivalents is to broaden the scope of protection beyond what is afforded by the patent claims by an additional independent inquiry into whether the accused device is equivalent to the claimed invention.<sup>23</sup> The inclusion of an equivalence determination within literal infringement complicates the application of the doctrine of equivalents, because any analysis of literal infringement will necessarily involve an assessment of both identical and equivalent structures. Given the seemingly duplicative determination of equivalence, the application of the doctrine of equivalents appears to be redundant in the context of means-plus-function claims. In *D.M.I., Inc. v. Deere & Co.*,<sup>24</sup> the Federal Circuit attempted to differentiate between § 112, paragraph 6 and the doctrine of equivalents:

In applying the doctrine of equivalents, the fact finder must determine the range of equivalents to which the claimed invention is entitled, in light of the prosecution history, the pioneer-non-pioneer status of the invention, and the prior art. In applying the 'means plus function' paragraph of § 112 however, the sole question is whether the single means in the accused device which performs the function stated in the claim is the same as or equivalent of the corresponding structure described in the patentees specification as performing that function.<sup>25</sup>

In practice, both measures of equivalence involve a similar analysis of insubstantial differences between the accused device and the asserted claim.<sup>26</sup> If the literal scope of means-plus-function claims already includes equivalent structures, it is unclear what room, if any, is left for applying the doctrine of equivalents.

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cially established to prevent competitors from undermining the scope of an existing patent by developing devices that insubstantially differ from the claimed invention. *See, e.g.,* Wayne Kennard, *Judicially Created Doctrine Of Equivalents And Equivalents Under 35 U.S.C. § 112, Sixth Paragraph*, 532 PLI/PAT 219 (1998).

22. *See generally id.*

23. The doctrine of equivalents provides that "a product or process that does not literally infringe upon the express terms of a patent claim may nonetheless be found to infringe if there is 'equivalence' between the elements of the accused product or process and the claimed elements in the patented invention." *Warner-Jenkinson*, 520 U.S. at 21.

24. 755 F.2d 1570 (Fed. Cir. 1985).

25. *Id.* at 1575.

26. *Chiuminatta Concrete Concepts, Inc. v. Cardinal Indus., Inc.*, 145 F.3d 1303, 1310 (Fed. Cir. 1998).

The Federal Circuit has endorsed the application of a modified function-way-result test<sup>27</sup> to determine equivalence under § 112, paragraph 6.<sup>28</sup> Since § 112, paragraph 6 equivalence requires that the function of the element in the accused device be identical to the claim recitation, the function-way-result test compares the way the function is accomplished and the result achieved.<sup>29</sup> Because the “way” and “result” prongs are the same under the § 112, paragraph 6 inquiry and the doctrine of equivalents, once an accused device fails either prong under § 112, paragraph 6 inquiry, the patentee cannot ask for the same analysis under the doctrine of equivalents. In other words, because “an element of a device cannot be ‘not equivalent’ and equivalent to the same structure,”<sup>30</sup> the Federal Circuit eliminated the option of litigating patent infringement under the doctrine of equivalents if the accused device performs the identical function in a substantially different way or if it achieves a substantially different result.<sup>31</sup>

## II. CASE SUMMARIES

In *IMS Technologies v. Haas*<sup>32</sup> and *Kemco Sales v. Control Papers*,<sup>33</sup> the Federal Circuit addressed the issue of literal claim scope under § 112, paragraph 6 and the scope of equivalent structures. In addition to the modified function-way-result test, the court in *IMS* called for an analysis of the relative importance of the means clause to the invention as a whole.

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27. To satisfy the “function-way-result” test the accused device must perform substantially the same function, in substantially the same way, to achieve substantially the same result as each element in the patent claim. *Graver Tank & Mfg. Co. v. Linde Air Prods. Co.*, 339 U.S. 605 (1950).

28. *Dawn Equip. Co. v. Kentucky Farms, Inc.*, 140 F.3d 1009, 1016 (Fed. Cir. 1998).

29. *Id.*

30. *Chiuminatta Concrete Concepts*, 145 F.3d at 1311.

31. *Id.* If a patentee is able to invoke the function-way-result once for the determination of structural equivalence and again for the doctrine of equivalents determination, the patentee effectively would get “two bites at the apple.” *Id.* at 1311.

In narrow circumstances the Federal Circuit does provide an exception to its pronouncement foreclosing the option of litigating under the doctrine of equivalents. In *Chiuminatta*, the Federal Circuit held that if the accused device employed technology that was unavailable at the time the patent was issued, a finding of no literal infringement under § 112, paragraph 6 did not preclude the application of the doctrine of equivalents. *Id.* at 1310. In *Kraft Foods, Inc., v. International Trading Co.*, 203 F.3d 1362 (Fed. Cir. 2000), the Federal Circuit clarified that the *Chiuminatta* holding applied *only* to means-plus-function claims.

32. 206 F.3d 1422 (Fed. Cir. 2000).

33. 208 F.3d 1352 (Fed. Cir. 2000).

This contextual approach to means-plus-function claims allows the court to vary the range of equivalent structures depending on the relative importance of the means clause to the invention as a whole. If the means-plus-function element is at the point of novelty, the range of permissible equivalents is considerably narrower. If, however, the means-plus-function element is relatively insignificant to the invention, the range of permissible equivalents is broad. The *Kemco* opinion advocates a narrower view of § 112, paragraph 6 equivalence and therefore indirectly supports a broader role for the doctrine of equivalents. Together, these decisions illustrate the tensions between the doctrine of equivalents and § 112, paragraph 6, as well as the inconsistent judicial approaches to interpreting means-plus-function claims.

**A. *IMS Technology, Inc. v. Haas Automation, Inc.***

IMS Technology Inc. (“IMS”) sued Haas Automation Inc. (“Haas”) for infringement of U.S. Patent 4,377,754 (“the ’754 patent”), which used means-plus-function language to claim a control apparatus for a machine tool.<sup>34</sup> The Federal Circuit reversed the district court’s grant of summary judgment for the defendant and remanded the case, on the grounds that the district court erred in its claim construction by failing to consider the relative importance of the means clause to the invention as a whole.<sup>35</sup>

*1. Factual Background*

The ’754 patent claims a control apparatus that enables the operator of a machine tool, used to cut or remove material from an object, to interactively control the operations of the tool on the shop floor.<sup>36</sup> The numerical control apparatus claimed in the ’754 patent enables the operator to create a program by using a keyboard to respond to a series of prompts displayed on a screen.<sup>37</sup> The program is subsequently converted to electrical signals that ultimately control the movement of the machine tool.<sup>38</sup> During its creation, the program is temporarily stored in random access memory (“RAM”) and may be stored permanently on a tape cassette,<sup>39</sup> or in an unspecified storage format.<sup>40</sup>

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34. *IMS Tech., Inc. v. Haas Automation*, 206 F.3d 1422, 1425 (Fed. Cir. 2000).

35. *Id.* at 1425.

36. *Id.* at 1426. Prior to this invention the operator was unable to interactively control the machine tool, and the control program for the machine tool required a programmer to input the relevant coordinates prior to the commencement of operations. *Id.*

37. *Id.* at 1426.

38. *Id.*

39. *Id.*

40. *Id.*

The defendant, Haas, manufactured machine tools with interactive programming capability.<sup>41</sup> Haas' control system used either a floppy disk drive or an RS-232 data port for data storage.<sup>42</sup> IMS filed suit against Haas alleging that the Haas control system infringed claims 1 and 7 of the '754 patent.<sup>43</sup>

## 2. *The Federal Circuit Decision*

On appeal the Federal Circuit reviewed de novo whether a floppy disk drive could be an equivalent structure to a cassette recorder.<sup>44</sup> The Federal Circuit held that the district court erred in its interpretation of the term "interface means," which if properly construed encompassed a tape cassette recorder and its equivalents.<sup>45</sup>

The Federal Circuit determined that the "interface means" was subject to § 112, paragraph 6, and that the means clause recited two functions.<sup>46</sup> One function was "recording" a control program and parameters from al-

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41. *Id.*

42. *Id.* at 1426. The RS-232 data port may be used to connect the numerical control to an external storage device allowing the program to be permanently stored.

43. *Id.* The pertinent portion of claim 1 recites: "programmable microcomputer control apparatus for controlling the relative motion between a tool and a workpiece comprising: . . . interface means for transferring a control program and control parameters from an external medium into said alterable memory and for recording the control parameter contents of said memory onto an external medium; . . ." *Id.* at 1427. Based on its construction of "interface means," the district court ruled that a tape cassette was not equivalent to a floppy disk drive, and granted summary judgment of non-infringement. *Id.* at 1428. IMS appealed. *Id.*

44. *Id.* at 1437.

45. *Id.* According to the Federal Circuit, the district court also erred in its construction of the "data block" limitation by construing the claim too narrowly rather than relying on the ordinary meaning of the phrase. *Id.* at 1437. The Federal Circuit concurred with the district court that the claim element at issue was subject to a § 112, paragraph 6 construction. The court noted that § 112, paragraph 6

does not limit all terms in a means-plus-function or step-plus-function clause to what is disclosed in the written description and the equivalents thereof; § 112, paragraph 6 applies only to interpretation of the means or step that performs a recited function when a claim recites insufficient structure or acts for performing the function. . . . The 'data block' is not the means that causes the sequential display and is therefore not subject to construction under § 112, paragraph 6.

*Id.* at 1432. Thus, the court determined that, in the absence of ambiguity in the claim language or contradictory statements in the written description or prosecution history, the term data block should be interpreted according to its ordinary meaning. Given the district court's errors in claim construction, the summary judgment of non-infringement was vacated. *Id.*

46. *Id.* at 1430.

terable memory into an external medium. The other was "transferring" a control program and parameters from an external medium into alterable memory.<sup>47</sup> According to the court, the corresponding structures disclosed in the written description were, respectively, the peripheral interface adapter ("PIA") and the tape recorder.<sup>48</sup>

To support a finding of literal infringement under § 112, paragraph 6, the accused Haas device must perform a function identical to the "interface means" using an identical or equivalent structure.<sup>49</sup> The court found that the floppy disk employed by Haas performed transfer and recording functions identical to those performed by the tape cassette recorder employed by IMS.<sup>50</sup> Given that a tape cassette recorder is clearly not an identical structure to a floppy disk, the court considered whether the two structures were equivalent under § 112, paragraph 6,<sup>51</sup> taking into account the substantiality of the differences in the context of the claimed invention.<sup>52</sup>

Writing for the panel, Judge Plager stated that "the context of the invention should be considered when performing a § 112, paragraph 6 equivalence analysis just as it is in a doctrine of equivalents determination."<sup>53</sup> Judge Plager further explained that when the particular structure corresponding to a means-plus-function claim element is of little consequence to the claimed invention, the range of permissible equivalents might be broader than in instances when the corresponding structure is an integral aspect of the claimed invention.<sup>54</sup> Thus, two structures that would be considered equivalent in one set of circumstances might not be considered equivalent in another.<sup>55</sup> In its analysis of whether a floppy disk drive was equivalent to a tape cassette recorder, the court considered the relative importance of the structure to the whole invention.<sup>56</sup> The court concluded that the physical characteristics of the "interface means" were not impor-

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47. *Id.*

48. *Id.* at 1432. Both the PIA and the tape recorder are necessary to record and transfer the control program and parameters from the external medium to the alterable memory. These two functions together compose the claimed "interface means." *Id.* at 1431.

49. *Id.* at 1435.

50. *Id.*

51. *Id.*

52. *Id.* at 1436.

53. *Id.* at 1436. This analysis was partially based on an earlier Federal Circuit decision, where the court established equivalence under the doctrine of equivalents based on a similar analysis. *Texas Instruments, Inc. v. U.S. Int'l Trade Comm'n*, 805 F.2d 1558 (Fed. Cir. 1986).

54. *IMS Tech.*, 206 F.3d at 1437.

55. *Id.* at 1436.

56. *Id.* at 1436-37.

tant to the invention as a whole, and therefore the range of permissible equivalents under § 112, paragraph 6 was broad.<sup>57</sup>

To determine whether the differences between the tape cassette recorder and the floppy disk drive were substantial “in light of the role played by the ‘interface means’ in the claimed invention” the court suggested the condensed function-way-result test.<sup>58</sup> Since issues of material fact existed, the Federal Circuit vacated the district court’s grant of summary judgment and remanded the case.<sup>59</sup>

### ***B. Kemco Sales v. Control Papers Co.***

Plaintiff Kemco Sales (“Kemco”) alleged that Control Papers (“Control”) infringed U.S. Patent No. 5,405,197 (“the ’197 patent”).<sup>60</sup> In its analysis of equivalence under § 112, paragraph 6, the Federal Circuit did not consider the relative importance of the means clause to the invention as a whole and affirmed the district court’s grant of summary judgment for the defendant.

#### *1. Factual Background*

The ’197 patent discloses a plastic, tamper-resistant security envelope, which allows the user to readily determine whether the integrity of the seal was compromised.<sup>61</sup> The envelope employs two seals, one to seal the contents within the envelope and the other to serve as an indicator for any tampering.<sup>62</sup> The disputed claim<sup>63</sup> was phrased in means-plus-function format and therefore subject to § 112, paragraph 6. The disclosed means for sealing the envelope is a plastic flap that folds over the opening and is subsequently secured to the outside panel.<sup>64</sup> The accused device similarly employs a dual sealing mechanism, but it closes by a dual-lip structure,

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57. *Id.* at 1437.

58. *Id.*

59. *Id.*

60. *Kemco Sales, Inc. v. Control Papers Co.*, 208 F.3d 1352, 1354 (Fed. Cir. 2000).

61. *Id.* at 1355.

62. *Id.*

63. The pertinent portion of the disputed claim states: “A tamper-evident sealing system for an envelope made at partially of plastic material comprising: . . . [a] plastic envelope closing means secured to the plastic envelope material to close the opening and to form a closed pocket, the closing means having at least one traverse edge . . .” *Id.* at 1355.

64. *Id.* at 1356. In the preferred embodiment the first sealing means utilizes an adhesive tape located on an extended flap that is folded over to close the envelope and secure the contents. The second sealing means similarly employs an adhesive tape on an extended flap and also functions by a fold over mechanism. *Id.*

which seals by virtue of an internal adhesive.<sup>65</sup> The accused device does not employ a fold-over flap, but rather requires that the edges of the envelope be pressed against one another to accomplish the sealing function.<sup>66</sup>

## 2. *The Federal Circuit Decision*

In determining whether the fold-over flap and the dual lip seals were § 112, paragraph 6 equivalents, the Federal Circuit applied the function-way-result test.<sup>67</sup> The Federal Circuit affirmed the district court's conclusion that the corresponding structure was a fold-over flap, which was secured to the outside panels of the envelope.<sup>68</sup> The dual lip seal of the accused device performed the same function recited in the means clause, namely the prevention of exit or entry once the envelope was sealed.<sup>69</sup> The Federal Circuit held that the dual-lip technology closed the envelope in a substantially different way from the disclosed invention and achieved a substantially different result.<sup>70</sup> Since the "way" and the "result" were substantially different, the Federal Circuit concluded that the accused device did not literally infringe the '197 patent. Consideration of the doctrine of equivalents was precluded because the accused device operated in a substantially different way and achieved a substantially different result.<sup>71</sup> The Federal Circuit did not consider the substantiality of the differences in the context of the claimed invention.

### III. DISCUSSION

Historically, courts have vacillated between an extremely generous interpretation of means clauses that focuses almost exclusively on the similarity in function between the accused device and the claimed invention,<sup>72</sup> and an extremely rigid approach that compares the physical similarity of the disclosed and the accused structures.<sup>73</sup> *IMS*<sup>74</sup> and *Kemco*<sup>75</sup> exemplify

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65. *Id.* at 1357-58. As in the claimed invention the first sealing means is aimed at securing the contents of the envelope, while the second sealing means provides a mechanism to indicate any evidence of tampering. *Id.*

66. *Id.*

67. *Id.* at 1364.

68. *Id.* at 1361. The construction adopted by the court was based on the written description and the provided drawings. *Id.* at 1362.

69. *Id.* at 1361.

70. *Id.* at 1364-65.

71. *Id.*

72. *See, e.g.,* *Odetics, Inc. v. Storage Tech. Corp.*, 185 F.3d 1259 (Fed. Cir. 1999); *Al-Site Corp. v. VSI Int'l, Inc.*, 174 F.3d 1308 (Fed. Cir. 1999).

73. *See, e.g.,* *Odetics, Inc. v. Storage Tech. Corp.*, 185 F.3d 1259 (Fed. Cir. 1999) (Lourie, J., dissenting); *Laitram Corp. v. Rexnord, Inc.*, 939 F.2d 1533 (Fed. Cir. 1991).

the incongruous judicial approaches to the interpretation of means-plus-function clauses. Although *Kemco* represents the current judicial trend—namely a rigid construction of means-plus-function claims permitting only a narrow range of acceptable equivalents—*IMS* indicates that the Federal Circuit continues to vacillate in its approach to interpreting means-plus-function claims.

The inconsistent approaches to construction of means-plus-function claims have made any prospective assessment of claim scope nearly impossible. Inventors are unable to evaluate the breadth of existing patent rights and are forced to rely on federal litigation for an assessment of patent scope. Innovation is hampered because competitors cannot reliably assess the boundaries of existing patents. As a result, a competitor may decide not to develop a cheaper substitute because she cannot ascertain whether her product will infringe an existing patent. Patentees and potential competitors both deserve a more uniform rule for determining the scope of means-plus-function claims.

In establishing a more consistent rule of claim construction, the Federal Circuit must consider which rule would be most equitable to both the patentees and potential competitors. If maximizing certainty were the only issue, the simplest approach would be to construe claims extremely narrowly and limit the patentee to the literal language of the claims. This approach is, however, too inflexible as it allows a competitor to escape liability by incorporating seemingly trivial alterations into a claimed invention.<sup>76</sup> An equitable approach must include some flexibility to allow the courts to fairly adjudicate the case at bar.

The most equitable approach is a middle path in which the court evaluates the scope of a means-plus-function claim in light of an explicit determination of the importance of the means clause to the invention as a whole.<sup>77</sup> Judge Rich has advocated this contextual approach to means clauses. The contextual approach is most equitable to the patentee since it guards against competitors escaping liability by implementing trivial variations to insignificant aspects of the claimed invention.

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74. 206 F.3d 1422 (Fed. Cir. 2000).

75. 208 F.3d 1352 (Fed. Cir. 2000).

76. *See, e.g., Warner-Jenkinson Co. v. Hilton Davis Chemical Co.*, 520 U.S. 17 (1997); *Graver Tank & Mfg. Co. v. Linde Air Prods. Co.*, 339 U.S. 605 (1950).

77. *Baltimore Therapeutic Equip. v. Loredian Biomedical, Inc.*, 30 U.S.P.Q.2d 1672, 1677 (Fed. Cir. 1994) (Rich, J., concurring).

### A. The Rigid Approach

In *Laitram v. Rexnord*,<sup>78</sup> the Federal Circuit construed § 112, paragraph 6 to mean that for a finding of literal infringement the “patentee must prove . . . that the means in the accused device is the structural equivalent to the means described in the specification.”<sup>79</sup> The court held that the accused structure was not equivalent to the disclosed structure because, although the two performed the same function and were “similar,” they were not “structurally equivalent.”<sup>80</sup> Structural equivalence requires a component by component comparison of the physical attributes of the accused and the disclosed structures.<sup>81</sup> According to Judge Lourie, an assessment of “any significant differences in structural details” requires a deconstruction of both structures and an “analysis of their component parts.”<sup>82</sup> This rigid approach confines means-plus-function claims to an extremely narrow scope and renders the patent rights relatively worthless.

*Kemco* exemplifies the inequity of the rigid approach. The competitor evaded infringement by making a relatively insignificant structural alteration to the sealing mechanism disclosed by the patentee. The crucial aspect of the *Kemco* invention is the use of two independent sealing mechanisms to create a tamper resistant envelope. The precise means by which the envelope is sealed—via a dual lip mechanism or a fold over flap—is a less vital aspect of the invention. The application of a rigid approach to claim construction is particularly bothersome in instances such as *Kemco* where, because of a narrow claim construction, a trivial structural substitution is sufficient to avoid infringement.

In the context of means-plus-function claims, a rigid approach to claim construction principally discriminates against inventions whose components are most easily described in functional language. In order to avoid infringement, a patentee is forced to disclose an exhaustive list of variant structures for every functionally claimed component regardless of the relative importance of that component to the invention as a whole.

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78. 939 F.2d 1533.

79. *Id.* at 1536.

80. *Id.* The claimed invention was “a modular plastic conveyor belt . . . which allows smooth transfer of containers to and from the head and tail ends of a conveyor via a transfer comb.” *Id.* at 1534-35. The Federal Circuit held that although the accused device performed the same function, *Laitram*’s V-shaped molded plastic structure was not an equivalent to an H-shaped structure employed by the defendant. *Id.* at 1536.

81. *Odetics Inc. v. Storage Tech. Corp.*, 185 F.3d 1259, 1277 (Fed. Cir. 1999) (Lourie, J., dissenting).

82. *Id.*

## B. The Broad Approach

The contrary approach to the narrow evaluation of means-plus-function claims focuses almost exclusively on the identity between the claimed function and the function performed by the accused device. In *Odetics v. Storage Technology Corp.*,<sup>83</sup> the Federal Circuit disparaged the rigid approach, as confusing individual structural components with the concept of claim limitations and as having no basis in the law.<sup>84</sup> Instead, the court chose to focus on the identity of function between the accused and disclosed structure.<sup>85</sup> The invention was a tape cassette handling system for library data storage, and the disputed claim recited a “rotary means.” The patent disclosed as a corresponding structure “a set of tape holders or bins, a rod providing the axes of rotation, and a gear capable of receiving a force sufficient to cause the structure to accomplish the claimed ‘rotary’ function.”<sup>86</sup> The court ruled that the “bin array” of the accused device was equivalent to the “rotary means” employed by the patentee because both structures exerted force against the teeth of a gear to effectively turn a bin about a rod.<sup>87</sup> Since both structures exerted force to turn a bin, the court determined that the accused and disclosed structures were equivalent for the purpose of a literal infringement determination.<sup>88</sup> The court did not consider the fact that in one case the device utilized a pin system, whereas in the other the device relied on a gear tooth mechanism.<sup>89</sup>

Although this broad approach affords the patentee more flexibility, it extends patent rights beyond a reasonable scope. Since “almost by definition, two structures that perform the same function may be substituted for one another,”<sup>90</sup> a means-plus-function claim element would necessarily read onto any and all structures that accomplished the recited function. As a result, an inventor would be able to unfairly expand the scope of his patent rights beyond the disclosed invention. Because the *Odetics* approach neglects to compare the structures on any level, it runs the risk of permitting overly broad patent rights.

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83. 185 F.3d 1259.

84. *Id.* at 1268.

85. *Id.* at 1269.

86. *Id.* at 1265.

87. *Id.* at 1269-70.

88. *Id.* at 1270-72.

89. *Id.* at 1277 (Lourie, J., dissenting).

90. *Chiuminatta Concrete Concepts, Inc. v. Cardinal Indus., Inc.*, 145 F.3d 1303, 1309 (Fed. Cir. 1998).

### C. The Contextual Compromise

Given the inequities generated by both the rigid and the broad approaches, the courts ought to adopt a compromise that permits the required flexibility but does not result in overly generous patent protection. The incompatible interpretations of § 112, paragraph 6 compelled Judge Rich to expound on equivalence in his concurring opinion in *Baltimore Therapeutic Equipment v. Loredian Biomedical*.<sup>91</sup> Noting that the statutory phrase “and equivalents thereof” is not in any way qualified, Judge Rich opined that the phrase has a broad but not unlimited meaning.<sup>92</sup> According to Judge Rich:

[H]ow far beyond what is disclosed a court may expand the meaning of a means clause . . . [is] dependent on various factors taken into consideration in construing claims generally such as the pioneering status of the invention as a whole, importance of the recited ‘means’ to the invention as a whole, and the like.<sup>93</sup>

Effectively, Judge Rich advocated a wider range of permissible equivalents when the claimed means is not at the point of novelty. If the means clause describes a function that is at the point of novelty, the range of permissible equivalents should be narrower. Judge Rich conceded that the accused device must perform the identical function as named in the means clause, but he disagreed that the structure required a structural equivalent.<sup>94</sup> According to Judge Rich, an “equivalent structure” is conceptually different from a “structural equivalent.” Judge Rich considered “structural equivalence” to be a narrow application of the statutory language that needlessly focused the comparison on physical attributes. Judge Rich advocated a consideration of the invention as a whole in any “equivalence” determination: “[e]quivalence of the[] structures . . . is not the determining factor but rather how they function in the particular environment of the claimed combination.”<sup>95</sup>

### D. The Contextual Approach Yielded an Equitable Result in *IMS v. Haas*

The decision in *IMS* applied the contextual approach advocated by Judge Rich. In *IMS*, the court began its § 112, paragraph 6 claim construction analysis by determining the importance of the means clause to the in-

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91. 30 U.S.P.Q.2d 1672, 1677 (Fed. Cir. 1994) (Rich, J., concurring).

92. *Id.*

93. *Id.*

94. *Id.*

95. *Id.* at 1678.

vention as a whole. The court acknowledged that given the “similarity of the tests of equivalence under § 112, paragraph 6 and the doctrine of equivalents, the context of the invention should be considered when performing a § 112, paragraph 6 equivalence analysis just as it is in the doctrine of equivalents.”<sup>96</sup> Concluding that the means clause was of little importance to the invention as a whole, the court permitted a broad range of equivalents. After determining the relative importance of the means clause, the court remanded the case with a suggestion that the modified function-way-result test be employed to find the appropriate range of equivalents.<sup>97</sup> The contextual approach employed in *IMS* is unlike most previous Federal Circuit decisions, which did not consider whether the means-plus-function claim element was important to the invention as a whole.<sup>98</sup>

The contextual approach advocated by Judge Rich affords the patentee and the public more certainty, and results in a more equitable determination of patent scope than would be permissible under the rigid approach. The contextual approach, thus, represents an optimal compromise between certainty and equity in the construction of means-plus-function claims. In *IMS*, the court acknowledged that in certain instances applying the contextual approach would result “in a finding of equivalence under § 112, paragraph 6 even though the two structures arguably would not be considered equivalent structures in other contexts, e.g., if performing functions other than the claimed function.”<sup>99</sup> Unless the invention itself was a tape cassette recorder, it is difficult to imagine a situation where a floppy disk drive would not be considered equivalent to a tape cassette recorder. The potential existence of such a situation however, does not jeopardize the validity of the contextual approach to claim construction. If a means-plus-function claim is used to describe an aspect of the invention that is at the

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96. *IMS Tech. v. Haas Automation*, 206 F.3d 1422, 1436 (Fed. Cir. 2000). In support of its contention the court cited both an earlier § 112, paragraph 6 decision, *Texas Instruments, Inc. v. U.S. International Trade Commission*, 805 F.2d 1558, 1563 (Fed. Cir. 1986), Judge Rich’s concurrence in *Baltimore Therapeutic Equipment*, 30 U.S.P.Q.2d at 1677 (Rich, J., concurring), and the recent Supreme Court opinion in *Warner-Jenkinson Co. v. Hilton Davis Chemical Co.*, 520 U.S. 17, 40 (1997), which discusses the importance of a comparison to the invention as a whole in the context of the doctrine of equivalents.

97. *IMS Tech. v. Haas Automation*, 206 F.3d 1422, 1436-1437 (Fed. Cir. 2000).

98. See, e.g., *Dawn Equipment Co. v. Kentucky Farms, Inc.*, 140 F.3d 1009 (Fed. Cir. 1998); *Chiuminata Concrete Concepts, Inc. v. Cardinal Indus., Inc.*, 145 F.3d 1303 (Fed. Cir. 1998); *Valmont Indus., Inc. v. Reinke Mfg. Co.*, 983 F.2d 1039 (Fed. Cir. 1993).

99. *IMS Tech.*, 206 F.3d at 1436 (citing *Odetics, Inc. v. Storage Tech. Corp.*, 185 F.3d 1259, 1269-71 (Fed. Cir. 1999)).

point of novelty, an equitable infringement determination may require that two structures which may have been considered equivalent in a prior context would no longer be considered equivalent. This possibility does not result in uncertainty because the novel aspect of any invention is readily ascertainable.

Not considering the context may unfairly limit the scope of means-plus-function claims. In the absence of the contextual approach, a competitor may implement seemingly trivial changes and successfully escape infringement liability based on a technicality. For instance, if the Federal Circuit in *IMS* had not considered the relative importance of the “interface means,” Haas would have avoided infringement by making a trivial substitution of one well-known recording means for another. If the court had applied the usual rigid approach, the accused device would have been held noninfringing because a floppy disk drive is not a ‘structural equivalent’ of a cassette recorder. A physical comparison of the two structures reveals that their individual components are quite different; the tape cassette recorder uses a spooling tape, while the floppy disk drive uses a spinning magnetic disk. Although the accused device would most likely have been held infringing if the court had elected the broad approach, an excessive focus on function would necessarily lead to overly broad patent rights. The patentee’s claim would necessarily read onto all structures that perform the recited function. While the broad approach would not yield an absurd result in the context of the *IMS* invention, this approach degenerates into inequity when the functional claim element is at the point of novelty.

#### **E. The Court Should Have Adopted the Contextual Approach in *Kemco Sales v. Control Papers***

In *Kemco*, the Federal Circuit did not examine the importance of the means clause to the invention as a whole.<sup>100</sup> In order to determine whether the accused structure was a § 112, paragraph 6 equivalent, the court simply employed the modified version of the function-way-result test.<sup>101</sup> The *Kemco* court acknowledged that the ultimate determination was whether the differences are “insubstantial” and that “[e]quivalence, in the patent law, is not the prisoner of a formula and is not an absolute to be considered in a vacuum.”<sup>102</sup> Nonetheless, the court chose to strictly apply the modified function-way-result test, and the analysis culminated in a finding

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100. *Kemco Sales, Inc. v. Control Papers Co.*, 208 F.3d 1352, 1364 (Fed. Cir. 2000).

101. *Id.*

102. *Id.* at 1364 n.6. (citing *Graver Tank & Mfg. Co. v. Linde Air Prods. Co.*, 339 U.S. 605 (1950)).

of no literal infringement.<sup>103</sup> Although the court recognized that the equivalence determination ought to be flexible, it did not consider the importance of the means clause to the invention as a whole, which would have introduced flexibility.<sup>104</sup>

In *Kemco*, the disputed means clause, the “closing means” for an envelope, was not an integral aspect of the invention and should have received a broader range of permissible equivalents. If the court had adopted the contextual approach, a finding of infringement would have been more likely. The novel aspect of the invention is the use of two sealing means to allow for tamper-evident sealing. Whether the envelope is sealed via a dual lip mechanism or a fold over flap is a less vital aspect of the invention.

#### IV. CONCLUSION

*IMS Technology, Inc., v. Haas Automation, Inc. and Kemco Sales, Inc. v. Control Papers Co.*, illustrate the Federal Circuit’s nonuniform standards for evaluating the breadth of means-plus-function claims. In *IMS*, the court chose to base its determination of equivalence on the relative importance of the means clause to the invention as a whole. In *Kemco*, the court did not even mention this approach and instead analyzed the claims solely by applying the modified function-way-result test. In both cases, the ultimate infringement determination resulted from the particular approach employed by the court. The Federal Circuit must adopt a more consistent approach to claim construction in order to enable prospective evaluations of claim scope. But certainty in the adjudication of functional claims must not be achieved by abandoning equity. A rigid approach to construing means-plus-function claims would yield greater certainty but would not be sufficiently flexible to adequately protect patentees. A broad approach would provide ample flexibility but, could result in nonsensically broad patent claims. If the courts adopt the contextual approach as the standard methodology, a more certain and equitable determination of the appropriate scope of protection for a given means clause will be possible.

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103. *Id.* at 1364.

104. *Id.*



**VEHICULAR TECHNOLOGIES CORP. V. TITAN  
WHEEL INTERNATIONAL, INC.,  
ZODIAC POOL CARE, INC. V. HOFFINGER  
INDUSTRIES, INC.,  
& OPTICAL DISC CORP. V. DEL MAR AVIONICS**

*By Daniel H. Mao*

The doctrine of equivalents was established to prevent an infringer from insubstantially modifying a patented invention and thereby escaping liability from infringement.<sup>1</sup> The application of this equitable doctrine may, however, improperly broaden the scope of the claimed invention. In a number of recent cases, the Federal Circuit attempted to balance between these competing concerns. This Note examines three of those cases. In two cases, *Zodiac Pool Care, Inc. v. Hoffinger Industries, Inc.*<sup>2</sup> and *Optical Disc Corp. v. Del Mar Avionics*,<sup>3</sup> the Federal Circuit properly limited the scope of the doctrine of equivalents by avoiding a claim interpretation that would vitiate a claim element in its entirety,<sup>4</sup> while in *Vehicular Technologies Corp. v. Titan Wheel International, Inc.*,<sup>5</sup> the court improperly adopted an “all-advantages” approach in applying the function-way-result test. This second approach blurs the difference between the essential and incidental functions of a claim element, and is thus inconsistent with the public policy that underlies the doctrine of equivalents.

## **I. BACKGROUND**

Under the doctrine of equivalents, the accused product or process infringes the asserted patent if the accused product or process is equivalent

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1. Under the doctrine of equivalents, the accused product or process infringes the asserted patent if the accused product or process is equivalent to the patented invention. See ROBERT L. HARMON, *PATENTS AND THE FEDERAL CIRCUIT* 270 (4th ed. 1998).

2. 206 F.3d 1408 (Fed. Cir. 2000).

3. 208 F.3d 1324 (Fed. Cir. 2000).

4. See *Warner-Jenkinson Co. v. Hilton Davis Chem. Co.*, 520 U.S. 17, 29 (1997) (“It is important to ensure that the application of the doctrine, even as to an individual element, is not allowed such broad play as to effectively eliminate that element in its entirety.”).

5. 212 F.3d 1377 (Fed. Cir. 2000).

to the patented invention.<sup>6</sup> The doctrine of equivalents was established to prevent an infringer from insubstantially modifying a patented invention and thereby escaping liability.

#### A. All Elements Approach for the Doctrine of Equivalents

In *Warner-Jenkinson Co. v. Hilton Davis Chemical Co.*, the Supreme Court, required that the doctrine of equivalents be applied element by element.<sup>7</sup> The Supreme Court held that in determining whether two devices or processes are equivalent, "each element contained in a patent claim is deemed material to defining the scope of the patented invention, and thus the doctrine of equivalents must be applied to individual elements of the claim, not to the invention as a whole."<sup>8</sup> The all-elements approach does not require a one-to-one correspondence between the components of the accused device or process and elements of the asserted claim.<sup>9</sup> Infringement may occur when several components of the accused device, in combination, perform a function accomplished by a single claim limitation<sup>10</sup> or when several claim limitations perform functions carried out by a single component of the accused device.<sup>11</sup>

This all-elements approach lessens the tension between the doctrine of equivalents and the definitional and public-notice functions of the statutory claiming requirement.<sup>12</sup> If the doctrine of equivalents is not applied to each claim element, an accused device or process may infringe a patented invention even if the accused device or process does not possess a feature corresponding to a claim element. Consequently, this claim element would fail to limit the scope of the invention and to inform the public of the boundary of the patentee's patent rights.

#### B. Various Equivalency Tests for the Doctrine of Equivalents

Courts have used a number of tests to determine whether an element of a claim and a feature of an accused device or process are equivalent. For

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6. See HARMON, *supra* note 1, at 270.

7. 520 U.S. 17, 29 (1997) (affirming the holding of the Federal Circuit in *Pennwalt Corp. v. Durand-Wayland, Inc.*, 833 F.2d 931, 934-935 (Fed. Cir. 1987) that infringement can be found only if every claim limitation or its substantial equivalent is found in the accused device or process).

8. *Warner-Jenkinson*, 520 U.S. at 29.

9. *Dolly, Inc. v. Spalding & Evenflo Co.*, 16 F.3d 394, 398 (citing *Intel Corp. v. Int'l Trade Comm'n*, 946 F.2d 821, 832 (Fed. Cir. 1991)).

10. See *Dolly*, 16 F.3d at 398 (citing *Intel*, 946 F.2d at 832)).

11. See *id.* (citing *Sun Studs, Inc. v. ATA Equip. Leasing Inc.*, 872 F.2d 978 (Fed. Cir. 1989), *overruled on other grounds*, *A.C. Aukerman Co. v. R.L. Chaides Constr. Co.*, 960 F.2d 1020, 1038-1039 (Fed. Cir. 1992)).

12. See *Warner-Jenkinson*, 520 U.S. at 29.

example, equivalence can be established if the two “do the same work in substantially the same way, and accomplish substantially the same result.”<sup>13</sup> The Supreme Court adopted this function-way-result test in *Graver Tank & Manufacturing Co. v. Linde Air Products Co.*<sup>14</sup>

In *Graver Tank*, the Court applied the function-way-result test by considering interchangeability between a claim element and a feature of an accused device or process in the eyes of a person having ordinary skill in the art.<sup>15</sup> The function-way-result test is another way of determining whether differences between the claimed invention and the accused device or process are insubstantial. Hence, the Federal Circuit has also used the “insubstantial differences” test to evaluate equivalency.<sup>16</sup>

In *Warner-Jenkinson*, the Supreme Court held that as to the various tests to evaluate equivalency, “different linguistic frameworks may be more suitable to different cases, depending on their particular facts.”<sup>17</sup> Whether the function-way-result test or the “insubstantial differences” test is better in the abstract is less important than the tests’ probative effect in determining whether the differences are insubstantial.<sup>18</sup> Regardless of which test is used, the doctrine of equivalents cannot broaden the scope of any claim element so much that the element no longer limits the scope of the invention. In other words, the doctrine of equivalents cannot effectively eliminate a claim element in its entirety.<sup>19</sup>

### C. The Federal Circuit Cases Following *Warner-Jenkinson*

Since *Warner-Jenkinson*, the Federal Circuit has limited the scope of equivalents in cases such as *Sage Products, Inc. v. Devon Industries, Inc.*<sup>20</sup> and *Tronzo v. Biomet Inc.*,<sup>21</sup> in order to avoid vitiating a claim element.

In *Sage*, Sage Products, Inc. (“Sage”) sued Devon Industries, Inc. (“Devon”) for infringing its patent on a container for disposing of medical waste.<sup>22</sup> Sage’s patent claimed a disposal container comprising:

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13. *Union Paper-Bag Mach. Co. v. Murphy*, 97 U.S. 120, 125 (1877).

14. 339 U.S. 605, 608 (1950).

15. *See id.* at 609-12 (reasoning that the differences between magnesium used in the patented composition and manganese used in the accused composition are insubstantial because “persons reasonably skilled in the art would have known of the interchangeability of an ingredient not contained in patent with one that was”).

16. HARMON, *supra* note 1, at 276-277 (citing *Hilton Davis Chem. Co. v. Warner-Jenkinson Co.*, 62 F.3d 1512, 1518-1520 (Fed. Cir. 1995) (en banc)).

17. *Warner-Jenkinson Co. v. Hilton Davis Chem. Co.*, 520 U.S. 17, 40 (1997).

18. *Id.*

19. *Id.* at 29.

20. 126 F.3d 1420 (Fed. Cir. 1997).

21. 156 F.3d 1154 (Fed. Cir. 1998).

- a. a hollow upstanding container body,
- b. an elongated slot *at the top of the container body* for permitting access to the interior of the container body,
- c. barrier means disposed adjacent said slot . . . comprising
  - i. a first constriction extending over said slot, and
  - ii. a complementary second constriction extending beneath said slot, and
  - iii. a closure disposed adjacent said slot.<sup>23</sup>

The accused device possessed one constriction above and another below an elongated slot, but the elongated slot was not at the top of the container body.<sup>24</sup> Instead, the elongated slot lay within the container body.<sup>25</sup> The Federal Circuit held that Sage's claim required that the first constriction be situated above the elongated slot.<sup>26</sup> Because the elongated slot was claimed to be "at the top of the container body," the first constriction had to be above the top of the container body.<sup>27</sup> But Sage argued that "one constriction above and one constriction below" as claimed was equivalent to "two constrictions below the top of the container" in the accused device.<sup>28</sup> In ruling against Sage, the Federal Circuit held that Sage's argument would effectively remove the "top of the container" and "over said slot" limitations from the claim.<sup>29</sup>

Similarly, in *Tronzo*, a patentee sued a competitor for infringing a patent that claimed an artificial hip socket with "a generally conical outer surface."<sup>30</sup> The accused device had a hemispherical surface.<sup>31</sup> In the written description, the patentee had specifically touted the advantages of the conical surface over other shapes.<sup>32</sup> However, in the infringement lawsuit, the patentee argued that the conical surface was equivalent to the accused device's hemispherical surface because any shape would be equivalent to

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22. 126 F.3d at 1422.

23. *Id.* at 1422.

24. *Id.* at 1423.

25. *Id.*

26. *Id.* at 1422-23 ("The court also properly interpreted 'extending over said slot' to require that the first constriction be 'above' the elongated slot.").

27. *See id.* at 1422 ("The district court properly interpreted 'top of the container body' to mean the 'highest point, level, or part of.'").

28. *Id.* at 1424.

29. *Id.*

30. 156 F.3d 1154, 1156 (Fed. Cir. 1998) (citing claims 2 and 10 of *Tronzo's* U.S. Patent No. 4,743,262 (issued May 10, 1988)).

31. *See id.* at 1160.

32. *Id.* at 1159.

the conical shape.<sup>33</sup> The Federal Circuit found the patentee's argument unpersuasive because "it would write the 'generally conical outer surface' limitation out of the claims." Following the all-elements approach the court ruled that the accused device did not infringe the patent under the doctrine of equivalents.<sup>34</sup>

In both *Tronzo* and *Sage*, the Federal Circuit refused to expand the patent's scope through the doctrine of equivalents so much as to vitiate a claim element.

## II. CASE SUMMARIES

In the following three cases, the Federal Circuit continued its efforts to establish some bright-line rules for evaluating equivalence.<sup>35</sup>

### A. *Zodiac Pool Care, Inc. v. Hoffinger Industries, Inc.*<sup>36</sup>

Zodiac Pool Care, Inc. ("Zodiac") sued Hoffinger Industries, Inc. ("Hoffinger") for infringing U.S. Patent No. 5,014,382 ("the '382 patent").<sup>37</sup> After a jury verdict of infringement under the doctrine of equivalents, the district court granted Hoffinger's motion for judgment as a matter of law and issued a noninfringement ruling.<sup>38</sup> Zodiac appealed.

#### 1. *Technical Background of the '382 Patent and the Accused Device*

The patent-in-suit claimed a swimming pool cleaner. Such devices typically have a body and a flexible disk that actually contacts the pool surface. The '382 patent claimed a swimming pool cleaner comprising "a stop for preventing upward flexing of the peripheral edge [of the disk] beyond a predetermined amount located forward of the body and above and *substantially inward* of the peripheral edge."<sup>39</sup> Hoffinger's pool cleaner

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33. *Id.* at 1160 ("According to [plaintiff's] expert testimony, any shape would be equivalent to the conical limitation. . .").

34. *Id.*

35. In addition to the three cases discussed in this Note, see *Festo Corp. v. Shoketsu Kinzoku Kogyo Kabushiki Co.*, 234 F.3d 558 (Fed. Cir. 2000) (en banc). There, the Federal Circuit established a bright-line rule for evaluating equivalents when claims have been amended during patent prosecution. This decision was issued too late for inclusion in this Note.

36. 206 F.3d 1408 (Fed. Cir. 2000).

37. *Id.* at 1410.

38. *Id.*

39. U.S. Patent No. 5,014,382, claim 1 (issued May 14, 1991) (emphasis added).

had an arm, used as a stop, that extended at least to the peripheral edge of the disk.<sup>40</sup>

## 2. *The Federal Circuit Decision*

In *Zodiac*, the Federal Circuit affirmed the district court's noninfringement ruling under the doctrine of equivalents.<sup>41</sup> The Federal Circuit construed the phrase "a stop . . . located . . . substantially inward of the peripheral edge" to mean that the entire stop must be inside the peripheral edge of the disk.<sup>42</sup> The court held that a stop that extends at least to the peripheral edge of a disk was not equivalent to a stop located substantially inward of the peripheral edge.<sup>43</sup> Otherwise, the doctrine of equivalents would reduce claim limitations to "functional abstracts, devoid of meaningful structural limitations, on which the public could rely"<sup>44</sup> and would "effectively eliminate that element in its entirety."<sup>45</sup>

### B. *Optical Disc Corp. v. Del Mar Avionics*<sup>46</sup>

Optical Disc Corp. ("ODC") sued Del Mar Avionics ("Del Mar") for infringing U.S. Patent No. 5,297,129 ("the '129 patent").<sup>47</sup> The district court granted Del Mar's motion for summary judgment and ruled that Del Mar's FireTrac system did not infringe the '129 patent either literally or under the doctrine of equivalents.<sup>48</sup> ODC appealed this noninfringement ruling.

#### 1. *Technical Background of the '129 Patent and the Accused Device*

The '129 patent relates to the fabrication of compact discs ("CDs").<sup>49</sup> Commercial CDs are usually copied from a master CD, which is fabri-

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40. See 206 F.3d at 1412 ("Hoffinger produced evidence that its weight arm could not function as the stop in limitation (d), because its arm extended at least to the peripheral edge of the disk, and thus was not located 'substantially inward' thereof.").

41. *Id.* at 1417.

42. See *id.* at 1414 ("[T]he applicant obtained the patent only after he disclaimed a relationship between the stop and the disk's edge that permitted the stop to extend up to and beyond the edge.").

43. *Id.* at 1416.

44. *Id.* (citing *Sage Prods., Inc. v. Devon Indus., Inc.*, 126 F.3d 1420, 1424 (Fed. Cir. 1997)).

45. *Id.* (citing *Warner-Jenkinson Co. v. Hilton Davis Chem. Co.*, 520 U.S. 17, 29 (1997)).

46. 208 F.3d 1324 (Fed. Cir. 2000).

47. *Id.* at 1331.

48. *Id.* at 1332-33.

49. *Id.* at 1326-27.

cated through a “thermal dye polymer process.”<sup>50</sup> In this process, a layer of dye polymer is deposited on a blank master CD, and a laser beam is then focused onto the dye polymer layer.<sup>51</sup> During the fabrication, the laser beam moves relative to the dye polymer layer, and the power of the laser varies in order to control which parts of the polymer layer get vaporized. The polymer layer becomes vaporized when the heat generated by the laser beam raises the layer’s temperature above a threshold, leaving a pit in the dye polymer layer.<sup>52</sup> The pitted and non-pitted areas store information in the master CD.<sup>53</sup>

The ’129 patent optimizes the shape of the pits to minimize errors in data retrieval from a CD. Each pit has a leading edge, formed when the temperature of the polymer layer exceeds the threshold temperature, and a trailing edge, formed when the temperature of the polymer layer falls below the threshold temperature.<sup>54</sup> If the layer’s temperature decreases gradually, the trailing edge of the pit develops a preferred “canoe” shape, rather than an undesirable “hot dog” shape.<sup>55</sup> The “canoe” shape, as well as a desirable symmetry between the leading and the trailing edges, can be achieved by controlling the increase and decrease of the laser beam power. Since the laser beam power is modulated by a modulator drive signal, the shape of the leading and trailing edges are ultimately determined by the modulator drive signal, which is generated by a waveform shaping circuit.<sup>56</sup>

The ’129 patent claims “a waveform shaping circuit for use in an optical recording apparatus, which includes . . . waveform shaping means . . . for producing a shaped modulator drive signal having steep leading edges . . . and *ramped trailing edges* changing amplitude at a prescribed rate . . . .”<sup>57</sup> The steep leading edge and the ramped trailing edge of the modulator drive signal create the preferred leading and trailing edges in the master CD, which are symmetrical and canoe shaped.<sup>58</sup> In contrast, Del Mar’s FireTrac system employed a modulator drive signal with a double-

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50. *Id.* at 1325-26.

51. *Id.* at 1326.

52. *Id.*

53. *See id.*

54. *Id.*

55. *See id.* at 1326-29.

56. *Id.* at 1327.

57. *Id.* at 1330-31 (quoting U.S. Patent No. 5,297,129, claim 1 (issued Mar. 22, 1994) (emphasis added)).

58. *See id.* at 1326, 1328.

step trailing edge to create similarly symmetrical and canoe shaped leading and trailing edges.<sup>59</sup>

## 2. *The Federal Circuit Decision*

The Federal Circuit held that there was an issue of material fact as to whether the double-step trailing edge was equivalent to the claimed ramped trailing edge. The Federal Circuit first construed the element "ramped trailing edges" to mean "a . . . trailing edge which moderates its decrease in laser power from a write level to a base level, over time, to produce a less abrupt passage through the thermal threshold of the moving medium."<sup>60</sup> Del Mar contended that the *Tronzo* court held that a specific shape of an accused device cannot be equivalent to a different shape of a claimed structure.<sup>61</sup> The Federal Circuit disagreed, reasoning that *Tronzo* applied the all-elements approach to avoid writing a limitation out of a claim.<sup>62</sup> Consequently, the Federal Circuit vacated the noninfringement ruling under the doctrine of equivalents and remanded the case for further consideration.<sup>63</sup>

### C. *Vehicular Technologies Corp. v. Titan Wheel International, Inc.*<sup>64</sup>

Vehicular Technologies Corp. ("Powertrax") sued Titan Wheel International, Inc. et al. (collectively "Tractech") for infringing U.S. Patent No. 5,413,015 ("the '015 patent").<sup>65</sup> In response to Powertrax's motion, the district court issued a preliminary injunction against Tractech under the doctrine of equivalents.<sup>66</sup> Tractech appealed this injunction, and the Federal Circuit vacated the district court's ruling in *Vehicular Technologies Corp. v. Titan Wheel International, Inc.* ("*Vehicular P*").<sup>67</sup> Subsequently, the district court granted summary judgment of noninfringement under the doctrine of equivalents.<sup>68</sup> Powertrax then appealed this noninfringement ruling.

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59. *See id.* at 1331-32.

60. *Id.* at 1334.

61. *See id.* at 1337.

62. *Id.*

63. *Id.* at 1339.

64. 212 F.3d 1377 (Fed. Cir. 2000).

65. *Vehicular Techs. Corp. v. Titan Wheel Int'l, Inc.* [hereinafter "*Vehicular P*"], 141 F.3d 1084, 1085, 1087 (Fed. Cir. 1998).

66. *Id.* at 1087.

67. *Id.* at 1092-93.

68. *Vehicular Techs. Corp. v. Titan Wheel Int'l, Inc.* [hereinafter "*Vehicular IP*"], 212 F.3d 1377, 1378 (Fed. Cir. 2000).

### 1. *Technical Background of the '015 Patent and the Accused Device*

The '015 patent claims a locking differential mechanism for motor vehicles.<sup>69</sup> A locking differential is installed between the two half-axles of an automotive vehicle, and can shift all the drive force to the wheel that has traction if the other wheel slips.<sup>70</sup> Prior art locking differentials comprise a spring-disk-pin assembly, in which a spring contacts a stop pin through a thin disk.<sup>71</sup> The disk, however, often slides at the end of the spring and can even fall off.<sup>72</sup> To overcome this problem, the '015 patent replaces the spring-disk-pin assembly with a spring-spring-pin assembly, in which two concentric springs, without a disk, are directly in contact with a stop pin.<sup>73</sup> The '015 patent claims “[a] differential mechanism comprising . . . biasing means interposed between said driving surface faces comprising at least a pin in alignment with a spring assembly consisting of two concentric springs bearing against one end of said pin . . . .”<sup>74</sup> Tractech, in making the accused device, replaced the inner spring of the patented device with a plug, which was stuck in one end of the outer spring and directly contacted the pin.<sup>75</sup>

### 2. *The Federal Circuit Decision*

In *Vehicular Technologies Corp. v. Titan Wheel International, Inc.* (“*Vehicular I*”),<sup>76</sup> the Federal Circuit applied the function-way-result test in determining that the spring-spring-pin assembly of the '015 patent was not equivalent to the spring-plug-pin assembly of Tractech's accused device.<sup>77</sup> The court reasoned that the spring-spring-pin assembly enhanced the reliability of the locking differential because the inner spring served as a backup for the outer spring.<sup>78</sup> The court held that providing enhanced reliability was a key function of the claim limitation “consisting of two concentric springs.”<sup>79</sup> Since the accused spring-plug-pin assembly could not serve as a backup, the court ruled that the accused device was not

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69. U.S. Patent No. 5,413,015, col. 1, ll. 7-8 (issued May 9, 1995).

70. *Vehicular I*, 141 F.3d at 1085.

71. *See id.* at 1086.

72. *Id.*

73. *See id.*

74. U.S. Patent No. 5,413,015, claim 1 (issued May 9, 1995) (emphasis added).

75. *Vehicular I*, 141 F.3d at 1087.

76. 212 F.3d 1377 (Fed. Cir. 2000).

77. *See id.* at 1382 (citing *Vehicular I*, 141 F.3d at 1091).

78. *Id.* at 1380.

79. *See id.* at 1382.

equivalent to the claimed spring-spring-pin assembly.<sup>80</sup> The court reinforced this conclusion by noting that the claim recited a “spring assembly *consisting of two concentric springs*,” which forbids an open-ended construction.<sup>81</sup>

Judge Rader, in his concurring opinion, reasoned that the narrow scope of the “*consisting of two concentric springs*” limitation was foreseeable, and its substitute structure in the accused device were both foreseeable.<sup>82</sup> Nonetheless, the patentee adopted this limitation in his claims.<sup>83</sup> “[A]s between the patentee who had a clear opportunity to negotiate broader claims but did not do so, and the public at large, it is the patentee who must bear the cost of his failure to seek protection for this foreseeable alteration of its claimed structure.”<sup>84</sup>

### III. DISCUSSION

The doctrine of equivalents prevents a competitor from escaping infringement liability by making insubstantial changes to a patented invention and thereby taking the copied matter outside of the literal scope of a claim.<sup>85</sup> On the other hand, patent claims are intended to inform the public of the scope of the patentee’s rights.<sup>86</sup> Hence, the equitable objective of the doctrine of equivalents may conflict with the notice function of claims. To reduce this tension, the Federal Circuit has attempted to provide some standards for applying the doctrine of equivalents.

In *Zodiac* and *Optical Disc*, the Federal Circuit applied and further clarified the helpful standards set forth in *Sage* and *Tronzo*, while the court in *Vehicular* improperly adopted an “all-advantages” approach for the function-way-result test. This second approach blurs the difference between the essential and incidental functions of a claim element, and is thus inconsistent with the public policy underpinning the doctrine of equivalents.

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80. *See id.* at 1382-83.

81. *Id.* (emphasis added).

82. *See id.* at 1384 (emphasis added).

83. *Id.*

84. *Id.* at 1383-84 (quoting *Sage Prods., Inc. v. Devon Indus., Inc.*, 126 F.3d 1420, 1425 (Fed. Cir. 1997)).

85. *Graver Tank & Mfg. Co. v. Linde Air Prods. Co.*, 339 U.S. 605, 607 (1950).

86. *Warner-Jenkinson Co. v. Hilton Davis Chem. Co.*, 520 U.S. 17, 29 (1997).

**A. *Zodiac and Optical Disc: Applying and Clarifying the Holdings of Sage and Tronzo***

**1. *A Claimed Structural Relationship is Not Equivalent to a Contradictory Structural Relationship***

The Federal Circuit in *Sage* provided a guideline to minimize the conflict between the equitable objective of the doctrine of equivalents and the public-notice function of claims: a claimed structural relationship cannot be equivalent to a contradictory structural relationship.<sup>87</sup> The application of such guideline starts with claim construction. In *Zodiac*, the claim language “substantially inward” literally precluded the stop from extending to the peripheral edge of a disk and perhaps beyond.<sup>88</sup> Because the accused cleaner possessed a stop that extended at least to the peripheral edge of the disk,<sup>89</sup> the structural relationship in the accused device was excluded by the claim limitation. Therefore, according to *Sage*, the accused structural relationship could not be equivalent to the claim element.<sup>90</sup>

The restriction imposed by the *Zodiac* court on the range of equivalents is just what the public needs if it is to rely on the claim language. The claim language “substantially inward” would make the public reasonably believe that the claim element, a stop “substantially inward” of the edge of a disk, does not cover a stop that extends at least to the peripheral edge of a disk. Therefore, if the court found this claim element equivalent to the accused device under the doctrine of equivalents, the claim “would be reduced to [a] functional abstract[], devoid of meaningful structural limitations on which the public could rely.”<sup>91</sup> Consequently, due to fear of infringement, the public would hesitate to come up with related inventions. Patent law would then fail to achieve its policy goal of “providing a market-driven incentive to invest in innovation.”<sup>92</sup> Therefore, the Federal Cir-

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87. See Craig Y. Allison, *What It Means to “Entirely Vitiolate” a Claim Element in Light of Warner-Jenkinson*, 82 J. PAT. & TRADEMARK OFF. SOC’Y 563, 570 (2000).

88. See *Zodiac Pool Care, Inc. v. Hoffinger Indus., Inc.*, 206 F.3d 1408, 1414 (Fed. Cir. 2000). This claim construction is controversial. Judge Bryson, in his dissenting opinion, interpreted “substantially inward” as “mostly or mainly inward.” *Id.* at 1418.

89. *Id.* at 1412.

90. *Sage Prods., Inc. v. Devon Indus., Inc.*, 126 F.3d 1420 (Fed. Cir. 1997); see also *Dolly, Inc. v. Spalding & Evenflo Co.*, 16 F.3d 394, 400 (Fed. Cir. 1994) (“[T]he concept of equivalency cannot embrace a structure that is specifically excluded from the scope of the claims.”).

91. *Sage*, 126 F.3d at 1424.

92. ROBERT P. MERGES ET AL., *INTELLECTUAL PROPERTY IN THE NEW TECHNOLOGICAL AGE* 137 (2d ed. 2000).

cuit in *Zodiac* properly affirmed the district court's noninfringement ruling under the doctrine of equivalents.

2. *A Structural Relationship that Is Highly Touted for its Advantages over the Prior Art Has a Narrow Range of Equivalents*

Courts can mitigate the tension between the equitable objective of the doctrine of equivalents and the public-notice function of the claim if a structural relationship, highly touted by the patentee, receives a narrow range of equivalents.<sup>93</sup> The patentee's emphasis on a particular structural relationship would make the public believe that the patented invention must possess that structural relationship without much variation. In *Tronzo*, the patentee touted the advantages of a conical surface, and thereby led the public to believe that a surface with a different shape would fall outside the scope of the invention. Hence, if the touted structural relationship received a broad range of equivalents, the doctrine of equivalents would conflict with the public-notice function of the claim. Consequently, fear of infringement would discourage the public from coming up with related inventions.

On the other hand, when the patentee did not tout the advantages or emphasize the importance of a specific claimed shape, the claim limitation may be held equivalent to a different specific shape, as exemplified in *Optical Disc*. In this case, the Federal Circuit construed a "ramped trailing edge" as "a . . . trailing edge which moderates its decrease in laser power from a write level to a base level, over time, to produce a less abrupt passage through the thermal threshold of the moving medium."<sup>94</sup> In contrast, the accused device employed a double-step trailing edge.<sup>95</sup> In the written description of the '129 patent, ODC did not claim that "ramped trailing edges" were superior to all other types of edges; instead, ODC only stated that "ramped trailing edges" could produce a desirable result that some other types of edges, including single-step edges, could not produce.<sup>96</sup> In

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93. See Allison, *supra* note 87, at 573 ("[In *Tronzo*], [t]he patent owner's theory of equivalents was erroneous as a matter of law at least in part because the specification touted the advantages of a 'conical' cup and distinguished other shapes as being inferior. The court was not willing to allow the asserted claims to cover an accused device that did not have the specifically touted 'conical' shape.").

94. *Optical Disc Corp. v. Del Mar Avionics*, 208 F.3d 1324, 1334-35 (Fed. Cir. 2000).

95. *Id.* at 1331.

96. See *id.* at 1329 (citing U.S. Patent No. 5,297,129, col. 9, ll. 39-42, 44-60 (issued Mar. 22, 1994) ("The written description [of the '129 patent] notes that, while the [single-

other words, ODC did not state that other types of edges, including double-step edges, could not generate the preferred symmetrical and canoe-shaped leading and trailing edges. Therefore, the public does not need to assume that variations in the signal edge fall outside the scope of the claim under the doctrine of equivalents. The court would not harm the public by finding that Del Mar's FireTrac system infringed ODC's invention. Therefore, the Federal Circuit's decision to vacate the district court's summary judgment of noninfringement did not conflict with the public-notice function of the claim and instead furthered the equitable objective of the doctrine of equivalents.

## **B. *Vehicular*: Improperly Adopted the "All-Advantages" Approach**

In contrast to *Zodiac* and *Optical Disc*, *Vehicular* in effect adopted a new approach, the "all-advantages" approach, that limits the range of equivalents.<sup>97</sup> This approach undermines the public policy underpinning the doctrine of equivalents, and should be abolished by the Federal Circuit.

### *1. The Federal Circuit in Effect Adopted the "All-Advantages" Approach for the Function-Way-Result Test*

In its application of the function-way-result test for the doctrine of equivalents, the *Vehicular* court, without explicit declaration, in effect adopted a new "all-advantages" approach by requiring that the corresponding component of the accused device possesses all the advantages of a claim element.

More specifically, the court relied solely on the written description of the patent in suit and determined that providing enhanced reliability was a substantial function of "a spring assembly consisting of two concentric springs."<sup>98</sup> To support this conclusion, the court cited two paragraphs from the patent specification.<sup>99</sup> But the two paragraphs only indicate that im-

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]step[] modulator drive signal B1 results in good pit symmetry (B3), the pits have blunt ends, making tracking difficult for some players.").

97. See *Vehicular I*, 141 F.3d 1084, at 1093-98 (Fed. Cir. 1998) (Newman, J., dissenting). In the section titled "The 'All-Advantages' Rule," Judge Newman stated that "[t]he panel majority holds that the advantages mentioned in the specification, although not included in the claims, must be possessed by the accused device before there can be a finding of infringement by equivalency." *Id.* at 1093.

98. See *Vehicular II*, 212 F.3d 1377, 1382 (Fed. Cir. 2000).

99. See *id.* at 1380, 1382 (quoting U.S. Patent No. 5,413,015 (issued May 9, 1995)). The two paragraphs are as follows:

proving reliability is one of several functions of a spring assembly, not necessarily a substantial function.

Further, other evidence indicate that enhanced reliability is not a substantial function. For instance, the summary of the invention clearly states that "the *primary* object of the present invention is to provide a means of assembly which simplifies both manufacture and installation of component parts in said differential mechanism."<sup>100</sup> In comparison with this primary object, enhancing reliability is a less important function of the spring assembly. Enhanced reliability is not characterized as "a long-standing need,"<sup>101</sup> nor is it described as a primary object of the invention.<sup>102</sup> Therefore, enhanced reliability seems incidental to Powertrax's adoption of the spring assembly.

Defendant's expert testimony also supports this interpretation that favors the plaintiff.<sup>103</sup> In his testimony, defendant's expert did not mention

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Another object of the present invention is to provide a differential mechanism wherein component parts of the assembly, such as clutch members, are joined together by a resilient means comprising a pair of oppositely-wound concentric springs bearing against a pin so that the strength of the spring and reliability of the resilient means are increased.

U.S. Patent No. 5,413,015, col. 2, ll. 14-20 (issued May 9, 1995).

[Because of the dual spring feature], should one spring break or become weakened, the mechanism will continue to function as the second spring will bear the load and prevent the broken spring from exiting the assembly.

*Id.* at col. 4, ll. 26-29.

100. *Id.* at col. 2, ll. 10-13 (emphasis added). This primary object was achieved by the utilization of the spring assembly, as stated in the patent:

The double spring arrangement of the resilient means 23 comprising the two oppositely-wound concentric springs 33 and 34 replace the single spring used in conventional mechanisms. By such means, the subject invention greatly improves manufacturability and assembly. The present invention further permits impingement of the spring assembly 23 directly on the end of the opposing pin 24. *This practice of assembly simplifies both manufacture and installation*, and assembly and installation may be performed by unskilled persons using simple hand tools rather than complicated specialized tools so that a viable, marketable product which functions well is provided.

*Id.* at col. 4, ll. 37-39 (emphasis added).

101. *Cf. id.* at col. 1, ll. 45-49. The patentee stated the long-standing need for the primary object of the invention, but not for enhanced reliability.

102. *See id.* at col. 2, ll. 14-20.

103. *Vehicular I*, 141 F.3d 1084, 1095 (Fed. Cir. 1998) (Newman, J., dissenting). During the trial, the defendant's Director of Engineering testified:

enhancing reliability as a function of the spring assembly. His testimony shows that enhancing reliability may not be a substantial function, even though another non-primary object of the invention, “provid[ing] a resilient means interconnecting the clutch members,”<sup>104</sup> may have been.

Given the evidence above, a reasonable fact-finder could conclude that the defendant’s spring-plug-pin assembly performs substantially the same function as the plaintiff’s spring-spring-pin assembly. Therefore, the Federal Circuit should have vacated the district court’s summary judgment of noninfringement under the doctrine of equivalents and remanded the case.

Instead, the Federal Circuit affirmed the district court’s summary judgment and completely ignored the substantiality. The court emphasized that enhanced reliability was a stated object of the invention without considering whether all of the stated objects were substantial. In effect, the court declared that all of the advantages listed as the objects of the invention are substantial functions of a claim element, regardless of whether the patentee has listed an insubstantial function in an effort to promote the commercial value of his patent. Hence, the *Vehicular* court improperly required, for finding equivalence under the function-way-result test, that the corresponding component of the accused device possesses all the advantages of a claim element. This new requirement may be called the “all-advantages” approach.<sup>105</sup>

## 2. *The “All-Advantages” Approach Is Inconsistent with the Public Policy Underpinning the Doctrine of Equivalents*

The “all-advantages” approach is detrimental to achieving the equitable objective of the doctrine of equivalents, which is to prevent “a fraud on a patent.”<sup>106</sup> An unscrupulous competitor may avoid literal infringement by making insubstantial modifications to a patented device and conse-

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[The inner spring has] only two possible functions. Number one is to fill up a hole, that was my judgment is the reason that it was in. So that the pin that was adjacent to the spring would bear against a nice, full flat surface, and the only other possible reason would be to give you more spring force, and I didn’t feel that we needed additional spring force.

*Id.*

104. See U.S. Patent No. 5,413,015, col. 2, ll. 33-39 (issued May 9, 1995). Among the non-primary objects, another object of the spring assembly is “to provide a resilient means interconnecting the clutch members in a differential assembly which includes springs that impinge *directly* on the ends or their respective opposing pins rather than on a connecting medium or some other portion of the assembly as is experienced with conventional differential mechanisms.” *Id.* (emphasis added).

105. See *Vehicular I*, 141 F.3d at 1093-98 (Fed. Cir. 1998) (Newman, J., dissenting).

106. *Graver Tank & Mfg. Co. v. Linde Air Prods. Co.*, 339 U.S. 605, 608 (1950).

quently, producing an inferior device that performs the primary function of the patented device, but does not provide one minor advantage listed in the written description of the patent. Under the doctrine of equivalents, these modifications should not enable the competitor to escape liability for infringement.<sup>107</sup> In contrast, the "all-advantages" approach compels the court to find the modified device noninfringing under the doctrine of equivalents if one component of the inferior device does not perform one minor function of the corresponding, novel claim element. Thus, the "all-advantages" approach undermines the equitable objective of the doctrine of equivalents.

It may be argued that the "all-advantages" approach is necessary to avoid an application of the doctrine of equivalents that vitiates a claim element. This same objective can be achieved relying on the "insubstantial differences" test or the function-way-result test.<sup>108</sup> For example, according to *Sage and Zodiac*, the *Vehicular* court could have reached the same conclusion without inventing the "all-advantages" approach, because the spring-spring-pin assembly is contradictory in structure to the spring-disk-pin assembly. Being insubstantially different or performing "substantially the same function" is conceptually distinct from providing all of the advantages listed in the written description, because not all of the listed advantages are substantial functions. Thorough evaluations of the importance of each listed advantage are critical for the proper application of the doctrine of equivalents. By excluding such substantive evaluations, the "all-advantages" approach places the inventor "at the mercy of verbalism and subordinating substance to form," contradicting the underlying rationale of the doctrine of equivalents.<sup>109</sup>

Furthermore, the "all-advantages" approach would make the patent drafter hesitant to disclose the advantages of an invention in the written description, and thus cannot effectively assist the public to "promote the progress of science and useful arts."<sup>110</sup>

Under the patent law, the written description must only satisfy the enablement requirement, the clear claim requirement, and the written description requirement.<sup>111</sup> None of these requirements obliges the patentee

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107. *See id.* at 607.

108. *See Warner-Jenkinson Co. v. Hilton Davis Chem. Co.*, 520 U.S. 17, 39-40 (1997).

109. *Graver Tank*, 339 U.S. at 607.

110. U.S. CONST. art I, § 8, cl. 8.

111. *See* 35 U.S.C. § 112, ¶ 1 (1994), and MERGES, *supra* note 92, at 224 ("The first paragraph of § 112 has been interpreted in such a way that three distinct requirements are

to disclose the advantages of the invention.<sup>112</sup> On the other hand, the patentee may choose to disclose at least some advantages of his invention in order to overcome the prior art and promote the commercial value of his patent. During patent examination, the patentee can overcome the prior art by claiming a novel and nonobvious device structure, or by claiming an unexpected function if the claimed device structure is anticipated or obvious. Since claiming an unexpected function in addition to a novel and nonobvious structure would unnecessarily narrow the scope of the invention, the patentee in his initial application usually discloses, but does not claim, the unexpected function of the claimed device. If the examiner finds the claimed structure anticipated or obvious, then the patentee can insert the unexpected function into the claim. On the other hand, anticipated or obvious functions of the invention cannot help the claim to overcome the prior art. Nonetheless, the patentee usually discloses many such advantages in order to promote the commercial value of his patent.

The “all-advantages” approach invented by the Federal Circuit would deter the patentee from disclosing any advantage that is unnecessary to the patentability of his invention, because unnecessary disclosure of such an advantage would limit the range of equivalents.<sup>113</sup> The narrow range of equivalents would reduce the commercial value of the patent. Therefore, most patentees would choose not to disclose any unexpected advantage if the device structure is itself novel and nonobvious. In addition, most patentees would avoid disclosing expected or obvious advantages. The non-disclosure of advantages, especially the nondisclosure of the unexpected functions of a pioneer invention, would impede the dissemination of knowledge because the public would have difficulty in recognizing these advantages. Consequently, patents would become less effective in assisting the public to “promote the progress of science and useful arts.”<sup>114</sup>

Finally, the “all-advantages” approach cannot be applied consistently to all patents. If a patent does not disclose any advantage, the Federal Circuit would be forced to rely on other evidence such as expert testimony to identify the substantial function of a claim element. On the other hand, if a patent discloses some advantages, the Federal Circuit, adopting the “all-advantages” approach, would ignore expert testimony. Hence, the “all-

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now said to spring from it: (1) the written description requirement; (2) the clear claim requirement; and (3) the enablement requirement.”).

112. The utility requirement under § 101 may require some disclosure. *See* 35 U.S.C. § 101 (1994).

113. The patentee may still disclose the structural differences between the claimed device and the prior-art devices.

114. U.S. CONST. art I, § 8, cl. 8.

advantages" approach cannot treat a patent without any disclosed advantage the same way as a patent with even one disclosed advantage. In other words, the "all-advantages" approach is, itself, inconsistent.

3. *The Application of the "All-Advantages" Approach May Create Confusion*

If the "all-advantages" approach established in *Vehicular* were deemed proper, it might be possible for an accused device to escape a finding of infringement under the doctrine of equivalents by performing one minor advantage that is not listed in the asserted patent and then exaggerating the importance of this advantage in a patent application for the accused device. The accused device would be patentable if its variation in structure were novel and nonobvious over the asserted patent and other prior art, even if the asserted patent is a blocking patent. By, extending the "all-advantages" approach to the patent of the accused device, the court could find the accused device noninfringing under the doctrine of equivalents, because the accused device performs one function that is not performed by the asserted device. Such an extension would further erode patent protection under the doctrine of equivalents. The Federal Circuit should reject this extension and instead perform a substantive evaluation of the importance of each listed advantage.

In addition, the lack of substantive evaluation of the importance of advantages under the "all-advantages" approach may lead to arbitrary results in infringement cases. The finding of infringement or noninfringement would depend upon whether any advantage was disclosed and which advantage the drafter decided to enumerate. This arbitrariness could be cured by requiring that a component of the accused device possesses all the advantages of a claim element, including those not enumerated in the asserted patent. This modification to the "all-advantages" approach would require courts to rely on expert testimony to find out what all the advantages were. More fundamentally, this modification makes the range of equivalents narrower for inventions possessing multiple advantages than for inventions possessing fewer advantages. Inventions with multiple advantages are often pioneering, and pioneer inventions should enjoy a broad, not narrow, range of equivalents.<sup>115</sup> Therefore, the court should not modify the "all-advantages" approach to encompass the advantages not described in the asserted patent.

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115. MERGES, *supra* note 92, at 279 (citing 4 DONALD S. CHISUM, CHISUM ON PATENTS §18.04[2] (1998)).

#### 4. *The Federal Circuit Should Abandon the "All-Advantages" Approach*

In summary, the Federal Circuit should consider all available evidence to distinguish substantial functions from incidental functions under the doctrine of equivalents. Courts developed this equitable doctrine to prevent an accused infringer from changing only minor details of a claimed invention while retaining its essential functionality.<sup>116</sup> In determining whether an advantage is essential, the Federal Circuit should perform a substantive evaluation, rather than rely solely upon whether the advantage was listed as an object of the invention in the written description.

### IV. CONCLUSION

The Federal Circuit needs to strike a balance between the equitable objective of the doctrine of equivalents and the public-notice function of patent claims. The court in *Zodiac* and *Optical Disc* appropriately limited the range of the doctrine of equivalents. In *Zodiac*, the Federal Circuit held that a claim limitation that recites a particular structural relationship cannot be equivalent to a contradictory structural relationship in an accused device. When the difference between the claimed invention and the accused device lies on a continuum, and the claimed structure was not highly touted by the patentee, the *Optical Disc* court held that infringement under the doctrine of equivalents should be decided by a jury.

In *Vehicular*, however, the Federal Circuit overly emphasized the importance of the public-notice function of claims and in effect adopted an "all-advantages" approach for the function-way-result test. The "all-advantages" approach unduly narrows the patentee's right under the doctrine of equivalents, and is thus not consistent with the public policy underpinning patent law. The court should have performed a substantive evaluation to distinguish the essential advantages from merely incidental ones, and properly determine the range of equivalents in order to prevent "a fraud on a patent."<sup>117</sup>

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116. *Sage Prods., Inc. v. Devon Indus., Inc.*, 126 F.3d 1420, 1424 (Fed. Cir. 1997).

117. *Graver Tank & Mfg. Co. v. Linde Air Prods. Co.*, 339 U.S. 605, 608 (1950).



## SPEEDPLAY, INC. V. BEBOP, INC. & PRIMA TEK II, L.L.C. V. A-ROO CO.

By Christa P. Worley

Under the Patent Act,<sup>1</sup> only a patentee or its successor in title has a remedy by civil action for patent infringement.<sup>2</sup> The Court of Appeals for the Federal Circuit has ruled that whether a party is a successor in title depends upon the substantive rights granted in an agreement rather than the name by which the agreement calls itself.<sup>3</sup> This ruling raised the possibility that an exclusive licensee could have sufficient rights to bring suit without joining the licensor. The Federal Circuit finally clarified the law of licensee standing in *Speedplay, Inc. v. Bebop, Inc.*<sup>4</sup> In its holding, the court affirmed that a licensee with all substantial patent rights had standing to sue without joining the patentee.

Five months after *Speedplay*, the Federal Circuit again muddled the law of licensee standing. In *Prima Tek II v. A-Roo Co.*,<sup>5</sup> the Federal Circuit held that a sublicensee of a license-to-license agreement lacked standing to sue,<sup>6</sup> even though it had full rights to a patent.<sup>7</sup>

This Note contrasts the two decisions, demonstrating that the *Prima Tek* decision was inconsistent with the “all substantial rights” rule of *Speedplay*. It contends that the doctrine of collateral estoppel might have provided a more sensible basis for denying standing to the sublicensee in *Prima Tek* and that compulsory joinder of the patentee is unjustified.

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1. 35 U.S.C. §§ 1-376 (1994).

2. 35 U.S.C. § 281 (1994) (“A patentee shall have remedy by civil action for infringement of his patent.”). The term “patentee” includes “not only the person to whom the patent was issued but also the successors in title to the patentee.” *Id.* § 100(d).

3. *See Vaupel Textilmaschinen KG v. Meccanica Euro Italia S.P.A.*, 944 F.2d 870, 875 (Fed. Cir. 1991) (holding that although the grant of rights to the plaintiff was not a formal assignment, it was tantamount to an assignment because it granted all substantial rights under the patent).

4. 211 F.3d 1245 (Fed. Cir. 2000).

5. 222 F.3d 1372 (Fed. Cir. 2000).

6. *Id.* at 1382.

7. *See id.* at 1380, 1382 (denying *Prima Tek II* standing to sue despite the fact that *Prima Tek I* had no right to exclude others from practicing the patents “because that right . . . flowed to *Prima Tek II*”).

## I. LICENSEE STANDING: *SPEEDPLAY, INC. V. BEBOP, INC.*<sup>8</sup>

### A. Background

The Patent Act provides that “[a] patentee shall have remedy by civil action for infringement of his patent.”<sup>9</sup> The statute defines “patentee” as including “not only the patentee to whom the patent is issued but also the successors in title to the patentee.”<sup>10</sup> Licensees who sue for patent infringement, therefore, must show that they are, in effect, successors in title.

The Supreme Court addressed this question in *Waterman v. Mackenzie*,<sup>11</sup> when a licensee brought an infringement suit against a third party.<sup>12</sup> The license granted the plaintiff the right to manufacture and sell the patented invention, but not the right to use it.<sup>13</sup> In determining whether the licensee had standing to sue, the Supreme Court stated that the term “license agreement” was not dispositive as to whether a licensee could bring suit. Instead, the substance of the agreement determined whether a grantee could bring suit.<sup>14</sup> A grant that conveyed all the patent rights would amount to an assignment and confer standing upon the grantee.<sup>15</sup> Because the license at issue did not convey the right to use, it did not amount to assignment.<sup>16</sup> As a result, the Court held that the licensee lacked standing to sue.<sup>17</sup>

Thirty-five years later, in *Independent Wireless Telegraph Co. v. Radio Corp. of America*,<sup>18</sup> the Supreme Court indicated that an exclusive licensee had standing to bring suit if it joined the patentee.<sup>19</sup> In that case, plaintiff Radio Corporation of America (“RCA”) had the exclusive right to

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8. 211 F.3d 1245 (Fed. Cir. 2000).

9. 35 U.S.C. § 281 (1994).

10. *Id.* § 100(d).

11. 138 U.S. 252 (1891).

12. *Id.* at 257. Mrs. Waterman, the assignee of the patent in suit had licensed the patent to her husband. She subsequently assigned her rights in the patent to a third party, but the assignment was subject to the license to Mr. Waterman. *See id.*

13. *Id.*

14. *Id.* (“Whether a transfer of a particular right or interest under a patent is an assignment or a license does not depend upon the name by which it calls itself, but upon the legal effect of its provisions.”).

15. *Id.*

16. *Id.*

17. *Id.*

18. 269 U.S. 459 (1926).

19. *Id.* at 464.

use and sell the patented invention but not the right to make the invention. So, the grant was merely an exclusive license, not an assignment.<sup>20</sup> Relying on *Waterman*, the Court held that RCA, as an exclusive licensee, could sue for infringement to protect its interests but had to join the patentee.<sup>21</sup> The Court reasoned that the patentee was an indispensable party to the suit in order to give jurisdiction under the patent statute and to avoid multiple litigation.<sup>22</sup>

The Federal Circuit has relied on the *Waterman* rule when licensees have attempted to bring patent infringement suits. In one case, *Vaupel Textilmaschinen KG v. Meccanica Euro Italia S.P.A.*, the Federal Circuit held that an exclusive licensee could sue in its own name because it had “all substantial rights” under a patent.<sup>23</sup> Relying on the *Waterman* rule that the substance of the agreement—rather than the name attached to it—controlled,<sup>24</sup> the court concluded that when a licensor retained no substantial right in the licensed patent, the licensor was not an indispensable party who must be joined under Rule 19 of the Federal Rules of Civil Procedure.<sup>25</sup> The decision in *Vaupel* did not state that an exclusive licensee always had standing to sue in its own name; rather, when a license granted all substantial rights, the license was tantamount to an assignment and, therefore, conferred standing upon the licensee.<sup>26</sup>

Since *Vaupel*, the Federal Circuit consistently reviewed cases in which either the licensees did not assert standing to sue alone or the exclusive licenses at issue were not assignments.<sup>27</sup> It was not until *Speedplay* that the Federal Circuit again reviewed a case in which an exclusive license

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20. *Id.* at 461.

21. *See id.* at 466. The Court went on to hold that if the patentee refused to join, the licensee “may make the owner . . . a co-plaintiff without his consent in the bill against the infringer.” *Id.* at 472.

22. *Id.* at 468.

23. *Vaupel Textilmaschinen KG v. Meccanica Euro Italia S.P.A.*, 944 F.2d 870, 875 (Fed. Cir. 1991); *see also* *Textile Prods., Inc. v. Mead Corp.*, 134 F.3d 1481, 1484 (Fed. Cir. 1998) (acknowledging that an exclusive licensee could have standing to sue alone).

24. *Vaupel*, 944 F.2d at 875.

25. *Id.*

26. *Id.* at 875; *see also* 35 U.S.C. § 281 (1994) (providing that only a patentee has a remedy by civil action for patent infringement); *Id.* § 100(d) (1994) (stating that the term “patentee” in the statute includes “not only the person to whom the patent was issued but also the successors in title to the patentee”).

27. 8 DONALD S. CHISUM, PATENTS § 21.03[2][c] (Cumulative Supp. 2000). *See, e.g.*, *Ortho Pharmaceutical Co. v. Genetics Institute, Inc.*, 52 F.3d 1026, 1032 (Fed. Cir. 1995) (“[Plaintiff] does not assert it has standing to sue alone.”); *Rite-Hite Corp. v. Kelley Co.*, 56 F.3d 1538, 1553 (Fed. Cir. 1995) (holding that contracts to merely sell products in an exclusive sales territory was insufficient to confer standing).

transferred sufficient rights to confer standing to sue without joining the patent owner as co-defendant.

**B. Case Summary: *Speedplay, Inc. v. Bebop, Inc.***<sup>28</sup>

Richard Bryne, founder and CEO of Speedplay, owned a number of patents on his inventions related to bicycle pedals, including U.S. Patent No. 4,942,778 (“the ’778 patent”).<sup>29</sup> Bryne licensed these patents to Speedplay via a Contribution and License Agreement (“CLA”), which gave Speedplay the “sole right to enforce . . . [the] Licensed Patents,” which included the ’778 patent.<sup>30</sup> Relying on this provision, Speedplay sued Bebop for infringement of the ’778 patent.<sup>31</sup> Bebop raised the defense that Speedplay lacked standing to sue, arguing that Speedplay did not have all the substantial rights in the ’778 patent because various provisions of the CLA limited the grant of rights to Speedplay.<sup>32</sup>

The Federal Circuit rejected each of Bebop’s arguments, holding that Speedplay retained all substantial rights in the patent and therefore had standing to sue.<sup>33</sup> First, the Federal Circuit ruled that a provision entitling the inventors to initiate legal action in the event that Speedplay “fail[ed] to halt infringement” did not interfere with Speedplay’s enforcement of the patent.<sup>34</sup> The Federal Circuit emphasized that the right of the inventors to initiate their own action was illusory because Speedplay retained the right to sublicense to any alleged infringer.<sup>35</sup> Second, the Federal Circuit ruled that a clause prohibiting Speedplay from assigning its interest in the license without the inventors’ consent did not deprive Speedplay of subject right since the inventors could not withhold their consent unreasonably.<sup>36</sup> The Federal Circuit stated that *Vaupel* compelled the conclusion that the provision did not meaningfully restrict Speedplay’s patent rights because the only reasonable basis for Bryne to withhold his consent would be the impairment of his consideration for entering into the CLA.<sup>37</sup> Third, the court ruled that a provision requiring Speedplay to assign to the inventors all rights to any improvements it made to the invention was not actually

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28. 211 F.3d 1245 (2000).

29. *Id.* at 1248-49.

30. *Id.*

31. *See id.* at 1250.

32. *Id.* at 1251.

33. *Id.* at 1252.

34. *Id.* at 1251.

35. *Id.*

36. *Id.* at 1251-52.

37. *Id.* (holding that a provision that simply protects a licensor’s consideration does not meaningfully restrict the licensee’s rights).

restrictive because the provision further stipulated that the CLA would cover any improvements assigned to the inventors. In effect, the improvements would rebound back to Speedplay, so mandatory assignment of improvements did not really curtail Speedplay's rights.<sup>38</sup> The final two limiting provisions restricted Speedplay's foreign sales and gave the inventors the right to review Speedplay's financial books. Since a U.S. patent's reach is limited to the United States, the Federal Circuit held that no restriction on foreign sale could diminish a licensee's U.S. patent rights.<sup>39</sup> The court also ruled that inventor's right to review Speedplay's books upon insolvency constituted a "policing mechanism" rather than a deprivation of proprietary rights in the licensed patent.<sup>40</sup>

Since the restrictions in the license to Speedplay did not leave the patent owners with any substantial right in the '778 patent, the Federal Circuit held that Speedplay could sue for patent infringement without joining the patentee.<sup>41</sup>

## II. SUBLICENSEE STANDING: *PRIMA TEK II, L.L.C. V. A-ROO CO.*<sup>42</sup>

### A. The Question of Sublicensee Standing

Given the lack of case law regarding sublicensee standing, it is difficult to predict whether a sublicensee would be able to bring an infringement suit without joining the patentee. The uncertainty applies as well where the sublicensee obtained rights via a license-to-license agreement.<sup>43</sup> The *Vaupel* and *Speedplay* holdings suggest that the transfer of all substantial patent rights to a sublicensee should confer upon the sublicensee in a license-to-license agreement standing to sue. While this result makes sense, it was not the result reached by the Federal Circuit when a sublicensee case came before it.

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38. *Id.* at 1252.

39. *Id.* (citing *Vaupel Textilmaschinen KG v. Meccanica Euro Italia S.P.A.*, 944 F.2d 870, 875 (Fed. Cir. 1991)).

40. *Speedplay*, 211 F.3d at 1252.

41. *Id.*

42. 222 F.3d 1372 (Fed. Cir. 2000).

43. As used in this Note, a license-to-license agreement is a contract wherein a patentee grants a party permission to license the patent to a sublicensee third party. Before the Federal Circuit, A-Roo characterized the transaction between Southpac and Prima Tek I as a "license to license." *Id.* at 1379.

**B. Case Summary: *Prima Tek II, L.L.C. v. A-Roo Co.***<sup>44</sup>

Patent owner Southpac International (“Southpac”), a Cook Islands corporation, entered into a license agreement with Prima Tek I granting to Prima Tek I the “exclusive worldwide right to make, use and sell the products and processes covered by the patents.”<sup>45</sup> This grant of rights, however, was merely an instrument for Prima Tek I to grant a license to Prima Tek II, Prima Tek I’s subsidiary. The license to Prima Tek I provided that Prima Tek I had rights in the patent “only to the extent necessary to grant a license to Primatek II.”<sup>46</sup> Accordingly, Prima Tek I transferred all rights to make, use, and sell the patented product to Prima Tek II via a sublicense agreement.<sup>47</sup> The sublicense agreement contained the same termination and enforcement clauses as the original license to Prima Tek I. Specifically, “the license automatically terminated at the end of the initial two-year term, or at the end of each year thereafter, unless Southpac notified Prima Tek I at least thirty days in advance of its intent to renew the agreement for an additional year.”<sup>48</sup> But unlike the license-to-license agreement between Southpac and Prima Tek I, in which Southpac agreed to be bound by any judgment against Prima Tek I, the sublicense agreement did not provide that either Prima Tek I or Southpac would be bound by any judgment against Prima Tek II.<sup>49</sup>

Prima Tek II brought an infringement action against A-Roo and was forced by the district court to join Prima Tek I.<sup>50</sup> The district court did not require joinder of Southpac. In its appeal, A-Roo insisted that the trial court erred as a matter of law in failing to join Southpac in the suit and that Prima Tek I and Prima Tek II therefore lacked standing to sue.<sup>51</sup> In support of its position, A-Roo argued, first, that the license was limited in duration and only renewable at Southpac’s option, and second, that all rights to Prima Tek I were granted solely to transfer the rights to Prima Tek II, which necessarily restricted Prima Tek I’s rights to the patents.<sup>52</sup>

The Federal Circuit rejected A-Roo’s first contention. As a starting point, the court acknowledged that a termination clause gives the patentee a reversionary interest in the licensed patent that could be a substantial

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44. *Id.*

45. *Id.* at 1374.

46. *Id.*

47. *Id.* at 1375.

48. *Id.* at 1374.

49. *Id.* at 1375.

50. *Id.* at 1375-76.

51. *Id.*

52. *Id.* at 1378.

right.<sup>53</sup> In *Vaupel*, however, the Federal Circuit held that a termination clause without a “hard” termination date was “entirely consistent with assignment.”<sup>54</sup> Because the license between Southpac and Prima Tek I did not have a “hard” termination date, the court ruled that the termination clause did not deprive Prima Tek I of standing to sue.<sup>55</sup>

On the other hand, the court accepted A-Roo’s contention that Prima Tek I did not receive “all substantial rights” in the patent.<sup>56</sup> The court reasoned that prior to the sublicense to Prima Tek II, Prima Tek I could not exercise the right to exclude because Prima Tek I only had the right to sublicense the patent to Prima Tek II.<sup>57</sup> After the sublicense, only Prima Tek II had the right to exclude.<sup>58</sup>

The court also held that Prima Tek II lacked standing to sue since its rights flowed from Prima Tek I, which did not have standing.<sup>59</sup> In the Federal Circuit’s words, “a licensee . . . cannot convey that which it does not possess.”<sup>60</sup>

Finally, the court held that Southpac’s agreement to be bound by any judgment rendered against Prima Tek I did not confer standing on Prima Tek I.<sup>61</sup> The Federal Circuit had articulated such a rule earlier in *Ortho Pharmaceutical Corp. v. Genetics Institute, Inc.*, holding that a “right to sue” clause was no alternative to owning all substantial rights in a patent.<sup>62</sup>

### III. DISCUSSION

The Federal Circuit’s decision to deny Prima Tek I and Prima Tek II standing to sue without joining Southpac conflicted with the “all substantial rights” rule of *Speedplay*. Collateral estoppel might have provided a more sensible basis for denying Prima Tek I and Prima Tek II standing to sue. As a result of the *Prima Tek* decision, Prima Tek I and Prima Tek II’s only alternative is to join Southpac.

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53. *Id.*

54. *Vaupel Textilmaschinen KG v. Meccanica Euro Italia S.P.A.*, 944 F.2d 870, 874 (Fed. Cir. 1991) (citing *Waterman v. Mackenzie*, 138 U.S. 252, 256 (1891)).

55. *See Prima Tek*, 222 F.3d at 1379.

56. *Id.* at 1380.

57. *Id.*

58. *Id.*

59. *Id.* at 1382.

60. *Id.* at 1382 (quoting *Dunham v. Indianapolis & St. Louis R.R.*, 8 F. Cas. 44, 45 (N.D. Ill. 1876)).

61. *Id.* at 1381.

62. 52 F.3d 1026, 1034 (Fed. Cir. 1995) (providing that a licensee’s proprietary interest in a patent confers standing rather than a “right to sue clause”).

### A. The “All Substantial Rights” Rule Affirmed in *Speedplay* Makes Sense

Statutory law, Supreme Court authority, and Federal Circuit precedent support *Speedplay*'s rule that an exclusive licensee with all substantial patent rights has standing to sue for infringement without joining the patentee.

Under the Patent Act, only a patentee or its successor in title has a remedy by civil action for patent infringement.<sup>63</sup> Ordinarily, courts have interpreted this as requiring that a patent owner or assignee initiates the suit.<sup>64</sup> Exceptions have been made to allow licensees to sue when the infringer is the licensor-patentee.<sup>65</sup> In addition, exclusive licensees usually have standing to sue, but not without joining the patentee as co-plaintiff.<sup>66</sup> In determining when licensees have standing, it is well settled that “whether a transfer of a particular right or interest under a patent is an assignment or a license does not depend upon the name by which it calls itself, but upon the legal effect of its provisions.”<sup>67</sup> As a result, use of the phrase “exclusive license” in an agreement is not dispositive; if an agreement actually transfers all substantial rights in the patent to the licensee, it is effectively an assignment and confers standing upon the licensee to sue alone.<sup>68</sup>

In *Waterman v. Mackenzie*, the Supreme Court enumerated the bundle of rights necessary to confer standing: the exclusive right to make, use, and sell the patented product or process; an undivided share in that exclusive right; and the exclusive right within and throughout a specified region of the United States.<sup>69</sup> An instrument that conveys all three rights is tantamount to an assignment, and the party to whom those rights were granted may bring suit for infringement in its own name.<sup>70</sup> In *Vaupel*, the Federal Circuit introduced the “all substantial rights” language, asserting

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63. See *supra* note 2 and accompanying text.

64. See, e.g., *Enzo APA & Son, Inc. v. Geapag A.G.*, 134 F.3d 1090, 1093 (Fed. Cir. 1998).

65. *Indep. Wireless Tel. Co. v. Radio Corp. of Am.*, 269 U.S. 459, 467-68 (1926) (citing *Littlefield v. Perry*, 88 U.S. (21 Wall.) 205, 223 (1874)). A licensee may wish to see a patentee if the patentee is the infringer of the patent.

66. *Textile Prods., Inc. v. Mead Corp.*, 134 F.3d 1481, 1484 (Fed. Cir. 1998).

67. *Waterman v. Mackenzie*, 138 U.S. 252, 256 (1891).

68. See *Vaupel Textilmaschinen KG v. Meccanica Euro Italia S.P.A.*, 944 F.2d 870, 875 (Fed. Cir. 1991).

69. *Waterman*, 138 U.S. at 255.

70. *Vaupel*, 944 F.2d at 875.

that a conveyance of all substantial rights—i.e., the three rights enumerated in *Waterman*—is an assignment.<sup>71</sup>

That a party has standing to bring suit if it possesses all substantial rights is equitable and accords with both *Independent Wireless*, which held that a patentee is an essential party to an infringement suit,<sup>72</sup> and Rule 19, which requires that all essential parties be joined.<sup>73</sup> In *Independent Wireless*, the Supreme Court reasoned that the patentee was an essential party because the patentee's presence would "enable the alleged infringer to respond in one action to all claims of infringement for his act."<sup>74</sup> If, however, the patentee has granted all substantial rights to a licensee, then the patentee has no claim of infringement and is no longer an essential party.

In *Speedplay*, the agreement that conveyed rights to Speedplay was called an exclusive license, but it transferred to Speedplay "the exclusive rights and license to manufacture, have manufactured, distribute, market, use and sell the Licensed Product" and the right to grant sublicenses until the expiration of the last of the Licensed Patents.<sup>75</sup> The license terms gave Speedplay all the rights that characterize an assignment.<sup>76</sup> Since the patentees retained no substantial rights in the patent, multiple litigation against Bebo would not occur even if Speedplay did not join the patentee in the suit. Thus, the Federal Circuit's ruling that *Speedplay* could sue alone was logical and fair.

## **B. The *Prima Tek* Ruling Is Inconsistent with *Speedplay***

In *Prima Tek*, the Federal Circuit ruled that a sublicensee in a license-to-license agreement did not have standing to sue, even though it joined the primary licensee. Unfortunately, instead of establishing a consistent doctrine that addresses issues of standing in the context of license-to-license agreements, the Federal Circuit applied two separate doctrines: first, in order to have standing, a licensee must have an exclusive grant to make, use, and sell products and processes covered by the patents;<sup>77</sup> and second, that "an owner or licensee of a patent cannot convey that which it

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71. *Id.*

72. *Indep. Wireless Tel. Co. v. Radio Corp. of Am.*, 269 U.S. 459, 468 (1926).

73. FED. R. CIV. P. 19(a). Rule 19(a) requires that "persons having a joint interest shall be made parties and be joined. . . . When a person who should join as a plaintiff refuses to do so, he may be made . . . in proper cases, an involuntary plaintiff." *Id.*

74. *Indep. Wireless*, 269 U.S. at 468.

75. *Speedplay, Inc. v. Bebo, Inc.*, 211 F.3d 1245, 1250 (Fed. Cir. 2000).

76. *Waterman* 138 U.S. at 255; see also *supra* text accompanying note 69.

77. See *Prima Tek II v. A-Roo Co.*, 222 F.3d 1372, 1377 (Fed. Cir. 2000).

does not possess.”<sup>78</sup> Inexplicably, the court did not apply either doctrine to all the facts.

1. *The Court's Application of the "All Substantial Rights" Doctrine*

In *Prima Tek*, the court employed the doctrine that a licensee has standing to sue if it has all substantial rights in the patent, the same doctrine articulated in *Speedplay*.<sup>79</sup> But the court applied this doctrine only to Prima Tek I. In doing so, the court completely ignored whether Prima Tek II had sufficient proprietary rights in the patent to sue without joining the patentee.

The court denied standing to Prima Tek I on the grounds that Prima Tek I did not have the right to make, use, or sell the patented invention.<sup>80</sup> The license to Prima Tek I gave it the right to transfer patent rights to Prima Tek II but never gave Prima Tek I the right to exercise any such proprietary rights.<sup>81</sup> It seems appropriate, therefore, that Prima Tek I did not have standing to sue.

It is rather puzzling that the court neglected to apply the “all substantial rights” doctrine to Prima Tek II. Indeed, Prima Tek II had the exclusive right to make, use and sell the patented invention and could sublicense the patent. Prima Tek II thus should have had standing to bring suit in its own name.<sup>82</sup> But the Federal Circuit held otherwise by applying an entirely different standard to Prima Tek II.

2. *The Court's Application of the "Transfer Of Rights" Doctrine*

The court applied to Prima Tek II the “transfer of rights” doctrine: “It is clear that [a] patentee[] can not grant what does not belong to him, and if he gives a license or makes a contract for the use of the thing patented, he can only give what he has himself.”<sup>83</sup> Since Prima Tek I did not have standing to sue, the court reasoned that Prima Tek II likewise lacked standing because all of Prima Tek II’s rights flowed from Prima Tek I.<sup>84</sup> The court is, however, inconsistent in its application of the “transfer of rights” doctrine. The doctrine denies standing to a sublicensee but allows the transfer of substantive and exclusive patent rights to that same subli-

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78. *Id.* at 1382.

79. *Id.* at 1377.

80. *Id.* at 1380.

81. *See id.* at 1374.

82. *See id.*

83. *Id.* at 1382 (quoting *Dunham v. Indianapolis & St. Louis R.R.*, 8 F. Cas. 44, 45 (N.D. Ill. 1876)).

84. *Prima Tek*, 222 F.3d at 1382.

censee. In other words, it appears that Prima Tek I could transfer the right to make, use, and sell a patented invention, but it could not transfer standing.<sup>85</sup> It is entirely unclear why the court chose this approach.

Moreover, the Federal Circuit may have erred in applying the transfer of rights doctrine to standing. Standing is “the right to take the initial step that frames legal issues for ultimate adjudication,” and standing exists if a plaintiff has a legally protected interest at stake in litigation.<sup>86</sup> The Federal Circuit has consistently held that a “right to sue” clause does not transfer standing to bring suit.<sup>87</sup> In so holding, the court has implied that standing is not a right that parties may transfer by contract but rather a right granted by statute to protect proprietary interests through adjudication. When a party transfers legally protected rights, such as all substantial patent rights, standing goes to the party that receives those interests.<sup>88</sup> As a result, when Prima Tek I transferred the exclusive right to make, use, and sell the patented invention to Prima Tek II, standing should have been conferred upon Prima Tek II.

### C. Nonmutual Collateral Estoppel: A Better Result for Prima Tek

Although the Federal Circuit employed a confusing rationale for denying Prima Tek I and Prima Tek II standing to sue alone, the court’s outcome does not seem entirely unreasonable given the possibility of subsequent litigation involving Southpac.

Under the doctrine of nonmutual collateral estoppel,<sup>89</sup> once an issue has been litigated, the losing party (or parties) cannot relitigate that issue in another action.<sup>90</sup> For example, suppose that Prima Tek I and Prima Tek II had been allowed to sue A-Roo for infringement without joining Southpac and that A-Roo prevailed by establishing that the patent was invalid. Future alleged infringers could rely on nonmutual collateral estoppel to avoid liability in any infringement suit brought by Prima Tek I or Prima

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85. The Federal Circuit did not expressly state that the transfer of the right to make, use, and sell the patented invention was valid. *See id.* Therefore, this argument assumes that the Federal Circuit would not strike down the license agreement to Prima Tek II as unenforceable, for it is unlikely that the Federal Circuit would invalidate all license-to-license agreements.

86. BLACK’S LAW DICTIONARY 978 (6th ed. 1991).

87. *See Ortho Pharm. Corp. v. Genetics Institute, Inc.*, 52 F.3d 1026, 1034 (Fed. Cir. 1995).

88. As noted above, courts have well established that a party inherits sufficient interest through assignment to bring suit alone.

89. The doctrine of collateral estoppel is also known as the doctrine of issue preclusion.” *Jet, Inc. v. Sewage Aeration Sys.*, 223 F.3d 1360, 1365-66 (Fed. Cir. 2000).

90. STEPHEN C. YEAZELL, CIVIL PROCEDURE 783 (4th ed. 1996).

Tek II. But if Southpac sued A-Roo (or any other infringer), A-Roo would have to relitigate the issue of validity because Southpac did not have a “full and fair opportunity to litigate” in the original suit.<sup>91</sup> Because this would be unfair to A-Roo, it would be reasonable to require Southpac to be joined as co-plaintiff in the initial litigation as long as Southpac retained sufficient interest in the patent in suit.<sup>92</sup>

As discussed above, Southpac did not retain a present interest in the patent via the license-to-license agreement.<sup>93</sup> Southpac had indirectly transferred to Prima Tek II the exclusive right to make, use, and sell the patented product and to sublicense the patent; hence, Southpac no longer retained those rights for itself.<sup>94</sup> But Southpac did have a reversionary interest in the licensed patent because the license-to-license agreement included a termination clause that permitted Southpac to terminate the agreement upon notice.<sup>95</sup> Given that Southpac could regain its patent rights by terminating the license agreement, fairness dictates that Southpac be joined so that A-Roo will not be subject to repeat litigation. The Federal Circuit, however, ignored this consideration by dismissing the termination clause as being “entirely consistent with assignment” and therefore insufficient to deprive an exclusive licensee of standing to sue alone.<sup>96</sup>

#### D. Joinder as an Undesirable Alternative

The Federal Circuit’s *Prima Tek* decision creates difficulty for sublicensees in a license-to-license agreement who want to bring suit for patent infringement. A “right to sue” clause is insufficient to confer standing upon a sublicensee,<sup>97</sup> and as the court concluded in *Prima Tek*, a sublicensee in a license-to-license agreement ordinarily lacks standing to sue be-

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91. JAY DRATLER, JR., LICENSING OF INTELLECTUAL PROPERTY § 8.06[1][c] (1994). Nonmutual collateral estoppel is a variation of the doctrine in which an issue, i.e., a patent’s validity, cannot be relitigated once the patent is held invalid. The Supreme Court abandoned the doctrine of mutuality of estoppel in patent cases; however, in order to benefit from collateral estoppel a second defendant must demonstrate that “the party to be estopped had a full and fair opportunity to litigate his claim in the first action.” *Blonder-Tongue Laboratories Inc. v. University of Illinois Foundation*, 402 U.S. 313, 347 (1971).

92. This very concern motivated the Supreme Court holding in *Independent Wireless Telegraph Co. v. Radio Corp. of America*, 269 U.S. 459 (1926), that the patentee is an essential party.

93. See *supra* Part III.A.

94. See *Prima Tek II v. A-Roo Co.*, 222 F.3d 1372, 1374 (Fed. Cir. 2000).

95. *Id.* The termination clause provided that the license terminates automatically after two years, renewable by Southpac in one-year increments.

96. *Id.* at 1380.

97. *Id.* at 1381.

cause the party from whom it receives its rights does not have standing.<sup>98</sup> This is true even if the sublicensee is in privity with the licensee and patentee and, via the license-to-license agreement, has a grant of all substantial patent rights that amount to an assignment. Therefore, the sublicensee can only bring an action against an infringer if it joins the patent owner as a co-plaintiff.<sup>99</sup> This result is unjustified under the “all substantial rights” doctrine, and unfortunately may discourage businesses from entering into otherwise beneficial license-to-license agreements.

Although the *Prima Tek* decision does not explain Southpac’s and Prima Tek I and Prima Tek II’s motives for selecting a license-to-license agreement,<sup>100</sup> it is at least possible that vertical restraints<sup>101</sup> or cost allocations imposed by the arrangement yielded net gain in production efficiency. If a patentee opts to avoid license-to-license agreements, these benefits would not be realized. While the ultimate effect is unknown, it is possible that some benefit could be lost as a result of the *Prima Tek* holding.

#### IV. CONCLUSION

The Federal Circuit holding in *Speedplay* that a licensee with all substantial rights in a patent had standing to sue reaffirmed a reasonable rule. In *Prima Tek*, the Federal Circuit should have applied the same rule in deciding whether a licensee and sublicensee in a license-to-license agreement had standing to sue. Instead, the court confused the issue by applying a different and inconsistent doctrine to each party, with the result that li-

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98. *See id.* at 1382.

99. In *Prima Tek*, the district court held that Prima Tek I could join Southpac to the suit, so the option of compulsory joinder seemed available even though Southpac is incorporated in the Cook Islands. *Id.* at 1374. Generally, the technique of compulsory joinder of patentees is available to licensees that bring infringement actions, even if the patentee is not within the personal jurisdiction of the court before which the case is brought. *See Indep. Wireless Tel. Co. v. Radio Corp. of Am.*, 269 U.S. 459, 472 (1926) (holding that “if there is no other way of securing justice to the exclusive licensee, the latter may make the owner without jurisdiction a co-plaintiff without his consent in the bill against the infringer.”). Joinder is necessary in order to give the court subject matter jurisdiction under the patent laws. *See id.* at 468 (holding that “[t]he presence of the owner of the patent as a party is indispensable not only to give jurisdiction under the patent laws but also, in most cases, to enable the alleged infringer to respond in one action to all claims of infringement for his act . . .”).

100. *See Prima Tek II* at 1372.

101. *See Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977) (recognizing that vertical restraints are often good in that they can result in gains in productive efficiency that outweighs any possible loss of allocative efficiency).

censees and sublicensees in license-to-license agreements can never sue without joining the patentee. This unfortunate result could discourage parties from entering into beneficial license-to-license agreements.

## THE 2001 PTO UTILITY EXAMINATION GUIDELINES AND DNA PATENTS

By Timothy A. Worrall

Over the last half century, biotechnology has made tremendous contributions to medicine, agriculture, and industry. The understanding of basic biochemical processes has led to innovative methods of diagnosing and treating disease.<sup>1</sup> Modern agricultural advances have facilitated the introduction of essential nutrients into staple crops in under-developed countries.<sup>2</sup> With the pace of innovation showing no sign of slowing, the biotechnology industry holds even greater promise in the coming century.<sup>3</sup>

Many biotechnology research efforts focus on recombinant methods of copying, manipulating, and controlling deoxyribonucleic acid ("DNA").<sup>4</sup> In the past decade, both government and private efforts have succeeded in sequencing the genomes<sup>5</sup> of entire organisms, including humans.<sup>6</sup> DNA sequencing efforts have resulted in an enormous number of patent applications directed to DNA compositions.<sup>7</sup>

The initial responsibility for determining the patentability of inventions rests with the U.S. Patent and Trademark Office ("PTO"), which examines patent applications for compliance with statutory requirements. In response to concerns that the PTO granted proprietary rights to biotech-

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1. See BRUCE ALBERTS, ET AL., *MOLECULAR BIOLOGY OF THE CELL* 291 (3d ed. 1994).

2. See Dennis Normile, *Monsanto Donates Its Share of Golden Rice*, 289 *SCI.* 843 (2000) (detailing the introduction of genes necessary to synthesize vitamin A into rice to combat malnutrition in economically undeveloped countries).

3. See U.S. DEPARTMENT OF COMMERCE, *U.S. INDUSTRY AND TRADE OUTLOOK* § 11-14 (1999).

4. ALBERTS, ET AL., *supra* note 1, at 291-321.

5. See *id.* DNA consists of a "sequence," or linear chain, of nucleotide bases. The term "genome" refers to the total genetic information contained in an organism. *Id.* at G-10.

6. See Elizabeth Pennisi, *Finally, the Book of Life and Instructions for Navigating It*, 288 *SCI.* 2304 (2000).

7. See *id.*; see also Eliot Marshall, *The Patent Office Faces a 90-Year Backlog*, 272 *SCI.* 643 (1996) (discussing patent claims to thousands of DNA sequences by Incyte Pharmaceuticals, Inc.).

nology too liberally,<sup>8</sup> the agency promulgated Interim Utility Guidelines in December 1999 and January 2000,<sup>9</sup> and then final Utility Guidelines in January 2001.<sup>10</sup> The PTO also developed training materials to accompany the 1999 Revised Interim guidelines.<sup>11</sup> While the PTO correctly bases the utility guidelines on case law, the 1999 training materials misapply the law to DNA claims. Unless the PTO substantively amends the 1999 training materials, the PTO may incorrectly apply the utility standards to DNA claims and issue a large number of patents that the courts ultimately will hold invalid.

## I. BACKGROUND

DNA contains the fundamental genetic information necessary to almost all biological processes.<sup>12</sup> Methods of manipulating DNA offer nearly limitless possibilities for its use.<sup>13</sup> To take advantage of DNA technology, high-profile research efforts have focused on sequencing large numbers of DNA sequences.<sup>14</sup> Such methods have become possible due to advances in the life sciences. To fully appreciate the issues surrounding utility of DNA claims, a basic understanding of molecular biology, recombinant DNA and gene sequencing is helpful.

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8. See Revised Interim Guidelines for Examination of Patent Applications Under the 35 U.S.C. § 112, ¶1 "Written Description" Requirement, 64 Fed. Reg. 71,427, 71,427-37 (Dec. 21, 1999) [hereinafter 1999 Revised Interim Guidelines].

9. *Id.*; Revised Interim Utility Examination Guidelines, 65 Fed. Reg. 3425 (Jan. 21, 2000) (adding the word "Interim" to the title and correcting a typographical error; no other changes were made).

10. Utility Examination Guidelines, 66 Fed. Reg. 1092 (Jan. 5, 2001) [hereinafter 2001 Utility Guidelines].

11. United States Patent and Trademark Office, *Revised Interim Utility Guidelines Training Materials* (Jan. 21, 2000), available at <http://www.uspto.gov/web/menu/utility.pdf> [hereinafter *1999 Training Materials*]; As of the time of publication of this Note, the PTO has not released training materials to accompany the 2001 Utility Guidelines.

12. ALBERTS, ET AL., *supra* note 1, at 10-11.

13. *Id.* at 291-292.

14. See, e.g., J. Craig Venter et al., *Shotgun Sequencing of the Human Genome*, 280 SCI. 1540 (1998) (detailing the efforts of Celera, Inc. to sequence the human genome using automated sequencing technology).

## A. Molecular Biology and Recombinant DNA

### 1. Molecular Biology

The human body consists of cells having a variety of functions arranged into multiple organ systems.<sup>15</sup> While different cells in different organ systems play vastly different biological roles, the majority of cells have the same fundamental biochemical structure and contain the same genetic material.<sup>16</sup> Many different types of molecules, including DNA, ribonucleic acid (RNA), and proteins, play a fundamental role in cellular function.<sup>17</sup>

Genes, the functional units of heredity, are composed of DNA.<sup>18</sup> DNA consists of two complementary strands, each containing a series of four nucleotide bases.<sup>19</sup> The complementary strands hybridize, or lock together, to form a double helix.<sup>20</sup> A specific, ordered sequence of bases in a DNA strand identifies a particular gene.<sup>21</sup>

Genes control the biochemical function of cells by serving as blueprints for protein synthesis.<sup>22</sup> During protein synthesis, cells first transcribe, or copy, the specific DNA sequence of a gene into a carrier material called messenger RNA ("mRNA").<sup>23</sup> The mRNA acts as a template for protein synthesis.<sup>24</sup> The portion of mRNA serving as a template for functional proteins is called an open reading frame.<sup>25</sup>

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15. ALBERTS, ET AL., *supra* note 1, at 28-34.

16. *See id.* at 41.

17. *Id.* at 98-127.

18. BENJAMIN LEWIN, GENES VI 71-72 (1997).

19. *Id.* at 76-82. The four bases making up DNA are adenine (A), thymidine (T), guanine (G), and cytosine (C). Scientists represent a DNA sequence by listing the series of bases contained therein. *Id.*

20. *Id.* at 86-87.

21. *Id.*

22. *See* ALBERTS, ET AL., *supra* note 1, at 104-05. Proteins direct or influence almost every cellular function. Structurally, proteins consist of a series of distinct chemicals, called amino acids, joined end to end. The chain of amino acid folds into a three dimensional conformation that effects protein function. Thus, the specific amino acid sequence of each protein determines its biochemical properties. *Id.* at 111-30.

23. *Id.* at 104-05.

24. *See* LEWIN, *supra* note 18, at 88-225. A gene includes not only the DNA sequence encoding protein amino acids (exons), but also non-coding DNA sequences (introns) and regulatory regions. After a DNA sequence is translated to produce mRNA, specific enzymes splice mRNA to remove non-coding "intron" regions leaving the portion of the gene that encodes the functional protein. The spliced mRNA serves as the template for translation, during which amino acids are joined end-to-end based on the mRNA sequence. In an open reading frame, a three base "start codon" defines where

## 2. *Recombinant DNA*

Recombinant DNA methods allow scientists to manipulate and study identified genes and their corresponding proteins.<sup>26</sup> For example, DNA sequences that encode functional proteins can be introduced into bacteria to produce massive amounts of the protein.<sup>27</sup> Scientists can then use the protein in a method of treatment or to identify potential therapies.<sup>28</sup> In addition, identification of the DNA sequences that cause genetic diseases allows rapid diagnosis of those diseases, as well as the development of novel therapies.<sup>29</sup> Recombinant DNA technology in agribusiness has led to the introduction of essential nutrients into staple crops in third world countries.<sup>30</sup> Recombinant DNA technology thus provides enormous power to improve the quality of life throughout the world.

## 3. *Genome Sequencing*

The DNA sequences of each cell provide all the genetic information necessary to understand how an organism functions, and recombinant methods provide the means for manipulating genetic material toward productive ends.<sup>31</sup> At the beginning of the 1990s, however, the majority of the DNA sequences of almost every organism remained unknown.<sup>32</sup> To tap the vast potential of undiscovered genetic material, both public and private entities began massive DNA sequencing efforts.<sup>33</sup>

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translation of mRNA to protein begins, and a three base "stop codon" defines where translation of mRNA to protein ends. *Id.*

25. *See id.* at 86, 204. An open reading frame, or sequence encoding a protein, defines the DNA sequence bounded by start and stop codons. *Id.*

26. *See* ALBERTS, ET AL., *supra* note 1, at 291-331. Recombinant DNA technology includes methods of cleaving, or breaking, DNA at specific sites using restriction enzymes, sequencing isolated DNA molecules, identifying specific DNA or RNA sequences by hybridization to complementary DNA sequences, cloning a single DNA molecule and copying it in a rapidly replicating organism such as bacteria, and designing modified versions of genes. *Id.*

27. *See id.*

28. *Id.* at 320-21.

29. *See* Eric S. Landers & Robert A. Weinberg, *Genomics: Journey to the Center of Biology*, 287 SCI. 1777 (2000) (reviewing the progress and potential of gene-sequencing efforts).

30. *See* Normile, *supra* note 2.

31. *See* ALBERTS, ET AL., *supra* note 1, at 291.

32. *See* Landers & Weinberg, *supra* note 29, at 1777.

33. Pennisi, *supra* note 6, at 2304-05; *see also* Venter et al., *supra* note 14; *see also* Li Hui, *China, Denmark Team Up to Tackle the Pig*, 290 SCI. 913 (2000); Gretchen Vogel, *Sanger Will Sequence Zebrafish Genome* 290 SCI. 1671 (2000).

Many sequencing projects have focused on obtaining the DNA sequences of entire organisms.<sup>34</sup> The full genome sequence of an organism allows scientists to characterize how different genes interact with each other, as well as how organisms regulate the expression of specific genes.<sup>35</sup> By the year 2001, scientists had already sequenced the genomes of a number of different organisms.<sup>36</sup> Most notably, the publicly funded Human Genome Project and the privately funded Celera, Inc., jointly announced that they independently had completed sequencing the human genome.<sup>37</sup>

Other DNA sequencing strategies have focused on identifying and characterizing the portion of the genome that encode proteins.<sup>38</sup> These efforts focus on characterizing the sequences of mRNA transcripts.<sup>39</sup> Since mRNA transcripts correspond to the small portion of the genome that encodes proteins, isolating and sequencing mRNA allows researchers to focus on regions of the genome important for cell function.<sup>40</sup> mRNA sequences can then be converted to DNA, which researchers can easily manipulate using recombinant DNA methods.<sup>41</sup>

#### 4. *Patenting the Human Genome*

Patent applications claiming DNA sequences may have reached an unmanageable critical mass at the PTO. For example, Incyte Pharmaceuti-

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34. See, e.g., Pennisi, *supra* note 6, at 2304.

35. See LEWIN, *supra* note 18, at 1131-72. Cells closely regulate gene expression (the production of proteins by genes). Disruption of regulatory mechanisms can result in genetic disorders such as cancer. *Id.*

36. See Landers & Weinberg, *supra* note 29, at 1782.

37. See Pennisi, *supra* note 6.

38. See Mark D. Adams et al., *Sequence Identification of 2,375 Human Brain Genes*, 355 NATURE 632 (1992) (describing more rapid identification of expressed sequence tags (portions of expressed genes) by the National Institute of Health).

39. See generally LEWIN, *supra* note 18, at 629-630. mRNA serves as a copy of the portion of DNA that encodes proteins. Therefore, isolating the mRNA allows researchers to isolate the portion of DNA controlling biochemical processes in an organism. To exploit these sequences, researchers first isolate mRNA, then convert it to more stable DNA. After isolating the total mRNA in a cell, researchers convert mRNA to more stable complementary DNA, or cDNA. cDNA is a copy of DNA encoding a protein. When the cDNA sequence only includes a portion of a functional gene, the cDNA is called an expressed sequence tag ("EST"). A large number of cDNAs derived from a single source, called a cDNA library, contain all expressed DNA in a specific source. By sequencing the cDNAs in a library, specific genes encoding a functional protein can be identified and characterized. *Id.*

40. *Id.*

41. *Id.*

cals alone has filed over 400,000 patent applications<sup>42</sup> claiming expressed sequence tags ("ESTs").<sup>43</sup> Without specific guidance as to the proper utility standards for DNA compositions, large numbers of incorrectly examined patents may issue.

## B. Patentability of DNA and the Utility Requirement

The ability to obtain a large number of DNA sequences at low cost has resulted in an explosion of patent applications for DNA sequences.<sup>44</sup> Patents grant to an inventor the right to exclude others from making or using a claimed invention.<sup>45</sup> The ability to exclude others from using patented DNA sequences would allow the patent holder to control results of downstream research using the DNA sequence.

### 1. Statutory Patentability Requirements

Like all patent applicants, inventors claiming DNA compositions must meet the statutory patentability requirements to obtain a patent. Patent claims must demonstrate utility,<sup>46</sup> novelty,<sup>47</sup> and nonobviousness,<sup>48</sup> as well as enable<sup>49</sup> and fully describe the invention.<sup>50</sup> While Congress has enacted some statutory provisions specific to biotechnology, statutory patent requirements for biotechnology remain essentially the same as for other inventions.<sup>51</sup>

### 2. The Utility Requirement and Chemical Compositions

Section 101 of the Patent Act sets forth the statutory basis for the utility requirement:

Whoever invents or discovers any new and useful process, machine, manufacture, or composition of matter, or any new and useful improvement thereof, may obtain a patent therefore.<sup>52</sup>

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42. Marshall, *supra* note 7, at 643.

43. See *supra* text accompanying note 39.

44. See, e.g., Marshall, *supra* note 7.

45. U.S. CONST. art. I, § 8, cl. 8 (expressly providing Congress with the power to grant inventors "the exclusive right to their . . . discoveries").

46. 35 U.S.C. § 101 (1994).

47. *Id.* § 102.

48. *Id.* § 103.

49. *Id.* § 112.

50. *Id.*

51. See *id.* § 103(b) (precluding the rejection of process claims regarding the use or making of certain nonobvious compositions specific to biotechnology).

52. *Id.* § 101.

Courts have long held that an invention must have some beneficial use to society to satisfy the utility requirement.<sup>53</sup> The threshold “beneficial use” remains low, however, providing that a claimed invention need not perform functions more effectively than similar inventions or technologies.<sup>54</sup> Courts generally allow the market to determine whether an invention actually benefits society more than already existing technologies.<sup>55</sup>

Beginning in 1950, the court expanded this *de minimis* view of the utility requirement for chemical compositions with known chemical structure, but only for speculative or hypothetical use. In *In re Bremner*, an applicant claimed a new chemical composition, but failed to assert any specific use for the composition.<sup>56</sup> The court found the claimed invention unpatentable, holding that an application must disclose some specific use for the compound to satisfy the utility requirement.<sup>57</sup> Although the *Bremner* court required an assertion of utility for a claimed invention, the substantive utility requirements remained low.<sup>58</sup>

In *Brenner v. Manson*, the U.S. Supreme Court explicitly narrowed the utility requirements for inventions, particularly chemical compositions, having only hypothetical utilities.<sup>59</sup> In *Manson*, a patent claiming a steroid composition failed to articulate any use for the steroid but specified that other steroids having similar chemical structure had well-established utility.<sup>60</sup> The Court held that the experimentally established utility of a homolog, or chemical variant, of a claimed chemical compound failed to establish the utility of the claimed compound, since minor variations in

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53. See, e.g., *Lowell v. Lewis*, 15 F. Cas. 1018, 1019 (C.C. Mass. 1817) (No. 8565) holding that a patent meets the utility requirement so long as it is not “frivolous or injurious to the well-being, good policy, or sound morals of society”); see also *Bedford v. Hunt*, 3 F. Cas. 37, 37 (C.C. Mass. 1817) (No. 1217) (holding that the law requires an invention to be “capable of use, and that the use is such as sound morals and policy do not discountenance or prohibit it”).

54. See *Lowell*, 15 F. Cas at 1019 (stating that if an invention is less useful than other, similar inventions, “it will silently sink into contempt and disregard”).

55. *Id.*

56. *In re Bremner*, 182 F.2d 216, 216 (C.C.P.A. 1950).

57. *Id.* at 217.

58. In *In re Nelson*, 280 F.2d 172 (C.C.P.A. 1960), the court briefly appeared to back away from some implications of the *Bremner* decision. The *Nelson* court held an asserted utility of a claimed compound as a starting material in the synthesis of a class of steroids, at least some of which had therapeutic use, sufficient to establish utility. *Id.* at 180. But see *In re Kirk*, 376 F.2d 936, 945 (C.C.P.A. 1967) (holding that *Brenner v. Manson* 383 U.S. 519 (1966) essentially overruled *Nelson*).

59. 383 U.S. at 536.

60. *Id.* at 533-34.

chemical structure could result in large changes in biochemical function.<sup>61</sup> The Court further held that a claimed invention must have a "specific" and "substantial" practical utility.<sup>62</sup> While a patent must assert utility specific to the claimed invention,<sup>63</sup> the *Manson* court did not specify the requisite degree of use necessary to establish "substantial" utility.<sup>64</sup>

Subsequent cases have held that an unspecified general biological utility of a chemical compound fails to meet the required utility standard.<sup>65</sup> The credible assertion that a claimed compound can treat a specific disease, such as cancer, however, satisfies the utility requirement.<sup>66</sup> Courts have continued to define "practical utility" as "specific" and "substantial" utility,<sup>67</sup> and to hold that practical utility attributes "real-world value" to a claimed invention.<sup>68</sup> For pharmaceutical inventions, the assertion of utility as a treatment method combined with in vitro data generally satisfies the requirement for "practical utility."<sup>69</sup>

Courts have also extended the *Manson* decision to chemical compositions useful as intermediates in synthesizing a separate final product. In *In re Joly*, the court held that an applicant must assert some utility for the final product of the claimed intermediate to satisfy the utility requirement.<sup>70</sup> The court further held that the specific and substantial practical utility of the final product is an essential element in establishing the utility of an intermediate.<sup>71</sup>

The Federal Circuit most recently revisited the utility requirement in *In re Brana*.<sup>72</sup> In *Brana*, the applicant claimed a chemical composition and asserted that the compound could be used as an anti-tumor treatment.<sup>73</sup> The applicant supported this assertion in the patent specification by indi-

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61. *Id.* at 532-33.

62. *Id.* at 534.

63. *Id.*

64. *Id.* at 535.

65. *See In re Kirk*, 376 F.2d 936, 945 (C.C.P.A. 1967).

66. *See In re Brana* 51 F.3d 1560, 1565 (Fed. Cir. 1995) (distinguishing *In re Kirk* since the *Brana* application asserted specific utility of the compound directed to the treatment of a certain type of cancer).

67. *See, e.g., In re Ziegler*, 992 F.2d 1197, 1201 (Fed. Cir. 1993).

68. *See, e.g., Nelson v. Bowler*, 626 F.2d 853, 856 (C.C.P.A. 1980).

69. *See Cross v. Iizuka*, 753 F.2d 1040, 1048 (Fed. Cir. 1985) (holding that the in vitro tests are sufficient to establish the utility of pharmaceuticals under appropriate circumstances).

70. *In re Joly*, 376 F.2d 906, 908 (C.C.P.A. 1967).

71. *Id.* (quoting *In re Kirk*, 376 F.2d 936, 945 (C.C.P.A. 1967)).

72. 51 F.3d 1560 (Fed. Cir. 1995).

73. *Id.* at 1562.

cating that the compound showed promise in in vitro tumor cell models.<sup>74</sup> The Board of Patent Appeals and Interferences ("Board") upheld the rejection, but the Federal Circuit reversed the Board.<sup>75</sup> The Federal Circuit held that the PTO had failed to prove the prima facie burden for lack of utility.<sup>76</sup> Since an assertion that the compound had anti-tumor properties was a specific practical use and the claimed compound had better action in vitro than known anti-tumor drugs, the Federal Circuit held that the PTO had not demonstrated that a person of ordinary skill in the art would not believe that the claimed compound was an anti-cancer agent.<sup>77</sup>

While no court has yet ruled directly on the utility of DNA compositions, the Board has indicated that the practical utility standards apply to biotechnology patents. In *Ex parte Maizel*, the Board held that the lack of an asserted use for a claimed growth factor protein, while not an issue in controversy, may have indicated that the protein lacked practical utility.<sup>78</sup> In *Ex parte Deuel*, the Board questioned whether a DNA sequence derived from rat was sufficiently homologous to human DNA to be used as a probe for similar DNA sequences.<sup>79</sup>

## II. THE UTILITY GUIDELINES AND TRAINING MATERIALS

While the courts determine how statutory requirements apply to cases in controversy, the PTO serves as the first line of review for patent applications. To ensure that patent examination comports with statutory patentability requirements and case law, the PTO devised a series of guidelines specific to different statutory requirements.<sup>80</sup> The PTO first released utility guidelines in 1995.<sup>81</sup>

In December 1999 and January 2000, the PTO released Revised Interim Utility Guidelines in response to criticism that the PTO examined

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74. *Id.* at 1563 n.3.

75. *Id.* at 1562.

76. *Id.* at 1563.

77. *Id.* at 1565.

78. *Ex parte Maizel*, 27 U.S.P.Q.2d (BNA) 1662, 1668 (Bd. Pat. App. & Int'f 1992).

79. *Ex parte Deuel*, 27 U.S.P.Q.2d (BNA) 1360, 1365 (Bd. Pat. App. & Int'f 1993), overruled by *In re Deuel*, 51 F.3d 1552, 1560 (Fed. Cir. 1995) (while overruling the Board on the obviousness issue, the Federal Circuit left open further review by the PTO on other statutory grounds, including utility).

80. Guidelines for Examination of Applications for Compliance With the Utility Requirement, 60 Fed. Reg. 36,263 (July 14, 1995) [hereinafter 1995 Utility Guidelines].

81. *Id.*

biotechnology patents too liberally.<sup>82</sup> After receiving public comments on the interim guidelines, the PTO promulgated final Utility Examination Guidelines in January 2001.<sup>83</sup> The 2001 Utility Guidelines supersede the Revised Interim Utility Examination Guidelines.<sup>84</sup>

The 2001 Utility Guidelines require that a claimed invention either have a well-established utility or assert a specific, substantial, and credible utility.<sup>85</sup> In addition, the guidelines state that an invention should not be rejected for lack of utility if the claim has a well-established utility.<sup>86</sup> The PTO should determine whether the claimed invention asserts a particular practical utility, defined as a specific and substantial use that one skilled in the art would consider credible.<sup>87</sup> The guidelines state that the requirement of specific and substantial utility “excludes throw-away, insubstantial, or nonspecific utilities, such as the use of a complex invention as landfill.”<sup>88</sup> To reject an application on utility grounds, the PTO must establish a prima facie lack of utility by a preponderance of the evidence and allow applicants to rebut the prima facie showing.<sup>89</sup> The 2001 Utility Guidelines also caution that PTO personnel must presume that statements by applicants are true unless evidence shows that one of ordinary skill in the art would have legitimate basis to doubt the credibility of the applicant’s statement.<sup>90</sup>

The PTO developed training materials corresponding to the 1999 Revised Interim Guidelines.<sup>91</sup> The 1999 training materials define standards used in the guidelines and provide specific examples of applying the

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82. 1999 Revised Interim Guidelines, *supra* note 8, at 71,441 (In the commentary preceding the 1999 Revised Interim Guidelines, the PTO argued that some criticism of biotechnology examination standards would be better addressed by the utility requirement.).

83. 2001 Utility Guidelines, *supra* note 10, at 1098. The 2001 Utility Guidelines revise the 1999 Revised Interim Guidelines to clarify that (1) an examiner should reject a claim for lack of utility “where an applicant has not asserted a specific, substantial, and credible utility, and the examiner does not perceive a well-established utility” and (2) “evidence provided by an applicant is to be analyzed with regard to a concordance between the showing and the full scope and content of the claimed invention as disclosed in the application as filed.” *Id.* at 1096.

84. *Id.* at 1092.

85. *Id.* at 1098.

86. *Id.*

87. *Id.*

88. *Id.*

89. *Id.*

90. *Id.* at 1098-99.

91. 1999 Training Materials, *supra* note 11. As of the time of publication of this Note, the PTO has not yet released training materials associated with the 2001 Utility Guidelines.

guidelines to different claimed inventions.<sup>92</sup> The training materials define a *credible* utility as one that a person of ordinary skill in the art would believe.<sup>93</sup> The application must also disclose *specific* utility to the claimed subject matter, as opposed to a general utility for the broad class of inventions.<sup>94</sup> Finally, the training materials require that a claimed invention have a *substantial* utility that defines a “real world use.”<sup>95</sup> If claims fail to establish the requisite utility, the PTO should reject them on both utility and enablement grounds.<sup>96</sup>

Examples presented in the 1999 training materials focus almost exclusively on biotechnology patent claims.<sup>97</sup> Of the examples provided by the training materials, twelve of thirteen apply to biotechnology, and two focus on DNA compositions.<sup>98</sup> Of those, one applies to DNA fragments and the other focuses on DNA fragments containing a full open reading frame potentially capable of producing a protein by recombinant methods.<sup>99</sup>

Both the 2001 Utility Guidelines and the 1999 Revised Interim Utility Guidelines provide additional requirements to the previous 1995 utility guidelines.<sup>100</sup> The newly promulgated guidelines require that the asserted utility should be credible and satisfy both “specific” and “substantial” utility requirements.<sup>101</sup> The 1995 guidelines, however, required a specific utility but not substantial utility.<sup>102</sup>

### III. DISCUSSION

The new utility guidelines may prevent inventors from seeking patent protection for speculative DNA patents in order to control subsequent research and development. The 2001 Utility Guidelines correctly restate the utility requirement according to established case law. In the training materials that accompanied the 1999 Revised Interim Utility Guidelines, how-

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92. 1999 *Training Materials*, *supra* note 11, at 5-74 (comparing credible utility to inoperable or incredible inventions such as perpetual motion machines).

93. *Id.* at 5.

94. *Id.* at 5-6.

95. *Id.* at 6.

96. *Id.* at 10 (arguing that if an application fails to establish a use, the application implicitly fails to teach one skilled in the art how to use the invention).

97. *Id.* at 13-74.

98. *Id.*

99. *Id.* at 50-55; *see also supra* text accompanying note 24.

100. Compare 2001 Utility Guidelines, *supra* note 10, and 1999 Revised Interim Guidelines, *supra* note 8, with 1995 Utility Guidelines, *supra* note 80.

101. 2001 Utility Guidelines, *supra* note 10, at 1098; *see also* 1999 Revised Interim Guidelines, *supra* note 9, at 71442.

102. 1995 Utility Guidelines, *supra* note 80, at 36,265.

ever, the PTO misapplies the established case law by applying utility standards outside the scope of judicial precedent. Unless the PTO substantially revises the 1999 training materials, incorrect application of the 2001 Utility Guidelines may result in the issuance of DNA patents that the courts ultimately will invalidate.

#### A. Patents Claiming Uncharacterized DNA Sequences Discourage Subsequent Research and Development

Commentators have argued that granting broad patent rights to DNA compositions will give the patent holder excessive control of subsequent therapeutic developments related to the gene product.<sup>103</sup> DNA patents grant the owner the right to exclude others from making or using the DNA. Use of a claimed DNA composition requires a license from the patent owner.<sup>104</sup> Thus, ownership of DNA also gives the right to control compositions, therapies, and research efforts besides the DNA composition itself.<sup>105</sup> Since scientists routinely use recombinant DNA to synthesize proteins, any effort to produce an unpatented protein using patented DNA would require licensing the rights to the DNA.<sup>106</sup> When scientists implicate a gene product in a particular pathology or disease, the ability to develop or test the efficacy of drugs affecting the protein *in vitro* requires a license from an owner of the DNA encoding the protein.<sup>107</sup>

Since automated sequencing techniques allow scientists to acquire DNA sequences at very low cost, obtaining patent rights to such DNA sequences can be extremely profitable.<sup>108</sup> Between 1995 and 1999, the PTO faced an exponentially increasing number of patent applications claiming DNA sequences.<sup>109</sup> Biotechnology corporations such as Incyte Pharmaceuticals, Inc. have filed a large number of patent applications claiming DNA compositions.<sup>110</sup>

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103. See, e.g., Molly A. Holman & Stephen R. Munzer, *Intellectual Property Rights in Genes and Gene Fragments: A Registration Solution for Expressed Sequence Tags*, 85 IOWA L. REV. 735, 774-93 (2000) (arguing, in part, that granting patent rights to DNA fragments gives "power that decrease incentives for research on full-length genes, [and leads to] . . . underuse of genetic discoveries, . . . fractionation of licensing arrangements, and . . . downstream effects of market inefficiencies").

104. *Id.* at 776-83.

105. *Id.* at 776.

106. *Id.*

107. *Id.*

108. *Id.*

109. See, e.g., Marshall, *supra* note 7.

110. *Id.*

With very valuable rights available at low cost, requiring an inventor to assert a specific, substantial, and credible utility may prevent “shotgun” sequencers, who assert only speculative utility for a putative protein, from obtaining patent protection. The 2001 Utility Guidelines may limit claims to DNA compositions having only speculative utility.

### **B. Judicial Precedent Supports the 2001 Utility Guidelines**

The PTO promulgates examination guidelines for specific statutory patent requirements to guide patent office examination practice.<sup>111</sup> The agency bases the requirements on both statutory directives and court precedent.<sup>112</sup> PTO guidelines do not represent an attempt by the PTO to make law.<sup>113</sup> Rather, they constitute a means to promote consistent patent examination across general technologies and sub-species of technology.<sup>114</sup> The PTO therefore continues to do what it has always done: apply existing law to new technologies.

The 2001 Utility Guidelines are consistent with established case law that applies utility to chemical compositions. The guidelines specifically state that patent applications must articulate a specific and substantial practical utility as required by *Brenner v. Manson*.<sup>115</sup> The guidelines, however, remain sufficiently broad to accommodate a wide variety of inventions. While the PTO drafted the new utility guidelines in response to concerns related to biotechnology, the guidelines are applicable to all inventions.<sup>116</sup>

The guidelines correctly place the initial prima facie burden of proving a lack of utility on the PTO, and the subsequent burden on the applicant.<sup>117</sup> To satisfy the prima facie burden, the PTO must show that one of ordinary skill in the art would reasonably doubt the asserted utility.<sup>118</sup> The PTO has no duty to present evidence in every case, since unpredictability in chemi-

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111. See 2001 Utility Guidelines, *supra* note 10, at 1092.

112. See *id.* at 1097-98.

113. See *id.* (specifically stating that the “guidelines have been promulgated to assist Office personnel in their review of applications for compliance with the utility requirement” and “the guidelines do not alter the substantive requirements of 35 U.S.C. § 101 and § 112”).

114. *Id.*

115. 383 U.S. 519, 533-34 (1966).

116. See 2001 Utility Guidelines, *supra* note 10, at 1097-98.

117. See, e.g., *In re Brana* 51 F.3d 1560, 1566 (Fed. Cir. 1995) (holding that the PTO must provide evidence showing “that one of ordinary skill in the art would reasonably doubt the asserted utility” before the burden shifts “to the applicant to provide rebuttal evidence sufficient to convince such a person of the invention’s asserted utility”).

118. *Id.*

cal inventions may alone create reasonable doubt as to the accuracy of a claimed utility.<sup>119</sup> In cases where an invention conforms to well-known principles in the art, no additional evidence may be required.<sup>120</sup> The burden of rebutting the prima facie utility rejection then rests with the applicant.<sup>121</sup>

The guidelines also properly direct the PTO to reject claims lacking utility on both utility and enablement grounds.<sup>122</sup> The courts have long held that a lack of utility under § 101 also justifies a rejection under § 112.<sup>123</sup> If a claim asserts no use, it cannot teach one skilled in the art how to use the invention as required by § 112. Therefore, in promulgating the 2001 Utility Guidelines, the PTO does not overstep its authority and appears to apply standards consistent with case law.

### C. Applying the Utility Requirement to DNA Claims

The utility requirements for DNA sequences should mirror those already developed for chemical compositions.<sup>124</sup> DNA sequences, like other chemical compositions, have specific chemical structures that impart specific properties.<sup>125</sup> Like other chemical compositions, slight variations in the chemical structure of DNA can result in large changes in activity.<sup>126</sup> While some DNA compositions have experimentally established functions, their utility depends on the degree to which they have a practical use defined by case law.<sup>127</sup>

Claims to DNA compositions vary as to whether they assert a credible practical use. While some DNA compositions have an experimentally established function, others assert a speculative function based on homology (i.e., similarity to other known sequences).<sup>128</sup> The asserted utility of DNA

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119. See *In re Novak*, 306 F.2d 924, 928 (C.C.P.A. 1962) (holding that a patent examiner may request additional evidence of an asserted utility unless one of ordinary skill in the art would accept the assertion).

120. See, e.g., *In re Chilowsky*, 229 F.2d 457, 462 (C.C.P.A. 1956) ("Where the mode of operation alleged can be readily understood and conforms to the known laws of physics and chemistry . . . no further evidence is required.").

121. See, e.g., *Fujikawa v. Wattanasin*, 93 F.3d 1559, 1563 (Fed. Cir. 1996).

122. See, e.g., *In re Brana*, 51 F.3d at 1566.

123. See *id.* (citing *In re Marzocchi*, 439 F.2d 220, 223 (C.C.P.A. 1971)).

124. See discussion *supra* Part I.B.2.

125. See ALBERTS, ET AL., *supra* note 1, at 291-331.

126. See LEWIN, *supra* note 18, at 89-90.

127. See discussion *supra* Part I.B.2.

128. See generally Steven E. Brenner et al., *Assessing Sequence Comparison Methods with Reliable Structurally Identified Distant Evolutionary Relationships*, 95 PROCEEDINGS OF THE NAT'L ACAD. OF SCI. 6073 (1997). See also ALBERTS, ET AL., *supra* note 1, at G-12. The term "homology" broadly refers to "[s]imilarity in structure of [a

compositions tend to fall into two categories: (1) claims to polynucleotide sequences capable of use as probes for identical or similar sequences, and (2) claims to sequences comprising an open reading frame that encodes a putative full length protein.<sup>129</sup> Both cases require careful application of existing case law in evaluating whether the sequences meet the requisite standards of utility.

### 1. *The Utility Requirement and DNA Probes*

DNA probes consist of DNA sequences used to identify identical or similar sequences.<sup>130</sup> DNA contains two individual strands, each a series of nucleotide bases.<sup>131</sup> The sequence on one strand hybridizes, or sticks, to the complementary sequence on the other strand.<sup>132</sup> The more complementary the sequences, the stronger the hybridization.<sup>133</sup> By introducing a single strand of DNA (a "probe") having a specific sequence into a mixture containing unknown nucleotide sequences, scientists can identify similar sequences in the mixture based on the amount of hybridization.

DNA sequences can typically be used as probes to detect a point on a specific chromosome,<sup>134</sup> or to detect the presence or absence of mRNA in a specific group of cells.<sup>135</sup> There are few limits to the length of a DNA

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DNA or protein sequence] . . . reflecting a common evolutionary origin." *Id.* at G-12. Proteins from different organisms having similar sequences can have similar biochemical functions. *Id.* at 14-15. When researchers characterize a new DNA sequence, they compare the sequence of the encoded protein with known sequences to make an educated guess as to its relationship and function. *Id.* However, the ability to identify evolutionary relationships between a claimed DNA sequence and other known sequences depends on factors such as the number of experimentally verified sequences and the accuracy of sequence identification. *See* Brenner et al., *supra*, at 6087.

129. *See, e.g., 1999 Training Materials, supra* note 11, at 50-55. The 1999 training materials provide examples of DNA sequences that either contain an open reading frame, which may be used to characterize a protein, or sequences useful as probes to identify other similar sequences. *Id.*

130. ALBERTS, ET AL., *supra* note 1, at 300-05. DNA consists of two complementary strands, each binding preferentially and specifically to its complementary sequences. One strand labeled with a radioactive or fluorescent tag can be used to probe for complementary or nearly complementary DNA sequences. *Id.*

131. *Id.*

132. *Id.*

133. *Id.* at 300.

134. *Id.* at 130. DNA compositions may be used as chromosome markers assuming that their location on the chromosome has been determined. *Id.*

135. *See id.; see also supra* text accompanying note 24. Since the cell first translates DNA encoding functional genes to mRNA, using a DNA probe complementary to an expressed sequence can be used to measure the amount of expressed DNA in a specific group of cells. *Id.*

sequence used as a probe; while DNA sequences must have a finite length to bind targets specifically, sequences as large as an entire genome may be used.<sup>136</sup>

If a patent claims a DNA probe, the specification should assert a specific and substantial utility to satisfy the utility requirement articulated by case law.<sup>137</sup> A DNA probe clearly has a specific and substantial utility when used to detect a known complementary target sequence. For example, a probe used to detect the level of expression for an mRNA sequence having altered expression in cancer cells should satisfy the utility requirement.<sup>138</sup>

The probe target, however, does not need to have a known function in order to establish a specific and substantial practical utility for the probe.<sup>139</sup> For instance, sequences have the requisite utility if they can be used as markers for a specific location on a specific chromosome, or to detect altered expression in a certain type of tissue or disease without a known mechanism.<sup>140</sup> Even if biochemical function of the probe target is unknown, a DNA should satisfy the utility requirement provided that detecting the target itself is useful.

## 2. *The Utility Requirement and Open Reading Frames*

Other patents on DNA compositions assert that a claimed DNA composition can produce large amounts of a protein through recombinant methods. Sequences capable of producing a protein include open reading frames, which define a region of DNA capable of synthesizing a full-length protein.<sup>141</sup> Claimed open reading frame sequences range from well-

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136. See Charles D. Laird and Brian J. McCarthy, *Magnitude of Interspecific Nucleotide Sequence Variability in Drosophila*, 60 GENETICS 303, 314 (1968) (illustrating that there is no conceptual upper limit to the length of DNA useful as a probe, since the entire genomes of two different organisms can be hybridized to detect sequence similarity).

137. See, e.g., *Brenner v. Manson*, 383 U.S. 519, 534-35 (1966).

138. See, e.g., Eric R. Fearon and Bert Vogelstein, *A Genetic Model for Colorectal Tumorigenesis*, 61 CELL 759 (1990).

139. See *In re Cortright*, 165 F.3d 1353, 1359 (Fed. Cir. 1999) (holding that "statements that a physiological phenomenon was observed are not inherently suspect simply because the underlying basis for the observation cannot be predicted or explained"); see also *Newman v. Quigg*, 877 F.2d 1575, 1581 (Fed. Cir. 1989) ("It is not a requirement of patentability that an inventor correctly set forth, or even know, how or why the invention works."); *Fromson v. Advance Offset Plate, Inc.*, 720 F.2d 1565, 1570 (Fed. Cir. 1983) ("It is axiomatic that an inventor need not comprehend the scientific principles on which the practical effectiveness of his invention rests.").

140. See LEWIN, *supra* note 18, at 623.

141. See *id.* at 88-225, 629; see also text accompanying *supra* note 39. Researchers typically first identify open reading frames from mRNA transcripts.

characterized DNA sequences having experimentally confirmed functions to DNA sequences having only hypothetical functions based on the degree of homology (sequence similarity) to sequences with known functions.<sup>142</sup>

For a claimed open reading frame DNA sequence to satisfy the utility requirement, the protein encoded by the DNA sequence should assert a specific and substantial utility.<sup>143</sup> Open reading frames function essentially as de facto intermediates in protein synthesis.<sup>144</sup> Like steroid compounds used as intermediates to synthesize a final compound, the utility of DNA intermediates depends on the utility of the final protein. The ability to produce a protein does not necessarily satisfy the utility requirement because the protein sequence may not have any known use.

Open reading frames vary widely in the degree to which their encoded proteins assert a credible specific and substantial utility. At one extreme, DNA sequences encoding proteins having experimentally verified function and use satisfy the utility requirement.<sup>145</sup> At the other extreme, the function of an unknown protein can be hypothesized based on sequence similarity, or homology, to known sequences with known function.<sup>146</sup>

The determination of utility based on homology to known sequences goes straight to the heart of many speculative DNA claims. To demonstrate a lack of utility for a claimed DNA composition homologous to sequences having experimentally verified function, the PTO must establish that one of ordinary skill in the art would reasonably doubt the asserted utility on its face.<sup>147</sup> According to case law, a claimed composition used as an intermediate fails to satisfy the utility requirement if the final product bears structural similarity to chemical compounds with unknown function.<sup>148</sup> Unlike the chemical compositions at issue in *In re Brana*, asserted utilities based on chemical similarity frequently have not been tested in vitro. In addition, the Board has suggested that a DNA sequence having an asserted utility based solely on homology to other similar sequences fails to satisfy the utility requirement.<sup>149</sup> Scientific studies suggest that asser-

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142. See Brenner, *supra* note 128, at 6073.

143. See Brenner v. Manson, 383 U.S. 519, 534-35 (1966).

144. See LEWIN, *supra* note 18, at 88-225.

145. In this case, the claimed invention has been reduced to practice.

146. See, e.g., Brenner, *supra* note 128.

147. See, e.g., *In re Chilowsky*, 229 F.2d 457, 462 (C.C.P.A. 1956) ("Where the mode of operation alleged can be readily understood and conforms to the known laws of physics and chemistry . . . no further evidence is required.")

148. See, e.g., *In re Joly*, 376 F.2d 906, 908 (C.C.P.A. 1967).

149. See *Ex parte Deuel*, 27 U.S.P.Q.2d (BNA) 1360, 1365 (Bd. Pat. App. & Int'f 1993), *overruled by In re Deuel*, 51 F.3d 1552 (Fed. Cir. 1995) (while overruling the

tions of specific function based on homology can have limited predictive value and are often case specific.<sup>150</sup> Due to the unpredictability of determining function based on homology, DNA sequences containing open reading frames<sup>151</sup> may fail to satisfy the utility requirement in the absence of either exceedingly close sequence homology or experimental evidence.<sup>152</sup>

#### D. The Revised Interim Utility Training Materials

As of the time of publication of this Note, the PTO has not yet published training materials to accompany the 2001 Utility Guidelines. The training materials developed for the 1999 Revised Interim Utility Guidelines, however, indicate that the PTO might misapply judicial precedent. Despite abundant, longstanding case law directed to chemicals having known structures but only speculative utility, the training materials fail to make a direct comparison of the utility requirements for DNA compositions to the utility requirements established for other biochemical compositions.

The 1999 interim utility training materials provide two examples of how the PTO should apply the utility guidelines to DNA claims.<sup>153</sup> The first example presents claimed DNA sequence fragments from a cDNA library containing no open reading frame, while the second presents a claimed sequence fragment containing an open reading frame.<sup>154</sup> In both examples, the PTO misapplies case law involving chemical compositions to claims to DNA compositions.

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Board on the obviousness issue, the Federal Circuit left open further review by the PTO on other statutory grounds including utility).

150. See Brenner, *supra* note 128, at 6078 (providing a systematic study of search algorithms for homologs (sequences derived from a common ancestor)). The study concludes:

even the best database searching procedures tested fail to find the large majority of distant evolutionary relationships at an acceptable error rate. Thus, if the procedures assessed here fail to find a reliable match, it does not imply that the sequence is unique; rather, it indicates that any relatives it might have are distant ones.

*Id.*

151. See *supra* text accompanying note 25.

152. See *id.*

153. See *1999 Training Materials*, *supra* note 11, at 50-55.

154. See LEWIN, *supra* note 18, at 88-225, 629; see also *supra* text accompanying notes 24, 26, 39.

### 1. *Misapplication of the Utility Requirement to DNA Probes*

Example 9 of the training materials presents a hypothetical patent application claiming DNA fragments derived from full-length, functional genes.<sup>155</sup> The hypothetical application asserts that the DNA fragments are useful as probes<sup>156</sup> to detect the full-length genes.<sup>157</sup> The PTO argues that the claimed DNA composition lacks specific utility since the probe target remains undefined, and lacks substantial utility because the target sequences have no known mechanism.<sup>158</sup>

The PTO incorrectly requires the probe target to have a known mechanism. Instead of requiring a probe to have specific, substantial, and credible utility consistent with case law, the PTO focuses on whether the applicant understands the biochemical mechanism of the probe target.<sup>159</sup> The Federal Circuit, however, has ruled that inventors need not disclose the mechanism by which an invention works, as long as the invention has a use.<sup>160</sup> By requiring the targets of DNA probes to have a known mechanism, the PTO would reject claims to DNA fragments for the wrong reasons.

Despite this error, the DNA fragments in Example 9 would still probably fail to establish a specific and substantial practical utility. Example 9 discloses that the claimed DNA fragments may be used for detecting the functional, full-length genes of which they are a part.<sup>161</sup> In *In re Kirk*, however, the Federal Circuit held that a claimed invention must be useful for more than further research on itself.<sup>162</sup> The probes probably fall into this category, since their only disclosed use is for further research on the genes that include them. Thus, the claimed DNA fragments described in the training materials would probably fail to satisfy the utility requirement.

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155. *1999 Training Materials*, *supra* note 11, at 50-53.

156. *See supra* text accompanying note 128.

157. *1999 Training Materials*, *supra* note 11, at 50-53.

158. *Id.*

159. *See id.*

160. *See, e.g., In re Cortright*, 165 F.3d 1353, 1359 (Fed. Cir. 1999) (holding that the disclosure of how a cure for baldness works is unnecessary to demonstrating its utility).

161. *See, e.g., In re Joly*, 376 F.2d 906, 908 (C.C.P.A. 1967) (holding, in part, when a chemical composition acts as an intermediate in the production of a final product whose only asserted use is for further research, the utility requirement is not satisfied).

162. *In re Kirk*, 376 F.2d 936, 938 (C.C.P.A. 1967). *Compare In re Brana*, 51 F.3d 1560, 1565 (Fed. Cir. 1995) (holding that *In re Kirk* was distinguishable since it contained only a very general asserted utility and had no correlation to experimental observation).

## 2. *Misapplication of the Utility Requirement to Open Reading Frames*

Example 10 of the 1999 Training Materials presents a hypothetical patent application claiming a DNA sequence useful in producing a protein by recombinant methods.<sup>163</sup> The specification discloses that the DNA sequence encodes a protein sequence with 95% homology<sup>164</sup> to ligase enzymes having experimentally determined functions, and 50% homology<sup>165</sup> to alpha-actin proteins having experimentally determined function.<sup>166</sup> The training materials posit that a DNA sequence having high sequence homology to a known DNA sequence satisfies the utility requirement, since the DNA sequence would have a utility that is well-known in the art.

The PTO incorrectly asserts that 95% homology to known ligases sufficiently establishes a well-known utility. While ligases have a well-known general function in biotechnology, the function of the specifically claimed sequence in the example lacks experimental identification.<sup>167</sup> In addition, individual ligases differ markedly in their target sequences.<sup>168</sup> The PTO, therefore, relieves itself of the obligation to consider whether assertions of utility based entirely on homology have the specific and substantial utility required by established case law.<sup>169</sup>

Instead of asserting that sequences with homology to known sequences have well-established utility, the PTO should consider whether the utility of the claimed sequence establishes the threshold specific and substantial practical utility required by the courts. Homology as a concept can be an aid in determining the possible function of a newly discovered gene sequence, since proteins with similar sequences frequently function in similar ways.<sup>170</sup> Small differences between similar sequences can have signifi-

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163. *1999 Training Materials*, *supra* note 11, at 53-55.

164. *See supra* text accompanying note 128.

165. *Id.*

166. *See* JAMES DARNELL ET AL., *MOLECULAR CELL BIOLOGY* 456-57, 876-80 (2d ed. 1990). Ligases are specific proteins that link two ends of a DNA molecule together. *Id.* at 456-57. Actins are proteins involved in muscle contraction and extra-cellular adhesion. *Id.* at 876-80.

167. *1999 Training Materials*, *supra* note 11, at 53-55.

168. *See* DARNELL ET AL., *supra* note 166, at 456-57.

169. If the asserted utility is well-established in the art, then there is no reason to determine whether it is specific or substantial. Yet according to the facts of the provided example, the utility of the putative protein product is not well-known, since it has never been produced and measured.

170. *See* ALBERTS, ET AL., *supra* note 1, at 35 (discussing how proteins from evolutionarily related organisms have varying sequences with the same function).

cant differences in biological activity.<sup>171</sup> In addition, even proteins with highly similar sequences can have markedly different functions.<sup>172</sup> In practice, the assertion of specific utility based entirely on homology would generally be regarded by one of ordinary skill in the art as an extremely limited predictor of actual function.<sup>173</sup> By failing to address the limitations of homology arguments, however, the PTO risks granting patents that the courts may subsequently invalidate for lack of utility.

### 3. *Public Comments on the Utility Requirement*

While the PTO has not yet published training materials to accompany the January 2001 Utility Guidelines, the agency responded to criticism of the 1999 Revised Interim Utility Guidelines and associated training materials, including criticism concerning the validity of sequence homology in establishing utility.<sup>174</sup> The PTO responses indicate that the agency will not allow or reject claims to DNA sequences per se based on homology to characterized sequences.<sup>175</sup> Rather, the PTO states that it must meet its prima facie burden depending on the facts of each case.<sup>176</sup> In light of the case law and scientific criticism concerning the reliability of basing assertions of utility on sequence homology, new training materials should provide guidance to examiners as to threshold requirements for rejecting claims to DNA sequences in patent applications.

## IV. CONCLUSION

Congress vests the PTO with the unenviable job of anticipating how the courts will decide cases involving new technologies. While the utility guidelines require higher utility standards for DNA claims, the training materials accompanying the 1999 Revised Interim Utility Guidelines suggest that the PTO may apply the guidelines without reference to closely analogous case law on speculative biochemical compositions. The new utility guidelines may limit the extent to which "shotgun cloners" can control downstream research on gene-products and the use of DNA. Unless the PTO revises the 1999 training materials, however, the agency still may issue a large number of patents that the courts ultimately will hold invalid.

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171. See LEWIN, *supra* note 18, at 89-93 (showing how acquired mutations in DNA can result in observable differences in the function of the protein encoded by the gene).

172. See *id.*

173. See Brenner, *supra* note 128 and accompanying text. Assessing the limits of homology in the context of DNA sequences lies beyond the scope of this Note.

174. 2001 Utility Guidelines, *supra* note 10, at 1096-97.

175. *Id.* at 1096.

176. *Id.*



# THE WELLCOME TRUST'S DISCLOSURES OF GENE SEQUENCE DATA INTO THE PUBLIC DOMAIN & THE POTENTIAL FOR PROPRIETARY RIGHTS IN THE HUMAN GENOME

*By Alexander K. Haas*

Acquiring proprietary rights in aspects of the human genome and its downstream products promises to be the gold rush of the twenty-first century. With the potential of revolutionizing the treatment and cures for diseases, the race is on to obtain proprietary rights in the genome or its downstream products. However, the Wellcome Trust's<sup>1</sup> recent announcement that the human genome's raw sequence will be placed in a publicly accessible database<sup>2</sup> has complicated this effort. Such public disclosures threaten to decrease what subject matter is entitled to intellectual property protection. These disclosures may thus benefit some parties' attempts to exploit the genome at the expense of others, raising the question of the motive behind these disclosures.<sup>3</sup>

This Note contends that these disclosures will indeed effectuate the purpose of patent protection—the progress of science in the production of useful inventions. Part I surveys the history and current state of the race, focusing on the Wellcome Trust's disclosures of raw sequence information. Part II examines the effect that such disclosures will have on patent rights, the dominant legal protection within the genomics field, in light of the tragedies of the commons and anticommons. Finally, Part III argues that because such disclosures decrease the possibility that an anticommons problem will arise in genomic information, they will ultimately promote the purposes of patent protection.

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1. A medical research charity founded by Sir Henry Wellcome in 1936. *See infra* Part I.C.

2. *See* The Wellcome Trust, *The Human Genome: The First Draft of the Book of Humankind*, at <http://www.wellcome.ac.uk/en/genome/> (last visited Feb. 1, 2001).

3. *See* Rebecca S. Eisenberg, *The Public Domain in Genomics* 2, Abstract, at <http://www.law.nyu.edu/ili/conferences/freeinfo2000/abstracts> (last visited Feb. 1, 2001) (suggesting that some pharmaceutical players are disclosing this information in order to spoil the intellectual property rights of those who started sequencing the genome earlier).

## I. THE HISTORY AND PLAYERS IN THE QUEST FOR PROPRIETARY RIGHTS IN THE GENOME

### A. The Human Genome Project

In 1990, the United States launched the Human Genome Project ("HGP") as a research project funded by the Department of Energy ("DOE") and the National Institutes of Health ("NIH").<sup>4</sup> Initially, the HGP had three goals: first, to identify all the genes (about 30,000) that constitute our genome;<sup>5</sup> second, to determine the sequence of the genome's three billion chemical bases;<sup>6</sup> and third, to license subsequently related technologies to the private sector.<sup>7</sup> Following the initial public investment, a public-private consortium began a cooperative effort that decreased the fifteen-year time frame originally predicted by almost a third.<sup>8</sup> As a result, in June 2000, the White House announced that a working draft of the genome was ready several years ahead of schedule.<sup>9</sup> This working draft maps nearly 97% of the human genome with 85% accuracy, with a complete version of the genome planned for 2002.<sup>10</sup>

Sequencing the genome, however, provides only a starting point towards the development of therapeutically useful and commercially viable

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4. *Five-Year Plan Goes to Capitol Hill*, HUMAN GENOME NEWS (U.S. Dep't of Energy/Nat'l Insts. of Health), May 1990, available at <http://www.ornl.gov/hgmis/publicat/hgn/v2n1/04five.html> (last visited Feb. 1, 2001) [hereinafter HUMAN GENOME NEWS].

5. "Genome" refers to the complete genetic make-up of an organism, comprised of Deoxyribonucleic acid ("DNA"). See About the Human Genome Project, at <http://www.ornl.gov/hgmis/project/about.html> (last modified Feb. 12, 2001).

6. "Sequencing" is the process of determining which nucleotides make up sections of the genome. See *id.* DNA is made up a sequence of nucleotides or chemical bases (adenine, guanine, thymine, or cytosine) each paired to its complementary base (i.e., adenine is always linked to guanine and thymine is always linked to cytosine on the complementary DNA strand) and connected by a phosphate backbone. See LUBERT STRYER, *BIOCHEMISTRY* 75-77 (4th ed. 1995).

7. See Human Genome Project Information, at <http://www.ornl.gov/hgmis/> (last modified Feb. 12, 2001).

8. HUMAN GENOME NEWS, *supra* note 4.

9. Press Release, The White House, President Clinton Announces the Completion of the First Survey of the Entire Human Genome and Hails Public and Private Efforts Leading to this Historic Achievement (Jun. 25, 2000), available at <http://www.ornl.gov/hgmis/project/clinton1.html>. The draft version of the human genome sequence was released on February 12, 2001, and is available at <ftp://ftp.sanger.ac.uk/pub/human/sequences> (last visited Feb. 12, 2001).

10. The Wellcome Trust, *The Human Genome: What is the Next Step?*, at <http://www.wellcome.ac.uk/en/genome/nextstep.html> (last visited Feb. 1, 2001) [hereinafter The Wellcome Trust].

products. In order to produce such products, researchers must analyze the raw sequence to determine the parts of the genome that encode genes, the areas that regulate their transcription,<sup>11</sup> and the functional products those genes ultimately encode.<sup>12</sup> It is this work that results in downstream applications that are diagnostically or therapeutically useful. For example, better diagnostic tools, producing genomic information, could promote early diagnosis and treatment of diseases. Also, genetic information may provide a guide to increasing a therapy's efficacy<sup>13</sup> based on an individual's genetics.<sup>14</sup> These downstream products are the HGP's ultimate goal. The stakes are high both for those with such medical problems and for companies trying to develop treatments. The question remains as to how proprietary rights will be allocated among the players to encourage investment of the enormous sums of money<sup>15</sup> this type of research requires.

## B. The Players in the Race of the Twenty-First Century

Currently, the marketplace contains three broadly defined industries that are capable of using genomic data: traditional pharmaceutical companies, biotechnology companies, and genomics companies. In order to understand the race and recent developments relating to the genome's public disclosure, one must first understand the players.

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11. Transcription refers to "[t]he flow of genetic information from DNA to RNA" that mediates the conversion of genetic information to a protein product. *See* STRYER, *supra* note 6, at 95-106.

12. Production of a protein from RNA is referred to as "translation" and is mediated by ribosomes that convert the base sequence of RNA into an amino acid sequence. *See id.* at 106-15 and 875-902.

13. The Wellcome Trust, *supra* note 10.

14. For example, NIH scientists recently pinpointed a gene that could be responsible for increased susceptibility to breast cancer. Accordingly, this information could be used both in early diagnosis and in designing targeted treatments for those with this genetic variant. *See* Press Release, National Institutes of Health, Scientists Pinpoint Location of Possible Third Gene Involved in Hereditary Breast Cancer to Chromosome 13 (Aug. 14, 2000), available at <http://www.nih.gov/news/pr/aug2000/nhgri-14.htm>.

15. *See* The Pharmaceutical Research and Manufacturers of America, *The Pharmaceutical Industry Profile: R&D The Key to Innovation*, at <http://www.phrma.org/publications/publications/profile00/chap2.phtml> (last visited Feb. 1, 2001) (stating that a typical drug averages half a billion dollars to reach the market) [hereinafter *The Pharmaceutical Industry Profile: R&D The Key to Innovation*].

1. *Traditional Pharmaceutical Companies (E.g., Merck, Glaxo Wellcome)*

Pharmaceuticals are drugs made from any living or nonliving source.<sup>16</sup> The pharmaceutical manufacturing industry has total worldwide sales reaching \$134 billion a year.<sup>17</sup> The industry's business model, known as a drug pipeline, involves extensive research and development that produces some successful products, which provide revenues to support future research. Developing a new drug averages about \$500 million.<sup>18</sup> This high cost partly results from intense regulatory scrutiny by the Food and Drug Administration ("FDA"),<sup>19</sup> since to be approved, a drug must first undergo clinical and effectiveness studies as well as safety tests examining possible side effects.<sup>20</sup>

To encourage pharmaceutical companies to make these investments, a new drug must be afforded protection. Patents are the primary means the industry uses to protect its new products. Patents afford exclusivity, allowing pharmaceutical companies to recoup the high research and development costs.<sup>21</sup> A patent holder may enjoin all use of the claimed invention, preventing competitors from entering the market for a twenty-year period.<sup>22</sup> Such protection is especially important in the pharmaceutical industry, since it is relatively easy for a competitor to copy an already proven drug.

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16. See Anthony Palazzo, *Pharmaceuticals Industry Basics*, Business.com, at <http://www.business.com/directory/pharmaceuticals/basics> (last visited Feb. 1, 2001).

17. This figure represents sales in 1999. *Id.*

18. This number includes recouping the cost of drugs that do not reach the market. See *The Pharmaceutical Industry Profile: R&D The Key to Innovation*, *supra* note 15.

19. See Federal Food Drug and Cosmetic Act, Drugs and Devices, 21 U.S.C. §§ 355 (new drugs), 351, 352, 353, 356 (1994); Investigational New Drug Application, 21 C.F.R. § 312.21 (2000).

20. See *id.*; see also Palazzo, *supra* note 16 (referring to FDA trials involving anywhere from twenty to thousands of test subjects to determine a drug's safety).

21. See *infra* Part II.A; The Pharmaceutical Research and Manufacturers of America, *The Pharmaceutical Industry Profile: Global Intellectual Property Protection*, at <http://www.phrma.org/publications/publications/profile00/chap8.phtml> (last visited Feb. 1, 2001) (stating that 65% of existing drugs would not have been developed in the absence of patent protection) [hereinafter *The Pharmaceutical Industry Profile: Global Intellectual Property Protection*].

22. See 35 U.S.C. § 154 (1994) (stating that the term begins from the time of application).

## 2. *Biotechnology Companies (E.g., Amgen, Genentech)*

Biotechnology is "the use of the cellular and molecular processes to solve problems or make products."<sup>23</sup> While the pharmaceutical industry focuses on the synthesis of products through chemical reactions, the biotechnology industry focuses on biological processes, such as recombinant DNA technology.<sup>24</sup> Since 1993, both the sales of biotechnology companies and the size of the biotechnology workforce have nearly doubled, along with the number of patents granted on biotechnological drugs and devices.<sup>25</sup> In addition to their sales revenues, biotechnology companies rely heavily on a mix of funding from IPOs, venture capitalists, and business relationships with pharmaceutical companies.<sup>26</sup>

Despite these differences, the pharmaceutical and biotechnology industries produce similar products that are subject to a common regulatory regime. Like pharmaceuticals, biotechnological products must pass extensive FDA testing in order to be sold in the United States.<sup>27</sup> Moreover, the biotechnology industry often produces products that are very similar to traditional pharmaceuticals, though through different processes.<sup>28</sup> Thus, the biotechnology industry, like the pharmaceutical industry, relies primarily on patent protection. The similarity of the products has spurred complex patent infringement actions between the two industries.<sup>29</sup>

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23. See Biotechnology Industry Organization, *Editors & Reporters Guide to Biotechnology*, at <http://www.bio.org/aboutbio/guide2000/whatis.html> (last visited Feb. 1, 2001) [hereinafter *Editors & Reporters Guide to Biotechnology*].

24. Recombinant DNA technology is the use of bacteria, yeast, or cultured animal cells to produce large quantities of a protein product. This is accomplished by splicing a gene that encodes the sought after protein into the host cell's genome and allowing that cell-line to produce the protein. See DONALD VOET, & JUDITH G. VOET, *BIOCHEMISTRY* 897-907 (2d ed. 1995).

25. See *Editors & Reporters Guide to Biotechnology*, *supra* note 23.

26. See *id.*

27. See Investigational New Drug Application, 21 C.F.R. § 312.21 (2000).

28. See, e.g., *Genentech, Inc. v. Eli Lilly & Co.*, 998 F.2d 931, 935 (Fed. Cir. 1993) (regarding a patent dispute involving two processes for producing human growth hormone).

29. See, e.g., *Scripps Clinic & Research Foundation v. Genentech, Inc.*, 927 F.2d 1565 (Fed. Cir. 1991) (involving a dispute over a constituent of human blood, Factor VIIIc).

### 3. *Genomics Companies (E.g., Celera, Human Genome Sciences)*

The genomics industry, a relative newcomer, seeks commercial applications for genome data.<sup>30</sup> Many companies within this industry focus on discovering genes that can be used to develop commercially viable products.<sup>31</sup> Several business models exist in the genomics industry: DNA sequencing companies that sell access to sequence information, drug discovery companies, and companies that use genomic data to provide diagnostic tools.<sup>32</sup> To date, none of these companies are profitable, as they have not yet produced commercial products, and most obtain funding from IPOs and venture capitalists.<sup>33</sup> If and when genomic drugs are produced, they will undergo the same clinical trials required of the pharmaceutical and biotechnology industries. Similarly, genomics companies have sought and will seek patent protection for sequence data and future products.<sup>34</sup>

Even though genomics companies have not yet produced any drugs, they are already in competition with the traditional pharmaceutical and biotechnology industries to find uses for genome data. Suppose that a genomics company held a patent on a portion of the genome or other upstream product. That company could then enjoin its use by pharmaceutical or biotechnology companies seeking to produce a downstream product. In effect, the genomics company would control the downstream product's production through its possession of the upstream patent. Indeed, DNA sequencing companies sought to avoid public disclosure<sup>35</sup> of genome sequences so that they could sell the information to others.<sup>36</sup> Such disclosures provide this data to pharmaceutical and biotechnological researchers at the expense of these genomics companies.

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30. See Alexander Julian, M.D., *Genomics Primer*, at <http://www.biospace.com/articles/genomics.primer.print.cfm> (last visited Feb. 1, 2001).

31. See *id.*

32. Genomics companies, unlike biotechnology companies, rely more heavily on genome data to identify possible drug targets. See *id.*

33. See *id.*

34. Celera, a genomics company, has filed over 6,500 patent applications to date based on its genomic research. See Justin Gillis, *Gene Researcher Draws Fire on Filings*, WASH. POST, Oct. 26, 1999, at E1.

35. See Kristen Philipkoski, *Celera Wins Genome Race*, WIRED NEWS, Apr. 6, 2000, at <http://www.wirednews.com/news/technology/0,1282,35479,00.html> (referring to conflicts between Celera and the Wellcome Trust). Such public disclosures, by nature, destroy patent rights because they constitute prior art. See *infra* Parts II.A.1, II.A.2, III.B.

36. See Eisenberg, *supra* note 3, at 7 (noting that companies engaged in DNA sequencing are "reticent to give the same information away for free").

### C. The International Consortium and the Wellcome Trust

While the DOE and NIH initiated a major research effort into sequencing the human genome, by 1996 they were joined by over a dozen public and private institutions constituting "the international consortium."<sup>37</sup> The Wellcome Trust ("the Trust"), the world's largest medical charity, leads this international consortium and has contributed about one-third of the research leading to HGP's genome data to date.<sup>38</sup> It maintains that its purpose is to "foster and promote research with the aim of improving human and animal health."<sup>39</sup> In his will, Sir Henry Wellcome<sup>40</sup> created the Trust, which currently holds assets totaling about £13 billion, from which it derives income.<sup>41</sup> Although the Trust maintains that it is an independent entity from Glaxo Wellcome, it currently "maintains a 4.7 per cent stake" in the company.<sup>42</sup> Arguably, the Trust has some pecuniary interest in the pharmaceutical industry's long-term viability.

In 1996, the Trust convened the "Strategy Meetings on Human Genome Sequencing" in Bermuda.<sup>43</sup> The meeting brought together members of the international consortium to discuss issues of sequencing strategy, policy, and data dissemination.<sup>44</sup> The Bermuda meeting produced an agreement regarding the HGP that has profound implications for the potential proprietary rights in the genome.

In the Bermuda Agreement, the international consortium agreed unanimously on the appropriate institutional response regarding the newly

37. The international consortium is made up of at least sixteen public and private institutions including both the U.S. Department of Energy and The Sanger Centre (funded directly by the Wellcome Trust). For an exhaustive list of the consortium's membership, consult the Wellcome Trust's website at <http://www.wellcome.ac.uk/en/genome/consortium.html> (last visited Feb. 1, 2001).

38. See The Wellcome Trust, *The Human Genome: What is the Sanger Center?*, at <http://www.wellcome.ac.uk/en/genome/sanger.html> (last visited Feb. 1, 2001).

39. See The Wellcome Trust, *Laying the Foundations*, at <http://www.wellcome.ac.uk/en/1/awt.html> (last visited Feb. 1, 2001).

40. Henry Wellcome founded the pharmaceutical company Burroughs Wellcome & Co., which was succeeded by Glaxo Wellcome, Inc. See The Wellcome Trust, *Frequently Asked Questions*, at <http://www.wellcome.ac.uk/en/1/awtfaq.html#1> (last visited Feb. 1, 2001).

41. *Id.*

42. *See id.*

43. See *International Large-Scale Sequencing Meeting*, HUMAN GENOME NEWS (U.S. Dep't of Energy/Nat'l Insts. of Health), Apr.-June 1996, available at <http://www.ornl.gov/hgmis/publicat/hgn/v7n6/19intern.html> (last visited Feb. 1, 2001); The Wellcome Trust, Genetics Advisory Group, at <http://www.wellcome.ac.uk/en/1/awtpubprecr97gag.html> (last visited Feb. 1, 2001).

44. *See id.*

sequenced human genome. First, the consortium agreed that all raw sequence data from the genome should be “freely available and in the public domain.”<sup>45</sup> To accomplish this goal the consortium agreed that disclosures of raw sequence data should occur as quickly as possible.<sup>46</sup> Specifically, all sequencing centers must release finished sequences into public databases on a daily basis.<sup>47</sup> Second, the agreement attacks the notion of proprietary rights in the raw sequence.<sup>48</sup> Proprietary rights would still be available in the “patenting of useful benefits derived from genetic information,”<sup>49</sup> although not in the raw sequence itself. The consortium’s position favors those seeking rights to downstream products from the genome at the expense of those claiming rights to the sequences themselves. This Note analyzes whether this institutional response to the new resource is in fact a good one.

## II. LEGAL AND THEORETICAL BACKGROUND

The implications of disclosing genome information must be analyzed in the context of the dominant intellectual property protection in these industries: patent law. In *Diamond v. Chakrabarty*,<sup>50</sup> the Supreme Court held that a genetically engineered bacterium not found in nature was patentable. Since that time, the United States Patent and Trademark Office has issued patents on a variety of biotechnological products and processes,

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45. See The Human Genome Organisation, *Summary of Principles Agreed at the International Strategy Meeting on Human Genome Sequencing*, (Feb. 25-28, 1996), at <http://www.gene.ucl.ac.uk/hugo/bermuda.htm> (last visited Feb. 1, 2001) (stating that the purpose of such disclosures is to “encourage research and development and to maximize [the] benefit to society”).

46. *Id.*

47. *Id.*

48. Disclosure of such sequence data is “to prevent such [sequencing] centres establishing a privileged position in the exploitation and control of human sequence information.” *Id.*

49. See The Human Genome Organisation, *HUGO Statement on Patenting of DNA Sequences*, (Apr. 2000), at <http://www.gene.ucl.ac.uk/hugo/patent2000.html> (last visited Feb. 1, 2001); The Wellcome Trust, *The Human Genome: What is the Trust’s View of Patenting of Genes?*, at <http://www.wellcome.ac.uk/en/genome/patenting.html> (last visited Feb. 1, 2001) (stating that patents should be confined to beneficial products derived from genomic research).

50. 447 U.S. 303 (1980).

including patents on genes<sup>51</sup> and other genomic products, as long as the requirements for patentability<sup>52</sup> are met.

### A. Patents and their Limitations

Of particular importance in analyzing the Wellcome Trust's disclosures are their effect on the statutory requirements of novelty and nonobviousness. Only these requirements<sup>53</sup> are affected by the amount of prior art.<sup>54</sup> Thus, as public disclosures increase the amount of existing prior art, they affect what subject matter may be patented.

#### 1. A Patent Primer

The Constitution expressly grants Congress the power to issue patents in order "[t]o promote the Progress of Science and useful Arts by securing for limited Time to Authors and Inventors the exclusive Right to their respective Writings and Discoveries."<sup>55</sup> This makes explicit the utilitarian view that state-conferred exclusivity afforded by patent protection should be granted only in exchange for disclosures that sufficiently advance society's knowledge.<sup>56</sup> In particular, knowledge within the public domain is undeserving of patent protection.<sup>57</sup> The consortium's disclosures should be viewed in this framework.

Holding a patent, like ownership of real property, provides the owner with exclusivity against other potential users of that resource. Specifically, patent law grants the right to exclude others from "making, using, or sell-

51. See, e.g., U.S. Patent No. 6,130,322 (issued Oct. 10, 2000) (issuing a patent on an "invention [that] relates to the three coding sequences of the BRCA1 gene" involved in breast cancer).

52. These requirements for patentability are: patentable subject matter, novelty, nonobviousness, utility, and enablement. See 35 U.S.C. §§ 101, 102, 103, 112 (1994).

53. See *id.* § 102 (1994) (novelty); *id.* § 103 (1994) (nonobviousness).

54. Prior art constitutes any description of the invention in a printed publication anywhere in the world or the invention's public use or sale in this country prior to application with the United States Patent and Trademark Office. If a prior art reference exists at the time of application, no patent may issue on that invention. See *id.* § 102 (1994); see also United States Patent and Trademark Office Website, *Novelty and Other Conditions for Obtaining a Patent*, at <http://www.uspto.gov/web/offices/pac/doc/general/novelty.htm> (last visited Feb. 1, 2001).

55. U.S. CONST. art. I, § 8, cl. 8.

56. These considerations are utilitarian because the benefit society receives from the invention and the disclosures to the patent office are believed to be greater than the cost of granting a limited monopoly. See *Bonito Boats Inc. v. Thunder Craft Boats Inc.*, 489 U.S. 141, 150-51 (1989).

57. See *Graham v. John Deere Co.*, 383 U.S. 1, 6 (1966) ("Congress may not authorize the issuance of patents whose effects are to remove existent knowledge from the public domain, or to restrict free access to materials already available.").

ing” the inventions described in an issued patent.<sup>58</sup> Such exclusivity forms the core of a patent holder’s intellectual property protection, as it allows her to bar almost all uses of the patented invention, even where the infringer uses the invention only in developing other downstream products.<sup>59</sup> Although this protection provides the pharmaceutical, biotechnology, and genomics industries with incentives to innovate,<sup>60</sup> development and downstream products can be blocked by upstream patents.

## 2. *The Novelty Requirement*

Under § 102(a) of the Patent Act, an invention is not patentable if it was previously known or used in the United States, or if it has been described in a written publication or patented anywhere in the world.<sup>61</sup> An invention is not new if “a single prior art reference contains each and every limitation of the claimed invention.”<sup>62</sup> Prior art includes all references that are in the public domain or are publicly accessible.<sup>63</sup> Thus, a DNA sequence published in an Internet database would constitute prior art, barring anyone else from patenting that sequence. After one year, the inventor who published the sequence would also be barred under § 102(b).<sup>64</sup> Therefore, if the international consortium disseminates the genome’s raw sequence, then no patents can issue on that raw sequence.

## 3. *The Nonobviousness Requirement*

The Patent Act’s nonobviousness requirement is broader and takes a more expansive view of prior art. Under § 103, patents may only issue if the invention is not obvious in view of all prior art, including relevant art

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58. See 35 U.S.C. § 154; 3 DONALD S. CHISUM, CHISUM ON PATENTS § 1 (1998).

59. See Michael A. Heller & Rebecca S. Eisenberg, *Can Patents Deter Innovation? The Anticommons in Biomedical Research*, 280 SCIENCE 698, 699 (1998).

60. The incentive is the exclusivity afforded by a patent, which helps the drug developer to recoup the costs needed to develop a drug and bring it through existing regulatory hurdles. See *id.* (stating that pharmaceutical and biotechnology companies rely on patents far more than other industries).

61. The Patent Act provides that no patent may issue if the “invention was known or used by others in this country, or patented or described in a printed publication in this or a foreign country, before the invention thereof by the applicant of the patent.” 35 U.S.C. § 102(a) (1994).

62. *Rockwell Int’l Corp. v. United States*, 147 F.3d 1358, 1363 (Fed. Cir. 1998).

63. See, e.g., *In re Hall*, 781 F.2d 897 (Fed. Cir. 1986) (invalidating a patent due to the existence of a published dissertation available only from a Department of Chemistry and Pharmacy in Germany).

64. One year after publication, the prior art reference bars even the inventor from acquiring a patent on the published subject matter. 35 U.S.C. § 102(b) (1994).

from related fields.<sup>65</sup> Whether or not an invention is obvious in light of the prior art is a question of law based on factual inquiry.<sup>66</sup> A determination of an invention's obviousness requires a court to examine: "(1) the scope and content of the prior art; (2) the level of ordinary skill in the prior art; (3) the differences between the claimed invention and the prior art; and (4) objective indicia of nonobviousness."<sup>67</sup> In effect, only inventions *sufficiently different* from what came before deserve patent protection. On this basis, the dissemination of raw sequence data into the public domain will destroy the patentability, of any invention that would be obvious from the sequence data.

## B. Tragedies of the Commons and Anticommons

Any commonly shared resource (known as a "commons") that is accessible to all who wish to exploit it faces one of two potential problems: resource overuse or underuse. If the Trust successfully places the genome's raw sequence into the public domain, it will create such a commons in genomic information. Therefore, the genome's accessibility in a public database raises the following issues.

### 1. *The Tragedy of the Commons: Resource Overuse*

Commentators have used Garrett Hardin's theory of the tragedy of the commons<sup>68</sup> to analyze commons issues in many settings for more than thirty years.<sup>69</sup> According to Hardin's theory, any rational exploiter of a common resource will try to maximize his individual gain from the resource by increasing his use without regard to the long-term effects of such use.<sup>70</sup> Indeed, no countervailing incentive exists for any exploiter to conserve the limited resource over time.<sup>71</sup> This results in each owner ex-

65. Section 103 states that patents should not issue "if the differences between the subject matter sought to be patented 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 to which said subject matter pertains." 35 U.S.C. § 103 (1994). A person of ordinary skill is deemed to know all of this relevant prior art.

66. See *Graham v. John Deere Co.*, 383 U.S. 1, 17-18 (1966).

67. See *id.*; *American Imaging Servs. v. Intergraph Corp.*, No. 99-1485, 2000 U.S. App. Lexis 13949, at \*16 (Fed. Cir. June 12, 2000).

68. See Garrett Hardin, *The Tragedy of the Commons*, 162 *SCIENCE* 1243, 1244-45 (1968).

69. For example, Hardin himself used the tragedy of the commons to describe the problem of air pollution, as clean air is a common resource that is prone to overexploitation through lack of adequate upkeep of the commons in question, such as the air. See *id.*

70. See *id.* ("Each man is locked into a system that compels him to increase his [use] without limit—in a world that is limited.").

71. See *Heller & Eisenberg*, *supra* note 59.

ternalizing the costs<sup>72</sup> he incurs onto others who use the resource. The resource ultimately succumbs to tragedy, because “too many owners each . . . use a given resource and no one has a right to exclude,”<sup>73</sup> leading to resource overuse.

Consequently, some system of restrictions—a kind of property regime—is needed to combat the problems inherent in a commons. To be effective, a private property system must demarcate the boundaries between exploiters so that they are unable to externalize the cost of their use onto others.<sup>74</sup> Such a system will prevent resource overuse, avoiding the tragedy of the commons.

## 2. *The Tragedy of the Anticommons: Resource Underuse*

The tragedy of the anticommons can be viewed as the mirror image of the tragedy of the commons.<sup>75</sup> Instead of resource overuse due to the inability of users to exclude others, the tragedy of the anticommons arises when multiple users have the right to exclude others from a scarce resource, leading to its underuse.<sup>76</sup> This occurs when there are so many excluders that it becomes economically impracticable to obtain the needed permission to use the resource from enough excluders.<sup>77</sup>

While privatization involving the fragmentation of property rights can increase incentives to innovate, increased fragmentation magnifies the potential for an anticommons tragedy. Suppose a plot of land is fragmented between a large numbers of owners, each of whom has the right to exclude others from his subplot. Because high transaction costs are involved, no one owner will bargain with all the others to make productive use of the plot as a whole.<sup>78</sup> As such, the high number of excluders prevents the resource’s productive use and the property becomes underused.<sup>79</sup>

72. To externalize costs means to place the costs incurred through the use of a resource on others instead of bearing those costs in a “pay-to-use-the-property system.” See Harold Demsetz, *Toward a Theory of Property Rights*, 57 AM. ECON. REV. PAPERS AND PROCEEDINGS 347, 355-57 (1967).

73. *Id.*; see also Hardin, *supra* note 68 (“Freedom in a commons brings ruin to all . . .”).

74. See Demsetz, *supra*, note 72.

75. See Michael A. Heller, *The Boundaries of Private Property*, 108 YALE L.J. 1163, 1166 (1999).

76. See *id.* (discussing that in the real world as the number of parties that have a right to exclude increases, the transaction costs involved in negotiating increases dramatically, leading to a market breakdown).

77. See *id.*

78. See *id.* at 1170-72.

79. This assumes that individual use of each subplot is less productive than use of the plot as a whole.

The tragedy of the anticommons rarely arises in our society, however, because legal systems evolve to embrace effective boundary rules that promote efficient use of resources.<sup>80</sup> An effective boundary rule limits the number of potential excluders, thereby preventing transaction costs from becoming prohibitive and preventing property from being too fragmented among potential excluders. Examples of this are laws that preserve the marketability of land by preventing continual subdivision of land into smaller and smaller lots.<sup>81</sup> The question remains whether patent law provides a boundary rule to effectively avoid an anticommons tragedy relating to proprietary rights in the genome.

### III. DISCUSSION

In the drug context, the patent regime's goal is to promote the development of new and useful therapies. This Note argues that the Wellcome Trust's disclosures and the resulting destruction of patent rights in the genome itself will ultimately effect this goal. It demonstrates that the Wellcome Trust's disclosures will decrease the number of potential upstream patents. Fewer patents in the raw sequence itself and in other obvious upstream products will decrease the number of potential excluders. Having fewer potential excluders decreases the likelihood of an anticommons. This will promote efficient use of genomic information in producing downstream products. Thus, the institutional response, which destroys some potential upstream patent rights, will strengthen and promote the patent system's ultimate goals.

#### A. The Effect of Dissemination of Raw Sequence Data on the Patentability of Genomic Products

Two consequences follow from the Wellcome Trust's disclosures of raw sequence data into the public domain. First, the raw sequence is rendered unpatentable, as it is no longer novel.<sup>82</sup> Second, all obvious products that stem from the sequence are likewise rendered unpatentable.<sup>83</sup> The

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80. According to Professor Heller, a boundary rule prevents over-fragmentation of resources where there are potentially "multiple owners of a single resource." See Heller, *supra* note 75, at 1200-02.

81. For example, the Sioux Indian Nation dealt with the problem of land that was so fragmented that all economic value to the land was destroyed. See *id.* at 1214-16; Hodel v. Irving, 481 U.S. 704, 707 (1987) ("Good, potentially productive, land was allowed to lie fallow, amidst great poverty, because of the difficulties of managing property held in this [fragmented] manner.").

82. See *supra* Part II.A.2.

83. See *supra* Part II.A.3.

corollary to this is that downstream products, which are more removed and not obvious from the raw sequence, would still be patentable.

1. *The Trust's Disclosures Render the Raw Sequence Unpatentable*

Disclosure of the genome's raw sequence destroys its patentability by destroying the novelty of those sequences. Information available on the Internet will be considered "known . . . by others" under § 102.<sup>84</sup> As the raw sequence data is accessible to the public once released on the Internet,<sup>85</sup> this will be considered a publication under the same section.<sup>86</sup>

The Trust's disclosures create a commons in the genome's raw sequence, which cannot be patented by anyone, and hence belong to the public at large. One may question whether a tragedy of the commons will develop with respect to the maintenance and accuracy of such information. This is unlikely to occur for two reasons. First, there is already a commitment from both public and private institutions to have a database 99.99% accurate for the entire genome by 2002.<sup>87</sup> Second, the potential success of downstream products will provide the incentive to maintain raw sequence data.

2. *Useful Products Removed from the Raw Sequence Are Patentable*

Obvious products derived from the raw sequence would be rendered unpatentable under 35 U.S.C. § 103.<sup>88</sup> For example, it is unlikely that a human gene could be patented, even if it were not continuous on the genome. Even though discontinuous genes are interrupted by introns<sup>89</sup> making them different from the raw sequence, they may still be obvious, as

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84. See *Graham v. John Deere Co.*, 383 U.S. 1, 6 (1966).

85. See The Human Genome Organisation, *supra* note 45.

86. See *Akzo N.V. v. U.S. Int'l Trade Comm'n*, 808 F.2d 1471, 1479 (Fed. Cir. 1986) ("[P]rior art reference[s] . . . plac[e] the allegedly disclosed matter in the possession of the public.").

87. See The Wellcome Trust, *The Human Genome: Questions and Answers about the Human Genome Project*, at <http://www.wellcome.ac.uk/en/1/awtptregenabt.html#13> (last visited Feb. 1, 2001).

88. See 35 U.S.C. § 103 (1994); *supra* Part II.A.2.

89. The genes of eukaryotic organisms (organisms, including humans, whose cells contain a nucleus) are disrupted at various points by intervening base pair sequences ("introns"), which do not encode part of the protein. These discontinuous genes are converted into an uninterrupted message through excision of intervening sequences. See STRYER, *supra* note 6, at 112-15.

introns can be identified by specific sequences present on the genome.<sup>90</sup> Arguably, such a gene would be obvious and unpatentable in light of the genome's publication.

However, other downstream products could pass the obviousness requirement. For instance, the body alters most proteins after translation so that they will fold properly and have proper biological function. Enzymes often carry out this post-translational modification of proteins<sup>91</sup> by selectively adding amino acids to or removing amino acids from the protein. Some of these types of protein products downstream from the genome would be nonobvious, and, of course, also novel, despite the disclosed sequence information. In addition, certain diagnostic and therapeutic products derived from genetic materials may be novel and nonobvious notwithstanding the presence of the genome in the public domain. For instance, diagnostic kits, which detect aberrant genomic sequences, would still be patentable where the kit was developed through ingenious labor.<sup>92</sup>

## **B. Disclosures into the Public Domain Are a Good Institutional Response to a Newly Tapped Resource**

The Trust's disclosures into the public domain destroy patent rights both in the genome's sequence and in obvious downstream products. At first blush, the destruction of patent rights does not seem like the preferred outcome, since patents provide incentives to innovate and produce downstream products. However, because of the potential of an anticommons arising in the biomedical context, a decrease in the number of upstream patent holders will actually effectuate the purposes of patent law by promoting development of beneficial products derived from the genome.

### *1. The Potential for an Anticommons Tragedy*

The genomics field is especially ripe for an anticommons tragedy because it often takes a wide variety of basic products, which may belong to different patent holders, in order to innovate and produce commercially viable downstream products.<sup>93</sup> Although a patent holder's power to prevent infringing uses of the patented invention provides an incentive to

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90. Recognizable nucleotide base pairs surrounding the intron provide information to the nuclear machinery to excise that portion of sequence prior to the completion of translation of a gene to a protein product. *See* VOET, *supra* note 24, at 944-47.

91. *See id.* at 1007-10 (referring to the process of protein modification following translation whereby the protein become mature and gains much of its native function).

92. *See, e.g.*, U.S. Patent No. 6,057,097 (issued Feb. 5, 2000) (issuing a patent in a diagnostic kit to detect specific DNA or proteins found in the cell membrane).

93. *See* Heller & Eisenberg, *supra* note 59, at 699.

innovate, it also increases the potential of an anticommons tragedy due to the large number of potential excluders.<sup>94</sup>

Licensing of patent rights may not solve the problem. In the genomics field, the need to get licenses from many patent holders to produce a downstream product leads to high transaction costs and raises a real danger of an anticommons tragedy. Suppose that patents could issue either on a gene itself or on gene fragments.<sup>95</sup> If so, the number of potential excluders will be very high, as there are many parties sequencing the genome. Patent holder X may exclude others from using his portion of the genome, while other patent holders may exclude patent holder X from the portion of the genome that their patents claim. In order for X (or any other patent holder) to produce an economically viable product, X will need to negotiate with every other patent holder who claims some upstream element required to develop the final product.<sup>96</sup> The transaction costs for such a process would be quite high.<sup>97</sup> According to the theory of the anticommons, such costs will lead to underuse of the resource.<sup>98</sup> This translates to fewer downstream therapeutic applications of genomic information.

One example of this phenomenon is the expressed sequence tags<sup>99</sup> (“ESTs”) problem. ESTs and other gene fragments have been patented without any knowledge as to their biological function.<sup>100</sup> Often the patent holders of these fragments own overlapping sections of the same gene. Creation of commercially viable products is likely to require the use of multiple gene fragments.<sup>101</sup> The fact that a party seeking to produce a

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94. See *supra* Part II.B.1.

95. This itself is an area of some dispute. See, e.g., Robert P. Merges & Rebecca S. Eisenberg, *Opinion Letter as to the Patentability of Certain Inventions Associated with the Identification of Partial cDNA Sequences*, 23 AIPLA Q.J. 1, 13-20 (1995) (discussing the patentability of ESTs).

96. See Robert P. Merges, *Contracting into Liability Rules: Intellectual Property Rights and Collective Rights Organizations*, 84 CALIF. L. REV. 1293, 1298 (1996) (stating that such negotiation will be “tricky”).

97. See Heller, *supra* note 75 (referring to the high transaction costs that arise from a high number of excluders and a limited resource). *But see id.* at 1298 & n.9.

98. See *id.*

99. Expressed Sequence Tags are particular sets of chemical base pairs, which identify coding regions in genomic sequences, and may be used to identify portions of the genome that ultimately code protein products. See M.D. Adams, et. al., *Complementary DNA Sequencing: Expressed Sequence Tags And Human Genome Project*, 252 SCIENCE 1651-56 (1991).

100. See American Society of Human Genetics, *American Society of Human Genetics Position Paper on Patenting of Expressed Sequence Tags*, (Nov. 1991) at <http://www.faseb.org/genetics/ashg/policy/pol-08.htm> (last visited Feb. 1, 2001).

101. See Heller & Eisenberg, *supra* note 59.

downstream product must deal with many EST patent holders is precisely the type of situation giving rise to an anticommons problem.<sup>102</sup>

### 2. *Novelty and Nonobvious Requirements as Boundary Rules*

Preventing an anticommons tragedy requires an effective boundary rule that can limit the number of potential excluders.<sup>103</sup> The requirement that patents only issue on new and nonobvious products or processes are boundary rules that limit what may be patented,<sup>104</sup> and, thus, limit the number of potential owners. These requirements will thus serve to prevent an anticommons tragedy in genome information, once the sequence data has been disclosed.

### 3. *Decreasing the Potential for an Anticommons Tragedy*

Although the potential exists for an anticommons in genomic information, the Trust's disclosures into the public domain decrease this possibility. As previously stated, these disclosures decrease the number of upstream and overlapping patents on genomic information, meaning that fewer potential excluders will exist.<sup>105</sup> On Heller's theory, this decrease in the number of possible excluders translates to lower transaction costs for those seeking to produce downstream products from genomic information.<sup>106</sup> Thus, the potential for an anticommons in genomic information decreases, as does the potential for resource underuse.

Consequently, the Trust's disclosures should increase, not decrease, the number of nonobvious downstream products created through the use of genomic information. It is these beneficial products that are more useful to society and hence more deserving of patent protection. Thus, the Trust's disclosures are an excellent institutional response to a newly created common resource, ultimately promoting the goals of patent law in advancing the progress of science.

## C. **The Outlook for Genomics Companies Absent Patent Protection**

This benefit to society could come at a high cost to genomics companies, many of which had planned to sell access to genome data. It is far from clear that these companies can survive without the ability to patent the raw sequence and obvious downstream products. Time will tell.

102. See Heller, *supra* note 75.

103. See *id.*

104. See *id.* at 1200-02; *supra* Part II.B.2.

105. See *supra* Part III.B.

106. See Heller, *supra* note 75, at 1165-66.

Alternative forms of intellectual property protection, absent some reform by Congress,<sup>107</sup> however, do not appear promising. For instance, copyright protection seems incapable of protecting the investments made by these companies in acquiring genome data.<sup>108</sup> Some scholars have advocated trade secret protection for researchers.<sup>109</sup> Trade secret protection, while perhaps applicable to the kind of information that genome companies have as long as it is secret,<sup>110</sup> would be destroyed as soon as an independent publicly accessible database is published.<sup>111</sup> Another option would be for genomic companies to claim misappropriation of the fruits of their hard work; however, it seems likely that once the consortium develops an independent database using its own resources, any claim under misappropriation would fail.<sup>112</sup> In sum, it does not appear that a traditional intellectual property system can provide incentives to the genomic companies because of the problems associated with property rights systems.<sup>113</sup> But, genomic companies may be able to survive without property rights. For instance, some companies may be able to profit from information in the public domain by providing access that is easier or more efficient to use.<sup>114</sup>

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107. One possibility would be some sort of database protection for the genomic databases put together by these companies. For a discussion of legal issues surrounding protection for databases see J.H. Reichman & Pamela Samuelson, *Intellectual Property Rights in Data?*, 50 VAND. L. REV. 51, 72 (1997).

108. Copyright protection protects only "original works of authorship" and would not apply to investments in a publicly accessible database. See 17 U.S.C. § 102(a) (1994); *Feist Publ'ns v. Rural Tel. Serv. Co.*, 499 U.S. 340 (1991).

109. Richard A. Epstein, *Property Rights in cDNA Sequences: A New Resident for the Public Domain*, 3 U. CHI. L. SCH. ROUNDTABLE 575, 578 (1996).

110. *Metallurgical Indus., Inc. v. Fourtek, Inc.*, 790 F.2d 1195, 1199 (4th Cir. 1986) ("[T]he subject matter involved must, in fact, be secret.").

111. Independent publication by the Trust would likely destroy any secret in the raw sequence, as it would not longer be secret. See *Ford Motor Co. v. Lane*, 67 F. Supp 2d 745 (E.D. Mich. 1999).

112. See Leo J. Raskind, *The Misappropriation Doctrine as a Competitive Norm of Intellectual Property Law*, 75 MINN. L. REV. 875 (1991) (discussing the history and doctrine of misappropriation); see, e.g., *Int'l News Serv. v. Assoc. Press*, 248 U.S. 215 (1918).

113. See *Merges*, *supra* note 96, at 1302 & n.17 (stating that the problem with property rights systems is that they are based on exclusivity with the holder of the right setting the price of access to the resource).

114. For example, legal databases such as Lexis-Nexis profit because their publicly accessible records would be too difficult for many people to use or access without their services.

Another option, as Professor Merges suggests, is the use of private liability rule organizations to contract into liability rules.<sup>115</sup> The advantage of liability rules in the intellectual property context is that they provide a cost ceiling to access the resource.<sup>116</sup> For instance, the American Society of Composers, Authors, and Publishers (“ASCAP”) is a collective organization that acts as a central location for “members to control public performances of their works.”<sup>117</sup> ASCAP acts as a collective right organization by allowing parties to come and negotiate with a single entity for the right to perform a copyrighted work publicly.<sup>118</sup> As such, ASCAP allows parties to easily contract into a liability rule—the cost of purchasing the public performance right.<sup>119</sup> Essentially, the government and the players attempting to exploit the genome would agree that commercial use of genome databases requires some sort of compulsory fee.

An example of this would be a registration system recently proposed to deal with the EST problem.<sup>120</sup> The registration system would first provide some exclusive rights to the discoverer of an EST, followed by a period of compulsory licensing of the right to conduct research on the EST, followed by the EST entering the public domain.<sup>121</sup> Such a registration would allow competitors to negotiate and license their discoveries to other researchers.<sup>122</sup> Like ASCAP, those interested in doing research would not have to negotiate with holders of EST patents and there would be a means of fee sharing for the right to conduct research—decreasing transaction costs.<sup>123</sup> Another benefit of registration is that without patent rights and the exclusivity they afford any anticommons tragedy dissipates. Such a system could avoid many of the problems that a patent based rights system is fraught with and would be an excellent use of liability rules to solve a potential failing of the patent system in the biomedical context.

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115. A liability rule is a “general rule of compensation applicable to all who take the right.” See Merges, *supra* note 96, at 1303.

116. See *id.* at 1304

117. *Id.* at 1329.

118. See *id.* at 1337-38.

119. See *id.* at 1303.

120. See Molly A. Holman & Stephen R. Munzer, *Intellectual Property Rights in Genes and Gene Fragments: A Registration Solution for Expressed Sequence Tags*, 85 IOWA L. REV. 735, 813-26 (2000).

121. See *id.* at 813-14.

122. See *id.* at 814.

123. See *id.* at 817-18.

#### IV. CONCLUSION

Parceling out patent rights in genetic information in order to encourage useful downstream products is a major challenge of the upcoming decade. Doing so in an efficient manner is especially important in the biomedical context.

The Wellcome Trust's decision to disclose the raw sequence of the human genome will have a positive impact on the parceling out of genomic proprietary rights. These disclosures increase the quantity of prior art in the world and hence decrease the number of upstream products that can be patented. Decreasing the number of upstream owner-excluders reduces the potential for an anticommons tragedy, lowers transaction costs, and increases the production of useful products derived from the genome. In effect, the patent rules relating to prior art act as the necessary boundary rule that will prevent an anticommons from occurring. Although these disclosures will ultimately destroy patent rights in this field, it is unclear whether genomic companies will be unable to survive without patent protection. In particular there are several possibilities for genomic companies to derive value from the genome in the absence of patent protection—notably contracting into liability rules or registration systems.

It is clear, however, that the institutional response that destroys upstream patent rights should have the practical effect of increasing the number of useful products that reach consumers. Thus, the Wellcome Trust's disclosures will effectuate the ends of the patent system "[t]o promote the Progress of Science and useful Arts."<sup>124</sup> It appears that the race is off to a good start.

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124. See U.S. CONST. art. I, § 8, cl. 8.

## NORTHERN TELECOM LTD. V. SAMSUNG ELECTRONICS CO.

By Michael R. Franzinger

Congress established the Federal Circuit partly to harmonize patent jurisprudence. Nevertheless, in the context of the best mode doctrine, the court arguably failed to achieve uniformity for many years. Controversy attended the question of whether the best mode requirement applies to components that are not part of the claimed invention but nevertheless are highly beneficial in the invention's practical implementation.

In *Northern Telecom Ltd. v. Samsung Electronics Co.*,<sup>1</sup> the Federal Circuit dealt squarely with this issue. While perhaps not resolving the controversy entirely, the court made what may be its most explicit statement to date that the best mode requirement only extends as far as the claim limitations. On the whole, the greater fairness and certainty that should result from this rule trump any associated harms.

### I. BACKGROUND

#### A. The Best Mode Requirement

U.S. law requires all patent applications to:

contain a written description of the invention, and of the manner and process of making and using it, in such full, clear, concise, and exact terms as to enable any person skilled in the art to which it pertains, or with which it is most nearly connected, to make and use the same.<sup>2</sup>

Further, this written description must "set forth the best mode contemplated by the inventor of carrying out his invention."<sup>3</sup>

The best mode requirement promotes full disclosure of innovations for which a patent is granted.<sup>4</sup> In the words of Judge Giles Rich, "the sole purpose of this . . . requirement is to restrain inventors from applying for

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1. 215 F.3d 1281 (Fed. Cir. 2000).

2. 35 U.S.C. § 112 (1994).

3. *Id.*

4. Roy E. Hofer, *The Best Mode Defense after the Federal Circuit's First Decade*, C785 ALI-ABA 1, 10 (1992).

patents while at the same time concealing from the public preferred embodiments of their inventions which they have in fact conceived.”<sup>5</sup> The purposes of the patent system would be frustrated if inventors were permitted to retain the details of their inventions as trade secrets.<sup>6</sup>

In practice, courts employ a two-step test to determine compliance with the best mode requirement. First, they determine whether or not the inventor preferred a particular mode of practicing the invention.<sup>7</sup> If he did, the inquiry shifts to whether or not he disclosed that mode adequately in view of the scope of the claims and the level of skill in the art.<sup>8</sup> A patent claim that fails this test is invalid.

Courts have handled the interaction of the best mode requirement with the scope of the claims inconsistently. Even though the Federal Circuit has helped stabilize the best mode doctrine by explicitly considering the effect of claim scope on the best mode requirement, uncertainty persists regarding how broadly the requirement is to be interpreted.<sup>9</sup> Some cases seem to indicate that the patentee must disclose everything necessary to achieve the benefit of the invention (the “Necessity Rule”),<sup>10</sup> while others take the narrower view that unclaimed subject matter is not subject to the requirement (the “Claims-Only Rule”).<sup>11</sup>

## B. Early Cases: Establishment of the Necessity Rule

### 1. *Flick-Reedy Corp. v. Hydro-Line Manufacturing Co.*<sup>12</sup>

*Flick-Reedy* was the first modern case to invalidate a patent claim for noncompliance with the best mode requirement.<sup>13</sup> *Flick-Reedy*'s patent covered a seal for “preventing leakage between the end of a cylinder tube and the head.”<sup>14</sup> The written description stated that one of the surfaces

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5. *In re Gay*, 309 F.2d 769, 772 (C.C.P.A. 1962).

6. See Hofer, *supra* note 4, at 10-11.

7. *Chemcast Corp. v. Arco Indus.*, 913 F.2d 923, 927-28 (Fed. Cir. 1990).

8. *Id.* at 928.

9. See Roy E. Hofer & L. Ann Fitzgerald, *New Rules for Old Problems: Defining the Contours of the Best Mode Requirement in Patent Law*, 44 AM. U. L. REV. 2309, 2331 (1995).

10. See, e.g., *Chemcast*, 913 F.2d 923; *Flick-Reedy Corp. v. Hydro-Line Mfg. Co.*, 351 F.2d 546 (7th Cir. 1965).

11. See, e.g., *Engel Indus. v. Lockformer Co.*, 946 F.2d 1528 (Fed Cir. 1991); *Randomex, Inc. v. Scopus Corp.*, 849 F.2d 585 (Fed. Cir. 1988). The terms “Necessity Rule” and “Claims-Only Rule” are those of the author and are not found in any cases.

12. 351 F.2d 546 (7th Cir. 1965).

13. Hofer & Fitzgerald, *supra* note 9, at 2321.

14. *Flick-Reedy*, 351 F.2d at 550.

joined at the seal was precision-machined with a “special tool.”<sup>15</sup> The patent contained no further description of the tool, and the inventor testified that he elected to keep this detail secret because of the difficulty of enforcing the patent.<sup>16</sup> The Seventh Circuit held that the failure to describe the special tool was a violation of the best mode requirement.<sup>17</sup>

In so doing, the Seventh Circuit created the Necessity Rule. The court did not explicitly consider the scope of the claims; instead, it merely noted that the close “sealing relation” between the cylinder and head was “an essential element of the patent” and that “the special tool was an aid” in obtaining this relation.<sup>18</sup> A broad but plausible interpretation of *Flick-Reedy* is that the best mode requirement mandates detailed disclosure of any item necessary to achieve the benefit of the claimed invention.<sup>19</sup> This is the essence of the Necessity Rule.

2. International Telephone and Telegraph Corp. (“ITT Corp.”) v. Raychem Corp.<sup>20</sup>

Employing a modified Necessity Rule, the First Circuit in *ITT Corp.* confined the scope of the best mode requirement to that which is “crucial” to the invention. Under *ITT Corp.*’s rule, some components do not have to be disclosed, even if they are associated with improved results, when the invention is put into practice. The patent at issue covered a type of two-layer polymer insulation for wires in jet aircrafts.<sup>21</sup> The defendant argued that the patent was invalid because the patentee did not disclose the formula of a proprietary compound included in the outer layer.<sup>22</sup> The First Circuit disagreed, affirming the district court’s finding that the addition of the compound “had no effect on the qualities of the finished insulated wire” and “was not crucial to the manufacturing process,” but merely made manufacturing the insulation more profitable by allowing faster extrusion of the outer layer.<sup>23</sup> Thus, the court held that the patent satisfied

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15. *Id.*

16. *Id.*

17. *Id.*

18. *Id.* (internal quotation marks omitted).

19. For such a broad interpretation, see Hofer & Fitzgerald, *supra* note 9, at 2322. See also Christopher S. Marchese, *Confusion, Uncertainty, and the Best Mode Requirement*, 2 FED. CIRCUIT B.J. 1, 18 (1992) (characterizing the *Flick-Reedy* court’s approach to the best mode requirement as “broad, sweeping in even that which is unclaimed”).

20. 538 F.2d 453 (1st Cir. 1976).

21. *Id.* at 454.

22. *Id.* at 459.

23. *Id.* at 460.

the best mode requirement.<sup>24</sup> It distinguished *Flick-Reedy* on the ground that the compound in the case at bar was “not essential to the production of the patented [product].”<sup>25</sup> Still, in so doing, it appeared that the court was, in principle, following the Necessity Rule.

### C. The Federal Circuit’s Attempt to Stabilize the Scope of the Best Mode Requirement

As with many other patent law doctrines, the best mode requirement lacked a coherent set of principles before the creation of the Federal Circuit.<sup>26</sup> The “essential” language of the First and Seventh Circuits was rather conclusory. Furthermore, the *Flick-Reedy* and *ITT Corp.* decisions neglected to focus on the precise language of the claims.

The Federal Circuit addressed the best mode requirement in a series of cases. Beginning with *DeGeorge v. Bernier*<sup>27</sup> and *Spectra-Physics, Inc. v. Coherent, Inc.*,<sup>28</sup> the court suggested a move toward limiting the best mode disclosure requirement to only those facets of the invention actually mentioned in the claims.<sup>29</sup> The court, however, proceeded to decide *Randomex, Inc. v. Scopus Corp.*<sup>30</sup> and *Chemcast Corp. v. Arco Industries*,<sup>31</sup> which cast doubt on the limitation and harked back to the Necessity Rule of *Flick-Reedy*. Numerous cases since have failed to establish a clear winner between these two viewpoints.<sup>32</sup> In the absence of an en banc or Supreme Court decision, the 1985 Federal Circuit opinion in *DeGeorge* is viewed as the controlling law.<sup>33</sup> But that case is not always followed. One might even say that there is an intra-circuit split on the issue of the scope of the best mode disclosure requirement.<sup>34</sup>

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24. *Id.*

25. *Id.*

26. *See* Hofer, *supra* note 4, at 9.

27. 768 F.2d 1318 (Fed. Cir. 1985).

28. 827 F.2d 1524 (Fed. Cir. 1987).

29. *See* Marchese, *supra* note 19, at nn.145, 154.

30. 849 F.2d 585 (Fed. Cir. 1988).

31. 913 F.2d 923 (Fed. Cir. 1990).

32. *See* Marchese, *supra* note 19, at 39.

33. *Newell Co. v. Kenney Mfg. Co.*, 864 F.2d 757, 765 (Fed. Cir. 1988).

34. *Cf.* Marchese, *supra* note 19, at 39 (“[T]wo inconsistent positions have emerged on where to draw the line of disclosure.”). Marchese states that “[t]hese inconsistent cases do not rise to a split in the court. This is because in some cases, perhaps many, the two positions will yield the same result, depending of course on the facts.” *Id.*

### 1. Cases Applying the Claims-Only Rule

#### a) *DeGeorge v. Bernier*

In *DeGeorge*, the Federal Circuit narrowed the scope of the best mode requirement as interpreted in *Flick-Reedy* and *ITT Corp.* The claim at issue was directed toward an “[a]pparatus for controlling the operation of a data processing system printer.”<sup>35</sup> After construing the claim not to include a word processor, the court held that the inventor was not required to disclose the type of word processor with which the invention was intended to work.<sup>36</sup> Unlike the *Flick-Reedy* court, the Federal Circuit did not address the issue of whether a word processor was “essential” or “necessary” to the invention.<sup>37</sup> Instead, the court apparently considered the best mode requirement to apply only to that which is actually included in the claims, thus establishing the Claims-Only Rule.

#### b) *Spectra-Physics, Inc. v. Coherent, Inc.*

In *Spectra-Physics*, even though the Federal Circuit appeared to confine its focus to the claimed invention, it still found that the patentee had violated the best mode requirement.<sup>38</sup> The invention in *Spectra-Physics* was a type of ion laser.<sup>39</sup> Among the limitations of the claim at issue was a “means for attaching the distal edge of each of [a series of copper] cup rims along the inside wall of [a] tube.”<sup>40</sup> The patentee disclosed brazing, and specifically “TiCuSil” brazing, as one means for attaching the copper cups.<sup>41</sup> No details about TiCuSil brazing were, however, presented in the written description.<sup>42</sup> Because TiCuSil brazing was the patentee’s preferred way of attaching the cups, the Federal Circuit determined that the claim was invalid for failure to disclose the best mode in sufficient detail.<sup>43</sup> Importantly, however, *Spectra-Physics* accords with *DeGeorge* because the court did not require the patentee to disclose the best mode of

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35. *DeGeorge v. Bernier*, 768 F.2d 1318, 1320 (Fed. Cir. 1985). The “claim” at issue was actually an interference count, but its language exactly mirrored that of a claim in Bernier’s patent.

36. *Id.* at 1325.

37. *See Hofer & Fitzgerald, supra* note 9, at 2324.

38. *Spectra-Physics, Inc. v. Coherent, Inc.*, 827 F.2d 1524, 1526 (Fed. Cir. 1987).

39. *Id.*

40. *Id.* at 1527. *See generally* 35 U.S.C. § 112, ¶ 6 (1994) (permitting and describing the scope of means-plus-function claims). For an analysis of means-plus-function claims, *see generally* Eva M. Ogielska, Note, *IMS Technology, Inc. v. Haas Automation, Inc. & Kemco Sales, Inc. v. Control Papers, Inc.*, 16 BERKELEY TECH. L.J. 71 (2000).

41. *Spectra-Physics*, 827 F.2d at 1536.

42. *Id.* at 1537.

43. *Id.* at 1536.

practicing any item that was not (at least obliquely) mentioned in the claim.

2. *Cases Applying the Necessity Rule*

a) *Randomex, Inc. v. Scopus Corp.*

The *Randomex* court called for a broader scope for the best mode requirement. In *Randomex*, the court did apply the best mode requirement to an unclaimed component associated with the invention,<sup>44</sup> but based on the particular facts of the case, it did not find a violation.<sup>45</sup> The patent in question covered a device for cleaning disk packs for mainframe computers.<sup>46</sup> The court held that the best mode requirement applied to the detergent used to clean the disks, even though the detergent was not literally part of the claimed invention.<sup>47</sup> However, *Randomex's* disclosure of "Randomex Cleaner No. 50281" was sufficient to meet the best mode requirement.<sup>48</sup>

b) *Chemcast Corp. v. Arco Industries*

The court in *Chemcast* was bolder than the *Randomex* court in departing from *DeGeorge*. The patent in *Chemcast* covered "[a] grommet for sealing an opening in a panel" with a locking portion made from a material with "a durometer hardness rating of more than 70 Shore A."<sup>49</sup> The patentee disclosed neither the particular material he had used in making the grommets, nor its hardness (75 Shore A); thus, the court determined that he violated the best mode requirement.<sup>50</sup> Writing for the court, Judge Mayer stated outright that "most of the cases in which we have said that the best mode requirement was violated addressed situations where an inventor failed to disclose nonclaimed elements that were nevertheless necessary to practice the best mode of carrying out the claimed invention."<sup>51</sup>

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44. *Randomex, Inc. v. Scopus Corp.*, 849 F.2d 585, 586 (Fed. Cir. 1988).

45. *Id.* at 590.

46. *Id.* at 586.

47. *Id.*

48. *Id.* (citing U.S. Pat. No. 3,803,660, col. 5, ll. 49-53 (issued Apr. 16, 1974)). In light of this holding, the application of the requirement to unclaimed subject matter may be dictum.

49. U.S. Pat. No. 4,081,879 (issued Apr. 4, 1978). The Shore A durometer measures soft rubber and other elastomeric materials. *Chemcast Corp. v. Arco Indus.*, 913 F.2d 923, 925 n.1 (Fed. Cir. 1990).

50. *Id.* at 928.

51. *Id.* (citing *Dana Corp. v. IPC Ltd. Pshp.*, 860 F.2d 415, 419 (Fed. Cir. 1988); *Spectra-Physics, Inc. v. Coherent, Inc.*, 827 F.2d 1524, 1537 (Fed. Cir. 1987)). Judge Mayer is stretching things a bit when he cites *Spectra-Physics* in support of his statement of the Necessity Rule ("failure to disclose specific braze cycle constituting preferred

Judge Mayer's sweeping statement of the Necessity Rule is dictum because the locking material was actually claimed, but it indicates that, at the time, the Federal Circuit was not of one mind on the subject of the scope of the best mode requirement.

#### D. Continuing Inconsistency

More recent Federal Circuit cases have continued to differ in the weight accorded to claim scope in the best mode analysis. Cases that follow the Claims-Only Rule include *Engel Industries v. Lockformer Co.*<sup>52</sup> and *Christianson v. Colt Industries Operating Corp.*<sup>53</sup> Other cases consider the body of facts when deciding the best mode question and allow "weighing the materiality of the undisclosed, unclaimed subject matter."<sup>54</sup> These cases include *Wahl Instruments, Inc. v. Acvious, Inc.*<sup>55</sup> and *Dana Corp. v. IPC Limited Partnership.*<sup>56</sup> *Northern Telecom v. Samsung* contains the clearest pronouncement yet that the Claims-Only Rule best comports with section 112 of the patent statute.

## II. CASE SUMMARY

Northern Telecom brought an action against Samsung for infringement of U.S. Patent No. 4,030,967 ("the '967 patent") in the U.S. District Court for the Northern District of California. The district court entered summary judgment supporting the plaintiff's interpretation of the '967 patent's sole

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means of attachment violated best mode even though no particular attachment means claimed"). *Spectra-Physics* contained a means-plus-function claim, which according to 35 U.S.C. § 112 literally covers the means disclosed in the specification. Thus, brazing was effectively part of the claim.

52. 946 F.2d 1528, 1531 (Fed. Cir. 1991) ("The best mode inquiry is directed to what the applicant regards as the invention, which in turn is measured by the claims. Unclaimed subject matter is not subject to the disclosure requirements of § 112; the reasons are pragmatic: the disclosure would be boundless, and the pitfalls endless.").

53. 822 F.2d 1544, 1563 (Fed. Cir. 1987) (holding that the best mode requirement did not mandate disclosure of how to manufacture a complete M-16 rifle, when the patents claimed only certain individual rifle parts), *vacated on other grounds by Christianson v. Colt Indus. Operating Corp.*, 986 U.S. 800 (1988).

54. Marchese, *supra* note 19, at 43.

55. 950 F.2d 1575, 1580 (Fed. Cir. 1991) (stating that "[o]ne must look at . . . all of the circumstances in order to evaluate whether the inventor's failure to disclose particulars of manufacture gives rise to an inference that he concealed information which one of ordinary skill in the art would not know," but sustaining patent's validity in the face of failure to disclose certain details of the manufacturing process).

56. 860 F.2d 415, 420 (Fed. Cir. 1988) (invalidating patent on valve stem seal for failure to disclose fluoride treatment that improved seal's performance).

independent claim but invalidating the patent for noncompliance with the best mode requirement.<sup>57</sup>

### A. Technical Background

The '967 patent covered a "process for gaseous etching of aluminum and aluminum oxide, including an initial step of plasma etching in the presence of a gaseous trihalide comprising at least in part, a boron trihalide."<sup>58</sup> The etching process was useful in the manufacture of integrated circuit semiconductor devices.<sup>59</sup> In a typical manufacturing process, a silicon wafer is coated with a conductive layer of aluminum or an aluminum alloy, then covered with a mask of nonetchable material.<sup>60</sup> An aluminum etching process removes portions of the conductive layer according to a pattern in the mask. The mask is then removed, leaving a desired pattern of conductive material on the silicon surface.<sup>61</sup>

Northern Telecom developed and patented an etching process using a gas plasma containing one or more of the boron trihalides.<sup>62</sup> Use of the plasma led to sharper pattern definition and less toxicity than the older "wet etching" processes.<sup>63</sup> The boron trihalides were significant because they removed the naturally occurring protective layer of aluminum oxide, which had frustrated previous attempts at gaseous etching of aluminum.<sup>64</sup> With the oxide removed, certain components of the plasma react with the exposed sections of the conductive layer, rendering those sections easy to remove.<sup>65</sup>

An alternative gaseous etching process is sputter etching, which may be used on its own or in combination with plasma etching. In this process, opposite electrical charges are imparted to the gas and the metal surface. The ions in the gas are pulled toward the surface, striking it and physically dislodging atoms from the metal.<sup>66</sup> Reactive ion etching is a hybrid of the

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57. Northern Telecom Ltd. v. Samsung Elecs. Co., No. C95-0449, 1998 U.S. Dist. LEXIS 14265, at \*3 (N.D. Cal. Sept. 4, 1998). The best mode requirement is an objective inquiry into whether inventor's disclosure is adequate to enable one of ordinary skill in the art to practice the best mode of the invention, which depends on the scope of the invention and the level of skill in the relevant art. 35 U.S.C. § 112 (1994).

58. Northern Telecom Ltd. v. Samsung Elecs. Co., 215 F.3d 1281, 1283 (Fed. Cir. 2000); U.S. Pat. No. 4,030,967, col. 4, ll. 6-9 (issued June 2, 1977).

59. See *Northern Telecom*, 215 F.3d at 1283.

60. *Id.*

61. *Id.*

62. U.S. Pat. No. 4,030,967, col. 4, ll. 6-9 (issued June 2, 1977).

63. *Northern Telecom*, 215 F.3d at 1284.

64. *Id.*

65. *Id.*

66. *Id.*

two processes—positively charged particles in the plasma strike the negatively charged metal surface, while active radicals in the plasma react with the metal to form easily removable compounds.<sup>67</sup>

After removal of the mask and the etched metal, the final manufacturing step involves heating the device to a temperature above 400°C.<sup>68</sup> Such a high temperature can cause silicon to diffuse into the aluminum layer, however, leaving holes which are then filled by protrusions from the aluminum layer (“spearing”).<sup>69</sup> If the integrated circuit device includes multiple conductive layers, then spearing may cause short circuits between layers.<sup>70</sup> Using an aluminum silicon alloy in the conductive layer solves the spearing problem: when the aluminum is already saturated with silicon, no more silicon will diffuse into it from the silicon layer.<sup>71</sup> The ’967 patent did not disclose the alloy remedy for the spearing phenomenon.<sup>72</sup>

## B. Case History

### 1. *The District Court’s Ruling*

On the claim construction and infringement issues, the district court held in Northern Telecom’s favor. The court determined that the claimed “plasma etching” did not exclude ion bombardment.<sup>73</sup> Samsung had defended against infringement on the grounds that its process used the hybrid reactive ion etching. Samsung had interpreted Northern Telecom’s definition of “plasma etching” as excluding the ion bombardment component that is present in reactive ion etching.<sup>74</sup>

The district court also construed “aluminum and aluminum oxide” to exclude alloys such as aluminum silicon. But since a process that etched an aluminum alloy would etch both aluminum and the other component(s) of the alloy, the court held that such a process could still literally infringe the ’967 patent.<sup>75</sup>

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67. *Id.*

68. *Id.* at 1285.

69. *Id.*

70. *Id.*

71. *Id.*

72. *Id.* at 1286.

73. *Northern Telecom Ltd. v. Samsung Elecs. Co.*, No. C-95-449, 1996 U.S. Dist. LEXIS 21786, at \*44 (N.D. Cal. Sept. 13, 1996).

74. *See Northern Telecom*, 215 F.3d at 1285; *Northern Telecom*, 1996 U.S. Dist. LEXIS 21786, at \*47-48.

75. *See Northern Telecom*, 215 F.3d at 1285; *Northern Telecom*, 1996 U.S. Dist. LEXIS 21786, at \*49-50. The distinction between this and the previous finding is subtle. According to the court, the terms “aluminum and aluminum oxide” do not encompass

In a later proceeding, the district court held the '967 patent invalid for failure to disclose the best mode of practicing the invention.<sup>76</sup> The court based its conclusion on the fact that Northern Telecom did not disclose the use of an aluminum silicon alloy to prevent spearing.<sup>77</sup> It was undisputed that the inventors knew that aluminum silicon alloy was useful and even necessary for the manufacture of very-fine-line semiconductor devices.<sup>78</sup>

Northern Telecom appealed the best mode decision.<sup>79</sup> Samsung cross-appealed, challenging the court's claim construction and the ruling of literal infringement.<sup>80</sup>

## 2. *The Federal Circuit's Ruling*

In a unanimous opinion written by Judge Clevenger, the Court of Appeals for the Federal Circuit upheld the district court's claim construction and finding of literal infringement, but reversed the finding of violation of the best mode requirement. In affirming the infringement ruling, the court refused to accept Samsung's assertion that the additional limitation of an aluminum "layer" must be read into the claim. Samsung had relied, *inter alia*, on the argument that such a limitation was necessary to ensure that the '967 patent only covered processes that etched a significant amount of aluminum.<sup>81</sup> However, the court pointed out that simply mixing other components with aluminum would not render the accused process noninfringing.<sup>82</sup>

The court also rejected Samsung's proposed construction of the term "plasma etching" as excluding ion bombardment. The court held that plasma etching alone, as disclosed by Northern Telecom, was merely the

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aluminum alloys. *Id.* at \*47-48. But etching such alloys is still literal infringement because, in etching an aluminum alloy, one would inherently be etching aluminum. *Id.* at \*49-50. An interesting question, but one beyond the scope of this Note, is whether or not there is a line to be drawn between alloys (solutions of one metal in another) and crystalline compounds. Might "aluminum" be construed even to encompass a compound such as aluminum chloride?

76. *Northern Telecom*, 1998 U.S. Dist. LEXIS 14265, at \*37.

77. *Id.* at \*36-37.

78. *See Northern Telecom*, 215 F.3d at 1285-86; *Northern Telecom*, 1998 U.S. Dist. LEXIS 14265, at \*20-21. In this case, "very-fine-line" means having a line width of 2 microns. *Northern Telecom*, 1998 U.S. Dist. LEXIS 14265, at \*18.

79. *Northern Telecom*, 215 F.3d at 1283.

80. *Id.*

81. *Id.* at 1290.

82. *Id.* The court did not deny that the logical extension of this line of reasoning was that the patent covered even processes in which the etched material contained a "trace" amount of aluminum. *Id.* at 1291. However, "aluminum oxide" was still, independently, required for literal infringement. *Id.* at 1291-92.

preferred embodiment of the invention; it did not exclude the ion bombardment also found in Samsung's process.

Finally, the Federal Circuit reversed the district court's best mode ruling, noting that "the contours of the best mode requirement are defined by the scope of the claimed invention."<sup>83</sup> Because there was no requirement in the claims that the process be suitable for fine-line etching, the use of an aluminum silicon alloy was unnecessary for the performance of the claimed process.<sup>84</sup> Having thus determined that the component at issue was not within the scope of the best mode requirement, the court did not need to reach the factual issues of whether or not the inventor possessed a preferred mode, and whether or not he disclosed it.<sup>85</sup>

### III. DISCUSSION

*Northern Telecom* apparently resolves the best mode scope controversy in favor of the Claims-Only Rule. This result entails a sacrifice of the public's right to some disclosure, but it also renders the best mode requirement more equitable and patent litigation more predictable.

#### A. *Northern Telecom* Adds Weight to the Precedent Favoring the Claims-Only Rule

##### 1. *The District Court Followed the Necessity Rule*

The district court's opinion echoed the sentiments of the *Flick-Reedy*, *Randomex*, and *Chemcast* courts. The district judge began by stating that patent validity depends on disclosure of "the best method known for carrying out the claimed invention and . . . the best physical way to make use of it."<sup>86</sup> These are two different statements, and only the first unquestionably follows from the statutory language directing that the inventor "shall set forth the best mode contemplated by the inventor of carrying out his invention."<sup>87</sup> "[T]he best physical way to make use of" the invention is ambiguous—it could be a mere rewording of "the best method known for carrying out the claimed invention," or it could be a mandate for detailed disclosure of the circumstances in which the invention is preferably employed. Subsequent statements and the court's holding of invalidity point toward the latter interpretation. While paying lip service to the principle that "the best mode requirement is limited by the scope of a patent's

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83. *Id.* at 1286.

84. *Id.* at 1287-88.

85. *Id.* at 1289.

86. *Northern Telecom*, 1998 U.S. Dist. LEXIS 14265, at \*10.

87. 35 U.S.C. § 112 (1994).

claims[.]”<sup>88</sup> the court nonetheless held that “because aluminum alloy was necessary to achieve the best results from the plasma-etching process,” it should have been disclosed.<sup>89</sup> The court went on to cite *Chemcast* and *Randomex* in support of this proposition.<sup>90</sup>

## 2. *The Federal Circuit Followed the Claims-Only Rule*

In construing the best mode requirement not to extend to the aluminum silicon alloy, the Federal Circuit came down on the side of the Claims-Only Rule. The court cited *DeGeorge* and *Spectra-Physics* in support of its assertion that “unclaimed matter that is unrelated to the operation of the claimed invention does not trigger the best mode requirement.”<sup>91</sup> The court determined that the claim at issue was for a method of etching aluminum, not a complete aluminum-based microelectronic device. Therefore, the fact that the inventor, when using the method in its intended context, preferred to use it on an aluminum alloy is irrelevant.<sup>92</sup>

The *Northern Telecom* result increases the likelihood that future cases will confine the scope of the best mode requirement to that which is part of or directly related to the claims. This additional case in the *DeGeorge* line makes it more difficult for future district courts and circuit panels to distinguish their cases and apply a broader conception of the best mode requirement.<sup>93</sup> On a more basic level, *Northern Telecom* clarifies the message of *DeGeorge* and *Spectra-Physics* by explicitly endorsing the Claims-Only Rule.<sup>94</sup>

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88. *Northern Telecom*, 1998 U.S. Dist. LEXIS 14265, at \*23.

89. *Id.* at \*24-25.

90. *Id.* at \*34-36 (citing *Chemcast v. Arco Indus.*, 913 F.2d 923, 928 (Fed. Cir. 1990); *Randomex, Inc. v. Scopus Corp.*, 849 F.2d 585, 588 (Fed. Cir. 1988)).

91. *Northern Telecom Ltd. v. Samsung Elecs. Co.*, 215 F.3d 1281, 1289 (Fed. Cir. 2000) (citing *DeGeorge v. Bernier*, 768 F.2d 1318, 1325; *Spectra-Physics, Inc. v. Coherent, Inc.*, 827 F.2d 1526, 1536). The panel appears to have viewed the beneficial effect of the aluminum silicon alloy, realized only in a subsequent step after the claimed etching process is complete, as “unrelated to the operation of” the invention.

92. *Northern Telecom*, 215 F.3d at 1289.

93. At least one subsequent case has explicitly followed *Northern Telecom*'s rule and perhaps even extended it. See *Eli Lilly & Co. v. Barr Lab., Inc.*, 222 F.3d 973, 984 (Fed. Cir. 2000) (holding that failure to disclose a preferred recrystallization solvent in patents claiming a compound and a process for making it was not a best mode violation “because the patents simply do not claim a recrystallization process or a recrystallization solvent”). Despite his previous statements apparently favoring the Necessity Rule, Chief Judge Mayer joined in the *Eli Lilly* opinion. Cf. *supra* text accompanying note 51.

94. See *DeGeorge*, 768 F.2d at 1325 (stating only that “[b]ecause [a] properly construed count does not include a word processor, failure to meet the best mode requirement here should not arise from an absence of information on the word processor”); *Spectra-Physics*, 827 F.2d at 1533, 1537 (holding that the best mode requirement man-

## B. *Northern Telecom* May Serve to Establish the *Flick-Reedy* Approach Conclusively in Object-of-Process Cases

Because it is the first “object-of-process” case to come before the Federal Circuit, *Northern Telecom* may set a conclusive standard for the scope of the best mode requirement in this narrow category of cases.<sup>95</sup> Future courts deciding whether or not a patentee must disclose the best material upon which to perform a claimed process will most likely look to this case and answer in the negative. In light of the general confusion surrounding the scope of the best mode requirement, a district court would probably be relieved to have a fact pattern that parallels a particular Federal Circuit case so that it could avoid having to split hairs between the Claims-Only and Necessity cases.

It is not clear, however, that “object-of-process” is even a worthwhile categorization of patent cases. First, as evidenced by the dearth of past cases on point, the issue does not come up very often.<sup>96</sup> Second, and more importantly, the object-of-process fact pattern has little logical significance beyond being a species of the genus of things necessary to achieve the benefit of the invention. It would be difficult to advance a principled justification for a per se rule in object-of-process cases coupled with a more vague standard in cases involving other types of generally beneficial but unclaimed elements. Therefore, this aspect of *Northern Telecom*, while conclusive, is not very significant.

## C. Best Mode May Now Be More of a Question of Law

In the past, courts have often unwittingly merged the scope of the best mode requirement with the two-step best mode inquiry. As noted above, the inquiry consists of two questions of fact: did the inventor possess a preferred mode, and if so, did he disclose it? The scope of the requirement

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dated disclosure of the details of a process by which the claimed “means for attaching” was formed, but never making an explicit statement about best mode scope); *but see* Hofer, *supra* note 4, at 41 (“Unclaimed subject matter is not subject to the best mode disclosure requirement”) (citing *Engel Indus. v. Lockformer Co.*, 946 F.2d 1528, 1531). *Northern Telecom* had not been decided at the time of Hofer’s writing.

95. An “object-of-process” case (the author’s term) is one in which the issue is whether or not the patentee must disclose the preferred object on which to perform a claimed process.

96. As an illustration of this point, none of the thirty-six cases cited by Hofer in his summary of the Federal Circuit’s best mode jurisprudence deals with the object of a claimed process. *See* Hofer, *supra* note 4, at *passim*.

had, on occasion, been treated as a legal question,<sup>97</sup> but as the Federal Circuit stated in *Chemcast*, the best mode inquiry at large has been treated as a question of fact:

Assessing the *adequacy* of the disclosure, as opposed to its *necessity*, is largely an objective inquiry that depends upon the scope of the claimed invention and the level of skill in the art. Notwithstanding the mixed nature of the best mode inquiry, and perhaps because of our routine focus on its subjective portion, we have consistently treated the question as a whole as factual.<sup>98</sup>

After *Northern Telecom*, claim construction is clearly crucial to determining the scope of the best mode requirement. Claim construction is, of course, a question of law since *Markman v. Westview Instruments*.<sup>99</sup> After a *Markman* hearing, it will probably be obvious whether or not disclosure of the best mode is required for the component at issue.<sup>100</sup> Thus, the *Markman* hearing, already of tremendous importance in most patent cases,<sup>101</sup> will take on even greater significance.

The best mode two-step factual inquiry remains intact. The trier of fact still needs to determine whether or not the inventor preferred a particular embodiment of the claimed invention and whether or not he disclosed this embodiment.<sup>102</sup> Judicial determination of the scope of the requirement merely defines the product or process components to which this inquiry is applied.

Ultimately, though, if the jury had any control over the scope issue before *Northern Telecom*, that control appears to be gone. Under the Claims-Only Rule, it is hard, perhaps impossible, to think of a case in which the claim construction could fail to be dispositive of best mode scope. Thus, the court's conclusions regarding claim scope are controlling. Because appellate courts may more easily overturn conclusions of law than findings

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97. See, e.g., *Randomex, Inc. v. Scopus Corp.*, 849 F.2d 585, 588-90 (Fed. Cir. 1988) (treating the scope of the requirement as part of the court's jury question drafting process, rather than as an issue for the jury itself to resolve).

98. *Chemcast v. Arco Indus.*, 913 F.2d 923, 928 (Fed. Cir. 1990) (emphasis in original).

99. 517 U.S. 370, 372 (1996) (declaring claim construction to be exclusively an issue for the court).

100. A *Markman* hearing is a proceeding at which a court determines the scope of a patent's claims. ROBERT P. MERGES ET AL., *INTELLECTUAL PROPERTY IN THE NEW TECHNOLOGICAL AGE* 249 (2d ed. 2000).

101. *Id.*

102. *Northern Telecom Ltd. v. Samsung Elecs. Co.*, 215 F.3d 1281, 1286 (Fed. Cir. 2000) (citing *Chemcast*, 913 F.2d at 928).

of fact,<sup>103</sup> *Northern Telecom* probably portends greater involvement for the Federal Circuit as well.<sup>104</sup>

#### **D. The Federal Circuit Sacrificed Some Disclosure for Greater Certainty**

The rule announced in *Northern Telecom* renders judicial determination of best mode scope more predictable than it would be under the Necessity Rule. Formerly, if they followed the Necessity Rule, courts (or juries) engaged in the highly discretionary process of deciding whether or not the component at issue was necessary to achieve the benefit of the claimed invention. Under the Claims-Only Rule, fortified in *Northern Telecom*, district courts, patent drafters, and potential litigants possess more guidance for assessing the scope of the best mode requirement. Courts can avoid having to gauge the necessity of a component that is outside the scope of the claims, and drafters and potential litigants will not have to guess the court's decision on such a discretionary issue. The clarity of the Claims-Only Rule is still limited by the uncertainty of claim construction, but it is a step in the right direction.

In exchange for this increased clarity, the public loses the right to some beneficial technical disclosure. The *Northern Telecom* district judge would probably wonder what good Northern Telecom's disclosure is if one skilled in the art cannot obtain any real benefit from it, for one would not be able to make very-fine-line microelectronic devices without independently discovering the necessity of the alloy. This loss must be taken into account when weighing the policy implications of the *Northern Telecom* decision.

Still, the Federal Circuit's approach is arguably the most logical and fair one because, if there is a principled line to be drawn anywhere in determining the scope of the best mode requirement, it is at the claim boundaries. The fact is that Northern Telecom claimed a process for etching aluminum and aluminum oxide, not a process for making a fine-line microelectronic device. Since Northern Telecom's right to exclude extends no further than the metes and bounds of its patent claim, it would be

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103. Federal appellate courts review trial courts' conclusions of law de novo, while they adopt the stricter "clearly erroneous" standard when considering findings of fact. BARBARA ALLEN BABCOCK & TONI M. MASSARO, *CIVIL PROCEDURE: CASES AND PROBLEMS* 1120-21 (1997).

104. See generally William C. Rooklidge & Matthew F. Weil, *Judicial Hyperactivity: The Federal Circuit's Discomfort with its Appellate Role*, 15 *BERKELEY TECH. L.J.* 725 (2000) (arguing that the Federal Circuit has shown a strong propensity to expand its own role in the patent infringement adjudication process).

incongruent to hold it to a broader disclosure requirement. It would also be inequitable, given that patents are issued in exchange for public disclosure of the invention. The government should not mandate disclosure broader in scope than the patent that it issues. If Northern Telecom had actually claimed a process of making a microelectronic device or a product consisting of the device itself, it naturally should have disclosed the alloy, but a narrower disclosure requirement should apply to the narrower etching process patent.<sup>105</sup>

The diminution in litigation-related transaction costs due to a more transparent best mode doctrine may counterbalance the public's loss of disclosure. Making the best mode result turn largely on the outcome of the *Markman* hearing will probably not in itself reduce litigation. But a clarified rule that best mode scope parallels claim scope will likely preclude attempts like Samsung's to raise the best mode defense with respect to peripheral components not directly related to the claimed invention. Under the *Flick-Reedy* rule, a defendant could almost always argue that an undisclosed component distantly related to the claimed invention was necessary to achieve the invention's full benefit.<sup>106</sup> Requiring the disclosure only of the invention as claimed will tend to discourage such hand-waving arguments in the future.

#### IV. CONCLUSION

The Federal Circuit, and the regional circuits before it, established two reasonably distinct lines of cases dealing with the scope of the best mode requirement. *Northern Telecom v. Samsung* clearly augments the line of cases applying the best mode requirement only to that which is in the claims. The district court's understandable adherence, given the doctrinal ambiguity, to the cases requiring disclosure of anything necessary to achieve the benefit of the invention did not withstand appeal.

*Northern Telecom* helps to clarify the best mode doctrine. But given the persistence of the Necessity Rule in the face of Claims-Only Rule

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105. Incidentally, Northern Telecom's patent drafter practiced in a country (Canada) where the patent system has no best mode requirement. This probably explains what a U.S. patent drafter might call his incautious decision not to disclose the alloy. The increasing global harmonization of patent law may eventually lead to the abolition of the best mode requirement in the United States, rendering this controversy moot. See generally MERGES ET AL., *supra* note 100, at 319-21.

106. See, e.g., *Randomex, Inc. v. Scopus Corp.*, 849 F.2d 585, 586 (Fed. Cir. 1988) (applying the best mode requirement to a detergent used with a disk cleaning device, even though only the cleaning device was claimed, in accord with the defendant's argument).

precedent, this case may not ultimately settle the controversy. At the very least, however, it establishes a clear but narrow rule that the preferred object of a claimed process need not be disclosed.

While the drawbacks of the Claims-Only Rule are evident, the benefits appear to outweigh them. The rule comes at the cost of some disclosure, to the public's certain detriment. It also puts more weight on the *Markman* hearing, gives more power to the judge in a jury trial of infringement, and grants the Federal Circuit a freer hand in managing patent cases, all of which may or may not be beneficial. Ultimately, though, because the rule increases potential litigants' certainty regarding the scope of the best mode requirement and because it aligns the requirement's scope with the scope of patent protection, *Northern Telecom's* rule represents sound public policy.



## COMEDY III PRODUCTIONS, INC. V. NEW LINE CINEMA

By Jennifer A. Lee

Popular and artistic culture does not exist in a vacuum. Music, film, books, and art all build upon what has preceded them. As Judge Alex Kozinski wrote, "Nothing today, likely nothing since we tamed fire, is genuinely new: Culture, like science and technology, grows by accretion, each new creator building on the work of those who came before."<sup>1</sup> Aside from this inevitable dependence, creators of artistic works often deliberately choose to incorporate portions of earlier works in reference, tribute, or parody.

Artists and authors are not free to use previous works with impunity, however. Copyright law protects artistic works by granting the creator a monopoly, limited in both duration and scope. The law strikes a bargain between the creator and the public; the creator can control his work for a certain period of time, after which the public is granted free access to it.<sup>2</sup> This temporary monopoly is often extremely lucrative to the party who owns it. It is, therefore, no surprise that many attempt to claim or extend it by replacing an expired copyright with some other form of intellectual property protection. One common tactic is to claim a trademark right in the work itself. Another is to assert a right of publicity as an heir or assignee of the artist who created the work.

The plaintiff in *Comedy III Productions, Inc. v. New Line Cinema*<sup>3</sup> attempted both when the defendant, a motion picture production company, incorporated a Three Stooges film clip into the background of a scene in a new movie.<sup>4</sup> The Ninth Circuit rejected Comedy III's trademark infringement claim<sup>5</sup> and refused to acknowledge Comedy III's right of publicity

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1. *White v. Samsung Elecs. of Am., Inc.*, 989 F.2d 1512, 1513 (9th Cir. 1993) (Kozinski, J., dissenting).

2. *See Merriam v. Holloway Publ'g Co.*, 43 F. 450, 451 (E.D. Mo. 1890) ("The copyright law gives an author or proprietor a monopoly of the sale of his writings for a definite period, but the grant of a monopoly implies that, after the monopoly has expired, the public shall be entitled ever afterwards to the unrestricted use of the book.").

3. 200 F.3d 593 (9th Cir. 2000).

4. Appellant Comedy III Productions, Inc.'s Opening Brief at 5, *Comedy III Prods., Inc. v. New Line Cinema*, 200 F.3d 593 (9th Cir. 2000) (No. 98-55301).

5. *Comedy III*, 200 F.3d at 596.

claim simply by failing to discuss it.<sup>6</sup> Unfortunately, the court's brief and conclusory opinion both misstates a key point of trademark law and fails to sufficiently explain the legal rationale for its decision. As such, both the finality of the decision and its strength as precedent are questionable. This Note fills in the gaps left by the court's analysis by exploring, in more detail and clarity than presented by the court, some of the theories by which its decision may be upheld.

## I. BACKGROUND

This section begins with an overview and comparison of copyrights and trademarks, the two areas of law which form the major foundation of the Ninth Circuit's opinion in *Comedy III*. The section then turns to a brief introduction to the right of publicity, which, although absent from the court's opinion, forms a major component of the parties' arguments.<sup>7</sup> It concludes with a discussion of the potential conflicts that may arise between trademarks or rights of publicity and First Amendment free speech rights.

### A. The Rationale and Limits of Copyright Law

Copyright law is rooted in the United States Constitution, which authorizes Congress to "promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive right to their respective Writings and Discoveries."<sup>8</sup> This directive sets out both the purpose and the means of copyright protection and hints at its underlying tensions. The government seeks to give artists and authors sufficient incentive to create their works by granting them copyrights which enable them to profit from those works.<sup>9</sup> However, these private interests clash with the public's free access to creative works. The Copyright Act<sup>10</sup> attempts to balance these conflicting interests, in part by providing for the expiration of copyrights after 70 years.<sup>11</sup>

The balance between the author's interest in protecting her work and the public's interest in using that work freely is therefore not static. In-

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6. *See id.* at 593-96.

7. *See infra* notes 108-109 and accompanying text.

8. U.S. CONST. art. I, § 8, cl. 8.

9. 1 NIMMER ON COPYRIGHT § 1.10[B][1] (release no. 51, May 2000).

10. 17 U.S.C. §§ 101-1101 (1994).

11. The 1976 Copyright Act created a term of 50 years after the death of the author. 17 U.S.C. § 302(a) (1994). The 1998 Sonny Bono Copyright Term Extension Act added an additional 20 years to the basic term. Act of Oct. 27, 1998, Pub. L. 105-298, Title I, 112 Stat. 2827 (codified at 17 U.S.C.A. § 302 (1994 & West Supp. 1999)).

stead, it shifts dynamically as time progresses. During the author's lifetime, and for some time after, the law favors the author's rights to control her work. However, as time goes by, this interest diminishes until, at last, the copyright expires. From that point on, the public's interest prevails.

## B. Trademark Law and the Focus on Consumer Perceptions

Trademarks serve as shortcuts in consumer culture by allowing consumers to make assumptions about the quality or source of goods and services represented by familiar marks. Trademark law protects consumers from fraud.<sup>12</sup> If a seller uses a mark identical or similar to another, consumers may mistakenly purchase the wrong product.<sup>13</sup> Trademark law also protects sellers and manufacturers from losing profits by preventing competitors from unfairly capitalizing on their consumer goodwill and brand-name recognition.<sup>14</sup>

Classic trademark infringement involves "palming off," in which one seller intentionally tries to divert the customers and profits of another by selling a similar product under a similar trademark.<sup>15</sup> Federal law guards against palming off through section 43(a) of the Lanham Act.<sup>16</sup> Standard trademark infringement analysis consists of two prongs: ownership of a valid mark and infringement.<sup>17</sup> Whether the plaintiff owns a valid mark depends in part on the mark's level of "distinctiveness." The level of distinctiveness, in turn, determines both what proof is necessary to show the mark deserves legal protection and the breadth of that protection.<sup>18</sup> To

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12. Joseph P. Bauer, *A Federal Law of Unfair Competition: What Should Be the Reach of Section 43(a) of the Lanham Act?*, 31 UCLA L. REV. 671, 705 (1984).

13. *Id.* at 705.

14. 1 MCCARTHY ON TRADEMARKS § 2:31 (4th ed. 1998).

15. *See* 4 MCCARTHY § 25:1.

16. Lanham Trade-Mark Act (Trade-Mark Act of 1946) § 43(a), 15 U.S.C. § 1125(a) (1994). Section 43(a) focuses solely on defendants engaged in commercial activities. For example, section 43(a)(1)(A) is limited to those who use a mark in commerce. *Id.* § 1125(a)(1)(A). Likewise, section 43(a)(1)(B) concerns only false sponsorship or endorsement "in commercial advertising or promotion." *Id.* § 1125(a)(1)(B). This emphasis reflects the commercial nature of both trademarks themselves and the reasons for protecting them. The Ninth Circuit has interpreted section 43(a) as extending to the right of publicity. *See White v. Samsung Elecs. of Am., Inc.*, 971 F.2d 1395, 1399-1400 (9th Cir. 1992). The right of publicity is discussed in more detail in Parts I.C. and III.B, *infra*.

17. 2 MCCARTHY, *supra* note 14, § 15:1.

18. *See id.* Mark distinctiveness is arrayed along a spectrum comprised of four categories. In order of least to most distinctive, these categories are: (1) generic marks, (2) descriptive marks, (3) suggestive marks, and (4) arbitrary or fanciful marks. *Id.* § 11:2. Arbitrary or fanciful marks are considered inherently distinctive, for they lack natural association with any product. *Id.* Some examples of well-known arbitrary or fanciful

prove the second prong of trademark analysis, infringement, the plaintiff must show a likelihood of consumer confusion.<sup>19</sup>

### C. The Right of Publicity: A New Form of Personal Property

The right of publicity is the "inherent right of every human being to control the commercial use of his or her identity."<sup>20</sup> The origins of the right of publicity lie within the older right of privacy.<sup>21</sup> However, while the right of privacy protects an individual's dignity and self-esteem, the right of publicity concerns an individual's property right in her own identity or persona.<sup>22</sup> The concept of a right of publicity as a free-standing form of intellectual property is relatively new. Judge Frank of the Second Circuit first coined the term "right of publicity" in 1953 in *Haelan Laboratories, Inc. v. Topps Chewing Gum, Inc.*<sup>23</sup> Currently, fifteen states have

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marks are "Tide" (laundry detergent), "Tiffany & Co." (jewelry), and "Tupperware" (food containers). They carry the highest degree of protection and the lowest standard of proof—a party may claim rights in an arbitrary or fanciful mark simply by proving it was the first to use the mark. See ROBERT P. MERGES ET AL., *INTELLECTUAL PROPERTY IN THE NEW TECHNOLOGICAL AGE* 578 (2d ed. 2000). By contrast, a descriptive mark, which describes some characteristic of a product, could theoretically apply to any product with a similar property. Therefore, a person cannot acquire rights in a descriptive mark unless it possesses sufficient secondary meaning such that consumers recognize the product sold under that mark as originating from a single source. *Id.* Examples of descriptive marks that are valid trademarks include "Softsoap" and "Holiday Inn."

19. See 2 MCCARTHY, *supra* note 14, § 15:1. Proof of actual consumer confusion is not required. This distinction both lessens the plaintiff's burden of proof and eliminates frivolous claims against clearly ridiculous or exaggerated appropriations of marks. See Alison P. Howard, *A Fistful of Lawsuits: The Press, the First Amendment, and Section 43(a) of the Lanham Act*, 88 CALIF. L. REV. 127, 135-36 (2000). The Ninth Circuit advanced the now-standard test for likelihood in *AMF Inc. v. Sleekcraft Boats*, 599 F.2d 341, 348-49 (9th Cir. 1979).

20. 4 MCCARTHY, *supra* note 14, § 28:1.

21. *Id.* § 28:5. The legal concept known as the right of privacy was created in a landmark law review article. See Charles Warren & Louis Brandeis, *The Right to Privacy*, 4 HARV. L. REV. 193 (1890).

22. 4 MCCARTHY, *supra* note 14, § 28:6. For a more detailed discussion of the background and history behind the right of publicity, see Arlen W. Langvardt, *The Troubling Implications of a Right of Publicity "Wheel" Spun Out of Control*, 45 U. KAN. L. REV. 329 (1997).

23. 202 F.2d 866, 868 (2d Cir. 1953). Melville B. Nimmer followed up shortly after with the first in-depth analysis of this new right. Melville B. Nimmer, *The Right of Publicity*, 19 LAW & CONTEMP. PROBS. 203 (1954).

right of publicity statutes.<sup>24</sup> Seventeen recognize a common law right of publicity.<sup>25</sup>

A right of publicity claim is specific to the plaintiff asserting it, or to that person's assignee.<sup>26</sup> To prevail, the plaintiff must show that the defendant, without permission, used the plaintiff's identity in a manner likely to damage its commercial value.<sup>27</sup> For example, actor Paul Newman markets and sells a line of food products under the name "Newman's Own." Each Newman's Own product bears a picture or likeness of Newman on its label. Since Paul Newman's identity is a key marketing tool for Newman's Own products, Newman could assert that an unauthorized use of his likeness damages his ability to use his identity in a commercial fashion. This proof requirement resembles trademark's likelihood of confusion standard.<sup>28</sup> Right of publicity also draws the same commercial/noncommercial distinction as trademark:<sup>29</sup> only commercial uses constitute violations of the right.<sup>30</sup>

#### D. Comparison of Trademark and Copyright Law

The contrasting policy goals of copyright and trademark law create several doctrinal differences. The most obvious is duration: copyright protection lasts for a certain term of years, whereas trademark protection is potentially infinite.<sup>31</sup> Another difference lies in the required showing for infringement. Trademark infringement occurs only when it is likely that

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24. California, Florida, Indiana, Kentucky, Massachusetts, Nebraska, Nevada, New York, Oklahoma, Rhode Island, Tennessee, Texas, Virginia, Washington, and Wisconsin. 4 MCCARTHY, *supra* note 14, § 28:17 n.1.

25. Alabama, California, Connecticut, Florida, Georgia, Hawaii, Illinois, Kentucky, Michigan, Minnesota, Missouri, New Jersey, Ohio, Pennsylvania, Texas, Utah, and Wisconsin. *Id.* § 28:16. California's statutory right of publicity is contained in California Civil Code sections 3344 and 3344.1. CAL. CIV. CODE §§ 3344, 3344.1 (West 2000).

26. 4 MCCARTHY, *supra* note 14, § 28:7. *See, e.g.*, CAL. CIV. CODE § 3344.1(a)(1) (West 2000) (imposing liability on any person who uses another's identity "without such person's prior consent"); *id.* § 3344.1(b) (allowing for the free transfer of publicity rights); *Wendt v. Host Int'l, Inc.*, 125 F.3d 806 (9th Cir. 1997) (referring to damages under a common law right of publicity claim for unauthorized appropriations of a *plaintiff's* identity).

27. 4 MCCARTHY, *supra* note 14, § 28:7.

28. *See supra* Part I.B.

29. *See supra* note 16.

30. *See Langvardt, supra* note 22, at 343. For example, California Civil Code section 3344 applies only to use of another's persona "for advertising or selling or soliciting purposes." CAL. CIV. CODE § 3344(a) (West 2000). Similarly, California Civil Code section 3344.1 only pertains to uses "on or in products, merchandise, or goods, or for purposes of advertising or selling." CAL. CIV. CODE § 3344.1(a)(1) (West 2000).

31. *See* 1 MCCARTHY, *supra* note 14, § 6:31.

consumers will be confused about the sponsorship or origin of a product.<sup>32</sup> Copyright infringement, however, occurs whenever a party violates any one of the exclusive rights set out in 17 U.S.C. § 106.<sup>33</sup> Therefore, simply copying a work may infringe a copyright; however, simply copying a trademark is not per se infringement of that mark.<sup>34</sup>

These differences do not, however, make copyright and trademark mutually exclusive. A single work may meet the separate requirements of each. For example, a picture of an individual falls within section 102 of the Copyright Act;<sup>35</sup> however, it may also serve as a mark identifying a good or a service.<sup>36</sup> This dual nature makes it possible, in a single act, to simultaneously violate both the copyright and trademark rights that adhere to a single object.<sup>37</sup>

### **E. The Tension between Intellectual Property Rights and the First Amendment**

Copyright, trademark, and publicity rights exist in constant tension with the First Amendment right to free speech.<sup>38</sup> The monopolies granted by these intellectual property rights greatly restrain the public's ability to use artistic works or marks freely. Accordingly, many intellectual property statutes incorporate trade-offs that attempt to balance these conflicting interests. For example, copyright expires in time, and trademarks are restricted to commercial use.<sup>39</sup>

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32. See *Prestonettes, Inc. v. Coty*, 264 U.S. 359, 368 (1924) ("A trade-mark only gives the right to prohibit the use of it so far as to protect the owner's good will against the sale of another's product as his.").

33. 17 U.S.C. § 106 (1994). The copyright owner has the exclusive right to reproduce, distribute, perform, display and prepare derivative works based upon the copyrighted work. *Id.*

34. See *Quality Inns Int'l, Inc. v. McDonald's Corp.*, 695 F. Supp. 198, 218 (D. Md. 1988) ("Unlike a copyright, mere reproduction of a trademark is not an infringement.").

35. 17 U.S.C. § 102(a)(5) (1994).

36. 1 MCCARTHY, *supra* note 14, § 6:14. For example, each illustration of Paul Newman's face on a Newman's Own product is copyrightable as an original creative work. However, these illustrations are also the marks that identify Newman's Own products.

37. See *Nintendo of Am., Inc. v. Dragon Pac. Int'l*, 40 F.3d 1007 (9th Cir. 1994) (awarding plaintiff both copyright and trademark statutory damages for defendant's unauthorized marketing and sale of video game cartridges). For example, one could violate both copyright and trademark rights by affixing a picture of Paul Newman to a generic jar of spaghetti sauce.

38. See 2 SMOLLA AND NIMMER ON FREEDOM OF SPEECH § 21:2 (3d ed. 1996) ("[C]opyright and the First Amendment, held 'side by side,' may, in fact, be contradictory.").

39. See *supra* Part I.A-B.

The First Amendment also protects some uses of intellectual property that might otherwise infringe.<sup>40</sup> For example, trademarks may be used without permission from the owner if the use is merely nominative—that is, where consumer confusion is unlikely because a mark is only used to denote the *plaintiff's* goods or services.<sup>41</sup> In *New Kids on the Block v. News America Publishing, Inc.*, the Ninth Circuit found no trademark infringement where two national newspapers conducted telephone polls asking readers to name their favorite member of a popular singing group.<sup>42</sup> In refusing to hold the newspapers liable, the court concluded that since the defendants had not implied that the New Kids had sponsored or endorsed their polls, they were entitled to a fair use defense.<sup>43</sup> Moreover, the court noted that “it is often virtually impossible to refer to a particular product for purposes of comparison, criticism, point of reference or any other such purpose without using the mark.”<sup>44</sup>

An even stronger free speech flavor underlies the protection of trademark parodies. In *L.L. Bean v. Drake Publishers*, the defendant published a short magazine humor article that parodied the plaintiff's well-known mail-order catalog.<sup>45</sup> In defending the magazine article as a form of expression protected by the First Amendment, the court cast free speech protection in generous terms to include even parodies that conveyed relatively trivial messages such as the reminder “that we are free to laugh at the images and associations linked with the mark.”<sup>46</sup>

The Supreme Court has considered the conflict between the right of publicity and the First Amendment only once. In *Zacchini v. Scripps-Howard Broadcasting Co.*,<sup>47</sup> a human cannonball performer sued a news station for filming and broadcasting his circus act in violation of publicity rights. The Supreme Court denied the defendant's First Amendment defense and held that the plaintiff possessed a valid right of publicity.<sup>48</sup>

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40. For example, certain uses of trademarks, even though they may impose on the mark owner's rights to some extent, are allowed by the First Amendment in the interest of having an informed public. 2 SMOLLA AND NIMMER, *supra* note 38, § 21:5.

41. See 2 MCCARTHY, *supra* note 14, § 15:1.

42. 971 F.2d 302, 309 (9th Cir. 1992).

43. *Id.* at 309. The trademark fair use defense is superficially similar but conceptually distinct from the copyright fair use defense.

44. *Id.* at 306.

45. 811 F.2d 26, 27 (1st Cir. 1987).

46. *Id.* at 34.

47. 433 U.S. 562, 564 (1977).

48. See *id.* In noting that “[p]etitioner does not seek to enjoin the broadcast of his performance; he simply wants to be paid for it,” the Supreme Court emphasized the personal property nature of publicity rights. *Id.* at 578.

Free speech/intellectual property inquiries often turn on whether the use at issue is commercial.<sup>49</sup> For example, trademark uses may be considered either "commercial" or "expressive."<sup>50</sup> Commercial uses promote or otherwise imply sponsorship of a product; expressive uses, on the other hand, merely convey information or opinion.<sup>51</sup> The two categories are not mutually exclusive. Newspapers, for example, contain elements of both: the articles disseminate information to the public, but they also entice consumers to buy the newspaper.<sup>52</sup> Generally, the more expressive the use is, the more likely it will be found worthy of First Amendment protection.<sup>53</sup> In cases where a use is primarily expressive, it is usually said that the interest in having an informed and enlightened public outweighs the intellectual property rights of an individual.<sup>54</sup>

## II. CASE SUMMARY

### A. Facts and Procedural History

New Line Cinema released the motion picture *The Long Kiss Goodnight* in 1996. In one scene, the heroine of the film, played by Geena Davis, talks to her former boss on the telephone. While they are speaking, a television in the background plays a short clip of The Three Stooges movie *Disorder in the Court*.<sup>55</sup>

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49. *L.L. Bean*, 811 F.2d at 32. For example, in copyright cases, whether a use was commercial is often of paramount importance to an assertion of fair use. *See, e.g.*, *Harper & Row, Publishers, Inc. v. Nation Enters.*, 471 U.S. 539, 562 (1985) ("The fact that a publication was commercial as opposed to nonprofit is a separate factor that tends to weigh against a finding of fair use."). Unlike copyrights, patents do not give rise to free speech issues. *See* 1 NIMMER, *supra* note 9, § 1.10[C][2].

50. *See* 2 SMOLLA AND NIMMER, *supra* note 38, § 21:5. Where publicity rights are concerned, this distinction is recast as "commercial" versus "communicative" uses. *See* 4 MCCARTHY, *supra* note 14, § 28:41.

51. *See* 2 SMOLLA AND NIMMER, *supra* note 38, § 21:5.

52. *See* 4 MCCARTHY, *supra* note 14, § 28:41.

53. *See id.*; *cf.* *S.F. Arts & Athletics, Inc. v. United States Olympic Comm.*, 483 U.S. 522, 536 (1987) (upholding the United States Olympic Committee's congressionally-granted monopoly over the use of the word "Olympic," in part because it did not prohibit expressive uses by other parties). *But see* *New Kids on the Block v. News Am. Publ'g*, 971 F.2d 302, 309 (9th Cir. 1992) ("Where, as here, the use does not imply sponsorship or endorsement, the fact that it is carried on for profit and in competition with the trademark holder's business is beside the point.").

54. *See, e.g.*, 4 MCCARTHY, *supra* note 14, § 28:41.

55. *Comedy III Prods., Inc. v. New Line Cinema*, 46 U.S.P.Q.2d 1930, 1935 n.3 (C.D. Cal. 1998); *see also* *THE LONG KISS GOODNIGHT* (New Line Productions 1996).

Comedy III Productions claims to be the exclusive owner of all “rights, title, and interest” in *The Three Stooges*.<sup>56</sup> Shortly after the release of *The Long Kiss Goodnight*, Comedy III filed a complaint against New Line in California state court for violations of Lanham Act section 43(a)<sup>57</sup> and state unfair competition law.<sup>58</sup> New Line removed the suit to federal court<sup>59</sup> and filed a motion to dismiss pursuant to Federal Rule of Civil Procedure 12(b)(6).<sup>60</sup> Following oral argument, the district court granted New Line’s motion, giving Comedy III leave to amend. Comedy III amended its complaint to add two new claims: (1) damages for unfair competition—passing off, and (2) damages for unfair competition—misappropriation.<sup>61</sup> New Line again filed a Rule 12(b)(6) motion to dismiss. After issuing a request for Comedy III to articulate how it owned a valid trademark that would allow the relief it sought, the court dismissed Comedy III’s complaint with prejudice.

## B. The Ninth Circuit’s Decision

The Ninth Circuit affirmed the district court’s dismissal of Comedy III’s claim. In applying the standard two-prong trademark infringement analysis,<sup>62</sup> the court emphasized that the central issue was whether Comedy III could claim a valid trademark right in *The Three Stooges*’ clip.<sup>63</sup> Comedy III insisted that it claimed a right, not in the clip of *Disorder in the Court* itself, but in the name, likeness, and overall act of *The Three Stooges*.<sup>64</sup> The court refused to accept this distinction, concluding that Comedy III’s claim could not be separated from a claim in the film footage itself, which falls within the scope of the federal Copyright Act, not

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56. *Id.* at 1931. Comedy III Productions was formed in 1959 by Moe Howard, Larry Fine, and Curly Joe DeRita, three of the six actors who played *The Three Stooges* over the decades. Appellant Comedy III Productions, Inc.’s Opening Brief at 3, *Comedy III Prods., Inc. v. New Line Cinema*, 200 F.3d 593 (9th Cir. 2000) (No. 98-55301); *The Three Stooges Official Website*, at <http://www.threestooges.com/bios/curlyjoe.htm> (last visited Jan. 30, 2001).

57. Lanham Trade-Mark Act (Trade-Mark Act of 1946) § 43(a), 15 U.S.C. § 1125(a) (1994).

58. *Comedy III*, 46 U.S.P.Q.2d at 1930.

59. 15 U.S.C. § 1121(a) grants original jurisdiction to federal district courts over all actions arising under the Lanham Act. 15 U.S.C. § 1121(a) (1994).

60. Rule 12(b)(6) allows a defendant to assert that the plaintiff has failed to state a claim upon which relief can be granted. FED. R. CIV. P. 12(b)(6).

61. *Comedy III*, 46 U.S.P.Q.2d at 1930.

62. *See supra* Part I.B.

63. *Comedy III Prods., Inc. v. New Line Cinema*, 200 F.3d 593, 594-95 (9th Cir. 2000).

64. *Id.* at 595.

the Lanham Act.<sup>65</sup> Since it had failed to find a valid trademark, the court did not reach the issue of infringement.<sup>66</sup>

The court did not explicitly address Comedy III's common law right of publicity claim, but it did distinguish numerous cases cited by Comedy III in support of its Lanham Act misappropriation claim. In *White v. Samsung Electronics America, Inc.*, the Ninth Circuit construed the Lanham Act to protect against the use of a celebrity's likeness in a television advertisement for electronic products.<sup>67</sup> Similarly, in *Wendt v. Host International, Inc.*, the Ninth Circuit held that the unauthorized replication of a celebrity's likeness in animatronic robots violated the Lanham Act.<sup>68</sup> In addition, *Waits v. Frito-Lay, Inc.* interpreted the Lanham Act as guarding against the unauthorized simulation of an individual's distinctive voice.<sup>69</sup> The court distinguished New Line's use of the *Disorder in the Court* clip from these cases by concluding that it was neither a simulation of an aspect of The Three Stooges, nor a use whose purpose was to sell a product.<sup>70</sup>

Only one case cited by Comedy III, *In re Florida Cypress Gardens, Inc.*, addressed Lanham Act protection of an act performed by a character.<sup>71</sup> However, that case involved use of the act's name, not the act itself. The court distinguished *Florida Cypress* because New Line had not used The Three Stooges' name in its film or marketing.<sup>72</sup>

The Ninth Circuit concluded that Comedy III's "fanciful argument" would unjustifiably extend Lanham Act protection to an entirely new context.<sup>73</sup> While it noted that Comedy III's claim would have been stronger were it seeking to enjoin the sale of The Three Stooges' likenesses on T-

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65. A copyright claim to the clip itself is clearly moot since the copyright to *Disorder in the Court* has long since expired. *See id.*

66. The court rejected Comedy III's argument that New Line's failure to pay Comedy III a fee, coupled with the fact that others had done so, provided evidence of trademark infringement. *See id.* Persons or companies may issue licenses to public domain works, not because they own any intellectual property rights, but because they own a work, or a copy of a work, which is rare or difficult to obtain. It is common practice in the movie industry to purchase licenses for such works simply for the sake of convenience.

67. 971 F.2d 1395, 1396, 1401 (9th Cir. 1992).

68. 125 F.3d 806, 808-09 (9th Cir. 1997).

69. 978 F.2d 1093, 1096 (9th Cir. 1992).

70. *See Comedy III*, 200 F.3d at 596.

71. 208 U.S.P.Q. 288 (1980).

72. *Comedy III*, 200 F.3d at 596.

73. *Id.* at 595-96.

shirts,<sup>74</sup> the court refused to “entertain this expedition of trademark protection squarely into the dominion of copyright law.”<sup>75</sup>

### III. DISCUSSION

*Comedy III Productions, Inc. v. New Line Cinema* significantly limits the scope of trademark law. Of particular note is the Ninth Circuit’s decision to uphold the dismissal of Comedy III’s claim on the pleadings under Rule 12(b)(6).<sup>76</sup> Rule 12(b)(6) is a tool of enormous potential for civil defendants, for it can halt a suit at the earliest stage, saving the parties from costly and time-consuming discovery as well as the need to conduct a trial.<sup>77</sup> Because of this rule’s power and finality, the hurdle it sets is very low and is generally easy for plaintiffs to overcome.<sup>78</sup> Courts give plaintiffs every benefit of the doubt when considering a motion for dismissal by reading the material allegations of a complaint as favorably to them as possible, within reasonable limits.<sup>79</sup> As a result, only the weakest and most poorly drafted claims fail to clear the Rule 12(b)(6) bar.<sup>80</sup> By failing to fully explain its reasoning, the *Comedy III* court missed an opportunity to make a strong statement against similarly “fanciful” claims.<sup>81</sup>

The following discussion attempts to fill in the gaps left by the court’s abbreviated opinion by presenting a cohesive view of why the law does not allow claims such as Comedy III’s. Section A explains how, even

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74. *Id.* at 595. The court was likely making an oblique reference to *Comedy III Productions, Inc. v. Saderup, Inc.*, a case in which Comedy III sued an artist who made charcoal sketches of The Three Stooges and sold them on T-shirts. The case was accepted for review by the California Supreme Court. *Comedy III Prods., Inc. v. Saderup, Inc.*, 83 Cal. Rptr. 2d 533 (Cal. 1999) (unpublished opinion).

75. *Comedy III*, 200 F.3d at 596.

76. *Id.*

77. See Constance M. Boland & Lesley Szanto Friedman, *Motions to Dismiss Under FRCP 12(b): Strategy and Tactics*, 633 PLI/LIT 17, 19 (2000). Federal Rule of Civil Procedure 12(b)(6) allows for dismissal if the plaintiff fails to state a claim upon which relief can be granted. FED. R. CIV. P. 12(b)(6).

78. See *Duncan v. AT&T Communications, Inc.*, 668 F. Supp. 232, 234 (S.D.N.Y. 1987) (giving examples of claims which may be dismissed under Rule 12(b)(6), such as those “so poorly composed as to be functionally illegible” or “baldly conclusory”). Federal Rule of Civil Procedure 8(a) sets the standard for sufficient claims, requiring only a short and plain statement of the claim showing that the pleader is entitled to relief. FED. R. CIV. P. 8(a).

79. See *Russell v. Landrieu*, 621 F.2d 1037, 1039 (9th Cir. 1980).

80. See *Comedy III Prods., Inc. v. New Line Cinema*, 46 U.S.P.Q.2d 1930, 1933 (C.D. Cal. 1998) (“[I]t is only under extraordinary circumstances that dismissal is proper under Rule 12(b)(6).”).

81. See *Comedy III*, 200 F.3d at 595.

though the Ninth Circuit's conclusions regarding the validity of Comedy III's trademark claim were correct, the court's reasoning was flawed. Section B briefly explores the Ninth Circuit's reasons for not discussing Comedy III's right of publicity claim before turning to an analysis of the merits of that claim.

## A. Comedy III's Trademark Claim

### 1. *The Three Stooges Clip Is Not an Enforceable Trademark*

The Ninth Circuit correctly refused to accept Comedy III's assertion that it merely claimed the acts and likenesses of The Three Stooges, and not the movie clip depicting those acts and likenesses.<sup>82</sup> Despite the superficial limits of its legal claim, Comedy III's true goal was to enjoin the use of the clip itself, a work that clearly falls under 17 U.S.C. § 102(a)(6).<sup>83</sup> The court therefore properly barred Comedy III from reviving a copyright<sup>84</sup> by dressing it in trademark's clothing.

### 2. *The Ninth Circuit's Opinion Misstates the Relationship between Copyright and Trademark*

Although the court's analysis of Comedy III's trademark claim began accurately, the court veered into dangerous waters when it declared that "the Lanham Act cannot be used to circumvent copyright law. If material covered by copyright law has passed into the public domain, it cannot then be protected by the Lanham Act without rendering the Copyright Act a nullity."<sup>85</sup> The court's sole support was *Smith v. Chanel, Inc.*,<sup>86</sup> a case involving trademarks in perfume advertising.<sup>87</sup> Nowhere does *Smith* discuss the boundaries between copyright and trademark—it is purely a trademark case.<sup>88</sup> Since *Smith* does not actually apply to the instant case, the court is left with an unsupported, conclusory, and ultimately incorrect assertion.

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82. *Id.*

83. 17 U.S.C. § 102(a)(6) (1994).

84. A copyright of which it was not even the original owner or assignee. Appellant Comedy III Productions, Inc.'s Opening Brief at 6, *Comedy III Prods., Inc. v. New Line Cinema*, 200 F.3d 593 (9th Cir. 2000) (No. 98-55301).

85. *Comedy III*, 200 F.3d at 595.

86. 402 F.2d 562 (9th Cir. 1968).

87. *Comedy III*, 200 F.3d at 595.

88. *Smith* only mentions the word "copyright" once in the entire opinion. That one instance clearly has nothing to do with the overlap, or lack thereof, between copyright and trademark law. *See Smith*, 402 F.2d at 567 ("Consumer allegiances built over the years with intensive advertising, trademarks, trade names, copyrights and so forth extend substantial protection to firms already in the market.").

Viewed in one light, the court's statement may be read as asserting that copyright and trademark protection are mutually exclusive. Ample case law holds to the contrary.<sup>89</sup> The two forms of intellectual property are analytically distinct and may co-exist within the same protected work.<sup>90</sup> The Seventh Circuit has observed that "courts have consistently held that a product's different qualities can be protected simultaneously, or successively, by more than one of the statutory means for protection of intellectual property."<sup>91</sup>

Alternatively, one may read the opinion as declaring that public domain material cannot be covered by the Lanham Act, and hence formerly-copyrighted works cannot be trademarks. Case law is divided on this point. In *G. & C. Merriam Co. v. Syndicate Publishing Co.*, the Supreme Court refused to prohibit the use of the name "Webster" by a company that competed with the publisher of the original Webster Dictionary.<sup>92</sup> However, in *Warne & Co. v. Book Sales, Inc.*,<sup>93</sup> a federal district court came to a different conclusion. Plaintiff Warne was the original publisher of Beatrix Potter's well-known Peter Rabbit children's books, seven of which were in the public domain.<sup>94</sup> The court held as a matter of law that Warne was not barred from claiming trademark rights in the cover illustrations for these books.<sup>95</sup>

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89. See, e.g., *Nintendo of Am., Inc. v. Dragon Pac. Int'l*, 40 F.3d 1007, 1011 (9th Cir. 1994) (allowing statutory damages under both Copyright Act and Lanham Act for the same act of infringement); *Museum Boutique Intercontinental, Ltd. v. Picasso*, 880 F. Supp. 153, 166-67 (S.D.N.Y. 1995) (noting that dual protection under copyright and trademark laws is not uncommon); *Warne & Co. v. Book Sales, Inc.*, 481 F. Supp. 1191, 1196 (S.D.N.Y. 1979) ("Dual protection under copyright and trademark laws is particularly appropriate for graphic representations of characters.").

90. See Leslie A. Kurtz, *The Independent Legal Lives of Fictional Characters*, 1986 WIS. L. REV. 429, 474 (1986).

91. *Titan Sports, Inc. v. Hellwig*, No. 3:98-CV-467(EBB), 1999 U.S. Dist. LEXIS 10523 (D. Conn. Apr. 26, 1999) (quoting *Kohler Co. v. Moen, Inc.*, 12 F.3d 632, 638 (7th Cir. 1993)).

92. *G. & C. Merriam Co. v. Syndicate Publ'g Co.*, 237 U.S. 618, 622 (1915) ("After the expiration of [the copyright to the original Webster Dictionary], it is well settled that [the Webster name] cannot be acquired by registration as a trademark; for the name has become public property, and is not subject to such appropriation.").

93. 481 F. Supp. 1191 (S.D.N.Y. 1979).

94. The copyright in some of these books had expired, while the other books had never been copyrighted in the United States. *Id.* at 1193.

95. See *id.* at 1196 ("The fact that a copyrightable character or design has fallen in the public domain should not preclude protection under the trademark laws so long as it is shown to have acquired independent trademark significance, identifying in some way the source or sponsorship of the goods."); see also *Tempo Communications, Inc. v. Columbian Art Works, Inc.*, 223 U.S.P.Q. 721, 721 (N.D. Ill. 1983) ("[T]he expiration of a

The divergent outcomes of these cases may stem in large part from the fact that different aspects of the formerly copyrighted works and different public perceptions of those characteristics were at issue. *Warne* involved creative illustrations, one of which had been used by the plaintiff on a variety of other products and had come to symbolize the plaintiff's company.<sup>96</sup> *Merriam*, on the other hand, involved the name of the product itself, a name which the Court felt had become a generic term for dictionaries and was thus invalid as a trademark.<sup>97</sup> However, commentators and courts still debate where to draw the line between copyright and trademark.<sup>98</sup> Given the conflicting case law and commentary, it is clear that the *Comedy III* court's blanket statement that public domain works are un-touchable by trademark goes too far.

It is difficult to determine exactly what rule for delineating the boundary between copyright and trademark the Ninth Circuit was trying to articulate in *Comedy III*. Although it is possible to read the decision as the court stating what it believed to be an established point of law, the above discussion proves the inaccuracy of this view. If, on the other hand, the court wished to announce a rule that stood apart from those in other jurisdictions, it also failed to make its point clear.

3. *Regardless of the Validity of Comedy III's Alleged Mark, New Line's Use Does Not Infringe*

Although the court did not reach the infringement prong of its trademark analysis, New Line would not have been guilty of infringement even if Comedy III had owned a valid trademark in the clip. A trademark infringement claim depends on a showing that consumers are likely to be confused about the source of a product.<sup>99</sup> In *Rogers v. Grimaldi*,<sup>100</sup> Ginger

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copyright or a patent does not bar an action under the Lanham Act for trademark infringement."); cf. 1 MCCARTHY, *supra* note 14, § 1:31 ("The fact that a company does not own one form of intellectual property does not mean that it lacks ownership of another form of valid intellectual property in the same article, creation or trade symbol.").

96. *Warne*, 481 F. Supp. at 1194 n.2.

97. *See Merriam*, 237 U.S. at 622.

98. For opposing viewpoints on how trademark law should treat formerly copyrighted fictional characters, compare Kurtz, *supra* note 90 (arguing that restricting the use of formerly copyrighted characters through trademark undermines copyright policy) with Michael Todd Helfand, *When Mickey Mouse Is As Strong As Superman: The Convergence of Intellectual Property Laws to Protect Fictional Literary and Pictorial Characters*, 44 STAN. L. REV. 623 (1992) (advocating the use of trademark to protect characters which have fallen into the public domain).

99. *See Maljack Prods., Inc. v. Goodtimes Home Video Corp.*, 81 F.3d 881 (9th Cir. 1996) (holding that others may copy a motion picture whose copyright has expired and use its title, so long as their actions do not cause source confusion).

Rogers, the famed dancer and actress, sought damages and injunctive relief for the defendant's distribution of a film entitled *Ginger and Fred*.<sup>101</sup> The Second Circuit upheld the district court's summary judgment in favor of the defendant, holding that "a title with at least some artistic relevance to the work" is not false advertising under the Lanham Act where it is not "explicitly misleading as to the content of the work."<sup>102</sup> Under the *Rogers* standard, it seems doubtful that courts would find that a feature far less integral to a film than its title, such as New Line's use of an unnamed clip, gives rise to a likelihood of confusion.

Comedy III also failed to allege that New Line altered the clip itself in any way or used it in other than its original form.<sup>103</sup> It is well established that mere copying of a public domain work does not constitute trademark infringement if it does not lead to consumer confusion.<sup>104</sup> Leslie Kurtz explains this principle as follows:

When a public domain work is copied, along with its title, there is little likelihood of confusion even when the most minimal steps are taken to distinguish the publisher of the original from that of the copy. The public is receiving just what it believes it is receiving—the work with which the title has become associated. The public is not only unharmed, it is unconfused.<sup>105</sup>

Even if Comedy III could have convinced the court that it owned a valid trademark in the *Disorder in the Court* clip, it could not have prevailed in its trademark infringement claim against New Line. It is highly unlikely that viewers of *The Long Kiss Goodnight*, were they even to notice the *Disorder in the Court* clip, would leap to conclude that The Three

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100. 875 F.2d 994, 997 (2d Cir. 1989).

101. *Ginger and Fred* was the work of two Italian film legends: director Federico Fellini and actor Marcello Mastroianni.

102. *Rogers*, 875 F.2d at 1000.

103. *Comedy III Prods., Inc. v. New Line Cinema*, 46 U.S.P.Q.2d 1930, 1935 (C.D. Cal. 1998).

104. See 1 MCCARTHY, *supra* note 14, § 6:31; see also *Warne & Co. v. Book Sales, Inc.*, 481 F. Supp. 1191, 1197 (S.D.N.Y. 1979). The district court in *Comedy III* discussed this point in detail. See *Comedy III*, 46 U.S.P.Q.2d at 1935. However, the Ninth Circuit did not comment upon it, despite Comedy III's allegation in its appellate brief that by "commingling [sic] . . . the images, voices, and sounds" from the clip with those of New Line's new film, New Line had created a new transformative work that derived from The Three Stooges clip. Appellant Comedy III Productions, Inc.'s Opening Brief at 28, *Comedy III Prods., Inc. v. New Line Cinema*, 200 F.3d 593 (9th Cir. 2000) (No. 98-55301).

105. Leslie A. Kurtz, *Protection for Titles of Literary Works in the Public Domain*, 37 RUTGERS L. REV. 53, 77 (1984).

Stooges or their heirs had somehow produced or sponsored New Line's film. Without this likelihood of confusion, there is simply no infringement. In addition, absent consumer confusion, freedom of expression concerns tend to favor allowing New Line to use the clip in its creative film.<sup>106</sup>

## B. Comedy III's Right of Publicity Claim

Comedy III's second major claim asserted that, in using the *Disorder in the Court* clip, New Line violated the common law right of publicity belonging to the actors who portrayed The Three Stooges.<sup>107</sup> Despite both Comedy III and New Line's extensive treatment of the publicity right issue, neither the district court nor the Ninth Circuit addressed it.<sup>108</sup> Perhaps the Ninth Circuit's neglect of this issue stems from the fact that California does not recognize a common law right of publicity for deceased celebrities<sup>109</sup> and that, even though California has established such a right

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106. See *supra* Part I.E.

107. Comedy III did not explicitly assert a right of publicity claim before the district court; rather, it alleged unfair competition in the forms of passing off and misappropriation. See *Comedy III Prods., Inc. v. New Line Cinema*, 46 U.S.P.Q.2d 1930, 1930 (C.D. Cal. 1998). However, in its appellate brief, Comedy III recast its unfair competition allegations as a common law right of publicity claim. See *Appellant Comedy III Productions, Inc.'s Opening Brief at 2, 43-47, Comedy III Prods., Inc. v. New Line Cinema*, 200 F.3d 593 (9th Cir. 2000) (No. 98-55301).

108. See generally *Comedy III Prods., Inc. v. New Line Cinema*, 200 F.3d 593 (9th Cir. 2000); *Comedy III*, 46 U.S.P.Q.2d at 1930-36; *Appellant Comedy III Productions, Inc.'s Opening Brief at 2, 43-47, Comedy III Prods. v. New Line Cinema*, 200 F.3d 593 (9th Cir. 2000) (No. 98-55301); *Defendant-Appellee New Line Cinema Corporation's Answering Brief at 35-39, Comedy III Prods., Inc. v. New Line Cinema*, 200 F.3d 593 (9th Cir. 2000) (No. 98-55301). The district court did allude to publicity rights briefly when distinguishing various cases cited by Comedy III. *Comedy III*, 46 U.S.P.Q.2d at 1935 ("In addition, the Plaintiff relies on *Wendt*, as 'particularly relevant . . . in that it addresses both of the primary sources of Comedy III's right in the present case: the common law right of publicity and section 43(a) of the Lanham Act.'") (quoting Plaintiff's Letter to the Court, September 24, 1997).

109. Since right of publicity claims are personal, they are generally brought by someone who is still living. See *Wendt v. Host Int'l, Inc.*, 125 F.3d 806, 808-09 (9th Cir. 1997); *Waits v. Frito-Lay, Inc.*, 978 F.2d 1093, 1096 (9th Cir. 1992); *Rogers v. Grimaldi*, 875 F.2d 994, 996-97 (2d Cir. 1989). Some jurisdictions do allow heirs and assignees to assert a common law right of publicity claim for a deceased person. See, e.g., *McFarland v. Miller*, 14 F.3d 912, 918 (3d Cir. 1994) (holding that right of publicity is descendible under New Jersey common law); *Martin Luther King, Jr., Center for Social Change, Inc. v. American Heritage Prods., Inc.*, 694 F.2d 674 (11th Cir. 1983) (same under Georgia common law). California, however, does not. California's rule was established by the companion cases of *Lugosi v. Universal Pictures*, 25 Cal. 3d 813 (1979) and *Guglielmi v. Spelling-Goldberg Productions*, 25 Cal. 3d 860 (1979). *Lugosi* involved a claim by the widow and son of renowned horror actor Bela Lugosi against Universal Pictures, alleging

through statutes,<sup>110</sup> Comedy III's claim falls squarely within an express exemption to the law.<sup>111</sup> The court may also have been swayed by New Line's argument that Comedy III's right of publicity claim was procedurally improper.<sup>112</sup> Regardless, the right of publicity, although similar to trademark, is a separate, free-standing legal concept that provides an alternative route to relief for many would-be trademark claims.<sup>113</sup> Without a discussion of this important counterpart to trademark, the Ninth Circuit's analysis of Comedy III's case is incomplete.

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unauthorized use of Lugosi's likeness as he appears in one of his most famous roles, Count Dracula. *Lugosi*, 25 Cal. 3d at 816-17. In denying the plaintiffs' claim, the court held that "the right to exploit name and likeness is personal to the artist and must be exercised, if at all, by him during his lifetime." *Id.* at 824. *Lugosi* did leave plaintiffs a way around its rule by hinting that an exception might be made if the original artist had exploited his right of publicity during his lifetime. *See id.* at 822-23. However, the court shut even this small door in *Guglielmi* by issuing a curt, two-paragraph opinion which stated the *Lugosi* rule as barring a postmortem right of publicity, without qualification. *Guglielmi*, 25 Cal. 3d at 861.

110. In the wake of *Lugosi* and *Guglielmi*, California revived the postmortem right of publicity through statutory means. California Civil Code section 3344.1 provides that "[a]ny person who uses a deceased personality's [identity in a commercial manner]. . . shall be liable for any damages sustained by the person or persons injured as a result thereof." CAL. CIV. CODE § 3344.1(a)(1) (West 2000) (formerly Cal. Civ. Code § 990). The right granted by this statute only lasts for 70 years following the artist's death. *Id.* § 3344.1(g). The specific purpose of the statute was to legislatively overrule *Lugosi*. 4 MCCARTHY, *supra* note 14, § 28:27. In the aftermath of *Astaire v. Best Film & Video Corp.*, 116 F.3d 1297 (9th Cir. 1997), a right of publicity suit brought by Fred Astaire's widow, California Civil Code section 990 was amended, renumbered as California Civil Code section 3344.1, and renamed the Astaire Celebrity Image Protection Act. *See* Scott L. Whiteleather, *Still Dancing: An Article on Astaire v. Best Video and its Lasting Repercussions*, 7 UCLA ENT. L. REV. 267, 286 (2000).

111. California Civil Code section 3344.1 includes several exemptions to the statutory right of publicity. In particular, section 3344.1(a)(2) states that audiovisual entertainment works—a category that clearly includes motion pictures—does not fall within the scope of the statute. CAL. CIV. CODE § 3344.1(a)(2) (West 2000).

112. New Line asserted that Comedy III's appellate brief claim for right of publicity represented an impermissible attempt to raise a new legal issue on appeal, not merely a change in nomenclature. Defendant-Appellee New Line Cinema Corporation's Answering Brief at 27-30, *Comedy III Prods., Inc. v. New Line Cinema*, 200 F.3d 593 (9th Cir. 2000) (No. 98-55301). It is unclear whether the Ninth Circuit's failure to directly address the right of publicity was a tacit acceptance of New Line's argument.

113. Courts have held that Lanham Act section 43(a) encompasses some right of publicity claims. *See, e.g., White v. Samsung Elecs. of Am., Inc.*, 971 F.2d 1395, 1399 (9th Cir. 1992).

1. *Comedy III May Assert a Right of Publicity in Fictional Characters*

One unusual issue raised by Comedy III's claim is whether a party can claim a right of publicity in a fictional character. Typically, people assert claims over the publicity rights of real persons.<sup>114</sup> Comedy III, however, claimed a right of publicity in The Three Stooges, not in the actors who played them.<sup>115</sup>

The Third Circuit has given qualified approval to publicity rights claims in fictional characters. In *McFarland v. Miller*,<sup>116</sup> the plaintiff, George McFarland, had become famous in his youth for portraying the character Spanky in the *Our Gang* and *Little Rascals* films. Miller operated a restaurant called "Spanky McFarland" that featured numerous images of McFarland's *Little Rascals* character as part of the interior decor.<sup>117</sup> McFarland sued Miller for violation of his common law right of publicity, and the Third Circuit ultimately held that an actor may validly claim a right of publicity in a character he played if the character and the actor are, in effect, equivalent.<sup>118</sup>

The Ninth Circuit has also addressed this question. In *Wendt v. Host International, Inc.*,<sup>119</sup> Host International created animatronic robots resembling the characters Norm and Cliff from the television show *Cheers* and placed them in airport bars modeled after the *Cheers* set.<sup>120</sup> George Wendt and John Ratzenberger, who played Norm and Cliff, sued Host International for violating their common law rights of publicity.<sup>121</sup> In reversing the lower court's summary judgment against the plaintiffs, the Ninth Circuit held that the right of publicity attached to the actors' physical like-

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114. See, e.g., *Zacchini v. Scripps-Howard Broad. Co.*, 433 U.S. 562 (1977); *White*, 971 F.2d at 1395.

115. See *Comedy III Prods., Inc. v. New Line Cinema*, 200 F.3d 593, 595 (9th Cir. 2000).

116. 14 F.3d 912, 914 (3d Cir. 1994).

117. *Id.* at 916.

118. See *id.* at 920 ("Where an actor's screen persona becomes so associated with him that it becomes inseparable from the actor's own public image, the actor obtains an interest in the image which gives him standing to prevent mere interlopers from using it without authority."); see also *Price v. Hal Roach Studios, Inc.*, 400 F. Supp. 836 (S.D.N.Y. 1975) (allowing a common law right of publicity in the on-screen images of Stan Laurel and Oliver Hardy). For an in-depth analysis of the *McFarland* standard, see Langvardt, *supra* note 22, at 391-99.

119. 125 F.3d 806 (9th Cir. 1997).

120. *Id.* at 809.

121. *Id.*

nesses rather than their characters, and that therefore, the key issue was the degree to which the robots resembled the actors themselves.<sup>122</sup>

Both *McFarland* and *Wendt* reached the same conclusion, but by very different paths. *McFarland* implied that the right of publicity may be tied to the fictional character, not the actor, and that the actor earns the right of publicity by proving a certain degree and exclusivity of association with that character.<sup>123</sup> *Wendt*, by contrast, viewed the right of publicity as personal to the actor himself; thus, whether the public recognizes the actor because of his association with a popular character is unimportant.<sup>124</sup>

Comedy III's claim would most likely satisfy the *McFarland* standard. Moe, Larry, and Curly all did other entertainment work, but in the public mind they are "Moe, Larry, and Curly—The Three Stooges." The dividing line between screen image and public persona blurs even further where, as in *McFarland*, the actor and the character he portrays use the same name.<sup>125</sup> "Moe Howard," "Larry Fine," and "Curly Howard" are stage names, but they are the names by which the public identified those actors as real individuals as well as The Three Stooges characters. Comedy III's claim would also easily pass the bar set by *Wendt*, for New Line's use involved film footage of the actors, which by definition replicated their exact likenesses. Thus, the mere fact that The Three Stooges are fictional characters does not bar Comedy III from asserting a right of publicity in them.

## 2. *Comedy III's Right of Publicity Claim Undermines the First Amendment*

Like trademark rights, an unrestrained right of publicity possesses the potential to restrict the First Amendment's guarantee of free speech. Although it lacks precedential authority, Judge Kozinski's dissent to the Ninth Circuit's refusal to rehear *White v. Samsung Electronics America, Inc.*<sup>126</sup> en banc highlights some important free speech conflicts that could

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122. See *id.* at 811-12.

123. See *McFarland*, 14 F.3d at 920.

124. See *Wendt*, 125 F.3d at 811 ("While it is true that appellants' fame arose in large part through their participation in Cheers, an actor or actress does not lose the right to control the commercial exploitation of his or her likeness by portraying a fictional character.").

125. See also *Price v. Hal Roach Studios, Inc.*, 400 F. Supp. 836, 838-39 (S.D.N.Y. 1975) (involving a right of publicity suit by Lucille Hardy Price and Ida K. Laurel, the widows of the famous comedy duo Laurel and Hardy).

126. 971 F.2d 1395, 1397-99 (9th Cir. 1992) (holding in favor of publicity rights).

arise if *White* were followed too generously.<sup>127</sup> Chief among these is the crippling effect an expansive right of publicity would have on artists' freedom to utilize portions of pre-existing public domain works in new creative works.<sup>128</sup> In addition, Judge Kozinski noted that even commercial speech is entitled to some level of First Amendment protection, albeit less than that given to noncommercial speech.<sup>129</sup>

If allowed, Comedy III's right of publicity claim would restrict New Line's First Amendment rights in two significant ways. First, it would renege upon the bargain struck by copyright law between the intellectual

127. 989 F.2d 1512 (1993) (Kozinski, J., dissenting). Numerous commentators have echoed Judge Kozinski's cautionary words. *See, e.g.*, Roberta Kwall, *The Right of Publicity vs. The First Amendment: A Property and Liability Rule Analysis*, 70 IND. L.J. 47 (1994); Richard S. Robinson, *Preemption, the Right of Publicity, and a New Federal Statute*, 16 CARDOZO ARTS & ENT. L.J. 183 (1998); Diane Leenheer Zimmerman, *Fitting Publicity Rights into Intellectual Property and Free Speech Theory: Sam, You Made the Pants Too Long!*, 10 DEPAUL-LCA J. ART & ENT. L. 283 (2001). These criticisms apply mainly to common law publicity rights, for right of publicity statutes do a better job of balancing the competing interests. For example, California Civil Code section 3344.1(2) specifically exempts not only plays, books, newspapers, and audiovisual works, but also advertisements or commercial announcements for any of those works from the publicity rights granted by the section. CAL. CIV. CODE § 3344.1(2) (West 2000); *see also id.* § 3344(f) (exempting the owners or employees of any medium used for advertising from liability under the section if they were not aware the use was unauthorized). These statutory exemptions mirror the common law's greater deference to noncommercial speech. *See supra* Part I.E.

128. Judge Kozinski illustrated his point by citing numerous examples of well-known books, songs, and movies that utilize well-known trademarks, all of which presumably would not have enriched our culture without the protective shield of free speech. *White*, 989 F.2d at 1514. He also noted that an unfettered right of publicity could place excessive liability on those who parody or otherwise comment on public figures. *Id.* at 1519 ("Parody, humor, irreverence are all vital components of the marketplace of ideas. . . . [T]he last thing the First Amendment will tolerate . . . is a law that lets public figures keep people from mocking them. . . .").

129. *Id.* The Supreme Court laid to rest the notion that commercial speech was exempt from the First Amendment in *Virginia State Board of Pharmacy v. Virginia Citizens Consumer Council, Inc.*:

It is clear . . . that speech does not lose its First Amendment protection because money is spent to project it, as in a paid advertisement of one form or another. . . . Speech likewise is protected even though it is carried in a form that is "sold" for profit . . . and even though it may involve a solicitation to purchase or otherwise pay or contribute money.

425 U.S. 748, 761 (1976). This view is now reflected in state statutes. *See, e.g.*, CAL. CIV. CODE § 3344(e) (West 2000) (stating that commercial use of another's identity does not violate the statute "solely because the material containing such use is commercially sponsored or contains paid advertising").

property rights of the individual and the free access rights of the public.<sup>130</sup> The copyright in *The Three Stooges' Disorder in the Court* has expired.<sup>131</sup> Comedy III, however, wanted to snatch the film out of the public domain and back into private hands. Claims like Comedy III's could, therefore, potentially confer copyright-like rights on a party that neither created a work nor owned any rights in it as an assignee. Second, Comedy III's claim would intrude upon the freedom of expression given to those who produce artistic works. Opening such artists to liability for drawing upon any number of "public domain" works would have a serious chilling effect upon the creative process. If allowed, claims such as Comedy III's would therefore represent a significant threat to the freedoms of speech and expression granted to the public by the First Amendment.

#### IV. CONCLUSION

The Ninth Circuit correctly declined to entertain Comedy III's Lanham Act and unfair competition claims. However, rather than hand down a strong rule that clearly delineates one of the boundaries between copyright and trademark law, the court issued a conclusory and unsupported holding that may endanger the finality of its decision and calls into question the strength with which this case may serve as precedent. In addition, the court has missed an opportunity to reaffirm its right of publicity rules. This lost chance is all the more disappointing given the Ninth Circuit's usual role as a leading jurisdiction in the shaping of publicity rights law.

Furthermore, it is conceivable that, contrary to the Ninth Circuit's rule, an exact reproduction of an artist's performance could, in fact, become a trademark after the copyright in the performance expires. It has become increasingly common for advertisements on television, radio, and the Internet to incorporate portions of the original recordings of classic songs.<sup>132</sup> For example, Philips Electronics has recently adopted The Beatles' "Getting Better" as a musical counterpart to its slogan, "Let's Make Things Better."<sup>133</sup> The chorus of the song appears along with the

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130. See *supra* Part I.A.

131. See *supra* note 65.

132. Some classic songs recently used in television commercials include Jimi Hendrix's "Are You Experienced?" (Reebok DMX running shoes), Queen's "Another One Bites the Dust" (Aiwa stereo systems), and The Knack's "My Sharona" (Taco Bell "Chalupas").

133. Philips chose "Getting Better" specifically to provide "a strong musical button so that Philips' TV spots are recognized instantly." *Philips Profile: Building the brand with flagship products*, at <http://www.news.philips.com/profile/brand/brand1.html> (last visited Feb. 4, 2001).

Philips logo at the end of each Philips television commercial. Presumably, Philips currently licenses the song from The Beatles. However, if Philips were to continue using "Getting Better" as part of its commercial signature, one could envision a point in the distant future, after The Beatles' copyright in the song has expired, when Philips could lay claim to the song as a trademark, assuming that it has remained the sole electronics company to use it. It is, therefore, advisable not to view the Ninth Circuit's rule in *Comedy III Productions, Inc. v. New Line Cinema* as setting an outer limit on trademark law.

## THE ANTICYBERSQUATTING CONSUMER PROTECTION ACT & SPORXY'S FARM L.L.C. v. SPORTSMAN'S MARKET, INC.

By P. Wayne Hale

In response to the Internet phenomenon known as “cybersquatting,” many large companies cried out, “There oughtta be a law!”<sup>1</sup> As a result, Congress enacted the Anticybersquatting Consumer Protection Act<sup>2</sup> (“ACPA”) to fill in the gaps that were apparent when the Federal Trademark Dilution Act (“FTDA”) was applied to cybersquatters. The ACPA is a powerful and effective new weapon available to trademark holders, but the strength of this new weapon may have come at a cost to the free spirit that has pervaded the Internet since its inception.

The Second Circuit, in *Sporty's Farm L.L.C. v. Sportsman's Market, Inc.*,<sup>3</sup> availed itself of an early opportunity to apply the newly enacted ACPA to a case that was tried before its enactment. Using *Sporty's Farm* and other cases as examples, this Note reviews the problems that arise when applying the FTDA to cybersquatters and analyzes how the ACPA addresses those problems.

The Note begins with an overview of the cybersquatting problem, then reviews the provisions of the FTDA used to combat this problem. The provisions of the newly enacted ACPA are reviewed next, and their application is illustrated in *Sporty's Farm*—the first appellate decision under the ACPA.<sup>4</sup> Finally, the Note reviews the specific areas where Congress found the FTDA lacking in appropriate protection for mark holders and discusses how Congress drafted the ACPA to provide protection in those areas. The Note concludes with an overall assessment of the new legislation's costs and benefits.

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1. See S. REP. NO. 106-140, at 4-7 (1999) (detailing the testimony heard from various companies complaining about the cybersquatting dilemma).

2. 15 U.S.C.A. § 1125(d) (West Supp. 2000).

3. *Sporty's Farm L.L.C. v. Sportsman's Market, Inc.*, 202 F.3d 489 (2d Cir. 2000), *cert. denied*, 120 S. Ct. 2719 (2000).

4. As of this writing, at least one other circuit has taken the opportunity to thoroughly review the ACPA in a published opinion. See *Virtual Works, Inc. v. Volkswagen of America, Inc.*, No. CIV.A.99-1289-A, 2001 WL 50988 (4th Cir. Jan. 22, 2001).

## I. BACKGROUND

### A. The Problem with Domain Names that Gives Rise to Cybersquatting

Recent years have seen an explosion in the commercial use of the Internet,<sup>5</sup> resulting in a diminished supply of online “addresses.” Conducting business on the Internet is paperless and efficient, with fewer transaction costs, resulting in reduced prices and higher profits.<sup>6</sup> An individual searching for a company online can often find it by typing in the company’s name or an abbreviation of the name followed by “.com.”<sup>7</sup> Thus, companies conducting business online have an obvious incentive to maintain a web site with a domain name<sup>8</sup> that matches or describes their company, logo, or service. The inherently limited supply of domain names,<sup>9</sup> combined with the ease of their acquisition,<sup>10</sup> quickly resulted in a shortage problem.<sup>11</sup>

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5. *Sporty’s Farm*, 202 F.3d at 493.

6. *Id.*

7. *Id.* For this reason, many businesses attempt to reserve all names identical or reasonably similar to their trademarks, trade names, products, or other advertising endorsements. See also *Porsche Cars N. Am., Inc. v. Porsch.Com*, 51 F. Supp. 2d 707, 709 (E.D. Va. 1999) (noting that companies seeking to advertise their products on web sites typically seek domain names that mnemonically promote their company and thereby increase the likelihood that people will be able to locate their presence on the Internet).

8. A domain name is an address used to designate a specific webpage on the Internet. Domain names consist of two parts: a top level domain and secondary level domain. To illustrate, the domain name sportsmans.com consists of a top level domain suffix “.com,” and a secondary level domain “sportsmans.”

9. Domain names are unique in that only one entity may maintain a webpage at a domain name at any given time. See Network Solutions, *Frequently Asked Questions: What is a Web Address (domain name)?*, at [http://www.networksolutions.com/en\\_US/help/general.jhtml](http://www.networksolutions.com/en_US/help/general.jhtml) (last visited Feb. 1, 2001). So while two businesses may maintain the same common brick and mortar name, such as “Sportsman’s,” only one Internet based company may occupy sportsmans.com online.

10. Domain name registrars continue to grant domain names as they have always been granted—primarily on a first-come, first-served basis upon payment of a small registration fee. Network Solutions, Inc., *Web Address Registration: What Does it Cost?*, at <http://www.networksolutions.com/catalog/domainname/> (last visited Feb. 1, 2001) (listing the price for registration of a secondary level domain name in various top level domains: \$35 per year to register a “.com” domain name, \$30 for a “.net,” \$50 for a “.tv,” and \$25 for a “.org”). The process does not generally require an inquiry into whether a given domain name request matches a trademark held by someone other than the person requesting the name. See H. REP. NO. 106-412, at 5-6 (1999).

11. See Jennifer Golinveaux, *What’s in a Domain Name: Is “Cybersquatting” Trademark Dilution?*, 33 U.S.F. L. REV. 641, 644 (1999) (stating that during the past six

Many owners of well known marks were slow or reluctant to accept the Internet as a potential commercial avenue, allowing others to register domains reflecting their marks<sup>12</sup> and giving rise to the problem known as "cybersquatting."<sup>13</sup> After registering a mark, the typical cybersquatter tries to sell it to the mark owner at a substantial profit.<sup>14</sup> The simplicity of the registration process and the low cost of maintaining domain name rights has made it relatively easy for cybersquatters to profit from the process.<sup>15</sup> Some mark holders grudgingly paid the "ransom" in order to get their marks back,<sup>16</sup> but others believed that their trademark rights ought to protect them from such piracy—and demanded justice in the courts.<sup>17</sup>

## **B. Domain Name Protection under the Federal Trademark Dilution Act**

Before the enactment of the ACPA, trademark dilution was the most effective cause of action against cybersquatting.<sup>18</sup> The term "dilution" is

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years over four million domain names have been reserved, reflecting the exponential growth of domain name reservation).

12. Cybersquatters tend to purchase alphanumeric combinations that reflect well-known (or soon to be well-known) companies' trade names, trademarks, service marks, or any other identifiable combination of letters and numbers. The term "mark" is used generically to refer to all of these.

13. There has been some debate over whether the more appropriate characterization of such individual is that of "cybersquatter" or "entrepreneur" For a criticism of the cybersquatter characterization, see Jessica Litman, *The DNS Wars: Trademarks and The Internet Domain Name System*, 4 J. SMALL & EMERGING BUS. L. 149 (2000) (arguing that this country has historically encouraged entrepreneurial acts such as those engaged in by the misnamed "cybersquatter"). The definition of acts necessary to constitute cybersquatting has also been debated. The Senate Report on the ACPA identifies five types of individuals the ACPA intends to cover. See S. REP. NO. 106-140, at 5-6 (1999). For a criticism of this approach, see Neil L. Martin, *The Anticybersquatting Consumer Protection Act: Empowering Trademark Owners, But Not The Last Word on Domain Name Disputes*, 25 J. CORP. L. 591, 595 (noting that the majority of commentators have confined the label "cybersquatter" to the "ransoming scenario," so the ACPA functionally serves to address a larger area of trademark law involving unauthorized mark users on the Internet).

14. See *Sporty's Farm L.L.C. v. Sportsman's Market, Inc.*, 202 F.3d 489, 493 (2d Cir. 2000), *cert. denied*, 120 S. Ct. 2719 (2000).

15. The process does not generally require an inquiry into whether a given domain name request matches a trademark held by someone other than the person requesting the name. See H. REP. NO. 106-412, at 5-6 (1999); see also *supra* note 10.

16. See H. REP. NO. 106-412, at 5-7 (1999).

17. See S. REP. NO. 106-140, at 4-7 (1999).

18. Trademark infringement has proven largely ineffective in pursuing cybersquatters because of the requirement that mark owners prove a "likelihood of confusion." 15 U.S.C. § 1125(a) (Supp. IV 1998). If the goods sold under a domain name are not similar to the mark holder's goods, then there is little chance of consumer confusion. At least one

defined as the “lessening of the capacity of a famous mark to identify and distinguish goods or services.”<sup>19</sup> Courts interpret the FTDA to provide protection to the owner of a mark if: (1) it is a famous mark; (2) the mark is used commercially; (3) the use of the mark occurred after the mark obtained its famous quality; and (4) the use of the trademark creates a likelihood of dilution of the mark’s distinctiveness.<sup>20</sup> Satisfying these requirements in the cybersquatting context has proven difficult in most cases, but courts have found liability in others.<sup>21</sup>

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court has overcome this obstacle by finding “initial interest confusion” actionable, *Brookfield Communications, Inc. v. West Coast Entertainment Corp.*, 174 F.3d 1036, 1062-64 (9th Cir. 1999), but on the whole, dilution has proven to be the most successful cause of action in the courts prior to enactment of the ACPA.

19. *Jews For Jesus v. Brodsky*, 993 F. Supp. 282, 306 (D.N.J. 1998) (FTDA enacted to unify the traditional state law doctrines of blurring and tarnishment).

20. *Avery Dennison Corp. v. Sumpton*, 189 F.3d 868, 874 (9th Cir. 1999) (listing the elements that must be proven to maintain a federal trademark dilution action). The relevant text of the FTDA states that:

(1) The owner of a famous mark shall be entitled, subject to the principles of equity and upon such terms as the court deems reasonable, to an injunction against another person’s commercial use in commerce of a mark or trade name, if such use begins after the mark has become famous and causes dilution of the distinctive quality of the mark, and to obtain such other relief as is provided in this subsection. In determining whether a mark is distinctive and famous, a court may consider factors such as, but not limited to—

(A) the degree of inherent or acquired distinctiveness of the mark;

(B) the duration and extent of use of the mark in connection with the goods or services with which the mark is used;

(C) the duration and extent of advertising and publicity of the mark;

(D) the geographical extent of the trading area in which the mark is used;

(E) the channels of trade for the goods or services with which the mark is used;

(F) the degree of recognition of the mark in the trading areas and channels of trade used by the marks’ owner and the person against whom the injunction is sought;

(G) the nature and extent of use of the same or similar marks by third parties; and

(H) whether the mark was registered under the Act of March 3, 1881, or the Act of February 20, 1905, or on the principal register.

15 U.S.C. § 1125(c) (Supp. IV 1998).

21. *Compare* *Panavision Int’l, L.P. v. Toeppen*, 141 F.3d 1316, 1325-26 (9th Cir. 1998) (holding that the elements of trademark dilution were satisfied in the cybersquatting context), *with* *Lockheed Martin Corp. v. Network Solutions Inc.*, 43 U.S.P.Q. 2d 1056 (C.D. Cal. 1997) (holding that registering a trademark alone does not satisfy the elements required to maintain a dilution cause of action).

Courts analyze the famousness requirement by applying the eight non-exclusive factors enumerated under the FTDA.<sup>22</sup> One of the key factors in this analysis is the “degree of inherent or acquired distinctiveness” a mark has.<sup>23</sup> Acquired distinctiveness refers to the degree of “consumer association” built up in a mark.<sup>24</sup> Inherent distinctiveness refers to the inherent qualities of a mark that make it unique when used on certain goods, a quality which may be present before the mark has ever been used.<sup>25</sup> Other famousness factors enumerated under the FTDA focus on plaintiff’s use of the mark or the result thereof, since fame only accrues after a sufficient number of consumers associate the mark with a product or source.<sup>26</sup> These factors include the length of time the mark was associated with the goods in question,<sup>27</sup> the amount of advertising the mark has received,<sup>28</sup> and how well known the mark has become in a substantial portion of the United States.<sup>29</sup> Courts have sometimes been moved by a deserving plaintiff’s plight to find that substantially less than general public or national recognition was enough to establish fame.<sup>30</sup> More recent decisions, however, have raised this famousness threshold, stating that the FTDA was intended to protect only “truly prominent and renowned” trademarks.<sup>31</sup> This heightened standard reduces the class of mark holders eligible for protection under the FTDA, thereby effectively denying some mark holders relief against cybersquatters.<sup>32</sup>

The FTDA’s commercial use requirement poses another troubling barrier in the pursuit of sophisticated cybersquatters. The Lanham Act requires “use in commerce,” which is use of the mark “in any manner on

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22. 15 U.S.C. § 1125(c)(1) (Supp. IV 1998); *see supra*, note 20.

23. 15 U.S.C. § 1125(c)(1)(A) (Supp. IV 1998); *see Hasbro v. Clue Computing, Inc.*, 66 F. Supp. 2d 117, 131 (D. Mass. 1999) (noting that factors (A) and (G) deserve slightly more consideration than the others).

24. *See Hasbro*, 66 F. Supp. 2d at 131.

25. *Sporty’s Farm L.L.C. v. Sportsman’s Market, Inc.*, 202 F.3d 489, 497 (2d Cir. 2000), *cert. denied*, 120 S. Ct. 2719 (2000).

26. *See id.*

27. 15 U.S.C. § 1125(c)(1)(B) (Supp. IV 1998).

28. *Id.* § 1125(c)(1)(C).

29. *Id.* § 1125(c)(1)(F).

30. *See, e.g., TeleTech Customer Care Management, Inc. v. Tele-Tech Co.*, 977 F. Supp. 1407 (C.D. Cal. 1997) (finding that the mark “TeleTech” was hardly a household name but was still famous within its area of commerce, also referred to as “niche” fame).

31. *See Avery Dennison Corp. v. Sumpton*, 189 F.3d 868, 875 (9th Cir. 1999) (providing a statutory rationale for the limited reach of the FTDA).

32. *See id.* at 878 (finding it unlikely that plaintiff’s marks qualified as famous under the heightened standard required under the FTDA).

goods," their containers, tags, or displays.<sup>33</sup> To prove commercial use, a plaintiff must establish that the defendant is using the trademark "as a trademark" in commerce.<sup>34</sup> If a court holds that merely registering a domain name does not constitute commercial use,<sup>35</sup> this requirement may be difficult to satisfy when clever cybersquatters leave their sites unoccupied or post "fair use" criticisms or commentaries.

Proving a likelihood of dilution of the mark's distinctiveness has typically been established by showing tarnishment or blurring,<sup>36</sup> but courts have taken the initiative of including cybersquatting as a form of dilution.<sup>37</sup> Tarnishment occurs when the domain name is "besmirched" in some way, typically when a trademarked domain name is linked to a site that is sexual in nature.<sup>38</sup> Blurring occurs when a famous mark is "used without permission in association with goods or services that are different from those sold by the trademark owner,"<sup>39</sup> thus weakening the ability of the mark to identify and distinguish the source.<sup>40</sup> In addition to these traditional forms of dilution, with a little bootstrapping, some courts recognized the act of cybersquatting itself as dilution by lessening the ability of a mark holder to identify and offer its goods online.<sup>41</sup> Congress could see that such bootstrapping was necessary to rein in sophisticated cybersquat-

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33. 15 U.S.C. § 1125(c)(1) (Supp. IV 1998); *id.* § 1127 (defining "use in commerce").

34. *See Avery Dennison*, 189 F.3d at 880.

35. *See id.* at 879-80.

36. *See Golinveaux*, *supra* note 11, at 656 (noting that a trademark may be diluted through tarnishment or blurring).

37. *See, e.g., Panavision Int'l, L.P. v. Toepfen*, 141 F.3d 1316, 1325 (9th Cir. 1998) (finding the defendant's reservation of the trademark as a domain name for the purpose of later selling it to the rightful trademark owner constituted "commercial use" of a trademark in violation of trademark law); *Wash. Speakers Bureau, Inc. v. Leading Auths., Inc.*, 49 F. Supp. 2d 496, 498 (E.D. Va. 1999) (recognizing cybersquatting as the commercial use of a trademark).

38. *See, e.g., Toys "R" Us, Inc. v. Akkaoui*, 40 U.S.P.Q. 2d 1836, 1839 (N.D. Cal. 1996) (holding that the "Toys 'R' Us" trademark had been diluted through tarnishment by the defendant's web site "adultrus.com," which offered sexual products for sale over the Internet).

39. *See Golinveaux*, *supra* note 11, at 656 (noting that blurring dilutes a trademark because it lessens the consuming public's ability to distinguish between products; the use of KODAK pianos, for instance, will cause consumers to identify the name KODAK with products other than cameras, thereby lessening the uniqueness of the trademark).

40. 4 J. THOMAS MCCARTHY, MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION § 24.94, at 24-175 (4th ed. 2000).

41. *See Brookfield Communication, Inc. v. West Coast Entertainment Corp.*, 174 F.3d 1036 (9th Cir. 1999).

ters under the FTDA, so it enacted new legislation to deal squarely with the problem.

### C. The Anticybersquatting Consumer Protection Act

The substantive requirements necessary to prove a cause of action under the ACPA reflect the competing interests at stake when the legislation was enacted. Congress enacted the ACPA to protect consumers and American businesses, to promote the growth of online commerce, and to provide clarity in "cybersquatting law" for mark owners, while at the same time balancing the rights of all Americans to free speech and other protected uses of trademarks.<sup>42</sup> A court may find liability under the ACPA where a famous or distinctive mark was "registered, trafficked in, or used" as a domain name by an individual acting with a "bad faith intent to profit."<sup>43</sup> The ACPA provides a court with nine nonexclusive factors that may be helpful in deciding whether the domain name registrant acted with the requisite bad faith intent to profit.<sup>44</sup> Liability cannot be found in any

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42. See S. REP. NO. 106-140, at 7-8 (1999); *Sporty's Farm L.L.C. v. Sportsman's Market, Inc.*, 202 F.3d 489, 495 (2d Cir. 2000), *cert. denied*, 120 S. Ct. 2719 (2000).

43. 15 U.S.C.A. § 1125(d)(1)(A) (West Supp. 2000). The court in *Sporty's Farm* has noted that "bad faith intent to profit" is a term of art under ACPA, not necessarily to be equated with bad faith in other contexts. *Sporty's Farm*, 202 F.3d at 499 n.13.

44. The first four factors suggest circumstances that may indicate good faith, while the last five factors suggest circumstances that may indicate bad faith intent. The pertinent section of the ACPA states:

(B)(i) In determining whether a person has a bad-faith intent described under subparagraph (a), a court may consider factors such as, but not limited to—

(I) the trademark or other intellectual property rights of the person, if any, in the domain name;

(II) the extent to which the domain name consists of the legal name of the person or a name that is otherwise commonly used to identify that person;

(III) the person's prior use, if any, of the domain name in connection with the bona fide offering of any goods or services;

(IV) the person's bonafide noncommercial or fair use of the mark in a site accessible under the domain name;

(V) the person's intent to divert consumers from the mark owner's online location to a site accessible under the domain name that could harm the goodwill represented by the mark, either for commercial gain or with the intent to tarnish or disparage the mark, by creating a likelihood of confusion as to the source, sponsorship, affiliation, or endorsement of the site;

(VI) the person's offer to transfer, sell, or otherwise assign the domain name to the mark owner or any third party for financial gain without having used, or having an intent to use, the domain name in the bona

case where the court determines that “the person believed and had reasonable grounds to believe that the use of the domain name was a fair use or otherwise lawful.”<sup>45</sup> In addition, the traditional trademark defenses are expressly retained.<sup>46</sup>

The remedies available under the ACPA are a significant extension beyond those available under traditional trademark law. Congress extended the injunctive relief provisions of the Lanham Act to violations of the ACPA,<sup>47</sup> allowing a court to grant the mark owner an injunction if deemed “reasonable.”<sup>48</sup> The damages provision of the ACPA however, provides a new form of relief. At any time before final judgment has been rendered, a mark holder may elect either actual or statutory damages.<sup>49</sup> If a mark holder elects statutory damages, the ACPA allows a court to grant damages in an amount “not less than \$1,000 and not more than \$100,000 per domain name, as the court considers just.”<sup>50</sup> Since it can be difficult to

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fide offering of any goods or services, or the person’s prior conduct indicating a pattern of such conduct,

(VII) the person’s provision of material and misleading false contact information when applying for the registration of the domain name, the person’s intentional failure to maintain accurate contact information, or the person’s prior contact indicating a pattern of such conduct,

(VIII) the person’s registration or acquisition of multiple domain names which the person knows are identical or confusingly similar to trademarks or service marks of others that are distinctive at the time of registration of such domain names, or dilutive of famous marks of others that are famous at the time of registration of such domain names, without regard to the goods or services of the parties;

(IX) the extent to which the mark incorporated in the person’s domain name registration is or is not distinctive and famous within the meaning of subsection (c)(1) of this section.

15 U.S.C.A. § 1125(d)(1)(B) (West Supp. 2000).

45. *Id.* § 1125(d)(1)(B)(ii).

46. The ACPA also includes an explicit savings clause for traditional trademark defenses: fair use, product comparison, news reporting, commentary, criticism, parody, and other First Amendment related uses. 15 U.S.C.A § 1051 (West Supp. 2000) (“Savings Provisions” Note); *see also* S. REP. NO. 106-140, at 11 (1999).

47. Anticybersquatting Consumer Protection Act, Pub. L. No. 106-113, § 3003, 113 Stat. 1501, 1501A-548 (“INJUNCTIONS.—Section 34(a) of the Trademark Act of 1946 (15 U.S.C. 1116(a)) is amended in the first sentence by striking ‘(a) or (c)’ and inserting ‘(a), (c), or (d).’”).

48. 15 U.S.C.A. § 1116(a) (West Supp. 2000).

49. *Id.* § 1117(d). If the plaintiff can prove actual damages, treble damages may be awarded at the trial judge’s discretion. *Id.* § 1117(a).

50. *Id.* § 1117(d).

prove actual damages in cybersquatting cases, this provision makes it easier to obtain compensation from a cybersquatter.<sup>51</sup>

The ACPA also provides for an action against the domain name itself, or an in rem cause of action.<sup>52</sup> A mark owner can obtain in rem jurisdiction over a domain name registration where the owner of a mark has used "due diligence" in an attempt to locate the domain name registrant or in cases where the plaintiff cannot obtain in personam jurisdiction over the registrant.<sup>53</sup> Congress hoped to alleviate the difficulties associated with serving process against domain name owners who might be located anywhere in the world.<sup>54</sup> To ensure that "notions of fair play and substantial justice" are met, Congress limited the remedies available to a plaintiff pursuing an in rem action to cancellation of the offending domain name registration or transfer of the registration to the mark holder.<sup>55</sup>

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51. See S. REP. NO. 106-140, at 7 (1999). As under general trademark law, in "exceptional cases" the prevailing party may also be awarded reasonable attorney's fees. See 15 U.S.C.A. § 1117(a) (West Supp. 2000).

52. (A) The owner of a mark may file an in rem civil action against a domain name in the judicial district in which the domain name registrar, domain name registry, or other domain name authority that registered or assigned the domain name is located if—

(i) the domain name violates any right of the owner of a mark . . . and

(ii) the court finds that the owner—

(I) is not able to obtain in personam jurisdiction over a person who would have been a defendant in a civil action under paragraph (1); or

(II) through due diligence was not able to find a person who would have been a defendant in a civil action under paragraph (1) by—

(aa) sending a notice of the alleged violation and intent to proceed under this paragraph to the registrar; and

(bb) publishing notice of the action as the court may direct promptly after filing the action.

15 U.S.C.A. § 1125(d)(2) (West Supp. 2000).

53. *Id.*

54. Congress recognized that it is a common practice of cybersquatters to give false names or addresses to a domain name registration authority to avoid service of process. Congress specifically drafted the in rem provisions of the ACPA to provide trademark owners with relief in such cases. See S. REP. NO. 106-140, at 10 (1999).

55. 15 U.S.C.A. § 1125(d)(2)(D)(i) (West Supp. 2000).

## II. *SPORTY'S FARM: THE FIRST APPELLATE DECISION UNDER THE ACPA*

### A. Background

Sportsman's Market ("Sportsman's") was a mail order catalogue company that was quite well-known among pilots and aviation enthusiasts.<sup>56</sup> The company annually distributed approximately 18 million catalogues nationwide and had yearly revenues of about \$50 million.<sup>57</sup> Sportsman's used the registered trademark "Sporty's" on all of its aviation catalogues, as part of its phone number (1-800-SPORTYS), and in substantial advertising campaigns.<sup>58</sup>

Omega Engineering ("Omega") was a mail order catalogue company that mainly sold scientific process measurement and control instruments.<sup>59</sup> One of the co-owners of Omega was a pilot who subscribed to an aviation catalogue operated by Sportsman's.<sup>60</sup> Omega registered the domain name sportys.com after deciding to enter into the aviation catalogue sales business as a direct competitor of Sportsman's.<sup>61</sup> Approximately nine months after Omega's registration of sportys.com, while litigation was pending, Omega formed a wholly owned subsidiary named "Sporty's Farm" that sold Christmas trees and "sold" sportys.com to the new business.<sup>62</sup>

Sporty's Farm brought a declaratory action against Sportsman's seeking the right to continue to use sportys.com.<sup>63</sup> Sportsman's counterclaimed and also sued Omega as a third-party defendant on several grounds including trademark infringement, trademark dilution under the FTDA, and unfair competition under Connecticut State law.<sup>64</sup> Both sides sought an injunction against the other over the use of sportys.com.<sup>65</sup>

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56. *Sporty's Farm L.L.C. v. Sportsman's Market, Inc.*, 202 F.3d 489, 493 (2d Cir. 2000), *cert. denied*, 120 S. Ct. 2719 (2000). Sportsman's is also involved in some sales of tools and home accessories. *Id.*

57. *Id.* Sixty percent of this revenue derives from aviation sales. *Id.*

58. *Id.* at 494. Approximately \$10 million per year was spent advertising the "Sporty's" logo. *Id.*

59. *Id.*

60. *Id.*

61. *Id.*

62. *Id.* at 498. The CEO of Omega, who managed Sporty's Farm, claimed he derived the company name from a farm he grew up on that was named after a beloved childhood dog named "Spotty." *Id.* at 494.

63. *Id.* at 494.

64. *Id.*

65. *Id.*

## B. The District Court Decision

After a bench trial applying the FTDA, the United States District Court for the District of Connecticut rejected all of Sportsman's claims except the trademark dilution claim.<sup>66</sup> The court concluded that "Sporty's" was a famous mark entitled to protection under the FTDA since "Sporty's" enjoys general name recognition in the consuming public.<sup>67</sup> The court also held that "Sporty's" was diluted because the registration of sportys.com effectively compromised Sportsman's ability to identify and distinguish its goods online.<sup>68</sup>

The court issued an injunction ordering Sporty's Farm to relinquish all rights to sportys.com but would not allow Sportsman's to collect damages, costs, or attorney's fees.<sup>69</sup> Both parties appealed to the Second Circuit, with Sporty's Farm appealing the unfavorable injunction, and Sportsman's contesting the denial of damages.<sup>70</sup>

## C. The Second Circuit Decision

### 1. *The Decision to Apply the Newly Enacted ACPA on Appeal*

Even though the district court only ruled on Sportsman's FTDA claims, a panel of the Second Circuit decided to apply the newly enacted ACPA on appeal.<sup>71</sup> Writing for the panel, Judge Calabresi noted that "it is clear that the new law was adopted specifically to provide courts with a preferable alternative to stretching federal dilution law."<sup>72</sup> Noting a "particularly good fit" in the present case, and adequate findings of fact by the district court, the appellate court decided to apply the newly enacted ACPA directly.<sup>73</sup>

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66. *Id.*

67. *Id.* at 494-95.

68. *Id.* at 495.

69. *Id.* Such remedies are only possible when the perpetrator's acts constitute "willful dilution." 15 U.S.C. § 1117(a) (Supp. IV 1998).

70. *Sporty's Farm*, 202 F.3d at 495.

71. As a general rule, appellate courts are to apply the law that exists at the time of the appeal, unless it is more appropriate to remand for further fact-finding and consideration. *See Hamm v. City of Rock Hill*, 379 U.S. 306, 312 (1964) ("If subsequent to the judgment and before the decision of the appellate court, a law intervenes and positively changes the rule which governs, the law must be obeyed, or its obligation denied.").

72. *Sporty's Farm*, 202 F.3d at 497.

73. *Id.* As a procedural matter, the court later dismisses the "impermissibly retroactive" argument because the statute authorizes "prospective relief," which the Supreme Court has found a permissible reason for retroactivity. *Id.* at 502.

## 2. *The Classification of the “Sporty’s” Mark and “Confusingly Similar” Determination*

The court initially examined the “Sporty’s” mark to see if it was distinctive or famous, and thus entitled to the ACPA’s protection.<sup>74</sup> Sportsman’s filed a special affidavit, which afforded them a presumption that their registered trademark was inherently distinctive.<sup>75</sup> The Second Circuit agreed with the lower court’s finding that “Sporty’s” was a distinctive mark as used in connection with Sportsman’s catalogue of merchandise and advertising.<sup>76</sup> After reaching this conclusion, the court did not decide whether the “Sporty’s” mark was famous, as distinctiveness alone was enough to warrant protection under the ACPA.<sup>77</sup>

The court next addressed the question of whether the domain name sportys.com is “identical or confusingly similar” to the “Sporty’s” mark.<sup>78</sup> The court noted that sportys.com is functionally identical to the “Sporty’s” mark since apostrophes cannot be used in domain names, and therefore found it to be confusingly similar.<sup>79</sup>

## 3. *The Determination of a Bad Faith Intent to Profit*

The court went on to decide whether Omega had a “bad faith intent to profit,” a necessary prerequisite to liability under the ACPA.<sup>80</sup> Based on the nine statutory factors, the court held that there was more than enough evidence to find a bad faith intent to profit. The first factor was indicative of bad faith because Omega did not have any intellectual property rights in sportys.com when it registered the domain name.<sup>81</sup> Under the second factor, the court noted that the domain name did not consist of the legal name of the party that registered it (Omega), so Sporty’s Farm did not have any right to be identified by it.<sup>82</sup> The third factor, the prior use of the domain

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74. *Id.* at 497; *see also* 15 U.S.C.A. § 1125(d)(1)(A)(ii) (West Supp. 2000).

75. *Sporty’s Farm*, 202 F.3d at 497.

76. *Id.*

77. *Id.* The court, in dicta and with some reservation, noted that the mark would probably be held to be famous. *Id.*

78. *Id.*

79. *Id.* at 497-98.

80. *Id.* at 498; 15 U.S.C.A. § 1125(d)(1)(A)(i) (West Supp. 2000).

81. 15 U.S.C.A. § 1125(d)(1)(B)(i)(I) (West Supp. 2000). The court noted that Sporty’s Farm was not formed until after the domain name was registered and did not begin operations until after the current lawsuit was filed. *Sporty’s Farm*, 202 F.3d at 498.

82. 15 U.S.C.A. § 1125(d)(1)(B)(i)(II) (West Supp. 2000). The court noted that Sporty’s Farm did not exist when sportys.com was registered, so although the domain name included part of the business’s name that used it, this factor did not indicate good faith. *Sporty’s Farm*, 202 F.3d at 499.

name in connection with a bona fide offering of goods or services, was also found indicative of bad faith because Sporty's Farm did not use the site until after the litigation began.<sup>83</sup> Under the sixth factor, where a court may consider the registrant's prior offer to sell the domain name without using it first, the court found that Omega's sale of the mark to Sporty's Farm was suspicious and therefore indicative of bad faith.<sup>84</sup> Finally, the court considered under the ninth factor the extent to which the mark is "distinctive and famous" as defined by the FTDA. Reiterating its finding that the Sporty's mark is distinctive, the court concluded that this factor tilted towards a finding of bad faith use.<sup>85</sup> The court was most swayed towards a bad faith finding, however, by the unique facts of the case: that Omega planned to compete directly with Sportsman's and was clearly attempting to deprive Sportsman's of the domain name.<sup>86</sup>

The Second Circuit found Sporty's Farm in violation of Sportsman's statutory rights and affirmed the lower court's injunction directing transfer of the domain name rights.<sup>87</sup> Damages were not awarded under the ACPA because Omega registered the domain name before the enactment of the ACPA.<sup>88</sup> The court also considered damages under the FTDA and state law but found no basis for a damages award.<sup>89</sup>

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83. 15 U.S.C.A. § 1125(d)(1)(B)(i)(III) (West Supp. 2000); *Sporty's Farm*, 202 F.3d at 499.

84. 15 U.S.C.A. § 1125(d)(1)(B)(i)(VI) (West Supp. 2000); *Sporty's Farm*, 202 F.3d at 499. Although Sporty's Farm was a wholly owned subsidiary, the court considered it a "third party," technically making the sale from Omega to its subsidiary a sale "without prior use." *Id.*

85. 15 U.S.C.A. § 1125(d)(1)(B)(i)(IX) (West Supp. 2000); *Sporty's Farm*, 202 F.3d at 499. Presumably, the more distinctive or famous a mark is, the more it is deserving of protection, so bad faith intent to profit may more easily be found.

86. *Sporty's Farm*, 202 F.3d at 499. Interestingly enough, this "unique factor" is one of the factors listed as evidence of bad faith under ICANN's newly formed UDRP. *Uniform Domain Name Dispute Resolution Policy*, at <http://www.icann.org/udrp/udrp-policy-24oct99.htm> (Oct. 24, 1999).

87. *Sporty's Farm*, 202 F.3d at 499.

88. *Id.* at 500 n.14 (noting that damages may only be awarded for domain name registrations occurring after the enactment of the ACPA). The ACPA, however, does not preclude an award of damages under any other cause of action. 15 U.S.C.A. § 1125(d)(3) (West Supp. 2000).

89. *Sporty's Farm*, 202 F.3d at 500-501. Under the FTDA, to award damages there must be "willful intent" to dilute the mark; under the state unfair competition cause of action, there must be a violation of some sort of unfair business practice. *Id.*

### III. DISCUSSION

There has been some debate over what ought to constitute unlawful cybersquatting.<sup>90</sup> In the Senate Report on the ACPA, Congress identified categories of behavior that the bill is aimed at preventing. The bill is intended to apply to those who “lock up” domain names with the intent to extract ransoms from mark owners—behavior referred to as “cyber piracy” or cybersquatting by most courts.<sup>91</sup> The bill is also intended to prevent behavior traditionally considered unfair competition under trademark law, such as preying on consumer confusion or free-riding on a mark holder’s goodwill.<sup>92</sup> Congress cited the dispute between Disney and a business using the domain name *disneytransportation.com* as an example of such unfair competition. Despite its lack of affiliation with the Walt Disney Company, the site greets online consumers with “a picture of Mickey Mouse and offers shuttle services in the Orlando area and reservations at Disney hotels.”<sup>93</sup>

After determining the types of behavior Congress believed mark holders ought to be protected from,<sup>94</sup> Congress drafted the ACPA as an amendment to the Lanham Act to address the situations where the FTDA failed to provide appropriate protection.<sup>95</sup> The remainder of this Note will review the specific areas where Congress found the FTDA to be lacking in appropriate mark holder protection and then discuss how Congress drafted the ACPA to fill in such gaps.

#### A. The High Standard for Protection of Marks under the FTDA

A cybersquatter may “lock up” a domain name and hold it for ransom without fear of sanction under the FTDA if the mark is not famous since the FTDA is only supposed to protect “famous marks.”<sup>96</sup> In many early cases the famousness requirement was not a significant barrier for mark

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90. See sources cited *supra* note 13 (authors expressing their views on the proper characterization of a cybersquatter).

91. See S. REP. NO. 106-140, at 5 (1999).

92. See *id.* at 6.

93. *Id.*

94. Congress listed a total of five types of behavior it considered “culpable,” but the two primary examples noted here are broadly representative of the forms of behavior Congress denounced. See *id.* at 5-6 (1999).

95. There has also been significant development of ICANN’s UDRP and the relief it offers in domain name disputes. For a detailed discussion of current developments, see John G. White, Note, *ICANN’s Uniform Domain Name Dispute Resolution Policy in Action*, 16 BERKELEY TECH. L.J. 229 (2001).

96. 15 U.S.C. § 1125(c) (Supp. IV 1998).

holders.<sup>97</sup> But as previously noted, the Ninth Circuit recently held that a mark must be “truly prominent and renowned” in order to meet this threshold.<sup>98</sup> This famousness standard leaves promising newcomers, and others whose names are merely “distinctive,” with little or no protection under the FTDA.

Congress broadened the class of mark holders eligible for protection under the ACPA by protecting both famous and distinctive marks.<sup>99</sup> The Second Circuit, applying the distinctiveness standard to the “Sporty’s” mark in *Sporty’s Farm*, held that it was entitled to ACPA protection after finding that it was distinctive. The court then mentioned, in dicta, that the “Sporty’s” mark met the famousness criteria in “most respects.”<sup>100</sup> If *Sporty’s Farm* had been tried within the Ninth Circuit, under the “truly prominent and renowned” famousness test, the court would probably have had even more doubt as to the mark’s fame. It was not necessary to address the issue fully under the ACPA, however, since the mark was protectable once found to be distinctive.<sup>101</sup>

## B. The Commercial Use Requirement under the FTDA

Cybersquatters might evade liability under the FTDA so long as they fail to make “commercial use” of the domain name. The FTDA expressly states that it does not prevent noncommercial uses of a trademark.<sup>102</sup> Use of a mark as an “address” does not literally fit within the Lanham Act’s description of use “on goods,” which is intended to apply to such uses as

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97. See, e.g., *Intermatic Inc. v. Toeppen*, 947 F. Supp. 1227, 1239 (N.D. Ill. 1996) (allowing fame based on a limited examination, partly because the issue was not contested).

98. *Avery Dennison Corp. v. Sumpton*, 189 F.3d 868, 875 (9th Cir. 1999) (citing *I.P. Lund Trading ApS v. Kohler Co.*, 163 F.3d 27, 46 (1st Cir. 1998)).

99. 15 U.S.C.A. § 1125(d)(1)(A)(ii)(I) & (II) (West Supp. 2000). Remember that “distinctiveness” is an inherent characteristic of a mark, similar to “uniqueness,” which may exist on the day a mark is introduced into commerce. A mark’s “fame” is based on consumer association of the goods with the mark over a substantial geographic area, and this takes time to develop. A distinctive mark might not be famous at all. For a discussion of the differences, see *Nabisco, Inc. v. PF Brands, Inc.*, 191 F.3d 208, 215-16 (2d Cir. 1999). The definitions of these terms are apparently the same under the ACPA as they are under the FTDA. *Sporty’s Farm L.L.C. v. Sportsman’s Market, Inc.*, 202 F.3d 489, 497 n.10 (2d Cir. 2000).

100. *Sporty’s Farm*, 202 F.3d at 497 n.10 (noting that the famousness factor dealing with “the degree of recognition of the mark in the trading areas and channels of trade used by the mark’s owner and the person against whom the injunction is sought” might be questionable in establishing fame).

101. *Id.*

102. 15 U.S.C. § 1125(c)(4) (Supp. IV 1998) (“The following shall not be actionable under this section: . . . (B) noncommercial use of a mark.”).

the Nike swoosh on shoes or IBM stamped on a computer.<sup>103</sup> Early cases held that the mere reservation of a domain name, or warehousing of several domain names, did not qualify as trademark dilution because of the failure to find use in commerce.<sup>104</sup> For example, in *Lockheed Martin Corp. v. Network Solutions, Inc.*,<sup>105</sup> Lockheed Martin filed a complaint because several individuals had reserved variations of Lockheed's service mark as domain names. The court held that "the mere fact that a person registered a [trademark] or a variation thereof as a domain name does not mean that the person infringed or diluted Lockheed's mark."<sup>106</sup>

In more abusive cases such as *Panavision International v. Toeppen*,<sup>107</sup> the court held that an attempt to sell or arbitrage the domain name was commercial use,<sup>108</sup> but this type of commercial use does not clearly fall within the Lanham Act's definition. In *Panavision*, Toeppen registered as domain names several trademarks held by Panavision "as part of a scheme to obtain money."<sup>109</sup> But Toeppen was not making commercial use of the marks as product source identifiers; he merely used them to display photographs of Pana, Illinois.<sup>110</sup> The court did not discuss the Lanham Act's definition of use in commerce, focusing instead on the "evil" intent to sell the mark, and holding this to be use in commerce.<sup>111</sup> Congress noted in the Senate Report on the ACPA that it believed the outcome of this case was correct.<sup>112</sup> The reasoning used to arrive at the case result, however, must have been deemed suspect, as Congress was compelled to make changes when drafting the ACPA.

Unlike the FTDA, the ACPA does not require commercial use of the domain name. Instead, it allows courts to consider the circumstances surrounding any commercial use as a factor in deciding whether to find liability. By removing the strict requirement of commercial use, Congress re-

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103. See H. REP. NO. 104-374, at 3 (1995) (citing uses, which refer to products bearing another's mark, that would be actionable under the FTDA).

104. See, e.g., *Juno Online Services v. Juno Lighting*, 979 F. Supp. 684, 691 (N.D. Ill. 1997) (finding that reserving the right to use a domain name without using it, or "warehousing," is not enough to establish that defendant placed the mark on goods, or "used or displayed [the mark] in the sale or advertising of services," as required to find liability).

105. 43 U.S.P.Q. 2d 1056 (C.D. Cal. 1997).

106. *Id.* at 1058. This was an especially sympathetic case, however, as it was the domain name registrar being sued in lieu of the cybersquatter.

107. 141 F.3d 1316 (9th Cir. 1998)

108. *Id.*

109. *Id.* at 1318.

110. *Id.* at 1319.

111. *Id.* at 1324-26.

112. S. REP. NO. 106-140, at 14 (1999).

moved a loophole that sophisticated cybersquatters had previously used to avoid liability under the FTDA.<sup>113</sup> Congress also removed the need for courts to expand the definition of "use in commerce" beyond the FTDA's intended scope. Under the ACPA's bad faith intent to profit analysis, courts are now permitted to consider any commercial behavior engaged in by cybersquatters that indicates their registration was in bad faith.<sup>114</sup>

Commercial use is implicated in four of the nine nonexclusive factors,<sup>115</sup> one of which was found to be influential in *Sporty's Farm*. The Second Circuit held that Omega's formation of a business to sell goods on the eve of *Sporty's Farm's* trial date was not a "bona fide business" indicative of good faith under factor three.<sup>116</sup> In addition, the Second Circuit exercised its discretion under the ACPA to introduce other factors indicative of bad faith, noting that the most persuasive reason for its holding was the fact that Omega registered the domain name merely to keep it away from a "future [business] competitor."<sup>117</sup> Hence, "commercial use" has been relegated from a liability stumbling block under the FTDA to a number of relevant, but discretionary, factors in determining liability under the ACPA.

### C. The Lack of Deterrence under the FTDA

Congress deemed the FTDA an inadequate deterrent to cybersquatting because the threat of sanction did not outweigh the reward gained by engaging in the wrongful behavior.<sup>118</sup> Even if the FTDA made cybersquat-

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113. *Id.* at 7.

114. 15 U.S.C.A. § 1125(d)(1)(B)(i) (West Supp. 2000).

115. Under factor three of the bad faith intent to profit analysis, if the defendant has previously used the domain name in "connection with the bona fide offering of any goods or services," then the court may find evidence of good faith. *Id.* § 1125(d)(1)(B)(i)(III). The fifth factor of the bad faith intent to profit analysis directs a court to inquire into the registrant's intent to "divert consumers from the mark owner's online location to a site accessible under the domain name that could harm the goodwill represented by the mark, either for commercial gain or with the intent to tarnish or disparage the mark, by creating a likelihood of confusion . . ." *Id.* § 1125(d)(1)(B)(i)(V). Under bad faith intent to profit factor six, a court may consider the registrant's attempt to sell the domain name without having first used, or intended to use, the domain name in a bona fide offering of goods or services, or the prior history of attempting to sell domain names. *Id.* § 1125(d)(1)(B)(i)(VI). Under bad faith intent to profit factor eight, a court can consider the person's acquisition of multiple domain names that the registrant knows to be infringing or commercially dilutive of a distinctive or famous mark. *Id.* § 1125(d)(1)(B)(i)(VIII).

116. *Sporty's Farm L.L.C. v. Sportsman's Market, Inc.*, 202 F.3d 489, 499 (2d Cir. 2000), *cert. denied*, 120 S. Ct. 2719 (2000).

117. *Id.*

118. See S. REP. NO. 106-140, at 7-8 (1999).

ting unlawful, if the liability the cybersquatter faced was not greater than the expected profit multiplied by the chance of making a sale, cybersquatting would not be deterred. Cybersquatters can effectively tie up a domain name in the .com top level domain merely by spending \$35 to register the name.<sup>119</sup> If found liable under the FTDA, a defendant will probably be forced to hand over the domain name to the actual mark holder,<sup>120</sup> but obtaining a judgment for damages is contingent upon the mark holder establishing damages and willful dilution.<sup>121</sup> Hence, before the enactment of the ACPA, most courts ended up merely transferring the domain name to the victor without levying a “punishment” against the cybersquatter.<sup>122</sup> Congress determined that the mere threat of losing the domain name was not enough of a deterrent to prevent cybersquatters from continuing their behavior.<sup>123</sup>

Congress solved this deterrence problem directly by drafting the ACPA to allow a mark holder to opt for statutory damages in lieu of actual damages.<sup>124</sup> The ACPA amends the Lanham Act to allow a court to award statutory damages in an amount not less than \$1,000 and not more than

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119. See Network Solutions, Inc., *Web Address Registration: What Does it Cost?*, at <http://www.networksolutions.com/catalog/domainname/> (last visited Feb. 1, 2001) (listing the price for registration of a secondary level domain name in various top level domains: \$35 per year to register a “.com” domain name, \$30 for a “.net,” \$50 for a “.tv,” and \$25 for a “.org”).

120. See, e.g., *Avery Dennison Corp. v. Sumpton*, 999 F. Supp. 1337, 1342 (C.D. Cal. 1998) (issuing an injunction ordering domain name transfer, with no accompanying damages award).

121. 15 U.S.C. §§ 1125(c)(2), 1117(a) (Supp. IV 1998). Even assuming a plaintiff can establish willful intent, proving damages can be difficult. See S. REP. NO. 106-140, at 7 (1999); see also *Electronics Boutique Holdings Corp. v. Zuccarini*, 56 U.S.P.Q.2d 1705, 1711 (E.D. Pa. 2000) (emphasizing that the actual damages suffered by the mark holder as a result of cybersquatting were “incalculable”).

Some courts have erected yet another barrier for plaintiffs seeking to use the FTDA—requiring proof of actual, rather than likely, harm to establish dilution. See, e.g., *Ringling Bros.-Barnum & Bailey Combined Shows, Inc. v. Utah Div. of Travel Development*, 170 F.3d 449, 464-65 (4th Cir. 1999) (in order to maintain a cause of action under the FTDA, the complainant must establish actual damages, rather than merely a “likelihood of dilution,” through proof of actual loss or a skillfully constructed consumer survey). For a summary and analysis of the current circuit split on this issue, see Matthew S. Voss, Note, *Ringling Bros.-Barnum & Bailey Combined Shows, Inc. v. Utah Division of Travel Development & Nabisco, Inc. v. PF Brands, Inc.*, 15 BERKELEY TECH. L.J. 265 (2000).

122. *Avery Dennison*, 999 F. Supp. at 1342 (issuing an injunction ordering domain name transfer, but requiring the plaintiff to pay reasonable compensation for the domain name).

123. See S. REP. NO. 106-140, at 7 (1999).

124. 15 U.S.C.A. § 1117(d) (West Supp. 2000).

\$100,000 per domain name, as the court considers just.<sup>125</sup> The mark holder may opt for either remedy up until judgment is rendered, allowing him to choose the most favorable remedy if he can prove actual damages.<sup>126</sup> At least one court has taken full advantage of these new damages provisions, choosing to award the maximum penalty of \$100,000 per domain name against a cybersquatter who, according to the court, "boldly thumbs his nose at the rulings of [the] court and the laws of our country."<sup>127</sup>

The threat of such a large damage award clearly provides a disincentive to cybersquatting, one that may have deterred the defendant in *Sporty's Farm* from ever registering sportys.com if faced with the same decision today. As online businesses contemplate marketing schemes, such as Omega's plan to prevent Sportsman's from using its unique identifier online,<sup>128</sup> they will have to consider the probability that a large penalty will be levied against them if they are found to have a bad faith intent to profit.

#### **D. The Difficulty Proceeding against Online Defendants under the FTDA**

The global nature of cybersquatting gives rise to problems dealing with jurisdiction and service of process, which may be insurmountable without the ability to proceed in rem<sup>129</sup> against cybersquatters. Trademark holders attempting to police their marks are faced with a significant problem when cybersquatters register domain names under aliases or provide

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125. *Id.* In order to avoid problems with retroactivity, the damages provision does not apply to domain names that were registered before the enactment of the ACPA. *Id.* The applicability provisions following the text of the statute provide that the ACPA injunctive remedy applies to all registrations, but the damages provision does not apply to registrations that occurred before enactment of the ACPA on November 29, 1999. Consolidated Appropriations Act, 2000, Pub. L. No. 106-113, Div. B, § 1000(a)(9), 113 Stat. 1536, 1537 (1999).

126. See 15 U.S.C.A. § 1117(d) (West Supp. 2000).

127. *Electronics Boutique Holdings Corp. v. Zuccarini*, 56 U.S.P.Q.2d 1705, 1713 (E.D. Pa. 2000) (also awarding attorney's fees and an injunction order to transfer the domain names). At present, few published decisions on the damages provision of the ACPA are available. For another example, see *United Greeks, Inc. v. Klein*, 2000 WL 554196 (N.D.N.Y. 2000) (denying mark holder's request for \$10,000 per domain name, instead awarding \$2,000 per domain name, for a total of \$10,000 statutory damages).

128. See *Sporty's Farm L.L.C. v. Sportsman's Market, Inc.*, 202 F.3d 489, 499 (2d Cir. 2000), *cert. denied*, 120 S. Ct. 2719 (2000).

129. In certain situations where a defendant's property violates the law, but the defendant cannot be located, courts have allowed an in rem suit—a suit against the property itself. Rule 4(n) of the Federal Rules of Civil Procedure authorizes federal courts to exercise in rem jurisdiction over property within their domain if a federal statute so provides. FED. R. CIV. P. 4(n).

false contact information.<sup>130</sup> When there are multiple defendants, the problem compounds itself.<sup>131</sup> Without being able to locate, identify, or serve process on the owner of a potentially diluting domain name, a mark holder is left without legal remedy unless he is allowed to proceed in rem.

This problem poses yet another barrier to pursuing cybersquatters under the FTDA. In *Porsche Cars North America, Inc. v. Porsch.com*,<sup>132</sup> the District Court for the Eastern District of Virginia held that a mark holder could not proceed in rem against a domain name under the FTDA. Porsche had identified 128 domain names consisting of common misspellings and combinations using the mark "Porsche," registered by various individuals.<sup>133</sup> Porsche filed an in rem proceeding under the FTDA against the domain names, but the court held that even though the FTDA does not expressly preclude an in rem cause of action, "its language speaks strongly in favor of allowing in personam actions alone."<sup>134</sup> As a result, a cybersquatter might be able to evade judicial sanction by providing false or misleading contact information that prevents the mark holder from effectively serving process.

Congress addressed this problem in a manner that seems to respond directly to the concerns raised in *Porsche*.<sup>135</sup> Under the ACPA, a mark holder may file an in rem action against the domain name itself if the registrant cannot be located after reasonable efforts or if personal jurisdiction cannot be obtained.<sup>136</sup> The fact that several mark holders have already

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130. S. REP. NO. 106-140, at 10 (1999).

131. Which is not uncommon given the multitude of possible variations on any trademarked name.

132. *Porsche Cars N. Am., Inc. v. Porsch.com*, 51 F. Supp. 2d 707, 713 (E.D. Va. 1999).

133. *Id.* at 709.

134. *Id.* at 712 (noting that the language of the FTDA speaks strongly in favor of allowing in personam actions alone because the Act remedies only another "person's" use of the mark, and assesses damages against a "person"). While some of the domain name registrants' identities and addresses were unknown (such that an in personam action would be futile), most were known. *Id.* The court noted that the Due Process Clause requires "at least some appreciation" of the difference between defendants that cannot be reached and those that can. *Id.* at 713 (registrants whose identities and addresses are known would rightly object to having their interests adjudicated in absentia). Since Porsche's pursuit of an in rem remedy failed to differentiate between the two different classes of defendants, the complaint had to be dismissed as to all defendants. *Id.*

135. In fact, it seems Congress intended to address the case directly. See *Cybersquatting and Consumer Protection: Ensuring Domain Name Integrity* (Fed. News Service, July 22, 1999) (Prepared statement of Senator Spencer Abraham before the Senate Judiciary Committee).

136. 15 U.S.C.A. § 1125(d)(2) (West Supp. 2000). The plaintiff in *Sporty's Farm* would not have been permitted to take advantage of the in rem provision, since the de-

taken advantage of the in rem cause of action under the ACPA is practical evidence of the existing need that this provision satisfies.<sup>137</sup>

A mark holder proceeding in rem might be faced with the dilemma of having to prove a cybersquatter's bad faith intent to profit without knowledge of the squatter's identity. To ease this problem, under the ACPA a court may consider under factor seven a domain name registrant's provision of "material and misleading false contact information when applying for the registration of the domain name, the person's intentional failure to maintain accurate contact information, or the person's prior contact indicating a pattern of such conduct" in deciding whether the requisite bad faith intent to profit exists.<sup>138</sup> This factor might be the only helpful indicator of bad faith intent to profit when a mark holder proceeds in rem because the defendant could not be located. One court faced with this situation noted that factor seven, coupled with the similarity of the offending mark, "may well be sufficient to enable a plaintiff facing a defaulting domain name to obtain an in rem judgment against the domain name."<sup>139</sup> Courts might also choose to exercise their discretion when conducting the bad faith intent to profit analysis<sup>140</sup> and characterize the defendant's failure to show up at the hearing as evidence of bad faith. On the whole, Congress seems to have addressed effectively the problems presented when proceeding against difficult to reach or numerous cybersquatters such as those in the *Porsche* case.

### E. The ACPA's Dark Side

The strength of this new weapon against cybersquatters may not have come without a cost. The "free spirit" that has pervaded the Internet since its inception has arguably been dampened by this new legislation.<sup>141</sup> The

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fendant was clearly identified and personal jurisdiction was established. *See Sporty's Farm L.L.C. v. Sportsman's Market, Inc.*, 202 F.3d 489, 494 (2d Cir. 2000), *cert. denied*, 120 S. Ct. 2719 (2000).

137. *See, e.g.*, *Broadbridge Media, L.L.C. v. Hypercd.com*, 106 F. Supp. 2d 505 (S.D.N.Y. 2000); *Harrods v. Sixty Domain Names*, 110 F. Supp. 2d 420 (E.D. Va. 2000). As an interesting note, see White, *supra* note 95 (discussing how panels applying the UDRP deal with "defaulting" defendants, since ICANN's UDRP has no formal method of dealing with the situation when the defendant fails—for whatever reason—to participate in the arbitration proceedings).

138. 15 U.S.C.A. § 1125 (d)(1)(B)(i)(VII) (West Supp. 2000).

139. *Harrods*, 110 F. Supp. 2d, at 427.

140. *See* 15 U.S.C.A. § 1125 (d)(1)(B)(i) (West Supp. 2000).

141. *See* Jessica Litman, *The DNS Wars: Trademarks and The Internet Domain Name System*, 4 J. SMALL & EMERGING BUS. L. 149 (2000) (arguing that the ACPA, by unnecessarily empowering trademark owners, favors commercial speech over other forms

ACPA drafters made efforts to ensure that fair use and First Amendment rights were not impinged upon,<sup>142</sup> but any chilling effect on such domain name uses is difficult, if not impossible, to measure. The drafters of the FTDA noted that one of the reasons the bill adequately protected First Amendment rights was the fact that the bill did not prohibit noncommercial expression.<sup>143</sup> Under the ACPA, however, this limitation is now removed. Even more significantly, the ACPA's new statutory damages provision allows trademark owners—or their lawyers—to mention in their “cease and desist” letter that a court may award up to \$100,000 in statutory damages, regardless of the use the registrant made of the domain name.<sup>144</sup> Although Congress explicitly mentions examples of “acceptable” domain name registrations, such as the registration of pokey.org for a child nicknamed Pokey,<sup>145</sup> it is unlikely that the mark owner will mention this in its letter. It seems more likely that domain name holders will give

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of speech online—allowing mark owners to further suppress other online uses by amateurs, critics, fans, and children).

142. In developing this new cause of action on behalf of trademark holders, the drafters of the ACPA intended to balance the legitimate interests of good faith Internet users with attempts to clarify the law for trademark holders and online consumers. S. REP. NO. 106-140, at 8-9 (1999). The ACPA has a savings clause that explicitly preserves the traditional trademark defenses, such as fair use, comparative advertising, and First Amendment rights (such as free speech, parody, comment, criticism, and news reporting). 15 U.S.C.A. § 1051 (West Supp. 2000) (“Savings Provisions” following the text of the statute); *see also* S. REP. NO. 106-140, at 11 (1999). In addition, the ACPA was amended after presentation to include a provision intended to balance cybersquatting deterrence with protected trademark uses online by limiting the cause of action to only bad faith registrations and uses of others' marks by persons who seek to profit unfairly from the goodwill associated therewith. S. REP. NO. 106-140, at 8-10 (1999). Bad faith intent to profit cannot be found in any case in which the court determines that the person reasonably believed that the use of the domain name was a fair use or otherwise lawful. 15 U.S.C.A. § 1125 (d)(1)(B)(ii) (West Supp. 2000). In addition, the first four bad faith intent to profit factors provide “wobble room” for courts to consider the good faith use of a registrant. *See id.* § 1125 (d)(1)(B)(i)(I)-(IV). Moreover, the ACPA provides for costs & attorney's fees to the winner of an action, which may help restore a junior mark user that successfully litigates against a bullying senior user. S. REP. NO. 106-140, at 11 (1999). The ACPA also allows a domain name holder who proves that the trademark holder had insufficient basis for an action under the ACPA to collect any damages incurred as a result of the suit. *Id.*

143. H. REP. NO. 104-374, at 4 (1995) (noting that the bill adequately protects First Amendment rights because it does not prohibit noncommercial expression & explicitly exempts from liability traditional “fair uses” of a mark).

144. A damages provision dubbed “draconian” by some. *See Litman, supra* note 141 (noting that Senator Patrick Leahy referred to the bill's provisions as “draconian”).

145. S. REP. NO. 106-140, at 13 (1999).

up their names, regardless of any good faith intent to use, rather than face such a large, unfettered penalty.<sup>146</sup>

#### IV. CONCLUSION

The Second Circuit in *Sporty's Farm* was accurate in stating that the ACPA "constitutes a particularly good fit" for the facts of the case.<sup>147</sup> *Sporty's Farm* is representative of one type of case for which the ACPA was designed. Although the same result may have been warranted under the FTDA in this case, the ACPA truly provides courts with "a preferable alternative to stretching federal dilution law" by enumerating factors uniquely tailored to cybersquatting cases.<sup>148</sup>

Aside from the damages provision, the ACPA seems a generally appropriate solution to the problems presented when applying the FTDA to cybersquatters, even if there is some potential for undesired side effects. Congress has addressed the FTDA's problems with a flexible solution that gives courts the discretion to consider culpable patterns of behavior that might become apparent in the future. Given the need for new legislation<sup>149</sup> and the benefits of a law that is capable of adapting as technology advances, any chilling effect on good faith domain name registrants is probably a tolerable side effect.

The ACPA statutory damages provision clearly satisfies Congress's desire to deter cybersquatting, but an alternative solution that provides some guidance to the courts when determining the amount of statutory damages would probably be just as effective, yet have less of a chilling effect on good faith users. Congress gave courts broad discretion in determining liability but at the same time provided guidance to the courts in the form of a multi-factor test<sup>150</sup> with limitations.<sup>151</sup> Similar guidance seems appropriate when determining damages. One court faced with the problem of determining statutory damages considered several factors, including the

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146. For discussion from the viewpoint that the ACPA is bad for good faith users and small business owners, see The Domain Name Right Coalition, Home Page, at <http://www.netpolicy.com/dmainindex.html> (last visited Feb. 2, 2001).

147. *Sporty's Farm L.L.C. v. Sportsman's Market, Inc.*, 202 F.3d 489, 497 (2d Cir. 2000), *cert. denied*, 120 S. Ct. 2719 (2000).

148. *Id.*

149. See S. REP. NO. 106-140, at 7 (1999).

150. The "bad faith intent to profit" factors. 15 U.S.C.A. § 1125(d)(1)(B) (West Supp. 2000).

151. Bad faith intent to profit cannot be found in any case in which the court determines that the person reasonably believed that the use of the domain name was a fair use or otherwise lawful. *Id.* § 1125 (d)(1)(B)(ii).

defendant's overall profits from cybersquatting (not just profits from the domain names at issue in the case), the likelihood that his other domain names were infringing (evidenced by mark similarity and other suits or demands pending against him), the type of individual or organization that was "squatting" on (e.g., public health organizations), and the defendant's prior violations of the ACPA.<sup>152</sup> Whether such factors are appropriate is beyond the scope of this Note, but good faith domain name registrants would probably be better served if Congress provided at least some guidance or restrictions to assist courts in making this determination.

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152. *Electronics Boutique Holdings Corp. v. Zuccarini*, 56 U.S.P.Q.2d 1705, 1711-13 (E.D. Pa. 2000).

## ICANN'S UNIFORM DOMAIN NAME DISPUTE RESOLUTION POLICY IN ACTION

*By John G. White*

Domain names are prime real estate on the information superhighway. With the right domain in hand, individuals and corporations can reap the rewards of the Internet and electronic commerce revolution. But getting the domain name you want is not always easy.

For much of the Internet's relatively short history, Network Solutions, Inc. ("NSI") had exclusive control over the domain name system and registered domain names on a first-come, first-served basis.<sup>1</sup> NSI's monopoly drew considerable criticism and eventually calls for change.<sup>2</sup> In late 1998, the Internet Corporation for Assigned Names and Numbers ("ICANN")<sup>3</sup> took over management of the domain name system. Despite the changes, first-come, first-served remained the principal criterion for registration. This lack of regulation, combined with the low cost of domain name registration,<sup>4</sup> provided ample incentive for enterprising individuals to register

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1. See Kevin Eng, Note, *Breaking Through the Looking Glass: An Analysis of Trademark Rights in Domain Names Across Top Level Domains*, 6 B.U. J. SCI. & TECH. L. 7 (2000), available at <http://www.bu.edu/law/scitech/volume6/Eng.htm>; Diane Cabell, *Overview of Domain Name Policy Development*, at <http://eon.law.harvard.edu/udrp/overview.html> (last modified Apr. 20, 2000) [hereinafter Cabell, *Overview*]. Although domain name registration is international in scope, approximately eighty percent of all domain names are registered in the United States. Diane Cabell, *Foreign Domain Name Disputes 2000*, THE COMPUTER & INTERNET LAWYER, Oct. 2000, at 5 [hereinafter Cabell, *Foreign*].

2. For background information on NSI and the creation of ICANN, see Luke A. Walker, Note, *ICANN's Uniform Domain Name Dispute Resolution Policy*, 15 BERKELEY TECH. L.J. 289 (2000).

3. ICANN is a non-profit corporation dedicated to preserving the operational stability of the Internet. For more information, see ICANN, at <http://www.icann.org> (last modified Jan. 23, 2001).

4. NSI charges \$35.00 per year for basic .com domain name registration services. Network Solutions, Inc., *Web Address Registration*, at [http://www.networksolutions.com/en\\_US/catalog/domainname/](http://www.networksolutions.com/en_US/catalog/domainname/) (last visited Jan. 25, 2001).

domain names resembling well-known trademarks with the hopes of hitting the jackpot.<sup>5</sup> Cybersquatting was born.

Cybersquatting encompasses several distinct activities. The traditional cybersquatter registers domain names based on trademarks and tries to sell the domain names to the mark owners for a hefty profit.<sup>6</sup> A related practice is "cyberpiracy." A cyberpirate registers a domain name incorporating a variation of a trademarked term and uses it for a website that lures traffic intended for the mark owner's site.<sup>7</sup> Another variation is "typo-squatting." A typo-squatter registers domain names that incorporate variations of well known marks such as misspellings or missing characters (e.g., yahoo.com)<sup>8</sup> to take advantage of unsuspecting web surfers.<sup>9</sup> Finally, some people register domain names that resemble trademarks but never use them. These passive holders or "pseudo-cybersquatters"<sup>10</sup> do not construct active websites, make no offers to sell the domain names, and are often very difficult to contact.<sup>11</sup> This Note refers to pseudo-cybersquatting as "passive warehousing."

Cybersquatting is widely condemned.<sup>12</sup> Early efforts in the United States to combat cybersquatting involved traditional trademark infringe-

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5. See generally John Allen Howard Jr., *New Developments in Internet Law: The Anticybersquatting Consumer Protection Act (ACPA) and the ICANN Dispute Resolution Policy*, 23 AM. J. TRIAL ADVOC. 735 (2000).

6. Thomas R. Lee, *In Rem Jurisdiction in Cyberspace*, 75 WASH. L. REV. 97, 104 (2000).

7. *Id.* at 105; see also Cabell, *Overview*, *supra* note 1.

8. Yahoo! Inc. and GeoCities v. Data Art Corp., DataArt Enters., Inc., Stonybrook Invs., Global Net 2000, Inc., Powerclick, Inc., Yahoo Search, Inc., WIPO, No. D2000-0587, at <http://arbiter.wipo.int/domains/decisions/html/d2000-0587.html> (Aug. 10, 2000).

9. Robert D. Gilbert, *Squatters Beware: There Are New Ways to Get You*, NEW YORK L.J., Jan. 24, 2000, at T5; see also Rebecca W. Gole, *Playing the Name Game Two: A Glimpse at the Future of the Internet Domain Name System*, 51 FED. COMM. L.J. 403 (1999).

10. Gilbert, *supra* note 9.

11. More complex domain name disputes involve parties with roughly equal claims to domain names, such as businesses with the same or similar trademark. Unlike traditional "brick and mortar" markets where businesses in different industries or geographic locations can trademark similar or even identical names and coexist, domain names must be unique. Thus, a company with a legitimate trademark interest may be locked out of cyberspace without a clear remedy. This bleak prospect has fueled a frantic race by companies to register as many domain names as possible, often shutting out their competitors. Disputes involving this "racing" phenomenon involve in-depth factual inquiries and fall outside of the UDRP's scope. Gole, *supra* note 9, at 404-05.

12. See Walker, *supra* note 2, at 305-06 (discussing cybersquatting's effects on e-commerce); see also Cabell, *Foreign*, *supra* note 1, at 15 (discussing recent judicial and

ment and dilution claims.<sup>13</sup> While trademark owners achieved some success, results were inconsistent.<sup>14</sup> There were also early efforts to develop domain name dispute resolution programs; however, these programs achieved mixed results.<sup>15</sup> It became clear that society needed new legal institutions to resolve domain name disputes more effectively. In response, two new institutions emerged. The first is the Anticybersquatting Consumer Protection Act ("ACPA").<sup>16</sup> The ACPA provides trademark owners with new weapons to use against cybersquatters in court.<sup>17</sup> The second institution is ICANN's Uniform Domain Name Dispute Resolution Policy ("UDRP" or "the Policy").<sup>18</sup>

In order to succeed, the UDRP must balance the need to provide clear guidance that promotes fair and consistent decisions with the need to maintain adequate flexibility so that it applies to various factual situations under different legal systems. The UDRP's application to passive warehousing tests this delicate balance. While the UDRP clearly targets traditional cybersquatters, cyberpirates, and typo-squatters, its application to passive warehousing is less clear.<sup>19</sup> This Note analyzes how dispute resolution panels have taken advantage of the UDRP's inherent flexibility to develop a doctrine that, when properly applied, effectively addresses the problem of passive warehousing. The Note urges ICANN to take immediate steps to clarify the Policy's application to passive warehousing to ensure fair and efficient results.

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legislative developments around the world aimed at cracking down on cybersquatting); Jessica Litman, *The DNS Wars: Trademarks and the Internet Domain Name System*, 4 J. SMALL & EMERGING BUS. L. 149, 155-58 (2000).

13. Eng, *supra* note 1.

14. *Id.*; see also Litman, *supra* note 12, at 153-55 (citing and discussing several early cybersquatting cases, including *Panavision Int'l, L.P. v. Toeppen*, 141 F.3d 1316 (9th Cir. 1998)).

15. Walker, *supra* note 2, at 295-96 (discussing NSI's early dispute resolution programs).

16. 15 U.S.C.A. § 1125(d) (West Supp. 2000).

17. For an analysis of the ACPA, see P. Wayne Hale, Note, *Anticybersquatting Consumer Protection Act & Sporty's Farm v. Sportsman's Market*, 16 BERKELEY TECH. L.J. 205 (2001).

18. ICANN, *Uniform Domain Name Dispute Resolution Policy*, at <http://www.icann.org/udrp/udrp-policy-24oct99.htm> (Oct. 24, 1999) [hereinafter *UDRP*].

19. See *id.* § 4.

## I. BACKGROUND

### A. Overview of UDRP Processes and Procedures

Under ICANN rules, all registrars in the .com, .net, and .org top-level domains (“TLDs”) and their customers must participate in the UDRP.<sup>20</sup> The Policy requires parties to resolve most trademark-based<sup>21</sup> domain name disputes by agreement, court proceedings, or arbitration before a registrar can cancel, suspend, or transfer a domain name.<sup>22</sup> The cornerstone of the UDRP is a streamlined administrative proceeding designed to resolve cybersquatting cases.<sup>23</sup>

#### 1. *Approved Dispute Resolution Providers*

There are currently four ICANN-approved dispute resolution providers authorized to conduct administrative proceedings: the World Intellectual Property Organization (“WIPO”); the National Arbitration Forum (“NAF”); CPR Institute for Dispute Resolution (“CPR”); and eResolution (“eRes” or “DeC”).<sup>24</sup> WIPO has decided the majority of cases to date, followed by NAF, eRes, and CPR.<sup>25</sup> WIPO is popular with trademark owners because most of its panelists are lawyers or professors who are experi-

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20. ICANN, *Uniform Domain-Name Dispute-Resolution Policy, General Information*, at <http://www.icann.org/udrp/udrp.htm> (last modified June 17, 2000) [hereinafter *UDRP General Information*]. Efforts are underway to approve seven new TLDs: .aero, .biz, .coop, .info, .museum, .name, and .pro. ICANN announced initial approval of these TLDs on November 16, 2000. Negotiations with the new registrars are ongoing, and the adoption of the new TLDs is subject to final approval by the ICANN Board. The new TLDs should increase the supply of desirable domain names and might help reduce the number of domain name disputes. ICANN, Press Release, *ICANN Announces Selections For New Top-Level Domains*, at <http://www.icann.org/announcements/icann-pr16nov00.htm> (Nov. 16, 2000); see also Aaron Pressman, *ICANN: 7 Out of 44 Ain't Bad*, THE STANDARD, at <http://www.thestandard.com/article/display/0,1151,20272,00.html> (Nov. 16, 2000).

21. Efforts are underway to expand the UDRP to domain name disputes involving personal names, international nonproprietary names, international governmental organizations, geographical terms, and trade names. Tony Kreindler, *WIPO Launches Talks to Expand Domain Name Dispute Policy*, ADRWORLD.COM, at <http://adrworld.com> (July 12, 2000).

22. *UDRP General Information*, *supra* note 20.

23. *Id.*

24. ICANN, *Approved Providers for Uniform Domain Name Dispute Resolution Policy*, at <http://www.icann.org/udrp/approved-providers.htm> (last modified Oct. 17, 2000).

25. See ICANN, *List of Proceedings Under Uniform Domain Name Dispute Resolution Policy, UDRP Proceedings—Arranged by Proceeding Number*, at <http://www.icann.org/udrp/proceedings-list-number.htm> (last modified Jan. 24, 2001).

enced in trademark law.<sup>26</sup> By contrast, many of NAF's panelists are retired state court judges with limited trademark experience.<sup>27</sup>

Each provider follows unique procedures (although all procedures must be consistent with the Policy and the Rules)<sup>28</sup> and has its own fee schedule. For example, NAF charges \$750 for a single panelist to hear a case involving one disputed domain name; CPR charges \$2,000 for the same service.<sup>29</sup> The Complainant<sup>30</sup> gets to choose the provider and can elect to have a single panelist or three-person panel.<sup>31</sup> The Complainant pays all fees, unless the Respondent requests a three-person panel, in which case the parties split the cost.<sup>32</sup>

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26. See WIPO, *WIPO Domain Name Panelists*, at <http://arbiter.wipo.int/domains/panel/panelists.html> (last modified Jan. 24, 2001); see also Tamara Loomis, *Domain Names: Disputes Get Swift Resolution Under UDRP*, N.Y. L.J., July 27, 2000, at 5; Elizabeth Wasserman, *The New Masters of Domains*, THE STANDARD, at <http://www.thestandard.com/article/display/0,1151,17941,00.html> (Aug. 28, 2000).

27. See NAF, *List of Qualified Dispute Resolution Panelists*, at <http://www.arbforum.com/domains/domain-judges.html> (last visited Jan. 25, 2001); see also Loomis, *supra* note 26. Panelists at eRes and CPR come from diverse backgrounds, including lawyers, retired judges, and professors. See eRes, *List of Panelists*, at <http://www.eresolution.ca/services/dnd/arbitrators.htm> (last modified Jan. 10, 2001); CPR, *CPR Specialized Panels*, at [http://www.cpradr.org/specpan\\_domainname.htm](http://www.cpradr.org/specpan_domainname.htm) (last visited Jan. 25, 2001).

28. See ICANN, *Rules for Uniform Domain Name Dispute Resolution Policy*, at <http://www.icann.org/udrp/udrp-rules-24oct99.htm> (Oct. 24, 1999) [hereinafter *UDRP Rules*].

29. NAF, *Schedule of Fees*, at <http://www.arbforum.com/domains/domain-fees.html> (last visited Jan. 25, 2001); CPR, *CPR's Supplemental Rules and Fee Schedule*, at [http://www.cpradr.org/ICANN\\_RulesAndFees.htm](http://www.cpradr.org/ICANN_RulesAndFees.htm) (last visited Jan. 25, 2001). WIPO charges \$1,500 and eRes charges \$1,250 for the same service. Different rates apply for three-person panels and multiple domain names.

WIPO, *Schedule of Fees Under the ICANN Policy*, at <http://arbiter.wipo.int/domains/fees/index.html> (Aug. 15, 2000); eRes, *Schedule of Fees*, at <http://www.eresolution.ca/services/dnd/schedule.htm> (last modified Jan. 4, 2001).

30. The Complainant is always the trademark owner. The Respondent is always the domain name holder.

31. See *UDRP Rules*, *supra* note 28, § 6. If the Complainant elects to use a single panelist, the provider chooses the actual panelist. When either or both parties elect to have a three-person panel, each party gets to select a panelist and the provider selects a panelist. A recent study noted that parties select one-person panels over ninety percent of the time. M. Scott Donahay & Vijaya Rangan Palaniswamy, *The ICANN Cybersquatting Decisions #5*, at <http://eon.law.harvard.edu/udrp/decisions/2000-5.html> (last visited Jan. 25, 2001).

32. *UDRP*, *supra* note 18, § 4(g).

## 2. UDRP Proceedings

Proceedings begin when a trademark holder files a complaint with the dispute resolution service provider of choice.<sup>33</sup> To prevail, a Complainant must assert *and* prove that: (1) the domain name is identical or confusingly similar to the Complainant's trademark or service mark; (2) the domain name holder has no rights or legitimate interests in the domain name; and (3) the domain name was registered and is being used in bad faith.<sup>34</sup>

Complainants generally have little difficulty meeting the "identical or confusingly similar" requirement, as long as they have clear trademark rights.<sup>35</sup> A domain name is confusingly similar to a mark if it is similar in sound, appearance, and connotation; for example, the addition or deletion of a single letter is usually not enough to prevent a finding of likely confusion.<sup>36</sup> Furthermore, top-level domains (e.g., .com, .org) are not source-identifiers and therefore do not affect a term's overall meaning or similarity.<sup>37</sup>

Complainants must also establish that domain name holders do not have rights or legitimate interests in the disputed domains. Although section 4(a) of the Policy appears to place the overall burden of proof on the Complainant, many panels shift the burden regarding this factor to the Re-

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33. *UDRP Rules*, *supra* note 28, § 3.

34. *UDRP*, *supra* note 18, § 4(a).

35. *See, e.g.*, *Lowestfare.com LLC v. US Tours & Travel, Inc.*, DeC, No. AF-0284, at <http://www.eresolution.ca/services/dnd/decisions/0284.htm> (Sept. 9, 2000) (noting that Respondent registered the domain name thelowestfare.com six months before Complainant filed for mark registration and the "complex fact-based judgment concerning the validity or strength of the Complainant's alleged mark is not one that is intended to be made by the UDRP"); *Media West-GSI, Inc., and Gannett Satellite Info. Network, Inc. v. EARTHCARS.COM, Inc.*, WIPO, No. D2000-0463, at <http://arbitrator.wipo.int/domains/decisions/html/d2000-0463.html> (July 28, 2000) (holding that the term freepressclassifieds.com was not inherently distinctive and had not acquired secondary meaning, noting that Complainant had not registered the mark and failed to present evidence of consumer surveys).

36. *See, e.g.*, *Ty, Inc. v. O.Z. Names*, WIPO, No. D2000-0370, at <http://www.arbitrator.wipo.int/domains/decisions/html/d2000-0370.html> (June 27, 2000) (holding that the domain name beanybabies.com is confusingly similar to the Complainant's mark "Beanie Babies").

37. *See, e.g.*, *Microsoft Corp. v. Amit Mehrotra*, WIPO, No. D2000-0053, at <http://arbitrator.wipo.int/domains/decisions/html/d2000-0053.html> (Apr. 10, 2000) (holding that the domain name microsoft.org is identical to the Complainant's mark microsoft.com).

spondent.<sup>38</sup> The Policy lists three nonexclusive factors that indicate a Respondent's rights and interests in a domain name.<sup>39</sup>

Finally, a Complainant must establish that the Respondent both registered *and* used a domain name in bad faith. Proving bad faith is often the Complainant's biggest challenge.<sup>40</sup> The Policy lists four nonexclusive factors to consider in finding bad faith registration and use.<sup>41</sup> Part III discusses the bad faith requirement in detail.

Once a dispute resolution service provider receives a complaint, it follows the communications requirements in section 2 of the Rules to ensure that the Respondent receives actual and timely notice. Respondents have twenty days from the date the proceedings started to submit their response.<sup>42</sup> A response must specifically address the allegations in the complaint and explain why the Respondent should retain registration and use of the disputed domain name.<sup>43</sup> Once a panel receives a timely response, it usually will not accept further submissions from either party.<sup>44</sup> If a Re-

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38. See, e.g., *Wine.com, Inc. v. Zvieli Fisher*, WIPO, No. D2000-0614, at <http://arbiter.wipo.int/domains/decisions/html/d2000-0614.html> (Sept. 11, 2000) (noting that Respondents should bear the burden since they are in possession of key facts regarding potential legitimate use and to do otherwise would place a "heavy burden . . . on Complainants"). This burden shifting is consistent with § 4(c) of the UDRP. *UDRP, supra* note 18, § 4(c).

39. *UDRP, supra* note 18, § 4(c). The three factors are: (1) Prior to notification of the dispute, the Respondent was using or planning to use the domain name in connection with a bona fide offering of goods or services; (2) the Respondent has been commonly known by the domain name, even without trademark or service mark rights; or (3) the Respondent made legitimate noncommercial or fair use of the domain name without intending to mislead consumers or to tarnish the mark for commercial purposes. *Id.*

40. Amy Benjamin, *Proceedings Under UDRP Are Off and Running*, NAT'L L.J., May 1, 2000, at C1.

41. *UDRP, supra* note 18, § 4(b)(i)-(iv). See discussion *infra* Part III.

42. *UDRP Rules, supra* note 28, § 5(a).

43. *Id.* § 5(b).

44. Panels have some flexibility in this matter. See, e.g., *CBS Broad. Inc. v. VanityMail Serv., Inc.*, WIPO, No. D2000-0379, at <http://arbiter.wipo.int/domains/decisions/html/d2000-0379.html> (June 2, 2000) (allowing a supplementary complaint and a response to the supplementary complaint). In addition, the NAF allows supplementary complaints and responses subject to an additional fee; some commentators argue that such a policy encourages forum shopping and may lead to inconsistent decisions. See, e.g., David H. Bernstein & Sheri L. Rabiner, *Litigating by E-Mail with 'UDRP': Lessons From New Dispute Resolution Procedure for Domain Name Disputes*, N.Y. L.J., Aug. 21, 2000, at S3.

spondent fails to submit a response within the required twenty-day period, the Respondent is in default.<sup>45</sup>

Upon receipt of the response or after the twenty-day period expires (if there is no response), the dispute resolution service provider appoints the panel members.<sup>46</sup> A panel must make its final decision within fourteen days of appointment, although minor delays do occur.<sup>47</sup> A panel does not hold hearings; it must decide a complaint based on the written record and "any rules and principles of law that it deems applicable."<sup>48</sup> Remedies under the UDRP include only the cancellation or transfer of domain name registration; monetary damages are not available.<sup>49</sup> A Respondent on the losing end of a decision can postpone the transfer or cancellation of a domain name by filing a court action within ten days.<sup>50</sup>

## B. UDRP Status Report

Since ICANN implemented the UDRP on January 3, 2000, parties have initiated over 2,700 proceedings and dispute resolution panels have issued over 1,900 decisions involving over 3,450 domain names.<sup>51</sup> Approximately eighty percent of the decisions to date favor the Complainant trademark owners.<sup>52</sup> Of the 1,900 decisions handed down by panels, Re-

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45. Panels may extend the deadline in exceptional circumstances. *UDRP Rules, supra* note 28, § 14. Part II of this Note discusses the consequences of default.

46. *UDRP Rules, supra* note 28, § 6.

47. *Id.* § 15.

48. *Id.* Some panels visit websites using disputed domain names to fill in gaps in the record, particularly when the Respondent defaults. *See, e.g.,* Cortefiel, S.A. v. Miguel Garcia Quintas, WIPO, No. D2000-0140, at <http://arbiter.wipo.int/domains/decisions/html/d2000-0140.html> (Apr. 24, 2000).

49. *UDRP, supra* note 18, § 4(i).

50. *Id.* § 4(k). A recent district court ruling held that it was not necessarily bound by UDRP proceedings. *See, e.g.,* Weber-Stephen Products Co. v. Armitage Hardware and Bldg. Supply, Inc., 2000 WL 562470 (N.D. Ill. 2000) (staying the case pending the outcome of UDRP proceedings, but declining to state what standard would apply to UDRP proceedings if challenged in court). A few Respondents have taken advantage of the opportunity to appeal to the courts. *See* Oscar S. Cisneros, *Beating Down Your Biggest Fan*, WIRED NEWS, <http://www.wired.com/news/print/0,1294,37929,00.html> (Aug. 3, 2000) (reporting that the owner of the enthusiast site *dodgeviper.com*, after losing a UDRP proceeding, planned to take the case to court). *But see* David G. Post, *Juries and the UDRP*, ICANN Watch, at <http://www.icannwatch.org/archives/essays/968331924.shtml> (Sept. 6, 2000) (remarking that few cases have been appealed to the courts).

51. ICANN, *Statistical Summary of Proceedings Under Uniform Domain Name Dispute Resolution Policy*, at <http://www.icann.org/udrp/proceedings-stat.htm> (last modified Jan. 24, 2001).

52. *Id.*

spondents defaulted in approximately fifty percent of the cases.<sup>53</sup> When Respondents defaulted, Complainants won over ninety percent of the time.<sup>54</sup>

The UDRP already has a faithful following, particularly among practitioners. Proponents stress that the decisions are fair and the process is quick, inexpensive, and simple.<sup>55</sup> While singing its praises, proponents are quick to note that the Policy has strict limits.<sup>56</sup> Despite its limitations, most practitioners see the UDRP as an excellent tool and plan to use it in tandem with litigation.<sup>57</sup>

Most proponents do not find the high Respondent default rate surprising, at least at this early stage. In fact, many see it as a good sign, indicating that the Policy is effectively targeting simple, clear-cut cases of cybersquatting.<sup>58</sup> In these cases, Respondents default "because you've got them."<sup>59</sup> Proponents predict that as the influx of strong cybersquatting cases wanes, the default rate will decrease and Respondents will enjoy more success.<sup>60</sup> That trend has yet to appear; case results through September 2000 show a steady if not increasing monthly default rate of forty-five to fifty-five percent.

The UDRP has its critics. Galvanized by a few arguably controversial decisions,<sup>61</sup> free speech activists, some academics, and other interested

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53. *Id.* The Respondents in most passive warehousing cases default.

54. Unless otherwise noted, all statistical data contained in this Note are that of the author.

55. See Bernstein & Rabiner, *supra* note 44; Matt Railo, *Trademark Owners Weigh Court vs. UDRP*, NAT'L L.J., July 24, 2000, at C1; M. Scott Donahey & Ryan S. Hilbert, Note, *World Wrestling Federation Entertainment, Inc. v. Michael Bosman: A Legal Body Slam for Cybersquatters on the Web*, 16 COMPUTER & HIGH TECH. L.J. 421, 427 (2000); Michael LiRocchi et al., *Trademarks and Internet Domain Names in the Digital Millennium*, 4 UCLA J. INT'L L. & FOR. AFF. 377, 443 (2000); Orrie Dinstein & Elisabeth Cappuyns, *Assessing the First 100 Days of ICANN's Dispute Plan*, N.Y. L.J., June 1, 2000, at 1.

56. For example, the Policy is limited to clear-cut cases of abusive registration and use and is not well suited to complex factual disputes. See Ritchenya A. Shepard, *Counselors' Domain-Name Pains*, NAT'L L.J., Sept. 4, 2000, at B1.

57. *Id.*

58. Loomis, *supra* note 26.

59. *Id.*

60. *Id.*

61. See, e.g., *J. Crew Int'l, Inc. v. crew.com*, WIPO, No. D2000-0054, at <http://arbiter.wipo.int/domains/decisions/html/d2000-0054.html> (Apr. 20, 2000) (ordering the transfer of the domain name crew.com to the Complainant); *Excelentísimo Ayuntamiento de Barcelona v. Barcelona.com Inc.*, WIPO, No. D2000-0505, at <http://arbiter.wipo.int/domains/decisions/html/d2000-0505.html> (Aug. 4, 2000) (ordering the transfer of the domain name barcelona.com to the Complainant).

parties decry the UDRP as biased in favor of trademark owners.<sup>62</sup> They argue that it provides an uncontested forum for trademark owners to challenge any domain name that is remotely similar to one of their marks, thereby expanding trademark rights at the expense of free speech rights.<sup>63</sup> While these claims may certainly have merit, it appears at a glance that the number of highly controversial cases is quite small.

Others argue that because the Policy defines many terms loosely, panels have too much freedom to interpret provisions, resulting in inconsistent decisions that may be at odds with the Policy.<sup>64</sup> In response, there are proposals to establish an appellate mechanism to resolve inconsistencies.<sup>65</sup> Others, however, point out that panels are citing to previous decisions at an increasing rate, which may eventually result in more stable and predictable results.<sup>66</sup> Other reform-minded proposals advocate expanding the UDRP to cover more than trademark infringement and providing parties

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62. See, e.g., Laurie J. Flynn, *Trademarks Winning Domain Fights*, N.Y. TIMES, at <http://www.nytimes.com/library/tech/00/09/biztech/articles/04neco.html> (Sept. 4, 2000); Litman, *supra* note 12, at 163; Domain Shame, at <http://www.domainshame.com> (last visited Jan. 26, 2001); The TLD Lobby, at <http://www.tldlobby.com/> (last visited Jan. 26, 2001); Brian Livingston, *Groups Cite Bias in Domain Name Arbitration*, CNET NEWS.COM, at <http://www.news.com/Perspectives/Column/0,176,459,00.html> (July 7, 2000).

63. Livingston, *supra* note 62. The UDRP does address reverse domain name hijacking (a bad faith attempt by a trademark owner to deprive a registered domain name holder of a domain name). However, there do not appear to be significant consequences for reverse domain name hijacking under the UDRP. *UDRP Rules*, *supra* note 28, §§ 1, 15(e) (directing panels to, when appropriate, declare that the complaint was brought in bad faith).

64. See, e.g., Cabell, *Overview*, *supra* note 1.

65. Center for Democracy & Technology, *Information About the Candidates: North America*, at <http://www.cdt.org/dns/icann/elections/namerica-detail.shtml> (last visited Jan. 26, 2001).

66. An ongoing study of UDRP decisions has found that approximately sixty to seventy percent of recently decided cases cite previous decisions. In more traditional arbitration forums, parties resolve disputes with little if any public disclosure. However, ICANN, the dispute resolution service providers, and new services such as Domain Name Law Reports publish UDRP decisions online. As a result, the public and panelists have easy access to decisions. While the official status of prior decisions is unclear and panels are generally supposed to reach decisions on a case-by-case basis, an international body of law is clearly developing as panels cite to previous decisions at an increasing rate. Most panels give prior decision some persuasive weight, while a few act as if they are bound by precedent. John Hartje, *Resolving Internet Domain Name Disputes*, INTELLECTUAL PROPERTY TODAY, Aug. 2000, at 38; see also Oscar S. Cisneros, *Streamlining Domain Squabbles*, WIRED NEWS, <http://www.wired.com/news/politics/0,1283,39591,00.html> (Oct. 26, 2000).

with more time to resolve disputes.<sup>67</sup> Part IV addresses some of these proposals.

## II. THE CONSEQUENCES OF DEFAULT

As discussed in Part I, Respondents have defaulted in fifty percent of the decided cases. Most passive warehousing cases involve Respondents that default; therefore, understanding what the Policy requires in default situations and how panels interpret the requirement sets the stage for analyzing the Policy's application to the special case of passive warehousing.

Section 14 of the Rules addresses default. When a Respondent defaults, a panel can reach a decision on the complaint and may draw appropriate inferences from the default.<sup>68</sup> Panels use two distinct approaches. The first approach involves interpreting the Policy and Rules literally, requiring Complainants to bear the burden of proof on all issues. The second approach involves interpreting the Policy and Rules more broadly, often shifting the burden of proof to the Respondent. Panels justify this approach based on the Policy's overall purpose of curbing abusive domain name registrations.

### A. The Literal Interpretation Approach

The panel in the *industrialproductfinder.com* case<sup>69</sup> applied a literal interpretation of the Policy. The panel stressed that a Complainant "bears the burden of pleading at least a prima facie case."<sup>70</sup> Because of the "highly expedited nature of administrative proceedings," the "relative lack of formal due process," and the "relative difficulty in assessing complex factual questions," Complainants must "offer at least some modicum of specific, factual allegations, not merely conclusory legal assertions."<sup>71</sup> Other panels have employed a similar approach.<sup>72</sup>

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67. Justin Kelly, *ICANN Board Member Calls for End to Domain Dispute Policy*, ADRWORLD.COM, at <http://www.adrworld.com> (Oct. 23, 2000).

68. Panels must treat parties fairly and follow applicable administrative requirements. Furthermore, if a Complainant is to prevail, it must prove that each of the three elements (identical or confusingly similar, no rights or legitimate interests, and registration and use in bad faith) are present. *UDRP Rules*, *supra* note 28, § 14; *see also UDRP*, *supra* note 18, § 4(a).

69. *Raj Vasant Pandit v. Vishal Bhuta*, DeC, No. AF-0224, at <http://www.eresolution.ca/services/dnd/decisions/0224.htm> (July 10, 2000).

70. *Id.* § 5(a).

71. *Id.* at n.9 (analogizing Complainant's burden to a summary judgment motion where the moving party may not rest upon mere allegations).

72. *See, e.g., Cyro Indus. v. Contemporary Design*, WIPO, No. D2000-0336, at <http://www.arbitrator.wipo.int/domains/decisions/html/d2000-0336.html> (June 19, 2000)

## B. The Broad Interpretation Approach

In contrast, many panels adopt a broad interpretation of the Policy in cases where the Respondent defaults. The *canadiansuperstores.com* panel<sup>73</sup> noted that a literal reading of the Policy and Rules would “fatally” impair a Complainant’s ability to meet its burden of proof when a Respondent “wholly disregards its obligations and submits no response.”<sup>74</sup> The panel stressed that “punishing [C]omplainants for failing to proffer evidence that is unavailable to them” and “creating an incentive to Respondents . . . to gain tactical advantage by evading their obligation to respond” is “inconsistent with the spirit and intent of the ICANN Policy.”<sup>75</sup> Of the two approaches, the broad interpretation is most prevalent.<sup>76</sup> It serves as the foundation for applying the Policy to passive warehousing.

## III. FINDING BAD FAITH USE—THE EMERGENCE OF THE INACTION DOCTRINE

During the development of the UDRP, there were concerns that the Policy’s dual requirement to find both bad faith registration and use<sup>77</sup> on the part of a domain name holder was too onerous.<sup>78</sup> Some predicted that because of this constraint, the Policy would not clearly apply to passive warehousing. That prediction came true. Panels almost immediately faced

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(holding that in cases of default, panels must pay special attention to evaluating the accuracy of Complainant’s submissions); *Softquad Software Inc. v. Eleven-Eleven Ltd., DeC*, No. AF-0143, at <http://www.eresolution.ca/services/dnd/decisions/0143.htm> (June 1, 2000) (stressing that in default cases, the burden of proving required elements remains with the Complainant).

73. *Loblaws, Inc. v. Charlo Barbosa, DeC*, No. AF-0163, at <http://www.eresolution.ca/services/dnd/decisions/0163.htm> (June 23, 2000).

74. *Id.* § 5.

75. *Id.*

76. *See, e.g., Slep-Tone Entm’t Corp. v. Sound Choice Disk Jockeys, Inc., NAF*, No. FA93636, at <http://www.arbforum.com/domains/decisions/93636.html> (Mar. 13, 2000) (ordering the transfer of the domain name *sound\_choice.com* despite the fact that the defaulting Respondent appeared to use the name in connection with a bona fide offering of services); *Wine.com, Inc. v. Zvieli Fisher, WIPO*, No. D2000-0614, at <http://arbiter.wipo.int/domains/decisions.html/d2000-0614.html> (Sept. 11, 2000) (stating that it would place a heavy burden on Complainants to require them to prove a Respondent’s lack of rights or legitimate interests in a mark).

77. *UDRP, supra* note 18, § 4(b).

78. ICANN, *Second Staff Report on Implementation Documents for the Uniform Dispute Resolution Policy* § 4.5(a), at <http://www.icann.org/udrp/udrp-second-staff-report-24oct99.htm> (Oct. 25, 1999) (refusing to change the requirement of both bad faith registration and use based on the late stage of the UDRP’s development process and the need for further study) [hereinafter *Second Staff Report*].

the challenge of inferring bad faith use in circumstances where a domain name holder had not used the disputed domain name in the traditional sense (no website, no e-mail address, and no attempts to sell or otherwise transfer the domain name).

Sections 4(b)(i)-(iv) of the Policy list four nonexclusive factors that panels should consider in determining bad faith registration and use: (1) acquiring a domain name primarily for the purpose of selling, renting, or otherwise transferring the domain name to a trademark owner for a price in excess of documented out-of-pocket costs (targets traditional cyber-squatters); (2) registering a domain name to prevent the owner of a trademark from using the mark in a corresponding domain name, provided that there is a pattern of such conduct (may apply to passive warehousing); (3) registering the domain name primarily for the purpose of disrupting the business of a competitor (targets cyberpirates); or (4) using the domain name to attract intentionally, for commercial gain, users to a website by creating potential confusion with the Complainant's mark as to the source, sponsorship, affiliation, or endorsement of the website or products and services offered on the website (targets cyberpirates and typo-squatters).<sup>79</sup>

These factors are flexible. On one hand, they are illustrative, not exhaustive. On the other hand, they do not necessarily require "use" in the traditional sense. For example, someone could register a domain name to disrupt his or her competitor's business and accomplish that goal by simply holding the domain name indefinitely. Since most passive warehousing cases do not involve direct competitors,<sup>80</sup> the focus is squarely on section 4(b)(ii).<sup>81</sup> In the absence of active use, can panels infer a reasonable pattern of conduct indicating that the domain name holder registered the name to prevent the trademark owner from using it?

#### **A. The Inaction Doctrine**

The most well-developed approach used by panels to address passive warehousing of domain names is what this Note refers to as the "inaction doctrine." In analyzing the doctrine and assessing its viability, it is critical to determine whether it is consistent with the letter and spirit of the UDRP. If it is, the doctrine is an invaluable tool. If the doctrine extends beyond

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79. *UDRP*, *supra* note 18, § 4(b)(i)-(iv).

80. In most cases, the Complainant is a corporation or other business, while the Respondent is either an individual or a small business that specializes in marketing, sales, or domain name sales and leasing.

81. Registering a domain name to prevent the owner of a trademark from using the mark in a corresponding domain name, provided that there is a pattern of such conduct. *UDRP*, *supra* note 18, § 4(b)(ii).

the bounds of the Policy, however, it may expand trademark rights too far and jeopardize the credibility of the UDRP.

The doctrine first emerged in the *telstra.org* case.<sup>82</sup> The case involved the Complainant Telstra Corporation Limited, a well-known Australian telecommunications company, and a Respondent that went by the name Nuclear Marshmallows.<sup>83</sup> The disputed domain name *telstra.org* was identical to the Complainant's registered trademark.<sup>84</sup> The Respondent had not used the domain name for a website or any other online presence, and never offered to sell or otherwise transfer the name.<sup>85</sup> All efforts to contact the Respondent failed; in fact, it appeared that the Respondent had taken active measures to conceal its true identity.<sup>86</sup>

After finding that the Respondent had not actively used the domain name, the Panel conducted an extensive analysis of section 4(b) of the Policy, concluding that "it is possible, in certain circumstances, for inactivity by the Respondent to amount to the domain name being used in bad faith."<sup>87</sup> Applying this interpretation, the panel developed a fact-specific test requiring "close attention to all the circumstances of the Respondent's behavior."<sup>88</sup> The panel applied this test and found bad faith use.<sup>89</sup>

Several panels faced with similar passive warehousing cases have applied the same test to find bad faith use, firmly establishing the inaction doctrine.<sup>90</sup> These panels typically apply a combination of two to four of

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82. *Telstra Corp. Ltd. v. Nuclear Marshmallows*, WIPO, No. D2000-0003, at <http://arbiter.wipo.int/domains/decisions/html/d2000-0003.html> (Feb. 18, 2000).

83. *Id.* § 4.

84. *Id.*

85. *Id.*

86. *Id.*

87. *Id.* § 7.9.

88. *Id.* § 7.11.

89. *Id.* § 7.12. The panel based its decision on the following facts: (1) the trademark in question was widely known; (2) the Respondent provided no evidence of actual or planned good faith use of the domain name; (3) the Respondent took active steps to conceal his identity; (4) the Respondent actively provided false contact information in breach of the registration agreement; and (5) considering the previous facts, it was impossible to conceive of a legitimate active use of the domain name by the Respondent in light of the Complainant's trademark rights. *Id.*

90. This analysis focuses on eighteen cases (including the *telstra.org* case) that apply or address the inaction doctrine. Most of these cases explicitly cite the *telstra.org* decision as "precedent." See *Teledesic LLC v. McDougal Design*, WIPO, No. D2000-0620, at <http://arbiter.wipo.int/domains/decisions/html/d2000-0620> (Sept. 1, 2000); *Do the Hustle, LLC v. Donald Wilson*, WIPO, No. D2000-0627, at <http://arbiter.wipo.int/domains/decisions/html/d2000-0627.html> (Aug. 18, 2000); *ABF Freight Sys., Inc. v. Am. Legal*, WIPO, No. D2000-0185, at <http://arbiter.wipo.int/domains/decisions/html/d2000-0185.html> (May 9, 2000); *CBS Broad. Inc. v. Edward Enters.*, WIPO, No. D2000-0242,

the following factors: (1) the domain name is identical to or closely resembles a widely known trademark; (2) the Respondent failed to deny any allegations in the complaint or provide evidence of actual or planned good faith use; (3) the Respondent failed to reply to cease-and-desist letters, e-mails, or other correspondence from the Complainant sent prior to UDRP proceedings; (4) it is impossible to conceive of a legitimate active use of the domain name by the Respondent considering the Complainant's trademark rights; (5) the Respondent took active steps to conceal its identity by providing false or incomplete contact information during domain name registration; and (6) the Respondent registered other domain names that are recognizable as third party trademarks.

*1. The Domain Name Is Identical to or Closely Resembles a Widely Known Trademark*

Approximately forty-five percent of the panels in the surveyed decisions applied this factor. For example, in the *presidentchoicesocks.com* case,<sup>91</sup> the panel noted that when the disputed domain name is identical to the Complainant's well-known mark, panels could infer that the Respondent intended to prevent the Complainant from using the domain. This fac-

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at <http://arbiter.wipo.int/domains/decisions/html/d2000-0242.html> (May 24, 2000); *Guerlain S.A. v. Peikang*, WIPO, No. D2000-0055, at <http://arbiter.wipo.int/domains/decisions/html/d2000-0055.html> (Mar. 21, 2000); *Stralfors AB v. P D S AB*, WIPO, No. D2000-0112, at <http://arbiter.wipo.int/domains/decisions/html/d2000-0112.html> (Apr. 13, 2000); *Marconi Data Sys., Inc. v. IRG Coins and Ink Source, Inc.*, WIPO, No. D2000-0090, at <http://arbiter.wipo.int/domains/decisions/html/d2000-0090.html> (Apr. 11, 2000); *Compaq Computer Corp. v. Boris Beric*, WIPO, No. D2000-0042, at <http://arbiter.wipo.int/domains/decisions/html/d2000-0042.html> (Mar. 28, 2000); *Gordon Rush & Co. v. Ramon Rono*, NAF, No. FA95495, at <http://www.arbforum.com/domains/decisions/95495.htm> (Oct. 20, 2000); *Hewlett-Packard Co. v. Greg Martineau*, NAF, No. FA95359, at <http://www.arbforum.com/domains/decisions/95359.htm> (Aug. 30, 2000); *Aeroturbine, Inc. v. Domain Leasing Ltd.*, NAF, No. FA93674, at <http://www.arbforum.com/domains/decisions/93674.htm> (Mar. 23, 2000); *SeekAmerica Networks Inc. v. Tariq Masood and Solo Signs*, WIPO, No. D2000-0131, at <http://arbiter.wipo.int/domains/decisions/html/d2000-0131.html> (Apr. 13, 2000); *CIGNA Corp. v. JIT Consulting, DeC*, No. AF-00174, at <http://www.eresolution.ca/services/dnd/decisions/0174.htm> (June 6, 2000); *Phillips Int'l, Inc. v. Rao Tella*, NAF, No. FA95461, at <http://www.arbforum.com/domains/decisions/95461.htm> (Sept. 21, 2000); *Ass'n of British Travel Agents Ltd. v. Sterling Hotel Group Ltd.*, WIPO, No. D2000-0086, at <http://www.arbiter.int/domains/decisions/html/d2000-0086.html> (Mar. 29, 2000); *Loblaws, Inc. v. Yogen Int'l, DeC*, No. AF-0164, at <http://www.eresolution.ca/services/dnd/decisions/0164.htm> (June 9, 2000); *Sporoptic Pouilloux S.A. v. William H. Wilson*, WIPO, No. D2000-0265, at <http://arbiter.wipo.int/domains/decisions/html/d2000-0265.html> (June 16, 2000).

91. *Loblaws*, AF-0164.

tor is consistent with section 4(b)(ii) of the Policy;<sup>92</sup> evidence that the domain name is identical to or closely resembles a widely known trademark is essential to support an inference that the Respondent intended to prevent the Complainant from using its mark in a domain name.

2. *Respondent's Failure to Respond to Allegations or Show Actual or Planned Good Faith Use*

This factor is also popular with panels; approximately forty-five percent of the panels in the surveyed decisions applied it. However, because most inaction doctrine cases involve Respondents who default, this factor simply states the obvious. As a result, some panels have criticized the application of this factor, noting that a Respondent's failure to respond to the complaint and show actual or planned good faith use does not establish bad faith use.<sup>93</sup> Although the factor may be more determinative in cases where the Respondent submits an inadequate response, panels should give little if any weight to this factor in the typical passive warehousing case.

3. *Respondent's Failure to Respond to Earlier Correspondence from Complainant*

Approximately forty percent of the panels in the surveyed decisions applied this factor. In these cases, the Complainant had made efforts to contact the Respondent, usually via a cease-and-desist letter, prior to initiating UDRP proceedings. Some panels found this factor determinative of bad faith use. For example, in the *cignadirect.com* case, the panel rejected other inaction doctrine factors but concluded that the Respondent's failure to respond to the Complainant's cease-and-desist letter was an "admission by silence."<sup>94</sup> The panel argued that a reasonable party would respond to such a letter with a correction or denial.<sup>95</sup> Other panels, however, have not found this factor particularly persuasive in finding bad faith use.<sup>96</sup>

This factor works best in combination with other factors; it does not stand well on its own. Panels usually do not investigate why Respondents fail to reply to letters or e-mails. Perhaps the Respondents did not receive the correspondence, or perhaps they were intimidated by cease-and-desist

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92. This section addresses domain name holders that register many domain names that are confusingly similar to well-known marks, preventing trademark owners from using their marks in corresponding domain names.

93. See *Loblaws*, AF-0164, § 5; *CIGNA Corp.*, AF-00174, § 5.

94. *CIGNA Corp.*, AF-0174, § 5.

95. *Id.*

96. See, e.g., *Sporoptic Pouilloux S.A. v. William H. Wilson*, WIPO, No. D2000-0265, at <http://arbitrator.wipo.int/domains/decisions/html/d2000-0265.html> (June 16, 2000).

letters and did not know how to proceed.<sup>97</sup> Whatever the explanation may be, it seems unfair to enable a Complainant to prove, at least indirectly, a Respondent's bad faith use by sending correspondence to the Respondent prior to initiating UDRP proceedings. Panels should use this factor with caution and only in combination with other factors.

4. *Impossible to Conceive of a Legitimate Active Use of the Domain Name by the Respondent*

Approximately thirty percent of the panels in the surveyed decisions applied this factor. Some panels found it determinative. In the *viasatellite.com* case, the panel concluded that "it makes no sense whatever to wait until [the Respondent] actually 'uses' the name, when inevitably, where there is such use, it will create the confusion described in the Policy."<sup>98</sup> Thus, for this panel, the mere threat of harm was enough to find bad faith use.<sup>99</sup> Similarly, in the *abta.net* case, the panel found that the threat of infringing well known marks was sufficient to support a finding of bad faith use.<sup>100</sup>

Other panels, however, sharply criticize this factor. For example, in the *presidentchoicesocks.com* case, the panel argued that a "threat of infringement" approach "would, in effect, render the additional requirement of bad faith use entirely meaningless."<sup>101</sup> This stance reflects an underlying concern that, given the limited fact-finding abilities of the panels, automatic application of this factor might cause panels to overlook potentially legitimate noncommercial or fair uses of the domain name by a Respondent. After all, the threat of harm to a Complainant might exist even if the Respondent has a right to and legitimate interest in the domain name.<sup>102</sup> As a result, panels should be very cautious when applying this factor and use it only in combination with other factors supporting an inference of bad faith use.

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97. This scenario is realistic since most Respondents are individuals and do not necessarily have experience with legal transactions.

98. *Phillips Int'l, Inc. v. Rao Tella*, NAF, No. FA95461, at <http://www.arbforum.com/domains/decisions/95461.htm> (Sept. 21, 2000).

99. *Id.*

100. *Ass'n of British Travel Agents Ltd. v. Sterling Hotel Group Ltd.*, WIPO, No. D2000-0086, at <http://www.arbiter.int/domains/decisions/html/d2000-0086.html> (Mar. 29, 2000).

101. *Loblaws, Inc. v. Yogen Int'l, DeC*, No. AF-0164, § 5, at <http://www.eresolution.ca/services/dnd/decisions/0164.htm> (June 9, 2000).

102. In such a case, the Respondent should prevail.

5. *Respondent Took Active Steps to Conceal its Identity by Providing False or Misleading Contact Information*

Only twenty percent of the panels in the surveyed decisions applied this factor. During the registration process, domain name registrants must provide accurate contact information (e.g., name, address, phone number, e-mail address, etc.). When panels applied this factor, there was usually strong evidence that the Respondent fabricated misleading information.<sup>103</sup> In those cases, the factor is a reasonable indicator of at least some bad faith. However, in most cases, panels likely are reluctant to apply this factor because it is probably quite common for domain name registrants to forget to update contact information. Forgetfulness falls short of bad faith.

6. *Respondent Registered Other Domain Names that Are Recognizable as Third Party Trademarks*

Only eleven percent of the panels in the surveyed cases applied this factor. In the *guerlain.net* case, the panel found bad faith use based in part on the fact that the Respondent owned twenty-four other domain names, fourteen of which were easily recognizable as third party trademarks.<sup>104</sup> Similarly, in the *stralfors.com* case, the panel inferred bad faith use based in part on evidence that the Respondent was in the business of registering and selling domain names.<sup>105</sup> On the other hand, in the *cignadirect.com* case, the panel noted that although the Respondent had registered at least fifty other domain names, the panel did not know why the Respondent registered the domain names and therefore could not infer bad faith use absent some finding of intent.<sup>106</sup>

Although intent is certainly useful in inferring bad faith, when this factor is combined with other factors, it can lead to a strong inference of bad faith use. The factor finds strong support in section 4(b)(ii) of the Policy; evidence that someone is warehousing several domain names that resemble trademarks is a good indicator of the required pattern of conduct.

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103. *See, e.g.*, *Telstra Corp. Ltd. v. Nuclear Marshmallows*, WIPO, No. D2000-0003, at <http://arbiter.wipo.int/domains/decisions/html/d2000-0003.html> (Feb. 18, 2000).

104. *Guerlain S.A. v. Peikang*, WIPO, No. D2000-0055, § 6, at <http://arbiter.wipo.int/domains/decisions/html/d2000-0055.html> (Mar. 21, 2000).

105. *Stralfors AB v. P D S AB*, WIPO, No. D2000-0112, at <http://arbiter.wipo.int/domains/decisions/html/d2000-0112.html> (Apr. 13, 2000) (noting Respondent registered over forty domain names that were identical to the trademarked term *Stralfors*).

106. *CIGNA Corp. v. JIT Consulting, DeC*, No. AF-00174, § 5, at <http://www.eresolution.ca/services/dnd/decisions/0174.htm> (June 6, 2000).

## B. Why ICANN Must Formally Address Passive Warehousing

Although some inaction doctrine factors are vulnerable to criticism on their own, when combined with other factors, they form a powerful tool to help panels infer bad faith use in passive warehousing cases. If applied in a reasonable way, the doctrine leads to fair and efficient results. In many respects, it is remarkable that the doctrine is so well established and consistent. Panels have applied the doctrine to varied factual situations in cases originating in the United States, Australia, Sweden, Canada, and Great Britain. This international consistency is testament not only to the clarity and strength of the Policy, but also to the diligence and fairness of the panels.

Despite the success and consistency of the doctrine, however, without formal guidance from ICANN, the doctrine runs the risk of being misapplied or ignored, resulting in unfair or inefficient results. The following cases illustrate these risks.

Some panels have applied the inaction doctrine too broadly. In these cases, the panels simply cite the *telstra.org* case as binding authority for the proposition that passive use equals bad faith use, and infer bad faith use without conducting the requisite fact-specific analysis.<sup>107</sup> Although factors indicating bad faith use may have been present in the case, the panels did not reference them in their written decisions. As a result, it at least appears that the panels used the inaction doctrine to justify what are essentially default judgments in favor of the Complainants. That approach conflicts with section 4(a) of the Policy, which requires Complainants to establish at least a *prima facie* case. Fortunately, this “trend” appears confined to just a few cases at this point.

In stark contrast are cases where panels overlook opportunities to apply the inaction doctrine. The *buyvuarnetsunglasses.com* case is a prime example.<sup>108</sup> The panel did not refer to the inaction doctrine at all, stating that the UDRP does not apply to cybersquatters who register domain names “but do not use them.”<sup>109</sup> The panel made this finding despite its own conclusions that passive warehousing was “deplorable” and that the Respondent was a cybersquatter who registered the name in bad faith.<sup>110</sup>

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107. See, e.g., *Aeroturbine, Inc. v. Domain Leasing Ltd.*, NAF, No. FA93674, at <http://www.arbforum.com/domains/decisions/93674.htm> (Mar. 23, 2000); *SeekAmerica Networks Inc. v. Tariq Masood and Solo Signs*, WIPO, No. D2000-0131, at <http://arbiter.wipo.int/domains/decisions/html/d2000-0131.html> (Apr. 13, 2000).

108. *Sporoptic Pouilloux S.A. v. William H. Wilson*, WIPO, No. D2000-0265, at <http://arbiter.wipo.int/domains/decisions/html/d2000-0265> (June 16, 2000).

109. *Id.* § 6A (quoting *Second Staff Report*, supra note 78).

110. *Id.* § 6F.

The panel concluded that *any* future use of the domain name by the Respondent would *automatically* be in bad faith, warning the Respondent not to use the domain name in the future.<sup>111</sup> Finally, the panel suggested that the Complainant file a new complaint if and when the Respondent uses the domain name.<sup>112</sup>

The panel had a perfect opportunity to apply the inaction doctrine to arrive at the correct result, but failed to do so, citing the restraints of the Policy. Instead, it reached a decision that maintained an impasse. While it is possible that the decision might encourage the Respondent to hand over the domain name to the Complainant, it is more likely that the Respondent will continue to warehouse the name without any consequences—a result that seems in striking conflict with the overarching goals of the Policy. Moreover, requiring the Complainant to file a new complaint to enforce its rights is inefficient. At least in this case, the inaction doctrine would have supported a more efficient and correct result.

#### IV. CONCLUSION

The UDRP has clearly established itself as a powerful tool to combat cybersquatting. Now that the Policy has been in place for over a year, ICANN should take immediate steps to evaluate the Policy's performance and implement appropriate improvements.<sup>113</sup> Part of the evaluation must address passive warehousing and should consider formally adopting the inaction doctrine. Adopting the doctrine would improve the efficiency, fairness, and predictability of results. Clarifying the Policy could help resolve the perceived need for a potentially costly and inefficient appellate mechanism. Such a mechanism may interfere with the UDRP's three great advantages: speed, simplicity, and cost. Panels can make the right decisions without sacrificing any of those qualities.

ICANN should also study the reasons underlying the high default rate and take appropriate action. While some panels make considerable efforts to contact Respondents and often extend deadlines,<sup>114</sup> their options are limited given the constraints of the Policy. Ensuring that more Respon-

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111. *Id.*

112. *Id.*

113. ICANN's Domain Name Supporting Organization will conduct a review of the UDRP in the near future. Oscar S. Cisneros, *ICANN't Believe That Domain Name*, WIRED NEWS, at <http://www.wired.com/news/print/0%2C1294%2C37801%2C00.html> (July 27, 2000).

114. *See, e.g.*, Chemco Rubber Ltd. v. Greg Ricks, DeC, No. AF-0235, at <http://www.eresolution.ca/services/dnd/decisions/0235.htm> (July 13, 2000) (granting an extension for filing a response).

dents are represented would enhance the credibility and fairness of the Policy, particularly since many Respondents do not have to carry a heavy burden to prevail.<sup>115</sup>

Much of the criticism of the UDRP as a biased “slam dunk” mechanism for trademark holders appears unfounded. Domain name holders would seem to be at their most vulnerable when their interests are not represented. As the passive warehousing cases illustrate, panels usually make considerable efforts to verify that the claims against the domain name holders have some substance. Ultimately, it is up to ICANN to take active measures to improve the Policy to promote its long term viability and credibility.

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115. For example, in two cases involving passive warehousing where Respondents did submit a response, both Respondents prevailed after making arguably weak showings regarding alleged planned future use. *William Beaumont Hospitals v. Wildfire Media*, NAF, No. FA95564, at <http://www.arbforum.com/domains/decisions/95564.htm> (Oct. 20, 2000) ([beaumonthospital.com](http://beaumonthospital.com)); *Bd. of Trs. of The Leland Stanford Junior Univ. v. Thomas Manski*, NAF, No. FA95543, at <http://www.arbforum.com/domains/decisions/95543.htm> (Oct. 9, 2000) ([stanforduniversity.com](http://stanforduniversity.com)).



## WAL-MART STORES, INC. V. SAMARA BROS.

By *Antonia L. Sequeira*

For years courts have struggled over how to determine if trade dress can be inherently distinctive and thus eligible for protection under the Lanham Act without a showing of secondary meaning. In the words of Justice Sandra Day O'Connor: "it's hard to know how to define inherently distinctive . . . it's sort of like pornography: I know it when I see it."<sup>1</sup> With the landmark decision in *Wal-Mart Stores, Inc. v. Samara Bros.*<sup>2</sup> the Supreme Court ostensibly clarified this elusive concept by excluding an entire category of trade dress from inherent distinctiveness eligibility: product design.<sup>3</sup>

The *Wal-Mart* decision suitably advances many policies underlying intellectual property law. Though product designs can no longer be inherently distinctive, trade dress protection is still obtainable for designs that have acquired secondary meaning; some designs can also be protected under other intellectual property regimes.<sup>4</sup> Moreover, in contrast with its 1992 decision in *Two Pesos, Inc. v. Taco Cabana, Inc.*,<sup>5</sup> where the Court appeared to offer increased protection to unique product packages and designs, the Court in *Wal-Mart* shifted the balance toward encouraging competition.<sup>6</sup>

Doctrinally, however, *Wal-Mart* falls short of setting forth constructive precedent in trade dress law. The Supreme Court did not delineate how to distinguish between product design and packaging; instead it left this burden to the lower courts. The Court also failed to clearly reconcile *Wal-Mart* with its seemingly conflicting opinion in *Two Pesos*. Despite these

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1. Transcript of Record at 4, *Wal-Mart Stores, Inc. v. Samara Bros.*, 529 U.S. 205 (2000) (No. 99-150).

2. 529 U.S. 205 (2000).

3. *See id.* at 212 ("It seems to us that design, like color, is not inherently distinctive.").

4. *See id.* at 214 (stating that design patents and copyrights could be alternative forms of protection for product designs).

5. 505 U.S. 763 (1992).

6. *See* Julius Rabinowitz, '*Wal-Mart*' Clarifies Product Appearance Trade Dress, *High Court Added a Condition to Lanham Act Protectability: Proof of Secondary Meaning*, 22 NAT'L L.J., May 1, 2000, at C4 (noting that the *Two Pesos* Court focused on protecting small businesses, while the *Wal-Mart* Court had the opposite concern).

doctrinal flaws, from a policy standpoint the Supreme Court decided correctly in opting to promote competition.

## I. BACKGROUND

### A. Trade Dress Protection and the Lanham Act

Historically, the foremost goal of trade dress protection was to prevent a manufacturer from dressing his product like that of another manufacturer, thus deceiving consumers into mistakenly purchasing goods from the wrong maker.<sup>7</sup> By the late nineteenth century, courts had expanded this form of protection to encompass product packaging and unique product shapes.<sup>8</sup> Trade dress law had two main purposes. First, it protected consumers from confusion by allowing them to distinguish between differently dressed products and to associate the dress with a particular producer.<sup>9</sup> Second, trade dress protection benefited producers by allowing them to protect the good will invested in their products.<sup>10</sup> Producers could uniquely dress their products, thereby allowing consumers to distinguish between competing products and continue to purchase a favored brand of product.<sup>11</sup>

The Lanham Act,<sup>12</sup> enacted in 1946, provided broad federal protection against unfair competition.<sup>13</sup> Section 43(a) offered protection against “deceptive marking, packaging, and advertising of goods” that could poten-

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7. See STEPHEN F. MOHR ET AL., U.S. TRADE DRESS LAW: EXPLORING THE BOUNDARIES 1 (Int'l Trademark Ass'n eds., 1997).

8. See *id.*

9. See Lanham Act § 43(a), 15 U.S.C. § 1125(a) (1994) (protecting consumers against use of words, terms, names, symbols or devices that are “likely to cause confusion . . . as to the origin, sponsorship, or approval” of goods).

10. See J. THOMAS MCCARTHY, 4 MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION § 2.15 (2000) (describing a trademark as a mere “symbol of the good will of the owner’s goods or services”).

11. See *id.* § 2.18 (explaining that buyers tend to stick with a product or service found acceptable in the past and trademarks are the symbols that advertise the goodwill that producers have invested in these products). Producers are also encouraged to “maintain a high quality product” if they are assured that “any goodwill associated with their products is not misappropriated by competitors.” *Fun-Damental Too, Ltd. v. Gemmy Indus. Corp.*, 111 F.3d 993, 999 (2d Cir. 1997) (stating that “Congress recognized that a trademark aids competition in the marketplace because it helps a consumer distinguish among competing products”).

12. 15 U.S.C. § 1125(a) (1994 & Supp. IV 1998).

13. JEROME GILSON, GILSON ON TRADEMARK PROTECTION & PRACTICE § 7.02 (2000).

tially mislead a consumer with regard to a product's true source.<sup>14</sup> In 1988, Congress amended the Act to provide broader protection and codified what had become a well-recognized rule of case law that both registered and unregistered marks and trade dress were protectable.<sup>15</sup> Traditionally, trade dress law protected the overall image of containers and labels used in product packaging, but by the early 1980s, courts had further extended trade dress law to protect "the shape and design of the product itself."<sup>16</sup>

## B. Inherent Distinctiveness in the Context of Trade Dress

Most courts examine three main criteria when considering trade dress infringement: nonfunctionality, likelihood of confusion, and distinctiveness.<sup>17</sup> First, a design or package cannot be protected unless it is nonfunctional.<sup>18</sup> Extending trade dress protection to functional package or design features would hinder competition by allowing only one producer to employ these necessary features.<sup>19</sup> Second, it must be likely that the similar design or packaging will cause consumers to confuse the infringing product with the product for which protection is sought.<sup>20</sup> Third, the trade dress must possess either inherent or acquired distinctiveness. Trade dress is inherently distinctive if it immediately causes consumers to recognize that the product comes from a single source or producer.<sup>21</sup> Trade dress has acquired distinctiveness when it has secondary meaning in the minds of con-

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14. See MOHR ET AL., *supra* note 7, at 13 (quoting 20th Century Wear, Inc. v. Sanmark-Stardust, Inc., 747 F.2d 81, 91 (2d Cir. 1984)).

15. See 4 MCCARTHY, *supra* note 10, § 5.9.

16. *Id.* § 8.1.

17. See *id.* § 7.53.

18. See *id.* § 7.54.

19. See *Inwood Labs., Inc. v. Ives Labs., Inc.*, 456 U.S. 844, 850 n.10 (1982) ("[A] product feature is functional if it is essential to the use or purpose of the article or if it affects the cost or quality of the article."). In some courts, a design must also not be "aesthetically functional," meaning that visually attractive features must not solely serve the non-trademark function of making the product aesthetically pleasing rather than helping consumers associate the product with its source. See ROBERT P. MERGES ET AL., *INTELLECTUAL PROPERTY IN THE NEW TECHNOLOGICAL AGE* 745 (2d ed. 2000); see also 4 MCCARTHY, *supra* note 10, § 7.79 (discussing the theory of "aesthetic functionality"). But see § 7.81 for a criticism of the doctrine of "aesthetic functionality" as an "unwarranted and illogical expansion of the functionality policy."

20. See 4 MCCARTHY, *supra* note 10, § 7.54.

21. See JEROLD A. JACOVER & KATHLEEN E. BRENNAN, *Trade Dress and Product Configuration Law*, in *PROTECTING TRADE DRESS* 21, 27 (Robert C. Dorr & Christopher H. Munch eds., 1992). For a product feature to be inherently distinctive, the public need not be able to identify the specific source that created the product; the public must only recognize that a single producer made the product. See *id.*

sumers.<sup>22</sup> Secondary meaning is established when the trade dress has been used exclusively and the product has been advertised to such an extent that consumers have come to recognize the trade dress as designating the product's source.<sup>23</sup>

With regard to the distinctiveness factor, the circuit courts disagree over how to determine inherent distinctiveness, resulting in various tests. Many courts initially applied a test that was announced by Judge Friendly in *Abercrombie & Fitch Co. v. Hunting World, Inc.*<sup>24</sup> The *Abercrombie* test separates trademarks into the following spectrum of distinctiveness in order of the strongest type of mark to the weakest: (1) arbitrary or fanciful marks; (2) suggestive marks; (3) descriptive marks; and (4) generic marks.<sup>25</sup> Arbitrary, fanciful, and suggestive marks are always inherently distinctive since they give little or no clue as to the product type and consumers can immediately associate these marks with a product source.<sup>26</sup> Descriptive marks can only be protected after they have acquired secondary meaning since they describe a type of product.<sup>27</sup> Generic marks can never be protected as trademarks because they refer to a category of products rather than the source.<sup>28</sup>

Though the *Abercrombie* test was useful in determining which trademarks were inherently distinctive, some courts ruled that it could not be properly applied to trade dress.<sup>29</sup> Two years after the *Abercrombie* test was developed, the Court of Customs and Patent Appeals articulated an alternative test in *Seabrook Foods, Inc. v. Bar-Well Foods Ltd.*<sup>30</sup> Under this test, a court determines:

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22. See ADAM L. BROOKMAN, TRADEMARK LAW: PROTECTION, ENFORCEMENT AND LICENSING § 6.04 [B] (2000).

23. See *id.* (commenting that secondary meaning is established through "long and exclusive use of the dress in connection with the product or service").

24. 537 F.2d 4 (2d Cir. 1976).

25. See *id.* at 9; see also 4 MCCARTHY, *supra* note 10, §§ 11.1-2.

26. See *Abercrombie*, 537 F.2d at 11; see also 4 MCCARTHY, *supra* note 10, §§ 11.1-2 (discussing the spectrum of distinctiveness categories); *Zatarains, Inc. v. Oak Grove Smokehouse, Inc.*, 698 F.2d 786, 791 (5th Cir. 1983) (mentioning "Kodak" as an example of a fanciful mark and "Coppertone" as an example of a suggestive mark).

27. See *Abercrombie*, 537 F.2d at 10; see also 4 MCCARTHY, *supra* note 10, §§ 11.1-2; *Zatarains*, 698 F.2d at 790 (noting that "Alo" is an example of a descriptive mark that might refer to products containing the gel of the aloe vera plant).

28. See *Abercrombie*, 537 F.2d at 9; see also 4 MCCARTHY, *supra* note 10, §§ 11.1-2; *Zatarains*, 698 F.2d at 790 (discussing cellophane and aspirin as examples of generic terms that are not protectable as trademarks).

29. See *Duraco Products, Inc. v. Joy Plastic Enters., Ltd.*, 40 F.3d 1431, 1440-42 (3d Cir. 1994) (rejecting the *Abercrombie* test for product designs).

30. 568 F.2d 1342 (C.C.P.A. 1977).

(1) whether the particular dress consists of a common basic shape or design; (2) whether it is unique or unusual in a particular field; and (3) whether it is a 'mere refinement of a commonly-adopted and well-known form of ornamentation for a particular class of goods viewed by the public as a dress or ornamentation for the goods.'<sup>31</sup>

Rather than just putting trade dress into a spectrum of distinctiveness, as in *Abercrombie*, the *Seabrook* test distinguishes distinctive from nondistinctive trade dress by focusing directly upon whether the trade dress is unique or common.<sup>32</sup> Courts differed over which test to apply to trade dress as well as over whether trade dress could ever be inherently distinctive.

In *Two Pesos v. Taco Cabana*,<sup>33</sup> the Supreme Court resolved the conflict over whether trade dress, like trademarks, could be inherently distinctive. The Court found that the overall image of a Mexican restaurant, including décor and festive color schemes, was inherently distinctive. Since the Court failed to specify whether this restaurant image constituted packaging or design,<sup>34</sup> the lower courts remained in conflict over whether product designs could ever be inherently distinctive and which tests to apply.

Two years after *Two Pesos*, the Third Circuit, in *Duraco Products, Inc. v. Joy Plastic Enterprises, Ltd.*,<sup>35</sup> questioned whether a product design could ever be inherently distinctive.<sup>36</sup> The court rejected the application of the *Abercrombie* test for product design cases and formulated its own test.<sup>37</sup> Under the *Duraco* test, a product design is afforded protection if it is: "(1) unusual and memorable; (2) conceptually separable from the product; and (3) likely to serve primarily as a designator of origin of the product."<sup>38</sup> The Second Circuit, in *Knitwaves, Inc. v. Lollytogs, Ltd.*,<sup>39</sup> also rejected the *Abercrombie* test and formulated its own test employing only

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31. GILSON, *supra* note 13, § 7.02 (quoting *Seabrook Foods*, 568 F.2d at 1344).

32. For example, the First Circuit applied this test in *I.P. Lund Trading ApS v. Kohler Co.*, 163 F.3d 27 (1st Cir. 1998), since it found that other factors, along with those in the *Abercrombie* test, should be considered in determining distinctiveness. *See id.* at 39-41.

33. 505 U.S. 763 (1992).

34. *See id.*

35. 40 F.3d 1431 (3d Cir. 1994).

36. *See id.* at 1442-48.

37. *Id.* at 1441 (rejecting the *Abercrombie* test as being inapplicable to product features, since it was difficult to effectively separate such features into categories within the spectrum of distinctiveness).

38. *Id.*

39. 71 F.3d 996 (2d Cir. 1995).

the third prong of the *Duraco* test.<sup>40</sup> In contrast, a few courts continued to apply the *Abercrombie* test to product designs after *Two Pesos*, interpreting it to hold that both packaging and design can be inherently distinctive.<sup>41</sup>

In *Wal-Mart Stores, Inc. v. Samara Bros.*<sup>42</sup> the Supreme Court resolved the issue of inherent distinctiveness for product designs, but failed to explain how to distinguish between design and packaging. The Court also did not articulate which inherent distinctiveness test should be applied in product packaging cases.

## II. CASE SUMMARY

### A. Facts

Samara Bros. ("Samara") designs and manufactures children's clothing.<sup>43</sup> The heart of Samara's business is a clothing line composed primarily of spring and summer one-piece seersucker outfits, displaying appliques of hearts, fruits, teddy bears, flowers, and other such shapes.<sup>44</sup> In 1995, Wal-Mart Stores, Inc. ("Wal-Mart"), a well-known retailer, contracted with Judy-Philippine, Inc., one of its suppliers, to produce a line of children's clothing patterned after photographs of Samara's appliqué garments with only minor modifications.<sup>45</sup> In June 1996, a buyer at J.C. Penney, one of the stores that sold Samara's garments under contract, informed Samara that its designs were being sold by Wal-Mart at a lower price than permitted by J.C. Penney's contract.<sup>46</sup> Samara soon discovered

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40. See *id.* at 1008-09. The court refused to employ the three-part *Duraco* test explaining that it was not rooted in the Lanham Act's language. See *id.* at 1009 n.6.

41. The Eighth Circuit, in *Stuart Hall Co. v. Ampad Corp.*, 51 F.3d 780 (8th Cir. 1995), confirmed its adherence to the *Abercrombie* test and interpreted *Two Pesos* to hold that trade dress encompasses both product packaging and design. *Id.* at 787-88. A district court within the Ninth Circuit, in *DCNL, Inc. v. Almar Sales Co.*, 47 U.S.P.Q.2d 1406 (N.D. Cal. 1997), expressed agreement with these views of the Eighth Circuit and stated that *Two Pesos* was "just as much a product configuration case as a product packaging case." *Id.* at 1413 (discussing *Stuart Hall*, 51 F.3d at 787). Similarly, the Fourth Circuit, in *Ashley Furniture Industries, Inc. v. Sangiacomo N. A., Ltd.*, 187 F.3d 363 (4th Cir. 1999), held that the *Abercrombie* test should be applied when considering inherent distinctiveness in product design issues. *Id.* at 371. The court stated that *Two Pesos* "clearly contemplated trade dress protection for inherently distinctive product configurations." *Id.* at 373.

42. 529 U.S. 205 (2000).

43. *Id.* at 207.

44. *Id.*

45. *Id.*

46. *Id.* at 208.

that Wal-Mart was manufacturing and selling copies of Samara's clothes and sued for infringement of unregistered trade dress under section 43(a) of the Lanham Act.<sup>47</sup>

### B. The District Court Decision

After the jury found Wal-Mart liable, Wal-Mart moved for judgment as a matter of law.<sup>48</sup> The district court denied Wal-Mart's motion, holding that though certain nondistinctive elements of Samara's designs could not be protected, the jury could have reasonably found that the "combination of these elements was distinctive and thus protectable."<sup>49</sup> Wal-Mart appealed this judgment to the Second Circuit.<sup>50</sup>

### C. The Second Circuit Decision

On appeal, the Second Circuit affirmed the denial of Wal-Mart's motion.<sup>51</sup> Referring to its opinion in *Landscape Forms, Inc. v. Columbia Cascade Co.*<sup>52</sup> and applying the third prong of the *Duraco* test,<sup>53</sup> the court found that the "overall look" of a product and a distinctive combination of design elements could indicate a product's source.<sup>54</sup> The court held that Samara's clothing involved a distinctive combination of elements, and so

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47. *Id.* Samara sued various retailers, including K-Mart, Caldor, Hills, and Goody's as well as Judy-Philippine, Inc., but all of these defendants settled except Wal-Mart. *See Samara Bros. v. Wal-Mart Stores, Inc.*, 165 F.3d 120, 123 (2d Cir. 1998), *vacated by* 529 U.S. 205 (2000). The jury found Samara's trade dress to be protectable, and found that Wal-Mart had willfully infringed Samara's 13 copyrights and willfully infringed Samara's trade dress. *See Samara Bros. v. Judy-Philippine, Inc.*, 969 F. Supp. 895, 896 (S.D.N.Y. 1997), *aff'd.* 165 F.3d 120 (2d Cir. 1998), *vacated by* 529 U.S. 205 (2000).

48. *Samara Bros.*, 969 F. Supp. at 897. Wal-Mart also moved for a new trial and Samara moved for injunctive relief with respect to the trade dress claim. *See id.*

49. *Id.* at 898. Wal-Mart's motion for a new trial was denied and Samara's motion for injunctive relief was granted, but only to the extent of enjoining Wal-Mart from "infringing on Samara's trade dress by manufacturing, purchasing, selling, or otherwise distributing any garments" that were copied from Samara garments or that bore appliquéés from Samara's garments. *Id.* at 901. The court refused to grant Samara's broader motion for an injunction enjoining Wal-Mart from infringing any of seven categories of Samara's trade dress. *Id.* at 900.

50. *Samara Bros.*, 165 F.3d at 122. Wal-Mart also sought a new trial claiming that the district court erred when instructing the jury. *Id.* at 122.

51. *Id.* at 132.

52. 113 F.3d 373 (2d Cir. 1997) (holding that the design of outdoor furniture was not inherently distinctive, thus could not be protected under the Lanham Act without a showing of secondary meaning).

53. *See Samara Bros.*, 969 F. Supp. at 898. The third prong of the *Duraco* test asks whether the trade dress was "likely to be . . . an indicator of the product's source." *Duraco Products, Inc. v. Joy Plastic Enters., Ltd.*, 40 F.3d 1431, 1441 (3d Cir. 1994).

54. *Samara Bros.*, 165 F.3d at 122 (discussing *Landscape Forms*, 113 F.3d at 378).

could be inherently distinctive.<sup>55</sup> The Supreme Court granted certiorari on the question of “what must be shown to establish that a product’s design is inherently distinctive.”<sup>56</sup>

#### D. The Supreme Court Decision

In a unanimous opinion, the Supreme Court held that unregistered product design trade dress could not be inherently distinctive because consumers do not typically associate the product design with the product’s source.<sup>57</sup> Thus, product designs can only be protected upon a showing of secondary meaning.<sup>58</sup> The Court reversed the Second Circuit’s decision and remanded for proceedings consistent with its opinion.<sup>59</sup>

Writing for the Court, Justice Scalia first compared product designs to color.<sup>60</sup> The Court recalled its discussion of trademarks in *Qualitex Co. v. Jacobson Products*,<sup>61</sup> where it held that colors, while able to serve as trademarks, could never be inherently distinctive. Analogizing to *Qualitex*, the Court found that product designs, like colors, do not immediately cause a consumer to think of a brand or product source.<sup>62</sup> Thus, both colors and product designs require a showing of secondary meaning in order to qualify for protection under the Lanham Act. The Court further explained that even a unique product design is not inherently distinctive since it is typically intended to make a product more appealing and not to identify a brand.<sup>63</sup> As an example, the Court considered a cocktail shaker shaped like a penguin.<sup>64</sup> The Court explained that consumers know that even this unusual design “is intended not to identify the source, but to render the product itself more useful or more appealing.”<sup>65</sup>

In the Court’s view, applying the inherent distinctiveness principle to product designs might harm consumers by depriving them of the chance to

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55. *Id.* at 127. The court also affirmed on Samara’s Copyright Act claim, denied Wal-Mart’s motion for a new trial, and reversed the district court’s grant of an injunction to Samara. *See id.* at 132. The court remanded the case so the district court could “refashion an injunction” corresponding with the Second Circuit’s opinion. *Id.*

56. *Wal-Mart Stores, Inc. v. Samara Bros.*, 528 U.S. 808 (1999).

57. *Wal-Mart Stores, Inc. v. Samara Bros.*, 529 U.S. 205 (2000).

58. *Id.* at 216.

59. *Id.*

60. *See id.* at 211-12.

61. 514 U.S. 159 (1995) (holding that the green and gold color of a brand of dry cleaning pads could be protected as a trademark, but only after a showing of secondary meaning).

62. *See Wal-Mart*, 529 U.S. at 211-12 (discussing *Qualitex*, 514 U.S. 159 (1995)).

63. *Id.*

64. *Id.*

65. *Id.*

benefit from aesthetic designs of competing products.<sup>66</sup> Consumers should not be deprived of competition by a “rule of law that facilitates plausible threats of suit against new entrants based upon alleged inherent distinctiveness.”<sup>67</sup> Competition would be deterred by the mere threat of a successful suit.<sup>68</sup> “[G]iven the unlikelihood of inherently source-identifying design, the game of allowing suit based upon alleged inherent distinctiveness . . . [is] not worth the candle.”<sup>69</sup> The Court noted that the availability of other methods of protection, such as patents and copyrights, offsets any harm a producer may suffer from the requirement that secondary meaning be shown before product design can be protected under trade dress law.<sup>70</sup>

The Court also discussed its decision in *Two Pesos v. Taco Cabana*,<sup>71</sup> where it held that trade dress, at least in the form of restaurant décor, could be inherently distinctive. The Court clarified that *Two Pesos* “unquestionably establishes the legal principle that trade dress can be inherently distinctive.”<sup>72</sup> Nonetheless, the Court concluded that the *Two Pesos* holding was “inapposite” to the *Wal-Mart* holding, since *Two Pesos* involved product packaging or “some *tertium quid* that is akin to product packaging,” while *Wal-Mart* involved product design.<sup>73</sup>

Finally, the Court recognized that the lower courts would have some difficulty drawing lines between product design and product packaging.<sup>74</sup> The Court suggested the classic Coca-Cola bottle as an example of a product feature that could either be considered packaging (for the soda) or design (for people who collect the bottles).<sup>75</sup> By way of guidance, the Court simply commented that lower courts should lean toward classifying ambiguous cases as product design rather than packaging.<sup>76</sup>

### III. DISCUSSION

Although the Court’s conclusion appropriately advances the policies underlying intellectual property law, it leaves unresolved a number of contentious issues that will continue to plague the lower courts. The Court

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66. *See id.*

67. *Id.*

68. *Id.* at 214.

69. *Id.*

70. *See id.*

71. 505 U.S. 763 (1992).

72. *Wal-Mart*, 529 U.S. at 215.

73. *Id.*

74. *Id.*

75. *Id.*

76. *Id.*

should have provided more guidance on how to distinguish between product design and packaging, and should have reconciled its *Two Pesos* opinion with the *Wal-Mart* decision.

**A. The Court Reached the Correct Conclusion, from a Policy Perspective**

The Court reached the correct result as a policy matter, for two main reasons. First, *Wal-Mart* will likely benefit consumer's interests since it promotes competition in the marketplace. Second, *Wal-Mart* does not leave product designs unprotected, but instead requires proof of secondary meaning and encourages designers to seek protection under patent or copyright law.<sup>77</sup>

*1. Promoting Competition and Consumer Interests*

The competitive interest in duplicating product designs is stronger than the interest in imitating packaging. Packaging only acts as an encasement for the actual product prior to sale and is normally the portion of a product that will probably be discarded upon purchase. Thus, competition is unlikely to be threatened by allowing trade dress protection for a packaging style without a showing of secondary meaning. In contrast, design is intertwined with the product. Therefore, a producer with trade dress rights to a product design will have rights to the product itself, and not just the product's disposable packaging.<sup>78</sup> Permitting exclusive trade dress rights to an actual product (absent any showing of secondary meaning) may jeopardize competition, particularly since trade dress protection is unlimited in duration.<sup>79</sup>

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77. *See id.* (suggesting design patents and copyrights as alternative protections and holding that a design is protectable only upon a showing of secondary meaning).

78. *See Landscape Forms, Inc. v. Columbia Cascade Co.*, 113 F.3d 373, 380 (2d Cir. 1997) (stating that "granting trade dress protection to an ordinary product design would create a monopoly in the goods themselves"). In *I.P. Lund Trading ApS v. Kohler Co.*, 163 F.3d 27 (1st Cir. 1998), Judge Boudin, in his concurring opinion, expressed concern regarding whether the public interest in replicating a product design can be outweighed by the need to offer protection for a designer's investment in his trade dress. *See id.* at 53 (Boudin, J., concurring).

79. *See id.* ("[T]he threat to the public interest, ordinarily countered by the time limit on patent protection, is acute where a permanent protection is offered not to a word or symbol but to the design of an article of manufacture."). Trade dress protection, however, is not necessarily limited in duration; protection can be lost through abandonment of a trade dress or trademark and also through genericide. *See GILSON, supra* note 13, § 2.02 (discussing how a change in the meaning of a trademark in the public's mind can cause a trademark to deteriorate into a generic name, thereby losing its protection under the Lanham Act); *see also id.* § 3.05 (noting that trademark abandonment, resulting in loss of

By holding that product design cannot be inherently distinctive, the Court furthered the interests of consumers and promoted competition.<sup>80</sup> The *Wal-Mart* decision will make it more difficult for producers to prove that a design deserves trade dress protection.<sup>81</sup> To show inherent distinctiveness, a producer must demonstrate that his design is immediately source identifying.<sup>82</sup> To prove secondary meaning, however, the producer must make the costly and laborious showing that over time consumers have come to recognize the trade dress as originating from a single source.<sup>83</sup> As a result, it will be more difficult for producers to acquire exclusive trade dress rights to product designs.<sup>84</sup> This will encourage competitors to create cheaper knockoffs of these unprotected designs, and thereby provide consumers with more options in the marketplace.

The Supreme Court held correctly in limiting trade dress protection for product designs, even if the decision results in some loss of design diver-

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trademark protection, can occur “through nonuse of the trademark for an extended period, coupled with an intent by the trademark owner to relinquish its legal rights” or “when, because of conduct of the trademark owner, the trademark ceases to function as a designation of origin and no longer distinguishes the owner’s goods from those of others”).

80. See, e.g., Lisa I. Fried, *High Court Makes Guarding Product Design Harder Trademark Case*, N.Y. L.J., Mar. 30, 2000, at 5 (arguing that *Wal-Mart* potentially will promote the consumer’s choice, and, thus, the heightened competition resulting from the decision will be beneficial to consumers).

81. See Fried, *supra* note 80, for a discussion contending that *Wal-Mart* “could make it significantly harder for owners of designs to protect their creations.” Since *Wal-Mart* requires an owner of a product design to “affirmatively prove that the public associates the design with its maker, the High Court has imposed a difficult and costly burden on manufacturers of clothing, appliances and other goods.” *Id.*

82. See Ralph J. Gabric et al., *Trade Dress and Product Configuration Law*, in TRADE DRESS LAW § 2.03[B][1] (Robert C. Dorr & Christopher H. Munch, eds. 2000).

83. See, e.g., 4 MCCARTHY, *supra* note 10, §15.5; BROOKMAN, *supra* note 22, § 6.04 [B]. Courts will consider secondary meaning factors such as the advertising expenditures by trade dress owners, surveys of consumers who associate the trade dress with a single source, how long the trade dress was used, and whether use was exclusive. See *id.* § 6.04 [B][1]. Thus, a producer will often be limited to protecting only designs that have existed for a while and will be forced to spend a great deal of money on advertising and surveys to prove that the design deserves trade dress protection. With modern media and technology, however, it may be possible for a producer to publicize a design quickly and sufficiently to cause consumers to recognize the design source, thus warding off competitors. See Craig S. Mende, *How the High Court Sliced the Safety Net against Knockoffs*, BRANDWEEK, Aug. 21, 2000, at 30.

84. See *supra* note 79; see also Mende, *supra* note 83 (arguing that *Wal-Mart* has made it harder for a producer to stop someone from making a product similar to his, giving the example that the design of a children’s shirt can be copied unless the design has already become so well recognized that consumers assume that the same producer has made another shirt with the same design).

sity in the marketplace. Limiting trade dress protection of designs could result in retailers like Wal-Mart choosing to produce lower quality knock-offs of popular designs rather than investing resources to create their own innovative designs.<sup>85</sup> Consumers who are interested in diversity in products (rather than cheap, but similarly designed knockoffs) could lose the benefit of making choices between creative designs. Thus, the need for some form of product design protection is apparent, but trade dress law may be an inappropriate vehicle for this protection. The purpose of trade dress law is to prevent consumer confusion as to a product's source and not to promote marketplace diversity.<sup>86</sup> Most of the time, however, consumers probably will not automatically associate a new product design with a source. In *Wal-Mart*, Justice Scalia stated that since product designs rarely will be immediately source-identifying, it is worthwhile to put forth a rule declaring that product design can never be inherently distinctive.<sup>87</sup> Otherwise, competition would be deterred by the "game of allowing suit based upon alleged inherent distinctiveness."<sup>88</sup> Though a successful suit would be very unlikely, just the threat of such a suit may hinder competition, and this would be more detrimental to consumers than the initial loss of protection for those few designs that might really be inherently distinctive.<sup>89</sup> Hence, in the interests of promoting competition, the Court's decision to require secondary meaning for product designs was probably a wise one, though it may make trade dress protection of designs a more challenging feat.

## 2. *Design Patents, Copyrights, and Secondary Meaning*

*Wal-Mart* does not eliminate all trade dress protection for product designs, but rather encourages producers to develop secondary meaning in their designs. Proving secondary meaning, however, may be an onerous chore, given that such proof is costly and time-consuming.<sup>90</sup> Requiring proof of secondary meaning may leave some designs initially unprotected

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85. See, e.g., 4 MCCARTHY, *supra* note 10, § 2.4 (discussing the idea that trademarks give a manufacturer an "incentive to improve the quality of his product" and without such protections, "a manufacturer would gain little or nothing from improving his product's quality").

86. See *id.* § 8.1 (explaining that "unlike patent and copyright law, trade dress law does not exist as a reward for innovation or creativity," but instead it "exists only if it can be proven that the trade dress identifies and distinguishes" the product source).

87. See *Wal-Mart Stores, Inc. v. Samara Bros.*, 529 U.S. 215 (2000).

88. *Id.*

89. See *id.*

90. See Part III.A.1 and note 83, *supra*, for a discussion of the difficulties associated with proving secondary meaning.

until consumers develop an association between the design and the product source. Clothing designers, for example, change their styles or create new designs so frequently that they would seldom be able to protect the designs if a showing of secondary meaning is required.<sup>91</sup>

Despite these problems, however, the Court was correct in requiring a showing of secondary meaning for trade dress protection of product designs. By requiring secondary meaning, *Wal-Mart* simply mandates a higher showing of proof regarding distinctiveness. Thus, only those designs proven to identify source will be sheltered from competitor imitation under the Lanham Act. Trade dress protection, which is unlimited in duration, may not be the appropriate form of intellectual property protection for product designs that are not yet source identifying and do not cause consumer confusion (e.g., rapidly evolving clothing designs).<sup>92</sup>

*Wal-Mart* also encourages producers to turn to other methods of design protection. As the Court in *Wal-Mart* clarifies, a “producer can ordinarily obtain protection for a design that *is* inherently source identifying . . . but that does not yet have secondary meaning, by securing a design patent or a copyright.”<sup>93</sup> Producers who cannot show secondary meaning for their designs should seek protection under these intellectual property regimes, rather than under trade dress law. Some problems exist, however, with the use of design patents or copyrights to protect designs.<sup>94</sup> For instance, design patents are expensive and may take a long time to obtain.<sup>95</sup> Additionally, copyrights do not provide full protection, because they protect only sketches and patterns, not entire clothing items.<sup>96</sup>

The Supreme Court did not clearly address these shortcomings in intellectual property protection for product designs that have not developed

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91. See Fried, *supra* note 80, (stating the view of Raymond Dowd, a partner with New York firm, Dowd & Marotta, who represents fashion designers who modify clothing so frequently, that many do not register their designs, and designers “regularly see their runway fashions copied before they even hit the stores”).

92. See *Bonito Boats, Inc. v. Thunder Craft Boats, Inc.*, 489 U.S. 141, 157 (1989) (holding that the general public has the right to copy product designs, which are not protected by a patent or copyright, if there is no consumer confusion or deception regarding the design).

93. *Wal-Mart*, 529 U.S. at 215; see also Dolores K. Hanna, *Maximizing Trade Dress Protection*, in TRADE DRESS LAW § 9.02[C], [D] (discussing both copyrights and design patents as effective means of protecting trade dress).

94. See Fried, *supra* note 80 (discussing how “design patents are difficult and expensive to attain, and copyright law does not provide full protection either”).

95. See *id.*

96. See *id.* (“While patterns and sketches are copyrightable, the dress or shirt itself is not.”).

secondary meaning. Nonetheless, the fact that trade dress, patents, and copyrights fail to protect some product designs may mean that a new form of intellectual property protection is necessary to offer such protection.<sup>97</sup>

## B. Doctrinal Problems with the Supreme Court's Decision

Though the Court seems to have reached a correct decision from a policy standpoint, two main doctrinal problems are apparent in the Court's method of reaching its conclusion. First, the Court in *Wal-Mart* burdened lower courts with the task of distinguishing between packaging and design without explaining how this distinction should be made. Second, the Court failed to reconcile its seemingly conflicting *Two Pesos* opinion with its current reasoning in *Wal-Mart*.

### 1. Distinguishing between Packaging and Design

The *Wal-Mart* decision is beneficial in that the lower courts no longer have to consider the confusing issue of whether or not a product design is inherently distinctive.<sup>98</sup> In creating its bright-line rule, however, the Court may have complicated trade dress law. Although the Court removed the issue of whether a design is inherently distinctive, the Court failed to explain how to deal with an equal or even greater problem: distinguishing between product packaging and design. *Wal-Mart* may have shifted the producer's battle from arguing that his designs are inherently distinctive to contending that his designs constitute packaging.<sup>99</sup> The lower courts will

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97. Perhaps product designs that do not meet the requirements for protection under any of the existing intellectual property regimes should be left unprotected.

98. See Part I.A., *supra*, for a discussion of the lower courts' various tests in trying to determine inherent distinctiveness. By holding that product designs can never be inherently distinctive, the Court seems to have created a more efficient bright-line rule. The Court, however, did not examine any situations in which product designs actually do appear to be inherently distinctive, such as the design of some motor vehicles. The shape and design of the Volkswagen Beetle or the Lamborghini Countach are so unique that they are likely to automatically cause consumers to recognize that they originate from a single source. Furthermore, a few courts have recognized the designs of vehicle features to be inherently distinctive. *See, e.g.*, *Ferrari s.p.a. v. Roberts*, 944 F.2d 1235, 1239-40 (6th Cir. 1991) (holding that the shape and appearance of the Ferrari could be protected as a product configuration case); *Rolls-Royce Motors Ltd. v. A & A Fiberglass, Inc.*, 428 F. Supp. 689, 698 (N.D. Ga. 1977) (holding that the Rolls-Royce grille was protected as a type of product configuration trade dress). Though some product designs may fail to fit within the Court's bright-line rule, as long as the rule properly classifies *most* designs, it will likely increase efficiency in trade dress law. *See, e.g.*, *Bowen v. Massachusetts*, 487 U.S. 879, 927 (1988) (finding that it is efficient to have a bright-line rule for dealing with challenges to Medicaid disallowance decisions).

99. Fried, *supra* note 80, (arguing that "the High Court has paved the way for plaintiffs to argue that their designs are not designs at all, but really packaging," so the Court

have to establish, without much guidance from the Supreme Court, a whole new method for distinguishing between design and packaging; the courts may apply different and conflicting tests, just as they do for determining inherent distinctiveness.<sup>100</sup> If after applying these new tests, the feature is found to be packaging, then a court must once again muddle through the same old group of inherent distinctiveness tests to decide whether the packaging is inherently distinctive. The Supreme Court failed to explain which inherent distinctiveness test should be applied in this situation, and it failed to provide a definition of or test for distinguishing between packaging and design.

The Court itself recognized that in some situations the lower courts might have difficulty distinguishing between packaging and design.<sup>101</sup> The Court discussed the classic glass Coca-Cola bottle as an example. At first glance, the classic Coke bottle appears to be product packaging, meant only as dressing for the actual product—the soda. For a collector, however, the bottle may be the actual product of interest, and the soda just an added feature of a collectible good. If the bottle is the product, then it is the product's design that courts will examine for distinctiveness.<sup>102</sup> Thus, packaging and design can be indistinguishable, depending on the product that one is buying (the soda or the classic bottles of Coca-Cola) and even depending on the buyer (a soda buyer or a classic bottle collector).

*Two Pesos v. Taco Cabana* provides another example of packaging that could also be characterized as product design.<sup>103</sup> The Court found that the overall image of a Mexican restaurant, including décor, festive atmosphere, and dining and patio areas decorated brightly with murals, paintings, and artifacts, was inherently distinctive.<sup>104</sup> Yet, restaurant décor ar-

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may have “shifted the battle” from asking if something is inherently distinctive to asking whether it is packaging or design). For an example, see *Continental Lab Products v. Medax Int'l*, 114 F. Supp. 2d 992, 997-98 (S.D. Cal. 2000), where a plaintiff initially argues that his product design is inherently distinctive, but later (after the *Wal-Mart* decision issues) claims that his trade dress qualifies as packaging.

100. See Part I.A, *supra*, for a discussion of the different tests used by the courts to decide if a product feature is inherently distinctive.

101. See *Wal-Mart Stores, Inc. v. Samara Bros.*, 529 U.S. 205, 215 (2000). See *McKernan v. Burek*, 118 F. Supp. 2d 119 (Mass. Dist. Ct. 2000), as one example of a recent case, where the court faced the difficulty of deciding whether an ornamental bumper sticker constituted packaging or design since the “packaging and the product are so intertwined that distinguishing between them may be regarded as a scholastic endeavor.” *Id.* at 123-24.

102. See *Wal-Mart*, 529 U.S. at 215.

103. See *Two Pesos, Inc. v. Taco Cabana, Inc.*, 505 U.S. 763 (1992).

104. See *id.*

guably has elements of both packaging and design.<sup>105</sup> If consumers visit the Mexican restaurant for the dining ambiance, then the restaurant room and its furnishings are the actual product. The festive style of the restaurant makes up the design of the product, or the restaurant ambiance. If, however, the food is the restaurant's product, then the festive atmosphere may be considered a package meant to dress up the product in an appealing manner.

The *Wal-Mart* Court provided only a weak explanation of how the lower courts should deal with product features that could be either design or packaging, and did not follow its own suggestion when discussing *Two Pesos*.<sup>106</sup> Referring to the Coca-Cola bottle example, the Court concluded that in cases where it is difficult to decide if the product feature is packaging or design, "courts should err on the side of caution and classify ambiguous trade dress as product design, thereby requiring secondary meaning."<sup>107</sup> Yet, in *Two Pesos*, which is arguably a close case between packaging and design, the Court found the restaurant interior design to be inherently distinctive.<sup>108</sup> Indeed, the lower courts had difficulty deciding whether to treat *Two Pesos* as a packaging or a design case because the Supreme Court had generically referred to the décor as trade dress.<sup>109</sup> In *Wal-Mart*, the Court only vaguely described the *Two Pesos* restaurant décor as packaging or "some *tertium quid* that is akin to product packaging."<sup>110</sup> Troublingly, the Court declared *Two Pesos* to be a packaging case immediately before it directed the lower courts to err on the side of finding

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105. See, e.g., *Stuart Hall Co. v. Ampad Corp.*, 51 F.3d 780, 787-88 (8th Cir. 1995) (discussing *Two Pesos* and suggesting that restaurant décor could be akin to configuration as well as packaging; the product of the restaurant is the restaurant experience, including the room, furnishings, and the food).

106. See *Wal-Mart*, 529 U.S. at 215 (clarifying that the *Two Pesos* restaurant décor did not constitute product design).

107. *Id.*

108. See *Two Pesos*, 505 U.S. at 776.

109. The Third Circuit interpreted *Two Pesos* to involve packaging, while the Eighth and Fourth Circuits interpreted it as a product design case. See Deborah F. Buckman, *When Is Trade Dress "Inherently Distinctive" for Purposes of Trade Dress Infringement Actions Under § 43(a) of Lanham Act (15 U.S.C.A. § 1125(a))—Cases After Two Pesos*, 161 A.L.R. FED. 327, § 2(a) (2000) (discussing the Third Circuit's interpretation that *Two Pesos* was a product packaging case, while the Eighth Circuit understood the Court to be eliminating any distinction between packaging and design trade dress and interpreted *Two Pesos* to be a product configuration case); see also Symposium, *Trade Dress Protection: The Issue of Distinctiveness and Potential Conflicts*, 7 N. KY. L. REV. 1041, 1048 (also discussing the same views of the Third and Eighth Circuits along with the Fourth Circuit's view that *Two Pesos* was a design case).

110. *Wal-Mart*, 529 U.S. at 215.

close cases to be product design.<sup>111</sup> The Court gave no explanation for why *Two Pesos* is a packaging case or why the Court chose not to err on the side of calling it a design case.

## 2. *Failure to Reconcile Wal-Mart and Two Pesos*

By refusing to overrule *Two Pesos*, the Court has left as applicable law a case that arguably conflicts with the rule it adopted in *Wal-Mart*. The *Wal-Mart* decision represents a distinct retreat from the *Two Pesos* holding. The *Two Pesos* opinion focused primarily on the producer's interests, including a producer's right to the goodwill of his business, his right to maintain a competitive position, and the burdens his company would face if he were required to demonstrate secondary meaning.<sup>112</sup> *Two Pesos* seemed to be broadening unregistered trade dress protection. In contrast, the consumer-oriented *Wal-Mart* decision considered how product design suits based on inherent distinctiveness issues might deprive consumers of the benefits of competition.<sup>113</sup>

Additionally, the *Wal-Mart* Court seems to have modified its application of the Lanham Act. In *Two Pesos*, the Court emphasized the lack of textual basis in section 43(a) of the Lanham Act for "treating inherently distinctive . . . trademarks differently from inherently distinctive trade dress," to support its conclusion that unregistered trade dress could be inherently distinctive.<sup>114</sup> Since the Lanham Act did not treat trademarks and trade dress differently, there would be no reason for the Court to do so.<sup>115</sup> Interestingly, however, the Lanham Act also lacks a textual basis for treating product packaging differently from product design; the Act only refers to protection, in general, to avoid consumer confusion.<sup>116</sup> The *Wal-Mart* Court failed to address this issue. This change in Lanham Act interpretation may complicate how the lower courts choose to read the Lanham Act,<sup>117</sup> and it suggests that if the Lanham Act does not support treating

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111. *Id.*

112. *See Two Pesos*, 505 U.S. at 774-76.

113. *See Wal-Mart*, 529 U.S. at 212-13.

114. *Two Pesos*, 505 U.S. at 774.

115. *See id.*

116. *See* Lanham Act § 43(a), 15 U.S.C. § 1125(a) (2000). The court, in *Ashley Furniture Industries, Inc. v. Sangiacomo N.A. Ltd.*, 187 F.3d 363 (4th Cir. 1999), discussed the *Two Pesos* Court's emphasis on the language of the Lanham Act that supported treating trade dress and trademark the same, and noted that "the creation of a new rule to be applied only to product configuration would comport neither with the language of the statute nor with the Court's preference for uniformity." *Id.* at 371.

117. When interpreting the Lanham Act, the lower courts will be faced with choosing whether or not to look to the literal text of the Lanham Act, as the Supreme Court did in *Two Pesos*, as opposed to using the much looser *Wal-Mart* interpretation.

packaging and design differently, perhaps the Court should not have done so either, from a doctrinal standpoint. At the very least, the Court should have clarified why its "lack of textual basis" interpretation was not applicable in *Wal-Mart*.<sup>118</sup>

In addition to changing its application of the Lanham Act, the Court may have modified its definition of inherent distinctiveness. In *Two Pesos*, for example, the Court clarified that trade dress is inherently distinctive if it is "capable of identifying products or services as coming from a specific source."<sup>119</sup> In *Wal-Mart*, however, the Court suggested that a product feature is inherently distinctive if a producer intends the feature to represent a source.<sup>120</sup> Instead of focusing solely on whether a product feature will automatically represent the source or is capable of identifying the source, the Court considered whether a feature is *intended* to represent the source.<sup>121</sup> The Court discussed a penguin-shaped cocktail shaker as an example of a design that is not inherently distinctive; consumers will know the design is "intended not to identify the source, but to render the product itself more useful or more appealing."<sup>122</sup> Customers may, however, perceive a design as indicating the source even though it was intended only to be an attractive ornamentation. Even a design or package that was not intended to indicate the product source may result in consumer confusion if copied, and the Lanham Act should protect such consumers against confusion, regardless of producer intent.<sup>123</sup> Hence, from a doctrinal view, this flaw may suggest that the Court used an improper analysis to reach its conclusion.

The Court should have strengthened its opinion from a doctrinal standpoint by resolving these problems. At the very least, the Court should have addressed the inconsistencies between *Wal-Mart* and *Two Pesos*. More appropriately, the Court should have treated the *Two Pesos* restaurant décor as a form of product design and overruled *Two Pesos*.<sup>124</sup>

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118. See *Two Pesos*, 505 U.S. at 774.

119. *Id.* at 773.

120. See *Wal-Mart*, 529 U.S. at 212-13.

121. *Id.* at 213.

122. *Id.*

123. See JACOVER & BRENNAN, *supra* note 21, at 27 (explaining that the "stated purpose of the Lanham Act is to protect consumers from deceitful practices"). This protection from confusion, however, is restrained by the functionality doctrine, which sacrifices the chance of some consumer confusion in exchange for allowing functional product features to be copied. See MOHR ET AL., *supra* note 7, at 85.

124. This Note does not contend that *Two Pesos* was incorrect in demonstrating that some types of trade dress can be inherently distinctive. Instead, this Note contends that,

Though this alternative would not remove the need for a manageable test to distinguish between packaging and design, it would have at least resolve the inconsistencies between *Two Pesos* and *Wal-Mart*.

#### IV. CONCLUSION

Although *Wal-Mart* may be disquieting for the lower courts that must distinguish between product packaging and design, as a policy matter, the Supreme Court came to the correct result. This decision will likely promote both consumer interests and competition. *Wal-Mart* also does not greatly harm designers since there are still other, though possibly imperfect, methods of protecting designs. The opinion does, however, demonstrate some doctrinal flaws. The Court did not provide the lower courts with an explanation of how to deal with the burdensome issue of distinguishing between packaging and design. Moreover, the Court failed to reconcile *Two Pesos* and *Wal-Mart*. In the interest of promoting favorable precedent in trade dress law, the Court should have provided a test to distinguish between packaging and design and should have chosen to overrule *Two Pesos*.

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in light of *Wal-Mart*, the *Two Pesos* Court was incorrect in holding that the Mexican restaurant décor at issue was inherently distinctive.



## FORD MOTOR CO. V. LANE

*By Franklin B. Goldberg*

The Internet provides an unprecedented outlet for rapid and widespread dissemination of information. By operating a website with searchable content, even a novice homepage designer can channel considerable traffic to her site. As she begins to post more interesting information (e.g., information on a musical artist or links to corporate sites), the operator may inadvertently trigger an intellectual property violation through the unauthorized use of copyrighted or trademarked material. Even more troublesome, though, is that the website's facilitator can intentionally publish confidential information, thereby jeopardizing viable trade secrets.

A court may grant the trade secret holder injunctive relief should a misappropriator threaten such action. However, this remedy seemingly is available only if the trade secret misappropriator breaches a fiduciary duty to the trade secret holder when disseminating the confidential information. Absent such a duty, the trade secret holder may pursue monetary or criminal sanctions only *after* the trade secret's public disclosure. The Eastern District of Michigan applied this standard in *Ford Motor Co. v. Lane*,<sup>1</sup> denying Ford injunctive relief because Robert Lane was never a Ford employee, and therefore did not breach a fiduciary duty to Ford. This result seems peculiar, however, as Ford would no doubt find it difficult to recover the combined value of its research, blueprints, and fuel economy statistics from a thirty-two-year-old nursing student.

Although squarely within the limits of standard prior restraint doctrine,<sup>2</sup> the court's holding in *Ford v. Lane* was improper. Because the scope and character of public dissemination available through the Internet differs substantially from standard forums of protected expression—e.g., newspapers, periodicals, and television programs—the law needs to change. General trade secret principles, related notions in other legal fields, and practical considerations demonstrate that the court in *Lane* should have crafted a more effective remedy.

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1. 67 F. Supp. 2d 745 (E.D. Mich. 1999).

2. Prior restraint doctrine, grounded in the First Amendment's protections of pure speech, "imposes a special bar on attempts to suppress speech prior to publication." LAURENCE H. TRIBE, *AMERICAN CONSTITUTIONAL LAW* § 12-34, at 1040 (2d ed. 1988).

## I. CASE SUMMARY

### A. Facts

Robert Lane operated a website with the domain name fordworldnews.com, later renamed blueovalnews.com.<sup>3</sup> With prior approval from Ford Motor Company, Lane accessed and utilized information from Ford's press release website.<sup>4</sup> Upon learning that his domain name incorporated the name "Ford," however, Ford blocked Lane's access to the press releases.<sup>5</sup> Lane responded to this action by threatening to publish "sensitive" photographs and materials that Ford would find "disturbing," and to solicit the additional disclosure of confidential information from Ford employees.<sup>6</sup> Within a few months he posted classified information relating to engine design and fuel economy strategies, along with a Ford engineering blueprint.<sup>7</sup> When Ford threatened legal action, Lane released approximately forty more documents "including materials with high competitive sensitivity" onto his website.<sup>8</sup> Throughout these exchanges, Lane was aware that the documents were confidential, that Ford employees were bound by a confidentiality agreement, and that in providing him with these documents, the employees were violating their agreements with Ford.<sup>9</sup>

### B. Procedural History

In response to Lane's actions, Ford filed a complaint and a motion for a temporary restraining order ("TRO"), alleging copyright infringement, statutory conversion, intentional interference with contractual relations, misappropriation of trade secrets, misappropriation, trademark infringement, and unfair competition.<sup>10</sup> Ford alleged that Lane misappropriated trade secrets by soliciting and receiving information from Ford employees that he knew or had reason to know was confidential.<sup>11</sup>

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3. *Lane*, 67 F. Supp. 2d at 747.

4. *Id.*

5. *Id.* Upon Ford's instruction, Robert Lane then changed fordworldnews.com to blueovalnews.com.

6. *Id.* After meeting with Ford, however, Lane agreed to obtain Ford's approval before using any other Ford documents.

7. *Id.*

8. *Id.*

9. *Id.* at 748.

10. *Id.*

11. *Id.* Robert Lane counterclaimed, alleging a Sherman Antitrust Act violation. *See Ford Motor Co. v. Lane*, 86 F. Supp. 2d 711 (E.D. Mich. 2000). Specifically, Lane claimed that "Ford had the capability to produce higher-mileage, lower emissions cars and trucks but chose not to because of their 'gentlemen's agreement' with other auto

The court granted the TRO, enjoining Lane from “destroying, despoiling or electronically deleting or erasing” the information obtained from Ford and ordering him to provide the court with all such documents within his possession (along with their source and details pertaining to their acquisition).<sup>12</sup> Furthermore, the court restrained him from “(1) using, copying or disclosing any internal document of Ford Motor Company . . . , (2) committing any acts of infringement of Ford Motor Company’s copyrights . . . , [and] (3) interfering with Ford’s contractual relationship with its employees by soliciting Ford employees to provide Ford trade secrets or other confidential information.”<sup>13</sup> Lane acquiesced to the stipulations in the TRO, with the exception of the provision restricting his use, copying, and disclosing of Ford’s internal documents.<sup>14</sup> Lane filed a motion to show cause for this provision.<sup>15</sup>

### C. District Court’s Decision

The district court dissolved the TRO, holding that the First Amendment provides an affirmative defense to trade secret misappropriation when the moving party seeks a prior restraint on speech.<sup>16</sup> While finding that “Ford has presented evidence to establish that Lane is likely to have violated the Michigan Uniform Trade Secrets Act,” the court nonetheless concluded that “the Act’s authorization of an injunction violates the prior restraint doctrine and the First Amendment as applied under these circumstances.”<sup>17</sup> Accordingly, the court held that “[i]n the absence of a confidentiality agreement or fiduciary duty between the parties, Ford’s commercial interest in its trade secrets and Lane’s alleged improper conduct in

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makers.” *Id.* at 713. The District Court for the Eastern District of Michigan dismissed this suit. *Id.*

12. *Lane*, 67 F. Supp. 2d at 748.

13. *Id.* at 748-49.

14. *See id.* at 749.

15. *Id.* As a practical matter, the operator hosting Lane’s site removed its content soon after the court issued the TRO, as mandated by the Digital Millennium Copyright Act. *See* Kurt A. Wimmer, *Secrets on the Net*, 22 NAT’L L.J., Dec. 6, 1999, at A12; *see also* Digital Millennium Copyright Act, Pub. L. No. 105-304, § 512, 112 Stat. 2860, 2878-79 (1998) (codified as amended in scattered sections of U.S.C.) (“A service provider shall not be liable . . . [if] the service provider responds expeditiously to remove, or disable access to, the material that is claimed to be infringing upon notification of claimed infringement . . . only if . . . a court has ordered that the material be removed from the originating site . . . and the party giving the notification includes in the notification . . . that a court has ordered that the material be removed from the originating site . . .”).

16. *See Lane*, 67 F. Supp. 2d at 746, 754.

17. *Id.* at 750.

obtaining the trade secrets are not grounds for issuing a prior restraint."<sup>18</sup> In its decision, the court cited significant Supreme Court and circuit court precedent<sup>19</sup> and refused to expand the law to allow Ford an equitable remedy under the Michigan Uniform Trade Secrets Act ("Michigan Act"). It did not foreclose the possibility of a legal remedy, however, due to Lane's unauthorized dissemination of confidential information.

## II. LEGAL BACKGROUND

### A. Trade Secret Law

Trade secret law operates on the theory that innovators will lack the incentive to devote energy to projects without a legal framework protecting their endeavors.<sup>20</sup> Trade secret law also fosters a standard of business ethics, promoting good-faith transactions while punishing wrongdoing through criminal or civil sanctions.<sup>21</sup>

Trade secret law in the United States does not exist in a single doctrine. Rather, states rely on their own legislative acts and common law that generally apply either the principles reflected in the *Restatement (First) of Torts* or those from the more recent Uniform Trade Secrets Act ("UTSA").<sup>22</sup> The *Restatement* provides trade secret protection for "any

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18. *Id.* at 753.

19. *E.g.*, *Near v. Minnesota*, 283 U.S. 697, 701 (1931) (holding that freedom of the press prevents prior restraints on "malicious, scandalous, and defamatory" publication); *In re Providence Journal Co.*, 820 F.2d 1342, 1351 (1st Cir.1986) (holding that even if a temporary restraining order "was to last only a short period and merely [preserve] the status quo," this action is nonetheless improper "absent the most compelling circumstances"); *Procter & Gamble Co. v. Bankers Trust Co.*, 78 F.3d 219, 225 (6th Cir. 1996) (holding that Business Week's planned publications of trade secrets "did not constitute a grave threat to a critical government interest or to a constitutional right sufficient to justify a prior restraint."). *See generally* *Reno v. ACLU*, 521 U.S. 844 (1997) (holding that the First Amendment protects speech on the Internet). Unlike the cited cases, though, the *Lane* court did not categorize Lane's disclosures as contributions to the public dialogue, thereby justifying Lane's acts. Rather, without further explanation, the court held that "[a]lthough there are distinctions one can draw between the case brought by Ford and the existing precedent on prior restraint, those distinctions are defeated by the strength of the First Amendment." *Lane*, 67 F. Supp. 2d at 752.

20. *See* *Kewanee Oil Co. v. Bicron Corp.*, 416 U.S. 470, 481-82 (1974); *see also* JERRY COHEN AND ALAN S. GUTTERMAN, *TRADE SECRET PROTECTION AND EXPLOITATION* 13 (1998).

21. *See* Ryan Lambrecht, *Trade Secrets and the Internet: What Remedies Exist for Disclosure in the Information Age?*, 18 *REV. LITIG.* 317, 320-21 (1999).

22. *RESTATEMENT (FIRST) OF TORTS* § 757 (1939); *UNIF. TRADE SECRETS ACT*, 14 U.L.A. 437 (1985 & Supp. 1990); *see also* COHEN & GUTTERMAN *supra* note 20, at 13-14.

formula, pattern, device or compilation of information which is used in one's business, and which gives him an opportunity to obtain an advantage over competitors who do not know or use it."<sup>23</sup> Moreover, should a trade secret be lost due to an improper disclosure, the trade secret holder may pursue monetary damages to compensate for past harm or seek an injunction against future harm that may result from further disclosures.<sup>24</sup>

In recent years, most states have shifted away from the *Restatement* and have adopted the slightly broader protections afforded by the UTSA.<sup>25</sup> The UTSA defines a trade secret as any

information, including a formula, pattern, compilation, program, device method, technique, or process, that (i) derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use, and (ii) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.<sup>26</sup>

Similar to the *Restatement*, this Act holds that the "[a]ctual or threatened misappropriation [of a trade secret] may be enjoined."<sup>27</sup> The Michigan Act,<sup>28</sup> at issue in this case, is modeled after the UTSA.<sup>29</sup>

23. See RESTATEMENT (FIRST) OF TORTS § 757 cmt. b (1939). The Supreme Court echoed this formulation in *Kewanee Oil Co. v. Bicron Corp.*, 416 U.S. 470 (1974), affirming a district court's permanent injunction on the disclosure or use of trade secret related to the manufacture of synthetic crystals. See *id.* at 473-74. In sum, the Restatement and subsequent cases establish that information qualifies as a trade secret if it "(1) was used in one's business, (2) provided a competitive advantage, and (3) was secret, with the secrecy requirement ultimately being the most important of the three." COHEN & GUTTERMAN, *supra* note 20, at 14.

24. See RESTATEMENT (FIRST) OF TORTS § 757 cmt. e (1939).

25. As of this publication, forty-two states and the District of Columbia have adopted the UTSA. See UNIF. TRADE SECRETS ACT, 14 U.L.A. 163 (Supp. 2000). Notably, the UTSA states that any information that "derives independent economic value" from its secrecy might qualify as a trade secret, whereas the Restatement offers protection only upon the trade secret's use in a business setting. UNIF. TRADE SECRETS ACT § 1(4), 14 U.L.A. 438 (1985 & Supp. 1990); RESTATEMENT (FIRST) OF TORTS § 757 cmt. b (1939).

26. UNIF. TRADE SECRETS ACT § 1(4), 14 U.L.A. 438 (1985 & Supp. 1990).

27. *Id.* § 2(a) at 449. "Misappropriation" means either the (i) acquisition of a trade secret of another by a person who knows or has reason to know that the trade secret was acquired by improper means; or (ii) disclosure or use of the trade secret of another without express or implied consent by a person who (A) used improper means [e.g. "theft, bribery, misrepresentation, breach, or inducement of a breach of a duty to maintain secrecy or espionage through electronic or

The Restatement, UTSA, and Michigan Uniform Trade Secrets Act are similar in that they all allow a trade secret claim only if three conditions are met. First, the protected subject matter must be “the type of knowledge or information that trade secret law was meant to protect, and it must not be generally known to all.”<sup>30</sup> Most importantly, this criterion assures that the information is both a secret valuable enough to warrant legal protection and is generally unknown in a trade or industry.<sup>31</sup> Second, the information must have been wrongfully obtained or used, i.e., misappropriated.<sup>32</sup> Plaintiffs must prove this element so as not to thwart the proper acquisition and utilization of information. Finally, the plaintiff must prove that she took reasonable precautions to prevent disclosure of the information.<sup>33</sup> Although often left to the subjective evaluation of the courts,<sup>34</sup> this standard requires trade secret owners to take adequate precautions against unwarranted disclosure rather than merely relying on the courts to police the maintenance of their secrets.<sup>35</sup>

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other means,” *id.* § 1(1) at 437] to acquire knowledge of the trade secret; or (B) at the time of disclosure or use, knew or had reason to know that his knowledge of the trade secret was (I) derived from or through a person who had utilized improper means to acquire it; (II) acquired under circumstances giving rise to a duty to maintain its secrecy or limit its use; or (III) derived from or through a person who owed a duty to the person seeking relief to maintain its secrecy or limit its use; or (C) before a material change of his [or her] position, knew or had reason to know that it was a trade secret and that knowledge of it had been acquired by accident or mistake.

*Id.* § 1(2) at 438. For similar language, see MICH. COMP. LAWS ANN. § 445.1902 (West 1998).

28. MICH. COMP. LAWS ANN. § 445.1901-10 (West 1998).

29. Michigan adopted the UTSA in 1998, subject to several modifications. *See* UNIF. TRADE SECRETS ACT § 1(4), 14 U.L.A. 163 (Supp. 2000).

30. ROBERT P. MERGES ET AL., *INTELLECTUAL PROPERTY IN THE NEW TECHNOLOGICAL AGE* 35 (2d ed. 2000).

31. *See id.*

32. *Id.*

33. *Id.* at 36.

34. *See* *Rockwell Graphics Sys., Inc. v. DEV Indus.*, 925 F.2d 174, 179 (7th Cir. 1991) (holding that what is a “reasonable precaution . . . depends on a balancing of costs and benefits that will vary from case to case and so require an estimation and measurement by persons knowledgeable in the particular field of endeavor involved”).

35. There is no single accepted rationale for this requirement. *See* MERGES ET AL., *supra* note 30, at 36.

## B. The First Amendment and Prior Restraints

The First Amendment provides that “Congress shall make no law . . . abridging the freedom of speech, or of the press.”<sup>36</sup> In interpreting the First Amendment, courts hold that “speech should be regulated only in the most rare and extreme circumstances, for the freedom to speak one’s mind is essential in discovering the truth on matters of public interest, enriching the intellectual vitality of society, and fulfilling the potential of the individual.”<sup>37</sup> It is through this lens that courts view prior restraints, and it therefore follows that a court will question *any* limitation on free speech.

This notion has ample support in case law. For example, in *Near v. Minnesota*<sup>38</sup> the Supreme Court held a Minnesota statute unconstitutional because it condoned state censorship of malicious, scandalous, and defamatory speech intended for publication.<sup>39</sup> Quoting Blackstone, the Court noted that “[t]he liberty of the press is indeed essential to the nature of a free state; but this consists in laying no previous restraint upon publications.”<sup>40</sup> Forty years later, the Supreme Court reaffirmed this doctrine. Citing *Bantam Books v. Sullivan*,<sup>41</sup> the Court in *New York Times Co. v. United States*<sup>42</sup> held that “[a]ny system of prior restraints of expression comes to this Court bearing a heavy presumption against its constitutional validity.”<sup>43</sup> Once again restating its reservations regarding speech restrictions, in *CBS v. Davis*,<sup>44</sup> the Supreme Court added that a court may enjoin speech “only where the evil that would result from the reportage is both great and certain and cannot be militated by less intrusive measures.”<sup>45</sup>

Circuit courts similarly recognize the nearly universal prohibition of prior restraints on speech.<sup>46</sup> The First Circuit, for example, in deciding *In*

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36. U.S. CONST. amend. I. Under the Fourteenth Amendment, First Amendment protections extend to the individual states. See U.S. CONST. amend. XIV.

37. Lambrecht, *supra* note 21, at 326. See *infra* Parts II.B. and III.B. for relevant Supreme Court and circuit court holdings.

38. 283 U.S. 697 (1931).

39. *Id.* at 701-02.

40. *Id.* at 713.

41. 372 U.S. 58, 70 (1963).

42. 403 U.S. 713 (1971).

43. *Id.* at 714.

44. 510 U.S. 1315 (1994).

45. *Id.* at 1317-18 (holding that Federal Beef Processors, Inc. did not meet this burden, as the harm caused by broadcasting footage of its meat-packing facilities was based on merely “speculative predictions” and “factors unknown and unknowable”).

46. These opinions are relevant to this discussion for purposes of comparison with the Supreme Court’s application of prior restraint doctrine.

*re Providence Journal Co.*,<sup>47</sup> observed that “[o]f all the constitutional imperatives protecting a free press under the First Amendment, the most significant is the restriction against prior restraint upon publication.”<sup>48</sup> Similarly, the Sixth Circuit, in *Procter & Gamble v. Bankers Trust Co.*,<sup>49</sup> held that prior restraints on speech were permissible only when absolutely necessary to advance a substantial government interest and where the plaintiff faces irreparable harm that cannot be prevented by less severe means.<sup>50</sup> Therefore, courts have uniformly noted their reservations about issuing prior restraints, as they seemingly run counter to the First Amendment. In theory, unless one’s speech falls within a limited number of exceptions, one should be at liberty to disseminate information on any subject matter and in any public medium.

### C. First Amendment Prohibitions on Prior Restraints Are in Tension with Trade Secret Laws

Contrary to general principles advancing the value of and protections extended to free speech, trade secret statutes explicitly preclude certain public disclosures. Specifically, one *may not* disseminate confidential information in *any* public medium. Consequently, there is an inherent tension between the First Amendment and trade secret law.

Given the judicial hesitance in permitting prior restraints on speech, one might expect the First Amendment to trump trade secret protections when the two doctrines conflict. Nonetheless, prior restraints—in the form of preliminary injunctions—are somewhat common in trade secret cases so long as the movant establishes that “1) it will suffer irreparable injury if this injunction is not granted, 2) that such injury outweighs the likely harm which would be inflicted on the defendant by the requested relief, 3) [the] likelihood of success by the plaintiff on the merits [is substantial], and 4) that the requested relief will not adversely affect the public interest.”<sup>51</sup> For example, in *Cherne Industrial, Inc. v. Grounds & Assoc., Inc.*,<sup>52</sup> the Minnesota Supreme Court held that the moving party satisfied the requisite conditions and granted a preliminary injunction to prevent the future use of confidential customer lists.<sup>53</sup> The Third Circuit issued a similar ruling in

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47. 820 F.2d 1342 (1st Cir. 1986).

48. *Id.* at 1345.

49. 78 F.3d 219 (6th Cir. 1996).

50. *See id.* at 225 (citing *CBS v. Davis*, 510 U.S. 1315, 1317 (1994)).

51. 3 MILGRIM ON TRADE SECRETS § 14.01[1], 14-17 (Supp. 2000); *see also* Ford Motor Co. v. Lane, 67 F. Supp. 2d 745, 749 (E.D. Mich. 1999).

52. 278 N.W.2d 81 (Minn. 1979).

53. *See id.* at 92-94.

*SI Handling Systems, Inc. v. Heisley*,<sup>54</sup> holding that an employer could enjoin a former employee's disclosure of a coefficient of friction used in making calculations for "material handling system" designs.<sup>55</sup> Courts have likewise permitted injunctions for unwarranted disclosures of accounting records<sup>56</sup> and supply agreements.<sup>57</sup>

Although courts may occasionally preempt trade secret disclosures, many courts have added a fifth requirement to the test for preliminary injunctions—a breach of a fiduciary duty between the trade secret holder and the misappropriator. *Cherne* and *SI Handling*, and indeed, *Lane*, explicitly rely on this criterion.<sup>58</sup> As mentioned above, the court in *Lane* expressly precluded injunctive relief because there was no confidentiality agreement or a fiduciary duty between Ford and Lane, and therefore held that "Ford's commercial interest in its trade secrets and Lane's alleged improper conduct in obtaining the trade secrets are not grounds for issuing a prior restraint."<sup>59</sup> This result is questionable, however, as the insertion of this fifth requirement runs counter to the strict wording of the UTSA and Michigan Act. On their faces, these statutes permit a court to enjoin improper disclosures<sup>60</sup> merely if the trade secret was acquired "by a person who knows or has reason to know that the trade secret was acquired by improper means," or was disclosed or used "without express or implied consent."<sup>61</sup>

### III. THE DISTRICT COURT'S HOLDING IN *LANE* WAS IMPROPER

Starting with the proposition that prior restraints on speech should be allowed in only the most narrowly tailored and exceptional circumstances,

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54. 753 F.2d 1244 (3d Cir. 1985).

55. *Id.* at 1248-49, 1263-64.

56. See *KLM Royal Dutch Airlines, N.V. v. deWit*, 415 N.Y.S.2d 190 (N.Y. Sup. Ct. 1979).

57. See *Merck & Co. v. Lyon*, 941 F. Supp. 1443 (M.D.N.C. 1996).

58. The court in *Lane* expressed its general hesitance at issuing prior restraints, holding that "[t]he Michigan Uniform Trade Secrets Act is not unconstitutional on its face, as an injunction may issue against one who plans to reveal a trade secret in violation of an employment contract or in breach of a fiduciary duty." *Ford Motor Co. v. Lane*, 67 F. Supp. 2d 745, 750 n.6 (E.D. Mich. 1999); see also *Cherne*, 278 N.W.2d at 94. See generally *SI Handling Sys.*, 753 F.2d 1244.

59. *Lane*, 67 F. Supp. 2d at 753.

60. MICH. COMP. LAWS ANN. § 445.1903(1) (West 1998); UNIF. TRADE SECRETS ACT § 2(a), 14 U.L.A. 449 (1985 & Supp. 1990).

61. MICH. COMP. LAWS ANN. § 445.1902(b) (West 1998); UNIF. TRADE SECRETS ACT § 1(2), 14 U.L.A. 438 (1985 & Supp. 1990).

the court held that the First Amendment provided a partial defense to trade secret misappropriation: Robert Lane may still face criminal or civil sanctions, but Ford may not enjoin his disclosures.<sup>62</sup> Nonetheless, this need not be the result. First, precedent within trade secret law clearly authorizes prior restraints, regardless of the presence of a fiduciary relationship between the parties. Second, prior restraints are permitted in a variety of contexts analogous to trade secret law, further suggesting that denying an injunction in the present case was improper. Third, the district court relied upon precedent that may not apply to trade secret disclosures on the Internet. Finally, there are practical arguments against reading the Michigan Act (and the UTSA) to preclude preliminary injunctions in trade secret cases such as *Lane*.

#### A. Precedent Supports Preliminary Injunctions

Restraints on speech, and sometimes action, are common throughout the law. Within trade secret, copyright, and defamation and libel law, a court may restrict one's right to disseminate information in a public medium in appropriate circumstances.

##### 1. *Precedent in Trade Secret Law Supports Preliminary Injunctions*

###### a) Protective Orders and the Freedom of Information Act

When courts require a party facing litigation to identify its trade secrets with particularity during discovery or trial, these courts afford the trade secret holder some procedural protections against public dissemination.<sup>63</sup> As already witnessed in *Lane*, a court may grant a temporary injunction if the defendant has misappropriated confidential information from the plaintiff.<sup>64</sup> Courts additionally permit more substantial restrictions, by issuing protective orders during discovery and trial proceedings.<sup>65</sup> One leading commentator on trade secrets notes that

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62. See *Lane*, 67 F. Supp. 2d at 753.

63. See generally 3 MILGRIM, *supra* note 51, § 14.02[1], at 14-60.

64. See *Lane*, 67 F. Supp. 2d at 746 n.1.

65. See FED. R. CIV. P. 26(c):

"Protective orders. Upon motion by a party or by the person from whom discovery is sought, accompanied by a certification that the movant has in good faith conferred or attempted to confer with other affected parties in an effort to resolve the dispute without court action, and for good cause shown, the court in which the action is pending or alternatively, on matter relating to a deposition, the court in the district where the deposition is to be taken may make any order which justice requires to protect a party or person from annoyance, embarrassment,

one fundamental tension in trade secret litigation is the trade secret plaintiff's need to litigate to protect its trade secrets without forfeiting the secrecy of the matter as an incident of litigation. Another basic tension is the desire of the plaintiff to not further educate an allegedly errant defendant in the intricacies of plaintiff's trade secrets.<sup>66</sup>

As such, it is unnecessary to identify the nature of a trade secret in a publicly filed document such as a complaint.<sup>67</sup> Indeed, in some situations, a plaintiff may successfully convince a court that no trade secret disclosures are permissible, or at worst only certain aspects of them are.<sup>68</sup> In those cases in which a court deems the disclosure necessary, the court will often employ in camera hearings and the use of sealed records to prevent public dissemination of the confidential information.<sup>69</sup>

Aside from judicial protection, the U.S. Congress has instituted its own safeguards with respect to trade secrets. The Freedom of Information Act<sup>70</sup> generally allows public access to all documents within the public record.<sup>71</sup> However, the statute exempts "trade secrets and commercial or financial information obtained from a person and privileged or confidential."<sup>72</sup> The federal government, therefore, recognizes that although the

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oppression, or undue burden or expense, including . . . that a trade secret or other confidential research, development, or commercial information not be revealed or be revealed only in a designated way."

66. 3 MILGRIM, *supra* note 51, § 14.02[1], at 14-60.

67. *Id.* §14.02, at 14-60.

68. *See Gate-Way, Inc. v. Wilson*, 94 Cal. App. 2d 706, 713-14 (1949); *Hartman v. Remington Arms Co.*, 143 F.R.D. 673, 674-78 (D. Mo. 1992) (completely prohibiting the discovery of highly valuable product-development trade secrets of the defendant).

69. 3 MILGRIM, *supra* note 51, § 14.02[6], at 14-199, 14-201. The same holds true when an administrative agency hears a case. *Id.* § 14.02[4][c], at 14-116-17, 14-202. The Supreme Court has limited the right to publish certain confidential information obtained pursuant to additional types of litigation, outside of the trade secret arena, as well. In *Seattle Times Co. v. Rhinehart*, 467 U.S. 20 (1984), for example, the Supreme Court affirmed an injunction which prevented a newspaper from publishing the names of members in a religious organization. The Court reasoned that because the *Seattle Times* obtained the names through a compulsory legal process, restricting this disclosure did not violate the First Amendment. *See id.* at 32-33. Put simply, "restraints placed on discovered, but not yet admitted, information are not a restriction on a traditionally public source of information," assuming this prior restraint advanced other substantial interests. *Id.* For a more thorough discussion, see 1 SMOLLA AND NIMMER ON FREE SPEECH § 15:51, 15-81 (1999).

70. 5 U.S.C. § 552 (1994 & Supp. IV 1998).

71. *See id.* § 552(a).

72. *Id.* § 552(b)(4).

public's interest is best served by its ability to search through public documents, this right is not absolute.

These judicial and legislative protections demonstrate that within some areas of the trade secret doctrine, courts permit a restraint on public dissemination of confidential information. In applying the standards set forth above, courts and administrative agencies acknowledge the value in holding a trade secret. Moreover, courts do not qualify these safeguards by conditioning trade secret protection on the presence of a fiduciary relationship, as required in *Ford v. Lane*.

#### b) Inevitable Disclosures

The doctrine of inevitable disclosures also imposes prior restraints. In certain situations, an employer may successfully prevent a former employee from beginning work at a different company within the same field, maintaining that such action would most likely result in the improper dissemination of trade secrets. In *PepsiCo, Inc. v. Redmond*,<sup>73</sup> for example, the Seventh Circuit held that PepsiCo's former general manager could not accept a position with Quaker, PepsiCo's competitor.<sup>74</sup> PepsiCo argued successfully that in the course of his new employment, Redmond would inevitably rely upon and disclose PepsiCo's trade secrets, including beverage pricing, marketing, and distribution information.<sup>75</sup> In this case (and indeed in all successful inevitable disclosure cases), the court allowed a prior restraint on not only the employee's oral or written expression, but on the employee's *actions*, as well.<sup>76</sup>

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73. 54 F.3d 1262 (7th Cir. 1995).

74. *See id.* at 1272.

75. *See id.* at 1269-72.

76. *See also* *Teradyne, Inc. v. Clear Communications Corp.*, 707 F. Supp. 353, 355-56 (1989) (suggesting that "[t]hreatened misappropriation can be enjoined under the Illinois law" [where there is a] "high degree of probability of inevitable and immediate disclosure and use of . . . trade secrets"); *Uncle B's Bakery, Inc. v. O'Rourke*, 920 F. Supp. 1405, 1433 n.17 (N.D. Iowa 1996) (holding that a bagel manufacturer may enjoin a former employee from working for a competitor "in order to protect a former employer from disclosure of trade secrets where disclosure appears inevitable from the nature of the former employee's employment with the competitor"). Misappropriation claims as a result of inevitable disclosures, however, rarely succeed. *See, e.g.*, *Campbell Soup Co. v. Giles*, 47 F.3d 467, 471-72 (1st Cir. 1995) (denying an inevitable disclosure claim because the plaintiff failed to convince the court that a former employee would inevitably disclose trade secrets to his new employer, and even if he did, Campbell would not have been irreparably harmed); *FMC Corp. v. Cyprus Foote Mineral Co.*, 899 F. Supp. 1477, 1479 (W.D.N.C. 1995) (holding that an inevitable disclosure claim cannot prevent a former employee's future employment even though the employee's past and future employers are the only two producers of battery-quality lithium products in the United States).

This doctrine is particularly important to the analysis of *Ford v. Lane*, and to trade secret law in general. Initially, the general legal trend grants trade secrets only narrow protections, as evidenced by the “fiduciary duty” requirement. In contrast, inevitable disclosure claims broaden trade secret protections by restricting not only free speech, but actions as well. Further, and as a corollary to the latter, the inevitable disclosure doctrine questions the internal logic of the *Lane* decision. Specifically, if a court is willing to restrict a party’s actions *and* speech by limiting her employment opportunities, it seems that a court would necessarily allow for a restriction on *only* speech, regardless of a fiduciary duty between the parties. In *Lane*, however, the court followed standard prior restraint precedent. In so doing, not only did it unnecessarily narrow a field somewhat conducive to expansion, it additionally perpetuated a legal inconsistency.<sup>77</sup>

## 2. *Precedent in Other Areas of the Law Supports Preliminary Injunctions*

### a) Copyright

Within the confines of intellectual property law itself, the courts, via statutory and constitutional applications, have established an arena in which prior restraints are par for the course.<sup>78</sup> The Copyright Act of 1976 provides such speech restrictions, stating that “[a]ny court having jurisdiction of a civil action arising under this title may . . . grant temporary *and* final injunctions on such terms as it may deem reasonable to prevent or restrain infringement of a copyright.”<sup>79</sup> The Eleventh Circuit Court of Appeals, in *Cable/Home Communication Corp. v. Network Productions, Inc.*,<sup>80</sup> offered a clear application of this rule along with its policy justifications. It noted that “[s]ince the Copyright Act is the congressional implementation of a constitutional directive to encourage inventors by protecting their exclusive rights in their discoveries, copyright interests also must be guarded under the Constitution, and injunctive relief is a common judi-

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77. Although illustrative, *PepsiCo. v. Redmond* may nonetheless prove distinguishable from *Ford Motor Co. v. Lane*. In the former, there was a fiduciary relationship between the parties; in the latter there was not.

78. See Mark A. Lemley and Eugene Volokh, *Freedom of Speech and Injunctions in Intellectual Property Cases*, 48 DUKE L.J. 147, 150 (1998); see also MERGES ET AL., *supra* note 30, at 554 (“[P]reliminary injunctions are generally granted as a matter of course where a plaintiff can convince the court that a finding of infringement is likely.”).

79. 17 U.S.C. § 502(a) (1994) (emphasis added). Moreover, copyright law allows injunctive relief against “[a]nyone who violates the exclusive rights of the copyright owner,” not merely parties who breach a fiduciary duty to the rights holder. *Id.* at § 501 (1994) (emphasis added).

80. 902 F.2d 829 (11th Cir. 1990).

cial response to infringement of a valid copyright.”<sup>81</sup> Thus, courts regularly enjoin the speech of infringing parties to protect the economic and creative interests of the copyright holder.<sup>82</sup>

State legislatures enacted trade secret laws to protect inventors’ rights to their discoveries, just as Congress passed the Copyright Act of 1976 to protect artists’ rights to their creations. Further, a trade secret holder, like a copyright holder, faces substantial economic loss if a misappropriator wrongfully uses or discloses her work. It therefore seems inconsistent for courts to allow prior restraints within one arena of intellectual property law, but disallow it in another—even though the legal and policy justifications behind the laws are similar—merely because the misappropriator herself did not breach a fiduciary duty.<sup>83</sup>

#### b) Defamation and Libel

The First Amendment and common law generally preclude prior restraints on the publication of defamatory or libelous material.<sup>84</sup> Indeed, such remedies are not only extraordinary, but presumptively invalid,<sup>85</sup> even if the disseminated speech is false or injurious to someone’s character.<sup>86</sup> Moreover, some courts completely bar injunctive relief because defamation and libel actions often allow an adequate legal remedy.<sup>87</sup>

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81. *Id.* at 849.

82. Yet, “[e]ven when a copyright violation may occur. . . the issuance of a prior restraint should by no means be a routine matter.” SMOLLA AND NIMMER, *supra* note 69, § 15:60, at 15-103.

83. Copyright law, in contrast with trade secret law, may allow such speech restrictions because of the limitations and exceptions afforded to non-copyright holders within the Copyright Act of 1976. *See* Copyright Act of 1976, P.L. 94-553, 90 Stat. 2541 (current version at 17 U.S.C. § 107 (1994)). Because the basis of trade secrets protection is *secrecy*, however, similar limitations and exceptions within trade secret law would prove impractical.

84. *See* RODNEY A. SMOLLA, LAW OF DEFAMATION § 9.13[1][a], at 9-37 (1988).

85. *See supra* Part II.B.

86. *See* Parker v. Columbia Broadcasting Sys., Inc., 320 F.2d 937, 939 (2d Cir. 1963) (holding that an order enjoining appellant from communicating with any person with regard to any “matters contained” in a stockholder’s memorandum, including allegations of fraud and misconduct on the part of appellees and their counsel, violates the First Amendment); *Konigsberg v. Time, Inc.*, 288 F. Supp. 989, 989 (S.D.N.Y. 1968) (holding that “[a] court of equity will not, except in special circumstances, issue an injunctive order restraining libel or slander or otherwise restricting free speech.” Moreover, “[t]o enjoin any publication, no matter how libelous, would be repugnant to the First Amendment to the Constitution, and to historic principles of equity.”).

87. *See, e.g.*, Community for Creative Non-Violence v. Pierce, 814 F.2d 663, 672 (D.C. Cir. 1987); *Alberti v. Cruise*, 383 F.2d 268, 272 (4th Cir. 1967); *McLaughlin v. New York*, 784 F. Supp. 961, 978 (N.D.N.Y. 1992).

Nonetheless, several courts have veered from this strict position, suggesting that they might enjoin defamatory speech, particularly if the speech injures business-related interests.<sup>88</sup> For example, the Third Circuit, in *System Operations v. Scientific Games Development Corp.*,<sup>89</sup> suggested that defamation may warrant injunctive relief.<sup>90</sup> Although the court reversed an injunction that restrained the defendant from disparaging the plaintiff's products and interfering with his contractual relationships, it indicated that a prior restraint would have been proper had the moving party satisfied a four-pronged test.<sup>91</sup> Further, the Court of Appeals of Texas, in *Karamchandani v. Ground Technology, Inc.*,<sup>92</sup> upheld an injunction preventing the appellant from sending letters to the appellee's clients. The court of appeals averred that because appellant's communication attempted to coerce these clients to discontinue business with appellee, the trial court acted within its discretion by granting the injunction.<sup>93</sup> Finally, within a concurring opinion in *Lothscheutz v. Carpenter*,<sup>94</sup> the Sixth Circuit Court of Appeals posited that a court can temporarily enjoin future speech if the offending party reiterates the same libelous and defamatory charges made prior to the suit.<sup>95</sup> Moreover, the concurrence maintained that a permanent injunction might also be proper if necessary to protect the injured party's personal reputation and business relations.<sup>96</sup>

These cases, therefore, demonstrate that courts might compromise their standard prohibitions of prior restraints on speech. In *System Operations* and *Karamchandani*, the courts suggested that a prior restraint on

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88. See generally *Vondran v. McLinn*, 1995 WL 415153 (N.D. Cal. July 5, 1995) (reviewing cases enjoining defamatory business-related speech).

89. 555 F.2d 1131 (3d Cir. 1977).

90. See *id.* at 1141. This court chose not to hold that "a preliminary injunction against a competitor's product disparagement necessarily violate[s] the constitutional prohibition against prior restraints on speech," instead leaving the issue unanswered. *Id.* at 1146.

91. "[T]he moving party must generally show (1) a reasonable probability of eventual success in the litigation and (2) that the movant will be irreparably injured pendente lite if relief is not granted. Moreover, while the burden rests upon the moving party to make these two requisite showings, the district court 'should take into account, when they are relevant, (3) the possibility of harm to other interested persons from the grant or denial of the injunction, and (4) the public interest.'" *Id.* at 1141 (citing *Oburn v. Shapp*, 521 F.2d 142, 147 (3d Cir. 1975)). This test is similar to the standard courts apply when allowing injunctions in trade secret cases. See *supra* Part II.C; 3 MILGRIM, *supra* note 51, §14.01[1], at 14-17.

92. 678 S.W.2d 580 (Tex. App. 1984).

93. See *id.* at 582.

94. 898 F.2d 1200 (6th Cir. 1990).

95. See *id.* at 1208 (Wellford, J., concurring in part and dissenting in part).

96. See *id.* at 1208-09.

statements that defame a product, interfere with contractual relationships, or harm other business interests may be proper. If a court is willing to enjoin someone's libelous or defamatory speech in these cases, no logical leap is needed to allow a prior restraint of Lane's dissemination of Ford's economically valuable trade secrets. Further, in *Lothscheutz*, the concurrence held that a party's speech, which merely perpetuates defamatory statements made prior to the suit, may properly be enjoined. Therefore, the *Lothscheutz* standard clearly would have allowed an injunction in *Lane*, preventing Lane from perpetuating his unwarranted disclosures. Equally important, these cases all permit injunctive relief from a harm caused by wrongful conduct, regardless of a breach of a fiduciary duty between the parties. Because Ford's injuries arose from Lane's misappropriations of trade secrets, themselves wrongful acts, *System Operations*, *Karamchandani*, and *Lothscheutz* indicate that an alternative holding in *Lane* would have had judicial, albeit merely persuasive, support.

## **B. Unfavorable First Amendment Precedent Should Not Be Applied to Trade Secret Cases**

In its decision in *Ford v. Lane*, the district court relied upon hallmark Supreme Court and circuit court cases within First Amendment law to preclude a prior restraint on Robert Lane's disclosures. These cases all demonstrate the judiciary's unwillingness to chill the free exchange of expression within newspapers, magazines, or nationally broadcast television shows. As the following section demonstrates, however, these cases can be distinguished from *Lane*, suggesting that they do not apply to trade secret disclosures on the Internet.

### *I. Near v. Minnesota*

In *Near v. Minnesota*, the defendant published "The Saturday Press," a newspaper which regularly printed editions "largely devoted to malicious, scandalous and defamatory articles" concerning public figures, the Jewish Race, and local and national organizations.<sup>97</sup> The Minnesota Supreme Court initially upheld a statute that permitted a prior restraint on the newspaper's publication because its acts fell within the definition of a public nuisance.<sup>98</sup> The U.S. Supreme Court reversed, however, noting that because the "administration of government has become more complex" and open to malfeasance and corruption, there is a "primary need [for] a vigilant and courageous press."<sup>99</sup> As such, "liberty of the press, historically

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97. 283 U.S. 687, 703 (1931).

98. *Id.* at 706-07.

99. *Id.* at 719-20.

considered and taken up by the Federal Constitution . . . [grants] principally although not exclusively, immunity from previous restraints or censorship.”<sup>100</sup>

Although at first glance *Near* seems to support the district court’s holding in *Lane*, this is not necessarily the case. On a practical level, “The Saturday Press” was a publicly disseminated periodical that frequently commented on public figures, the Minneapolis press, Jews, and members of grand juries.<sup>101</sup> By contrast, blueovalnews.com was a personal website that disclosed confidential information without public commentary on issues of social concern.<sup>102</sup> The potential economic consequences of the prior restraints also distinguish their holdings. If the Supreme Court had upheld the Minnesota statute in *Near*, thereby allowing the censorship of public speech, the publishers might have lost a few subscriptions. The result would have been quite different had the Eastern District of Michigan allowed a prior restraint on Robert Lane’s disclosures. In this scenario, Ford would have retained—rather than lost—the value of its trade secrets (potentially millions of dollars).<sup>103</sup> Further, any financial harm only would have befallen the web server, as it might have lost Lane’s business. Because Lane’s speech added little to public discourse, and because its main effect was substantial economic harm, the propositions advanced in *Near* therefore prove inapplicable.

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100. *Id.* at 716.

101. *Id.* at 703.

102. Although Robert Lane initially used his website to disseminate information of public interest, Lane altered the site’s content to include “sensitive” trade secrets when Ford requested that fordworldnews.com be changed to blueovalnews.com. *Ford Motor Co. v. Lane*, 67 F. Supp. 2d, 745 747 (E.D. Mich. 1999). One might nonetheless argue that because Ford is a large corporation, any information regarding its business (including its trade secrets) is of public concern, or that because some of Lane’s postings referenced problems with Mustang engines and Ford’s approach to emission standards, this too was of public interest and was thus protected by the First Amendment. On the whole, however, “the documents published more recently appear to be design and product information more useful to Ford’s competitors—published for the purpose of flexing First Amendment muscle.” *Lane*, 67 F. Supp. 2d at 753. This point takes on additional importance in the discussion of *CBS, Inc. v. Davis*, 510 U.S. 1315 (1994), *infra* Part III.B.3.

103. As mentioned in *supra* note 15, the website host of blueovalnews.com removed the site’s content as mandated by the Digital Millennium Copyright Act, and therefore mitigated some of Ford’s harm. Nonetheless, in foreclosing the availability of equitable relief in cases such as *Lane*, the court opened the door for subsequent trade secret violations via unauthorized Internet disclosures.

## 2. New York Times Co. v. United States

The majority opinion in *New York Times Co. v. United States* quickly dismissed the United States' attempt to prevent the New York Times and Washington Post from publishing a classified study entitled "History of U.S. Decision-Making Process on Viet Nam Policy."<sup>104</sup> In its ruling, the Court reviewed well-established precedent on prior restraints and concluded that the government did not meet the substantial burden necessary to authorize such an act.<sup>105</sup> Justice Black's concurrence further grounded the Court's reasoning, positing that "every moment's continuance of the injunctions against these newspapers amounts to a flagrant, indefensible, and continuing violation of the First Amendment."<sup>106</sup> This opinion then turned to the role of the press in the United States:

The press was to serve the governed, not the governors. The Government's power to censor the press was abolished so that the press would remain forever free to censure the Government. The press was protected so that it could bare the secrets of government and inform the people . . . *The New York Times*, the *Washington Post*, and other newspapers should be commended for serving the purpose that the Founding Fathers saw so clearly.<sup>107</sup>

This reasoning indicates that *New York Times* is inapplicable to *Lane*. Once again, it seems inappropriate to compare blueovalnews.com, a personal website that disseminates misappropriated trade secrets while adding little to the public discourse, to *The New York Times* or *Washington Post*, globally disseminated newspapers that facilitate the free exchange of ideas.<sup>108</sup> Further, the concurring opinion insists that a democracy should ensure that its participants have free access to criticize the government. Does this necessarily mean that a democracy's participants have the right to harm a corporation's economic interests by publishing confidential trade secrets? Probably not. When we add to this the fact that the district

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104. 403 U.S. 713, 714 (1971).

105. *See id.*

106. *Id.* at 714-15. (Black, J., concurring).

107. *Id.* at 717.

108. Moreover, newspapers rely on editorial boards to weigh liability concerns and public interest values when deciding what to print. Because "it may be true that publication on the Internet is subject to fewer editorial restraints than *The New York Times*, *Business Week*, or *The Washington Post*," however, the district court in *Lane* took this editorial function upon itself. *Ford Motor Co. v. Lane*, 67 F. Supp. 2d 745, 752-53 (E.D. Mich. 1999). One could argue, therefore, that a prior restraint is not only permissible, but necessary in the absence of effective self-regulation.

court presumably *would* have restrained Lane's disclosures had he breached a fiduciary duty to Ford,<sup>109</sup> in direct opposition to the free speech values espoused in *New York Times*, the district court's application of the latter ruling becomes even more questionable.

### 3. CBS Inc. v. Davis

*CBS Inc. v. Davis*,<sup>110</sup> also cited by the district court, adds an additional dimension to the analysis. In this case, CBS sought to televise footage taken at the factory of Federal Beef Processors, Inc. ("Federal"). The South Dakota Circuit Court granted a temporary restraining order, holding that a broadcast of this type would likely cause irreparable economic injury to Federal, as a significant portion of national chains might thereafter refuse to purchase beef processed at its facilities.<sup>111</sup> Nonetheless, Justice Blackmun stayed this injunction, maintaining that an "indefinite delay of the broadcast will cause irreparable harm to the news media [rather than to Federal] that is intolerable under the First Amendment."<sup>112</sup> Importantly, Blackmun noted that because Federal could not prove that it would suffer significant economic harm upon broadcast, the Supreme Court could not "rely on such speculative predictions as based on 'factors unknown and unknowable'" in allowing a prior restraint.<sup>113</sup>

The Eastern District of Michigan's reliance on *CBS* to deny a prior restraint against Robert Lane is misplaced. First, a nationally broadcast program seeking to expose unsanitary practices within the beef industry appears starkly different from a student's disclosure of trade secrets.<sup>114</sup> Second, unlike restraining "48 Hours," enjoining Lane's disclosures probably would not have caused him irreparable harm. Rather, he could have maintained his website and posted *non*-confidential information about Ford. Third, disclosing the unsanitary conditions within the Federal plant would have—at most—*indirectly* benefited its competitors, as distributors and consumers might have opted for different sources of meat upon viewing the exposé. In contrast, Ford's competitors could *directly* benefit from Lane's disclosures, as they could usurp the information and incorporate

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109. *Id.* at 753.

110. 510 U.S. 1315 (1994).

111. *See id.* at 1316.

112. *Id.* at 1318.

113. *Id.* (citing *Nebraska Press Ass'n v. Stuart*, 427 U.S. 539, 563 (1976)).

114. *CBS* would only prove applicable to *Ford v. Lane* if Lane disclosed the trade secrets solely to expose unsafe manufacturing designs. Although Lane's public dissemination may have had this effect, his motive was apparently retaliation—rather than public concern—thereby proving *CBS* inapplicable. *See Lane*, 67 F. Supp. 2d at 747-48.

the statistics and blueprints into their business plans and production designs.

Finally, and perhaps most fundamental to this discussion, Justice Blackmun tacitly implied that if Federal could prove that airing the tape would certainly cause it substantial economic hardship, the Court might not have stayed the injunction.<sup>115</sup> In *Lane*, however, the court recognized that Lane's continued publication of trade secrets would undoubtedly harm Ford's economic interests.<sup>116</sup> Nonetheless, it disallowed a restriction of Lane's speech that would have conclusively insulated Ford from certain economic loss.

#### 4. Procter & Gamble Co. v. Bankers Trust Co.

*Procter & Gamble Co. v. Bankers Trust Co.*<sup>117</sup> is also distinguishable from *Lane*. In this case, McGraw-Hill, the publishers of "Business Week," sought to reverse an injunction prohibiting publication of confidential information regarding a legal suit.<sup>118</sup> The Court of Appeals for the Sixth Circuit, in applying the aforementioned Supreme Court precedent, ruled that the permanent injunction was an unconstitutional prior restraint on speech.<sup>119</sup> In reversing the lower court, it held that "[f]ar from falling into that 'single, extremely narrow class of cases' where publication would be so dangerous to fundamental government interests as to justify a prior restraint . . . [t]he private litigants' interests in protecting . . . their commer-

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115. See *CBS*, 510 U.S. at 1318. Indeed, Blackmun found the equivocal language in the lower court's opinion dispositive in precluding a prior restraint (the lower court held that airing the tape "could result" in economic harm and would "likely cause irreparable injury to Federal") (emphasis added). *Id.*

116. *Lane*, 67 F. Supp. 2d at 753 ("the documents published more recently appear to be design and product information . . . useful to Ford's competitors").

117. 78 F.3d 219 (6th Cir. 1996).

118. See *id.* at 221. The court maintained this prior restraint through successive injunctive orders, the last of which "was open-ended in duration and did not set a date for a hearing." *Id.* at 222. McGraw-Hill immediately appealed to the Court of Appeals for Sixth Circuit, which held that the district court's injunction "could best be characterized as a temporary restraining order, and was therefore not a final order and not appealable." *Id.* McGraw-Hill then unsuccessfully petitioned Supreme Court Justice Stevens for an emergency stay. See *id.* At Stevens' suggestion, the district court commenced a factual hearing to determine how the documents had been acquired. The next day, the court again extended the injunction. See *id.* at 222-23. Three weeks after initially enjoining its publication, the district court permanently enjoined *Business Week* from using "the confidential materials that it obtained unlawfully." *Id.* at 223.

119. See *id.* at 225.

cial self-interest simply does not qualify as grounds for imposing a prior restraint.”<sup>120</sup>

At first glance, this case apparently suggests that economic harm is not a factor when considering the constitutionality of a prior restraint. Like *Near*, *New York Times*, or *CBS*, however, *Procter & Gamble* cannot be applied to a decision concerning trade secret disclosures on the Internet. The court in *Procter & Gamble* tacitly supported this proposition by noting that *Business Week* sought to publish a “news story” which was of “public concern,” and that *Business Week* followed “journalistic protocol” by seeking commentary from the parties.<sup>121</sup> In *Lane*, however, Lane did not post a news story, and the trade secret disclosures were of questionable public concern. Further, Lane did not follow any journalistic protocol as he never sought commentary from Ford before posting the trade secrets. Quite the contrary, he disclosed much of the information in retaliation to Ford’s commencing a legal action against him.<sup>122</sup> *Procter & Gamble*, therefore, cannot squarely support a holding that the First Amendment protects Lane from a prior restraint.

##### 5. Summary of Case Law

The Supreme Court and circuit courts view prior restraints of speech with a cautious eye. However, in supporting its decision, the Eastern District of Michigan cited cases that were clearly distinguishable from *Ford Motor Co. v. Lane*. First, the cases concerned speech couched in nationally distributed and widely known media, not on an Internet user’s personal website. Second, although they indicated that speculative economic harm might not weigh into a judge’s calculations when issuing prior restraints, the cases did not necessarily prohibit prior restraints if the harm was certain. Finally, the opinions strongly espoused the value of public discourse on issues of societal interest. Robert Lane, however, did not criticize public figures, a widely practiced religion, or American foreign policy. Nor did he expose conditions inside a meat factory or attempt to publish journalistic works. Rather, he misappropriated confidential information at the expense of Ford.<sup>123</sup>

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120. *Id.* at 224 (citing *New York Times Co. v. United States*, 403 U.S. 713, 726 (1971) (Brennan, J., concurring)).

121. *Id.* at 224-25.

122. *See Lane*, 67 F. Supp. 2d at 747.

123. This analysis is necessarily case-specific. One might argue that had Lane’s disclosures revealed issues of substantial public concern—labor conditions within the factories, workers’ rights, etc.—a court might justifiably have issued a prior restraint. Similarly, if the content and readership of blueovalnews.com were similar to that of msnbc.com (which like *The New York Times* or *Washington Post* discusses current

### C. A Preliminary Injunction in *Ford Motor Co. v. Lane* is Practical

As discussed above,<sup>124</sup> the UTSA and Michigan Act do not condition a prior restraint in trade secret cases on the breach of a fiduciary duty. Yet, introducing such a requirement may leave Ford without adequate legal recourse. Indeed, holding Robert Lane liable at law, thus requiring Ford to extract damages from a potentially judgment-proof defendant,<sup>125</sup> may be no recourse at all. Moreover, criminal sanctions, although perhaps a deterrent, would not restore Ford to its position before the misappropriation.

Further, and as a corollary to the latter concern, broadly applying the principles in *Lane* may provide competing businesses incentives to misappropriate trade secret if such acts prove "efficient."<sup>126</sup> For example, assume employee X steals corporation C's trade secrets. X then gives them to her friend, Y, who posts them on the Internet. As long as no one catches X, the trade secrets are lost because the court will not restrain Y's disclosures, as demonstrated in *Lane*. Now imagine X is really a large corporation. Having enticed one of C's employees (who necessarily has a fiduciary duty to C) to breach a confidentiality agreement with C, it can easily misappropriate C's trade secrets. X can give them to Y, assuring Y that it would pay any legal damages in a misappropriation suit. To allay Y's concerns of criminal penalties, X need only raise its offer to make the gamble more attractive. Under *Lane*, as long as X stands to gain more than it spends on the exchange, i.e., as long as the misappropriation is "efficient," there seems to be little that the law can do to prevent the trade secret disclosure.

## IV. CONCLUSION

In *Ford Motor Co. v. Lane*, the Eastern District of Michigan relied upon standard First Amendment precedent in precluding a prior restraint of Robert Lane's trade secret disclosures. This holding, however, contradicts the literal reading of the Michigan Act. Moreover, it diverges from

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events, social policy concerns, and other issues of public interest through a widely accessed news medium), it might warrant First Amendment protection. Blueovalnews.com, however, avoids such classification, as discussed above. Therefore, one cannot comfortably fit *Ford v. Lane* within the scope of the relied upon precedent.

124. See *supra* Part. II.C.

125. It is very unlikely that someone in Robert Lane's position could pay a huge cash award to a harmed trade secret holder.

126. Just as a breach of contract is efficient if "the party contemplating breach will gain enough from the breach to have a net benefit even though he compensates the other party for his resulting loss," RESTATEMENT (SECOND) OF CONTRACTS reporter's note, ch.16 (1981), the same may hold true in trade secret cases.

analogous treatment both within and outside of trade secret law, and improperly applies First Amendment precedent to a personal website that not only lacks public commentary but also guarantees economic harm to the trade secret holder. If universally applied, it may even encourage trade secret disclosures.

Because anyone can access and utilize the Internet, conditioning injunctive relief on the breach of a fiduciary duty between a trade secret holder and misappropriator places valuable secrets needlessly at risk. *Ford Motor Co. v. Lane* makes it clear, therefore, that a court should not permit the Internet, which greatly enhances one's ability to search, retrieve, and transfer information, to become a vehicle for unchecked trade secret misappropriations.



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**ANTITRUST**



## UNITED STATES V. MICROSOFT CORP.

*By Mark Geier*

The dawn of the information age,<sup>1</sup> where markets are characterized by strong economies of scale,<sup>2</sup> network effects,<sup>3</sup> and rapid innovation, has created new challenges for antitrust law and policy. Strong economies of scale and network effects lead to markets dominated by one firm. Although such markets often have efficiencies and benefits, antitrust law must be able to control abuses of this naturally acquired power without damaging the competitive structure of the market.

Microsoft, the world's largest software company and one of the leaders of the information economy, has held a dominant position in the personal computer operating system market for more than a decade. Microsoft used its power aggressively to maintain its supremacy in current markets and expand into new ones, prompting the government to bring an antitrust suit. As the first major case of its kind to be fully litigated, this case will likely structure the nation's antitrust policy as applied to information markets.

This Note begins by summarizing the factual and legal issues in *United States v. Microsoft Corp.*<sup>4</sup> It then addresses the difficulty of litigating complex antitrust cases involving rapidly evolving markets and concludes by discussing the appropriate role of antitrust enforcement in the information age.

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1. Information in this context is broadly defined as "anything that can be digitized." CARL SHAPIRO & HAL R. VARIAN, *INFORMATION RULES: A STRATEGIC GUIDE TO THE NETWORK ECONOMY* 3 (1999).

2. Economies of scale occur where a firm's average total costs decrease as its level of production increases. *Id.* at 21. In information products, economies of scale result from high initial research and development (fixed) costs combined with very low per unit (marginal) costs of production thereafter. *Id.* at 20-21.

3. Network effects result from the presence of a network of users and make a particular information product more attractive to buyers as more people possess it. *Id.* at 175. There are two types of networks: virtual networks, where consumers are not actually connected to each other (e.g., operating systems), and real networks, where consumers are connected (e.g., fax machines). *See id.* at 174.

4. 87 F. Supp. 2d 30 (D.D.C. 2000).

## I. BACKGROUND

### A. Factual Background

The U.S. government and nineteen states brought suit against Microsoft in May 1998, alleging violations of sections 1 and 2 of the Sherman Antitrust Act.<sup>5</sup> The crux of the government's case was that Microsoft used its dominant market position in the personal-computer ("PC") operating system market to attempt to monopolize the Internet browser market and to limit the development of middleware technologies.<sup>6</sup> The government contended that Microsoft acted to protect a barrier to entry<sup>7</sup> into the operating system market and maintain its monopoly position.<sup>8</sup>

#### 1. Relevant Technologies

The government's case revolves around the interactions between operating system, Internet browser,<sup>9</sup> and middleware technologies. An operating system supports software functions through its exposure of interfaces called "application programming interfaces" ("APIs").<sup>10</sup> APIs allow developers to access blocks of code that perform important tasks for the application.<sup>11</sup> In performing this function, the operating system acts as a platform for applications.<sup>12</sup>

Middleware is non-operating-system software that supplies its own set of APIs.<sup>13</sup> Middleware has the potential to serve as an operating-system-independent platform, allowing developers to write one version of an ap-

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5. Government's Complaint at 1, *United States v. Microsoft Corp.*, 87 F. Supp. 2d 30 (D.D.C. 2000) (Nos. 98-1232, 98-1233), available at <http://www.usdoj.gov/atr/cases/f1700/1763.htm> (last visited Feb. 2, 2001) [hereinafter Government's Complaint]; 15 U.S.C. §§ 1-7 (1994).

6. Government's Complaint, *supra* note 5, at 1-2. Middleware is defined *infra* Part I.A.1.

7. A barrier to entry is a market characteristic that prevents firms from entering a market. The height of barriers depends on objective factors (e.g., scale economies, product differentiation, capital requirements, and ability of established firms to block access), as well as anticipated reactions of market participants. PHILLIP AREEDA & LOUIS KAPLOW, *ANTITRUST ANALYSIS*, ¶ 114, at 18 (5th ed. 1997).

8. Government's Complaint, *supra* note 5.

9. Internet browsers are software programs that enable a users to retrieve and view resources on the Internet. *United States v. Microsoft Corp.*, 84 F. Supp. 2d 9, 14 (D.D.C. 1999).

10. *Id.* at 12 ("[APIs] are synapses at which the developer of an application can connect to invoke pre-fabricated blocks of code in the operating system.").

11. *Id.*

12. The operating system also controls the allocation and use of the computer's resources. *Id.*

13. *Id.* at 17.

plication that is able to function on several operating systems.<sup>14</sup> Sun Microsystems' ("Sun") Java technologies and Netscape's Communicator are examples of middleware.<sup>15</sup> Middleware requires an underlying operating system, but it makes the consumer's choice of an operating system less dependent on the availability of applications.<sup>16</sup> This is important because the number of applications available is a major factor in consumers' choice of operating systems.<sup>17</sup> Thus, by removing this factor, middleware lowers a barrier to entry into the operating system market.<sup>18</sup>

## 2. *Microsoft's Response to the Development of Middleware and Rise of the Internet*

In May 1995, Sun introduced its Java programming language.<sup>19</sup> Sun developed Java to enable applications to run on a variety of platforms with minimal porting.<sup>20</sup> To become a cross-operating-system platform, Sun needed a Sun-compliant Java runtime environment<sup>21</sup> to be present on computers running Windows.<sup>22</sup> To accomplish this goal, Sun contracted with Netscape to include a Java runtime environment with Netscape's Internet browser, Navigator.<sup>23</sup>

Microsoft's alleged misconduct began in May 1995, soon after Netscape released Navigator.<sup>24</sup> Microsoft executives, fearing that Netscape

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14. Currently, middleware is not able to support full-featured applications, and it is not clear that it will in the future. *Id.* at 17-18.

15. Netscape's Communicator is a group of related programs that includes its Internet browser, Navigator. Other examples include Apple's QuickTime Media Player, the RealNetworks' multimedia playback technologies, and Intel's Native Signal Processing software. *Id.* at 30.

16. *Id.* at 17.

17. *See id.* at 18. *But see* Richard McKenzie, *Microsoft's 'Application Barrier to Entry': The Missing 70,000 Programs*, available at <http://www.cato.org/pubs/pas/pa380.pdf> (questioning the number of applications necessary to make an operating system viable in the eyes of consumers).

18. *See Microsoft*, 84 F. Supp. 2d at 19-22.

19. *Id.* at 29.

20. *Id.* Porting is the process of adapting an application written for one platform to run on another. *Id.*

21. Sun's Java contains four elements: (1) the Java programming language; (2) the Java class libraries, which expose APIs; (3) the Java compiler, which converts code into Java "bytecode"; and (4) "Java virtual machines," which convert Java bytecode into instructions understandable to the operating system. *Id.* at 29. A Java runtime environment consists of the Java virtual machines and the Java class libraries. *Id.*

22. *Id.* at 30.

23. *Id.*

24. *Id.* at 29.

would develop Navigator as a competing platform,<sup>25</sup> proposed to split the browser market with Netscape.<sup>26</sup> After Netscape refused, Microsoft delayed release of technical information to Netscape,<sup>27</sup> thereby preventing Netscape from having a compatible version of Navigator available when Microsoft released Windows 95.<sup>28</sup>

In July 1995, Microsoft released the first version of its Internet Explorer browser ("Explorer").<sup>29</sup> Thereafter, Microsoft engaged in a multi-front strategy to accelerate Explorer's attainment of usage share.<sup>30</sup> Microsoft devoted substantial resources to the technical development of Explorer<sup>31</sup> and gave Explorer away by bundling it with Windows and by providing free copies to software developers and Internet access providers ("IAPs").<sup>32</sup> Microsoft also exchanged various inducements for agreements to distribute and promote Explorer and to inhibit the distribution of Navigator.<sup>33</sup>

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25. *Id.*

26. *Id.* at 31-32. Microsoft made the proposal on June 21, 1995 during a meeting with James Barksdale, Netscape's CEO. *Id.* This agreement would have effectively given Microsoft control over the standards employed by web or network based applications. *Id.* at 33.

27. *See id.* at 33.

28. *Id.* at 33. Microsoft exhibited similar conduct in dealing with several other companies that were developing middleware technologies. In each case Microsoft's conduct inhibited middleware technology from becoming widely used. *See id.* at 34-36 (describing conduct to dissuade Intel from developing its Native Signal Processing Software); *id.* at 36-37 (reciting conduct towards Apple's QuickTime multimedia software); *id.* at 37-38 (explaining conduct towards RealNetworks' "streaming" software); *id.* at 38-43 (relating conduct towards IBM's SmartSuite software).

29. *Id.* at 14.

30. *Id.* at 44. Usage share is the percent of users working on a given company's browser. SHAPIRO & VARIAN, *supra* note 1, at 290. This is the relevant measure for this product because many users have multiple browsers on their computer but use only one. *Id.*

31. *See Microsoft*, 84 F. Supp. 2d at 43-44. Microsoft spent \$100 million dollars a year from 1995 to 2000 to develop Explorer. *Id.*

32. *Id.* at 44. Microsoft made this decision even though it knew that Netscape was receiving substantial revenue from licensing Navigator. *Id.* In addition, Microsoft's efforts to maximize Explorer usage severely limited possible profits derived from Explorer. *Id.* at 46. Further, internal Microsoft e-mails and memoranda indicate a motive to gain browser usage in order to protect its leadership on the desktop. *Id.*

33. *Id.* at 45. Microsoft encouraged developers to utilize Microsoft's Internet technologies. *Id.*; *see also id.* at 49-53 (including Explorer with every copy of Windows); *id.* at 58-66 (preventing OEMs from modifying the Windows desktop); *id.* at 66-68 (offering preferential prices and treatment to OEMs who agreed not to install Navigator); *id.* at 69-72 (offering free complementary services facilitating the use of Explorer by IAPs); *id.* at 72-76 (exchanging favorable placement on Window's Internet Connection Wizard in

Among these exchanges were contracts requiring companies to distribute or promote Explorer exclusively. The most important contracts were those with original equipment manufacturers (“OEMs”)<sup>34</sup> and IAPs,<sup>35</sup> which provide the most efficient means of distributing browser software.<sup>36</sup> Microsoft entered into similar contracts with Internet content providers,<sup>37</sup> independent software vendors,<sup>38</sup> and Apple Computer.<sup>39</sup> From early 1996 to late 1998, Explorer’s usage share rose from five percent to forty-five to fifty percent, while Navigator’s share fell from eighty percent to approximately fifty-five percent.<sup>40</sup>

Aside from promoting Explorer, Microsoft also directly hindered the success of Sun’s Java programming language. After Microsoft received a license to distribute Java, Microsoft modified the version of Java included with Windows.<sup>41</sup> Microsoft’s modifications made Java easier for developers to use and made Java programs run faster.<sup>42</sup> The modifications, however, made it more difficult to port applications, frustrating Sun’s goal of developing Java as a cross-operating-system platform.<sup>43</sup> In response, Sun filed a separate suit alleging violation of the license terms and trademark infringement,<sup>44</sup> which was recently settled.<sup>45</sup>

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return for a fee, promotion and distribution of Explorer, and inducing customers to switch from Navigator to Explorer); *id.* at 77-86 (trading favorable placement on Window’s desktop and other considerations for agreements to distribute and promote Explorer to the exclusion of Navigator); *id.* at 77-85 (including an agreement with AOL).

34. Examples of OEMs are Compaq and Gateway.

35. Examples of IAPs are America Online and the Microsoft Network (“MSN”).

36. *Microsoft*, 84 F. Supp. 2d at 46-48.

37. *See id.* at 87-93. Microsoft engaged in a campaign to encourage Internet content providers (“ICPs”) to feature links and advertisements for Explorer, to distribute Explorer with their software, and to utilize Microsoft’s technologies when creating their content. *Id.*

38. *See id.* at 93-94. Microsoft encouraged independent software vendors (“ISVs”) to use Windows-specific technologies rather than Navigator’s. *Id.*

39. *See id.* at 94-98. To induce Apple to pre-install and promote Explorer, Microsoft threatened to stop porting MS Office to Apple’s Macintosh operating system. *Id.*

40. *Id.* at 98-99. Further, the court estimated that Explorer’s share would grow to between sixty and sixty-five percent by late 2000. *Id.* at 102.

41. *Id.* at 106.

42. *Id.*

43. *Id.* Microsoft also engaged in other practices that limited Java’s development as a cross-operating-system platform. *See id.* at 107-10.

44. *See Sun Microsystems, Inc. v. Microsoft Corp.*, 87 F. Supp. 2d 992 (N.D. Cal. 2000) (reinstating a preliminary injunction requiring Microsoft to stop selling all non-Sun compliant products bearing the Java trademark).

45. Matt Richtel, *Microsoft to Pay \$20 Million to Settle Lawsuit Over Java*, N.Y. TIMES, Jan. 23, 2001, at C4. The settlement terminated the licensing contract that sparked

### 3. *The Nature and Structure of Information Markets*

The dynamic nature of information markets is important to the discussion of *Microsoft*, as it affects the ability of litigation to correct market problems. The two most important characteristics are strong supply-side economies of scale<sup>46</sup> and network effects.<sup>47</sup> Markets characterized by these effects tend to “tip” because once a firm reaches a certain market share, network effects will help push its share towards one hundred percent.<sup>48</sup> This occurs because the “[a]doption of new technologies follow[s] an S-shaped curve with three phases: (1) flat during launch, then (2) a steep rise during takeoff as positive feedback kicks in, followed by (3) leveling off as saturation is reached.”<sup>49</sup>

Additionally, users of information products frequently face switching costs in adopting a new standard.<sup>50</sup> Switching costs for information products frequently rise with time because users become increasingly familiar with specific systems.<sup>51</sup> When these costs are high, users may become locked-in to a standard because the cost of switching is greater than the perceived benefit of the switch.<sup>52</sup> Lock-ins are common with information products “because information is stored, manipulated, and communicated using a ‘system’ consisting of multiple pieces of hardware and software and because specialized training is required to use specific systems.”<sup>53</sup> This may result in “‘path dependence’: an industry may be stuck with an inferior technology because of the cost advantage of the existing network.”<sup>54</sup>

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the suit, prohibited Microsoft from using Sun’s latest version of Java or the “Java compatible” trademark with its products, and mandated that Microsoft pay twenty million dollars to Sun. *Id.*

46. *Id.* at 20; *supra* text accompanying note 2.

47. *Id.* at 174; *supra* text accompanying note 3.

48. *Id.* at 176.

49. *Id.* at 178.

50. *Id.* at 103.

51. *Id.* at 121.

52. *Id.* at 104.

53. *Id.* at 116.

54. Richard Posner, *Antitrust in the New Economy*, Address at a conference on anti-trust sponsored by the American Law Institute-American Bar Association Committee on Continuing Professional Education (Sept. 14, 2000), *available at* <http://www.techlawjournal.com/atr/20000914posner.asp>; *see also* Daniel Rubinfeld, *Competition, Innovation, and Antitrust Enforcement in Dynamic Network Industries*, Address at Software Publishers Association 1998 Spring Symposium (March 24, 1998), *available at* <http://www.usdoj.gov/atr/public/speeches/1611.htm> (“Dynamic markets are often characterized by path dependence, i.e., the path of innovation is often determined by historical events that may or may not be tied to efficient pro-competitive behavior.”).

Another important characteristic of information markets is strong economies of scale. The combination of demand- and supply-side economies of scale results in very strong positive feedback because “growth on the demand-side both reduces cost on the supply-side and makes the product more attractive to other users—accelerating the growth in demand even more.”<sup>55</sup> This strong effect causes “entire industries to be created or destroyed far more rapidly than during the industrial age.”<sup>56</sup> These market dynamics, along with rapid technological innovation,<sup>57</sup> lead the information economy to be populated by temporary monopolies.<sup>58</sup> In these markets a new entrant with superior technology will very likely surpass the current dominant standard.<sup>59</sup>

These market characteristics make *Microsoft* an important and controversial case. The operating system market exhibits many of the traits discussed above, including strong network effects, high switching costs, and strong economies of scale.<sup>60</sup> This dynamic makes the application of anti-trust law particularly difficult in *Microsoft* and in information markets generally.

## B. The Sherman Act and Antitrust Policy

*Microsoft* implicates sections 1 and 2 of the Sherman Act.<sup>61</sup> Section 1 prohibits “every contract, combination . . . or conspiracy, in restraint of trade or commerce.”<sup>62</sup> Section 2 states that it is unlawful to “monopolize . . . any part of the trade or commerce among the several States, or with

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*But see* STAN LIEBOWITZ & STEPHEN E. MARGOLIS, DISMAL SCIENCE FICTIONS: NETWORK EFFECTS, MICROSOFT, AND ANTITRUST SPECULATION (Cato Inst. Policy Analysis No. 324, 1998) (questioning an inferior standard’s ability to achieve and maintain market dominance), at <http://www.cato.org/pubs/pas/pa324b.pdf>.

55. SHAPIRO & VARIAN, *supra* note 1, at 182.

56. *Id.* The combination of supply- and demand-side economies of scale is new and different from anything present in other industries. *Id.*

57. *United States v. Microsoft Corp.*, 84 F. Supp. 2d 9, 25-26 (D.D.C. 1999).

58. SHAPIRO & VARIAN, *supra* note 1, at 173.

59. *Id.*

60. *Microsoft*, 84 F. Supp. 2d at 19-20. In addition, the court found that these market dynamics gave rise to a concerted action problem among developers. *Id.* at 20-21. Developers know there will be a demand if there are a significant number of applications available for a new operating system; but it is very risky to be the first one, so no one acts. *Id.* This is countered by a first mover advantage, as the first developer to enter can earn high profits by being first in the category of software for an operating system. *Id.* at 21.

61. Government’s Complaint, *supra* note 5.

62. 15 U.S.C. § 1 (1994).

foreign nations.”<sup>63</sup> Because the statutory language is vague, courts have played a central role in shaping antitrust law and policy.<sup>64</sup>

Two competing economic frameworks shape current antitrust law and policy.<sup>65</sup> The Chicago school believes that antitrust law should try to maximize allocative efficiency<sup>66</sup> without impairing productive efficiency<sup>67</sup> such that it lowers consumer welfare.<sup>68</sup> The Chicago school’s influence is apparent in many of the major antitrust opinions of the last twenty-five years.<sup>69</sup> The traditional school, on the other hand, asserts that antitrust law should have broader goals.<sup>70</sup> These goals include promotion of efficiency but also include protection of competition, promotion of innovation, and prevention of market concentration.<sup>71</sup>

The Justice Department’s current policy is closest to the traditional view.<sup>72</sup> The government’s concern in *Microsoft*, and in information mar-

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63. *Id.* § 2.

64. See LAWRENCE SULLIVAN & WARREN GRIMES, *THE LAW OF ANTITRUST: AN INTEGRATED HANDBOOK* 8 (2000).

65. A third discipline is the post-Chicago school, which asserts that antitrust should have two goals: maximizing efficiency and preventing wealth transfer from consumers to firms with market power. *Id.* at 9.

66. The Pareto and Kaldor-Hicks definitions of allocative efficiency are widely accepted. 1 PHILLIP E. AREEDA & HERBERT HOVENKAMP, *ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION* ¶ 112(b)(1), at 119-20 (1996). A situation is Pareto efficient when “no change could make at least one person better off without simultaneously making at least one person worse off.” *Id.* at 119 n.3. Kaldor-Hicks efficiency occurs where “those who gain from the change gain enough so that they could fully compensate all losers from the change and still be better off themselves; that is net gains, measured by willingness to pay, exceed net losses.” *Id.* at 120 n.4.

67. Productive efficiency is “the ratio between the amount of a firm’s inputs and the amount of its outputs.” Herbert Hovenkamp, *Antitrust Policy After Chicago*, 84 MICH. L. REV. 213, 238 (1985). Thus, a firm is more efficient if it can make the same product with lower costs or resources than another. *Id.*

68. *Id.* at 215, (citing ROBERT BORK, *THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF* 91 (1978)).

69. See, e.g., *State Oil v. Khan*, 522 U.S. 3 (1997); *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.* 509 U.S. 209 (1993); *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2 (1984); *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977).

70. SULLIVAN & GRIMES, *supra* note 64, at 9-16.

71. *Id.* at 11-16. Other goals are the protection of individual firms and the prevention of wealth transfer from consumers to firms with market power. *Id.*

72. Joel I. Klein, *Rethinking Antitrust Policies for the New Economy*, Address at the Haas/Berkeley New Economy Forum (May 9, 2000), available at <http://www.usdoj.gov/atr/public/speeches/4707.pdf> (stating that the “core principles of antitrust” are “that free and competitive markets result in maximum economic develop-

kets generally, is that companies might “use their substantial market power to harm innovation, to retard technological progress, and ultimately to harm consumers.”<sup>73</sup>

### C. Legal Background

The government charged Microsoft with four violations of the Sherman Act.<sup>74</sup>

#### 1. Maintenance of Monopoly Power by Anticompetitive Means

To establish this section 2 violation, the government must prove: “(1) the possession of monopoly power and (2) the willful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident.”<sup>75</sup>

Monopoly power is “the power to control prices or exclude competition.”<sup>76</sup> To determine whether monopoly power exists, a court defines the relevant market and then assesses the defendant’s power to control prices or to exclude competition from that market.<sup>77</sup> The relevant market includes all possible substitutes for the defendant’s product viewed from the buyer’s perspective.<sup>78</sup> The court considers both geographic limitations on the market (e.g., tariffs or transportation costs) and limitations imposed by supply- and demand-side product substitution.<sup>79</sup> A finding of a dominant

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ment, wealth creation, and consumer welfare”). Whether this policy continues under the new Bush administration remains to be seen.

73. Rubinfeld, *supra* note 54, at 18-19.

74. See Government’s Complaint, *supra* note 5.

75. *Eastman Kodak Co. v. Image Tech. Servs., Inc.*, 504 U.S. 451, 480 (1992) (quoting *United States v. Grinell Corp.*, 384 U.S. 563, 570-71 (1966)).

76. *United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377, 391 (1956).

77. *United States v. Microsoft Corp.*, 87 F. Supp. 2d 30, 36 (D.D.C. 2000).

78. See *Eastman Kodak*, 504 U.S. at 481-82 (“The relevant market for antitrust purposes is determined by the choices available to Kodak equipment buyers.”); *Grinell*, 384 U.S. at 572 (stating that the relevant market is determined by the “commercial realities” of the market); *Du Pont*, 351 U.S. at 391 (The relevant “[m]arket is composed of products that have reasonable interchangeability for the purposes for which they are produced—price, use, and qualities considered.”).

79. See *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210, 218 (D.C. Cir. 1986). Supply-side substitutability is a producer’s or manufacturer’s ability to convert facilities to produce a similar product. *Id.* Demand-side substitutability is a consumer’s ability to find a similar product. *Id.*

market share and a barrier to entry<sup>80</sup> creates a presumption of monopoly power.<sup>81</sup>

If a court finds monopoly power, the plaintiff must also demonstrate that the defendant acquired or maintained that power by anticompetitive means.<sup>82</sup> The primary issue in this determination is whether the defendant's conduct has an exclusionary effect.<sup>83</sup> Predatory behavior is a type of exclusionary conduct that occurs when a firm with monopoly power consciously makes its products less attractive or incurs costs with no prospect of compensation other than building or maintaining a barrier against competition.<sup>84</sup> Once the defendant's conduct is deemed anticompetitive, liability attaches, unless the defendant can offer procompetitive justifications for the conduct.<sup>85</sup>

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80. Defined *supra* text accompanying note 7.

81. See *S. Pac. Communications Co. v. AT&T Co.*, 740 F.2d 980, 1001-02 (D.C. Cir. 1984); *United States v. AT&T Co.*, 524 F. Supp. 1336, 1347-48 (D.D.C. 1981).

82. See *Grinell*, 384 U.S. at 570-71; *Eastman Kodak*, 504 U.S. at 488 (Scalia, J., dissenting) (stating that section 2 is "directed to discrete situations" in which the behavior of firms with monopoly power "threatens to defeat or forestall the corrective forces of competition").

83. *Eastman Kodak*, 504 U.S. at 488 (Scalia, J., dissenting) (Exclusionary conduct is conduct that "has restricted significantly, or threatens to restrict significantly, the ability of other firms to compete in the relevant market on the merits of what they offer customers."). The defendant's intent in engaging in the conduct may be a secondary consideration. The Supreme Court in *United States v. Gypsum Co.* stated that "[c]onsideration of intent may play an important role in divining the actual nature and effect of the alleged anticompetitive conduct." 438 U.S. 422, 436 (1978). Other cases, however, state that subjective intent should not be a factor in the court's determination. *E.g.*, *Barry Wright Corp. v. ITT Grinell Corp.*, 724 F.2d 227, 232 (1st Cir. 1983) (stating that "intent to harm offers too vague a standard"); see also 3 AREEDA & HOVENKAMP, *supra* note 66, ¶ 651(a), at 74. ("The crucial point is that the nature and consequences of a particular practice are the vital consideration, not the purpose or intent.").

84. *United States v. Microsoft Corp.*, 87 F. Supp. 2d 30, 38 (D.D.C. 2000); *Neumann v. Reinforced Earth Co.*, 786 F.2d 424, 427 (D.C. Cir. 1986). Predatory behavior is patently anticompetitive and exclusionary. *Microsoft*, 87 F. Supp. 2d at 38; *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585, 610-11 (1985). Predatory pricing is found where (1) pricing is below some measure of cost and (2) the defendant will be able to recoup those losses through future supra-competitive prices. *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 222-24 (1993).

85. See *Eastman Kodak*, 504 U.S. at 483 (declining to grant summary judgment because there were factual questions as to whether defendant's justifications were sufficient or were merely pretextual); see also *Aspen Skiing Co.*, 472 U.S. at 605 (defining predatory behavior as "behavior that not only (1) tends to impair the opportunities of rivals, but also (2) either does not further competition or does so in an unnecessarily restrictive way").

## 2. *Attempt to Monopolize*

Section 2 of the Sherman Act also makes it unlawful to “attempt to monopolize . . . any part of the trade or commerce among the several States, or with foreign nations.”<sup>86</sup> The defendant is liable where the plaintiff demonstrates “(1) that the defendant has engaged in predatory or anti-competitive conduct with (2) a specific intent to monopolize and (3) a dangerous probability of achieving monopoly power.”<sup>87</sup>

Courts define anticompetitive and predatory conduct in this context as they do in other section 2 violations.<sup>88</sup> The second element requires that the defendant intend to monopolize the market or “to control prices or unreasonably restrict competition.”<sup>89</sup> The court may infer intent where the plaintiff proves the defendant engaged in predatory tactics.<sup>90</sup>

To satisfy the third element, the plaintiff must show that there is a dangerous probability that the defendant would acquire monopoly power through predatory tactics.<sup>91</sup> The plaintiff can make such a showing by pointing to a possible agreement between the defendant and another party that would have given the defendant monopoly power<sup>92</sup> or by demonstrating that the defendant has a high and rising market share.<sup>93</sup>

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86. 15 U.S.C. § 2 (1994).

87. *Spectrum Sports Inc. v. McQuillan*, 506 U.S. 447, 456 (1993).

88. *See id.* at 37; *see also supra* Part II.C.1.

89. *Conoco Inc. v. Inman Oil Co.*, 774 F.2d 895, 905 (8th Cir. 1985); *see also General Indus. Corp. v. Hartz Mountain Corp.*, 810 F.2d 795, 801 (8th Cir. 1987) (stating that “[t]he specific intent element requires that the defendant intended his acts to produce monopoly power”); *Ass’n for Intercollegiate Athletics for Women v. NCAA*, 735 F.2d 577, 585 (D.C. Cir. 1984) (asserting that “. . . specific intent in this context refers to a purpose to acquire monopoly power by driving one’s rival from the market by exclusionary or predatory means”).

90. *See Spectrum Sports*, 506 U.S. at 459 (Such proof “. . . may be sufficient to prove the necessary intent to monopolize, which is something more than an intent to compete vigorously.”); *see also* 3A AREEDA & HOVENKAMP, *supra* note 66, ¶ 805(b), at 324 (1996).

91. *See Colorado Interstate Gas Co. v. Natural Gas Pipeline Co. of Am.*, 885 F.2d 683, 693 (10th Cir. 1989).

92. *See United States v. Am. Airlines, Inc.*, 743 F.2d 1114, 1118-19 (5th Cir. 1984).

93. *See M & M Medical Supplies & Serv., Inc. v. Pleasant Valley Hosp., Inc.* 981 F.2d 160, 168 (4th Cir. 1992) (en banc) (“[C]laims involving greater than 50% share should be treated as attempts at monopolization when the other elements for attempted monopolization are also satisfied.”); *see also* 3A AREEDA & HOVENKAMP, *supra* note 66, ¶ 807(d), at 354-55 (1996). What constitutes a significantly high share is not clear, but shares below 50% generally are not sufficient. *See U.S. Anchor Mfg., Inc. v. Canadian Indus., Ltd.*, 7 F.3d 986, 1001 (11th Cir. 1993); *see also Barr Labs., Inc. v. Abbott Labs.*, 978 F.2d 98, 112-14 (3d Cir. 1992) (51% insufficient); *Bacchus Indus., Inc. v. Arvin Indus., Inc.*, 939 F.2d 887, 894-95 (10th Cir. 1991) (60% insufficient); *Indiana Grocery v.*

### 3. Tying

Tying is per se illegal<sup>94</sup> as an unreasonable "contract in restraint of trade or commerce" under section 1 of the Sherman Act.<sup>95</sup> Tying is, in essence, a contract between buyer and seller that conditions the purchase of one product (the tying product) on the purchase of another (the tied product). Tying violations are found where (1) two separate products are involved; (2) the defendant forces its customers to take the tied product to obtain the tying product; (3) the arrangement affects a substantial volume of interstate commerce; and (4) the defendant has market power in the tying product market.<sup>96</sup>

### 4. Exclusive Dealing Contracts

Section 1 of the Sherman Act also prohibits exclusive dealing contracts that unreasonably restrain commerce.<sup>97</sup> Courts apply a rule of reason<sup>98</sup> to claims of exclusive dealing contracts.<sup>99</sup> Courts look at several factors to evaluate the anticompetitive effects of such agreements, but at the threshold, courts focus on whether the percentage of the market foreclosed is substantial enough to largely exclude rivals from competition.<sup>100</sup> Con-

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Super Valu Stores, Inc., 864 F.2d 1409, 1414 (7th Cir. 1989) (50% insufficient); *United States v. Waste Mgmt. Inc.*, 743 F.2d 976, 983-84 (2d Cir. 1984) (48.8% insufficient); *Broadway Delivery Corp. v. United Parcel Serv. of Am., Inc.*, 651 F.2d 122, 129 (2d Cir. 1981) (below 50% insufficient); *Nifty Foods Corp. v. Great Atl. & Pac. Tea Co.*, 614 F.2d 832, 841 (2d Cir. 1980) (54.5% insufficient); *United States v. Empire Gas Corp.*, 537 F.2d 296, 305-07 (8th Cir. 1976) (47-50% insufficient).

94. Per se rules allow few, if any, efficiency arguments to be taken into account, and do not require a deep inquiry into the actual effects of the defendant's conduct. 7 AREEDA & HOVENKAMP, *supra* note 66, ¶ 1500, at 361-62. "[I]t is only after considerable experience with certain business relationships that courts classify them as per se violations." *United States v. Topco Assocs.*, 405 U.S. 596, 607-08 (1972).

95. 15 U.S.C. § 1 (1994).

96. *United States v. Microsoft Corp.*, 87 F. Supp. 2d 30, 47 (D.D.C. 2000); *see also Eastman Kodak Co. v. Image Tech. Servs., Inc.*, 504 U.S. 451, 461-62 (1992); *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 12-18 (1984).

97. 15 U.S.C. § 1 (1994).

98. A rule of reason is a deeper inquiry into an accused practice allowing the conduct to be justified by efficiencies it produces.

99. *See Business Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 724-26 (1988); *Jefferson Parish*, 466 U.S. at 44-45 (O'Connor, J., concurring); *Continental T.V., Inc., v. GTE Sylvania Inc.*, 433 U.S. 36, 49 (1977).

100. *E.g.*, *Tampa Elec. Co. v. Nashville Coal Co.*, 365 U.S. 320, 327 (1961). Other factors include the degree of exclusivity and the line of commerce implicated; the agreement's actual anticompetitive effect; the existence of pro-competitive justifications; the length and irrevocability of the contract; and the ability to achieve the same benefits using alternative means. *Id.*

tracts must exclude more than forty percent of a market to constitute a “substantial share.”<sup>101</sup>

## II. CASE SUMMARY

### A. The District Court’s Analysis and Conclusions

#### 1. *Maintenance of Monopoly Power in the Operating Systems Market by Anticompetitive Means*

The district court defined the relevant market as the worldwide licensing of Intel-compatible PC operating systems.<sup>102</sup> There were no viable substitutes on the demand-side, as all possibilities either lacked similar functionality or required users to incur substantial costs to switch to them from Windows.<sup>103</sup> Similarly, no supply-side substitutability existed, because it would be prohibitively expensive for a new operating system to gain acceptance into a market dominated by Microsoft.<sup>104</sup>

Next the court determined that Microsoft had a dominant, persistent, and increasing share of the relevant market.<sup>105</sup> Furthermore, the number of applications available for an operating system created a barrier to entry ensuring that no Intel-compatible PC operating system other than Windows could attract significant demand.<sup>106</sup> The presence of a barrier to entry and dominant market share created a presumption of monopoly power.<sup>107</sup>

Microsoft attempted to rebut the presumption of monopoly power on two fronts.<sup>108</sup> First, it asserted that the nature of the market constrained its

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101. See *United States v. Microsoft Corp.*, Nos. CIV.A.98-1232, 98-1233, 1998 WL 614485, at \*19 (D.D.C. Sept. 14, 1998) (and cases cited therein).

102. *United States v. Microsoft Corp.*, 87 F. Supp. 2d 30, 36 (D.D.C. 2000); *United States v. Microsoft Corp.*, 84 F. Supp. 2d 9, 14-18 (D.D.C. 1999).

103. *Microsoft*, 87 F. Supp. 2d at 36; see also *Microsoft*, 84 F. Supp. 2d at 14-15, 17 (ruling out server operating systems); *id.* at 15 (excluding non-Intel operating systems (e.g., Apple)); *id.* at 15-16 (declining to include information appliances (e.g., hand-held computers, wireless telephones)); *id.* at 16-17 (excepting network computers (e.g., server workstations)); *id.* at 17-18 (excluding middleware).

104. *Microsoft*, 87 F. Supp. 2d. at 36; see also *Microsoft*, 84 F. Supp. 2d at 14, 18-19 (explaining how the applications barrier to entry would make it costly to create enough demand for a new operating system).

105. *Microsoft*, 87 F. Supp. 2d. at 36 (finding that Microsoft’s share exceeded ninety-five percent); *Microsoft*, 84 F. Supp. 2d at 19.

106. *Microsoft*, 87 F. Supp. 2d. at 36; *Microsoft*, 84 F. Supp. 2d at 19-24.

107. *Id.*

108. *Microsoft*, 87 F. Supp. 2d. at 36-37.

ability to exercise monopoly power.<sup>109</sup> Second, it claimed that its technical innovation and pricing behavior were inconsistent with possession of monopoly power.<sup>110</sup> The court, however, stated that neither of these considerations affected Microsoft's ability to set prices above competitive levels and sustain them for extended periods without erosion of its monopoly power.<sup>111</sup> In addition, Microsoft's behavior was rational only if it knew it had monopoly power and if it was motivated by a desire to protect a barrier to entry to preserve such power.<sup>112</sup>

The court found that Microsoft engaged in anticompetitive conduct.<sup>113</sup> Specifically, Microsoft used its power to influence customers to terminate development of middleware,<sup>114</sup> to undermine Sun's Java technology,<sup>115</sup> and to take market share away from Netscape in the browser market.<sup>116</sup> Microsoft's conduct lacked a procompetitive motivation and was not justified by the federal copyright protection of its software.<sup>117</sup> In addition, Microsoft's actions viewed in their totality showed a strong anticompetitive effect and evinced its predacious nature.<sup>118</sup> Finding each element, the court held Microsoft liable for maintenance of monopoly power by anticompetitive means under section 2 of the Sherman Act.<sup>119</sup>

## 2. *Attempt to Obtain Monopoly Power in the Browser Market by Anticompetitive Means*

The district court found that Microsoft's 1995 proposal to Netscape and its subsequent efforts to decrease Netscape's market share constituted anticompetitive conduct.<sup>120</sup> The proposal also demonstrated Microsoft's

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109. Microsoft asserted that the market structure forced them to act, in essence, as they would have under competition. Defendant Microsoft's Proposed Conclusions of Law at 45-54, *United States v. Microsoft Corp.*, 87 F. Supp. 2d 30 (D.D.C. 2000) (Nos. 98-1232, 98-1233), available at <http://www.microsoft.com/presspass/trial/p-col/col.asp>. See *supra* Part I.A.3 for a more detailed discussion of this market structure.

110. *Microsoft*, 87 F. Supp. 2d at 37.

111. *Id.*

112. *Id.*

113. *Id.* at 43-44.

114. *Id.*; see also *Microsoft*, 84 F. Supp. 2d at 107, 108-110.

115. *Microsoft*, 87 F. Supp. 2d at 43-44; see also *Microsoft*, 84 F. Supp. 2d at 105-106.

116. *Microsoft*, 87 F. Supp. 2d at 38-39; see also *Microsoft*, 84 F. Supp. 2d at 44, 53-54, 57, 58, 103.

117. *Microsoft*, 87 F. Supp. 2d at 39, 40-41. Microsoft argued that its copyrights permitted them to prevent licensees from shipping modified versions of its product. *Id.*

118. *Id.* at 44. The court looked at Microsoft's tying, exclusive dealing, and attempt to monopolize as a singular course of conduct. *Id.*

119. *Id.*

120. *Id.* at 45.

specific intent to monopolize the browser market because Microsoft knew or should have known that the proposal would have given it monopoly power.<sup>121</sup> Microsoft's subsequent course of conduct to protect the applications barrier similarly evinced its intent to monopolize.<sup>122</sup>

The court stated that a dangerous probability of monopoly existed in two respects.<sup>123</sup> First, the proposal to Netscape would have given Microsoft monopoly power.<sup>124</sup> Second, Microsoft had a high and growing market share in the current browser market.<sup>125</sup> Finding each element, the court held Microsoft liable for attempting to monopolize the browser market under section 2 of the Sherman Act.<sup>126</sup>

### 3. *Tying of Explorer to Windows*

The district court applied the Supreme Court's market test<sup>127</sup> for two products and found that consumers viewed browsers and operating systems as separate products with separate demands.<sup>128</sup> The court stated that consumers were forced to take Explorer to get Windows because Microsoft conditioned its licenses to distribute Windows on the purchase of Explorer and because Microsoft refused to offer Windows without Ex-

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121. *Id.*; see also *Microsoft*, 84 F. Supp. 2d at 30-33.

122. *Microsoft*, 87 F. Supp. 2d at 45 (finding that although it was never an expressed goal, Microsoft's executives "knew, or should have known, that the tactics they actually employed were likely" to result in monopoly power).

123. *Id.* at 46.

124. *Microsoft*, 87 F. Supp. 2d at 46.

125. *Id.*; *Microsoft*, 84 F. Supp. 2d at 101-02.

126. *Microsoft*, 87 F. Supp. 2d. at 45-46, 57.

127. See *Eastman Kodak Co. v. Image Tech. Servs, Inc.*, 504 U.S. 451, 482 (1992) ("The proper market definition in this case can be determined only after a factual inquiry into the 'commercial realities' faced by consumers." (citing *United States v. Grinnell Corp.*, 384 U.S. 563, 572 (1966)); *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 19 (1984) (The question "turns not on the functional relation between [the two items], but rather on the character of the demand for the two items.")). The D.C. Circuit took a different view in interpreting a consent decree from a case involving Microsoft's tying of Explorer to Windows. *United States v. Microsoft Corp.*, 147 F.3d 935 (D.C. Cir. 1998). The consent decree prohibited Microsoft from conditioning the license of any of its products on the license of another one. *Id.* at 939. The decree expressly allowed, however, the licensing of "integrated" products. The court distinguished relevant Supreme Court precedent because those cases involved services rather than two products—which are at issue here. *Id.* The court stated that an integration is a single product if there are "facially plausible benefits to [the] integrated design" and noted that courts and juries are not equipped to inquire deeply into computer design. *Id.* at 950. The court tempered its decision by stating that "[w]hether or not this is the appropriate test for antitrust law generally, we believe it is the only sensible reading of [the consent decree]." *Id.*

128. *Microsoft*, 87 F. Supp. 2d 49; *Microsoft*, 84 F. Supp. 2d at 48.

plorer.<sup>129</sup> In addition, the large drop in Netscape's revenues constituted a substantial effect on commerce because it was not "de minimis."<sup>130</sup> Finally, Microsoft had sufficient market power in the tying product market, as it had monopoly power in the operating system market.<sup>131</sup> Finding all required elements, the court held Microsoft liable for unlawful tying under section 1 of the Sherman Act.<sup>132</sup>

#### 4. *Exclusive Dealing Contracts to Promote Explorer to the Exclusion of Navigator*

The district court found that Microsoft did not foreclose Netscape from a "substantial share" of the market.<sup>133</sup> Netscape retained retail outlets, Internet downloads, and mass mailings as distribution channels.<sup>134</sup> Accordingly, the court did not hold Microsoft liable for use of exclusionary contracts under section 1 of the Sherman Act.<sup>135</sup>

### B. **Remedy and Epilogue**

The district court held Microsoft liable under sections 1 and 2 of the Sherman Act and under similar state antitrust laws.<sup>136</sup> As a remedy, the court ordered Microsoft to divest either its operating systems or its applications business.<sup>137</sup> As of publication, the case is pending appeal in the U.S. Court of Appeal for the District of Columbia, which will hear the case en banc.<sup>138</sup>

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129. *Microsoft*, 87 F. Supp. 2d at 50; see also *Microsoft*, 84 F. Supp. 2d at 49-51, 58-59. The court stated that consumers were effectively forced to purchase Explorer because they could not remove it from the Windows desktop and Windows would not respect users' decision to choose another browser as their default. *Microsoft*, 87 F. Supp. 2d at 52-50.

130. *Microsoft*, 87 F. Supp. 2d at 49; see *Fortner Enters., Inc. v. United States Steel Corp.*, 394 U.S. 495, 501 (1947).

131. *Microsoft*, 87 F. Supp. 2d at 49. Courts have not delineated a specific percentage of market share required, but market power must be "appreciable" and monopoly power is sufficient. See *Eastman Kodak* 504 U.S. at 464, 481.

132. *Microsoft*, 87 F. Supp. 2d at 47-51, 57.

133. *Id.* at 53; *Microsoft*, 84 F. Supp. 2d at 103.

134. *Microsoft*, 87 F. Supp. 2d at 53; *Microsoft*, 84 F. Supp. 2d at 103. These channels enabled Netscape to more than double its user base from 1996 to 1998. *Id.*

135. *Microsoft*, 87 F. Supp. 2d at 53.

136. *Id.* at 56.

137. *United States v. Microsoft Corp.*, 97 F. Supp. 2d. 59, 64 (D.D.C. 2000). There are also conduct restrictions that will apply before divestiture occurs and that apply to the operating system business thereafter. *Id.* at 66-70.

138. Chief Judge Edwards, and Circuit Judges Williams, Ginsburg, Sentelle, Randolph, Rogers, and Tatel will hear the case en banc. Order of the D.C. Circuit, *United States v. Microsoft Corp.*, No. 00-5212 (D.C. Cir. Filed June 13, 2000), available

### III. DISCUSSION

The *Microsoft* case presents a myriad of legal and factual issues.<sup>139</sup> Assuming that Microsoft violated antitrust law, this discussion examines the difficulties inherent in litigating complex cases in rapidly changing markets and posits that antitrust litigation has a vital role to play in maintaining competition in information markets.

#### A. The Pace of Antitrust Litigation

The process of adjudication is necessarily lengthy.<sup>140</sup> In particular, antitrust cases involving information markets have the potential to be long, because the distinctions between pro and anticompetitive behaviors are extremely complex.<sup>141</sup> For instance, in the case of monopoly power, “the combination of intellectual property, network externalities, and rapid growth in consumer demand creates difficult questions.”<sup>142</sup> Additionally, information market cases pose “unusually difficult questions of fact because of the technical complexity of the products and services produced.”<sup>143</sup>

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at <http://ecfp.cadc.uscourts.gov/MS-Docs/1476/0.pdf>. Final briefs in the case were filed February 9, 2001. See Brief for Appellees (Final Version), *Microsoft* (D.C. Cir. Sept. 26, 2000) (Nos. 00-5212, 00-5213), available at <http://ecfp.cadc.uscourts.gov/MS-Docs/1693/0.pdf>; Brief for Defendant-Appellant (Final Version), *Microsoft* (D.C. Cir. Sept. 26, 2000) (Nos. 00-5212, 00-5213), available at <http://ecfp.cadc.uscourts.gov/MS-Docs/1696/0.pdf>; Reply Brief for Defendant-Appellant (Final Version), *Microsoft* (D.C. Cir. Sept. 26, 2000) (Nos. 00-5212, 00-5213), available at <http://ecfp.cadc.uscourts.gov/MS-Docs/1699/0.pdf>.

139. See, e.g., DAVID S. EVANS ET AL., DID MICROSOFT HARM CONSUMERS? TWO OPPOSING VIEWPOINTS (2000), available at <http://www.aei.brookings.org/publications/books/consumers.pdf>; John E. Lopatka & William H. Page, *Antitrust on Internet Time: Microsoft and the Law and Economics of Exclusion*, 7 SUP. CT. ECON. REV. 157 (1999).

140. See Posner, *supra* note 54, at 8 (“The law is committed to principles of due process that limit the scope for summary proceedings, and the fact that litigation is conducted by lawyers before tribunals that are not technically trained or experienced inevitably slows the process.”); see also AREEDA & KAPLOW, *supra* note 7, ¶ 154, at 94 (1997) (noting that private antitrust cases are, on average, almost twice as long as federal litigation generally).

141. See David J. Teece & Mary Coleman, *The Meaning of Monopoly: Antitrust Analysis in High-Technology Industries*, ANTITRUST BULL. 801, 845 (1998). “Many actions that harm competitors have valid justifications or are strongly related to competitive motivations. Distinguishing between these effects is frequently very difficult, and the politics of the process gives considerable advantage to the competitors.” *Id.* at 845.

142. Posner, *supra* note 54, at 8; see also AREEDA & KAPLOW, *supra* note 7, ¶ 154, at 94 (1997) (“Antitrust cases are often more complex than average cases, and a number assume truly immense proportions.”).

143. Posner, *supra* note 54, at 7.

The Microsoft trial proved that the judiciary can effectively hasten the process,<sup>144</sup> as it moved faster than previous major antitrust cases.<sup>145</sup> The presiding judge in *Microsoft*, Thomas Penfield Jackson, took several procedural measures to expedite litigation of the case.<sup>146</sup> In addition, Judge Jackson appointed a mediator to facilitate a settlement<sup>147</sup> and allowed direct appeal to the Supreme Court.<sup>148</sup> As a result, the trial took only nineteen months.<sup>149</sup> The appellate process will, however, delay final resolution. Microsoft appealed the case to the D.C. Circuit, and a subsequent appeal to the Supreme Court is likely. In light of these appeals, final resolution is not likely for another two years, bringing the total length of the case to just under four years.<sup>150</sup>

## B. The Role of Antitrust Enforcement in Information Markets

Full adjudication of an antitrust trial will likely take several years.<sup>151</sup> This lag complicates the application of antitrust law to dynamic information markets. *Microsoft*, however, illustrates the potential benefits of enforcement in certain situations. First, the development of new technological paradigms is not always as rapid as many claim; thus it is possible for

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144. See Andrew I. Gavil, *The End of Antitrust Trench Warfare?: An Analysis of Some Procedural Aspects of The Microsoft Trial*, 13 ANTITRUST 7, 9 (1999).

145. For example the government's cases against IBM and AT&T each lasted more than eight years. See generally FRANKLIN M. FISHER ET AL., FOLDED, SPINDLED, AND MUTILATED: ECONOMIC ANALYSIS AND U.S. V. I.B.M. (1983) (discussing the government's case against IBM and noting that the case lasted thirteen years before the suit was dropped); STEVE COLL, THE DEAL OF THE CENTURY: THE BREAKUP OF AT&T (1986) (discussing the government's case against AT&T).

146. Gavil, *supra* note 144, at 9. For example, Judge Jackson limited each side to twelve live witnesses at trial and ordered direct testimony to be submitted in writing. *Id.*

147. See Evan Hansen & Joe Wilcox, *Boldness, Pace Define Jackson's Rule*, CNET NEWS.COM, June 7, 2000, at <http://news.cnet.com/news/0-1003-200-2031600.html>.

148. Order of June 20, 2000, *United States v. Microsoft Corp.*, 87 F. Supp. 2d 30 (D.D.C. 2000) (No. 98-1233), available at <http://www.dcd.uscourts.gov/98-1232v.pdf>. The Supreme Court declined direct review and sent the case to the D.C. Circuit. *United States v. Microsoft Corp.*, 121 S. Ct. 25 (2000).

149. One must also consider the time required to investigate possible offenses, which may be substantial where detailed inquiries into market structure and dynamics are required.

150. The Software and Information Industry Association ("SIIA") asserts that an intermediate appeal means that the Supreme Court will not decide the case until Spring 2003. See Brief of Software and Information Industry Association and Computer and Communications Industry Association as Amici Curiae Supporting Jurisdiction at 12 n.5, *U.S. v. Microsoft Corp.*, 121 S. Ct. 25 (2000) (No. 00-139), available at <http://www.sii.net/sharedcontent/govt/issues/compete/amicus8-15-00.pdf> [hereinafter SIIA Brief].

151. Posner, *supra* note 54, at 8.

antitrust litigation to expedite a return to competition on the merits.<sup>152</sup> Second, a laissez-faire approach allows a monopolist to engage in anti-competitive conduct to entrench and insulate its dominant position, which can diminish innovation incentives.<sup>153</sup>

### 1. *New Technological Paradigms*

Rapid innovation in the software industry can result in new technological paradigms supplanting existing technologies.<sup>154</sup> This would render a litigated matter moot, as the defendant would either lose monopoly power or maintain monopoly power over an outdated industry or product.<sup>155</sup>

The efficacy of such litigation therefore depends on how long it will take for a new technology to develop and displace the defendant's product. Although this determination will be difficult in most cases, a close examination of the market can provide indications of how long it will take a new paradigm to displace a product. High barriers to entry and difficulty in bringing an innovation to market lower the probability of displacement of the defendant's product, suggesting that litigation will be effective. On the other hand, if there are no barriers and the innovation can rapidly enter the market, there will be a higher probability of displacement and ineffective litigation.

On balance, *Microsoft* presents a situation that is redressable by anti-trust litigation. First, the *Microsoft* court made detailed findings on the dynamics and realities of the market.<sup>156</sup> The court found that although the rate of innovation in the industry remained rapid, developing technologies would not supplant Microsoft's operating system in the near future.<sup>157</sup> Such an inquiry reduced the probability of superfluous antitrust enforcement against a displaced product.

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152. David A. Balto, *Networks and Exclusivity: Antitrust Analysis to Promote Network Competition*, 7 GEO. MASON L. REV. 523, 557 (1999) (stating that "radical change[s] to the competitive environment based on technological change are frequently made in antitrust investigations . . . [b]ut are frequently exaggerated").

153. See SIIA Brief, *supra* note 150, at 9.

154. See Teece & Coleman, *supra* note 141, at 804.

155. This problem is not new, and previously prompted the government to withdraw its complaint in the IBM case. See FISHER ET AL., *supra* note 145, at 1.

156. *United States v. Microsoft Corp.*, 84 F. Supp. 2d 9, 14-18 (D.D.C. 1999).

157. *Id.* Microsoft claims it faces current or imminent competition from several sources, including middleware. See Defendant Microsoft's Revised Proposed Findings of Fact at ¶¶ 199-239, *United States v. Microsoft Corp.*, 87 F. Supp. 2d 30 (D.D.C. 2000) (Nos. 98-1232, 98-1233), available at <http://www.microsoft.com/PressPass/trial/r-fof/default.asp> (last visited Feb. 2, 2001).

Second, the *Microsoft* court stated that a barrier to entry existed and that Microsoft acted to protect that barrier.<sup>158</sup> Artificial maintenance of a barrier to entry may delay a new technological paradigm from displacing an old paradigm (such as Microsoft's operating system) in two ways. First, allowing a dominant firm to maintain a barrier to entry reduces the incentive of competing firms to innovate and attempt to supplant the dominant firm's technology.<sup>159</sup> Second, even if new technology develops, a barrier to entry may allow a dominant firm to exclude new entry, thus avoiding displacement from the market. In this case, litigation would be especially worthwhile, as a judicial remedy can free the market to erode the barrier, preventing a dominant firm from maintaining its supremacy by blocking innovation and innovative products.<sup>160</sup>

## 2. Maintenance of Barriers to Entry, Deterrence, and Innovation

A laissez-faire approach to antitrust in information markets will allow a monopolist to utilize its market power to leverage itself into new markets.<sup>161</sup> If a dominant firm is able to gain market power in complementary markets, it could have the effect of insulating its initial monopoly.<sup>162</sup> This

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158. *Microsoft*, 84 F. Supp. 2d at 26.

159. Direct Testimony of Franklin M. Fisher, *United States v. Microsoft Corp.*, 87 F. Supp. 2d 30 (D.D.C. 2000) (No. 98-1232) at 107, at <http://www.usdoj.gov/atr/cases/f2000/2057.pdf> [hereinafter Testimony of Fisher]. Fisher states that Microsoft's conduct is "likely to send a message to all software developers: Microsoft will impede any innovation that threatens Microsoft's monopoly in operating systems. This will lessen developers' incentives to develop products that provide alternatives to the Windows platform." *Id.*; see also Jonathan B. Baker, *Promoting Innovation Competition Through the Aspen/Kodak Rule*, 7 GEO. MASON L. REV. 495, 514 (1999). "By controlling compatibility and interoperability of rivals' programs, and by implementing exclusive relationships that deny rivals' access to certain technologies, it is more difficult for competitors to offer new and superior programs and technologies." Steven C. Salop & R. Craig Romaine, *Preserving Monopoly: Economic Analysis, Legal Standards, and Microsoft*, 7 GEO. MASON L. REV. 617, 623 (1999); see also Balto, *supra* note 152, at 536-37 (discussing issues involving exclusivity and networks and stating that "exclusivity can deter innovation . . . by controlling critical inputs to the development of new products"). An example of this in *Microsoft* is the delay of release of necessary technical information to certain competitors. See, e.g., *United States v. Microsoft Corp.*, 84 F. Supp. 2d 9, 34 (D.D.C. 1999).

160. See, e.g., Teece & Coleman, *supra* note 141, at 813 (noting that a determination of whether a dominant company is acting to delay a paradigm shift may be a relevant standard in determining if its actions should be challenged).

161. See *supra* Parts I.A.2 and II.A.2.

162. Salop & Romaine, *supra* note 159, at 635. Chicago school economists contend that a monopolist has no incentive to leverage one monopoly into another because it will not increase the monopolist's profits. *Id.* at 624-25. Post-Chicago analysis suggests that this theory does not apply where this behavior serves "to raise barriers to competition that can preserve or enhance its monopoly power in the first product." *Id.* at 625. "For exam-

is possible in information markets because switching costs increase as the monopolist has more time to take advantage of positive feedback effects,<sup>163</sup> increasing the likelihood of tipping and lock-in.<sup>164</sup>

In its amicus brief submitted to the Supreme Court, the Software and Information Industry Association (“SIIA”)<sup>165</sup> argued that software market characteristics<sup>166</sup> lead to a geometric increase in the harms that flow from anticompetitive conduct, making it “imperative to rapidly adjudicate and effectively remedy antitrust violations while competition can still be restored.”<sup>167</sup> The SIIA estimated that in another year “Microsoft is likely to lock up, or at least to ‘tip,’ additional markets to insulate its monopoly.”<sup>168</sup>

There is empirical evidence that Microsoft is leveraging into the Internet browser market and into other markets as well.<sup>169</sup> The SIIA brief cites Microsoft’s “.NET” initiative, for example, as an attempt by Microsoft to set a Windows-specific standard<sup>170</sup> using the Windows monopoly to foreclose competition in the Internet server and applications markets.<sup>171</sup> There

ple, a new operating system entrant’s need to be able to change the expectations and behavior of a diverse set of both applications developers and users creates a difficult coordination problem.” *Id.* at 637.

163. See *supra* Part I.A.3; see also SHAPIRO & VARIAN, *supra* note 1, at 121; Testimony of Fisher, *supra* note 159, at 26 (noting that “network effects increase the risk that [anticompetitive] conduct will further entrench Microsoft’s monopoly”).

164. SHAPIRO & VARIAN, *supra* note 1, at 104.

165. SIIA is a trade association that represents the interests of greater than 1,000 firms in the software, information, and Internet Industries. See SIIA Brief, *supra* note 150, at 1.

166. See *supra* Part I.A.3.

167. SIIA Brief, *supra* note 150, at 9.

168. *Id.* at 9.

169. See *supra* parts I.A.2 and II.A.2.

170. *Id.* at 11 (citing Markoff, *Microsoft Plans to Shift Product Focus to the Internet*, N.Y. TIMES, June 23, 2000, at C1). Microsoft’s .NET initiative is a plan to eventually replace local storage of data on PCs with storage and programming on the Internet. See Microsoft, *Microsoft.NET Home Page*, at <http://www.microsoft.com/net/default.asp> (last visited Feb. 8, 2001). Microsoft also recently announced its Java User Migration Plan (“JUMP”) to Microsoft .NET, which facilitates the use of Java and Microsoft Visual J++ with Microsoft’s .NET platform. Press Release, Microsoft Corp., *Microsoft Announces Java User Migration Path to Microsoft .NET* (January 25, 2001), at <http://www.microsoft.com/presspass/press/2001/jan01/01-25JavaUpgradePR.asp>.

171. SIIA Brief, *supra* note 150 (citing Schlender, *Damn the Torpedoes! Full Speed Ahead*, FORTUNE, July 10, 2000, at 98, 110). “By taking control of a standard and making it proprietary, Microsoft can design the standard to reduce rather than increase interoperability.” Salop & Romaine, *supra* note 159, at 634. “This conduct also can further entrench Microsoft’s desktop operating system monopoly. If Microsoft gains monopoly power in servers, then a new entrant into desktop operating systems will face potential interoperability with server programs.” *Id.* at 635.

is also evidence that Microsoft is entering into the Linux market with its strategic agreement with Corel.<sup>172</sup>

The possibility of further entrenchment dictates not only that courts should intervene but also that they should make efforts to speed the final resolution of a case. Speed is essential because once a market has tipped, "it may be difficult or even undesirable to undo any anticompetitive effects that have arisen."<sup>173</sup> Anticompetitive behavior in network industries must therefore be "treated quickly and seriously."<sup>174</sup> The mandatory use of procedural devices to expedite litigation will help prevent a monopolist from taking advantage of prolonged proceedings, thus improving the effectiveness of enforcement.<sup>175</sup> The use of these devices will help to lower the social costs involved in enforcement, for the more rapidly the problem is dealt with, the less likely it is that users will be locked-in.

Another reason to litigate cases such as *Microsoft* is to deter future transgressions and positively affect innovation incentives.<sup>176</sup> To effectively deter similar anticompetitive conduct, the punishment must be severe enough to make the expected net costs of the practice greater than the expected benefits.<sup>177</sup> Prosecuting and sufficiently punishing<sup>178</sup> Microsoft

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172. Press Release, Corel Corp., *Corel and Microsoft Announce Strategic Alliance to accelerate delivery of applications for Microsoft's .NET Platform* (Oct. 2, 2000), at <http://www3.corel.com/cgi-bin/gx.cgi/AppLogic+FTContentServer?pagename=Corel/PressRelease/Details&id=CC100K16H9C>. Microsoft also purchased 24 million shares of non-voting Corel stock. *Id.* Corel is a software company that develops applications and a version of Linux. *Id.*

173. Rubinfeld, *supra* note 54, at 12. That is, it can be "socially costly to move from a less to a more efficient standard," making successful intervention difficult once switching costs reach a certain magnitude." *Id.* at 18. Additionally, "[o]nce the point is passed at which expectations in the marketplace have been significantly affected, it will be more difficult to intervene successfully." *Id.* at 16.

174. *Id.* at 12.

175. One obvious device is the Antitrust Expediting Act, 15 U.S.C. § 29(b) (1994), which allows direct appeal to the Supreme Court when the trial court certifies that "immediate consideration of the appeal by the Supreme Court is of general public importance in the administration of justice." *Id.* Indeed, the SIIA advocates use of this in its amicus brief. See SIIA Brief, *supra* note 150, at 2. The devices used by Judge Jackson in *Microsoft* are also plausible methods of speeding adjudication of a case. See Gavil, *supra* note 144.

176. See Baker, *supra* note 159, at 516.

177. See HERBERT HOVENKAMP, *ECONOMICS AND FEDERAL ANTITRUST LAW* § 15.3, at 387-88 (1985); Warren F. Schwarz, *An Overview of the Economics of Antitrust Enforcement*, 68 GEO. L. J. 1075, 1075 (1980).

178. The appropriate remedy is a separate issue not addressed in this Note.

will create a credible threat of antitrust scrutiny across the industry, deterring companies from engaging in similar conduct.<sup>179</sup>

The efficiency of a deterrence approach depends on whether its benefits outweigh its costs,<sup>180</sup> which in information markets essentially depends on its effect on aggregate industry innovation.<sup>181</sup> Antitrust enforcement will create a positive incentive to innovate by assuring new entrants that products will compete on their merits, as the law will limit dominant firm misconduct.<sup>182</sup> This positive incentive is countered by a disincentive to innovate resulting from a decrease in expected profits for dominant companies<sup>183</sup> and the risk of penalizing procompetitive, efficient conduct.<sup>184</sup>

Enforcement creates a plausible risk of overdeterrence in information markets. This is due, in part, to the difficulties in distinguishing between pro and anticompetitive conduct, which make it possible that lawful conduct will be litigated.<sup>185</sup> In addition, enforcement will reduce expected

179. See Baker, *supra* note 159, at 516. Deterrence occurs because enforcement creates a credible threat that “the antitrust prohibition on monopolization would operate in practice by limiting the dominant firm’s use of such tools to exclude.” *Id.*

180. Teece & Coleman, *supra* note 141, at 838. Innovation is “the most fundamental factor driving competition and insuring superior products and competitive prices for the consumer.” *Id.* at 839. One can also view this as balancing the possible harms that can flow from false acquittals and false convictions. Salop & Romaine, *supra* note 159, at 653-54.

181. Teece and Coleman define aggregate innovation as the sum of the incumbents and new entrant innovation. Teece & Coleman, *supra* note 141, at 839.

182. Fisher, *supra* note 159, at 107; see also *supra* text accompanying note 159. “In fact, it has been claimed that Microsoft’s reputation [as a predator] has led venture capitalists and potential competitors to avoid investing in products or markets in which Microsoft has an existing stake or has plans to invest.” Salop & Romaine, *supra* note 159, at 642.

183. The law decreases expected profits by limiting practices a dominant firm can use to extend its monopoly and acquire new monopolies. See Teece & Coleman, *supra* note 141, at 809. This effect can be particularly strong in information markets because of the high risk involved in developing products. *Id.*

184. Rubinfeld, *supra* note 54, at 16. Overdeterrence occurs where intervention “penalizes dominance that is the result of innovative efforts . . . . Such a policy will ‘have the effect of taxing technological improvements’ . . . . (To be sure, ill-considered intervention can also be inefficient even in the short run, to the extent that it prevents even a dominant firm from responding aggressively, but fairly, to competition).” *Id.*; see also Teece & Coleman, *supra* note 141, at 803 (stating that “[t]he opportunities for the agencies to harm competition are far greater than their opportunities to improve competition in sectors where there is rapid innovation”).

185. See *supra* note 184 and accompanying text.

profits for all successful companies, which is important given the high risk involved in developing information products.<sup>186</sup>

Overdeterrence, however, is unlikely to develop from *Microsoft*.<sup>187</sup> Given the possibility of becoming a standard setter, the decrease in expected net profits as a result of fruitful innovation is not likely to cause information companies to view innovation as unprofitable.<sup>188</sup> In winner-take-all competition, the reward to the resulting dominant firm is likely to be large and "it is unlikely that small reductions in the expected return . . . would make much difference to that firm's innovative effort."<sup>189</sup> In addition, the government was appropriately wary of the pitfalls of attacking procompetitive conduct when it brought charges against Microsoft.<sup>190</sup> Further, the fact that Microsoft exploited its dominant position to exclude rivals and insulate its monopoly, increases the positive effect enforcement will have on rivals' incentives to innovate after an antitrust intervention.<sup>191</sup>

Thus, the positive incentive resulting from antitrust enforcement will be greater than the disincentive resulting from decreased profits and the possibility of being penalized for procompetitive conduct.<sup>192</sup> This is true

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186. See Teece & Coleman, *supra* note 141, at 809; William J. Kolasky, *Network Effects: A Contarian View*, 7 GEO. MASON L. REV. 577, 596-97 (1996) ("Especially in network industries where large fixed costs need to be incurred to build the network, the prospect of earning economic rents once the natural monopoly has been captured is what provides the incentive to innovate and invest.").

187. See Teece & Coleman, *supra* note 141, at 845; *supra* text accompanying note 141.

188. See Baker, *supra* note 159, at 514-15.

189. See *id.* at 514-15. But see William J. Kolasky, *supra* note 186, at 596-97. With selective enforcement against only egregious conduct, however, this incentive will remain largely intact. See Baker, *supra* note 159, at 514-15.

190. Rubinfeld, *supra* note 54, at 1-2. Although this does not rule out the possibility of overdeterrence, the fact that the government considered possible pitfalls is apparent to industry participants, likely lowering the expectation of being punished for being successful. See *id.* at 2-17.

191. See Teece & Coleman, *supra* note 141, at 813. The authors state that "[i]n some cases it may be relevant to ask whether an incumbent's actions are designed to delay or prevent a paradigm shift that [offers significant improvement]." *Id.* They go on to argue, however, that because such behavior by a dominant firm is unlikely to be effective, it is not a real problem for antitrust enforcement. *Id.*; see also Joel I. Klein, *International Antitrust Enforcement in the Computer Industry*, 41 VILL. L. REV. 173, 178 (1996) ("The government must be especially vigilant to ensure that a de facto standard setter or monopolist does not . . . erect artificial barriers to entry that serve to maintain or to extend a naturally derived monopoly.").

192. Baker, *supra* note 159, at 514-15. "Enforcement of antitrust's prohibition against monopolization thus can be expected to encourage fringe firm innovation . . . without markedly discouraging dominant firm innovative effort when innovation compe-

because of the winner-take-all nature of information markets and the weight of the evidence in *Microsoft*. Therefore, under the facts in *Microsoft*, enforcement will be efficient because it will increase aggregate innovation.<sup>193</sup>

#### IV. CONCLUSION

Although antitrust litigation has inherent shortcomings that make its application to information markets problematic, it can still perform valuable functions where used thoughtfully. Overactive enforcement can cause serious disruptions to the market,<sup>194</sup> but a laissez-faire approach has its own shortcomings. By carefully scrutinizing market conditions and the nature and effect of the alleged anticompetitive conduct, the courts can strike a middle ground and thus optimize incentives.<sup>195</sup> The challenge for antitrust law is to determine which cases should be challenged and which should be left to self-correction.<sup>196</sup> *Microsoft* demonstrates characteristics to look for in making this determination. Litigation can restore competition in markets with high barriers to entry and where new technological paradigms arise relatively slowly. Litigation will likely prove particularly

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tition is winner-take-all and the dominant firm takes advantage of a complementary or collaborative relationship to exclude." *Id.* at 514.

193. See Baker, *supra* note 159, at 516. Deterrence occurs because enforcement creates a credible threat that

the antitrust prohibition on monopolization would operate in practice by limiting the dominant firm's use of such tools to exclude . . . Under such circumstances, Sherman Act § 2 would plausibly operate surgically: to remove an important inhibition on fringe firm innovation without interfering with the primary determinant of the dominant firm's incentive to innovate, the winner-take-all 'prize.' *Id.*

194. Kolasky, *supra* note 186, at 598, 615; see also Teece & Coleman, *supra* note 141, at 843 (stating that misguided "antitrust action might produce severe disincentive affects throughout the entire economy").

195. See Kolasky, *supra* note 186, at 598. Salop and Romaine explore this point by examining possible legal standards for monopolization cases. Salop & Romaine, *supra* note 159, at 655-65. In advocating the use of a standard that focuses on the necessity of the monopolist's restrictive conduct, the authors are in essence advocating a middle ground approach where only certain conduct is challenged in a manner that balances incentives to maximize consumer welfare. *Id.* at 660-61.

196. It is vital that we develop analytic tools that will help identify when we can expect antitrust intervention in network industries to be beneficial, and limit intervention accordingly. It is especially important that we take care to appreciate how the market itself can promote the realization of beneficial network effects and prevent antitrust law from interfering with this process.

Kolasky, *supra* note 186, at 584.

effective where a dominant firm acts to suppress innovation and maintain barriers to entry in attempt to delay displacement by a new paradigm. Enforcing antitrust laws in cases with the characteristics noted above, like *Microsoft*, will deter anticompetitive conduct by other companies, thereby increasing aggregate innovation incentives in information markets.

## ***IN RE* INDEPENDENT SERVICE ORGANIZATIONS ANTITRUST LITIGATION**

*By Nicolas Oettinger*

Patents and copyrights are government sanctioned monopolies. In order to encourage innovation and investment in research, the government provides the owners of these intellectual property rights the power to control production of and exclusively use their inventions. Antitrust laws, on the other hand, limit restraints of trade in order to prevent the abuse of market power and protect competition. Although these two sets of laws are seemingly at odds with each other, striking a balance between the two will promote both innovation and competition. Any imbalance between the two doctrines will ultimately pose the danger of causing harm to the concerns of both. Either innovation will suffer because of limited competition, or competition will decrease because of a lack of innovation in the marketplace.

An imbalance of power between patents and antitrust, suggested by previous decisions of the Court of Appeals for the Federal Circuit, is fully realized in the recent decision *In re Independent Service Organizations*<sup>1</sup> (“*ISO*”). The *ISO* decision demonstrates the Federal Circuit’s decided preference for intellectual property rights over antitrust concerns. After the *ISO* decision, it is unlikely that the exercise of intellectual property rights will give rise to antitrust liability. This means that a patent holder who possesses significant market power through his stable of patents is free to refuse to license his patents, thereby discouraging competition and hindering competitors from entering the markets controlled by his patents. This broad protection for intellectual property rights will likely harm competition by preventing potential innovators from developing and producing competing products. Ultimately, this bar to competition threatens innovation as well, and the broad protections of *ISO* might become a detriment to the intellectual property system.

### **I. BACKGROUND**

The Sherman Antitrust Act encourages competition by prohibiting restraints of trade and the unfair exercise of monopoly power. The owners of

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1. 203 F.3d 1322 (Fed. Cir. 2000).

patents and copyrights receive government-sanctioned monopolies in order to encourage innovation. In seeming conflict with antitrust law, patentees and copyright owners are allowed to exclude others from the use of their intellectual property, even if this exclusion restrains trade. The Federal Circuit has exclusive jurisdiction over appeals raising patent issues, and therefore its decisions have tremendous impact on the intersection of patent law and antitrust law.

### A. Antitrust

In 1890, Congress enacted the Sherman Act<sup>2</sup> to create a uniform federal law that would encourage competition in interstate commerce by outlawing monopolies and restraints of trade.<sup>3</sup> The first section of the Act outlaws restraints of trade based on agreements between competitors.<sup>4</sup> The second section of the Act outlaws actions by a single competitor to monopolize, or to attempt to monopolize, any part of trade or commerce.<sup>5</sup>

The prohibition of section 1 of the Sherman Act generally applies to the conduct of two or more separate parties.<sup>6</sup> The Supreme Court, however, has held that section 1 also prohibits tying arrangements when the seller has enough market power to force the buyer to purchase products that he would not accept in a competitive market.<sup>7</sup> Many such cases involve arrangements that require a party to pay for unpatented goods in order to receive patented products.<sup>8</sup>

Where an inquiry focuses on a single party, section 2 of the Sherman Act prohibits the exercise of market power to control prices or exclude competition.<sup>9</sup> Although the inquiry under section 2 focuses on market power, courts have resisted defining this as simply some function of market size and share.<sup>10</sup> The Supreme Court has held that section 2 does not prohibit a "monopoly in the concrete" or mere dominance of a market.<sup>11</sup>

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2. 15 U.S.C. §§ 1-7 (1994).

3. PHILLIP AREEDA & LOUIS KAPLOW, ANTITRUST ANALYSIS ¶ 131 (5th ed. 1997).

4. "Every contract . . . or conspiracy . . . in restraint of trade . . . is declared to be illegal." 15 U.S.C. § 1 (1994).

5. *Id.* § 2.

6. *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 767-69 (1984).

7. *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 13-15 (1984). Although this case did not involve intellectual property rights, the Court noted in dictum that market power could be presumed if "the government has granted the seller a patent or similar monopoly over a product." *Id.* at 16.

8. *See, e.g. In re Indep. Serv. Orgs. Antitrust Litig.*, 203 F.3d 1322 (Fed. Cir. 2000).

9. 15 U.S.C. § 2 (1994).

10. *Berkey Photo, Inc. v. Eastman Kodak Co.*, 603 F.2d 263, 274 (2d Cir. 1979).

11. *Standard Oil Co. v. United States*, 221 U.S. 1, 62 (1911).

Rather, the prohibition of section 2 extends to parties with market dominance who exercise their power to anticompetitive ends.<sup>12</sup> A company may lawfully dominate and maintain its market share so long as it does not impede competition.<sup>13</sup> Although there is no strict rule for defining the market power required for a monopoly, holding patents on the sole product in a market should raise antitrust concerns.<sup>14</sup>

Commentators often advance economic efficiency as the primary, if not exclusive, justification for antitrust laws.<sup>15</sup> Free from the restraints of conspiracies and monopolies, competition lowers prices, increases production, and encourages innovation, consumer choice, and fair business dealing.<sup>16</sup> While there are inconsistencies in the justifications for the prohibitions in the antitrust laws, courts have valued freedom of competition over price-fixing arrangements that lower consumers prices.<sup>17</sup> That restraints of trade seem reasonable or necessary does not prevent antitrust liability.<sup>18</sup>

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12. *Berkey Photo*, 603 F.2d at 273-75.

13. *See id.* at 274. *But see Standard Oil Co.*, 221 U.S. at 61-62 (suggesting that the omission in section 2 of a direct prohibition against monopolies indicates a confidence that “the centrifugal and centripetal forces resulting from the right to freely contract” will inevitably frustrate monopolies, so long as monopolies are prohibited from making unlawful contracts).

14. *See* Joseph P. Lavelle & Celine T. Callahan, *Patent, Antitrust Law Usually Don't Impose an Obligation to Deal*, LEGAL TIMES, March 8, 1999 (stating that the Court's decision that a market may consist solely of products by a single manufacturer could raise antitrust issues for manufacturers who wish to refuse to deal with certain retailers).

15. AREEDA & KAPLOW, *supra* note 3, at ¶ 130. *But see* S.J. Liebowitz & Stephen E. Margolis, *High Technology, Antitrust & the Regulation of Competition: Should Technology Choice be a Concern of Antitrust Policy?*, 9 HARV. J. LAW & TECH. 283, 284 (1996) (“There is disagreement over whether economic efficiency is now or ever was the goal of antitrust, and there are scores of disagreements about exactly what practices result in monopoly inefficiencies.”).

16. AREEDA & KAPLOW, *supra* note 3, at ¶ 130.

17. *United States v. Trans-Missouri Freight Assn.*, 166 U.S. 290 (1897) (rejecting the argument that the Sherman Act outlawed only “unreasonable” restraints on trade and ruling illegal a railroad association that set freight prices). Justice Peckham noted that combinations which artificially lower prices are also undesirable as they may drive out of business “the small dealers and worthy men” who would otherwise compete in the market.

18. *United States v. Addyston Pipe & Steel Co.*, 85 F. 271 (6th Cir. 1898), *aff'd* 175 U.S. 211 (1899) (holding that restraints adopted for the sole purpose of impeding competition were illegal no matter the reasons for adopting the restraints).

## B. Patent and Copyright

### 1. Patent Law

The Federal Circuit has rejected arguments that patents constitute an exception to the general rule against monopolies.<sup>19</sup> The court has noted that the right to exclude that is inherent in a patent is "the very definition of property."<sup>20</sup> That a patent can aid in the violation of antitrust laws does not necessarily create a conflict between patent and antitrust.<sup>21</sup> When a patented product represents a small segment of a market, antitrust laws ensure the patent holder's ability to compete in the market.<sup>22</sup> The potential conflict between patent and antitrust law arises, however, when the patented product consumes most of the relevant market or develops a new market in which it stands alone.<sup>23</sup> Despite this apparent conflict, one court described the aims of patent and antitrust laws as "complementary," because competition relates closely to innovation.<sup>24</sup> The patent system encourages investment and innovation that create new jobs, industries, and goods essential to our system of competition.<sup>25</sup>

Despite the broad rights granted to patent holders, the patent system contains safeguards against patent owners abusing their monopolies.<sup>26</sup> Patent misuse is one of the ways by which a patent holder becomes vulnerable to antitrust claims.<sup>27</sup> Misuse generally involves attempts to extend the patent beyond its lawful scope, such as illegal tying or collecting royalties on an expired patent.<sup>28</sup> Although Justice Douglas' language in *Mercoïd Corp. v. Minneapolis-Honeywell Regulator Co.*<sup>29</sup> suggested that patent misuse automatically falls under the antitrust law,<sup>30</sup> it is now

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19. Carl Schenck, A.G. v. Nortron Corp., 713 F.2d 782, 786 n.3 (Fed. Cir. 1983).

20. *Id.*

21. *Id.*

22. *See* Atari Games Corp. v. Nintendo of America, Inc., 897 F.2d 1572, 1576 (Fed. Cir. 1990).

23. *See id.*

24. *Id.* ("[T]he two bodies of law are actually complementary, as both are aimed at encouraging innovation, industry and competition.").

25. Loctite Corp. v. Ultraseal Ltd., 781 F.2d 861, 876-77 (Fed. Cir. 1985).

26. *See* 35 U.S.C. §§ 271(d)(4) and (5) (1994).

27. *See id.*; *see also* Walker Process Equip., Inc. v. Food Mach. & Chem. Corp., 382 U.S. 172 (1965) (holding that attempts to enforce a patent obtained by fraud on the Patent Office could give rise to section 2 liability).

28. JULIAN O. VON KALINOWSKI ET AL., ANTITRUST LAWS AND TRADE REGULATIONS § 75.01(1) (2000).

29. 320 U.S. 680 (1944).

30. *Id.* at 684 (stating that the legality of any attempt to increase the scope of the patent "is measured by the antitrust laws and not by the patent laws").

accepted that patent misuse rises to the level of an antitrust violation only when there is proof of both intent to monopolize and market power in the relevant market.<sup>31</sup>

## 2. Copyright

A copyright, like a patent, bestows upon its owner a limited monopoly.<sup>32</sup> The control afforded a copyright owner creates a potential for conflict between copyright and antitrust laws.<sup>33</sup> As with patents, the interest of the copyright holder in profiting from his intellectual property must be balanced against society's interests in maintaining free commerce and competition.<sup>34</sup> While the Federal Circuit has exclusive jurisdiction over patent appeals,<sup>35</sup> each circuit develops its own copyright law subject only to review by the Supreme Court.<sup>36</sup> The copyright issues raised in *ISO* are thus much less far reaching than the patent issues. While the Federal Circuit has demonstrated support of copyright interests over antitrust concerns,<sup>37</sup> parties with copyright and antitrust concerns are not required to bring suit in the Federal Circuit.

## C. The Federal Circuit

In 1982, Congress created the Federal Circuit as a new court of appeals having exclusive jurisdiction over patent appeals.<sup>38</sup> With this broad

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31. See VON KALINOWSKI ET AL., *supra* note 28, at § 75.01 n.7.

32. Stephen J. Davidson, *Exploring Tensions between Copyright Law and Competition*, COMPUTER LAW., Dec. 1997, at 1, 2 n.2.

33. See *id.* As a practical matter, almost all conflicts between copyright and antitrust laws arise with respect to media such as computer software, which have significant functional elements.

34. *Id.*; see also *id.* at 4 (citing *Computer Associates International, Inc. v. Altai, Inc.*, 982 F.2d 693, 696 (2d Cir. 1992)).

35. See discussion *infra* Part I.C.

36. See *In re Indep. Serv. Orgs. Antitrust Litig.*, 203 F.3d 1322, 1325 (Fed. Cir. 2000) (holding that the court must apply Tenth Circuit law to a copyright and antitrust issue arising on appeal from District of Kansas).

37. See *Data Gen. Corp. v. Grumman Sys. Support Corp.*, 36 F.3d 1147, 1186-87 (Fed. Cir. 1994).

38. Federal Courts Improvement Act of 1982, Pub. L. No. 97-164, 96 Stat. 25 (April 2, 1982). In order to create uniform federal patent law, Congress provided the Federal Circuit with exclusive jurisdiction over cases arising under the patent laws. See 28 U.S.C. §1295(a)(1) (1994) (granting the Federal Circuit exclusive jurisdiction "of an appeal from a federal district court . . . if the jurisdiction of that court was based, in whole or in part, on section 1338 of this title," except where the case involves only issues of copyright, mask work, or trademark rights); 28 U.S.C. §1338 (1994) (giving federal district courts original jurisdiction over civil actions "relating to patents, plant variety, protection, copyrights and trademarks," as well as actions relating to mask works and designs).

jurisdiction over patents, the Federal Circuit is in many ways the court of last resort for patent cases.<sup>39</sup> In reviewing a district court's ruling on federal antitrust law, the Federal Circuit applies the law of the circuit in which the district court sits.<sup>40</sup> The Federal Circuit, however, applies its own law to antitrust matters closely related to patent issues, including determinations of relevant markets and market power.<sup>41</sup> The court justified this approach by emphasizing the need to avoid circuit splits on important patent issues.<sup>42</sup> The court also stated that antitrust issues typically arise as counterclaims advanced by patent infringement defendants, so that antitrust issues are interwoven with the patent issues that already lie within the court's exclusive jurisdiction.<sup>43</sup>

The Federal Circuit's jurisdiction over all patent cases gives it an opportunity to specialize in an area of the law that is increasingly important in our technology-driven economy.<sup>44</sup> Some commentators, however, express concern that highly specialized courts are susceptible to rapid policy swings and other dangers.<sup>45</sup> The Federal Circuit has not hesitated to disregard the patent holdings of other circuits—usually ruling in favor of patent holders and against competitors invoking antitrust law.<sup>46</sup> For example, in

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39. A losing party in the Federal Circuit can seek certiorari review by the Supreme Court, but one commentator has suggested that it is unlikely the Court would become involved in a patent case. Martin J. Adelman, *The New World of Patents Created by the Court of Appeals for the Federal Circuit*, 20 U. MICH. J.L. REF. 979 (1987). Adelman suggests that with the extremely limited number of certiorari the Supreme Court grants and the large number of patent cases the Federal Circuit reviews, it is unlikely the Court will take on patent cases. *See id.* at 986 n.26. Adelman also notes that with the Federal Circuit having sole jurisdiction over patent cases, it is unlikely that a circuit split will motivate the Court to review a patent case. *Id.*

40. *Nobelpharma AB v. Implant Innovations, Inc.*, 141 F.3d 1059, 1068 (Fed. Cir. 1998) (“[W]e will . . . apply the law of the appropriate regional circuit to issues involving . . . elements of antitrust law such as relevant market, market power, damages, etc. . .”).

41. *See id.* As evidence of the Federal Circuit's autonomy in the field of patents, the court, apparently without fear of Supreme Court intervention, announced: “[W]e hereby change our precedent and hold that whether conduct in procuring or enforcing a patent is sufficient to strip a patentee of its immunity from the antitrust laws is to be decided as a question of Federal Circuit law.” *Id.*

42. *Id.*

43. *Id.*

44. *See Adelman, supra* note 39, at 982.

45. *Id.* at 983 n.13 (citing Richard Posner, *Will the Federal Courts of Appeals Survive Until 1984? An Essay on the Delegation and Specialization of the Judicial Function*, 56 S. CAL. L. REV. 761, 777 (1983); Simon Rifkind, *A Special Court for Patent Litigation? The Danger of a Specialized Judiciary*, 37 A.B.A. J. 425 (1951)).

46. *See generally In re Indep. Serv. Orgs. Antitrust Litig.*, 203 F.3d 1322 (Fed. Cir. 2000); *Intergraph Corp. v. Intel Corp.*, 195 F.3d 1346 (1999).

*Intergraph Corp. v. Intel Corp.*,<sup>47</sup> the Federal Circuit rejected the Second Circuit's rule of *Berkey Photo, Inc. v. Eastman Kodak Co.*<sup>48</sup> and noted that several other circuits had done the same.<sup>49</sup>

Certainly, the Federal Circuit has not hesitated to develop patent law that relates closely to, and in many cases impinges upon, antitrust law. For example, the Federal Circuit noted in *Intergraph* that the Supreme Court has held that in the absence of any purpose "to create or maintain a monopoly," the Sherman Act does not prevent a party from deciding with whom he will not deal.<sup>50</sup> Nevertheless, the Federal Circuit has gone further by holding that a patent holder—even one with monopolistic intent—does not violate antitrust laws so long as he does not unlawfully exceed the scope of his patent.<sup>51</sup> By the year 2000, the Federal Circuit had demonstrated its strong support of patents and copyrights, and its strong opposition to anything that might limit those rights.<sup>52</sup>

## II. CASE SUMMARY

### A. District Court Decision

In 1984, Xerox instituted a policy of not selling patented parts unique to its copiers to independent service organizations ("ISOs").<sup>53</sup> Through strict enforcement, this expanded policy severely impaired the ability of ISOs to purchase restricted parts.<sup>54</sup> The price of parts increased considerably, limiting the ISOs' ability to compete in the service market.<sup>55</sup> In 1994, the ISOs brought suit in the District Court of Kansas, alleging that Xerox's refusal to sell patented parts was a violation of the Sherman Act because Xerox effectively eliminated the ISOs as competitors in the service market.<sup>56</sup> Xerox counterclaimed for patent and copyright infringement, argu-

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47. 195 F.3d 1346 (1999).

48. 603 F.2d 263 (2d Cir. 1979) (holding that a patentee with market power in a first market could not use that power to gain competitive advantage in a second market, regardless of intent).

49. *Intergraph*, 195 F.3d at 1360 (citing *Aquatherm Indus. Inc. v. Fla. Power & Light Co.*, 145 F.3d 1258 (11th Cir. 1998); *Fineman v. Armstrong World Indus., Inc.*, 980 F.2d 171 (3d Cir. 1992)).

50. *Id.* at 1358 (citing *United States v. Colgate & Co.*, 250 U.S. 300, 307 (1919)).

51. *See Glass Equip. Dev. Inc. v. Besten, Inc.*, 174 F.3d 1337, 1343 (1999).

52. *See, e.g., Intergraph Corp. v. Intel Corp.*, 195 F.3d 1346 (1999); *see also Adelman, supra* note 39, at 987-88.

53. *In re Indep. Serv. Orgs. Antitrust Litig.*, 203 F.3d 1322, 1324 (Fed. Cir. 2000).

54. *See id.*

55. *See id.*

56. *See id.*

ing that plaintiffs' antitrust claims relied solely on Xerox's legal right to refuse to license its intellectual property and that Xerox's refusal to deal did not constitute patent and copyright misuse.<sup>57</sup> The district court granted summary judgment for Xerox, holding that if Xerox lawfully acquired the patent or copyright, then intent was irrelevant and refusal to license did not violate antitrust law.<sup>58</sup>

## B. Federal Circuit Decision

Reviewing the summary judgment de novo, the Federal Circuit applied its own law to antitrust claims related to patent licensing and the law of the Tenth Circuit to claims related to copyright licensing.<sup>59</sup>

### 1. Patent

The court began its discussion by noting the inherent conflict between antitrust law and intellectual property rights.<sup>60</sup> At issue in this case was how the antitrust laws limit patent and copyright holders' ability to exclude others and to refuse to license their intellectual property.<sup>61</sup> The court noted that a patent holder's right to exclude was broad and well supported by case law and statutes.<sup>62</sup>

Nevertheless, because of limits on those rights, the court noted two circumstances in which an infringement defendant could succeed in antitrust claims.<sup>63</sup> In *Glass Equipment Development Inc. v. Besten, Inc.*,<sup>64</sup> the court held that an infringement defendant could succeed in his antitrust claim if he could prove either (1) that the patentee obtained the patent by "knowing and willful fraud"<sup>65</sup> or (2) that the infringement suit was a sham.<sup>66</sup> *ISO* did not involve the first test because the ISOs did not allege any fraud at the Patent and Trademark Office ("PTO").<sup>67</sup> Hence, the ISOs had to show that Xerox's infringement suits were both objectively without

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57. *See id.*

58. *See id.*

59. *See id.* at 1325.

60. *See id.* (citing *Intergraph Corp. v. Intel Corp.*, 195 F.3d 1346, 1362 (Fed. Cir. 1999)).

61. *See id.*

62. *See id.* at 1326.

63. *See id.*

64. 174 F.3d 1337, 1343 (Fed. Cir. 1999).

65. The Supreme Court defined "knowing and willful fraud" in *Walker Process Equip., Inc. v. Food Mach. & Chem. Corp.*, 382 U.S. 172 (1965).

66. The Supreme Court defined a "sham" suit as one that is both objectively baseless and subjectively intended to further the patentee's anticompetitive motives. *Eastern R.R. Presidents Conference v. Noerr Motor Freights, Inc.*, 365 U.S. 127 (1961).

67. *See Indep. Serv. Orgs.*, 203 F.3d at 1326.

merit *and* subjectively motivated by a desire to cause anticompetitive injuries to potential competitors.<sup>68</sup>

The court rejected an argument by ISOs that Xerox illegally sought to leverage its dominance in the parts market into a dominance in the service market.<sup>69</sup> While the case law prohibits illegal tying and extension of a patent owner's monopoly beyond the scope of his patent, the court concluded that this case did not involve either of these impermissible activities.<sup>70</sup>

The court then declined to follow a Ninth Circuit holding that placed great importance on a patent holder's subjective motives for exclusion.<sup>71</sup> The court instead reiterated its rule that if a patent infringement suit was not objectively baseless, then the patentee's subjective motives would be immaterial.<sup>72</sup> At the end of its patent analysis, the court turned to the question of whether the defendant had exceeded the scope of its patent, concluding that Xerox had not.<sup>73</sup> Therefore, on the matter of Xerox's refusal to sell its patented parts, the court held that Xerox did not violate antitrust law.<sup>74</sup>

## 2. Copyright

The court then examined Xerox's refusal to distribute copyrighted manuals and software to plaintiffs. The court first noted that the Supreme Court had not directly addressed the issue of antitrust and the refusal to sell or license copyrighted works.<sup>75</sup> Without a Tenth Circuit decision on the matter, the court turned to the most extensive analysis of that issue which had been conducted by the First Circuit in *Data General Corp. v. Grumman Systems Support Corp.*<sup>76</sup> The First Circuit reasoned that a copyright holder's desire to exclude others from the use of his copyright was a "presumptively valid business justification" for any harm to competition that might result.<sup>77</sup> Therefore, the burden of overcoming this presumption

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68. *See id.* (citing *Nobelpharma AB v. Implant Innovations, Inc.*, 141 F.3d 1059, 1071 (Fed. Cir. 1998)).

69. *See id.* at 1327.

70. *See id.*

71. *See id.* (citing *Image Technical Servs. v. Eastman Kodak Co.*, 125 F.3d 1195 (9th Cir. 1996)).

72. *See id.* (citing *Nobelpharma*, 141 F.3d at 1072).

73. *See id.* at 1328.

74. *See id.*

75. *See id.*

76. *See id.* (citing *Data Gen. Corp. v. Grumman Sys. Support Corp.*, 36 F.3d 1147 (1st Cir. 1994)).

77. *Data General*, 36 F.3d at 1187.

rested with the antitrust plaintiff,<sup>78</sup> who must produce evidence that the copyright was illegally obtained.<sup>79</sup> The Federal Circuit noted that the Ninth Circuit extended this test in *Image Technical Services v. Eastman Kodak Co.* to allow plaintiffs to rebut the presumption by showing that the use of the copyright was a mere pretext to produce anticompetitive harm.<sup>80</sup> The Federal Circuit, however, rejected the Ninth Circuit's extension in favor of the First Circuit's rule, making it more difficult to overcome the presumption in favor of the copyright holder.<sup>81</sup> Therefore, because the ISOs did not allege that Xerox committed any fraud in obtaining its copyright, the court refused to examine Xerox's motivations for refusing to sell or license its copyrighted works.<sup>82</sup> The Federal Circuit concluded that Xerox's refusal lay within the scope of its copyright. Accordingly, the court upheld the summary judgment.<sup>83</sup>

### III. DISCUSSION

The *ISO* decision makes it unlikely that a patentee's exclusion of competitors will be found to violate antitrust laws, even when his conduct is motivated by anticompetitive concerns. Because of the Federal Circuit's exclusive jurisdiction over patents and the limited frequency with which the Supreme Court reviews Federal Circuit decisions, *ISO* likely will have a tremendous impact on antitrust matters arising in patent infringement cases. By giving extremely little weight to a patentee's anticompetitive motives, the *ISO* decision gives extreme favor to patent rights at the expense of antitrust concerns. This poses the danger of damaging the patent system if patentees engage in behavior that, prior to *ISO*, would have violated antitrust laws, and if this behavior deters potential competitors from investing in research and from entering new markets.

#### A. Consequences of the *ISO* Decision

After the *ISO* decision, a patent holder has very broad rights to refuse to license or sell his intellectual property even if the patent holder has anticompetitive motives. Under *Glass Equipment Development*<sup>84</sup> and *ISO*,

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78. See *Indep. Serv. Orgs.*, 203 F.3d at 1329 (citing *Data General*, 36 F.3d at 1187).

79. See *id.*

80. See *id.* (citing *Image Technical Servs. v. Eastman Kodak Co.*, 125 F.3d 1195, 1219 (9th Cir. 1996)).

81. See *id.* at 1329 (citing *Data General*, 36 F.3d at 1187 n.64).

82. See *id.* at 1330.

83. See *id.*

84. 174 F.3d 1337 (Fed. Cir. 1999), discussed *supra* notes 64-66 and accompanying text.

a court will not examine the motives of the patentee in an infringement suit unless a defendant can show either that the patentee committed fraud at the PTO,<sup>85</sup> or that the infringement suit is a sham.<sup>86</sup> A patent holder may also be subject to antitrust liability for attempting to misuse his right beyond the scope of his patent.<sup>87</sup> These are difficult conditions to prove, and represent virtually no limit on the right of a patentee to pursue anticompetitive ends.<sup>88</sup>

In order to prove fraud at the PTO, an infringement defendant must show, by “independent and clear evidence of deceptive intent,”<sup>89</sup> that the patentee made knowing and willful misrepresentations to the PTO that resulted in a patent which would not have issued but for the misrepresentations.<sup>90</sup> Mere failure to provide information to the PTO will not result in liability,<sup>91</sup> and the plaintiff’s showing of good faith mistake can rebut the defendant’s proof of deceptive intent.<sup>92</sup> Once the defendant clearly establishes deceptive intent, he must then prove that the patent would not have issued but for the misrepresentations.<sup>93</sup> This difficult task requires detailed evidence about the patent examiner’s handling of the patent application, and the plaintiff can rebut the evidence by showing that the misrepresentation was not the principal reason for the patent’s approval.<sup>94</sup>

In order to prove that an infringement suit is a sham, the defendant must show that the suit is both objectively baseless and subjectively moti-

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85. *Id.* at 1326.

86. *Id.*

87. *Id.* at 1327.

88. See Robert Pitofsky, Remarks at American Antitrust Institute Conference: An Agenda for Antitrust in the 21st Century (June 15, 2000), available at <http://www.ftc.gov/speeches/pitofsky/000615speech.htm> (arguing that the conditions required by the court appear to be almost nonexistent limits on the “virtually unfettered right of a patent holder to refuse to deal in order to achieve an anticompetitive objective”).

89. *Nobelpharma AB v. Implant Innovations, Inc.*, 141 F.3d 1059, 1071 (Fed. Cir. 1998).

90. *Id.* at 1070.

91. *Id.*

92. *Walker Process Equip., Inc. v. Food Mach. & Chem. Corp.*, 382 U.S. 172, 177 (1965).

93. *Nobelpharma*, 141 F.3d at 1071.

94. See Pitofsky, *supra* note 88 (stating that fraud at the PTO is “more difficult to prove than almost any other antitrust allegation because the Federal Circuit requires clear evidence that a patent applicant made knowing and willful misrepresentations that resulted in a patent that would not have issued in the absence of a misrepresentation”).

vated by bad faith.<sup>95</sup> Each of these conditions places a significant burden of proof on the alleged infringer who is raising antitrust counterclaims. He must first show that no objective litigant could reasonably believe that the infringement suit would succeed, and then he must prove that the patentee's desire to interfere with a competitor's business motivated the suit.<sup>96</sup> The patentee has an absolute defense if he can show any objectively reasonable basis for his claim, making the defendant's burden of proof quite high.<sup>97</sup> Misuse, or exceeding the patent's scope, might also subject a patentee to antitrust liability.<sup>98</sup> The Federal Circuit's brief treatment of the patent scope in *ISO*,<sup>99</sup> however, suggests that this bar, too, will be hard for an infringement defendant to overcome.

If a balance between patent and antitrust existed prior to *ISO*, the Federal Circuit has upset that balance with its decision.<sup>100</sup> Given the near total autonomy of the Federal Circuit to rule on antitrust issues that arise in patent cases, this imbalance will have unfortunate consequences for competition and innovation in the intellectual property economy. In high-technology markets dominated by patents, where intellectual property is often a barrier to entry, this decision may have chilling effects on innovation and disclosure.<sup>101</sup>

## B. The Federal Circuit Is Rarely Subject to Review

A number of factors contribute to the Federal Circuit's near total autonomy on patent issues.<sup>102</sup> The ultimate effect of this autonomy is that the Federal Circuit is, for all practical purposes and at least for the imme-

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95. *Nobelpharma*, 141 F.3d at 1071-72; see also *Professional Real Estate Investors, Inc. v. Columbia Pictures Industries, Inc.*, 508 U.S. 49, 60-61 (1993) (holding that sham litigation requires proof of objective baselessness and subjective intent).

96. *Nobelpharma*, 141 F.3d at 1071.

97. See Pitofsky, *supra* note 88 (arguing that this test is an extremely narrow limit on the ability of the patent holder to pursue anticompetitive ends).

98. See *Int'l Salt Co. v. United States*, 332 U.S. 392 (1947).

99. *In re Indep. Serv. Orgs. Antitrust Litig.*, 203 F.3d 1322, 1328 (Fed. Cir. 2000).

100. See Pitofsky, *supra* note 88 (examining whether the antitrust-intellectual property balance has changed).

101. See *id.*

102. See Adelman, *supra* note 39, at 986 n.26 (noting that the extremely limited number of certiorari petitions granted by the Supreme Court, combined with the unlikelihood of a circuit split on patent issues, means the Federal Circuit will rarely be reviewed by the Supreme Court). Adelman also argues that the Federal Circuit was created in part because of congressional dissatisfaction with the Supreme Court's treatment of patent cases, and this also contributes to the Supreme Court rarely reviewing the Federal Circuit. *Id.* at 986-87.

diate future, the court of last resort for patent issues and related antitrust matters.

The Supreme Court receives a large number of petitions for review on writ of certiorari and grants only a small number of those petitions. While the number of petitions granted to each circuit varies from year to year, the Federal Circuit is often among the least reviewed circuits. During the twelve-month period from October 1, 1998 to September 30, 1999, the Supreme Court received 5518 petitions for review on writ of certiorari.<sup>103</sup> The Court granted 137 of those petitions to the eleven regional circuits and the Court of the Appeals of the D.C. Circuit<sup>104</sup> but only two petitions to the Federal Circuit.<sup>105</sup> By comparison, in the same twelve-month period, the Court granted 22 petitions to the Fourth Circuit.<sup>106</sup> Similarly, in the twelve-month period from October 1, 1997 to September 30, 1998, the Court received 4995 petitions and granted 109 to the eleven regional circuits and the D.C. Circuit.<sup>107</sup> While the Court granted 22 petitions to the Eighth Circuit,<sup>108</sup> it granted only three to the Federal Circuit.<sup>109</sup>

One reason for the small number of petitions granted to appeals from the Federal Circuit is that a split among the circuits is one basis for Supreme Court review. With the Federal Circuit's sole jurisdiction over patents, this justification for Supreme Court review is essentially nonexistent.<sup>110</sup> Without a circuit split, the Supreme Court will likely grant review only when it believes that the Federal Circuit decided a case erroneously. While a conflict between the Federal Circuit and the Supreme Court could arise, one commentator has suggested that such a conflict would likely bring congressional intervention in favor of the Federal Circuit.<sup>111</sup>

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103. Leonidas Randolph Mecham, Administrative Office of the U.S. Courts, *Judicial Business of the United States Courts*, 1999 ANNUAL REPORT OF THE DIRECTOR, 93 (Table B-2), available at <http://www.uscourts.gov/judbus1999/b02sep99.pdf> (last visited Jan. 29, 2001).

104. *Id.*

105. Fla. Prepaid Postsecondary Educ. Expense Bd. v. Coll. Sav. Bank, 527 U.S. 627 (1999); Lehman v. Zurko, 525 U.S. 961 (1998).

106. Mecham, *supra* note 103.

107. Leonidas Randolph Mecham, Administrative Office of the U.S. Courts, *Judicial Business of the United States Courts*, 1998 ANNUAL REPORT OF THE DIRECTOR 99 (Table B-2), available at <http://www.uscourts.gov/dirprt98/b02sep98.pdf> (last visited Jan. 29, 2001).

108. *Id.*

109. LaChance v. Erickson, 522 U.S. 262 (1998); Pfaff v. Wells, 523 U.S. 1003 (1998); United States v. United States Shoe Corp., 523 U.S. 360 (1998).

110. Adelman, *supra* note 39, at 986 n.26.

111. *Id.* at 986-987 (stating that Congress's creation of the Federal Circuit indicated a "dissatisfaction with the effectiveness of Supreme Court review of patent issues"). Adelman

In practice, the Supreme Court has demonstrated a willingness to affirm Federal Circuit holdings, even those that radically alter patent law. For instance, for two hundred years, patent infringement cases had been tried before juries, and juries decided claim construction.<sup>112</sup> In *Markman v. Westview Instruments, Inc.*, the Federal Circuit changed that tradition, holding that the judge should interpret the meaning and scope of the claims as matters of law.<sup>113</sup> The Federal Circuit based its decision, in part, on its belief that judges, trained in the law, are better suited to provide uniformity in claim construction.<sup>114</sup> The decision represented a considerable change in the role of juries in patent infringement trials. Since infringement cases are often decided on issues of claim construction, *Markman* effectively removed juries from their role as triers of fact in most patent infringement cases.<sup>115</sup> In the view of some judges, that decision overturned two hundred years of jury trial in patent cases in the United States, and raised concerns over the role of the Seventh Amendment right to trial by jury in patent cases.<sup>116</sup> *Markman* was heard *en banc* by the Federal Circuit, with two judges filing concurring opinions<sup>117</sup> and another filing a lengthy dissent.<sup>118</sup> Yet the Supreme Court upheld *Markman* in a unanimous decision, agreeing with the majority of the Federal Circuit that the need for uniformity in patent law required that judges, not juries, determine claim construction.<sup>119</sup> The Supreme Court's unanimous affirmation of a precedent-altering, and widely criticized,<sup>120</sup> Federal Circuit decision suggests

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man goes on to suggest that this Congressional disapproval, along with other factors, has "essentially removed" the Supreme Court from playing any role in the patent system. *Id.*

112. *Markman v. Westview Instruments, Inc.*, 52 F.3d 967, 989 (1995) (Mayer, J. concurring).

113. *Id.* at 978.

114. *Id.* at 979.

115. *Id.* at 989 (Mayer, J., concurring).

116. *Id.* at 1000 (Newman, J., dissenting).

117. *Id.* at 989 (Mayer, J., concurring); *Id.* at 998 (Rader, J., concurring).

118. *Id.* at 999 (Newman, J., dissenting).

119. 517 U.S. 370, 391 (1996).

120. See, e.g., Greg J. Michelson, *Did the Markman Court Ignore Fact, Substance, and the Spirit of the Constitution in its Rush toward Uniformity?*, 30 LOY. L.A. L. REV. 1749, 1787 (1997) (arguing that the *Markman* decision disregarded that factual matters exist in claim construction and that by removing the jury from claim construction the decision effectively prevents them from playing any role in an infringement trial); Elizabeth J. Norman, *Markman v. Westview Instruments, Inc.: The Supreme Court Narrows the Jury's Role in Patent Litigation*, 48 MERCER L. REV. 955, 963 (1997) (arguing that the *Markman* decision's removal of juries from playing an important role in infringement trials runs counter to established Seventh Amendment jurisprudence).

that, at least for the present, the Court has no interest in taking issue with the Federal Circuit's sweeping changes.<sup>121</sup>

### C. Patent Rights are Favored at the Expense of Competition

#### 1. *The Federal Circuit's Autonomy Has Resulted in Support of Patents to the Detriment of Antitrust Law*

While the Federal Circuit has occasionally ruled against patent holders and in favor of antitrust claims, there has been a general trend of strong support for patent holders facing antitrust charges.<sup>122</sup> In *Loctite Corp. v. Ultraseal Ltd.*,<sup>123</sup> an early Federal Circuit case, the court upheld Loctite's infringement claim and denied Ultraseal's antitrust counterclaims. Declining to adopt a "preponderance of the evidence" standard, the court held that clear and convincing evidence was needed to rebut the presumption that the patentee had brought its infringement suit in good faith.<sup>124</sup> The court reasoned that the patent system serves a positive function in the system of competition by encouraging "investment based risk."<sup>125</sup> If the burden of proof on an infringement defendant were not high enough, then the threat of treble damages in an antitrust counterclaim might discourage good faith attempts at patent enforcement.<sup>126</sup>

More recently, in *Intergraph*, the Federal Circuit asserted that antitrust laws do not negate a patent holder's right to exclude others from his patents.<sup>127</sup> On the issue of illegal leveraging, the Federal Circuit held that the district court's ruling relied on an erroneous per se theory of future Sherman Act violations.<sup>128</sup> The Federal Circuit stated that this was an unwarranted expansion of antitrust theory that would penalize companies for

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121. See Gregory D. Leibold, *In Juries We Do Not Trust: Appellate Review of Patent-Infringement Litigation*, 67 U. COLO. L. REV. 623, 626-25 (1996) (expressing surprise that the Supreme Court unanimously affirmed the decision, despite the Court's long held position that the Seventh Amendment right to jury trial applied to patent infringement cases).

122. See generally Pitofsky, *supra* note 88 (expressing concern that in recent years the Federal Circuit has upset a balance between patent and antitrust interests); Richard Gray & David Banie, Note, *Intergraph Corporation v. Intel Corporation*, 16 COMPUTER AND HIGH TECH. L.J. 437, 447 (2000) (suggesting that the Federal Circuit's decision in *Intergraph* demonstrates its continued support for the proposition that the exercise of intellectual property rights will rarely lead to antitrust liability).

123. 781 F.2d 861 (1985).

124. *Id.* at 876.

125. *Id.* (citing *Patlex Corp. v. Mossinghoff*, 758 F.2d 594, 599 (Fed. Cir. 1985)).

126. *Id.* at 877.

127. 195 F.3d 1346, 1362 (Fed. Cir. 1999) (citing *Cygnus Therapeutic Sys. v. ALZA Corp.*, 92 F.3d 1153, 1160 (Fed. Cir. 1996)).

128. *Id.* at 1360.

conduct that, if it occurred, would not violate the Sherman Act.<sup>129</sup> The court based its decision in part on the district court's erroneous ruling that the mere presence of monopoly power is actionable under the antitrust laws.<sup>130</sup> This decision also followed the Federal Circuit trend of strongly criticizing any incursion onto patent rights by antitrust law.<sup>131</sup>

Subsequently, in *Glass Equipment Development*, the Federal Circuit ruled that a patent owner's infringement suit would not expose it to antitrust liability unless the defendant proved fraud or sham.<sup>132</sup> The defendant in *Glass Equipment Development* did not allege either fraud or sham, and so the court dismissed its antitrust claim with little discussion.<sup>133</sup> Although *ISO* restated the rule in more sweeping language, the *Glass Equipment Development* holding stands for same basic proposition—it is unlikely that the exercise of patent rights will subject the patent owner to antitrust liability.<sup>134</sup>

Despite the general trend described above, the Federal Circuit has, on occasion, held patent owners liable for antitrust violations. In *C.R. Bard, Inc. v. M3 Systems, Inc.*,<sup>135</sup> a patentee appealed from a jury verdict finding the patentee liable for infringement, misuse, fraud, and attempted monopolization due to improperly redesigning a patented product to exceed the scope of the original patent. In a complex opinion, the Federal Circuit upheld the jury verdict of attempted monopolization on the sole grounds that there was substantial evidence to support it.<sup>136</sup> However, the court overturned the jury verdicts of infringement, misuse, and fraud.<sup>137</sup> The Federal Circuit then denied the plaintiff's petition for rehearing *en banc*.<sup>138</sup> In a concurring opinion to that denial, Judge Gajarsa noted that on appeal of the antitrust violations, the plaintiff challenged only the sufficiency of the evidence.<sup>139</sup> Given the limited nature of *Bard*'s appeal, the Federal Circuit's opinion—and its decision to deny rehearing *en banc*—neither establishes nor suggests any new antitrust theory.<sup>140</sup> While the *Bard* decision does provide an example of the Federal Circuit ruling against a patent

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129. *Id.*; see also Gray & Banie, *supra* note 122, at 443-44.

130. Gray & Banie, *supra* note 122, at 447.

131. *Id.*

132. *Glass Equip. Dev., Inc. v. Besten, Inc.*, 174 F.3d 1337, 1343 (1999).

133. *Id.* at 1344.

134. *Id.* at 1343.

135. 157 F.3d 1340, 1346 (1998).

136. *Id.* at 1383 (Bryson, J. concurring).

137. *Id.* at 1358, 1367-69.

138. 161 F.3d 1380 (Fed. Cir. 1998).

139. *Id.* (Gajarsa, J., concurring).

140. *Id.* at 1381.

holder in an antitrust counterclaim, this decision was primarily based on the deferential standard of review and so does not suggest a retreat from the court's trend of strong patent support.<sup>141</sup>

2. *ISO Represents the Federal Circuit's Continuing Support for this Trend*

In *ISO*, the Federal Circuit ruled that its own law applies to antitrust matters arising in patent cases.<sup>142</sup> The court noted that, as a general proposition, regional circuit law controls when reviewing a district court judgment involving federal antitrust law.<sup>143</sup> When matters fall under the Federal Circuit's exclusive jurisdiction, however, then it must apply its own law.<sup>144</sup> Therefore, the court concluded that antitrust matters arising from a patent infringement suit were within the exclusive jurisdiction of the court and that Federal Circuit law should govern those matters.<sup>145</sup> In comparison, the court decided that Tenth Circuit law should govern the antitrust matters related to the copyright claim.<sup>146</sup> In sum, the Federal Circuit has created antitrust law favorable to its strong support of patent rights.

The *ISO* decision follows a trend apparent in the Federal Circuit's cases that favors patents over antitrust. The opinion itself is relatively short, especially in comparison to prior decisions like *Nobelpharma* or *Intergraph*, in part because the court was able to rely on the reasoning in those cases. The court held that its own law applies to antitrust claims by citing *Nobelpharma*.<sup>147</sup> The court cited *Intergraph* for the proposition that while intellectual property rights do not confer a privilege to violate antitrust laws, the right to exclude others does not conflict with the purpose of antitrust.<sup>148</sup> The court cited *Glass Equipment Development* for the proposition that a patent owner bringing an infringement suit is exempt from liability for the anticompetitive effects of his suit unless there was fraud at the PTO or the suit is baseless.<sup>149</sup> *ISO* thus unifies the Federal Circuit's prior decisions on patent rights and antitrust liability. The decision affirms, and then enhances, the court's position that the exercise of intellectual property rights will rarely give rise to antitrust violations.

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141. *Id.* at 1380.

142. *In re Indep. Serv. Orgs. Antitrust Litig.*, 203 F.3d 1322, 1325 (Fed. Cir. 2000).

143. *Id.*

144. *Id.* (citing *Pro-Mold & Tool Co. v. Great Lakes Plastics, Inc.*, 75 F.3d 1568, 1574-75 (Fed. Cir. 1996)).

145. *Id.*

146. *Id.*

147. *Id.* at 1325.

148. *Id.*

149. *Id.* at 1326.

## D. The *ISO* Decision Presents the Danger of Deterring Innovation

### 1. *Patentees who Dominate their Markets Will Likely Be Able to Hinder Competitors*

The practical result of the *ISO* decision is that companies like Xerox, who hold all or most of the important patents in an industry, can exercise more or less total control over their own industry and other related, downstream industries. Xerox's control over patented parts and copyrighted manuals and software allows it to exert significant control over the markets for sale and service of its copiers.<sup>150</sup> Under earlier antitrust analysis, this might have constituted impermissible expansion into a downstream market;<sup>151</sup> however, the Federal Circuit concluded, in a relatively brief section of the decision, that Xerox's actions to limit the ability of service organizations to compete were within the scope of its patent.<sup>152</sup>

Especially in emerging markets and technologies, where pioneer patents receive broad protection, the *ISO* case means that a patent holder with monopoly power over his market has the potential substantially to bar new entrants.<sup>153</sup> The patent holder is under no obligation to sell or license patented products to potential competitors.<sup>154</sup> If the technology remains valuable in the market during the life of the patent, this barrier could prove such a disadvantage that potential competitors might be severely discouraged from entering the market. Of course, where the technology's viability exceeds the life of the patent, competitors can enter the market after the patent has expired. The original patentee will still, however, have a significant head start over competitors, which might discourage new entrants.

In some markets, the commercially valuable technology might change so rapidly that the years of patent protection are useless because no patented product has commercial value for that long. Some commentators have argued that the high technology marketplace changes so quickly that, without the intervention of antitrust laws, consumers will punish patent holders who abuse their market power by raising prices and reducing out-

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150. *See id.* at 1329.

151. *See Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451, 479 n.29 (1992) (noting that the Court has often held that power gained through a patent or copyright can give rise to liability if "a seller exploits his dominant position in one market to expand his empire into the next").

152. *Indep. Serv. Orgs.*, 203 F.3d at 1328.

153. *See Pitofsky, supra* note 88 (arguing that especially in high tech markets, intellectual property is often the principal barrier to new entry).

154. *See* 35 U.S.C. § 271(d) (1994).

put.<sup>155</sup> Nevertheless, a patent monopolist still gains considerable advantage by excluding competitors, even for a short time, because of his head start in developing new technology based upon his original patents.<sup>156</sup> Competitors can of course use the published patents to develop their own products, but the original patent holder's control over his original products can limit competitors' ability to profit from their new products.

## 2. *Competition Encourages Innovation*

Commentators have argued that the Federal Circuit's strengthening of patent rights has been one cause for the increase in patent activity—both in prosecution and litigation—because inventors have confidence in the strong patent protection provided by the court.<sup>157</sup> The rights granted to patent holders encourage investment in research and development because investors know that if they obtain a valuable patent, they can receive a return on their investment.<sup>158</sup>

In *Nobelpharma*, the Federal Circuit expressed concern that private antitrust suits might have a chilling effect on the disclosure of inventions because inventors might not file patents out of fear of treble damages.<sup>159</sup> Yet, overbroad patent protection that allows one party to exclude others for anticompetitive reasons poses the danger of hindering potential innovators. Just as investors will hesitate to fund research if they might not receive adequate protection for their inventions, they will also hesitate to fund research if they can not compete in the marketplace.

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155. See Liebowitz & Margolis, *supra* note 15, at 318 ("The high technology marketplace appears to be quite capable of disciplining any firm that does not address the needs of its consumers, as demonstrated by the extraordinary rate of turnover of product leaders in these markets.").

156. See Pitofsky, *supra* note 88 (discrediting the argument that the antitrust laws are applicable only to traditional industries, and are not well suited to the modern high technology economy. Pitofsky cites the history of innovation in the telecommunications market since the break up of AT&T as evidence that competition, rather than monopoly power, best fosters innovation).

157. Jon F. Merz & Nicholas M. Pace, *Trends in Patent Litigation: The Apparent Influence of Patents Attributable to The Court of Appeals for the Federal Circuit*, 76 J. PAT. & TRADEMARK OFF. SOC'Y 579 (1994) (suggesting that an increase in patent filings after 1983 may be in part attributable to the advent of the Federal Circuit and its stabilization of patent law). The authors are careful to note that other factors, such as the patenting of new technologies like software and biotechnology, may also have contributed to the increase.

158. See *Loctite Corp. v. Ultraseal Ltd.*, 781 F.2d 861, 876 (Fed. Cir. 1985) (noting that the patent system motivates competition because it encourages investment based risk).

159. *Nobelpharma AB v. Implant Innovations, Inc.*, 141 F.3d 1059, 1069 (Fed. Cir. 1998).

It is true that market power is, at times, reasonably necessary to achieve efficiencies in the market.<sup>160</sup> For example, research and development joint ventures, where several competitors pool their resources to fund shared research, have a short term anticompetitive effect—a group with significant aggregate market power is conducting research. Nevertheless, the overall benefit to consumers from newly developed technologies, which a single firm could not develop, outweighs the need to enforce research competition.<sup>161</sup> This example shows that a balance can exist between patent and antitrust, a balance which the Federal Circuit could restore by giving the impact on competition some place in its consideration of antitrust counterclaims.

### 3. *A Balance between Patents and Antitrust*

It is appropriate for the Federal Circuit strongly to support patent rights and the right of patentees to exclude competitors. This encourages innovation by giving investors confidence that they can profit from investments in research. There is no disagreement with the fundamental principle that a patentee has no obligation to sell or license his patent to anyone.

The *ISO* decision, however, focuses almost entirely on this statutory right to exclude and more or less ignores any anticompetitive motives or effects, except in very limited instances. Concern about the *ISO* decision arises from fear that a patentee will be able to limit availability of his product with terms that severely impair competition, for instance, terms which effectively destroy competition in a related market.<sup>162</sup> After the *ISO* decision, it seems that the mere invocation of the right to exclude will eliminate any antitrust concerns.<sup>163</sup> It seems that antitrust concerns are eliminated without consideration given to the nature or severity of the harm to competition, or the importance of the limiting terms in order to protect incentives to innovate.<sup>164</sup>

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160. See Pitofsky, *supra* note 88. In response to the argument that market power always benefits innovation and therefore, the government should have a hands off policy in dealing with it, Pitofsky gives four examples of situations in which the modest anticompetitive effects of transactions are outweighed by resulting gains in innovation.

161. *See id.*

162. *See id.* (expressing concern that impact on competition will have little or no place in patent cases after the *ISO* decision).

163. There are the three instances in which a patentee can be liable for antitrust counterclaims, but these represent very narrow situations. *See id.* (arguing that these three situations place very few limits on the ability of a patentee to behave in an anticompetitive manner).

164. *See id.*

A better solution would be to balance the incentives to innovate against the anticompetitive effects of the patent.<sup>165</sup> The right to exclude should be valued much more highly than any single anticompetitive effects—exclusion is the fundamental property right associated with patents.<sup>166</sup> But some weight should be given to the anticompetitive effects of exclusion, and whether or not that exclusion is necessary to encourage innovation. If the exclusionary use of a patent is grossly anticompetitive, this should have some weight in considering whether or not the patent is valid in an infringement case.<sup>167</sup>

#### IV. CONCLUSION

The Federal Circuit has rejected what it perceives as an unwarranted “enlargement of antitrust theory and policy” that works to prohibit the exercise of patent rights.<sup>168</sup> This ruling creates a situation where it seems that the exercise of patent rights will very rarely lead to antitrust violations. While this provides even stronger protection for intellectual property rights, it might prove to be a bar to competition, as patent holders are free to monopolize so long as their infringement suits pass a minimal test. This imbalance between patent law and antitrust law poses the danger of being detrimental to innovation and ultimately detrimental to the patent system.

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165. *See id.* (arguing for a balancing of antitrust and patent concerns).

166. *See* Carl Schenck, A.G. v. Nortron Corp., 713 F.2d 782, 786 n.3 (Fed. Cir. 1983).

167. *See* Pitofsky, *supra* note 88 (concluding that a balancing of patent and antitrust concerns can be accomplished with great respect and concern for protecting a patentee’s rights and incentives to innovate).

168. *See* Intergraph Corp. v. Intel Corp., 195 F.3d 1346, 1360 (Fed. Cir. 1999) (stating that “the purpose of antitrust law is to foster competition in the public interest, not to protect others from competition . . . in their private interest”).



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**CONSTITUTIONAL LAW**



## UNITED STATES V. PLAYBOY ENTERTAINMENT GROUP, INC.

By Jennifer L. Polse

We are creating a world where anyone, anywhere may express his or her beliefs, no matter how singular, without fear of being coerced into silence or conformity.<sup>1</sup>

Technology expands the capacity to choose; and it denies the potential of this revolution if we assume the Government is best positioned to make these choices for us.<sup>2</sup>

Technological developments of the recent past have transformed the way we live, the way we work, the way we speak. Where once only those with a printing press could reach the masses, now anyone with a computer can publish online to millions of potential readers;<sup>3</sup> and where once television audiences could choose between ABC, NBC and CBS, now cable and satellite systems offer viewers a vastly-expanded and ever-growing menu of channels. But while new technologies bring expansive benefits to society, they also strain existing legal paradigms to the breaking point.

Nowhere is this strain more apparent than in the Supreme Court's First Amendment jurisprudence, which depends heavily on the nature of the medium of expression being regulated.<sup>4</sup> In the area of cable television programming in particular, the Court has struggled both to define an appropriate First Amendment standard<sup>5</sup> and to articulate precisely why and

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1. John Perry Barlow, *A Declaration of the Independence of Cyberspace*, (Feb. 8, 1996), available at [http://www.eff.org/pub/Misc/Publications/John\\_Perry\\_Barlow/barlow\\_0296.declaration](http://www.eff.org/pub/Misc/Publications/John_Perry_Barlow/barlow_0296.declaration).

2. *United States v. Playboy Entm't Group, Inc.*, 120 S. Ct. 1878, 1889 (2000).

3. See *Reno v. ACLU*, 521 U.S. 844, 853 (1997).

4. *Id.* at 868; *FCC v. Pacifica Found.*, 438 U.S. 726, 748 (1978). See generally Jarrod V. Henshaw, Note, *Denver Area Educational Telecommunications Consortium, Inc. v. FCC: Reconciling Traditional First Amendment Media Jurisprudence with Emerging Communications Technologies*, 41 ST. LOUIS U. L.J. 1015, 1037-38 (1997) (discussing the Court's discomfort with applying First Amendment doctrines to emerging media).

5. Compare *Turner Broad. Sys. v. FCC*, 512 U.S. 622, 639 (1994) (holding that cable's physical characteristics "do not require the alteration of settled principles of our

how the cable standard should differ from that applied to broadcast television. In *United States v. Playboy Entertainment Group, Inc.*, the Court finally defined a standard for cable regulations, holding that laws restricting speech on cable networks should be subject to the same searching scrutiny applied to regulations of the print media.<sup>6</sup>

*Playboy* provides further evidence of an emerging trend in the Court's First Amendment jurisprudence: reliance on technological solutions as an alternative to intrusive government regulation.<sup>7</sup> In reaching its holding, the *Playboy* Court relied heavily on cable systems' ability to support technology allowing individual control of programming accessibility.<sup>8</sup> This reliance demonstrates a sea change in the Court's approach to emerging technologies: When broadcast was in its infancy, the Court reacted to the newness of the technology by validating intrusive government regulations in the name of furthering the First Amendment rights of the public;<sup>9</sup> now, in contrast, the Court relies on technological, market-based solutions to increase the First Amendment protection it affords new media.<sup>10</sup> The difference in treatment between the two very similar media of broadcast and cable television illustrates how far the Court has come in recognizing technology's ability to "expand[] the capacity to choose,"<sup>11</sup> and ultimately to create a world in which diverse voices can speak freely "without fear of being coerced into silence or conformity."<sup>12</sup>

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First Amendment jurisprudence" and applying print media standards to cable) *with Denver Area Educ. Telecomm. Consortium, Inc. v. FCC*, 518 U.S. 727, 741-42 (1996) (plurality opinion) (considering a regulation of indecent cable speech under an ad hoc balancing test and declaring that "no definitive choice among competing analogies (broadcast, common carrier, bookstore) allows us to declare a rigid single standard . . .").

6. *Playboy*, 120 S. Ct. at 1886.

7. *See Reno*, 521 U.S. at 877 (noting that user-based filtering software presents a less restrictive alternative to expansive censorship of indecent online content); *Sable Communications of Cal., Inc. v. FCC*, 492 U.S. 115, 128-31 (1989) (finding a total ban on indecent dial-a-porn messages unconstitutional because a less restrictive scrambling-based technological solution existed).

8. *See Playboy*, 120 S. Ct. at 1887, 1890-91.

9. *See, e.g., Nat'l Broad. Co. v. United States*, 319 U.S. 190 (1943).

10. *See, e.g., Reno*, 521 U.S. at 877.

11. *Playboy*, 120 S. Ct. at 1889.

12. Barlow, *supra* note 1.

## I. BACKGROUND

### A. First Amendment Standards for Conventional Broadcast Media

The history of First Amendment protection for television and radio has been one of deviation from the standards applied to other media. For broadcast media in particular, the Court has interpreted the First Amendment to provide far less protection from government regulation than that it affords the print media.<sup>13</sup> This lack of First Amendment solicitude dates from the early days of radio broadcasting<sup>14</sup> and is best illustrated in the television context by the Court's decision in *Red Lion Broadcasting Co. v. Federal Communications Commission*.<sup>15</sup>

The *Red Lion* Court rejected a broadcaster's First Amendment challenge to the fairness doctrine,<sup>16</sup> which required broadcasters to give equal time to both sides of controversial public issues.<sup>17</sup> The broadcaster had argued that the fairness doctrine violated the First Amendment by inhibiting its discretion to air the issues it chose, with the slant it chose—a right the First Amendment guarantees to other speakers.<sup>18</sup> The Court, however, refused to treat broadcasters identically to other speakers, because “differences in the characteristics of new media justify differences in the First Amendment standards applied to them.”<sup>19</sup>

The technological characteristics of the broadcast medium led the Court to uphold the fairness doctrine.<sup>20</sup> The Court argued that historically, the scarcity of broadband frequencies created an environment in which multiple speakers attempting to use similar frequencies created too much

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13. See *Red Lion Broad. Co. v. FCC*, 395 U.S. 367, 388-90 (1969). See generally Jonathan Weinberg, *Broadcasting and Speech*, 81 CALIF. L. REV. 1101 (1993) (discussing and explaining the disjunction between traditional First Amendment doctrines and broadcasting regulation); Henshaw, *supra* note 4, at 1020-27 (comparing relaxed First Amendment treatment of broadcast media with other media).

14. *Nat'l Broad. Co. v. United States*, 319 U.S. 190 (1943). See generally Laurence H. Winer, *The Red Lion of Cable, and Beyond?—Turner Broadcasting v. FCC*, 15 CARDOZO ARTS & ENT. L.J. 1, 8 n.15 (1997).

15. 395 U.S. 367 (1969).

16. *Id.* at 400-01.

17. Weinberg, *supra* note 13, at 1126-27.

18. *Red Lion*, 395 U.S. at 386.

19. *Id.* at 386.

20. Because it is based in broadcast technology itself, the *Red Lion* rationale does not extend to the print media. Indeed, in *Miami Herald Publishing Co. v. Tornillo*, the Court struck down a right-of-reply statute for newspapers that attempted to create a statutory right similar to that created by the fairness doctrine in the broadcast context. See 418 U.S. 241, 256 (1974).

interference for any one speaker to be heard.<sup>21</sup> To end the resulting chaos, Congress created the Federal Communications Commission ("FCC") to license and monitor broadcast frequencies.<sup>22</sup> But because not every speaker could obtain a broadcast license, the *Red Lion* Court held that successful licensees owed a "proxy or fiduciary" duty to the public to present all sides of a controversy rather than just their own view.<sup>23</sup> In the Court's eyes, the First Amendment rights of viewers and listeners trumped those of the broadcasters themselves.<sup>24</sup> Though heavily criticized,<sup>25</sup> the *Red Lion* scarcity rationale has never been overruled,<sup>26</sup> and the Court has continued to rely on broadcast scarcity to justify regulations of broadcast that would rarely be upheld as applied to print media and most other speakers.<sup>27</sup>

The Court's approval of government regulation of indecent programming provides the best illustration of the reduced First Amendment protection afforded broadcast relative to other media.<sup>28</sup> In *FCC v. Pacifica Foundation*,<sup>29</sup> the Court considered an FCC determination that a daytime

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21. *Red Lion*, 395 U.S. at 388. Commentators have disagreed with the Court's historical analysis of early broadcasting. Professor Hazlett, for example, describes the historical situation as one of orderly distribution of broadcast licenses on a first-come, first-served basis. Thomas W. Hazlett, *Physical Scarcity, Rent Seeking, and the First Amendment*, 97 COLUM. L. REV. 905, 913 (1997). Under this theory, the Radio Act providing for public interest-based assignment of broadcast licenses grew out of a desire to regulate who would control the airwaves, rather than from a desire to remedy the nonexistent problem of broadcast interference. *Id.*

22. *Red Lion*, 395 U.S. at 388.

23. *Id.* at 389.

24. *Id.* at 390.

25. E.g., Thomas W. Hazlett, *The Rationality of U.S. Regulation of the Broadcast Spectrum*, 33 J.L. & ECON. 133, 137-38 (1990); Weinberg, *supra* note 13, at 1106. Ronald H. Coase, *The Federal Communications Commission*, 2 J. L. & ECON. 1 (1959).

26. *Turner Broad. Sys., Inc. v. FCC*, 512 U.S. 622, 638 (1994) (noting that "we have declined to question [the *Red Lion* rationale's] continuing validity as support for our broadcast jurisprudence, and see no reason to do so here." (citation omitted))

27. See *Denver Area Educ. Telecomm. Consortium, Inc. v. FCC*, 518 U.S. 727, 813 (1996) (Thomas, J., concurring in the judgment in part and dissenting in part); *FCC v. League of Women Voters*, 468 U.S. 364, 375-76 (1984) (considering the First Amendment implications of a restriction on editorial content applied to broadcasters under the more relaxed *Red Lion* standard and noting that they "would not hesitate to strike . . . down" a similar restriction applied to print media).

28. For an overview of the Court's approach to regulation of indecent broadcasts, see Robert E. Riggs, *Indecency on the Cable: Can It Be Regulated?*, 26 ARIZ. L. REV. 269, 279-85 (1984).

29. 438 U.S. 726 (1978).

radio broadcast of George Carlin's "Filthy Words" monologue<sup>30</sup> could be administratively sanctioned and that broadcasts of patently offensive material must be limited to times during which children would unlikely be listening.<sup>31</sup> On appeal, the Supreme Court affirmed the propriety of the FCC's order against Pacifica's statutory and First Amendment challenges.<sup>32</sup> Pacifica contended that the First Amendment precluded government regulation of its broadcast unless the monologue could be characterized as obscene.<sup>33</sup> The Court conceded that while the words at issue "ordinarily lack literary, political, or scientific value"<sup>34</sup> and typically constitute "no essential part of any exposition of ideas,"<sup>35</sup> they did not fall completely outside the protection of the First Amendment, and their use could be protected from government censorship in other circumstances.<sup>36</sup> Nevertheless, the Court ultimately held that in the broadcast context, regulation of indecent language did not offend the First Amendment when, as was the case in *Pacifica*, children could be listening to the broadcast.<sup>37</sup>

To support its decision to treat broadcast differently from other media, the Court noted initially that "each medium of expression presents special First Amendment problems," and that "of all forms of communication, it is broadcasting that has received the most limited First Amendment protection."<sup>38</sup> In the context of the indecent programming at issue in *Pacifica*, the Court limited broadcasters' First Amendment protection based on two

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30. The twelve minute monologue, which contained Carlin's thoughts on so-called filthy words that couldn't be broadcast on public airwaves, repeated those words continuously throughout the monologue. *Id.* at 729.

31. *Id.* at 722-23.

32. *Id.* at 750-51.

33. *Id.* at 744. The First Amendment does not require any heightened scrutiny of obscene speech. *Roth v. United States*, 354 U.S. 476, 485 (1957). In *Miller v. California*, 413 U.S. 15 (1973), the Court defined obscenity as material that (a) under contemporary community standards "taken as a whole, appeals to the prurient interest;" (b) "depicts or describes, in a patently offensive way, sexual conduct specifically defined by the applicable state law; and (c) . . . taken as a whole, lacks serious literary, artistic, political, or scientific value." *Id.* at 24 (1973).

34. *Pacifica*, 438 U.S. at 746.

35. *Id.* (quoting *Chaplinsky v. New Hampshire*, 315 U.S. 568, 769 (1942)).

36. *Id.* at 746-47. For example, concurring separately in *Pacifica*, Justice Powell noted that he did "not think Carlin, consistently with the First Amendment, could be punished for delivering the same monologue to a live audience composed of adults who, knowing what to expect, chose to attend his performance." *Id.* at 756 (Powell, J., concurring). Indeed, the Court has extended protection to similar language in other contexts. *E.g.*, *Cohen v. California*, 403 U.S. 15, 26 (1971) (holding that the First Amendment bars prosecution of an individual for wearing a jacket bearing the words "Fuck the Draft").

37. *Pacifica*, 438 U.S. at 750-51.

38. *Id.* at 748.

purported characteristics of broadcast media: (1) their “uniquely pervasive presence in the lives of all Americans;”<sup>39</sup> and (2) their “unique[] accessib[ility] to children, even those too young to read.”<sup>40</sup> Unlike material contained in print media, for example, due to their “unique pervasiveness,” patently offensive broadcasts “confront[] the citizen, not only in public, but also in the privacy of the home where the individual’s right to be left alone plainly outweighs the First Amendment rights of an intruder.”<sup>41</sup> And, in contrast to *Cohen v. California*, in which the Court admonished offended viewers of a “Fuck the Draft” slogan on Cohen’s jacket simply to avert their eyes rather than rely on the government to censor the message,<sup>42</sup> the *Pacifica* Court declared that “[t]o say that one may avoid further offense by turning off the radio when he hears indecent language is like saying that the remedy for an assault is to run away after the first blow.”<sup>43</sup> The Court also noted that offensive material in other media, such as books and movies, could be withheld from children by prohibiting its sale to minors. However, in the Court’s view, the invasive nature of broadcast rendered such restrictions unworkable, and prevention of reception by minors therefore required “restricting the expression at its source.”<sup>44</sup>

## B. First Amendment Limitations on Regulation of Cable “Broadcasting”

Due to its obvious similarities to broadcast television, cable television potentially could be regulated under the same paradigm that informs broadcast regulation. However, the medium-dependent nature of the Court’s First Amendment jurisprudence,<sup>45</sup> coupled with technological differences between cable and broadcast,<sup>46</sup> offered the possibility of a different level of scrutiny for the cable industry.<sup>47</sup> But until *Playboy*, the Court’s attempts to define a specific standard of review for cable were less than illuminating.<sup>48</sup> Prior to the Court’s decision in *Turner Broadcasting Sys-*

39. *Id.*

40. *Id.* at 749.

41. *Id.* at 748.

42. *Cohen v. California*, 403 U.S. 15, 21 (1971).

43. *Pacifica*, 438 U.S. at 748-49.

44. *Id.* at 749-50.

45. *Reno v. ACLU*, 521 U.S. 844, 868 (1997) (distinguishing Internet from broadcast regulations, and noting that “[e]ach medium of expression . . . may present its own problems.” (quoting *Southeastern Promotions, Ltd. v. Conrad*, 420 U.S. 546, 557 (1975) (alterations in original))).

46. *Turner Broad. Sys., Inc. v. FCC*, 512 U.S. 622, 640 (1994).

47. *See Riggs*, *supra* note 28, at 288.

48. Indeed, in a 1996 opinion Justice Thomas complained:

*tem, Inc. v. FCC*,<sup>49</sup> courts applied various standards to cable, including both the broadcast and print media standards.<sup>50</sup>

In *Turner*, the Court soundly rejected the government's attempt to apply the *Red Lion* standard to cable operators.<sup>51</sup> *Turner* involved a First Amendment challenge to the "must-carry" provisions of the Cable Act,<sup>52</sup> which required cable operators to use a certain number of their channels to transmit local broadcast television stations. Justice Kennedy, writing for the Court, concluded that because "cable television does not suffer from the inherent limitations that characterize the broadcast medium," the *Red Lion* standard, based as it was in the scarcity of broadband frequencies, could not apply to the cable medium.<sup>53</sup>

Turning to the appropriate level of scrutiny for the must-carry provisions, the Court seized upon the general First Amendment principles applicable to print media, which base the level of scrutiny on whether or not a law regulates speech on the basis of its content. Laws that "suppress, disadvantage, or impose differential burdens upon speech because of its content," including those "[l]aws that compel speakers to utter or distribute speech bearing a particular message" receive strict scrutiny.<sup>54</sup> Content-neutral laws, in contrast, receive only intermediate scrutiny.<sup>55</sup> The Court ultimately held that the must-carry provisions were content-neutral, and thus could be sustained if they further "an important or substantial governmental interest . . . unrelated to the suppression of free expression; and

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[o]ur First Amendment distinctions between media, dubious from their infancy, placed cable in a doctrinal wasteland in which regulators and cable operators alike could not be sure whether cable was entitled to substantial First Amendment protections afforded the print media or was subject to the more onerous obligations shouldered by the broadcast media.

Denver Area Educ. Telecomm. Consortium, Inc. v. FCC, 518 U.S. 727, 813-14 (1996) (Thomas, J., concurring in the judgment in part and dissenting in part) (citations omitted).

49. 512 U.S. 622 (1994).

50. Henshaw, *supra* note 4, at 1024.

51. *Turner*, 512 U.S. at 637.

52. 47 U.S.C. § 534 (1994 & Supp IV 1998).

53. *Turner*, 512 U.S. at 638-39.

54. *Id.* at 642. Under strict scrutiny, the government may regulate protected speech only to further a compelling interest, and it must choose the least restrictive alternative that furthers its purpose. *Sable Communications of Cal. v. FCC*, 492 U.S. 115, 126 (1989).

55. *Turner*, 512 U.S. at 642. Content-neutral laws "confer benefits or impose burdens on speech without reference to the ideas or views expressed. . . ." *Id.* at 643.

if the incidental restriction on alleged First Amendment freedoms is no greater than is essential to the furtherance of that interest."<sup>56</sup>

The question of the proper standard for cable regulations, which courts and commentators thought had been settled by *Turner*, became a moving target once again just two years later. In *Denver Area Educational Telecommunications Consortium, Inc. v. FCC*,<sup>57</sup> the Court considered three sections of the Cable Television Consumer Protection and Competition Act of 1992<sup>58</sup> that permitted cable operators to censor patently offensive material on leased and public access channels.<sup>59</sup> Despite its ringing endorsement of print media standards for cable television just two years earlier in *Turner*, the *Denver* Court could not arrive at a majority opinion defining the standard of review for regulations of indecent cable speech. Justice Breyer, writing for a plurality, explicitly refused to define "a rigid single standard" for cable, reasoning that it would be unwise to set a standard in the face of ongoing "changes taking place in the law, the technology, and the industrial structure related to telecommunications. . . ."<sup>60</sup> Instead, the plurality subjected the content-based restriction to "close judicial scrutiny,"<sup>61</sup> under which the statute could stand if "it properly addresses an extremely important problem, without imposing, in light of the relevant interests, an unnecessarily great restriction on speech."<sup>62</sup> This view did not, however, command a majority of the Court. Justices Kennedy and Ginsburg would have treated the leased and public access channels as common carriers and public fora respectively, and would have applied strict scrutiny.<sup>63</sup> Justice Thomas, writing for the Chief Justice and Justice Scalia, appeared to endorse strict scrutiny for content-based regulations affecting cable operators,<sup>64</sup> but decided that the cable viewers and leased access programmers attacking the law had not asserted interests protected by the First Amendment.<sup>65</sup>

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56. *Id.* at 662 (quoting *United States v. O'Brien*, 391 U.S. 367, 377 (1968)).

57. 518 U.S. 727 (1996) (plurality opinion).

58. 47 U.S.C. §§ 532(h), 532(j), and note following § 531 (1994).

59. *Denver Area Educ. Telecomm.*, 518 U.S. at 733.

60. *Id.* at 742 (opinion of Breyer, J.).

61. *Id.* at 741 (opinion of Breyer, J.).

62. *Id.* at 743 (opinion of Breyer, J.).

63. *Id.* at 783 (opinion of Kennedy, J., concurring in part, concurring in the judgment in part and dissenting in part).

64. *Id.* at 816-17 (opinion of Thomas, J., concurring in the judgment in part and dissenting in part).

65. *Id.* at 824 (opinion of Thomas, J., concurring in the judgment in part and dissenting in part).

Following *Denver*, there appeared to be no well-defined standard of review for content-based restrictions of indecent cable speech. Arguably, however, the *Denver* case muddied the waters by presenting a law that merely authorized, rather than required, private censorship by cable operators. In contrast, *Playboy* squarely presented the Court with a mandatory content-based restriction of offensive, but protected, cable speech, and the *Playboy* Court at last defined a clear standard of review for cable.

## II. CASE SUMMARY

### A. Facts and Procedural History

Playboy Entertainment Group prepares sexually explicit programming for broadcast on adult television networks, including Playboy Television and Spice.<sup>66</sup> Cable operators transmit such networks to monthly subscribers and to other viewers on a pay-per-view basis.<sup>67</sup> Because recipients of premium channels like Spice pay to receive the programming, cable operators naturally block nonsubscribers from receiving such channels.<sup>68</sup> However, due to imperfections in the scrambling technology used to block the receipt of premium channels, the audio, and occasionally the video, portions of the programming can be viewed by nonsubscribers. This technological imperfection, known as signal bleed, led directly to the speech restrictions at issue in *Playboy*.<sup>69</sup>

Congress addressed the growing concern over the possibility of children viewing indecent or obscene cable programming through signal bleed in section 505 of the Communications Decency Act of 1996 ("CDA").<sup>70</sup> Section 505 presents cable operators with a choice regarding "sexually explicit adult programming or other programming that is indecent on any channel . . . primarily dedicated to sexually-oriented programming. . . ."<sup>71</sup> Cable operators may either fully scramble such channels so that no signal bleed occurs in either the audio or video signal, or they must "limit the access of children to the programming . . . by not providing such programming during the hours of the day . . . when a significant number of children are likely to view it."<sup>72</sup> The FCC, to whom Congress delegated

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66. *United States v. Playboy Entm't Group, Inc.*, 120 S. Ct. 1878, 1883 (2000).

67. *Id.*

68. *Playboy Entm't Group, Inc. v. United States*, 30 F. Supp. 2d 702, 707 (D. Del. 1998), *aff'd* 120 S. Ct. 1878 (2000).

69. *See Playboy*, 120 S. Ct. at 1883.

70. 47 U.S.C. § 561 (Supp. IV 1998).

71. *Id.* § 561(a).

72. *Id.* § 561(b).

the task of determining the hours during which the channels may be broadcast if not fully scrambled,<sup>73</sup> limited the safe-harbor hours to between 10:00 p.m. and 6:00 a.m.<sup>74</sup> Congress also enacted section 504, complementary to section 505, which requires cable operators to block fully any channel upon request by a subscriber.<sup>75</sup>

Concerned about the potential burden section 505 would place on its ability to transmit sexually explicit programming, Playboy mounted a facial challenge to section 505, arguing that it violated the First Amendment's guarantee that "Congress shall make no law . . . abridging the freedom of speech."<sup>76</sup> Playboy sought, and obtained, a temporary restraining order enjoining enforcement of section 505.<sup>77</sup> Pursuant to section 561(a) of the CDA, a three judge district court convened to determine the constitutionality of section 505(a).<sup>78</sup> The district court denied Playboy's motion for a preliminary injunction and lifted the temporary restraining order, holding that section 505 was sufficiently narrowly tailored to survive strict scrutiny and therefore met First Amendment requirements.<sup>79</sup> The FCC subsequently announced that it would begin enforcement of section 505 on May 18, 1997.<sup>80</sup>

Over a year after the FCC began enforcement, the district court invalidated section 505, holding that it violated the First Amendment rights of cable network providers such as Playboy.<sup>81</sup> The government argued that the statute only regulated signal bleed, a secondary effect of speech, and

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73. *Id.*

74. In re Implementation of Section 505 of the Telecommunications Act of 1996, 11 F.C.C.R. 5386 (1996).

75. 47 U.S.C. § 560(a) (1994) (providing that "[u]pon request by a cable service subscriber, a cable operator shall, without charge, fully scramble or otherwise fully block the audio and video programming of each channel carrying such programming so that one not a subscriber does not receive it."); *Playboy Entm't Group, Inc. v. FCC*, 30 F. Supp. 2d 702, 708 (D. Del. 1998).

76. U.S. CONST. amend. I; *Playboy*, 30 F. Supp. 2d at 705-06. Playboy also argued that the Act violated the Fifth Amendment by singling out networks that primarily broadcast sexually explicit programming, instead of applying to all cable broadcasts of sexually oriented programming. *Id.* The court never reached the equal protection issue. *Id.* at 720 n.24.

77. *Playboy Entm't Group, Inc. v. United States*, 918 F. Supp. 813, 822-23 (D. Del. 1996).

78. *Playboy*, 30 F. Supp. 2d at 705.

79. *Playboy Entm't Group, Inc. v. United States*, 945 F. Supp. 772, 792 (D. Del. 1996), *aff'd mem.*, 520 U.S. 1141 (1997).

80. In re Implementation of Section 505 of the Telecommunications Act of 1996, 12 F.C.C.R. 5212, 5214 (1997).

81. *Playboy*, 30 F. Supp. 2d at 720.

was therefore content-neutral.<sup>82</sup> However, the court rejected the secondary effects argument, noting that while regulation of signal bleed may be content-neutral, the statute applies only to signal bleed from a subset of cable networks determined by reference to the content of the programmers' speech.<sup>83</sup> Such content-based restrictions must be examined under strict scrutiny and can be upheld only if the government shows that the statute is narrowly tailored to achieve a compelling government interest.<sup>84</sup> Beginning its strict scrutiny of the statute, the district court recognized that section 505 addresses three compelling government interests: (1) protecting children from harm suffered through viewing explicit sexually-related programming; (2) supporting parental authority by allowing parents to decide what moral beliefs to teach their children; and (3) ensuring individual privacy by preventing indecent programming from intruding into nonconsenting households through signal bleed.<sup>85</sup> Section 505 could properly further these interests only if it "is narrowly tailored to serve that end and . . . is the least restrictive alternative."<sup>86</sup>

The district court ultimately accepted Playboy's contention that the voluntary blocking required by section 504 offers a less restrictive means of serving the government's compelling interests in regulating the speech at issue.<sup>87</sup> The court first noted the large burden section 505's enforcement had placed on Playboy's freedom of speech. During the time the FCC enforced section 505, the "vast majority" of cable operators opted to time-channel Playboy's programming to the safe-harbor times of 10:00 p.m. to 6:00 a.m., rather than to use the more expensive technological solution of complete blocking.<sup>88</sup> Because between thirty and fifty percent of adult programming is viewed before 10:00 p.m., the time-channeling significantly restricted Playboy's speech.<sup>89</sup> The court reasoned that because section 504 requires blocking only upon request, it restricts less speech than section 505.<sup>90</sup> But pointing to the paucity of subscribers who had exercised their section 504 rights, the government argued that while it may be less

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82. *Id.* at 714.

83. *Id.* at 714-15.

84. *Id.* at 715; *Sable Communications of Cal., Inc. v. FCC*, 492 U.S. 115, 126 (1989) (noting that "[t]he Government may . . . regulate the content of constitutionally protected speech in order to promote a compelling interest if it chooses the least restrictive means to further the articulated interest").

85. *Playboy*, 30 F. Supp. 2d at 715.

86. *Id.* at 717.

87. *Id.*

88. *Id.* at 711.

89. *Id.*

90. *Id.* at 718.

restrictive, section 504 does not provide an equally effective means of preventing children from viewing signal bleed as does section 505.<sup>91</sup> Rejecting the government's ineffectiveness argument, the court noted that either lack of adequate notice or a general consensus that signal bleed does not present a large problem could explain the low number of requests for blocking under section 504.<sup>92</sup> Coupled with adequate notice, section 504 could be equally effective at blocking signal bleed for those parents who are concerned about the problem. Because section 504 offered a less restrictive, but potentially equally effective means of blocking signal bleed, the court declared section 505 an unconstitutional restriction on speech.<sup>93</sup>

## B. The Supreme Court's Decision

On appeal, a divided Court affirmed the district court in a ringing opinion by Justice Kennedy.<sup>94</sup> All nine justices agreed that as a content-based restriction on protected speech,<sup>95</sup> section 505 could be sustained only if it survived strict scrutiny:<sup>96</sup> the regulation must be "narrowly tailored to promote a compelling Government interest," and the government must use a less restrictive alternative if one exists.<sup>97</sup> According to the majority, the nature of the cable television medium helped legitimize the government's interest in regulating Playboy's speech; citing the Court's fractured plurality opinion in *Denver*,<sup>98</sup> the majority explained that "[c]able television, like broadcast media, presents unique problems which inform our assessment of the interests at stake, and which may justify restrictions that would be unacceptable in other contexts."<sup>99</sup> The intrusiveness of cable broadcasting therefore justified the government's interest in

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91. *Id.* at 719.

92. *Id.*

93. *Id.* at 719-20.

94. *United States v. Playboy Entm't Group, Inc.*, 120 S. Ct. 1878, 1893 (2000).

95. All the parties to the litigation proceeded on the assumption that the speech at issue did not fall under the legal definition of obscenity, as defined in *Miller v. California*, 413 U.S. 15, 24 (1973). See *Playboy*, 120 S. Ct. at 1885.

96. *Playboy*, 120 S. Ct. at 1886 (holding that "[s]ince § 505 is a content-based speech restriction, it can stand only if it satisfies strict scrutiny"); *id.* at 1898 (Breyer, J., dissenting) (noting that "[t]he basic, applicable First Amendment principles are not at issue" and applying strict scrutiny to the statute). While Justice Scalia joined Justice Breyer's dissent, his separate dissent indicates his willingness to apply a lower level of scrutiny to the speech at issue by finding that the statute "regulates the business of obscenity" rather than regulating speech per se. *Id.* at 1895 (Scalia, J., dissenting).

97. *Id.* at 1886.

98. *Denver Area Educ. Telecomm. Consortium, Inc. v. FCC*, 518 U.S. 727 (1996) (plurality opinion).

99. *Playboy*, 120 S. Ct. at 1886.

regulating indecent cable network programming in order to prevent children from accessing such programs absent parental consent.<sup>100</sup>

Although the Court accepted the government's compelling interest, it nevertheless held section 505 unconstitutional because a less restrictive means of regulating the speech existed: voluntary blocking.<sup>101</sup> Unlike broadcast, "[c]able systems have the capacity to block unwanted channels on a household-by-household basis."<sup>102</sup> Section 504 presented such an alternative means of regulation, and according to the majority, the government failed to demonstrate its ineffectiveness.<sup>103</sup> Throughout its opinion, the majority relied upon technology's ability to provide alternatives to blanket restrictions on speech.<sup>104</sup> Section 504, together with "market-based solutions such as programmable televisions, VCR's, and mapping systems" can prevent receipt of signal bleed by those who deem it problematic, without restricting Playboy's ability to transmit its programming during the day to those who wish to receive it.<sup>105</sup> Due to the existence of such alternatives, which the Court held could be equally effective at furthering the government's interest, the overly-restrictive section 505 violated the First Amendment.

### III. DISCUSSION

*Playboy's* primary significance lies in the strong First Amendment protection the Court afforded cable speech, a level of protection that stems in large part from cable's ability to support technology facilitating individual subscribers' efforts to shape their viewing experience. Justice Kennedy acknowledged that the government possessed a compelling interest in protecting children from the effects of viewing indecent programming through signal bleed without their parent's consent.<sup>106</sup> Instead of relying on the broad governmental ban on the speech at issue in *Playboy*, however, parents who are concerned about signal bleed must employ blocking

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100. *Id.*

101. The Court also approved of the district court's alternative grounds for finding the statute unconstitutional: that the government failed to meet its burden in showing that signal bleed presented a "pervasive, nationwide problem justifying its nationwide daytime speech ban." *Id.* at 1891.

102. *Id.* at 1887.

103. *Id.* at 1888.

104. *See id.* at 1887 (noting that "the Government cannot ban speech if targeted blocking is a feasible and effective means of furthering its compelling interests").

105. *Id.* at 1890.

106. *Id.* at 1886.

technology such as lock boxes and VCRs with channel-blocking capability.

**A. The Old Approach: Emerging Technology as a Justification for Reduced First Amendment Protection**

The Court's reliance on technology's ability to provide an alternative to government regulation differs significantly from its earlier approach to emerging media typified by *Red Lion*, *Pacifica*, and *Denver*. In all three cases, the Court reacted to rapid technological change with what could charitably be called extreme uneasiness but at times seemed more akin to fear or misunderstanding.

The scarcity rationale advanced in *Red Lion* rests on the scientific reality that only a limited number of broadcast frequencies exist and posits that in the absence of regulation only chaos would result.<sup>107</sup> While broadband scarcity may be an unavoidable truth, the Court's reaction to this technological fact contravenes basic First Amendment principles regarding prior restraints.<sup>108</sup> The Court generally treats prior restraints as presumptively unconstitutional and subjects them to heavy scrutiny even if content-neutral.<sup>109</sup> But since the FCC relied on a highly subjective public interest standard to allocate broadcast licenses,<sup>110</sup> the *Red Lion* Court upheld a blatantly content-based licensing scheme—largely because it failed to appreciate that the “chaos” of multiple entities seeking to broadcast would be better left to market forces and improved technological responses.<sup>111</sup>

The scarcity rationale rings even more hollow today than it did when first conceived. The rise of cable, the Internet, and the potential for digital television and radio to replace conventional broadcasting all combine to make scarcity moot.<sup>112</sup> While there will always be only a limited number

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107. As noted earlier, it is not clear that any actual chaos ever existed. *See supra* note 21.

108. For a recent example of the Court's treatment of prior restraints, see *Forsyth County v. Nationalist Movement*, 505 U.S. 123, 130 (1992).

109. Weinberg, *supra* note 13, at 1113.

110. *Id.* at 1114-30 (describing the operation of the public-interest based FCC licensing system).

111. Commentators have long argued that no legitimate reason exists for treating broadcast frequencies differently from other privately-owned natural resources. *See generally* Coase, *supra* note 25. Moreover, thanks to technological advances, many more broadcasters can operate without undue interference. In addition, the advent of cable and Internet-based alternatives to broadcast have decreased the necessity of procuring a “scarce” broadcast license in order to communicate through broadcast-like media.

112. *See FCC v. League of Women Voters*, 468 U.S. 364, 376 n.11 (1984).

of broadcast frequencies, that scarcity has no impact on ability to speak when other, directly-competitive replacement technologies exist that have virtually unlimited capacity. In *Turner*, the Court itself acknowledged that the scarcity rationale does not apply to the cable medium because it has much greater capacity to carry different channels.<sup>113</sup> Internet-based radio and television broadcasting offers potentially unlimited capacity to carry diverse voices. A speaker who has been frustrated in an attempt to receive a broadcast license thus can always resort to another virtually analogous medium.

The Court again displayed its discomfort with nonprint media in *Pacifica*, in which it approved an FCC limitation on the times at which indecent language could be broadcast.<sup>114</sup> Noting that “each medium of expression presents special First Amendment problems,” the Court refused to subject the content-based restriction to the same searching scrutiny with which it would have treated a similar regulation of the print media—or most other speakers.<sup>115</sup> It based its loose First Amendment treatment principally on broadcast’s “intrusiveness” and “pervasiveness.”<sup>116</sup> The Court reasoned that innocent listeners, especially children, could be startled to turn on their radio midday and hear indecent language, regardless of whether that language rose to the level of obscenity.<sup>117</sup> Similarly, channel surfers could be shocked if they chance upon indecent shows.<sup>118</sup> A regulation on the timing of the broadcast of such language could thus be justified by the need to protect such listeners from unwanted intrusions.

While compelling, this rationale cannot justify lower First Amendment scrutiny for content-based regulations of “intrusive” media such as cable and broadcast; it merely presents the sort of compelling interest that may justify narrowly tailored regulations.<sup>119</sup> Moreover, the intrusiveness of ca-

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113. *Turner Broad. Sys., Inc. v. FCC*, 512 U.S. 622, 638-39 (1994).

114. *FCC v. Pacifica Found.*, 438 U.S. 726, 749-50 (1978).

115. *Id.* at 748.

116. *Id.* at 748-49.

117. *Id.* at 749 (noting broadcasts’ “unique[] accesibil[ity] to children, even those too young to read”).

118. *Id.* at 748 (noting that “indecent material presented over the airwaves confronts the citizen, not only in public, but also in the privacy of the home, where the individual’s right to be left alone plainly outweighs the First Amendment rights of an intruder” (citations omitted)).

119. Indeed, this is the approach taken by Justice Breyer and the *Playboy* dissenters. They would find § 505 to be a narrowly tailored restriction to serve the compelling government interest in regulating indecent speech that intrudes into homes in which children may be watching television. *United States v. Playboy Entm’t Group, Inc.*, 120 S. Ct. 1878, 1903 (2000) (Breyer, J., dissenting).

ble and broadcast surely cannot be greater than that of the speech at issue in *Cohen*, in which Cohen startled unsuspecting members of the public by wearing a "Fuck the Draft" jacket where anyone could see him and be offended.<sup>120</sup> And while, unlike the message in *Cohen*, cable and broadcast media do intrude into the privacy of the viewers' homes, viewers invite the intrusion by purchasing a set and turning it on. Moreover, offended viewers can always change the channel or forbid their children access to television altogether if it proves to be an unsavory addition to the home. In short, no legitimate reason exists for the Court's insistence on subjecting new and intrusive media to different First Amendment standards than other forms of communication, and in *Playboy* the Court finally recognized that fact.<sup>121</sup>

### B. Emerging Technology as a Tool to Support Private Choice

The *Playboy* Court emphatically embraced technology's ability to provide alternatives to government-mandated censorship of cable. Justice Kennedy's analysis of whether section 505 represented a narrowly tailored response to signal bleed depended heavily on the ability of "market-based solutions such as programmable televisions, VCR's, and mapping systems (which display a blue screen when tuned to a scrambled signal) . . . [to] eliminate signal bleed at the consumer end of the cable."<sup>122</sup> In the face of a less-restrictive alternative, the government may not resort to broad, content-based bans on protected speech.<sup>123</sup>

But perhaps the more important aspect of the Court's decision lies in its recognition that technological solutions do more than merely provide a less restrictive alternative to government regulation. By allowing individuals to shape their media-viewing experiences according to the dictates of their personal preferences, technological solutions empower individual consumers in the marketplace of ideas, thus furthering First Amendment interests far more than does the putative public-interest regulation of broadcast approved in *Red Lion*.

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120. *Cohen v. California*, 403 U.S. 15, 16-17 (1971).

121. *Playboy*, of course, does not change the current treatment of broadcast, which still receives lessened First Amendment protection, as illustrated in *Pacifica*.

122. *United States v. Playboy Entm't Group, Inc.*, 120 S. Ct. 1878, 1890 (2000). For a description of the nature and operation of the principal technological means for restricting access to cable channels at the consumer end, including the V-chip, channel locking, lockboxes, and digital television, see Andrea K. Rodgers, *United States v. Playboy Entertainment Group, Inc. and Television Channel Blocking Technology*, 40 JURIMETRICS J. 499 (2000).

123. *Playboy*, 120 S. Ct. at 1891.

The Playboy Court's use of technology as a tool to further individual choice was foreshadowed by its opinions in *Sable Communications v. FCC*<sup>124</sup> and *Reno v. ACLU*.<sup>125</sup> In *Sable Communications*, the Court evaluated a Congressional attempt to ban obscene and indecent interstate commercial telephone messages, known as dial-a-porn.<sup>126</sup> Though the Court upheld the statute's ban of obscene messages,<sup>127</sup> it invalidated the ban on indecent messages based partly on the existence of a less-restrictive technological solution to the problem of restricting children's access to dial-a-porn.<sup>128</sup> Porn purveyors could require credit cards and access codes to exclude children from their systems.<sup>129</sup> More importantly, scrambling technology existed that allowed the message providers to send scrambled messages that could only be unscrambled by a box purchased by the consumer and sold only to adults.<sup>130</sup> The possibility that such a technological approach could effectively further the government's interest rendered the speech ban imposed by the statute unnecessarily overbroad.<sup>131</sup> Similarly, when explaining the CDA's failure to conform to the narrow tailoring required of content-based regulations, the *Reno* Court referenced, though did not rely upon, user-based filtering technology as an alternative to the CDA's broad ban on indecent Internet speech.<sup>132</sup> Thus, both *Sable Communications* and *Reno v. ACLU* demonstrate the Court's willingness to consider technology as an alternative to government speech regulations.

The *Playboy* Court did not merely accept technology as a less-restrictive alternative to government censorship. It explicitly recognized, perhaps for the first time, technology's ability to enhance personal freedom.<sup>133</sup> As the Court recognized, the First Amendment helps enforce government neutrality in the marketplace of ideas.<sup>134</sup> The government, "even with the mandate or approval of a majority," should not express judgments about the relative merits of various messages and ideas.<sup>135</sup> Such judgments are for the individual—both as a speaker and a listener.

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124. *Sable Communications v. FCC*, 492 U.S. 115 (1989).

125. 521 U.S. 844 (1997).

126. *Sable*, 492 U.S. at 117-18.

127. *Id.* at 124. The Court does not engage in any heightened First Amendment scrutiny of regulations of obscene speech. *See supra* note 33.

128. *Sable*, 492 U.S. at 126, 130-31.

129. *Id.* at 121-22.

130. *Id.* at 122.

131. *Id.* at 130-31.

132. *Reno v. ACLU*, 521 U.S. 844, 876 (1997).

133. *United States v. Playboy Entm't Group, Inc.*, 120 S. Ct. 1878, 1889 (2000).

134. *Id.*

135. *Id.*

But the price society pays for such freedom can be high. As the Court noted in *Cohen*, “the immediate consequence of this freedom may often appear to be only verbal tumult, discord, and even offensive utterance.”<sup>136</sup> And although the *Cohen* Court accepted as a sign of strength “[t]hat the air may at times seem filled with verbal cacophony”—an indication of robust public debate<sup>137</sup>—the immediate result of *Cohen* left many individuals unable to avoid speech to which they would personally prefer not to listen. At least for cable viewers, technology eliminates the concept of a captive audience, and empowers individuals to shape their own listening experience by blocking unwanted programming. At the same time, it allows those who wish to receive certain programming the freedom to do so. In this manner, technology is helping to create the world the *Red Lion* Court unsuccessfully sought when it approved the fairness doctrine in an attempt to validate the First Amendment rights of listeners and viewers. But while the *Red Lion* Court found it necessary to limit the rights of speakers in order to empower listeners, technological solutions allow individuals to shape their viewing experiences in conformity with their own tastes, without forcing speakers to censor their messages.

#### IV. CONCLUSION

In *Playboy*, the Court finally arrived at a First Amendment standard for cable speech. The Court could have adopted the same laissez-faire approach to cable regulations as it applies to broadcast. In rejecting that path and choosing to subject content-based regulations of cable to the same searching scrutiny it applies to similar regulations of the print media, the Court acknowledged the multiple roles technology can play in solving First Amendment dilemmas posed by invasive media such as television and radio. Individual blocking and filtering devices can prevent children from viewing material their parents find inappropriate with far greater precision than a broad government ban on all speech of a certain type. But far beyond merely providing a more narrowly-tailored alternative to government censorship, technology gives individual listeners the ability to shape their media experience to reflect their own tastes and desires. As Justice Kennedy put it, “[t]echnology expands the capacity to choose; and it denies the potential of this revolution if we assume the Government is best

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136. *Cohen v. California*, 403 U.S. 15, 24-25 (1971).

137. *Id.* at 25 (noting that “[w]e cannot lose sight of the fact that, in what otherwise might seem a trifling and annoying instance of individual distasteful abuse of a privilege, these fundamental societal values are truly implicated”).

positioned to make these choices for us.”<sup>138</sup> By allowing individual choice, technology enhances the values the First Amendment was designed to protect.

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138. *Playboy*, 120 S. Ct. at 1889.



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**TELECOMMUNICATIONS**



## BELL ATLANTIC TELEPHONE COS. V. FEDERAL COMMUNICATIONS COMMISSION

*By Ernest H. Chen*

Congress enacted the Telecommunications Act of 1996<sup>1</sup> (“the Act”) to promote entry and competition in telecommunications markets, with the ultimate goal of better services and lower prices for consumers.<sup>2</sup> Sections 251 and 252 of the Act specifically address the opening of local telephone markets,<sup>3</sup> which is particularly challenging due to the tremendous economic and default market advantages that the incumbents hold.<sup>4</sup>

To help level the playing field, the Act imposes a set of duties upon local exchange carriers (“LECs”), two of which are network interconnection and reciprocal compensation.<sup>5</sup> Network interconnection is required so that customers of different networks can call one another.<sup>6</sup> The related reciprocal compensation provision is a form of “inter-carrier compensation”<sup>7</sup>

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1. Pub. L. No. 104-104, 110 Stat. 56 (codified as amended in scattered sections of 47 U.S.C.).

2. *Id.* (stating in the preamble that the purpose of the Act is “to promote competition and reduce regulation in order to secure lower prices and higher quality services for American telecommunications consumers and encourage the rapid deployment of new telecommunications technologies”).

3. *See* 47 U.S.C. §§ 251-52 (Supp. IV 1998).

4. *See* In the Matter of 1998 Biennial Regulatory Review—Review of Depreciation Requirements for Incumbent Local Exchange Carriers; United States Telephone Association’s Petition for Forbearance from Depreciation Regulation of Price Cap Local Exchange Carriers, 15 F.C.C.R. 242, 265 (Dec. 30, 1999) (stating that “the incumbent LECs had a 97 percent share of the local exchange market in 1997”) [hereinafter 1998 Biennial Regulatory Review]; *see also* In the Applications of NYNEX Corporation Transferor, and Bell Atlantic Corporation Transferee, For Consent to Transfer Control of NYNEX Corporation and Its Subsidiaries, 12 F.C.C.R. 19,985, ¶ 42 (Aug. 14, 1997) (discussing barriers to entry into the local telecommunications marketplace).

5. 47 U.S.C. §§ 251(b)(1), 251(b)(5), 252(d) (Supp. IV 1998).

6. *Southwestern Bell Tel. Co. v. Pub. Util. Comm’n of Texas*, 208 F.3d 475, 477 (5th Cir. 2000).

7. When two or more carriers collaborate to complete a call, one carrier compensates the other(s) for their role(s) in completing the call. This is termed “inter-carrier compensation.” *See* In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Interconnection between Local Exchange Carriers and Commercial Mobile Radio Service Providers, 11 F.C.C.R. 15,499, ¶ 1034 (Aug. 8, 1996) [hereinafter Local Competition Order].

that allows an interconnecting LEC to be compensated for its costs in transporting and terminating inbound calls from another LEC's network.<sup>8</sup>

Currently, a debate centers on whether the Act's reciprocal compensation provisions require a LEC to compensate another LEC for completing inbound calls from the first LEC's customers to Internet Service Providers ("ISPs") located on the second LEC's network ("ISP-bound traffic").<sup>9</sup> Because many Competitive LECs ("CLECs") carry more ISP-bound traffic originating from Incumbent LECs' ("ILECs") customers than vice-versa,<sup>10</sup> the FCC's February 1999 decision<sup>11</sup> to exclude ISP-bound traffic from section 251's reciprocal compensation requirement<sup>12</sup> threatened to shift the advantage back to the ILECs and hurt the CLECs' ability to negotiate fair terms for interconnection and reciprocal compensation agreements. The D.C. Circuit vacated the ruling and remanded the case, correctly pointing out that the basis of the FCC decision was unsound,<sup>13</sup> and suggesting that the decision might be inconsistent with the FCC's own precedents.<sup>14</sup> Because the court's criticism of the FCC decision was valid and because inclusion of ISP-bound traffic in reciprocal compensation will further the Act's goals of increasing competition in the local market, lowering prices for consumers, and promoting the Internet, the FCC, on remand, should find section 251's reciprocal compensation requirement to apply to ISP-bound traffic.

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8. See 47 U.S.C. § 252(d)(2) (Supp. IV 1998).

9. See In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Inter-Carrier Compensation for ISP-Bound Traffic, 14 F.C.C.R. 3689, ¶ 1 (Feb. 26, 1999), *vacated by* 206 F.3d 1 (D.C. Cir. 2000) [hereinafter RC Ruling].

This Note uses the term "ISP-bound traffic" to specifically designate calls by end-users of one LEC network to an Internet Service Provider ("ISP") located within the local calling area but on another LEC network. Note, however, that connections between an end-user and an ISP's server may be long-distance in instances where the ISP's server is located outside of the end-user's local calling area.

10. See *Bell Atlantic Tel. Co. v. FCC*, 206 F.3d 1, 3 (D.C. Cir. 2000) (stating that CLECs "stand to receive reciprocal compensation on ISP-bound calls" and thus implying that on balance CLECs complete more ISP-bound calls from ILEC networks than vice versa).

11. RC Ruling, *supra* note 9.

12. See *id.* ¶¶ 7, 18, 19, 22; see also *Bell Atlantic*, 206 F.3d at 2-3 ("Having thus taken the calls to ISPs out of § 251(b)(5)'s provision for 'reciprocal compensation' . . .").

13. *Bell Atlantic*, 206 F.3d at 3.

14. See *id.* at 7-8.

## I. BACKGROUND

To facilitate competition through the entry of new local telephone carriers, the Federal Telecommunications Act of 1996 requires all local exchange carriers to interconnect their networks so that customers of different carriers can call one another.<sup>15</sup> The Act further requires LECs to “establish reciprocal compensation arrangements for the transport and termination of telecommunications” in order to compensate interconnected LECs for the costs incurred in completing inbound calls from other networks.<sup>16</sup> Shortly after the passage of the Act, the FCC determined that reciprocal compensation only applies to “local telecommunications traffic.”<sup>17</sup> Thus, reciprocal compensation only comes into play when two LECs serve customers in a single state-defined local calling area.<sup>18</sup>

The Act encourages voluntary negotiations of reciprocal compensation terms,<sup>19</sup> but at the same time, it provides some important basic guidelines.<sup>20</sup> Namely, reciprocal compensation agreements must provide for “mutual and reciprocal recovery by each carrier of costs associated with the transport and termination” of incoming calls.<sup>21</sup> These guidelines are important because interconnection is much more valuable to new entrants (CLECs) than to ILECs,<sup>22</sup> since ILECs, by default, have most of the customers in the market.<sup>23</sup> Therefore, without section 252’s guidelines, ILECs could easily use the value of interconnection to exercise leverage and extract one-way termination fees or charge exorbitantly high termination fees from CLECs.<sup>24</sup>

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15. *Southwestern Bell Tel. Co. v. Pub. Util. Comm’n of Texas*, 208 F.3d 475, 477 (5th Cir. 2000) (citing 47 U.S.C. § 251(a)(1) (Supp. IV 1998)).

16. 47 U.S.C. § 251(b)(5) (Supp. IV 1998); *see also* 141 CONG. REC. S5961, S5970 (daily ed. May 1, 1995).

17. 47 C.F.R. § 51.701(a) (1999); *see also* Local Competition Order, *supra* note 7, ¶ 1033 (stating that compensation for the transport and termination of long-distance telecommunications traffic is via access charges and is governed by sections 201 and 202 of the Act).

18. *See Bell Atlantic*, 206 F.3d at 4.

19. *See* 47 U.S.C. §§ 251(c)(1), 252(a)(1) (Supp. IV 1998).

20. *See id.* § 252(d)(2)(A).

21. *Id.*

22. *See* PETER W. HUBER ET AL., THE TELECOMMUNICATIONS ACT OF 1996 SPECIAL REPORT 21 (1996) (“[A]ccess to the incumbent’s ubiquitous network is far more valuable to the new entrant than vice versa.”).

23. *See* 1998 Biennial Regulatory Review, *supra* note 4, at 265 (stating that “the incumbent LECs had a 97 percent share of the local exchange market in 1997”).

24. *See* Local Competition Order, *supra* note 7, ¶ 55.

While the Act permits a wide scope of compensation arrangements (including voluntary “bill-and-keep” arrangements),<sup>25</sup> ILECs generally pushed for a reciprocal compensation scheme based on per-minute traffic<sup>26</sup> and negotiated for relatively high compensation rates (which many parties argued were above costs)<sup>27</sup> because they apparently expected to be net-terminators.<sup>28</sup> The allegedly high termination rates provided an incentive for CLECs to provide service exclusively to customers with high inbound call volume and low outbound call volume;<sup>29</sup> this way, the CLECs would sit on the collecting end of reciprocal compensation agreements.

Reciprocal compensation became a contentious issue between the ILECs and CLECs when the CLECs began winning the business of ISPs and demanding reciprocal compensation payments from ILECs.<sup>30</sup> CLECs with ISP customers received a high volume of inbound calls from ILEC customers dialing into the ISPs’ servers.<sup>31</sup> Since ISPs do not make many outbound calls, these CLECs began to terminate more minutes of inbound calls from ILEC networks than vice-versa. The ILECs thus faced paying out reciprocal compensation at the rates they had negotiated.

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25. See 47 U.S.C. § 252(d)(2)(B)(i) (Supp. IV 1998).

“[B]ill and keep is a system of reciprocal exchange of traffic in which each company receives something of value and can recover the costs for termination from its own end users in flat monthly charges.” In the Matter of Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers; Equal Access and Interconnection Obligations Pertaining to Commercial Mobile Radio Service Providers, 11 F.C.C.R. 5020, ¶ 37.

26. Donna N. Lampert Associates, P.C., *Competition, Reciprocal Compensation, and Internet-Bound Traffic: Issues and Policy Responses* (Sept. 18, 2000), at <http://www.incongress.com/issues/article.cfm?ArticleID=1263>.

27. See *id.* at 3.

28. A “net-terminator” is a LEC that has more inbound traffic than outbound traffic. Considering that ILECs controlled 97% of the local market in 1997, the ILECs’ prediction that they would be net-terminators was a fair one. The 3% of telephone subscribers with CLECs would probably make more local phone calls to the 97% of subscribers in the ILECs’ domain than vice versa. See 1998 Biennial Regulatory Review, *supra* note 4, at 265; Donna N. Lampert Associates, *supra* note 26, at 3; Kasey A. Chappelle, *The End of the Beginning: Theories and Practical Aspects of Reciprocal Compensation for Internet Traffic*, 7 COMMLAW CONSPECTUS 393, 397-98 (1999).

29. See Chappelle, *supra* note 28, at 398.

30. See Donna N. Lampert Associates, *supra* note 26, at 4; Chappelle, *supra* note 28, at 398.

31. These calls to ISPs also tended to be of long duration. See *Bell Atlantic Tel. Co. v. FCC*, 206 F.3d 1, 3 (D.C. Cir. 2000).

Many ILECs decided to refuse payment of reciprocal compensation on ISP-bound traffic,<sup>32</sup> arguing that ISP-bound traffic terminates at distant out-of-state websites and is therefore “interstate” traffic, which does not qualify for reciprocal compensation under section 251.<sup>33</sup> The CLECs maintained that ISP-bound traffic terminates locally at the ISPs’ facilities, and is therefore covered by section 251’s reciprocal compensation.<sup>34</sup>

Following some ILECs’ refusal of payment, the ILECs and CLECs took this fight into three arenas. The CLECs petitioned the FCC for a declaratory ruling that ISP-bound traffic is included within the reciprocal compensation provision of section 251 of the Act.<sup>35</sup> The CLECs and ILECs also asked state commissions to rule on reciprocal compensation agreements.<sup>36</sup> Finally, the ILECs sought relief from the 106th Congress in the form of a bill that would exempt ISP-bound traffic from section 251’s reciprocal compensation requirement.<sup>37</sup>

## II. CASE SUMMARY

### A. FCC’s Reciprocal Compensation Ruling

In its February 1999 reciprocal compensation ruling (“*RC Ruling*”), the FCC determined that “ISP-bound traffic is jurisdictionally mixed and appears to be largely interstate,” and therefore is not subject to section 251’s reciprocal compensation requirement, which applies only to “local

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32. See Chappelle, *supra* note 28, at 398. See, e.g., *Bell Atlantic Tel. Cos. v. FCC*, 206 F.3d 1 (D.C. Cir. 2000); *Southwestern Bell Tel. Co. v. Pub. Util. Comm’n of Texas*, 208 F.3d 475, 477 (5th Cir. 2000).

33. See *RC Ruling*, *supra* note 9, ¶¶ 7-8.

34. See *id.*

35. On behalf of its CLEC members, the Association for Local Telecommunications Services (“ALTS”) petitioned the FCC. *Id.* at 3690 n.1.

36. Under the Act, state commissions have the authority to interpret and enforce reciprocal compensation agreements. See 47 U.S.C. § 252 (Supp. IV 1998); *Southwestern Bell*, 208 F.3d at 479-80; see also *Association for Local Telecommunications Services, State and Court Decisions on Reciprocal Compensation* (June 30, 2000), at <http://www.alts.org/Filings/091800StateRecipCompDecisions.pdf> (summarizing state and court decisions on reciprocal compensation).

37. See H.R. 4445, 106th Cong. (2000); S. 2902 106th Cong. (2000). These bills, if passed, would have determined that dial-up calls to ISPs are interstate and not subject to reciprocal compensation. The problem with both of these measures was that while they would have eliminated the current confusion by clearly removing reciprocal compensation obligations for ISP-bound traffic, they did not address the real question of how LECs would be compensated for the real costs incurred in transporting and terminating ISP-bound traffic. Ultimately, the 106th Congress failed to pass either of these bills.

telecommunications services.”<sup>38</sup> But the FCC also added that a state commission may nevertheless “impose[] reciprocal compensation obligations for this traffic.”<sup>39</sup>

The FCC began its reasoning by reiterating a former ruling that section 251’s reciprocal compensation provision only applies to “the transport and termination of ‘local telecommunications traffic,’”<sup>40</sup> because the alternate category of service, long-distance telecommunications, is already covered by access charges.<sup>41</sup> The FCC then explained that it must “determine as a threshold matter whether [ISP-bound traffic] is interstate or intrastate.”<sup>42</sup> Next, the FCC stated that it would make a jurisdictional determination of the nature of ISP-bound traffic by applying an “end-to-end” analysis.<sup>43</sup> To justify using this analysis, the FCC cited two cases where the “end-to-end” analysis was applied: *Petition for Emergency Relief and Declaratory Ruling Filed by BellSouth Corporation (“BellSouth”)*<sup>44</sup> and *Teleconnect Company v. Bell Telephone Company of Pennsylvania (“Teleconnect”)*.<sup>45</sup>

In *BellSouth*, the FCC considered the jurisdictional nature of traffic that consisted of an incoming interstate call to a voicemail subscriber’s phone and an intrastate forwarding of that call by BellSouth from the subscriber’s phone<sup>46</sup> to BellSouth’s local voicemail facilities.<sup>47</sup> Using an “end-to-end” analysis, the FCC “determined that the entire transmission constituted one interstate call, because there is a continuous path of communications across state lines between the caller and the voice mail service.”<sup>48</sup> Hence, despite the “local” appearance of BellSouth’s voicemail service (which only involved local forwarding), the FCC pronounced the service jurisdictionally mixed (partially interstate) and preempted the

38. RC Ruling, *supra* note 9, ¶¶ 1, 7, 18, 19, 22; *see also* Bell Atlantic Tel. Cos. v. FCC, 206 F.3d 1, 2-3 (D.C. Cir. 2000).

39. RC Ruling, *supra* note 9, ¶ 1.

40. *Id.* ¶ 7 (quoting 47 C.F.R. § 51.701 (1999)).

41. *See id.* ¶ 9; *see also* Local Competition Order, *supra* note 7, ¶¶ 1033-34.

42. RC Ruling, *supra* note 9, ¶ 7.

43. Under “end-to-end” analysis, the FCC focuses on the “end points of the communication and . . . reject[s] attempts to divide communications at any intermediate points of switching or exchanges between carriers.” *Id.* ¶ 10.

44. 7 F.C.C.R. 1619 (Feb. 14, 1992) [hereinafter *BellSouth*].

45. 10 F.C.C.R. 1626 (Feb. 14, 1995), *aff’d sub nom.* Southwestern Bell Tel. Co. v. FCC, 116 F.3d 593 (D.C. Cir. 1997) [hereinafter *Teleconnect*].

46. Technically, the call is forwarded from the switch serving the subscriber’s phone. *BellSouth*, *supra* note 44, ¶ 8. However, this technical detail is of no consequence here. The important point is that BellSouth’s voicemail service only forwarded the call locally.

47. *See* RC Ruling, *supra* note 9, ¶ 10.

48. *Id.* (internal quotations omitted).

Georgia Public Utility Commission's authority over BellSouth's voicemail service.<sup>49</sup>

In *Teleconnect*, while addressing an access charge<sup>50</sup> issue, the FCC applied the "end-to-end" analysis in finding Teleconnect's service to involve a single interstate communication "extend[ing] from the inception of a call to its completion, regardless of any intermediate facilities."<sup>51</sup> *Teleconnect* also involved an apparently bi-segmented call: the first segment was an 800 call by an end-user to a long-distance carrier's switch via a LEC's network; the end-user then dialed the phone number of the party she wished to reach; the long-distance carrier's switch then executed the second segment of the call by connecting the end-user from the switch to the desired party, again via a LEC's network.<sup>52</sup> The FCC rejected an argument that the "800 call used to connect to [the long-distance carrier's] switch was a separate and distinct call from the call that was placed from that switch."<sup>53</sup> Instead, the FCC ruled that calls on Teleconnect's service were single end-to-end calls.<sup>54</sup> This finding meant that the defendant LECs could only charge Teleconnect, the long-distance carrier, the lower of two access charge rates as inter-carrier compensation.<sup>55</sup>

Using *BellSouth* and *Teleconnect* as precedent, the FCC proceeded with an "end-to-end" analysis for ISP-bound traffic, and found that the traffic does not terminate at the ISP's facilities but rather at the ultimate destination website(s), which may be out-of-state.<sup>56</sup> From this analysis, the FCC determined that ISP-bound traffic is jurisdictionally mixed but largely interstate.<sup>57</sup> The FCC then concluded that because ISP-bound traffic is jurisdictionally interstate, it is not subject to the reciprocal compen-

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49. *BellSouth*, *supra* note 44, ¶¶ 6, 12, 22.

50. Access charge, like reciprocal compensation, is a form of inter-carrier compensation. It is applicable for long-distance traffic, while reciprocal compensation is applicable for local telecommunications traffic. *See* Local Competition Order, *supra* note 7, ¶¶ 1033-34.

51. RC Ruling, *supra* note 9, ¶ 11 (quoting *Teleconnect*, *supra* note 45, ¶ 12).

52. This is similar to placing a phone call in the United States using a calling card.

53. RC Ruling, *supra* note 9, ¶ 11.

54. *See Teleconnect*, *supra* note 45, ¶¶ 8, 23.

55. Though a detailed discussion of the access charge regime is beyond the scope of this Note, it is helpful to understand that in *Teleconnect*, the access charge compensation which the long-distance carrier had to pay the defendant LECs for their roles in originating and transporting part of the call depended on whether this bi-segmented call was deemed a single call or two separate calls. A finding of "two separate calls" would have allowed the defendant LECs to charge the higher of two access charge rates. *See id.*, ¶¶ 2, 12.

56. RC Ruling, *supra* note 9, ¶ 12.

57. *Id.* ¶ 1.

sation requirement of the Act's section 251, which only applies to "local telecommunications."<sup>58</sup> Nevertheless, the FCC noted that while ISP-bound traffic is not subject to reciprocal compensation based on the Act, state commissions may still require reciprocal compensation for ISP-bound traffic in their interpretation of reciprocal compensation agreements.<sup>59</sup>

This ruling led to two unhappy camps—one consisting of ILECs led by Bell Atlantic and the other consisting of CLECs led by MCI WorldCom ("MCI").<sup>60</sup> The ILECs were quite content with the FCC's determination that ISP-bound traffic is beyond the scope of section 251's reciprocal compensation requirement, but did not like the additional verbiage giving state commissions the option to require reciprocal compensation for ISP-bound traffic.<sup>61</sup> The CLECs, on the other hand, maintained that the FCC erred in determining that ISP-bound traffic is not included in section 251's reciprocal compensation requirement.<sup>62</sup> Both sides sought judicial review of the FCC ruling by the D.C. Circuit.<sup>63</sup>

## B. The District of Columbia Circuit Decision

The D.C. Circuit bluntly criticized the FCC's reasoning in arriving at its conclusion, and vacated and remanded the case; however, the court was more reserved in its criticism of the conclusion itself. First, the court criticized the FCC's decision to apply the "end-to-end" analysis. It noted that the FCC had traditionally used this test to "determine whether a call is within its interstate *jurisdiction*"<sup>64</sup> but provided insufficient explanation for why the same test is applicable here for a quite different purpose—determining reciprocal compensation.<sup>65</sup> The court found the two cases the FCC relied on to justify its application of "end-to-end" analysis "not on point" as they involved long-distance telecommunications carriers rather than "information service providers" (e.g. ISPs).<sup>66</sup> The court elaborated on the difference between a long-distance call and a call to an information

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58. *See id.* ¶¶ 7, 18, 19, 22; *see also* Bell Atlantic Tel. Cos. v. FCC, 206 F.3d at 2-3 (D.C. Cir. 2000) ("Having thus taken the calls to ISPs out of § 251(b)(5)'s provision for 'reciprocal compensation' . . .").

59. RC Ruling, *supra* note 9, ¶ 1.

60. *Bell Atlantic*, 206 F.3d at 3.

61. *Id.* The CLECs have largely won the battle at the Commission level in most states. *See* Association for Local Telecommunications Services, *supra* note 36.

62. *See Bell Atlantic*, 206 F.3d at 3.

63. *See id.* United States Courts of Appeals have exclusive statutory jurisdiction to review the FCC's final orders. *See* 28 U.S.C. § 2342(1) (1994).

64. *Bell Atlantic*, 206 F.3d at 3 (emphasis in original).

65. *See id.*

66. *Id.* at 6.

service provider and reiterated MCI's argument that ISPs appear to be "no different from many businesses, such as pizza delivery firms, travel reservation agencies, credit card verification firms, or taxicab companies, which use a variety of communication services to provide their goods or services to their customers."<sup>67</sup> In short, the court held that the FCC did "not satisfactorily explain why an ISP is not, for purposes of reciprocal compensation, simply a communications-intensive business end-user selling a product to other consumer and business end-users."<sup>68</sup> On this ground, the court vacated the FCC ruling and remanded the case "for want of reasoned decisionmaking."<sup>69</sup>

The court also remanded the case on the independent ground that the FCC had not properly explained whether ISP-bound traffic fits into "exchange access"<sup>70</sup> or "telephone exchange service."<sup>71</sup> The court noted the FCC's concession on appeal that in the statutory world of the 1996 Act, "telephone exchange service" and "exchange access" are the only two categories of telephone traffic recognized.<sup>72</sup> The court added that the Act defines a call as "'exchange access' if offered 'for the purpose of the origination or termination of telephone toll services.'"<sup>73</sup> Finally, the court noted MCI's argument that "ISPs connect to the local network 'for the purposes of' providing information services, not originating or terminating telephone toll services."<sup>74</sup> While stating that the "statute appears ambiguous as to whether calls to ISPs fit within 'exchange access' or 'telephone exchange service,'"<sup>75</sup> the court criticized the FCC for brushing aside MCI's statutory argument which strongly suggests that ISP-bound traffic must be categorized as "telephone exchange service" (local telecommunications service) since ISPs do not assess toll charges for their services.<sup>76</sup>

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67. *Id.* at 7 (internal quotation marks and citations omitted).

68. *Id.* (internal quotation marks omitted).

69. *Id.* at 3.

70. "Exchange access" traffic is traffic offered "for the purpose of the origination or termination of telephone toll services." 47 U.S.C. § 153(16) (Supp. IV 1998). Long-distance telephone service is "telephone toll service," whereas local telephone service is not. *See id.* § 153(48).

71. *See Bell Atlantic*, 206 F.3d at 8-9. For purposes here, "telephone exchange service" is synonymous with "local telecommunications service." *See* 47 U.S.C. § 153(47) (Supp. IV 1998). The FCC has explained that "telephone exchange service" is local service. *See* Local Competition Order, *supra* note 7, ¶ 87 ("Because telephone exchange service is a local, intrastate service . . .").

72. *Bell Atlantic*, 206 F.3d at 8.

73. *Id.* at 9 (quoting 47 U.S.C. § 153(16)).

74. *See id.* at 4-5, 9.

75. *Id.* at 9.

76. *See id.* at 5.

While the court did not explicitly reverse the FCC ruling, it did point out several inconsistencies. The court noted that the FCC has historically treated traffic to Enhanced Service Providers ("ESPs"),<sup>77</sup> of which ISPs are a subclass, as "local" and exempted ESPs from the access charge system for long-distance calls.<sup>78</sup> The court added that the FCC has provided this exemption both for policy reasons as well as "on an acknowledgment of the real differences between long-distance calls and calls to information service providers."<sup>79</sup> The court, therefore, implied that the FCC's attempt to characterize ISP-bound traffic as nonlocal was inconsistent with the ESP exemption. The court further pointed out that the FCC ignored its own definition of "local telecommunications," as set forth in 47 C.F.R. § 51.701, and that "[c]alls to ISPs appear to fit" this definition of "local telecommunications."<sup>80</sup> Thus, the court provided several grounds on which the FCC can reverse its ruling on reciprocal compensation.

### III. DISCUSSION

Although the D.C. Circuit did not explicitly reverse the FCC's *RC Ruling*, the major flaws and contradictions in the ruling that the court correctly highlighted are insurmountable. The FCC ruling had significant logical gaps, and its conclusion contradicted a number of FCC precedents, including the FCC's definition of local telecommunications traffic and the FCC's historic treatment of ESPs. Moreover, inclusion of ISP-bound traffic in section 251's reciprocal compensation requirement will promote competition, lower prices, and the Internet, which are goals of the 1996 Act. Therefore, on remand, the FCC should reverse its prior conclusion to find that ISP-bound traffic is "local telecommunications traffic" for purposes of inter-carrier compensation and include ISP-bound traffic in section 251's reciprocal compensation requirement.

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77. Basic services involve standard voice transmission. See Chappelle, *supra* note 28, at 399. "Enhanced Service Providers" is a category which includes ISPs. The term "enhanced services" has been defined by the FCC as "services, offered over common carrier transmission facilities used in interstate communications, which employ computer processing applications that act on the format, content, code, protocol or similar aspects of the subscriber's transmitted information; provide the subscriber additional, different, or restructured information; or involve subscriber interaction with stored information." 47 C.F.R. § 64.702(a) (1999). The distinction was maintained within the Act, where Congress differentiated between "information services" and "telecommunications services" along the same lines as the enhanced/basic distinction. See 47 U.S.C. § 153(20) (Supp. IV 1998).

78. See *Bell Atlantic*, 206 F.3d at 7-8.

79. *Id.* at 8.

80. *Id.* at 6.

### A. The *RC Ruling* Was Based on the Wrong Test

While the FCC correctly framed the threshold question (whether ISP-bound traffic belongs in the local or long-distance service-category),<sup>81</sup> it applied an improper test to answer this question. It incorrectly assumed that a jurisdictional-nature determination of ISP-bound traffic is equivalent to a service-category determination for inter-carrier compensation purposes. Because the FCC's ruling hinged directly on its inappropriate application of the jurisdictional "end-to-end" analysis, the D.C. Circuit correctly vacated and remanded the ruling to the FCC.

#### 1. *A Jurisdictionally Interstate Finding Is Not Dispositive of the Service-Category Question*

The Act provides two forms of inter-carrier compensation—reciprocal compensation and access charge—to address the problem of how a terminating carrier will be compensated for its transport and termination costs when it does not directly bill the caller.<sup>82</sup> Because long-distance telecommunications traffic is already covered by the access charge regime,<sup>83</sup> it was reasonable for the FCC to determine that section 251's reciprocal compensation requirement is only applicable to "local telecommunications traffic."<sup>84</sup>

In the *RC Ruling*, the FCC mistakenly blurred the issue of jurisdiction with that of service-category for determining the appropriate form of inter-carrier compensation. The former merely determines whether the FCC or a state commission has regulatory authority over particular calls. The latter answers the separate question of how LECs are to be compensated for their costs when terminating an incoming call from a different network. A simple example illustrates the difference. In the *BellSouth* case cited by the FCC, the FCC found BellSouth's voicemail service to be jurisdictionally interstate based on the "end-to-end" analysis. Recall that BellSouth's service involved forwarding calls from a subscriber's phone to BellSouth's local voicemail facilities.<sup>85</sup> It would be ridiculous to claim that because of the "jurisdictionally interstate" finding, the forwarding aspect of the service necessarily involves long-distance service instead of local telecommunication service. It would be even more ludicrous to suggest

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81. See *RC Ruling*, *supra* note 9, ¶ 7.

82. See *id.* ¶ 9 ("Generally speaking, when a call is completed by two (or more) interconnecting carriers, the carriers are compensated for carrying that traffic through either reciprocal compensation or access charges.").

83. See *id.*

84. See 47 C.F.R. § 51.701 (1999).

85. See *supra* text accompanying notes 46-49.

that for billing purposes BellSouth or the voicemail subscriber should now have to pay long-distance charges on that portion of the call, even though the call was only forwarded within the local calling area. Hence, as this illustration reveals, a finding that a call is "jurisdictionally interstate" does not automatically make it a long-distance call.

2. *The FCC Inappropriately Applied the Jurisdictional "End-to-End" Analysis*

While the FCC attempted to justify its application of the "end-to-end" analysis to the reciprocal compensation question, the D.C. Circuit correctly pointed out that the two cases cited by the FCC to support its use of "end-to-end" analysis were not on point.<sup>86</sup> The two cited cases involved "switch[ing] by a long-distance communications carrier," whereas the instant case involves ISPs, which are not "telecommunications providers."<sup>87</sup> Though the court did not explain in detail why this distinction is important, it certainly hit the nail on its head when it wrote: "Even if the difference between ISPs and traditional long-distance carriers is irrelevant for jurisdictional purposes, it appears relevant for purposes of reciprocal compensation."<sup>88</sup>

The first case, *BellSouth*,<sup>89</sup> is easily distinguishable from the instant case, because it strictly involved a jurisdictional question as opposed to an inter-carrier compensation question. Hence, the "end-to-end" analysis, which the FCC has traditionally applied for jurisdictional questions,<sup>90</sup> was appropriate in *BellSouth*, where the issue was whether the Georgia Public Utility Commission had authority to "freeze" BellSouth's offering of voicemail service in an antitrust suit.<sup>91</sup> *BellSouth* is unhelpful to the FCC's arguments here because the "end-to-end" analysis was applied to a strictly jurisdictional question, as opposed to an inter-carrier compensation question.

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86. The FCC itself noted in a footnote that the cited cases were distinguishable from the instant case: "the cited cases involve interexchange carriers [i.e. long-distance carriers] rather than ISPs, and the Commission has observed that it is not clear that [information service providers] use the public switched network in a manner analogous to IXCs [long-distance carriers]. . ." RC Ruling, *supra* note 9, at 3697 n.36 (internal citation omitted). But the FCC conclusorily dismissed this distinction as being irrelevant. *Id.*

87. *Bell Atlantic Tel. Cos. v. FCC*, 206 F.3d 1, 6 (D.C. Cir. 2000).

88. *Id.* at 6-7.

89. 7 F.C.C.R. 1619 (Feb. 14, 1992).

90. *See Bell Atlantic*, 206 F.3d at 3.

91. *See supra* text accompanying notes 46-49 for details of the case.

The facts of the second case, *Teleconnect*,<sup>92</sup> are closer to the instant case since both address inter-carrier compensation issues, but *Teleconnect* is nonetheless distinguishable because, as the court pointed out, it involved a long-distance carrier rather than ISPs. *Teleconnect* addressed the question of whether LECs can recoup a higher or lower access charge from a long-distance carrier as compensation for the LECs' assistant role in originating and transporting calls. Regardless of the outcome, the LECs would have been adequately compensated for originating and transporting the calls.<sup>93</sup>

In contrast, in the instant case, because ISPs are exempt from paying access charges, the issue is whether a LEC will be compensated *at all* for transporting and terminating ISP-bound traffic. This distinction has legal significance because an interconnection duty without an associated inter-carrier compensation requirement could lead to inadequate or no compensation for costs which a LEC is legally required to incur. Here, an arbitrary application of jurisdictional "end-to-end" analysis to the inter-carrier compensation question could force a LEC into an involuntary "bill-and-keep" situation for ISP-bound traffic. This result may be constitutionally problematic in light of the Takings Clause.<sup>94</sup> Because of this distinction, the application of "end-to-end" analysis in *Teleconnect* does not justify the FCC's application of the same analysis in the instant case.

As the court aptly criticized, the cases cited by the FCC fail to justify its application of "end-to-end" analysis in the instant case.<sup>95</sup> Because the FCC's finding that ISP-bound traffic is not covered by section 251's reciprocal compensation requirement hinged directly on its incorrect decision

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92. 10 F.C.C.R. 1626 (Feb. 14, 1995), *aff'd sub nom.* Southwestern Bell Tel. Co. v. FCC, 116 F.3d 593 (D.C. Cir. 1997). See *supra* text accompanying notes 50-55 for a brief discussion of the case.

93. There was no argument nor evidence that compensation at the lower rate would have been insufficient to cover the defendant LECs' costs.

94. U.S. CONST. amend. V ("... nor shall private property be taken for public use without just compensation.").

On behalf of Bell Atlantic, Professor Richard A. Epstein considered whether bill-and-keep arrangements between LECs and Commercial Mobile Radio Service ("CMRS") providers ran afoul of the Takings Clause. Epstein concluded that "[o]wing to the imbalance in call origination, a bill and keep system works a major redistribution in wealth away from the LECs to the CMRS providers in a manner that is inconsistent with the takings clause of the Constitution." Letter from Richard Epstein to William Kennard, General Counsel, FCC, at 3, In the Matter of Interconnection between Local Exchange Carriers and Commercial Mobile Radio Service Providers (No. 95-185) (letter dated May 15, 1996), at [http://gulfoss2.fcc.gov/prod/ecfs/retrieve.cgi?native\\_or\\_pdf=pdf&id\\_document=1615930001](http://gulfoss2.fcc.gov/prod/ecfs/retrieve.cgi?native_or_pdf=pdf&id_document=1615930001).

95. See *Bell Atlantic*, 206 F.3d at 3.

to apply “end-to-end” analysis to the threshold question of whether the traffic is local or long-distance,<sup>96</sup> the court properly vacated and remanded the case to the FCC.

### B. ISP-Bound Traffic as “Local Telecommunications”

One simple approach to determining the service-category of ISP-bound traffic is to look at the FCC’s own definitions. In the same regulation where the FCC established that reciprocal compensation applies only for local telecommunications traffic,<sup>97</sup> the FCC defined local telecommunications traffic to mean: “[t]elecommunications traffic between a LEC and a telecommunications carrier . . . that originates and terminates within a local service area established by the state commission.”<sup>98</sup> The FCC further defined “termination” as “the switching of local telecommunications traffic at the terminating carrier’s end office switch, or equivalent facility, and delivery of such traffic to the called party’s premises.”<sup>99</sup>

ISP-bound traffic fits this definition of “local telecommunications traffic.” There is no real debate over whether a terminating LEC is a telecommunications carrier or whether ISP-bound traffic originates within the terminating LEC’s local calling area. The main issue is whether the ISP-bound traffic actually “terminates” within the same local calling area. Upon receipt of the ISP-bound traffic by a LEC, “[t]he traffic is switched by the LEC whose customer is the ISP and then delivered to the ISP. . . .”<sup>100</sup> Since the caller (or the caller’s computer modem) dialed the ISP’s access number, it seems reasonable to deem the ISP the “called party,” thereby completing the definition. Hence, the D.C. Circuit correctly pointed out that “[c]alls to ISPs appear to fit [the above] definition.”<sup>101</sup>

The *RC Ruling* simply ignored the FCC’s own definitions and instead applied the “end-to-end analysis.” But as discussed above, this choice was improper.<sup>102</sup> It seems much more straightforward to use the definitions provided in the same regulation<sup>103</sup> in which the FCC established that section 251’s reciprocal compensation only applies to “local telecommunications traffic” to answer this inter-carrier compensation question.

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96. *See id.* at 5.

97. 47 C.F.R. § 51.701(a) (1999).

98. *Id.* § 51.701(b)(1).

99. *Id.* § 51.701(d); *see also* Local Competition Order, *supra* note 7, ¶ 1040.

100. *Bell Atlantic*, 206 F.3d at 6.

101. *Id.*

102. *See supra* Part III.A.2.

103. *See* 47 C.F.R. § 51.701 (1999).

An alternative approach is to examine how ISP-bound traffic fits into statutorily defined categories of telecommunications traffic. In the Act, only two types of telecommunications traffic are described: “exchange access” and “telephone exchange service.”<sup>104</sup> The FCC has explained that “telephone exchange service” is local service.<sup>105</sup> Furthermore, on appeal, the FCC conceded that these two types of statutorily defined traffic occupy the field.<sup>106</sup> According to the Act, telephone traffic is “exchange access” traffic if offered “for the purpose of the origination or termination of *telephone toll services*.”<sup>107</sup> MCI argued that “ISPs connect to the local network ‘for the purpose of’ providing information services, not originating or terminating telephone toll services.”<sup>108</sup> MCI’s argument is supported by the FCC’s designation of ISPs as “information service providers” rather than “telecommunications providers” under the Act.<sup>109</sup> Because ISPs do not provide telephone toll service, ISP-bound traffic cannot qualify as “exchange access” traffic. This leaves only “telephone exchange service,” which, the FCC has declared, is equivalent to “local” service. Indeed, the FCC failed to adequately address this argument,<sup>110</sup> and thus the court properly remanded the case to the FCC on this independent ground.<sup>111</sup>

On remand, it will be difficult for the FCC to counter the argument that because ISPs do not offer telephone toll service, ISP-bound traffic does not qualify as “exchange access” traffic. Unless it is able to successfully demonstrate that ISP-bound traffic is “exchange access” traffic and not “telephone exchange service” traffic, the FCC must reverse its *RC Ruling*.

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104. See *Bell Atlantic*, 206 F.3d at 8.

105. Local Competition Order, *supra* note 7, ¶ 87 (“Because telephone exchange service is a local, intrastate service . . .”).

106. *Bell Atlantic*, 206 F.3d at 8.

107. 47 U.S.C. 153(16) (Supp. IV 1998) (emphasis added).

108. *Bell Atlantic*, 206 F.3d at 9.

109. See *id.* at 6 (“ISPs, in contrast, are ‘information service providers,’ Universal Service Report, 13 F.C.C.R. at 11,532-33 (¶66), which upon receiving a call originate further communications to deliver and retrieve information to and from distant web-sites.”).

110. See *id.* at 8.

111. *Id.*

### C. Inclusion of ISP-Bound Traffic in Section 251's Reciprocal Compensation Requirement Furthers the Goals of the Act

The common carrier provisions of the Act seek to open local telephone markets to competition<sup>112</sup> by removing regulatory barriers for new market entrants<sup>113</sup> and by counteracting market barriers to entry created by competitive advantages of ILECs. The ILECs' competitive advantages were limited by imposing statutory obligations on ILECs and granting the FCC the power to implement these provisions.<sup>114</sup> Of course, the ultimate goal is to benefit U.S. telecommunication consumers in the form of higher quality services, lower prices, and rapid development of new telecommunication technologies.<sup>115</sup>

#### 1. *Inclusion of ISP-bound Traffic in Reciprocal Compensation Promotes Competition and the Goal of Lower Prices for Consumers*

Including ISP-bound traffic in section 251's reciprocal compensation obligation will give CLECs more bargaining power in interconnection and reciprocal compensation negotiations with ILECs, and limit the ILECs' leverage and ability to demand high termination rates that do not represent actual termination costs. This outcome is consistent with the Act's goals of increasing competition in the local telephone market and lowering prices for consumers.

When Congress drafted the Act, it recognized that

[e]ffective interconnection arrangements are among the most critical issues for . . . competitors. . . . For example, arrangements must be made for networks to compensate each other for terminating calls that originate in another network. *Unless properly structured, the reciprocal compensation arrangements can raise significant barriers to entry by potential local competitors.*<sup>116</sup>

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112. See H.R. CONF. REP. NO. 104-458, at 113 (1996); see also H.R. CONF. REP. NO. 104-882 (1997) ("One of the primary goals of the new telecommunications law is the promotion of competition in the local telephone market.").

113. See Local Competition Order, *supra* note 7, ¶ 12.

114. See Thomas J. Hall, *The FCC and the Telecom Act of 1996: Necessary Steps to Achieve Substantial Deregulation*, 11 HARV. J. L. & TECH. 797, 801 nn.14-15 (1998).

115. Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56, 56 (pre-ample).

116. 141 CONG. REC. S5961, 5970 (daily ed. May 1, 1995) (statement of Sen. Byrd) (emphasis added).

Congress had the foresight to see the importance of including a reciprocal compensation provision for facilitating entry into and increasing competition in the local telephone market.

Similarly, the FCC has recognized that ILEC-CLEC interconnection negotiations are not typical commercial negotiations because "ILECs have virtually no incentive to cooperate in establishing reasonable terms and conditions for interconnection with CLECs."<sup>117</sup> Further, "ILECs have much greater bargaining power than CLECs,"<sup>118</sup> partly because interconnection is much more valuable to CLECs than to ILECs.<sup>119</sup> Accordingly, the FCC concluded that rules should be construed in favor of new entrants: "The inequality of bargaining power between incumbents and new entrants militates in favor of rules that have the effect of equalizing bargaining power in part . . . ."<sup>120</sup>

Ruling that ISP-bound traffic is included in section 251's reciprocal compensation obligation would follow this principle by favoring new entrants and bolstering the CLECs' bargaining power. Including ISP-bound traffic makes many CLECs with ISP customers net-terminators of traffic (relative to the ILECs), thus requiring ILECs to pay those CLECs transport and termination fees based on negotiated reciprocal compensation agreements. Since ILECs will have to pay this fee, ILECs will be more likely to propose termination rates for future reciprocal compensation agreements that more closely reflect actual costs of termination. Lower reciprocal compensation rates should ultimately translate to lower prices for consumers and encourage entry of new competitors into the local telephone market by lowering provisioning costs. At the same time, because ILECs will receive lower reciprocal compensation for delivering traffic, ILECs will be encouraged to invest in newer, more efficient technologies for transporting and terminating calls.

2. *ILECs Wrongly Identify Inclusion of ISP-bound Traffic in Reciprocal Compensation as the Cause of CLECs' Limited Competitive Incentives*

ILECs argue that inclusion of ISP-bound traffic in reciprocal compensation is inconsistent with the Act's goal of increasing competition because CLECs will only have incentive to serve a limited market (i.e. ISP

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117. Hall, *supra* note 114, at 801; *see also* Local Competition Order, *supra* note 7, ¶ 55.

118. Local Competition Order, *supra* note 7, ¶ 55.

119. *See* HUBER ET AL., *supra* note 22, at 21; *see also* Local Competition Order, *supra* note 7, ¶ 55. *See supra* text accompanying notes 22-24.

120. Local Competition Order, *supra* note 7, ¶ 55.

customers and other end-users with a high volume of inbound calls) in order to collect reciprocal compensation fees.<sup>121</sup> CLECs will have no incentive to enter or compete in other segments of the market, such as local residential user markets.<sup>122</sup>

This argument, however, is flawed because the inclusion of ISP-bound traffic in reciprocal compensation obligations is not the cause of the stated problem. Rather, the problem is due to high reciprocal compensation rates, which are significantly above actual transport and termination costs.<sup>123</sup> These high rates exist because ILECs generally pushed for high rates during the negotiations of first generation reciprocal compensation agreements and because single-tiered reciprocal compensation rates fail to take into account the difference in costs of transporting and terminating voice versus data traffic.<sup>124</sup>

Given the current single-tiered reciprocal compensation agreements, ILECs have a legitimate complaint that CLECs serving ISPs are receiving an imbalanced advantage, because the cost of transporting and terminating data traffic is generally less than that for voice traffic.<sup>125</sup> However, the fair solution to this problem is not to eliminate reciprocal compensation for ISP-bound traffic or data traffic altogether—after all, there are real costs, however low, incurred during the transport and termination of that traffic.<sup>126</sup> A reasonable solution is to restructure reciprocal compensation rates into two tiers: one for data traffic, another for voice traffic. This restructuring can be accomplished during negotiations of future reciprocal compensation agreements, since a two-tiered plan is not precluded by the Act.

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121. See Letter from Edward D. Young, III, Senior Vice President & Deputy General Counsel for Bell Atlantic, & Thomas J. Tauke, Senior Vice President of Government Relations for Bell Atlantic, to Hon. William E. Kennard, Chairman, FCC (July 1, 1998), at [http://gullfoss2.fcc.gov/prod/ecfs/retrieve.cgi?native\\_or\\_pdf=pdf&id\\_document=2101290001](http://gullfoss2.fcc.gov/prod/ecfs/retrieve.cgi?native_or_pdf=pdf&id_document=2101290001) (last visited February 4, 2001).

122. *Id.*

123. Ironically, while responding to charges that ILECs would set reciprocal compensation fees above actual costs, Bell Atlantic itself wrote prophetically: "If these rates are set too high, the result will be that new entrants, who are in a much better position to selectively market their services, will sign up customers whose calls are predominantly inbound, such as credit card authorization centers and internet access providers." Reply Comments of Bell Atlantic to the Request by ALTS for Clarification of the Commission's Rules Regarding Reciprocal Compensation for Internet Service Provider Traffic, Dkt. No. CCB/CPD 97-30, at 21 (May 30, 1996). The fact that CLECs have signed up customers whose calls are predominantly inbound strongly suggests that the reciprocal compensation rates are too high.

124. See Donna N. Lampert Associates, *supra* note 26, at 7.

125. *Id.*

126. See RC Ruling, *supra* note 9, ¶ 29.

This way, the rate for each tier can more accurately reflect the costs of terminating either voice or data traffic. This should lead to more balanced market incentives for CLECs.

3. *Inclusion of ISP-bound Traffic in Reciprocal Compensation Promotes the Internet*

Inclusion of ISP-bound traffic in section 251's reciprocal compensation requirement is also consistent with the FCC's policy justifications for exempting ISPs from access charges and the Act's general goal of promoting the Internet.<sup>127</sup>

The FCC has acknowledged that "no matter what the payment arrangement, LECs incur a cost when delivering traffic to an ISP that originates on another LEC's network."<sup>128</sup> Statutorily, the LEC may seek compensation for termination costs via access charges or reciprocal compensation.<sup>129</sup> However, recovery of costs through access charges is not possible due to the FCC's exemption of ISPs from that form of inter-carrier compensation.<sup>130</sup> ESPs, of which ISPs are a subclass, have been exempted from paying access charges since the FCC established the access charge regime for long-distance calls in 1983.<sup>131</sup> The FCC effectively treats ESPs "like end-users rather than long-distance carriers."<sup>132</sup> In 1997, it again preserved the status quo and "justified the exemption in terms of the goals of the 1996 Act, saying that its purpose was to 'preserve the vibrant and competitive free market that presently exists for the Internet and other interactive computer services.'"<sup>133</sup>

Providing this exemption strongly suggests that the FCC, consistent with the goals of the Act, does not want to impose extra costs on ISPs that could stifle the relatively new Internet industry. In effect, the FCC has implicitly decided, as a matter of policy, to have the general public (or at least the general telephone-service-consuming public) "subsidize" the costs of Internet access, rather than requiring Internet users themselves to pay a higher fee for access.

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127. See 47 U.S.C. § 230(b)(2) (Supp. IV 1998).

128. RC Ruling, *supra* note 9, ¶ 29.

129. See Local Competition Order, *supra* note 7, ¶ 1034.

130. See In the Matter of Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Transport Rate Structure and Pricing End User Common Line Charges, 12 F.C.C.R. 15,982, 16,133 ¶ 344 (May 16, 1997) [hereinafter Access Charge Reform].

131. See *Bell Atlantic Tel. Co. v. FCC*, 206 F.3d 1, 7 (D.C. Cir. 2000).

132. *Id.*

133. *Id.* (citing Access Charge Reform, *supra* note 130, ¶ 344, and quoting 47 U.S.C. § 230(b)(2)).

Recovery of costs of terminating ISP-bound traffic through reciprocal compensation depends partly on the FCC's decision on remand.<sup>134</sup> If ISP-bound traffic is not included in reciprocal compensation obligations, CLECs may not be able to recoup those transport and termination costs from the originating ILEC. But economics dictates that companies cannot continue operating without recovery of their cost basis, which means that CLECs will have to either exit the market (or at least exit the market serving ISP customers) or pass the transport and termination costs directly onto the ISP by charging higher monthly business end-user fees.

The first option would lead to diminished competition in the local telephone market, which is contrary to the goals of the Act. The second option would lead to higher prices for Internet access, since the ISP would likely pass the increased costs onto its customers. This would run counter to the implicit FCC policy of subsidizing Internet access. Therefore, to avoid these two possibilities, and to promote the goals of the Act, the FCC should rule that ISP-bound traffic is included in section 251's reciprocal compensation requirement.

#### IV. CONCLUSION

The D.C. Circuit correctly pointed out the flaws in the FCC's *RC Ruling*. Because the inconsistencies in the FCC's ruling are insurmountable, the FCC must reverse its ruling to find that ISP-bound traffic is "local" for inter-carrier compensation purposes and include ISP-bound traffic in section 251's reciprocal compensation obligation. In so doing, the FCC will foster competition in the local telephone market, help bolster the bargaining power of the CLECs (against the ILECs), and further the goals of the Act.

With the help of appropriate interconnection requirements coupled with properly structured reciprocal compensation agreements, the players in the local telephone market will be able to shape an industry with lower prices, higher quality service, and more advanced technologies for the benefit of consumers.

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134. The FCC has stated that even if ISP-bound traffic is not included in section 251's reciprocal compensation requirement, parties may nonetheless include it in their interconnection/reciprocal compensation agreements. However, this places tremendous strain on the CLECs who then have to repeatedly argue for its inclusion during negotiations and before state commissions. See *RC Ruling*, *supra* note 9, ¶ 1.

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## THE ELECTRONIC SIGNATURES IN GLOBAL AND NATIONAL COMMERCE ACT

By Jonathan E. Stern

Electronic commerce is rapidly redefining this nation's economy. This past year's revenues amounted to about \$490 billion in United States online purchases.<sup>1</sup> By 2004, the United States will transact online sales reaching an estimated \$3.2 trillion.<sup>2</sup> The Internet boom motivated the Clinton Administration to publish a July 1997 report encouraging the private sector to respond to the public's "war[iness] of conducting extensive business over the Internet because of the lack of a predictable legal environment governing transactions"<sup>3</sup> and to help create "a uniform commercial legal framework that recognizes, facilitates, and enforces electronic transactions worldwide."<sup>4</sup>

The Electronic Signatures in Global and National Commerce Act ("E-Sign" or the "Act"),<sup>5</sup> which took effect on October 1, 2000,<sup>6</sup> responds to this challenge by authorizing legally enforceable electronic signatures, contracts, and other electronic records that affect interstate or foreign commerce.<sup>7</sup> E-Sign is significant for commerce in general and electronic commerce in particular because it provides equal legal validity for electronic and paper-based agreements. Since "[l]egal uncertainty is the antithesis of strong and efficient markets," it is believed that E-Sign will revolutionize businesses in the United States by providing a basis for legal confidence in an area where lawful certainty has been glaringly absent.<sup>8</sup>

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1. Matthew R. Sanders, *Global eCommerce Approaches Hypergrowth*, at <http://www.forrester.com/ER/Research/Brief/0,1317,9229,00.html> (Apr. 18, 2000).

2. *Id.*

3. William J. Clinton & Albert Gore, Jr., *A Framework for Global Electronic Commerce*, at <http://www.iitf.nist.gov/elecomm/ecom.htm> (last visited Jan. 24, 2001).

4. *Id.*

5. Pub. L. 106-229, 114 Stat. 464 (codified at 15 U.S.C.A §§ 7001-7006 (West Supp. 2001)).

6. Section 107 of E-Sign provides certain exceptions to the requirement that E-Sign take effect on October 1, 2000. For example, all requirements by federal or state statute, regulation or other law that records be retained take effect on March 1, 2001. 15 U.S.C.A. § 7007(b)(1)(A)-(B) (West Supp. 2001).

7. *Id.* § 7001(a)(1)-(2).

8. *Electronic Signatures in Global and National Commerce (E-Sign) Act: Hearing on H.R. 1714 Before the Subcomm. on Finance and Hazardous Materials of the House*

Although E-Sign is certain to increase business and consumer trust in creating electronic contracts, the Internet continues to be an environment where individuals can anonymously penetrate into computers and databases, causing companies and individuals great financial harm.<sup>9</sup> Computer hackers<sup>10</sup> have regularly stolen private identifying information such as private keys and passwords, in order to purchase goods and commit crimes in other people's names.<sup>11</sup> Because of the Internet's porous security protection, members of the digital community have been exploring how to allocate risk in the event of a security breach. Through this inquiry, three core issues have been identified as security risks: authentication, integrity, and nonrepudiation.<sup>12</sup>

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*Comm. on Commerce*, 106th Cong. (1999) (statement of Michael Hogan, Senior Vice President and General Counsel, DLJ Direct, Inc.).

9. In the past year, for instance, hackers have penetrated into and attacked prominent websites such as Amazon.com, Yahoo, and eBay. M.J. Zuckerman, *Hackers, Security Pros Call Web Attacks Vandalism: Consultants Ponder Motive*, USA TODAY, Feb. 11, 2000, at 13A. Computer-savvy criminals have also appropriated personal information contained on large computer databases and then sold that data for a profit. See Ann Cavoukian, *Identity Theft: Who's Using Your Name*, at [http://www.ipc.on.ca/english/pubpres/sum\\_pap/papers/ident-e.htm](http://www.ipc.on.ca/english/pubpres/sum_pap/papers/ident-e.htm) (June 1997). Moreover, private information has even been uploaded from individuals' personal computers. In 1999, for instance, a flaw in Microsoft's Excel spreadsheet program was detected, which permitted computer hackers to copy private files from a person's home computer without his knowledge. Martha Mendoza, *Warning for Web Surfers: Hackers Able to Steal Off PCs with Excel*, ARIZ. REPUBLIC, Jan. 6, 1999, at A7. More recently, hackers broke into Microsoft's computer systems and may have stolen source code to newer versions of its Windows operating system as well as portions of Word and Excel. Janet Rae-Dupree, *Windows Hack Attack: Worming into Microsoft*, U.S. NEWS & WORLD REPORT, Nov. 6, 2000, at 44.

10. Webopedia defines hack as "to modify a program, often in an unauthorized manner, by changing the code itself." *Webopedia*, at <http://webopedia.internet.com/TERM/h/hack.html> (last visited Jan. 24, 2001).

11. See Cavoukian, *supra* note 9. In light of these recent security breaches, the results of a study conducted by the Information Technology Association of America in April 1999 should come as no surprise. See *Millennium Digital Commerce Act of 1999: Hearing on S.761 Before the Senate Comm. on Commerce, Science and Transportation*, 106th Cong. (1999) (statement of Harris N. Miller, President, Information Technology Association of America) [hereinafter Statement of Harris N. Miller]. Measuring the perceptions of top executives and their customers from across the information technology industry, the study found that 62% of respondents believed lack of trust was the primary barrier to e-commerce and that specific obstacles included privacy protection (60%), authentication (56%), and security (56%). *Id.* Results like these support the White House's belief that the public is "wary of conducting extensive business over the Internet." Clinton & Gore, *supra* note 3.

12. E.g., Amelia H. Boss, *Searching for Security in the Law of Electronic Commerce*, 588 PLI/PAT 401, 416 (2000); C. Bradford Biddle, *Misplaced Priorities: The Utah Digital Signature Act and Liability Allocation in a Public Key Infrastructure*, 33

This Note focuses on the element of authentication in electronic transactions<sup>13</sup> and examines which party should bear the risk of financial loss when the authenticity of a signature is raised.<sup>14</sup> Part I provides a brief overview of state legislation prior to E-Sign's enactment, as well as the various types of electronic signatures that can be used to create an electronic contract. Part II then describes E-Sign's most important provisions, including its scope, federal preemption clauses, and consumer protection provisions. Part III discusses E-Sign's approach and two other approaches to authenticating electronic signatures. Part IV illustrates the insufficiency of each model in fairly allocating risk to either the merchant or the unsophisticated consumer. Finally, this Note reviews these regimes and suggests which features of these different plans should be incorporated to create a law that provides consumer protections while also promoting the growth of e-commerce.

## I. CREATING AN ELECTRONIC CONTRACT AND SIGNATURE

Electronic signatures can be created in a variety of ways. Prior to E-Sign's enactment, states were inconsistent in defining which methods could create an authentic electronic signature. This Part describes those state provisions that preceded E-Sign's enactment as well as the range of electronic signatures that the Act currently permits.

### A. Electronic Signatures Prior to E-Sign

Before E-Sign became law, legislation differed on what would constitute a valid electronic signature. Originally, digital signatures<sup>15</sup> were the favored technology in electronic signatures statutes, as they supposedly offered "a technology-based cure for many of the security risks encoun-

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SAN DIEGO L. REV. 1143, 1146 (1996). Authentication addresses the issue of locating the source or sender of a message and verifying that it actually came from the sender. Integrity relates to the problem of proving that a message is complete and has not been distorted. Non-repudiation relates to the risk that a sender may disclaim a record after another party receives it. *Id.*

13. Note that the authentication element was identified by 56% of the respondents in the ITAA survey as an obstacle to e-commerce's development. Statement of Harris N. Miller, *supra* note 11.

14. See generally Biddle, *supra* note 12 (critiquing various model for allocating risk when privacy is compromised). The security risks of authenticity, integrity, and non-repudiation are often inseparable. Therefore, much of the following discussion is equally relevant to the other categories as well.

15. See *infra* text accompanying notes 33-40.

tered in online commerce.”<sup>16</sup> For example, in 1995, Utah<sup>17</sup> (followed by Minnesota<sup>18</sup> and Washington<sup>19</sup>) became the first state to enact an electronic signature statute setting forth specific rules governing digital signatures and public key infrastructures (“PKIs”).<sup>20</sup> By 1999, the popularity of digital signature statutes had waned significantly, and a technology-neutral approach became increasingly popular.<sup>21</sup> Just prior to October 1, 2000, when E-Sign went into effect, eighteen states, including Utah and Minnesota, had already adopted the Uniform Electronic Transactions Act (“UETA”), which permits any form of electronic symbol or message to qualify as a signature.<sup>22</sup> Under UETA, these signatures are valid whenever an electronic symbol or message is coupled with the signer’s intent to authenticate the contract.<sup>23</sup>

Although most states that had adopted an electronic signature statute eventually implemented a technology-neutral approach, businesses wishing to execute electronic contracts continued to lack certainty that their contracts would be recognized nationwide.<sup>24</sup> As a result, E-Sign was enacted to create greater uniformity and bolster the public’s confidence in the legal validity of electronic contracts throughout the nation.

## B. Variety of Electronic Signatures Permitted by E-Sign

E-Sign defines an electronic signature as “an electronic sound, symbol, or process attached to or logically associated with a contract or other record and executed or adopted by a person with the intent to sign the re-

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16. Boss, *supra* note 12, at 416.

17. UTAH CODE ANN. § 46-3-101 (1995).

18. MINN. STAT. ANN. § 325K (West 1997).

19. WASH. REV. CODE ANN. § 19.34 (West 1996).

20. A public key infrastructure is a system consisting of “digital certificates, Certification Authorities, and other registration authorities that verify and authenticate the validity of each party involved” in an online transaction. Currently, there is no existing uniform standard for constructing a PKI. *Webopedia*, at <http://webopedia.internet.com/TERM/P/PKI.html> (last visited Jan. 30, 2001).

21. See, e.g., *Allowing Use of Electronic Signature: Hearing Before the Subcomm. on Telecommunications, Trade and Consumer Protection of the House Comm. on Commerce*, 106th Cong. (1999) (statement of Daniel Greenwood, Deputy General Counsel, Information Technology Division Commonwealth of Massachusetts) (commenting that the Utah digital signature law reflected many outdated “trends”).

22. UNIF. ELEC. TRANSACTIONS ACT § 2(8), 7A U.L.A. 20 (Supp. 2000). These eighteen states are Arizona, California, Florida, Idaho, Indiana, Iowa, Kansas, Kentucky, Maine, Maryland, Minnesota, Nebraska, Ohio, Oklahoma, Pennsylvania, South Dakota, Utah, and Virginia. D. Benjamin Beard, *Removing Barriers to E-Commerce: The Uniform Electronic Transactions Act*, SF06 ALI-ABA 137, 139 (2000).

23. UNIF. ELEC. TRANSACTIONS ACT § 2(8), 7A U.L.A. 20 (Supp. 2000).

24. See *infra* text accompanying notes 49-55.

cord.”<sup>25</sup> Perhaps the easiest way to create a binding electronic signature under this provision would be to accept a contract by clicking “yes” on an icon on a computer screen.<sup>26</sup> An individual could also bind himself to a contract by signing an e-mail with his name or by typing an “X.”<sup>27</sup> Currently, many commercial transactions are effected using more advanced technological approaches. One common method of creating a valid signature is the “shared secrets” method. This process involves the use of passwords or credit card numbers to establish the necessary intent to conclude a transaction.<sup>28</sup> For example, one might purchase a novel by selecting the desired publication and then entering a credit card number to both pay for a book and manifest intent to be bound by the sale.

A more complex method of signing a contract is through biometric authentication.<sup>29</sup> Biometric authentication operates by sampling and electronically retaining a physiological characteristic of a user (such as a fingerprint) in that individual’s user profile. When the user invokes the authentication procedure, the characteristic is measured again and compared with the reference profile. Whenever an individual successfully replicates the previously stored physiological characteristic, the signature and identity of the individual is authenticated.<sup>30</sup> Biometric technology can identify

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25. 15 U.S.C.A. § 7006 (West Supp. 2001).

26. Harris Ominsky, *Oops! I Just Clicked My Life Away*, THE LEGAL INTELLIGENCER, July 26, 2000, at 7. While it is true that companies such as Amazon.com did permit click-through shopping prior to E-Sign, the Act formalizes the validity of these contracts. Until E-Sign, Amazon was forced to either rely on conflicting state laws that had enacted electronic or digital signature statutes or assume the risk that federal or state courts would enforce these contracts. In other words, Amazon did not have any clear indication that a consumer’s click on the “I Agree” or “yes” icon would necessarily bind either Amazon or the consumer to fulfill the terms of a contract.

27. David W. Carstens, *Contracts Have a New Look Thanks to E-Signature Act*, TEX. LAW., July 31, 2000, at 54. It has also been suggested that an individual could accept an offer by producing an electronic sound such as a musical note. Ominsky, *supra* note 26, at 7.

28. *E.g.*, Richard Raysman & Peter Brown, *The Impact of the New Federal E-Sign Act on New York Law*, 224 N.Y. L.J. 3 (Aug. 8, 2000) (describing the “shared secrets” method).

29. *See, e.g.*, American Biometric Company, *What is Biometric Authentication*, at <http://www.biomouse.com/whitepapers/biometric.htm> (last visited Jan. 24, 2001). Biometric authentication has recently become popular in the insurance and financial industries and its appeal continues to grow. *See, e.g.*, Sam Costello, *With Biometrics, You Are Your Own Password*, INFO WORLD DAILY NEWS, Nov. 15, 2000; Elizabeth Weise, *Body May be Key to a Foolproof ID*, USA TODAY, Aug. 8, 1998, at 4D.

30. *See, e.g.*, Benjamin Wright, *Eggs in Baskets: Distributing the Risks of Electronic Signatures*, 452 P.L.I./PAT 63, 69-70 (1996) (detailing the application of PenOp, a security pen biometric technology).

an individual through recognition of a fingerprint, signature, voice, or iris.<sup>31</sup> Therefore, to bind oneself to a contract, one might place one's hand on a specially designed platform. When one's handprint matches the previously stored print identifying the user, a binding electronic signature is immediately created.

The digital signature is another significant means of creating an electronic signature. As discussed above,<sup>32</sup> its initial popularity led some states, prior to the enactment of E-Sign, to confine legally cognizable electronic signatures narrowly to digital signatures.<sup>33</sup> Digital signatures involve the use of a private and public key pair<sup>34</sup> that are usually purchased by a sender and issued by a Certification Authority ("CA").<sup>35</sup> A CA, which can be created through a PKI,<sup>36</sup> is a trusted third party who checks and verifies the identity of the person requesting the key pair.<sup>37</sup> The private key that an individual receives is to remain secret and is not to be distributed to anyone other than the key owner. The public key, on the other hand, can be made widely available and can be found by accessing a CA's public database.<sup>38</sup> The public-private key pairs are mathematically related such that a message encrypted with a private key can only be decrypted with a public key.<sup>39</sup> Therefore, if a sender signs a document with his private key, the recipient can use the sender's public key and signature to confirm the authenticity of the document.<sup>40</sup>

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31. *Allowing Use of Electronic Signatures: Hearing Before the Subcomm. on Telecommunications, Trade and Consumer Protection of the House Comm. on Commerce*, 106th Cong. (1999) (statement of John Seidlarz, President and Chief Executive Officer, IriScan).

32. See *supra* text accompanying notes 16-20.

33. See, e.g., UTAH CODE ANN. §§ 46-3-101 to 46-3-504 (1995) (Utah's Digital Signature Law).

34. Public and private keys are made through the composition of complex mathematical algorithms that disguise messages and information. Michael Lee et al, *Electronic Commerce, Hackers, and the Search for Legitimacy: A Regulatory Proposal*, 14 BERKELEY TECH. L.J. 839, 850-51 (1999).

35. See Boss, *supra* note 12, at 416-17.

36. See *supra* note 20; *infra* text accompanying notes 104-06.

37. See Boss, *supra* note 12, at 417.

38. One article has explained that the public-private key set is similar to secret decoder rings that are found in boxes of cereal in that "each ring only fits into its companion ring and no other." Daniel J. Greenwood & Ray A. Campbell, *Electronic Commerce Legislation: From Written on Paper and Signed in Ink to Electronic Records and Online Authentication*, 53 BUS. LAW. 307, 311 (1997).

39. See Boss, *supra* note 12, at 416.

40. See Greenwood & Campbell, *supra* note 38, at 311. The technology operates in the following way. If Alice wishes to send secure information to Bob, Alice performs a mathematical computation on her document, known as a "hash" function, which creates a

## II. IMPORTANT PROVISIONS OF E-SIGN

### A. Electronic Contract Defined

E-Sign's terms provide a basis for creating legally valid documents that are electronically signed, recorded, and available for future reference.<sup>41</sup> It therefore allows parties to bind themselves contractually by means other than the traditional pen and paper.<sup>42</sup> For instance, by clicking "I Agree" on an online purchase form for the casebook *Intellectual Property in the New Technological Age*,<sup>43</sup> one has simultaneously created a legally binding electronic signature and electronic record.

A significant distinction between electronic commerce and paper-based commerce is that electronic transactions can be executed instantly between computers.<sup>44</sup> E-Sign facilitates this ease in consummating transactions by broadly defining the term "electronic signature." The speed with which contracts can be given effect is similarly enhanced by E-Sign's effort to promote the freedom of contract between parties.<sup>45</sup> To this end, E-Sign requires that consent to create an electronic contract is voluntary<sup>46</sup>

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unique string of code called a "message digest." Biddle, *supra* note 12, at 1149. Because the message digest is based on the specific content of Alice's original document, any changes to the document would yield a different message digest. Alice then encrypts this message digest using her private key, attaches this digital signature to the end of the document, and sends the document to Bob. *Id.* When Bob receives Alice's message, he can independently run the same hash function on the original message to determine what the content of the original message digest should be. He then decrypts Alice's digital signature, using Alice's public key. If Bob sees that the message digest in Alice's decrypted digital signature matches the message digest that Bob calculated from the message of his own, then Bob knows that the information has not been altered and that the message could only have been sent using Alice's private key. *Id.* If, on the other hand, the digests do not match, then the authenticity of the message is instantly called into question.

41. See *supra* Part I.B. An electronic signature is broadly defined as "an electronic sound, symbol, or process attached to or logically associated with a contract or other record and executed or adopted by a person with the intent to sign the record." 15 U.S.C.A. § 7006 (West Supp. 2001). The term electronic record "means a contract or other record created, generated, sent, communicated, received, or stored by electronic means." *Id.* Finally, the term "electronic" means "relating to technology having electrical, digital, magnetic, wireless, optical, electromagnetic, or similar capabilities." *Id.*

42. See *supra* text accompanying notes 26-40.

43. ROBERT P. MERGES ET AL., *INTELLECTUAL PROPERTY IN THE NEW TECHNOLOGICAL AGE* (2d ed. 2000).

44. Boss, *supra* note 12, at 404.

45. See 146 CONG. REC. S5215-02, \*S5218 (daily ed. June 15, 2000) (statement of Sen. McCain) (commenting that E-Sign "ensure[s] that private commercial actors get to choose the type of electronic signatures that they want to use").

46. 15 U.S.C.A. § 7001(b)(2) (West Supp. 2001) (The Act does not "require any person to agree to use or accept electronic records or electronic signatures.").

and that interested parties define what procedures will create an authentic signature or contract.<sup>47</sup> These provisions help to permit the application of an array of technologies that can bind parties to a contract through means such as click-through provisions, digital signatures, and biometrics.<sup>48</sup>

## B. Preemption

E-Sign provides that all state laws related to electronic signatures and contracts are preempted unless they constitute an adoption of UETA<sup>49</sup> or specify alternative procedures that are technologically neutral<sup>50</sup> and consistent with Titles I and II of the Act.<sup>51</sup> The principle underlying this provision is the presumed importance of uniformity among the states.<sup>52</sup> Proponents of E-Sign argue that states' differences in electronic signature laws impede the growth of e-commerce because parties are unwilling to

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47. *Id.* § 7001(c)(1)(A) (An electronic record satisfies the requirement that information be in writing if "the consumer has affirmatively consented to such use and has not withdrawn such consent.").

48. *See supra* Part I.B.

49. 15 U.S.C.A. § 7002(a)(1) (West Supp. 2001). The National Conference of Commissioners on Uniform State Laws approved the Uniform Electronic Transactions Act in July 1999 as a body of legislation validating the use of electronic records and electronic signatures. *See* UNIF. ELEC. TRANSACTIONS ACT, 7A U.L.A. (Supp. 2000); Summary of the Uniform Electronic Transactions Act, at [http://www.nccusl.org/uniformact\\_summaries/uniformacts-s-ueta.htm](http://www.nccusl.org/uniformact_summaries/uniformacts-s-ueta.htm) (last visited Feb. 9, 2001). With exception to the issue of determining the authenticity of a signature, there are a few minor differences between UETA and E-Sign that extend beyond the scope of this Note. However, the chair of the UETA Drafting Committee has authored a more thorough description of these differences. *See* Patricia Brumfield Fry, *A Preliminary Analysis of Federal and State Electronic Commerce Laws*, 5 ELECTRONIC COM. & L. REP. 735, 737-39 (2000).

50. States acting as market participants are exempted from having to take a technology-neutral stance. 15 U.S.C.A. § 7002(b) (West Supp. 2001). It stands to reason that this exception was instituted because a state engaged in an electronic transaction is inevitably forced to select a particular technology in conducting its transaction. *See Allowing Use of Electronic Signatures: Hearing Before the Subcomm. on Telecommunications, Trade, and Consumer Protection of the House Comm. on Commerce*, 106th Cong. (1999) (statement of Andy Pincus, General Counsel, U.S. Dept. of Commerce) [hereinafter Statement of Andy Pincus] (explaining that an earlier version of the Electronic Signatures bill that did not contain the above provision compelled the government to undermine its technology neutrality when having to choose one among competing authentication providers).

51. 15 U.S.C.A. § 7002(a)(2) (West Supp. 2001). Titles I and II present the key provisions related to the creation and enforceability of electronic signatures. Meanwhile, the Act's other Titles, III and IV, respectively address the responsibilities of the Secretary of Commerce in promoting electronic signatures and the authority of the Commission on Child Online Protection to accept gifts.

52. *See, e.g.*, 146 CONG. REC. S5215-02, \*S5217 (daily ed. June 15, 2000) (statement of Sen. McCain).

risk entering into an online contract without certainty regarding its legality nationwide.<sup>53</sup> Indeed, should conflicting state laws exist, companies would be forced to customize their services to meet the requirements of each state.<sup>54</sup> This, in turn, could disproportionately harm businesses by raising costs and making it difficult to serve customers cost-effectively.<sup>55</sup>

E-Sign's advocates also point out that, barring preemption, it could take many years before states independently enact uniform laws. For instance, it took nine years for the Uniform Commercial Code to be adopted, and even then, Louisiana and the District of Columbia did not adopt it entirely.<sup>56</sup> Similarly, the Uniform Securities Act, which was first proposed in the 1950s and was revised in the 1980s, still has failed to provide uniform state securities laws.<sup>57</sup> Thus, history has demonstrated that it is unwise to simply wait for the nation to uniformly enact UETA.<sup>58</sup> Instead, by requiring states to adopt either UETA or legislation that is significantly, if not entirely, similar to E-Sign, the United States immediately provides nationwide uniformity regarding the legal validity of an electronic contract.<sup>59</sup>

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53. *Electronic Signatures in Global and National Commerce (E-Sign) Act: Hearing on H.R. 1714 Before the Subcomm. on Courts and Intellectual Property of the House Comm. on the Judiciary*, 106th Cong. (1999) (statement of Howard Coble, Chairman, Subcommittee on Courts and Intellectual Property).

54. *Electronic Signatures in Global and National Commerce (E-Sign) Act: Hearing on H.R. 1714 Before the Subcomm. on Finance and Hazardous Materials of the House Comm. on Commerce*, 106th Cong. (1999) (statement of Thomas C. Quick, President and Chief Operating Officer, Quick & Reilly/Fleet Securities, Inc.).

55. *Id.*

56. *Electronic Signatures in Global and National Commerce (E-Sign) Act: Hearing on H.R. 1714 Before the Subcomm. on Finance and Hazardous Materials of the House Comm. on Commerce*, 106th Cong. (1999) (statement of M. Hardy Callcott, Senior Vice President and General Counsel, Charles Schwab & Co., Inc.).

57. *Id.*

58. Recent developments appear to undermine this claim. Indeed, it appears that UETA has swiftly gained nationwide recognition. In addition to the eighteen states that have already adopted UETA, as of August 2000, ten other states and the District of Columbia were considering its adoption. *See Beard, supra* note 22, at 139.

59. Opponents to the preemption clauses contained in E-Sign argue that the Act unnecessarily infringes upon states' rights. They argue that since the federal government is responsible in determining whether a state has complied with the statute, every contract case involving uncertainty as to the validity or legal effect of an electronic signature could possibly contain a federal question. This would necessarily result in federal involvement in areas of contract law that have traditionally been reserved to the states. Second, since E-Sign was partly motivated by a desire to respond to changing market conditions, preemption should be discouraged because states are more capable than the federal government in making swift adjustments to shifts in the market. *See Electronic Signatures in Global and National Commerce (E-Sign) Act: Hearing on H.R. 1714 Before the Subcomm. on Courts and Intellectual Property of the House Comm. on the Judi-*

### C. Consumer Protections

E-Sign appears to provide extensive consumer protections against unintentionally entering into an electronic contract; however, these provisions can be misleading. E-Sign mandates that if a statute, law, or regulation requires that information be provided or made available in writing to a consumer, the use of electronic records is permitted upon compliance with detailed specifications and disclosures.<sup>60</sup> In this case, the consumer must not only formally consent to receive records in electronic form,<sup>61</sup> but the party required to furnish the information must also:

- 1) inform the consumer of any right or option to receive a record in nonelectronic form;<sup>62</sup>
- 2) inform the consumer of the right to withdraw consent to receive electronic notice and explain any consequences or fees upon termination;<sup>63</sup>
- 3) inform the consumer whether the consent is to a particular transaction or to a category of notices made available during the course of the parties' relationship;<sup>64</sup>
- 4) describe the procedures for withdrawal of consent and for updating information that is needed to contact the consumer electronically;<sup>65</sup>
- 5) inform the consumer on how to obtain a paper-based copy of an electronic record and whether a fee will be charged;<sup>66</sup>
- 6) notify the consumer of the necessary hardware and software requirements for access to and retention of records;<sup>67</sup> and
- 7) ensure that the consumer consents electronically or confirms electronically in a manner that confirms that the consumer can access information in the necessary electronic form.<sup>68</sup>

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*ciary*, 106th Cong. (1999) (statement of Pamela Mead Sargent, National Conference of Commissioners on Uniform State Laws).

60. 15 U.S.C.A. § 7001(c) (West Supp. 2001).

61. *Id.* § 7001 (c)(1)(A).

62. *Id.* § 7001(c)(1)(B)(i)(I).

63. *Id.* § 7001(c)(1)(B)(i)(II).

64. *Id.* § 7001(c)(1)(B)(ii).

65. *Id.* § 7001(c)(1)(B)(iii).

66. *Id.* § 7001(c)(1)(B)(iv).

67. *Id.* § 7001(c)(1)(C)(i).

68. *Id.* § 7001(c)(1)(C)(ii).

Although these requirements appear extensive, the Act limits their reach with a provision holding that a failure to obtain electronic consent or confirmation of consent does not immediately deny the legal effectiveness, validity, or enforceability of any contract entered into with the consumer.<sup>69</sup> It is therefore unclear whether a contract is valid when a business that is statutorily required to make information available in writing fails to do so. Should a court find such contracts to be enforceable, all of the above provisions would effectively be rendered moot. Furthermore, these provisions do not require consumer consent before *all* electronic dealings. Rather, these clauses only apply when an existing law requires that information be provided or made available in writing to a consumer.<sup>70</sup> This means that e-businesses that are not currently required to provide paper-based records, such as Amazon.com, are not obligated to abide by any of these provisions.

Even though the sections described above only apply to a small class of consumers, E-Sign also contains provisions that benefit all individuals who fall outside of these clauses. For instance, due to the loss of “ceremonial psychology” that is involved when an individual signs a document while sitting in the presence of a notary who affixes a seal to verify the signer,<sup>71</sup> E-Sign requires that certain writings remain paper-based so that contractual parties can maintain awareness regarding the gravity of their signing.<sup>72</sup> Therefore, court orders,<sup>73</sup> notices regarding utility termination,<sup>74</sup> and regulations governing adoption, divorce, or other matters of family law<sup>75</sup> are all still processed through physical, nonelectronic documentation.<sup>76</sup> E-Sign also calls for a federal study of the extent to which the provisions of the law benefit or burden electronic commerce while charging the Department of Commerce<sup>77</sup> and the Federal Trade Commission<sup>78</sup> to recommend how the Act should be altered in order to protect consumers better. Lastly, the Act permits any federal regulatory agency, following notice to the public and an opportunity for public comment, to exempt a

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69. *Id.* § 7001(c)(3).

70. *Id.* § 7001(c)(1).

71. *See* Ominsky, *supra* note 26, at 7.

72. Much of this ceremony is lost on the Internet since individuals can now create valid contracts by simply clicking “yes” on an icon on their computer screens. *Id.*

73. 15 U.S.C.A. § 7003(b)(1) (West Supp. 2001).

74. *Id.* § 7003(b)(2)(A).

75. *Id.* § 7003(a)(2).

76. Uniform Commercial Code sections 1-207 and 1-206 and Articles 2 and 2A are also exempted from the electronic record provisions. *Id.* § 7003(a)(3).

77. *Id.* § 7005(a)-(b) (West Supp. 2001).

78. *Id.* § 7005(b).

category or type of record from requirements relating to consumer consent to the use of electronic records.<sup>79</sup> This exemption, however, can only be effected when it will not materially harm consumers and is necessary to eliminate a significant burden on electronic commerce.<sup>80</sup>

### III. THREE LEGISLATIVE MODELS FOR AUTHENTICATION

Although E-Sign makes significant strides in creating a national standard for forming electronic contracts, the Act does not explicitly address the problem of who should be responsible for proving the authenticity of a signature.<sup>81</sup> Consequently, E-Sign creates the possibility that consumers will be liable when their secret passwords and codes are stolen and fraudulently used.<sup>82</sup> Given the increasing difficulties in providing a safe environment in which to transact online business,<sup>83</sup> it is worthwhile to examine E-Sign and other models that contain elements that can help generate greater consumer confidence and security protection. This Part provides a description of the different models and Part IV analyzes the success and failure of each proposal in safeguarding the consumer while stimulating the growth of the digital economy.

#### A. E-Sign and UETA's Technology-Neutral Approach

E-Sign forbids any state or federal statute from requiring a specific technology for electronic transactions.<sup>84</sup> This technology-neutral approach instead allows the market to decide which technologies will best facilitate electronic commerce.<sup>85</sup> Naturally, this is a position that most businesses gladly embrace.<sup>86</sup> Without the hindrance of any specific technologies,

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79. *Id.* § 7004(d)(1).

80. *Id.*

81. *See supra* notes 9-11 and accompanying text.

82. *See infra* text accompanying notes 111-15.

83. *See supra* notes 9-11 and accompanying text.

84. 15 U.S.C.A. § 7002(a)(2)(A)(ii) (West Supp. 2001) (forbidding states from "accord[ing] greater legal status or effect to, the implementation or application of a specific technology or technical specification for performing the functions of creating, storing, generating, receiving, communicating, or authenticating electronic records or electronic signatures"). This "minimalist" approach is consistent with the principles enumerated in the *Framework for Global Commerce*. *See* Clinton & Gore, *supra* note 3.

85. *See* Boss, *supra* note 12, at 434-35.

86. Among the most ardent supporters of E-Sign included some of the largest companies in America such as Microsoft, America Online, American Express, DLJDirect, Citigroup, and Oracle. 146 CONG. REC. S5215-02, \*S5218 (daily ed. June 15, 2000) (statement of Sen. McCain).

businesses are free to construct their own methods and security procedures to transact business with customers.<sup>87</sup>

In addition to its promotion of technology-neutrality, E-Sign does not enumerate any standards for attributing responsibility in the event that an electronic signature is forged or stolen. Instead, E-Sign presumably relies on existing laws or future litigation to determine who will carry the evidentiary burden of proving the inauthenticity of a signature. UETA,<sup>88</sup> on the other hand, also adopts a technology-neutral regime but creates a framework for attributing an electronic signature. It states that “[a]n electronic record or signature is to be attributed to a person if it was the act of the person.”<sup>89</sup> Relevant evidence in establishing this fact includes any “showing of the efficacy of any security procedure” that helps to establish who attached the signature.<sup>90</sup> UETA also clarifies that the effect of a record or signature on the person to whom it is attributed is to be determined from the context and surrounding circumstances at the time of the creation, execution, or adoption of the record.<sup>91</sup> These provisions inform the individual that, in the absence of any identifiable abnormalities in the transmission of a signature, a consumer will likely have the burden of proving that a fraudulent signature does not belong to her.<sup>92</sup>

## B. The Credit Card and Automatic Teller Machine Model

The liability allocations and evidentiary burdens contained in the Truth in Lending Act<sup>93</sup> and the Electronic Fund Transfer Act (“EFTA”)<sup>94</sup> are “among the most radical, and successful, consumer protection initiatives of the 1970s.”<sup>95</sup> Both Acts place significant limitations on the liability of consumer credit cardholders for unauthorized transactions. Regulation Z issued by the Board of Governors of the Federal Reserve System<sup>96</sup> mandates that a cardholder will not be held responsible for more than \$50 or

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87. As discussed in Part IV however, though this is beneficial for merchants, it is unclear that this approach adequately protects consumers.

88. See *supra* text accompanying note 22.

89. UNIF. ELEC. TRANSACTIONS ACT § 9 (a), 7A U.L.A. 32 (Supp. 2000).

90. *Id.*

91. *Id.* § 9(b).

92. *Id.* § 9 cmt. 1.

93. 15 U.S.C. §§ 1601-1667e (1994). Regulation Z implements the provisions contained in the Truth in Lending Act. See Jane Kaufman Winn, *Open Systems, Free Markets, and Regulations of Internet Commerce*, 72 TUL. L. REV. 1177, 1232 (1998); 12 C.F.R. § 226.1(a).

94. 15 U.S.C. §§ 1693-1693r (1994). Regulation E implements the provisions contained in the Electronic Funds Transfer Act. Winn, *supra* note 93, at 1233.

95. Winn, *supra* note 93, at 1235.

96. 12 C.F.R. § 226.1.

the actual amount of unauthorized charges, whichever is less.<sup>97</sup> Even this small sum may not be charged to a cardholder unless the following requirements have been met:

- 1) the card was accepted by the consumer;
- 2) the card issuer provided the consumer with adequate notice of his or her personal liability;
- 3) the issuer provided the consumer with an adequate means of notifying the issuer in the event the card is lost or stolen;
- 4) the issuer provided a means of identifying the authorized user of the card; and
- 5) the unauthorized use occurred prior to notification by the cardholder to the issuer of the loss or theft of the card.<sup>98</sup>

This loss allocation rule places the risk of unauthorized use chiefly on the financial institutions responsible for issuing and processing the credit cards.<sup>99</sup> As a result of this loss allocation rule, credit card companies have invested large sums of money to reduce the incidence of credit card losses.<sup>100</sup>

With regard to Electronic Fund Transfers (“EFTs”), such as the use of an Automatic Teller Machine (“ATM”) for transfers or direct deposits from a consumer account, the provisions of Regulation E are similar to those of Regulation Z, except that under Regulation E consumer protections decrease when the consumer does not take immediate action to report a loss or theft.<sup>101</sup> As a result, Regulation E provides protection for the

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97. *Id.* § 226.12.

98. 12 C.F.R. § 226.12(b)(2)-(3).

99. 15 U.S.C. § 1693g(a) (1994).

100. Fraud loss prevention techniques include the placement of photographs on credit cards to make it more difficult to replicate them and data mining techniques that allow the card issuer to locate usage patterns that are associated with theft or fraudulent credit card use before the cardholder may even realize that her credit card has been compromised. *See Winn, supra* note 93, at 1235.

101. 12 C.F.R. § 205.6. The consumer who promptly reports the loss or theft of an “access device”—that is, a card, code, or other means of accessing a consumer’s account for the purposes of effecting an EFT—is liable for the lesser of \$50 or the amount of the unauthorized EFTs. *Id.* But a consumer who fails to notify a financial institution within two days of learning of the loss or theft may be liable for up to \$500. *Id.* Meanwhile, a consumer who fails to report the loss or theft of the access device within sixty days of the account statement being transmitted to the consumer may be liable for the entire amount of unauthorized charges that occur after the sixty days and before the consumer finally

conscientious EFT user but requires that the consumer assume liability for failing to report a genuine theft in a timely manner.

### C. Digital Signature Laws and the Open PKI System

In 1995, Utah became the first state to adopt a full-fledged digital signatures statute<sup>102</sup> that supported a public key infrastructure.<sup>103</sup> The Utah legislation was based on the efforts of the American Bar Association's Information Security Committee, which, following a four-year collaborative effort between attorneys and technologists, published a set of Digital Signature Guidelines.<sup>104</sup> The model presented by the Utah statute and the American Bar Association is referred to as the "open PKI" business model.

An open PKI model assumes that subscribers obtain a digital certificate from a certification authority that will securely link their identity to their public key for use in creating electronic contracts. Generally, "the certificate issued by the CA has no boundaries upon the class or set of relying parties . . . entitled to rely upon it."<sup>105</sup> Thus, an open PKI environment permits an individual to acquire a digital certificate and then enter into transactions that require a digital signature, such as the ordering of products online, signing contracts, and submitting papers to a government office.<sup>106</sup> Under the Utah Act, the state acts as the root certification authority and provides for the licensing of certification authorities.

In creating its PKI, the Utah law attempted to provide greater certainty as to the authenticity of an electronic signature. The Utah Act provides that if a digital signature is verified by the public key listed in a valid certificate issued by a licensed CA, it is established that (1) the subscriber has accepted the corresponding certificate and thereby assumed the duty to exercise reasonable care to protect the key, (2) the digital signature is that of the subscriber listed in the certificate, and (3) the digital signature was affixed with the intention of signing the message.<sup>107</sup> These provisions in-

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gives notice to the institution. *Id.* The financial institution has the burden of proving that a loss or theft was not reported in a timely manner. *Id.*

102. UTAH CODE ANN. § 46-3-101 (1995). The Utah digital signature provisions have since been replaced by UTAH CODE ANN. § 46-4-101, which substantially adopts UETA.

103. *See supra* note 20.

104. A copy of the Digital Signature Guidelines can be downloaded at <http://www.abanet.org/scitech/ec/isc/dsgfree.html> (last visited Feb 9, 2001).

105. Charles R. Merrill, *The Accreditation Guidelines—A Progress Report on a Work in Process of the ABA Information Security Committee*, 38 JURIMETRICS J. 345, 349 (1998).

106. Greenwood & Campbell, *supra* note 38, at 316.

107. UTAH CODE ANN. §§ 46-3-401, 46-3-406 (1995).

form us that there is a presumption that a digital signature contained in a contract belongs to the signature owner. Table 1 in the appendix summarizes the key provisions of each of the four models discussed above.

#### IV. COMPARATIVE ANALYSIS OF THE LEGISLATIVE MODELS

##### A. Technology Neutrality under E-Sign and UETA

One justification for E-Sign's technology-neutral approach<sup>108</sup> is the concern that technology can easily become obsolete, thereby rendering a technology-specific approach unsafe or inefficient.<sup>109</sup> Some academics argue that it is imprudent to require a specific technology when conducting electronic transactions before more is known about the actual practices of merchants and consumers in the e-commerce marketplace.<sup>110</sup> Moreover, requiring a particular technology can result in the consumer's use of technology that is relatively easy for a hacker to manipulate in order to steal an individual's identity and commit fraud. However, while the technology-neutral approach creates room for improvements in technology, E-Sign also permits the continuation of insecure electronic commercial transactions even when inexpensive and easily accessible alternatives are available.<sup>111</sup>

Perhaps the most pressing problem with E-Sign is that it mandates technology-neutrality without creating guidelines for attributing responsibility when the authenticity of a signature is called into question. Presently, current legislation and common law tort principles can be relied on when a consumer is found to have protected confidential information or passwords negligently. For instance, if Alice negligently types her secret password in a chat room and an individual discovers it and conducts transactions totaling \$25,000, current law mandates that Alice is liable for her irresponsible behavior.<sup>112</sup> However, existing case law has not yet determined whether Alice would be held liable in the event that she exercised reasonable care and her password was nevertheless stolen from her com-

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108. See *supra* Part III.A.

109. See Boss, *supra* note 12, at 441.

110. See Winn, *supra* note 93, at 1183.

111. An argument has also been made that it should be against public policy to allow large commercial transactions to take place without a minimum technology-specific threshold requirement. See Statement of Andy Pincus, *supra* note 50.

112. See C. Bradford Biddle, *Legislating Market Winners: Digital Signature Laws and the Electronic Commerce Marketplace*, 34 SAN DIEGO L. REV. 1225, 1236 (1997).

puter.<sup>113</sup> Today, hackers can break into an individual's computer with almost complete anonymity, and oftentimes, with impunity.<sup>114</sup> Consequently, not only will it be very difficult for Alice to locate the elusive password-snatcher, but she will also be forced to prove to the court that she indeed behaved with reasonable care.<sup>115</sup> Moreover, given that the thief will almost never be found, there are no specific provisions that dictate who should be held liable for the loss: Alice, the business who accepted her stolen password, or perhaps the company who originally issued Alice her password.

Although UETA does contain a framework for attributing responsibility, its provisions effectively guarantee the same result that could occur under E-Sign. By requiring the sender to prove the inauthenticity of a signature,<sup>116</sup> UETA formally establishes that, in the above scenarios, Alice would have the burden of proof in showing that she was not responsible for a stolen signature or password.<sup>117</sup> As in E-Sign, not only may she not be able to prove her innocence, but she may also lack the resources with which to hire competent counsel. Thus, regardless of whether states adopt UETA or accept E-Sign, consumers will often not have any legal protection when contracts are made using their stolen signatures.

In sum, the technology-neutral approach of both E-Sign and UETA can create a dangerous environment for consumers entering contracts using inferior technology. The laws also shift an inordinate amount of risk onto the unsophisticated consumer. Although UETA initially appears to be more valuable to the consumer by presenting a framework for attributing

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113. For example, a corrupt computer repairman might search Alice's files and copy her personal codes in the process of repairing her broken computer. There are also many other ways that a private key can be stolen: one can steal another's identity and receive a digital certificate in that person's name; an employee of a CA responsible for issuing certificates can be bribed; a disgruntled employee can steal a key and enter into beneficial commercial transactions; or a criminal could break the underlying algorithm to discover a CA's private key by analyzing the CA's public key. *See, e.g.*, Biddle *supra* note 12, at 1189; Michael J. Osty & Michael J. Pulcanio, *The Liability of Certification Authorities to Relying Third Parties*, 17 J. MARSHALL J. COMPUTER & INFO. L. 961, 967-68 (1999).

114. Gaining anonymity on the Internet is frightfully easy. For instance, Anonymizer.com provides a free service whereby anyone accessing its website can anonymously surf other webpages. *See* <http://www.anonymizer.com> (last visited Feb. 9, 2001). This reality has also been captured poignantly by a *New Yorker* cartoon featuring a conversation between two dogs seated next to a computer. The caption reads: "On the Internet, nobody knows you're a dog." Peter Steiner, *NEW YORKER*, July 5, 1993, at 61.

115. *See* Biddle, *supra* note 112, at 1236.

116. UNIF. ELEC. TRANSACTIONS ACT § 9 cmt. 2, 7A U.L.A. 32 (Supp. 2000).

117. Note that under E-Sign Alice will most probably have the burden of proof, whereas UETA explicitly states that the burden is on her.

the authenticity of a signature, in practice UETA will tend to favor businesses at the expense of consumers.

## B. The Credit Card Model

Currently, both merchants and consumers are protected from liability in credit card transactions.<sup>118</sup> However, if Regulations Z or E were applied to non-credit-card transactions, the burden of proving the authenticity of a signature would unfairly shift to the merchant, who would be required to assume all responsibility for negligent or fraudulent losses in excess of \$50.<sup>119</sup> By virtually eliminating consumer responsibility in the event of consumer negligence or fraud, the consumer would be well protected in the digital economy.<sup>120</sup> Yet, just as consumers are severely limited in their ability to prove that a fraudulent signature does not belong to them, merchants have little ability to detect whether an individual is providing passwords or digital signatures that do not belong to her.

Regulation Z and E-type legislation in non-credit-card transactions is also less practical in a technology-neutral digital economy. Unlike the credit card system, where a company is secure in the knowledge that consumer transactions can only be effected through limited, specific means—such as providing a credit card number or personal identification number—electronic signature transactions involve a great variety of devices and methods. It would not be fair, for example, to apply the same \$50

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118. Many credit card companies including American Express, Visa, and MasterCard have waived the \$50 liability limit in an effort to convince consumers to continue to use credit cards online. See Andrea Bennett, *The Best Ways to Pay Online*, MONEY MAG., Oct. 15, 2000, at 106 (discussing the “zero liability” programs offered by American Express, Visa, and MasterCard).

119. While it is true that consumers and merchants are usually protected from liability since most electronic transactions are effected using credit cards, the growing popularity of cybercash and other non-credit card means to pay for goods requires this examination of alternative means to protect the parties involved. See, e.g., Paul D. Glenn, *The Law of E-Commerce in the Financial Services Sector*, 1156 PLI/CORP 771, 787-88 (1999); Cymonie Rowe, *Technological Advances in Banking: A Move to a Global Economy*, 4 ILSA J. INT’L & COMP. L. 1303, 1304-05 (1998) (describing the growing importance of cybercash and other internet payment schemes).

120. Barring statutory obligations, merchants would be reluctant to accept the scheme voluntarily. For instance, our heroine Alice would certainly be pleased to only have to pay \$50 when a stolen password results in a \$25,000 loss, but there is no reason to assume that merchants or other contracting parties would be willing to assume the risk of loss. Instead, merchants are apt to require consumers to accept a merchant’s disclaimer denying responsibility in the event of fraud or misappropriation. Currently, both UETA and the former Utah statute explicitly side with merchants in these scenarios when stating that a signature is considered authentic unless proven otherwise. See UNIF. ELEC. TRANSACTIONS ACT § 9 cmt. 2, 7A U.L.A. 32 (Supp. 2000).

limit to both a situation where the merchant demands that signatures be effected through biometrics and a situation where a merchant allows any form of technology to constitute a signature.<sup>121</sup> The level of risk is calculated differently based on the technology used. In the credit card regime, however, credit card companies can structure how they issue credit cards or permit ATM transfers based on a uniform set of procedures. As a result, the ease with which Regulations Z or E can be applied to e-commerce transactions is limited.

### C. The Utah Act

Although the Utah Act ensures that a minimum technology threshold will govern all electronic transactions, the act functions in a similar way to E-Sign by shifting an inordinate amount of risk onto the consumer. For instance, a hacker who succeeds in identifying the methods used to control Alice's private key could forge her signature with great ease, potentially causing Alice significant financial hardship.<sup>122</sup> By requiring the sender to prove the inauthenticity of a signature,<sup>123</sup> Utah's provisions indicate that, in this scenario, it will be up to Alice to provide evidence to rebut the presumption that she authenticated the signature. Because the statute concentrates risk on the original holder of the private key, consumers will often have to pay for the loss.

The Utah law's state-sanctioned licensing of Certification Authorities arguably creates greater assurances as to the validity of an electronic signature. However, since the drafters of the Utah Act limited the liability of CAs in order to foster development of a certification authority industry,<sup>124</sup> the cap on CA liability inappropriately shifts too much risk onto the consumer. First, by permitting only digital signatures to authenticate contracts, the statute runs the risk that the technology will become easier to steal or imitate, as hackers will focus solely on cracking this one type of

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121. It is also inadvisable to promote such legislation in a technology-specific regime since technology is liable to become obsolete and, over time, will become more susceptible to manipulation and fraud. In addition, it is impractical to require that, to prevent fraud, consumers purchase expensive and more secure technology such as biometrics since its cost would be prohibitive to many and would effectively bar millions from contracting on-line.

122. Given recent events, this process should not be as difficult as it seems. For instance, in as early as 1994, a Russian computer programmer removed \$10 million from Citibank customer accounts after discovering the code that authorizes fund transfers. See David Gow & Richard Norton-Taylor, *Surfing Superhighwaymen: Banks Have Good Reason to Fear Thieves Who Hack Into their Secret Files*, THE GUARDIAN, Dec. 7, 1996, at 28.

123. See UTAH CODE ANN. §§ 46-3-401, 46-3-406 (1995).

124. Biddle, *supra* note 12, at 1192.

technology. Second, not only may digital signatures become obsolete,<sup>125</sup> digital signatures are already less reliable and more subject to fraud than signatures created through biometric technology.<sup>126</sup> Third, the Act does not create incentives for CAs to take adequate precautions to protect their private keys from fraudulent use. A more concerned CA, such as one facing financial liability, would be stimulated to take extensive safety measures, such as creating complex digital signature algorithms that are difficult for hackers to crack, or limiting the types of transactions for which an electronic signature can be used.<sup>127</sup>

The Utah statute is also unfair because a CA that negligently distributes an individual's electronic signature can externalize the cost of its negligence onto otherwise defrauded subscribers. Meanwhile, since the Utah Act assumes that a digital signature verified by a public key belongs to the certificate holder, the consumer is likely to be held completely liable for all fraudulent uses of her signature, regardless of whether it was stolen or negligently distributed by a third party.<sup>128</sup>

The presumption that a digital signature is signed by the owner of a private key also destroys a merchant's incentive to gather or consider any evidence other than the digital signature when he evaluates whether to hold a consumer responsible for a document.<sup>129</sup> It also allows a merchant to forgo the trouble of establishing a relationship with a consumer in order to confirm her responsibility.<sup>130</sup> As a result, even though the Utah Act tends to provide more security than E-Sign's approach, it suffers from the danger that digital signatures will become obsolete and that, similar to E-

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125. Note that consumer risks related to the use of inferior technology in the marketplace absent guidelines for protecting the non-negligent consumer have already been discussed above. See *supra* text accompanying notes 111-12.

126. See R.R. Jueneman & R.J. Robertson, Jr., *Biometrics and Digital Signatures in Electronic Commerce*, 38 JURIMETRICS J. 427, 453-54 (1998).

127. It is also worth noting that even if the market will ultimately eliminate a particular negligent CA that does not mean that the market will succeed in significantly eliminating the problem of CA negligence altogether. That is because it can conceivably take many months to identify a negligent party. Even after that party has been identified, the CA-owner can easily reinvent the company by shutting down the website and reopening under a different name. Moreover, even though the Utah statute requires state approval for CAs, it does not require the state to conduct any policing efforts that would deny negligent CAs from re-registering. Lastly, such a scheme is particularly easy on the Internet where the start-up costs of an e-business are small relative to most brick-and-mortar companies.

128. It is conceivable that comparative negligence rules may apply in those states that have enacted comparative negligence statutes.

129. See Wright, *supra* note 30, at 68.

130. *Id.*

Sign, the consumer will bear the bulk of the risk. Table 2 in the appendix summarizes the relative risks of the four models for electronic signatures discussed above.

## V. CONCLUSION: SEARCHING FOR A PRACTICAL SOLUTION

As Table 2 indicates, all of the above proposals contain distinct advantages and disadvantages. A technology-neutral regime such as E-Sign avoids the risk that outdated and increasingly insecure technology will be *required* in creating electronic contracts. However, technology neutrality also creates the likelihood that inferior and insecure technology *may* be applied when concluding contracts. The Utah statute remedies this difficulty by requiring the use of digital signatures, thereby guaranteeing that, in the immediate future at least, contracts will not be made with significantly inferior technology. At the same time, however, both E-Sign and the Utah law run the risk of making the consumer liable for both negligent and nonnegligent behavior. If Regulations Z or E were applied to the digital economy, the consumer would obtain significant protections, but the regulations would also result in the merchant's assumption of an inordinate amount of risk.

Clearly, none of the above proposals can perfectly address the liability concerns of authentication in e-commerce. Nevertheless, these schemes suggest the components that are needed to construct a fair system for authenticating electronic signatures. The historic success of the credit card and ATM schemes<sup>131</sup> demonstrates that one economically efficient solution to the problems of authentication is to allocate the risk of loss to a third party such as a Certification Authority. Since there does not appear to be any just way to allocate risk to either the consumer or the merchant, such a scheme would have the immediate effect of relieving both parties from the burdensome evidentiary requirements of proving the (in)authenticity of an electronic signature. In addition, since the CAs will be the parties assuming the risk, they should be allowed to determine the type of technology to be applied when using their certificates to authenticate a signer. Should this type of proposal be adopted, the key challenge for future legislators would be to create an economic model that aids in the profitability of CAs while shielding the consumer from having to prove fraud or nonnegligence. Otherwise, rather than promoting the growth of

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131. See Henry H. Perritt, Jr. *Legal and Technological Infrastructures for Electronic Payment Systems*, 22 RUTGERS COMPUTER & TECH. L.J. 1, 20-22.

electronic commerce, E-Sign and its progeny may instead become a great impediment.

## APPENDIX

**Table 1: Summary of Major Electronic Signature Provisions**

	<i>Permissible Technologies</i>	<i>Parties Involved</i>	<i>Presumption of Liability/ Evidentiary Burden</i>
E-Sign/UETA	All	Merchant and Consumer	Signature Owner
Regulation Z	All	Merchant, Consumer, and Credit Card Company	Consumer and Merchant do not have any evidentiary burdens
Regulation E	All	Merchant, Consumer, and Credit Card Company	The Credit Card Company is responsible for proving that a consumer failed to report fraud or negligence in a timely manner.
Utah's Digital Signature Act	Digital Signatures	Merchant, Consumer, and Certification Authority	Owner of Private Key

Table 2: Summary of Electronic Signature Proposals: Relative Risks

	<i>Risk to Consumer</i>	<i>Risk to Merchant</i>	<i>Risk to CA</i>	<i>Risk to Credit/ATM Card Issuer<sup>a</sup></i>	<i>Evidentiary Burden on Consumer</i>	<i>Risk of Unsafe Technology</i>	<i>Possibility of Obsolete Technology</i>
Technology Neutrality Under E-Sign & UETA	High	Low	N/A	Moderate	High	High	Low
Utah Digital Signature Statute	High	Low	Low	Moderate	High	Moderate	Moderate
Regulation Z (in the digital economy)	Low	High (in non-credit-card transactions)	N/A	Moderate	Low	Low	Low
Regulation E (in the digital economy)	Low	High (in non-credit-card transactions)	N/A	Moderate	Low	Low	Low

<sup>a</sup> This column applies only to credit card and ATM card related transactions.

## FEDERAL LEGISLATION REGARDING TAXATION OF INTERNET SALES TRANSACTIONS

By Christopher J. Schafer

In October 1998, amid the general confusion surrounding the taxation of Internet sales, Congress enacted the Internet Tax Freedom Act ("ITFA").<sup>1</sup> This law imposed a three-year moratorium on all new sales and use taxes<sup>2</sup> on electronic commerce. Congress passed this bill partly in response to the confusion surrounding remote sellers' sales tax liability and the lack of judicial guidance on that subject.

Generally backed by the Internet industry and ostensibly designed to prevent duplicative and discriminatory taxation of Internet sales,<sup>3</sup> the ITFA arguably threatens state sovereignty.<sup>4</sup> House Bill 3709, a bill that would have extended the ITFA for 5 years, passed the U.S. House of Representatives in mid-2000.<sup>5</sup> Its counterpart in the U.S. Senate, Senate Bill 2255, died in the Senate Committee on Commerce, Science and Transportation at the end of the 106th Congress.<sup>6</sup> Several other bills, introduced in both the House and the Senate, also aimed to extend the moratorium.<sup>7</sup>

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1. Internet Tax Freedom Act, Pub. L. No. 105-277, Div. C, Title XI, §§ 1100-1104, 112 Stat. 2681, 2681-719 (1998), available at <http://www.house.gov/chriscox/nettax/law.html> (last visited Nov. 5, 2000).

2. More properly called a "compensating use" tax, a "use tax" is designed as a supplement to the sales tax. Such taxes are levied when the buyer purchases a good or service from another state that would have been subject to sales tax if purchased in the buyer's home state. AARON LUKAS, CATO INSTITUTE, TAX BYTES: A PRIMER ON THE TAXATION OF ELECTRONIC COMMERCE 5 (1999). The term "use tax" is used interchangeably with "sales tax" here. If it is not, this will be made clear in context.

3. James John Jurinski, *Federalism and State Taxation of E-Commerce: Is the End in Sight for State Sales Taxes?*, 18 J. ST. TAX'N 30, 37 (1999).

4. See Charles E. McLure, Jr., *Taxation of Electronic Commerce: Economic Objectives, Technological Constraints, and Tax Laws*, 52 TAX L. REV. 269, 423 n.17 (1997) (citing Letter from the Nat'l Governors' Ass'n to Sen. John McCain, chairman, Comm. on Commerce, Science and Transportation & Sen. Ernest F. Hollings, ranking member, Comm. on Commerce, Science, and Transportation (Oct. 6, 1997), available at <http://www.nga.org/Releases/Letters/971010letter.htm>).

5. Internet Nondiscrimination Act of 2000, H.R. 3709, 106th Cong. (2000).

6. See Bill Summary & Status for the 106th Congress, S.2255, at <http://thomas.loc.gov/cgi-bin/bdquery/z?d106:SN02255:@@L&summ2=m&> (last visited Nov. 5, 2000).

7. See, e.g., H.R. 4460, 106th Cong. (2000); S. 2775, 106th Cong. (2000); H.R. 4462, 106th Cong. (2000); H.R. 4267, 106th Cong. (2000).

Along with the extension, some of these bills invited the states to enter into a compact that would simplify individual states' taxation systems.<sup>8</sup> Only upon agreeing to the compact would the states have been allowed to levy sales and use taxes on e-commerce transactions.<sup>9</sup> The tax system embodied by them would substantially change the way that the federal structure of our government operates and could undermine state sovereignty. To avoid this, it may be necessary to retool the current judicial standard for assessing tax liability, the "physical presence" standard. This standard would need to be redefined as a "significant" physical presence.

## I. BACKGROUND

### A. Taxing Jurisdictions in the United States

The ITFA alleviates some problems facing e-commerce vendors prior to its passage, such as taxation of the same transaction by multiple jurisdictions.<sup>10</sup> The federal nature of the U.S. government allows the states and their various localities to control taxation within their jurisdictions.<sup>11</sup> While usually not problematic, this system creates difficulties when the levying jurisdiction tries to tax a sales transaction in a jurisdiction where the buyer resides but the seller does not.<sup>12</sup> Due to the lack of interstate cooperation and uniform standards that dictate which jurisdiction may tax a certain transaction, it was possible that multiple jurisdictions could tax the same transaction.<sup>13</sup>

Compounding the problem of multiple taxation is that over 7,500 jurisdictions in the United States currently impose some form of sales or use tax.<sup>14</sup> These jurisdictions apply many different tax rates and define a tax-

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8. See H.R. 4460, 106th Cong. § 2(b)(2) (2000); S. 2775, 106th Cong. § 5 (2000); H.R. 4462, 106th Cong. § 5 (2000).

9. See H.R. 4460, 106th Cong. § 2(b)(2) (2000); S. 2775 106th Cong. § 7 (2000); H.R. 4462 106th Cong. § 7 (2000).

10. Internet Tax Freedom Act, Pub. L. No. 105-277, Div. C, Title XI, § 1104(6)(a), 112 Stat. 2681, 2681-719 (1998), available at <http://www.house.gov/chriscox/nettax/law.html> (last visited Nov. 5, 2000).

11. Jurinski, *supra* note 3, at 33.

12. Note that in the e-commerce context (as with sales taxes in general) the buyer actually pays the tax, rather than the seller. See MERRILL MATTHEWS JR., SHOULD WE TAX THE INTERNET? 5 (Institute for Policy Innovation, Policy Report No. 152, 2000). Since buyers will not ordinarily volunteer to pay such a tax and since it is not feasible to collect directly from the buyer, the issue is when the state has the power to impose a duty on the seller to collect the tax.

13. See generally KARL FRIEDEN, CYBERTAXATION: THE TAXATION OF E-COMMERCE 151-155 (2000).

14. *Id.* at 184.

able good or transaction in many different ways.<sup>15</sup> The multitude of jurisdictions, rates, and rules makes it difficult for any remote vendor to comply with all of them.<sup>16</sup> This is especially true of e-commerce vendors, who are accessible nationwide wherever an Internet connection is available. This morass of regulations may create an incentive for remote vendors to avoid tax liability.

## B. The Current Standard for Taxation of Remote Sales: The Physical Presence Standard

### 1. Supreme Court Precedent

In 1967, the Supreme Court laid down the current standard for the taxability of remote vendors in *National Bellas Hess, Inc. v. Department of Revenue of Illinois*.<sup>17</sup> In *Bellas Hess*, the State of Illinois sued a mail-order house to recover unpaid use taxes.<sup>18</sup> The defendant corporation was incorporated in Delaware and had its principal place of business in Missouri.<sup>19</sup> It communicated with customers in Illinois only by mail or common carrier.<sup>20</sup> The Court ruled that requiring the mail-order house to pay the use tax violated the Due Process and Commerce Clauses of the Constitution, in part because the tax placed an undue burden on interstate commerce.<sup>21</sup> The holding required that the remote seller have "retail outlets, solicitors, or property within a State" in order to be taxable there.<sup>22</sup> In other words, *Bellas Hess* created a physical presence requirement.

In 1992, the Court revisited that requirement in *Quill Corp. v. North Dakota*.<sup>23</sup> In reaffirming the *Bellas Hess* standard,<sup>24</sup> the Court stated that "*Bellas Hess* . . . stands for the proposition that a vendor whose only contacts with the taxing State are by mail or common carrier lacks the 'substantial nexus' required by the Commerce Clause."<sup>25</sup> Justice White's vig-

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15. See *id.* at 85, 116.

16. A vendor is responsible for collecting of taxes which it owes under the law of the applicable jurisdiction. Often, vendors avoid collection even when liability is clear. See *id.* at 355.

17. 386 U.S. 753 (1967).

18. *Id.*

19. *Id.* at 754.

20. *Id.*

21. *Id.* at 758-60.

22. *Id.* at 758.

23. 504 U.S. 298 (1992).

24. While the Court reaffirmed the standard with respect to tax liability, it did distinguish between the standards used to determine liability for taxation under the Due Process and Commerce Clauses. See *id.* at 305.

25. *Id.* at 311.

orous dissent questioned the logic of this "substantial nexus," or "physical presence" standard, arguing that the standard did not provide the bright-line rule that the majority claimed.<sup>26</sup>

## 2. *Congressional Moratorium on E-Commerce Taxation*

Both state and federal courts have interpreted the "physical presence" standard in various ways,<sup>27</sup> creating confusion as to when remote vendors will be liable for sales taxes. In response to this threat to the burgeoning area of electronic commerce, Congress passed the ITFA in October 1998.<sup>28</sup> The bill placed a moratorium on all taxes on the Internet, and on Internet transactions that were not already "generally imposed and actually enforced."<sup>29</sup> The moratorium will expire in October 2001.<sup>30</sup>

To find a more permanent solution to the problem of Internet taxation, the ITFA also created the Advisory Commission on Electronic Commerce to study the problem and report to Congress in 2000.<sup>31</sup> Although it released its report in April 2000, the Commission failed to offer any official findings or recommendations addressing the problem of sales and use taxation of e-commerce.<sup>32</sup> Partly as a result of this lack of findings, several bills were introduced in the 106th Congress that would have extended the moratorium for another several years.<sup>33</sup>

## II. **BILLS INTRODUCED IN THE 106TH CONGRESS**

Though none of the bills that were pending in the 106th Congress were enacted, they are important in understanding the situation surrounding e-commerce, and it is possible that similar legislation will be introduced in the 107th Congress. House Bill 3709 passed the House of Representatives on May 10, 2000.<sup>34</sup> The bill called for a five-year extension of the original

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26. *Id.* at 321-33 (White, J., dissenting).

27. *See, e.g.*, *Tyler Pipe Indus., Inc. v. Wash. State Dep't of Revenue*, 483 U.S. 232 (1987); *Standard Pressed Steel Co. v. Dep't of Revenue of Ill.*, 419 U.S. 560 (1975); *Scholastic Book Clubs, Inc., v. State Bd. of Equalization*, 207 Cal. App. 3d 734 (1989).

28. *Internet Tax Freedom Act*, Pub. L. 105-277, Div. C, Title XI, §§ 1100 to 1104, 112 Stat. 2681, 2681-719 (1998).

29. *Id.* § 1101(a)(1).

30. *Id.* § 1101(a).

31. *Id.* § 1102.

32. The Commission's proposal on sales and use taxes passed by only a majority, and was therefore considered neither an official finding or recommendation. ADVISORY COMMISSION ON ELECTRONIC COMMERCE, REPORT TO CONGRESS 20 (2000).

33. *See* H.R. 3709, 106th Cong. (2000); S. 2255, 106th Cong. (2000); H.R. 4460, 106th Cong. (2000); S. 2775, 106th Cong. (2000).

34. *Internet Nondiscrimination Act of 2000*, H.R. 3709, 106th Cong. (2000).

ITFA moratorium.<sup>35</sup> It also included a "Sense of the Congress" section that delineated what the states should include in any tax "relating to electronic commerce."<sup>36</sup> These factors included uniform definitions for goods or services, uniform tax returns, and other features that "the member States deem warranted to remote [sic] simplicity, uniformity, neutrality, efficiency and fairness."<sup>37</sup>

The Senate version of the House Bill, Senate Bill 2255, called for a five-year extension of the current moratorium but did not include any section corresponding to the Sense of the Congress section of House Bill 3709.<sup>38</sup> Related bills included House Bill 4460, House Bill 4462 and Senate Bill 2775, which also sought to extend the current moratorium.<sup>39</sup> Although they also included provisions paralleling the Sense of the Congress section of House Bill 3709, these bills also called for the creation of an interstate compact that would uphold the values of simplicity, uniformity, neutrality, efficiency and fairness in e-commerce taxation as promoted in House Bill 3709. Resembling House Bill 3709's Sense of Congress, the compact would allow only those states agreeing to its terms<sup>40</sup> to levy sales and use taxes on electronic commerce.<sup>41</sup> The most sweeping provisions in these bills required uniformity in the definitions of taxable services and goods, and mandated a single statewide sales and use tax rate.<sup>42</sup>

### III. DISCUSSION

The taxation of e-commerce presents three interrelated problems. First, the standard for such taxation is not clear. Second, even if the standard were clear, there is little agreement on whether taxing e-commerce would be beneficial as a policy matter. Third, federal control of e-commerce taxation would infringe state sovereignty and local control.

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35. Though the bill in its final form called for a five-year extension, the original version of the bill called for a permanent exemption for the taxation of e-commerce. H.R. 3709 § 2, version 1, available at [http://thomas.loc.gov/cgi-bin/query/D?c106:\]/temp/~c106CP8;TM::](http://thomas.loc.gov/cgi-bin/query/D?c106:]/temp/~c106CP8;TM::) (last visited Nov. 5, 2000). Perhaps this attests to the somewhat political nature of the legislation.

36. H.R. 3709, § 4.

37. *Id.*

38. See S. 2255.

39. H.R. 4460, 106th Cong. § 2(a) (2000); S. 2775, 106th Cong. § 3 (2000); H.R. 4462, 106th Cong. § 3 (2000).

40. H.R. 4460 § 2(b)(2); S. 2775 § 5(a); H.R. 4462 § 5(a).

41. H.R. 4460 § 2(b)(2); S. 2775 § 7(a); H.R. 4462 § 7(a).

42. H.R. 4460 § 2(b)(2); S. 2775 § 4(a); H.R. 4462 § 4(a).

## A. The Physical Presence Rule Is Unworkable

The physical presence standard is unworkable in the e-commerce context because it was crafted for a world based on mail-order commerce. Although similar in many areas, electronic and mail-order commerce differ significantly enough to render the physical presence standard inapplicable to e-commerce taxation. Additionally, the vague formulation of the standard compounds this difficulty.

### 1. Differences between Mail-Order and Electronic Commerce

Though the above bills would treat e-commerce differently from mail-order commerce, vendors in either type of commerce are currently subject to taxation according to the same physical presence standard. On its face, this rule makes sense; after all, both types of sales occur across jurisdictional (usually state) boundaries. However, electronic and mail-order commerce differ in several respects, making a physical presence requirement designed for mail-order commerce difficult to apply to electronic commerce.

First, the medium that facilitates the sale is different. Mail-order sales depend on the mail or a common carrier for the delivery of catalogs or promotional materials. On the other hand, delivery of the informational material for electronic sales happens across some sort of cable, usually telephone lines, with modems facilitating the process. Obviously, these two methods are similar in their delivery of information across jurisdictional lines. The difference between them, however, may be important given the Supreme Court's emphasis on mail or a common carrier when it originally articulated the physical presence standard in *Bellas Hess*. There, the Court found that a mail-order seller whose only contact with the buyer's state was through the mail or a common carrier did not meet the threshold for taxation.<sup>43</sup> Arguably, if the delivery of information over telephone lines and in-state modems constitutes more of a physical presence than delivery through the mail, the vendor would then become subject to taxation. This is conceptually plausible because the Court in *Bellas Hess* specifically mentioned its concern with those situations in which "the out-of-state seller was plainly accorded the protection and services of the taxing State."<sup>44</sup> Although the use of telephone lines and modems is not much of a physical presence, the equipment is more permanent and more likely to be maintained by the state than the facilities used by a transitory common carrier to deliver catalogs and mailings. Using telephone lines and

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43. Nat'l Bellas Hess, Inc. v. Dep't of Revenue of Ill., 386 U.S. 753 (1967).

44. *Id.* at 757.

modems to deliver information could conceivably, but not necessarily, fall under this "protection and services" language.<sup>45</sup>

A second difference between the two types of commerce is the protracted nature of mail-order transactions as compared to electronic transactions. Mail-order transactions occur at the speed of the postal service. The buyer must fill out her form and return it to the vendor through the mail. This transaction may require several days and span several states. In contrast, e-commerce transactions take place much faster, usually within seconds. Though an e-commerce vendor will often deliver products using the mail or a common carrier just like a mail-order seller,<sup>46</sup> the e-commerce vendor and its customer seal the agreement to purchase the good or service when the buyer clicks a mouse. The fact that the purchasing agreement takes place wholly within the buyer's state and is nearly instantaneous makes it unclear whether taxing such a transaction creates a burden on interstate commerce of the magnitude that the physical presence standard aims to prevent.<sup>47</sup>

A third important difference relates to the general nature of the Internet. Whereas mail-order sellers must direct their sales materials to a given state or jurisdiction, the average e-commerce vendor can reach anyone with Internet access simply by putting up a website. On an intuitive level, a mail-order seller should be amenable to taxation by a particular jurisdiction, because it reaches into and intends to transact business within that jurisdiction. This is not necessarily the case with e-commerce vendors, who may not intend to sell within any specific jurisdiction. Arguably, putting up a website renders a vendor liable to be taxed in every jurisdiction where the site is viewed or in which a buyer purchases from it. However, to hold the vendor liable for taxation within every jurisdiction would be procedurally ineffective and unwieldy, as well as unfair. So, though electronic and mail-order commerce are broadly similar, the differences be-

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45. It has been suggested that a web page may be viewed as software, at least if it is an interactive page. FRIEDEN, *supra* note 13, at 117. If categorized as such, the site would probably fall into the exception for software the Court seems to have created in *Quill* with its refusal to allow a few diskettes to count as physical presence. *Id.* at 288. That would require a more substantial showing of nexus. For example, Connecticut takes the position that America Online has nexus within the state because of the modems it owns therein. *Id.* at 287.

46. Though the product may be delivered through the mail or by common carrier, certain products, such as software, may be downloaded through the computer itself and eliminate any need for the common carrier. *See id.* at 106. Examples include the online software vendor Beyond.com.

47. *See Bellas Hess*, 386 U.S. at 753.

tween them hint that a single standard for the taxation of both types of commerce is at best inefficient and at worst infeasible.

## 2. *The Vagaries of the Physical Presence Rule*

Taxing e-commerce necessarily implicates the Dormant Commerce Clause of the Constitution. Inferred from the Commerce Clause,<sup>48</sup> the Dormant Commerce Clause stands for the proposition that, since regulation of interstate commerce is a power affirmatively granted to the Federal government, the states have no right to regulate it.<sup>49</sup> *Quill*'s reaffirmation of the physical presence standard represents an effort to uphold this doctrine by placing limits on a state's ability to tax remote sellers. However, the physical presence rule is difficult to apply to new technologies and new ways of remote selling because the rule itself is fundamentally vague.

Not only is it difficult to apply to electronic commerce, it is not the bright-line standard that it appears to be. Justice White clearly noted this point in his dissent in *Quill*.<sup>50</sup> He stated that, in his view, "the question of *Quill*'s actual physical presence is sufficiently close to cast doubt on the majority's confidence that it is propounding a truly 'bright-line' rule . . . it is a sure bet that the vagaries of 'physical presence' will be tested to their fullest in our courts."<sup>51</sup> He was correct. Even before *Quill*, the physical presence standard was difficult to apply, with courts reaching dissimilar results through the application of this supposed bright-line standard.<sup>52</sup> *Quill* only exacerbated the difficulty.

### a) The Standard Was Uncertain Before *Quill*

The difficulty began before the *Quill* decision. In *Bellas Hess*, the Court ruled that a seller must have "retail outlets, solicitors or property within a State" in order for it to be taxed by that state.<sup>53</sup> After *Bellas Hess*, the Court gradually moved away from the physical presence standard<sup>54</sup> and this complicated what had been an already difficult standard. As a re-

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48. U.S. CONST. art. I, § 8, cl. 3.

49. See *Gibbons v. Ogden*, 22 U.S. 1, 15-16 (1824).

50. *Quill Corp. v. North Dakota*, 504 U.S. 298, 330 (White, J., dissenting).

51. *Id.* at 330-31 (White, J., dissenting).

52. See, e.g., *Tyler Pipe Indus., Inc. v. Wash. State Dep't of Revenue*, 483 U.S. 232 (1987); *Standard Pressed Steel Co. v. Dep't of Revenue of Wash.*, 419 U.S. 560 (1975); *Scholastic Book Clubs, Inc. v. State Bd. of Equalization*, 207 Cal. App. 3d 734 (1989).

53. *Nat'l Bellas Hess, Inc. v. Dep't of Revenue of Ill.*, 386 U.S. 753, 758 (1967).

54. See *Tyler Pipe*, 483 U.S. at 232; *Standard Pressed Steel*, 419 U.S. at 560.

sult, different courts applied the idea of physical presence in diverging ways and with different reasoning.<sup>55</sup>

The Supreme Court itself applied different rationales for the imposition of a tax under the physical presence standard at times. For instance, in *Standard Pressed Steel Co. v. Department of Revenue of Washington*,<sup>56</sup> the Court stated that the presence of an employee of a corporation within a state in which the corporation owned no property<sup>57</sup> “made possible the realization and continuance of valuable contractual relations” within the state.<sup>58</sup> While it is easy to see how an employee representing a company could constitute a physical presence for the company, since that person physically resides within the state, the rationale that the Court stated is overbroad. Both mail-order catalogs and interactive websites that allow purchasing facilitate “contractual relations”<sup>59</sup> in the same manner as the employee liaison in *Standard Pressed Steel*. Yet, catalogs are not sufficient to confer liability according to *Bellas Hess*.<sup>60</sup>

The Court further muddied the standard in *Tyler Pipe Industries, Inc. v. Washington State Department of Revenue*.<sup>61</sup> There, the Court found that a nexus existed where the out-of-state seller used independent contractors to solicit sales.<sup>62</sup> The company neither owned property in the state nor employed residents of Washington.<sup>63</sup> The Court cited with approval the lower court’s determination that “the crucial factor governing nexus is whether the activities performed in th[e] state on behalf of the taxpayer are significantly associated with the taxpayer’s ability to establish and maintain a market in th[e] state.”<sup>64</sup> Again, a website or a catalog could be “significantly associated with the taxpayer’s ability to establish and maintain a market,” leading to further confusion in applying that rationale.

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55. See, e.g., *Tyler Pipe*, 483 U.S. at 232; *Standard Pressed Steel*, 419 U.S. at 560; *Scholastic*, 207 Cal. App. 3d at 734.

56. 419 U.S. 560 (1975).

57. The employee in question worked out of his home and therefore the employer did not own any office space to house him. *Id.* at 561.

58. *Id.* at 562.

59. *Id.*

60. See *Nat’l Bellas Hess, Inc. v. Dep’t of Revenue of Ill.*, 386 U.S. 753 (1967).

61. 483 U.S. 232 (1987). In *Tyler Pipe*, the Court vacated and remanded two cases where claimants asserted the invalidity of a tax exemption regarding a remote seller that sold into Washington state. However, the Court did affirm that an out-of-state manufacturer had sufficient nexus to be amenable to taxation where sales representatives performed certain activities related to the manufacturer’s business. See *id.* at 250-251.

62. *Id.* at 249.

63. *Id.*

64. *Id.* at 250 (citing *Tyler Pipe Indus., Inc. v. Wash. State Dep’t of Revenue*, 105 Wash. 2d 318, 323 (1986)).

State courts have made similar determinations to facilitate taxation. In *Scholastic Book Clubs, Inc. v. State Board of Equalization*,<sup>65</sup> Scholastic appealed a grant of summary judgment denying its claim for a refund of use taxes.<sup>66</sup> Scholastic used teachers as its liaisons with California students who purchased books from the company.<sup>67</sup> The court reasoned that the teachers were agents of the seller because they obtained "sales within California from local customers for a foreign corporation."<sup>68</sup> The California court further stated that, as agents, they created the necessary nexus and therefore tax liability for Scholastic. Yet again, websites can be thought of as "obtaining sales," making the court's reasoning confusing in an e-commerce setting. These decisions considerably confused the physical presence standard which originally created a tax exemption only for those remote sellers "whose only connection with customers in the State is by common carrier or the United States mail."<sup>69</sup>

b) *Quill* Did Little to Clarify the Physical Presence Standard

Enter *Quill*. The *Quill* Court reaffirmed the bright-line, physical presence rule it first propounded in *Bellas Hess*. However, when applying the standard, the Court did not seem to be applying a bright-line test of any sort. Though the remote seller did not have any store or salesperson within the taxing state, it did own some software that it licensed to its in-state clients.<sup>70</sup> The Court, in a footnote, dismissed the idea that this software showed a substantial nexus.<sup>71</sup> This rejection of a small amount of property as sufficient nexus introduces confusion into the supposed bright-line standard.<sup>72</sup> The issue became not whether the remote vendor owned "property within a State,"<sup>73</sup> but rather whether the property owned exceeded some minimal, undefined amount (here, a few diskettes did not suffice).<sup>74</sup>

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65. 207 Cal. App. 3d 734 (1989).

66. *Id.* *Scholastic* involved the issue of whether an out-of-state book seller was amenable to taxation when it used teachers to facilitate book sales. The company had neither a physical facility nor a regular employee in the state. *Id.* at 736.

67. *Id.*

68. *Id.* at 740.

69. *Nat'l Bellas Hess, Inc. v. Dep't of Revenue of Ill.*, 386 U.S. 753, 758 (1967).

70. *Quill Corp. v. North Dakota*, 504 U.S. 298, 315 (1992).

71. *Id.* at 315 n.8.

72. Steven J. Forte, *A Cyberspace Perspective: Use Tax Collection on Internet Purchases: Should the Mail Order Industry Serve as a Model?*, 15 J. MARSHALL J. COMPUTER & INFO. L. 203, 222 (1997).

73. *Bellas Hess*, 386 U.S. at 758.

74. *Quill*, 504 U.S. at 315.

So, while the Supreme Court purported to adhere to a bright-line rule in determining the taxability of a remote vendor, its latest word on the subject demonstrated otherwise. The *Quill* test fails to accurately predict tax liability because the rationales underlying the test do not give accurate guidance as to when such liability attaches. As mentioned above, several of the reasons given seem applicable to things that arguably have no physical root in the state, like websites. Despite these possibilities, commentators have argued that merely maintaining a website will not subject a company to tax liability.<sup>75</sup>

A further example of the uncertainty of applying the physical presence standard is the problem of servers. A server houses and routes information from place to place and contains information therein for a period of time.<sup>76</sup> It is possible that a server owned by a particular company constitutes a physical presence under the *Quill* standard.<sup>77</sup>

States have addressed this issue in varying ways. Both New Jersey and Texas treat servers as a substantial nexus for taxation.<sup>78</sup> California, on the other hand, in an effort to create a friendly climate for e-commerce, enacted a specific provision in its legal code that forbids using a server as the basis for taxation.<sup>79</sup> The Supreme Court has yet to address this issue. That there can be a difference between states on this issue points to the inadequacy and indeterminate nature of deciding tax liability for e-commerce vendors under the physical presence standard.

#### **B. Whether to Tax E-Commerce: The Case for and against Taxation**

Even if there were a judicially manageable standard for the taxation of remote commerce, there is no clear consensus as to whether, as a matter of public policy, government should tax such commerce. With the ITFA-mandated moratorium set to expire in October 2001,<sup>80</sup> several factions are

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75. Brian G. Ritz, Comment, *Nexus on the Net: A Taxing Question*, 36 DUQ. L. REV. 921, 946 (1998) (citing Gregory A. Ichel, *Internet Sounds Death Knell for Use Taxes: States Continue to Scream Over Lost Revenues*, 27 SETON HALL L. REV. 643, 655 (1997)).

76. See, e.g., FRIEDEN, *supra* note 13, at 162.

77. See *id.* at 154, 178.

78. *Id.* at 154; Hollis L. Hyans & Amy F. Nogid, *Oh Those Internet Sales; Dispute Over Whether to Tax Rages On*, N.Y. L.J., Mar. 6, 2000, at 7.

79. CAL CODE REGS. tit. 18, § 1684 (2001); see RICH PREM ET AL., ESTABLISHING A FRAMEWORK TO EVALUATE E-COMMERCE TAX POLICY OPTIONS 8 (2000).

80. Internet Tax Freedom Act, Pub. L. 105-277, Div. C, Title XI, § 1101, 112 Stat. 2681, 2681-719 (1998).

trying to advance their tax policy positions. The two basic positions are explained below.

### 1. *Pro-Taxation Arguments*

Proponents of taxation often note the amount of lost revenue attributable to the failure to tax Internet sales. Though states lose revenue, the exact amount remains in doubt.<sup>81</sup> Also, it is unclear whether the amount collected under a sales tax would be worth the probable discouragement of using the Internet as a shopping medium and the corresponding depressant effect on the U.S. economy.<sup>82</sup>

The U.S. General Accounting Office ("GAO") reported in March 2000 that estimated tax revenue losses for Internet sales ranged from \$300 million to \$3.8 billion in 2000.<sup>83</sup> The report noted, however, that "[l]ittle empirical data exist on the key factors needed to calculate the amount of sales and use tax revenues that state and local governments lose on Internet . . . sales."<sup>84</sup> This partly explains the wide variation in the estimates, but it also points to the fact that, in shaping Internet taxation policy, there are few, if any, absolute figures upon which to rely.

Moratorium critics and taxation proponents point to figures like those from the GAO to support their call for an Internet sales tax. Often, these proponents come from small states that perceive uncollected sales tax to be vastly undermining their state's revenue and therefore endangering their essential services due to a lack of funding.<sup>85</sup> It seems clear, however, that uncollected Internet sales taxes do not yet significantly affect state economies. Though there is a definite revenue loss, the amounts lost may be quite insubstantial compared to the states' revenue as a whole.<sup>86</sup> There is less agreement, however, on whether or not a permanent moratorium on

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81. U.S. GEN. ACCOUNTING OFFICE, PUB. NO. GAO/GGD/OCE-00-165, SALES TAXES: ELECTRONIC COMMERCE GROWTH PRESENTS CHALLENGES; REVENUE LOSSES ARE UNCERTAIN (2000) [hereinafter GAO REPORT].

82. PREM ET AL., *supra* note 79, at 3.

83. GAO REPORT, *supra* note 81, at 19.

84. *Id.* at 3.

85. See, e.g., *Taxing Internet Sales Levels the Playing Field*, BUS. WEEK, Mar. 27, 2000, at 234 (describing an interview with Kentucky Governor Paul E. Patton).

86. See ROBERT J. CLINE & THOMAS S. NEUBIG, ERNST & YOUNG ECONOMICS CONSULTING AND QUANTITATIVE ANALYSIS, THE SKY IS NOT FALLING: WHY STATE AND LOCAL REVENUES WERE NOT SIGNIFICANTLY IMPACTED BY THE INTERNET IN 1998 11 (1999) (finding that the losses due to uncollected Internet sales tax in 1998 represented less than one-tenth of one percent of state and local sales and use tax revenues); see also PREM ET AL. *supra* note 79, at 20-21 (citing Austan Goolsbee & Jonathan Zittrain, *Evaluating the Costs and Benefits of Taxing Internet Commerce*, NAT'L TAX J. 413-28 (1999)).

the collection of an Internet sales tax would eventually cause critical revenue consequences.<sup>87</sup>

Uncollected sales tax revenue does not, however, uniformly affect each individual state. Along with the lack of uniformity in taxation rules comes a lack of uniformity in reliance on revenue generated by sales taxes.<sup>88</sup> For example, the states of the Southwest—Arizona, New Mexico, Oklahoma and Texas—average a greater reliance on sales tax than do many other states.<sup>89</sup> Thus, it stands to reason that the uncollected sales taxes could have a larger effect on these states than others.

The second major pro-taxation argument is that it is simply an issue of basic fairness to tax Internet sales at the same rate as conventional “brick and mortar” sales. Proponents argue that no reason exists to give a subsidy to this industry, especially one that comes at the expense of conventional retailers.<sup>90</sup> Moratorium critics argue that this type of subsidy “violates traditional notions of tax neutrality, which strive to tax similarly situated taxpayers equally.”<sup>91</sup>

The last major pro-taxation argument is that the digital age requires a simplification of existing tax structures. Currently, more than 7,500 jurisdictions in the United States impose a sales tax.<sup>92</sup> Arguably, federal management of an Internet sales tax could be a viable way to simplify the sales tax structure and avoid the problems that come with remote vendors trying to comply with such a large number of sales tax rates.<sup>93</sup> Software currently available can keep track of the various tax rates of each jurisdiction in which a vendor sells and can assess the tax burden accordingly.<sup>94</sup> However, this software is often very expensive because it necessarily requires updates as a consequence of changing laws in the various taxing jurisdictions, as well as being costly to implement and install.<sup>95</sup> The federal government possibly could subsidize the purchase and dissemination of this

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87. Compare PREM ET AL., *supra* note 79, at 21 with LUKAS, *supra* note 2, at 10. See also ADVISORY COMMISSION ON ELECTRONIC COMMERCE, *supra* note 32, at 14-15.

88. See FRIEDEN, *supra* note 13, at 84.

89. *Id.*

90. See, e.g., *Taxing Internet Sales Levels the Playing Field*, BUS. WEEK, Mar. 27, 2000, at 234.

91. Jurinski, *supra* note 3, at 40-41.

92. FRIEDEN, *supra* note 13, at 184.

93. MATTHEWS, *supra* note 12, at 4 (describing but not endorsing such a policy).

94. PREM ET AL., *supra* note 79, at 3.

95. *Id.* at 3, 11. In addition to the cost issue, the software is not capable of determining tax exempt sellers, products or services. *Id.* at 11.

software.<sup>96</sup> Alternatively, it could exempt vendors who have revenue below a certain predetermined level from having to comply with the tax rates.<sup>97</sup>

## 2. *Anti-Taxation Arguments*

Opponents of e-commerce taxation primarily argue that a ban on such taxation is necessary to encourage dispersal of this beneficial technology.<sup>98</sup> They claim that the Internet is so important a technology that the United States ought not to discourage its growth through taxation.<sup>99</sup> Indeed, one study has suggested that enforcing currently existing sales taxes on Internet sales could reduce the number of online purchasers by twenty-four percent.<sup>100</sup> Since e-commerce may spur economic growth as a whole, not just the growth of online sales, discouraging Internet commerce through taxation could have a deleterious effect on the entire economy.<sup>101</sup>

Taxation opponents also argue that nontaxation of Internet commerce does not significantly diminish state and local revenues. A 1999 study found that the estimated revenue loss in 1998 due to uncollected e-commerce transactions was only approximately one-tenth of one percent of total sales and use tax collections.<sup>102</sup> If so, the potential revenue gained from placing a sales tax on e-commerce transactions may not counterbalance the negative effects such a tax would have on the economy through a decrease in the number of e-commerce transactions.<sup>103</sup>

An extension of this argument is that before taxing e-commerce transactions, it would be much more beneficial to place a tax on non-Internet remote transactions like mail-order sales. The amount of revenue lost due to these types of remote sales is currently much greater than that lost through Internet transactions.<sup>104</sup> Such taxation would create a large source of revenue for the states and at the same time, leave the Internet tax-free and encourage its growth.

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96. *See, e.g., id.* at 33 (summarizing David Polatseck's Sales Tax Simplification Proposal).

97. *See id.* at 17; H.R. 4462, 106th Cong. § 4(a)(12) (2000).

98. PREM ET AL., *supra* note 79, at 16.

99. *See id.*; *Taxing Internet Sales Hurts Consumers*, BUS. WEEK, Mar. 27, 2000, at 236 (interview with Massachusetts Governor Paul Cellucci).

100. MATTHEWS, *supra* note 12, at 15 (citing AUSTAN GOOLSBEE, *IN A WORLD WITHOUT BORDERS: THE IMPACT OF TAXES ON INTERNET COMMERCE* (1999)).

101. *See id.* at 11-13.

102. *See* CLINE & NEUBIG, *supra* note 86, at 9.

103. *See*, PREM ET AL., *supra* note 79, at 3.

104. GAO REPORT, *supra* note 81, at 19 (reporting non-Internet remote sales revenue loss of \$1.3 billion to \$5.3 billion).

Finally, opponents of taxation often argue that the existence of more than 7,500 sales tax imposing jurisdictions in the country<sup>105</sup> makes it difficult if not impossible to comply with all applicable taxes to which a company will be subject in the course of doing business. Use of the software described above is one way to deal with this problem.<sup>106</sup> However, such software places an expensive burden on Internet business. Due to the more burdensome cost structures of a small business,<sup>107</sup> not only would requiring such software place smaller vendors at a competitive disadvantage, but it also may discourage entry into the market because of the high cost of purchasing and updating the software.

### 3. *The Perils of Too Extreme a Position on Either Side*

The basic policy positions explained above create very different ramifications. It is indisputable that the pro-tax position certainly would allow states to earn more revenue. What is disputable is how much they would gain<sup>108</sup> and whether that amount would significantly aid state economies. Since e-commerce will likely become a much larger part of the national economy,<sup>109</sup> it is probable that the amount of money lost through untaxed e-commerce will greatly increase in the future. At the present time, however, the amount of money lost is probably not significant.

If taxation causes a decline in the number of people who buy over the Internet, this may affect growth in the e-commerce sector,<sup>110</sup> but it is unclear whether taxation will have any effect on this growth over the long term. As a public policy matter, then, the issue becomes how the United States as a society wants to balance the twin goals of keeping states' revenues at acceptable levels and encouraging the growth of a perceived beneficial industry. Commentators have argued that too extreme a position will have deleterious effects.<sup>111</sup>

## C. **Federal Control Would Infringe State Sovereignty and Local Control**

As illustrated above, many have commented on the wisdom of taxing or not taxing e-commerce. Despite the amount written, few have touched

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105. FRIEDEN, *supra* note 13, at 184.

106. *See supra* notes 92-97 and accompanying text.

107. *See* PREM ET AL., *supra* note 79, at 11, 17.

108. *See* GAO REPORT, *supra* note 81, at 19, 59-61.

109. *See* PREM ET AL., *supra* note 79, at 20-21.

110. *See* MATTHEWS, *supra* note 12, at 15 (citing AUSTAN GOOLSBEE, IN A WORLD WITHOUT BORDERS: THE IMPACT OF TAXES ON INTERNET COMMERCE (1999)).

111. *See, e.g.,* PREM ET AL., *supra* note 79, at 3, 21.

upon the effects that such policies would have on our federal system of government.

While there has been a recent spate of Supreme Court cases that reassert the sovereignty of the states,<sup>112</sup> it is indisputable that Congress has the power to control interstate taxation through the Commerce Clause.<sup>113</sup> It is another issue, however, whether the exercise of that power is a wise choice as a matter of public policy.

State and local control of taxation is a significant component of federalism.<sup>114</sup> Sales tax revenues often fund areas traditionally within state control, such as education.<sup>115</sup> The federal government, in turn, has traditionally respected the taxation of in-state commerce as a function of the states.<sup>116</sup> This is good policy, not only as a matter of tradition, but because states and their localities are better able to foresee their financial needs and deal with them in an effective manner. This is partly why a multitude of sales tax regimes exists in the United States,<sup>117</sup> and why there is no federally mandated general sales tax comparable to those in place in other nations, such as the European value-added-tax.<sup>118</sup> In fact, several governors charged that the suppression of the states' ability to tax through the ITFA was "the greatest affront to state sovereignty in ten years."<sup>119</sup>

If the federal government is to respect the ability of the states to levy sales and use taxes as they see fit, then one of the best ways to do this and simultaneously provide a feasible framework for taxation appears to be the use of the software described above.<sup>120</sup> However, this "software solution" also infringes on the rights of the states. As commonly envisioned, the use-tax-tracking software involves a third party, such as a federal adminis-

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112. See, e.g., *United States v. Morrison*, 529 U.S. 598 (2000) (striking down a provision of the Violence Against Women Act as outside of Congress's commerce power); *United States v. Lopez*, 514 U.S. 549 (1995) (striking down a law prohibiting gun possession near schools as outside of Congress's commerce power).

113. U.S. CONST. art. I, § 8, cl. 3 ("The Congress shall have Power To . . . regulate Commerce . . . among the several States.").

114. See Jurinski, *supra* note 3, at 33.

115. See *Taxing Internet Sales Levels the Playing Field*, BUS. WEEK, Mar. 27, 2000, at 234; see also LUKAS, *supra* note 2, at 13-14 (arguing that remote e-commerce firms shouldn't have to help cover the costs of local services).

116. FRIEDEN, *supra* note 13, at 83.

117. See *id.* at 184.

118. See *id.* at 81-82.

119. McLure, *supra* note 4, at 423 (citing Letter from the Nat'l Governors' Ass'n to Sen. John McCain, chairman, Comm. on Commerce, Science and Transportation & Sen. Ernest F. Hollings, ranking member, Comm. on Commerce, Science, and Transportation (Oct. 6, 1997)), available at <http://www.nga.org/Releases/Letters/971010letter.htm>.

120. See *supra* notes 92-97 and accompanying text.

trator, to mediate and validate the results from the use of the software. It is not clear that states would want to assign such a valuable and important function to a third party, federal or otherwise.<sup>121</sup> Relinquishing this sort of important state function to another entity is perhaps as great a relinquishment of sovereignty as federal preemption of taxation.

Another option for allowing states to collect revenue while preserving their sovereignty is an interstate compact, as proposed in the 106th Congress.<sup>122</sup> The provisions which sought to extend the moratorium posed an obvious challenge to state sovereignty by preventing states from collecting new revenue from e-commerce.<sup>123</sup> The proposals to create an interstate compact to simplify the tax system and allow only states that participate to collect sales taxes on e-commerce, while less intrusive, still infringe on state sovereignty.<sup>124</sup>

This point was not obvious from the face of the bills. Senate Bill 2775 provided for "State administration of all State and local sales and use taxes."<sup>125</sup> This language masked the fact that the federal government would still impede the states' ability to collect revenue by putting conditions on such collection. Additionally, other provisions impeded the states' capability to react to their own needs and change their tax policies. For instance, the bills provided for uniform definitions of goods and services that may be taxed.<sup>126</sup> Localities, however, may have valid reasons for exempting certain goods or services from taxation, such as giving certain industries an incentive to settle in or do business within the jurisdiction. If the actual terms of the compact deny these exemptions, certain localities would become disadvantaged. Thus, the compact would rob the state of a valuable tool—local administration and leadership of economic development—that is necessary for building its economy.

Furthermore, the bills may have eliminated the incentive for a company to relocate to a state with no sales tax. The bills may have removed this incentive to relocate because, if the compact provided for the taxation

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121. See MATTHEWS, *supra* note 12, at 4-5.

122. H.R. 3709, 106th Cong. (2000); S. 2255, 106th Cong. (2000); H.R. 4460, 106th Cong. (2000); S. 2775, 106th Cong. (2000). Though these bills died in the 106th Congress, they may be introduced in the 107th Congress.

123. H.R. 4460 § 2(a); S. 2775 § 3; H.R. 4462, 106th Cong. § 3 (2000).

124. H.R. 4460, § 2(b)(2); S. 2775 § 5(a); H.R. 4462 § 5(a).

125. S. 2775 § 4(a)(9). H.R. 4460 provides for substantially the same thing in § 2(b)(2).

126. H.R. 4460 § 2(a)(2); H.R. 4462 §§ 2(3), 4(a)(2); S. 2775 §§ 4(a)(2), 4(a)(4).

of the transaction in the state of purchase,<sup>127</sup> then the vendor would lose that tax advantage whenever it would sell out of state. If it anticipated that it would do most or all of its business outside of a state with no sales tax,<sup>128</sup> the vendor would have no incentive to locate there. This would rob the state of a valuable bargaining chip in its competition to attract businesses to the state.

Another problem was that the bills also mandated that the states should choose a uniform statewide sales tax rate for remote sales.<sup>129</sup> Though this could be a "blended" rate that reflected the average of the sales tax rate within a state,<sup>130</sup> this uniform rate would still inhibit the states' and localities' ability to adapt to their own particular circumstances. The federal government would effectively forbid the states from letting their localities determine their own needs and tax rates.

However, the compact would at least have allowed the states to collect revenue from e-commerce and would have defined the *Quill* standard for e-commerce. The compact would have prevented excessive burdens on interstate commerce. It would also have addressed the problem of the exemption from taxation for remote commerce.<sup>131</sup> As a matter of public policy, we should ask whether the resulting infringement on state sovereignty and local control is worth the additional revenue gain.

From the point of view of states' rights, the optimal solution to this dilemma would be to lift the ITFA and prohibit federal control over e-commerce taxation. The obvious problems with this suggestion lie in the tremendous administrative problems and the lack of fairness. It is easy to imagine a remote seller being taxed by several jurisdictions for the same transaction. If a buyer purchased in one state from a vendor located in a second state, and the order traveled through a server in a third state, then the seller could conceivably be liable for three separate taxes on that individual sale.

To combat this problem, the physical presence standard should be strengthened, perhaps through a federal statute, to allow only taxation of companies or sales with a "significant" physical presence. Perhaps servers

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127. The authorization to enter into a compact did not provide for the exact terms of such a compact, so it is possible that the transactions would not have been taxed at the point of purchase.

128. Indeed, the states that currently do not have sales taxes are among the less populous in the Union. See FRIEDEN, *supra* note 13, at 82. This leads to the conclusion that there would be less reason to locate in these states as they offer fewer customers.

129. H.R. 4460 § (2)(b)(2); S. 2775 § 6(a); H.R. 4462 § 6.

130. H.R. 4460 § (2)(b)(2); S. 2775 § 6(a); H.R. 4462 § 6.

131. *Quill Corp. v. North Dakota*, 504 U.S. 298, 318 (1992).

and buyers would not trigger such a requirement, and sales could be taxed at the point of origin. This more territorial approach to the problem could help eliminate severe administrative problems and still preserve the sovereignty of the states while maintaining local governmental control.<sup>132</sup>

#### IV. CONCLUSION

The lack of a manageable judicial standard for determining remote sellers' tax liability led to Congressional legislation on the issue. The Internet Tax Freedom Act currently prohibits the imposition of any new taxes on the Internet or e-commerce, but it is set to expire in late 2001. Many bills were introduced in the 106th Congress that would have extended this tax moratorium for several more years while creating an interstate compact to harmonize Internet taxation.<sup>133</sup> This compact would have streamlined the complicated tax system currently in place. However, these bills would have infringed upon traditional considerations of federalism and state sovereignty. In addition, from the standpoint of public policy, it is unclear whether taxing e-commerce would be beneficial. We must balance considerations of lost revenue and encouragement of a beneficial technology in order to determine a workable solution. A strong possibility for such a solution is for the federal government to take a "hands-off" approach to e-commerce taxation, coupled with the strengthening of the existing physical presence standard for determining amenability to such taxation.

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132. Note that because the tax on e-commerce sales is actually a tax on the buyer, questions could arise as to the state's jurisdiction to impose a tax on a person outside its borders.

133. Though the bills all died in the 106th Congress, they set forth the context regarding the debate around taxing e-commerce, and they may be reintroduced in the current congressional session.



## STATE REGULATION OF UNSOLICITED COMMERCIAL E-MAIL

*By Sabra-Anne Kelin*

A disgruntled employee (E) of a major corporation (C) wants to discuss with other employees the employment practices of C. Since C has many employees, E decides that the best way to contact all of them is via e-mail. E sends an e-mail message to all of C's employees at their business e-mail addresses. The e-mail presents some of C's employment practices and asks the employees to share their experiences. C sues E for sending unsolicited e-mail to its employees. The cause of action is for trespass to chattels, the chattels being C's network of e-mail servers.

The preceding situation is not a law school hypothetical—it actually happened.<sup>1</sup> The employee was Kourosh Hamidi, and the corporation was Intel.<sup>2</sup> On June 16, 1999, a state court permanently enjoined Hamidi and his nonprofit organization Former And Current Employees of Intel (“FACE Intel”) from sending unsolicited e-mail to addresses on Intel's computer systems.<sup>3</sup> Hamidi appealed the order on July 2, 1999.<sup>4</sup>

The Intel/Hamidi controversy illustrates one of many problems created by the increased use of and sensitivity to unsolicited e-mail. The private sector has tried to control unsolicited e-mail, but so far the proposed solutions are unacceptable. As for the public sector, state anti-spam legislation might be a viable alternative. However, in the past year, two state laws regulating unsolicited e-mail have been held unconstitutional under the dormant Commerce Clause.<sup>5</sup> This Note surveys the problem of unsolicited e-mail and examines its possible solutions. Due to the constitutional limi-

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1. Motion for Summary Judgment Tentative Ruling, *Intel Corp. v. Hamidi*, No. 98-AS-05067, 1999 WL 450944 (Cal. Super. Apr. 28, 1999).

2. *Id.*

3. Order for Entry of Final Judgment, *Intel Corp. v. Hamidi*, No. 98-AS-05067 (Cal. Super. June 16, 1999), available at <http://cyber.law.harvard.edu/msvh/hamidi/finalorder.html>.

4. Notice of Appeal, *Intel Corp. v. Hamidi*, No 98-AS-05067 (Cal. Super. July 2, 1999), available at <http://eon.law.harvard.edu/openlaw/intelvhhamidi/appealnotice.html>. For more information on the Intel v. Hamidi case, see FACE Intel, at <http://www.faceintel.com/> (last visited Feb. 11, 2001); Jocelyn Dabeau, Berkman Center for Internet & Society (Harvard Law School), *Intel v. Hamidi*, at <http://eon.law.harvard.edu/openlaw/intelvhhamidi/> (last modified Feb. 20, 2000).

5. See *infra* Part II.B.2.

tations on state legislation, federal legislation represents the most promising means to address the problems associated with unsolicited e-mail.

## I. E-MAIL AND THE RISE OF SPAM

Approximately 116.5 million Americans have used the Internet.<sup>6</sup> Although the Internet comprises many telecommunications technologies, such as the World Wide Web, telnet, and Internet Relay Chat, the most widely used application is electronic mail ("e-mail").<sup>7</sup> Nearly two years ago, it was estimated that 2.2 billion e-mail messages were sent worldwide daily, which translates to 803 billion sent annually.<sup>8</sup>

E-mail resembles conventional paper-based mail. Both can be used to send either a personalized message to one person or an impersonal message to many people simultaneously. Sending "bulk mail" (impersonal messages with many recipients) is an easy way to reach a large audience. Frequently commercial in nature, bulk e-mail consists largely of advertisements or solicitations for charitable donations. Since its recipients often do not want it,<sup>9</sup> bulk e-mail is commonly referred to as "junk" e-mail or "spam."<sup>10</sup> People who send spam are called "spammers."

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6. U.S. DEP'T OF COMMERCE, FALLING THROUGH THE NET: TOWARD DIGITAL INCLUSION 33 (2000), <http://search.ntia.doc.gov/pdf/ftn00.pdf>.

7. *Id.* at 47. About eighty percent of Internet users have used electronic mail. *Id.*

8. Calvin Whang, Comment, *An Analysis of California's Common and Statutory Law Dealing with Unsolicited Commercial Electronic Mail: An Argument for Revision*, 37 SAN DIEGO L. REV. 1201, 1203 n.6 (2000) ("Of the 2.2 billion electronic messages sent daily, some analysts think that 10% or 220 million messages are spam.").

9. A survey of over 1,000 Internet users reported that 43% of users hate bulk e-mail, and 25% consider it bothersome; 68.5% of respondents reported that junk e-mail is not useful at all. Barry D. Bowen, *Controlling Unsolicited Bulk E-mail*, UNIX INSIDER, at <http://www.sunworld.com/sunworldonline/swol-08-1997/swol-08-junkemail.html> (last modified Jan. 22, 2001).

10. Other commonly used phrases include "unsolicited bulk e-mail" ("UBE") and "unsolicited commercial e-mail" ("UCE"). Bulk e-mail can be either commercial (such as an advertisement) or non-commercial (such as a joke or chain letter). Both types are equally costly to Internet Service Providers ("ISPs") and recipients (see *infra* notes 14 to 19 and accompanying text). However, the spam controversy generally focuses on commercial bulk e-mail, since that is the most common type of bulk e-mail. Some state statutes regulate all unsolicited e-mail, whether commercial or not (Virginia, West Virginia, Oklahoma, Connecticut, and Rhode Island). These statutes raise many First Amendment issues, since the First Amendment protects non-commercial speech more than it protects commercial speech. This Note addresses only commercial spam.

Recently, advertisers have begun to take advantage of the low cost of sending bulk e-mail.<sup>11</sup> In 1999, analysts estimated that 80.3 billion pieces of junk e-mail are sent each year.<sup>12</sup> A recent study found that over ninety percent of e-mail users receive spam at least once a week, while almost fifty percent of users receive spam six or more times per week.<sup>13</sup> As the number of bulk e-mail messages has grown, so has the burden bulk e-mail imposes on Internet Service Providers ("ISPs") and recipients. A recent study estimated that ten percent of ISP revenues are used to combat spam.<sup>14</sup> ISPs suffer most of this loss<sup>15</sup> in the form of customer attrition<sup>16</sup> and extra costs for staffing (due to increased traffic and user complaints) and hardware (to obtain more storage and bandwidth).<sup>17</sup> Spam can also cause networks to shut down completely.<sup>18</sup> Costs imposed on the recipient include money spent for Internet access time to download, read, and delete the spam.<sup>19</sup>

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11. It is much less expensive to send bulk e-mail than conventional mail. Each additional piece of conventional mail requires both another paper copy and additional postage. With e-mail, however, the only cost to the sender is typing one more e-mail address into the recipient list. The true cost of bulk e-mail is shifted to other parties, such as the sender's ISP, the recipients' ISPs, and the recipients themselves. The sender never bears the additional costs imposed on the ISPs and the recipients. *Junk E-mail: Hearings Before the Senate Subcomm. on Communications of the Senate Comm. on Commerce, Science and Transportation*, 105th Cong. (1998), available at 1998 WL 12761269 (statement of Deirdre Mulligan, Staff Counsel, The Center for Democracy and Technology).

12. Whang, *supra* note 8, at 1203 n. 6.

13. Gartner Group, *ISPs and Spam: The Impact of Spam on Customer Retention and Acquisition* 4, <http://www.brightmail.com/global/pdf/gartner.pdf> (June 14, 1999).

14. Whang, *supra* note 8, at 1207 n.42.

15. Spam can cost ISPs hundreds of thousands of dollars per year. Bowen, *supra* note 9.

16. ISPs lose seven percent of their new customers every year to spam. Gartner Group, *supra* note 13, at 8-9.

17. *Id.* at 12.

18. Whang, *supra* note 8, at 1208. In response to these losses, ISPs have sued spammers, such as Cyber Promotions, for damages. *See, e.g., CompuServe, Inc. v. Cyber Promotions, Inc.*, 962 F. Supp. 1015 (S.D. Ohio 1997) (enjoining Cyber Promotions from sending any unsolicited advertisements to any electronic mail address maintained by CompuServe); *Am. Online, Inc. v. Cyber Promotions, Inc.*, 948 F. Supp. 436 (E.D. Pa. 1996) (allowing America Online to block Cyber Promotions from sending unsolicited e-mail advertisements over the Internet to members of America Online).

19. *See* Gartner Group, *supra* note 13, at 7. In addition, it is likely that ISPs will transfer their spam-related expenses to their customers.

## II. PRIVATE AND LEGISLATIVE RESPONSES TO SPAM

In response to rising spam costs, the private and public sectors have attempted to curtail spam.<sup>20</sup> This section begins with an overview of the private sector's response to spam, including norms, technology, and organizations. It then describes state legislative responses to spam, including general approaches to anti-spam legislation and specific anti-spam laws.

### A. Private Responses to Spam

The private responses to spam consist primarily of enforcement of Internet social norms.<sup>21</sup> Like other societal norms, Internet norms are largely unwritten. However, since most Internet users dislike spam,<sup>22</sup> commentators have argued that spamming violates Internet norms, sometimes referred to as "netiquette."<sup>23</sup> Indeed, violation of netiquette can sometimes have legal consequences.<sup>24</sup> ISPs and other private organizations are the primary actors in the private-sector spam regulation area.<sup>25</sup>

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20. The private sector responded to spam first, followed by the public sector. Although spam has only recently become a widespread problem (see *supra* note 12 and accompanying text), the private sector recognized that unwanted e-mail was a potential problem in the early days of the Internet. See, e.g., J. Postel, *On the Junk Mail Problem*, Network Working Group Request for Comments (RFC): 706, NIC #33861 (Nov. 1975), available at <http://www.landfield.com/rfcs/rfc706.html>; P. Denning, *Electronic Junk*, 25 COMMUNICATIONS OF THE ACM 163 (1982).

21. "Norms" have been described as "systems of rules and sanctions created and administered without reliance on State 'authority,' and outside of any formal State-managed process." David G. Post, *Of Black Holes and Decentralized Law-Making in Cyberspace* (Jan. 31, 2000) (unpublished manuscript), <http://www.temple.edu/lawschool/dpost/blackhole.html>.

22. See *supra* note 9.

23. M. Mitchell Waldrop, *Culture Shock on the Networks*, 265 SCIENCE 879, 880 (1994) (describing netiquette as "the unwritten rules that tell users not to waste other people's time with irrelevant electronic chatter—and especially, not to sully the network with self-serving advertisements and junk mail"); Joshua A. Marcus, Note, *Commercial Speech on the Internet: Spam and the First Amendment*, 16 CARDOZO ARTS & ENT. L.J. 245, 247 (1998) ("Netiquette, among other things, established that advertisers wishing to advertise on-line should confine their activities to sites where advertisements would be welcomed."). "Netiquette" is a combination of the words "net" (for Internet) and "etiquette."

24. Recently, a Canadian court held a spammer liable for violation of these somewhat vague netiquette rules. 1267623 Ontario Inc. v. Nexx Online Inc., [1999] 1999 Ont. Sup. C.J. LEXIS 465 (Ont. Sup. Ct. Just.).

25. At least one commentator has suggested that private self-regulation is the "most attractive" way to regulate the Internet. See Christopher S.W. Blake, Note, *Destination Unknown: Does the Internet's Lack of Physical Situs Preclude State and Federal Attempts to Regulate It?*, 46 CLEV. ST. L. REV. 129, 157 (1998).

### 1. *How ISPs and Other Organizations Control Spam*

ISPs control spam via their contractual use policies. Recently, ISPs have begun to include Internet norms regarding spam in their use policies.<sup>26</sup> While some of these use policies use the vague term “netiquette” to indicate acceptable behavior,<sup>27</sup> others explicitly disallow using the ISP to send spam.<sup>28</sup>

Because sending spam involves two ISPs, the sender’s and the recipient’s, a use policy can combat spam in two ways: by preventing subscribers from sending spam, and by blocking incoming spam from outside users. The first way obtains its legal power from the contract that the subscriber signed with the ISP. The second method, blocking incoming e-mail, does not have the same legal power because the outside user has no contract with the recipient’s ISP.<sup>29</sup> Thus, to control spam, an ISP uses filtering software.<sup>30</sup> Once detected by the filtering software, spam can be

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26. For example, America Online’s (“AOL”) Unsolicited Bulk E-mail Policy explicitly forbids using AOL’s network to “accept, transmit or distribute unsolicited bulk e-mail sent from the Internet to AOL members.” America Online, Inc., Unsolicited Bulk E-Mail, at <http://www.aol.com/info/bulkemail.html> (last visited Jan. 31, 2001). Yahoo’s Terms of Service prohibit using the Service to “upload, post, email, transmit or otherwise make available any unsolicited or unauthorized advertising, promotional materials, ‘junk mail,’ [or] ‘spam’ . . . or any other form of solicitation, except in those areas (such as shopping rooms) that are designated for such purpose.” Yahoo! Inc., Terms of Service § 6(g), at <http://docs.yahoo.com/info/terms/> (last visited Jan. 31, 2001).

27. Carl S. Kaplan, *An Argument for ‘Netiquette’ Holds up In Court*, N.Y. TIMES ON THE WEB, July 16, 1999, at <http://www.nytimes.com/library/tech/99/07/cyber/cyberlaw/16law.html>. 1267623 *Ontario* involved an ISP policy that required users to conform to netiquette. 1267623 *Ontario*, 1999 Ont. Sup. C.J. LEXIS 465, \*5.

28. See Kaplan, *supra* note 27.

29. However, some state laws give ISP policies the force of law. In general, these laws allow ISPs to sue spammers for trespass to chattels (the chattels being the ISP’s computer system). See, e.g., CAL. BUS. & PROF. CODE § 17538.45 (West Supp. 2000) (discussed *infra* Part II.B.2.b); see also Dan L. Burk, *The Trouble with Trespass*, 4 J. SMALL & EMERGING BUS. L. 27 (2000) (criticizing the use of trespass to chattels to prohibit electronic communications); Carl S. Kaplan, *Treat EBay Listings as Property? Lawyers See a Threat*, N.Y. TIMES ON THE WEB, July 28, 2000, at <http://www.nytimes.com/library/tech/00/07/cyber/cyberlaw/28law.html>.

30. One example of a spam-filtering product made for ISPs is Brightmail Anti-Spam. See Brightmail, Inc., *Brightmail Anti-Spam*, at <http://www.brightmail.com/isp/anti-spam/> (last visited Feb. 11, 2000). Common ways of detecting spam include examining the subject line and body of the e-mail for frequent use of words such as “make money” and “free offer.” Since the computer performs the detection, the detection is not perfect. Thus, there might be false positives (messages which are not spam but are treated like spam) and false negatives (messages which are spam but are not caught by the system). Blocking some non-spam e-mail and allowing some spam e-mail to go through are the major drawbacks of using filtering software. For a good overview of how filtering

automatically deleted or sent to a special folder in the recipient's mailbox. The first method results in the ISP automatically blocking all spam, while the second allows the recipient to choose whether to read or delete the spam.

Many consumer organizations also combat spam. The most vocal and active U.S. organizations include the Coalition Against Unsolicited Commercial Email ("CAUCE"),<sup>31</sup> SueSpammers.org,<sup>32</sup> and Junk Busters.<sup>33</sup> These organizations share knowledge about recent spam legislation and cases and information about how to combat spam personally and via legislative and lobbying activities.<sup>34</sup> In addition, one of these private organizations, Mail Abuse Prevention System ("MAPS"), produces the Realtime Blackhole List ("RBL")—a list of "hosts and networks which are known to be friendly, or at least neutral, to [spammers] either to originate or relay spam or to provide spam support services."<sup>35</sup> MAPS distributes the RBL to ISPs so that they can block e-mail coming into their networks from blacklisted networks. In order to produce the RBL, MAPS uses its own definition of spam. According to the RBL, acceptable e-mail solicitations must include a double-opt-in system.<sup>36</sup>

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software works, see ALAN SCHWARTZ & SIMSON GARFINKEL, STOPPING SPAM 74-85 (1998).

31. <http://www.cauce.org/> (last visited Feb. 14, 2000).

32. <http://www.suespammers.org/> (last visited Feb. 14, 2000).

33. <http://www.junkbusters.com/> (last visited Feb. 14, 2000).

34. Foreign anti-spam organizations include the European Coalition Against Unsolicited Commercial Email ("EuroCAUCE"), at <http://www.euro.cauce.org/en/> (last visited Feb. 11, 2001), the Coalition Against Unsolicited Bulk Email, Australia ("CAUBE.au"), at <http://www.caube.org.au/> (last visited Feb. 11, 2001), and CAUCE India, at <http://www.india.cauce.org/> (last visited Feb. 11, 2001). The spam industry has recently started regulating itself. On September 14, 2000, fifteen companies, including DoubleClick, Inc., and Yesmail.com, announced their intent to form a coalition to design e-mail standards to limit unsolicited e-mail. Press Release, Responsible Electronic Communications Alliance ("RECA"), *E-mail Marketing Companies Announce Coalition to Promote Standards, Consumer Choice* (Sept. 2000), at <http://www.responsibleemail.org/>.

35. Paul Vixie & Nick Nicholas, *Realtime Blackhole List: Getting into the MAPS RBL*, at <http://mail-abuse.org/rbl/candidacy.html> (last revised Feb. 2, 2000).

36. The first opt-in occurs when a new subscriber asks to receive mailings by submitting her e-mail address to the would-be mailer. The second opt-in occurs when the subscriber later confirms or verifies her desire to receive mail. Thus, a double-opt-in system requires verification of new mailing-list subscriptions. See Mail Abuse Prevention System, LLC, *Basic Mailing List Management Guidelines for Preventing Abuse*, at <http://mail-abuse.org/manage.html> (last revised Nov. 7, 2000).

## 2. *Results of Spam Control by ISPs and Organizations*

Using an ISP's policies to control incoming spam imposes a large burden on spammers, which may outweigh the cost benefits of spamming entirely, causing the spammer to abandon his activities.<sup>37</sup> While this is the goal of many people,<sup>38</sup> it is important to examine why and how this burden comes about.

By definition, spammers send the same e-mail to many recipients, each of whom belongs to an ISP, of which there are thousands in the United States alone.<sup>39</sup> Thus, one piece of spam may arrive at many different ISPs. To comply with the use policy of each ISP, a spammer must obtain the policy of each ISP, learn the requirements it places on incoming e-mail, and modify the spam so that it complies with each ISP's policy. Since each ISP can have a different—and potentially conflicting—use policy, it may be very difficult for one e-mail to comply with every ISP's policy. For example, one ISP policy could require that the subject line of spam begin with "ADV:", while another policy could require that the subject begin with "advertisement:". One e-mail cannot comply with both of these requirements.

The problem of complying with many different use policies is generally referred to as the problem of conflicting obligations.<sup>40</sup> If ISP use poli-

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37. See Kenneth D. Bassinger, Note, *Dormant Commerce Clause Limits on State Regulation of the Internet: The Transportation Analogy*, 32 GA. L. REV. 889, 912 (1998) ("With the recent flurry of [Internet rules] and the inconsistency among them, a rapidly changing regulatory structure could have serious chilling effects on the development of Internet commerce."); Dan L. Burk, *Federalism in Cyberspace*, 28 CONN. L. REV. 1095, 1132 (1996) ("If [online businesses] were subject to the regulation of the recipient jurisdiction, online commerce would face an almost insurmountable burden in attempting to predict what requirements might be imposed upon it."); *Am. Libraries Ass'n v. Pataki*, 969 F. Supp. 160, 181 (S.D.N.Y. 1997) ("Regulation by any single [entity] can only result in chaos, because at least some [entities] will likely enact [rules] subjecting Internet users to conflicting obligations. Without the limitations imposed by the Commerce Clause, these inconsistent regulatory schemes could paralyze the development of the Internet altogether.").

38. Note that some types of unsolicited e-mail may be socially desirable, such as those that inform recipients of recent events like crime waves or computer viruses. In addition, some people may argue that even unsolicited advertisements can be socially desirable.

39. In 1999, there were 5,775 ISPs in the United States. That number is expected to increase to 7,785 in 2000. Press Release, Cahners In-Stat Group, *National ISPs Stand to Gain Most in Growing U.S. Market* (Sept. 25, 2000), at [http://www.instat.com/pr/2000/is0004sp\\_pr.htm](http://www.instat.com/pr/2000/is0004sp_pr.htm).

40. The problem of conflicting obligations will be revisited in Part III.B.2.b, which discusses this problem with respect to state laws.

cies do in fact conflict, any sender might be unable to send one version of an e-mail message to recipients at two different ISPs while complying with both ISPs' use policies. Thus, conflicting obligations may silence mass e-mailers, whether commercial or not, creating a potentially unacceptable chilling effect on speech.

Turning to the MAPS system of spam control, while the RBL has successfully reduced the amount of spam received by its subscribers, it has been strongly criticized.<sup>41</sup> First, critics argue that single-opt-in systems are a valid way of obtaining permission from users to send them bulk e-mail.<sup>42</sup> Since MAPS requires a double-opt-in system, bulk e-mailers who obtain single-opt-in permission are nonetheless placed on the RBL.<sup>43</sup> This disagreement over the definition of "spam" is important, since the widespread use of the RBL results in MAPS' definition being applied to the entire Internet.

Critics also argue that MAPS' methods are overbroad:<sup>44</sup> If one user sends spam from an ISP, then all users of that ISP are placed on the

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41. See Post, *supra* note 21. For MAPS' response to these criticisms, see Paul Vixie, *MAPS RBL Rationale*, at <http://mail-abuse.org/rbl/rationale.html> (last revised July 19, 2000).

42. "Members can join [Harris Interactive's online] panel only after registering at the company's or one of 26 other sites that recruit panel members. Individuals must elect to opt-in or opt-out. . . . [MAPS], at their sole discretion, have defined what constitutes 'unsolicited'. . . . The entire process is subjective and unevenly applied." Press Release, Harris Interactive, *Harris Interactive Files Suit Against AOL, Microsoft, Qwest and Other ISPs Over Restraint of Trade* (July 31, 2000), at [http://www.harrisinteractive.com/news/index.asp?NewsID=127&HI\\_election=All](http://www.harrisinteractive.com/news/index.asp?NewsID=127&HI_election=All). Harris Interactive, an Internet-based market research firm that was placed on the RBL, sued MAPS on July 31, 2000. *Id.* The suit was dropped on September 13, 2000. Press Release, Harris Interactive, *Harris Interactive Drops ISP Lawsuit* (September 13, 2000), at [http://www.harrisinteractive.com/news/index.asp?NewsID=145&HI\\_election=All](http://www.harrisinteractive.com/news/index.asp?NewsID=145&HI_election=All).

43. Yesmail.com, a permission-based e-mail marketing firm that was placed on the RBL, sued MAPS in July 2000. Oscar S. Cisneros, *Yesmail Fights Blacklist Threat*, WIRE NEWS (July 18, 2000), at <http://www.wirednews.com/news/ebiz/0,1272,37621,00.html>. A federal district court sustained a temporary injunction barring MAPS from adding Yesmail.com to the RBL. *Id.* Yesmail and MAPS have since come to an agreement whereby Yesmail will change its e-mail policies, and MAPS will not place Yesmail on the RBL. Press Release, Mail Abuse Prevention System, LLC, *yesmail.com and MAPS Reach Agreement Over Email Permission Standards* (Aug. 1, 2000), at <http://mail-abuse.org/pressreleases/2000-08-01.html>.

44. [W]hat often happens is that the actual point of origination of the offending email can't be found (email return addresses are easily faked or omitted entirely). That in no way deters RBL. . . . [T]hey are then free to "shoot the messenger", and you are "guilty by association". You are guilty because someone you don't know sent an email to someone else that you also don't know.

RBL.<sup>45</sup> Thus, the RBL frequently blocks people who are not spammers. Since the RBL is a completely private enterprise, there is little recourse to change this policy or root out these false positives and remedy the situation by removing the innocent parties from the RBL. Consequently, RBL usage has blocked many legitimate e-mail messages.

Finally, many ISPs use the RBL to filter their e-mail, but because MAPS is a private organization, the public has little (if any) input into how it runs, including who is placed on the RBL. Thus, if MAPS chose to, it could cause the ISPs (and all of their subscribers) to shun an entire group of Internet users by placing these users' e-mail addresses on the RBL. Moreover, MAPS could choose to censor these users based on, for example, their public expression of a viewpoint with which MAPS disagrees.<sup>46</sup> This scenario demonstrates the need for oversight and a public voice in spam regulation.

## B. Legislative Responses to Spam

Legislation seems like a promising solution to control spam. The process is public, the system implementers would be accountable, and the rules would have a real effect because they have the force of law.<sup>47</sup> The United States and foreign countries<sup>48</sup> have enacted many laws to decrease spam in order to reduce its burden on ISPs and recipients. This section first describes the general categories of spam laws. It then examines some actual spam laws, focusing on those of Washington and California.

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Internet Frontier, RBL—Power Without Accountability, at <http://www.ifn.net/rblstory.htm> (last visited Jan. 25, 2001).

45. Vixie & Nicholas, *supra* note 35.

46. This possibility has already occurred in the world of website filtering software. Declan McCullagh, *The CyberSitter Diaper Change*, TIME DIGITAL (Jan. 12, 1997), at <http://www.time.com/time/digital/daily/0,2822,11595,00.html>. CyberSitter blocks websites that criticize it, including an article in Time magazine. Greg Lindsay, *CyberSitter Decides to Take a Time Out*, TIME DIGITAL (Aug. 8, 1997), at <http://www.time.com/time/digital/daily/0,2822,12392,00.html>.

47. Legislation is not a panacea because spam is a nationwide, even worldwide, problem. Even if spam were outlawed in an entire country, it could still be sent into that country from elsewhere. Thus, outlawing spam in the United States may simply result in spam being sent via foreign ISPs that are not subject to U.S. laws.

48. For information on anti-spam activities in foreign countries, see <http://www.spamlaws.com/eu.html> (European Union) and <http://www.spamlaws.com/world.html> (other countries).

### 1. *Categories of Spam Laws*

Spam laws can be categorized based on how they address the spam problem.<sup>49</sup> E-mail messages contain many pieces of information that tell the recipient about the sender. These include the return address, which specifies who sent the e-mail, and the header, which specifies the route the e-mail traveled through the Internet to reach the recipient.<sup>50</sup> Most anti-spam laws regulate the information conveyed in these two identifiers.<sup>51</sup>

Laws that seek to regulate spam must first define unsolicited commercial e-mail. A North Carolina statute provides a common statutory definition of "unsolicited": "not addressed to a recipient with whom the initiator has an existing business or personal relationship and not sent at the request of, or with the express consent of, the recipient."<sup>52</sup> In addition, North Carolina defines "commercial electronic mail" as "messages sent and received electronically consisting of commercial advertising material, the principal purpose of which is to promote the for-profit sale or lease of goods or services to the recipient."<sup>53</sup>

Once a specific e-mail has been identified as spam, the law attempts to control it in some way. For example, some laws require senders to place the phrase "ADV:" in the subject line of spam e-mail.<sup>54</sup> Often, spam laws

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49. Max P. Ochoa, Legislative Note, *Recent State Laws Regulating Unsolicited Electronic Mail*, 16 *COMPUTER & HIGH TECH. L.J.* 459, 461 (2000).

50. *Id.* at 462.

51. *Id.* Various other types of statutes also cut down on spam, for example by outlawing software that facilitates the sending of spam. *See, e.g.*, VA. CODE ANN. § 18.2-152.4(b) (Supp. 2000). This type of statute may be unconstitutional on First Amendment grounds because sometimes software is speech. *See, e.g.*, *Junger v. Daley*, 209 F.3d 481, 485 (6th Cir. 2000). Other states give courts long-arm jurisdiction over out-of-state spammers so that they can be prosecuted. *See, e.g.*, OKLA. STAT. tit. 15, § 776.3 (Supp. 2000). In addition, all states have passed laws that create safe harbors for ISPs. These laws shield ISPs from liability due to transmission of spam, *see, e.g.*, W. VA. CODE ANN. § 46a-6G-3(4) (Michie 1999), or attempts to prevent spam, *see, e.g.*, W. VA. CODE ANN. § 46a-6G-3(1)—(3) (Michie 1999). Lastly, state laws differ as to who may sue spammers. Possible plaintiffs include ISPs, recipients of spam, and state attorney generals. Ochoa, *supra* note 49, at 464. Violations of spam statutes may be either civil or criminal offenses, depending on the state. *Id.*

52. N.C. GEN. STAT. § 14-453(10) (1993).

53. *Id.* § 14-453(1b) (1999).

54. *See, e.g.*, CAL. BUS. & PROF. CODE § 17538.4(g) (West Supp. 2000), discussed *infra*; TENN. CODE ANN. § 47-18-2501(e) (Supp. 2000); COLO. REV. STAT. § 6-2.5-103(4) (Supp. 2000).

allow ISPs and recipients to sue spammers for damages if they fail to comply with state laws.<sup>55</sup>

Another type of anti-spam law, consumer protection statutes, requires that advertisers not mislead buyers with false information. Spammers may violate these statutes by deliberately providing false information to hide their identities, thereby avoiding complaints and lawsuits from recipients and ISPs. For instance, spammers may modify their messages to contain falsified (“spoofed”) return addresses and header information. Thus, one way to make spammers accountable for their actions is to use or adapt existing consumer protection statutes to outlaw misleading information in spam.

As applied to spam, consumer protection statutes generally require that no misleading subject line be used and that the sender of the e-mail not alter, misrepresent, or obfuscate the return address or header information.<sup>56</sup> While they do not prevent spam, these laws (1) help recipients identify spam via relevant subject lines; (2) make e-mail messages more traceable via the correct header information; and (3) make spammers accountable for their actions via the correct return address. Such statutes may provide some real protection for consumers. For example, in one state court case, the state sued a spammer for sending bulk e-mail with false return addresses.<sup>57</sup> The court held the spammer liable under a state consumer fraud statute and granted an injunction against the spammer.<sup>58</sup>

## 2. Actual State Spam Laws

In July 1997, Nevada became the first state to enact an anti-spam law,<sup>59</sup> since then, sixteen other states have also passed spam laws.<sup>60</sup> Commentators have questioned the constitutionality of state spam laws,<sup>61</sup> citing issues such as the First Amendment<sup>62</sup> and the dormant Commerce

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55. See, e.g., CAL. BUS. & PROF. CODE § 17538.45 (Supp. 2000), discussed *infra*; 1999 Conn. Acts 160 (Reg. Sess.); IDAHO CODE § 48-603E(4) (Michie Supp. 2000).

56. See, e.g., CAL. PENAL CODE § 502(c)(9) (West 1999); R.I. GEN. LAWS § 11-52-7 (2000); VA. CODE ANN. § 18.2-152.4(A)(7) (Supp. 2000).

57. *People v. Lipsitz*, 663 N.Y.S.2d 468 (Sup. Ct. 1997).

58. *Id.* at 477.

59. NEV. REV. STAT. ANN. §§ 41.705 (Michie 1999) (introduced Jan. 1997, enacted July 1997, effective July 1, 1998).

60. California, Colorado, Connecticut, Delaware, Idaho, Illinois, Iowa, Louisiana, Missouri, North Carolina, Oklahoma, Rhode Island, Tennessee, Virginia, Washington, and West Virginia. Scot M. Graydon, *Much Ado About Spam: Unsolicited Advertising, the Internet, and You*, 32 ST. MARY'S L. J. 77, 98 n.124 (2000).

61. See Burk, *supra* note 37, at 1096-97; Bassinger, *supra* note 37.

62. For an overview of the subject, see Marcus, *supra* note 23.

Clause.<sup>63</sup> Although a number of cases have addressed the problem of Internet content regulation and the dormant Commerce Clause,<sup>64</sup> only recently have any state spam laws been held unconstitutional under the dormant Commerce Clause. The next two sections discuss the Washington and California spam laws that were held to violate the dormant Commerce Clause.

a) Washington Anti-Spam Law

The Unsolicited Electronic Mail Act ("UEMA")<sup>65</sup> became operative on June 11, 1998, thereby making Washington the first state to effect public spam regulation.<sup>66</sup> The UEMA applies to e-mail sent from a computer in Washington or to an e-mail address that belongs to a Washington resident.<sup>67</sup> The Act explicitly prohibits spoofing<sup>68</sup> and also provides that spoofing violates Washington's consumer protection act.<sup>69</sup> ISPs and recipients can recover damages of \$1,000 or \$500 respectively, or actual damages (whichever is greater).<sup>70</sup> Lastly, the UEMA immunizes an ISP from liability for good faith blocking of the receipt or transmission through its servers of e-mail that violates the Act.<sup>71</sup>

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63. Other problems with state spam statutes include obtaining personal jurisdiction over the spammer. *See generally* Blake, *supra* note 25.

64. *See* Am. Libraries Ass'n v. Pataki, 969 F. Supp. 160, 169 (S.D.N.Y. 1997) (temporarily restraining the enforcement of New York's Internet Decency Law ("IDL") on dormant Commerce Clause grounds); Am. Civil Liberties Union v. Johnson, 4 F. Supp. 2d 1029, 1029 (D.N.M. 1998); *aff'd*, 194 F.3d 1149 (10th Cir. 1999) (enjoining action under an Internet content-related statute on dormant Commerce Clause grounds). The Pataki opinion has been criticized. *See* Charles R. Topping, Student Article, *The Surf Is Up, But Who Owns the Beach?—Who Should Regulate Commerce On the Internet?*, 13 N.D. J.L. ETHICS & PUB. POL'Y 179, 206 (1999) (suggesting that the IDL can escape dormant Commerce Clause problems by restricting its application to conduct occurring only in New York); James E. Gaylord, Note, *State Regulatory Jurisdiction and the Internet: Letting the Dormant Commerce Clause Lie*, 52 VAND. L. REV. 1095, 1116-17 (1999) (suggesting that the extraterritoriality principle relied on in Pataki will soon no longer be valid).

65. WASH. REV. CODE ANN. § 19.190 (West 1999).

66. Ochoa, *supra* note 49, at 461 n.12.

67. WASH. REV. CODE ANN. § 19.190.020(1) (West 1999).

68. Specifically, it is illegal to send unsolicited commercial e-mail that "[u]ses a third party's internet domain name without permission of the third party, or otherwise misrepresents any information in identifying the point of origin or the transmission path" or "[c]ontains false or misleading information in the subject line." *Id.*

69. *Id.* § 19.190.030.

70. *Id.* § 19.190.040.

71. *Id.* § 19.190.050.

A Washington trial court recently held that the UEMA violates the dormant Commerce Clause.<sup>72</sup> In a brief opinion, the court held that the Act “violate[d] the Federal Interstate Commerce Clause of the United States Constitution [and was] unduly restrictive and burdensome.”<sup>73</sup> The State Attorney General has appealed the decision.<sup>74</sup>

#### b) California Anti-Spam Laws

Three new spam laws took effect in California on January 1, 1999.<sup>75</sup> The Bowen Bill amended California’s “junk fax” law<sup>76</sup> to require spam<sup>77</sup> to meet two requirements. First, the subject line of a spam message must begin with the characters “ADV:”.<sup>78</sup> Second, the body of a spam message must contain a toll-free phone number or e-mail address that the recipient can use to notify the sender not to send her any more spam.<sup>79</sup> Violations

72. Order on Civil Motion Granting Defendant’s Summary Judgment, *Washington v. Heckel*, No. 98-2-25480-7SEA (Wash. Super. Mar. 10, 2000).

73. *Id.*

74. News Release, Attorney General of Washington, *AG’s Office Files Notice of Appeal in Anti-Spam E-mail Lawsuit* (Apr. 6, 2000), at [http://www.wa.gov/ago/releases/rel\\_spam\\_040600.html](http://www.wa.gov/ago/releases/rel_spam_040600.html).

75. David Kramer, *California’s New Anti-Spam Laws*, Wilson Sonsini Goodrich & Rosati Library, at <http://www.wsgr.com/library/libfileshtm.asp?file=spam.htm> (last visited Feb. 1, 2001).

76. CAL. BUS. & PROF. CODE § 17538.4 (West Supp. 2000).

77. The statute contains a slightly different definition of “unsolicited commercial e-mail” than the definition used in Business and Professions Code § 17538.45. Namely, UCE is defined as

any e-mailed document or documents consisting of advertising material for the lease, sale, rental, gift offer, or other disposition of any realty, goods, services, or extension of credit that . . . are addressed to a recipient with whom the initiator does not have an existing business or personal relationship [and] are not sent at the request of, or with the express consent of, the recipient.

*Id.* § 17538.4(e).

78. “In the case of email that consists of unsolicited advertising material for the lease, sale, rental, gift offer, or other disposition of any realty, goods, services, or extension of credit, the subject line of each and every message shall include ‘ADV:’ as the first four characters.” *Id.* § 17538.4(g).

If these messages contain information that consists of unsolicited advertising material for the lease, sale, rental, gift offer, or other disposition of any realty, goods, services, or extension of credit, that may only be viewed, purchased, rented, leased, or held in possession by an individual 18 years of age and older, the subject line of each and every message shall include “ADV:ADLT” as the first eight characters.

*Id.* § 17538.4(g). Approximately twenty-five percent of spam has adult content. Gartner Group, *supra* note 13, at 5.

79. CAL. BUS. & PROF. CODE § 17538.4(a)(2) (West Supp. 2000).

constitute a misdemeanor,<sup>80</sup> but the statute does not give ISPs or spam recipients a private cause of action against spammers.

On June 2, 2000, a San Francisco trial court held that the Bowen Bill violates the dormant Commerce Clause.<sup>81</sup> In a short opinion, the judge found that the statute “unconstitutionally subject[ed] interstate use of the Internet to inconsistent regulations, therefore violating the dormant Commerce Clause . . . .”<sup>82</sup> The next section discusses the constitutionality of the Bowen Bill.

Courts have not yet considered California’s other two spam laws. Section 502 of the Penal Code,<sup>83</sup> originally added by California’s Comprehensive Computer Data Access and Fraud Act, provides criminal penalties<sup>84</sup> for spoofing<sup>85</sup> if it causes damage to one or more computers.<sup>86</sup> Victims may also bring a civil suit against an offender convicted under Section 502.<sup>87</sup> In this manner, parties whose domain names have been spoofed by spammers can be compensated.

Section 17538.45 of the Business & Professions Code,<sup>88</sup> the Miller Bill, gives an ISP the right to sue people who use its network to send spam.<sup>89</sup> The Miller Bill allows an e-mail service provider<sup>90</sup> to sue someone who sends unsolicited commercial e-mail<sup>91</sup> either from the ISP or to an

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80. *Id.* § 17534.

81. Order Sustaining Defendants’ Demurrer Without Leave to Amend, *Ferguson v. Friendfinder, Inc.*, No. 307309 (Cal. Super. June 2, 2000).

82. *Id.*

83. CAL. PENAL CODE § 502 (West 1999).

84. *Id.* § 502(d).

85. Specifically, the statute prohibits the unauthorized use of another party’s domain name in connection with the sending of electronic mail messages. *Id.* § 502(c)(9).

86. *Id.*

87. *Id.* § 502(e)(1).

88. CAL. BUS. & PROF. CODE § 17538.45 (West Supp. 2000). For criticism of the Bowen Bill and the Miller Bill, see Whang, *supra* note 8.

89. For constitutional analysis of this statute, see David T. Bartels, *Review of Selected 1998 California Legislation: Business Associations and Professions: Canning Spam: California Bans Unsolicited Commercial E-mail*, 30 MCGEORGE L. REV. 420, 430 (1999) (suggesting that the statute does not violate the dormant Commerce Clause).

90. The statute defines “electronic mail service provider” as “any business or organization qualified to do business in California that provides registered users the ability to send or receive electronic mail through equipment located in this state and that is an intermediary in sending or receiving electronic mail.” CAL. BUS. & PROF. CODE § 17538.45(a)(3) (West Supp. 2000).

91. The statute defines “electronic mail advertisement” (i.e., commercial e-mail) as any “electronic mail message, the principal purpose of which is to promote, directly or indirectly, the sale or other distribution of goods or services to the recipient.” *Id.* § 17538.45(a)(1). “Unsolicited” is defined as “addressed to a recipient with whom the

ISP subscriber. Thus, the ISP can sue both registered users of the ISP and outsiders.<sup>92</sup> If successful,<sup>93</sup> the ISP can recover damages for network clogs or crashes.<sup>94</sup>

### III. THE DORMANT COMMERCE CLAUSE AND ITS EFFECT ON THE CONSTITUTIONALITY OF THE BOWEN BILL

Washington and California courts have found that certain state spam statutes violate the dormant Commerce Clause. Unfortunately, neither opinion revealed the court's reasoning. This section fills that gap by outlining the major dormant Commerce Clause doctrines and tests and then applying them to the Bowen Bill, the California statute held unconstitutional in *Ferguson v. Friendfinder*.

The Supreme Court has held that the Commerce Clause<sup>95</sup> contains a negative implication, the dormant Commerce Clause, which prohibits states from regulating interstate commerce.<sup>96</sup> Because Congress has the

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initiator does not have an existing relationship" and "is not sent at the request of or with the express consent of the recipient." *Id.* § 17538.45(a)(2).

92. This possibility was discussed *supra* Part II.A.1.

93. To succeed, the ISP must prove that (1) its mail servers are physically located in California; (2) the defendant transmitted spam (either from the ISP or to an ISP subscriber) by using a California mail server; (3) the defendant's use of the California mail servers was in violation of the ISP's use policy; and (4) the defendant had advance notice that his spam transmission would use the ISP's California mail servers in violation of the ISP's policy. CAL. BUS. & PROF. CODE § 17538.45 (West Supp. 2000).

94. Specifically, the ISP can recover \$50 per spam e-mail sent (up to \$25,000 per day) or actual damages, whichever is greater. *Id.* § 17538.45(f)(1).

95. The Commerce Clause states that "Congress shall have Power . . . [t]o regulate Commerce . . . among the several States." U.S. CONST. art. I § 8 cl. 3.

96. "[T]he negative or dormant implication of the Commerce Clause prohibits state taxation or regulation that discriminates against or unduly burdens interstate commerce and thereby impedes free private trade in the national marketplace." *General Motors Corp. v. Tracy*, 519 U.S. 278, 287 (1997) (internal quotation marks omitted). See generally Martin H. Redish & Shane V. Nugent, *The Dormant Commerce Clause and the Constitutional Balance of Federalism*, 1987 DUKE L.J. 569 (1987).

The dormant Commerce Clause first arose in dicta in *Gibbons v. Ogden*, when Chief Justice Marshall noted that "when a State proceeds to regulate commerce . . . among the several States, it is exercising the very power that is granted to Congress, and is doing the very thing which Congress is authorized to do." 22 U.S. (9 Wheat.) 1, 199-200 (1824). However, the Court did not officially acknowledge the negative aspect of the Commerce Clause until *Willson v. Black Bird Creek Marsh Co.*, 27 U.S. (2 Pet.) 245 (1829). In *Willson*, Marshall noted that state legislation might fail if it were "repugnant to the power to regulate commerce in its dormant state." *Id.* at 252. Such legislation did fail in the *Passenger Cases*. *Smith v. Turner*; *Norris v. City of Boston*, 48 U.S. (7 How.) 283 (1849). In those cases, the Court held (5-4) that statutes imposing bond requirements and

power to regulate interstate commerce, states cannot pass laws that unduly interfere with such regulation.<sup>97</sup> Over the years, the Court has struck down many state laws that offend the dormant Commerce Clause by affecting interstate commerce.<sup>98</sup> Note that the dormant Commerce Clause does not absolutely bar state regulation of interstate commerce. As part of its Commerce Clause powers, Congress can always explicitly authorize a state to act in a particular area otherwise precluded by the dormant Commerce Clause.<sup>99</sup> In such cases, Congress allows the states to regulate certain activities, rather than imposing its own law.

#### A. The Bowen Bill Falls within the Scope of the Dormant Commerce Clause

In its modern form, the dormant Commerce Clause prohibits states from discriminating against or unduly burdening interstate commerce. As a preliminary matter, the dormant Commerce Clause applies only to statutes that regulate activities that are within Congress' commerce power. The commerce power encompasses both interstate commerce itself, such as items shipped across state lines, and activities that affect interstate commerce, like shipping and transportation mechanisms (also known as "instruments of interstate commerce").

The Bowen Bill can violate the dormant Commerce Clause only if the area it regulates, spam, falls within the broad sweep of Congress's Commerce Clause power. There can be little doubt that sending spam qualifies as interstate commerce or an instrument of interstate commerce. Many courts have held that Internet communication, specifically e-mailing im-

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taxes on immigrants arriving at state ports were unconstitutional. However, the dormant Commerce Clause's role in the ruling is unclear. Only three of the eight separate opinions clearly relied on the dormant Commerce Clause for their results.

Some commentators doubt the legitimacy of the dormant Commerce Clause. See, e.g., Julian N. Eule, *Laying the Dormant Commerce Clause to Rest*, 91 YALE L.J. 425, 446-55 (1982); Redish & Nugent, *supra*, at 575-76; Richard D. Friedman, *Putting the Dormancy Doctrine Out of Its Misery*, 12 CARDOZO L. REV. 1745 (1991); Amy M. Petraghani, *The Dormant Commerce Clause: On Its Last Leg*, 57 ALB. L. REV. 1215, 1243 (1994).

97. See *Cooley v. Board of Wardens*, 53 U.S. (12 How.) 299, 317-19 (1851); *Willson*, 27 U.S. (2 Pet.) at 245; *Gibbons*, 22 U.S. (9 Wheat.) at 5-6.

98. See, e.g., *Dean Milk Co. v. City of Madison*, 340 U.S. 349 (1951) (produce regulations); *S. Pac. Co. v. Arizona ex rel. Sullivan*, 325 U.S. 761 (1945) (railroad regulations).

99. LAURENCE H. TRIBE, *AMERICAN CONSTITUTIONAL LAW* § 6-33 (3d ed. 2000); Glenn Harlan Reynolds, *Virtual Reality and "Virtual Welters": A Note on the Commerce Clause Implications of Regulating Cyberporn*, 82 VA. L. REV. 535, 541 n.20 (1996).

ages through the Internet, qualifies as interstate commerce.<sup>100</sup> Assuming that spam is commercial in nature, spam that crosses state lines is interstate commerce. Moreover, even if both sender and recipient are in the same state, the spam may still cross state lines before it reaches its destination and thus qualify as interstate commerce.<sup>101</sup>

In addition, many courts and commentators have argued that the Internet itself is an instrument of interstate commerce.<sup>102</sup> If so, then Congress may regulate the entire Internet, including spam.<sup>103</sup> These arguments rely on the similarities between the Internet and traditional instruments of interstate commerce, such as highways and railroads. Namely, both mechanisms transport commercial items across state lines.<sup>104</sup>

In *American Libraries Ass'n v. Pataki*,<sup>105</sup> the leading case in this area, a federal district court struck down on dormant Commerce Clause grounds a state law that prohibited sexual contact over the Internet between adults and minors.<sup>106</sup> In reaching this conclusion, the court reasoned that the "Internet is analogous to a highway or railroad. . . . [T]he similarity between the Internet and more traditional instruments of interstate commerce leads to analysis under the Commerce Clause."<sup>107</sup> Other cases where an Internet content regulation failed dormant Commerce Clause scrutiny include *ACLU v. Johnson*<sup>108</sup> and *Cyberspace Communications v. Engler*.<sup>109</sup>

100. *United States v. Schooley*, 1997 WL 517486 at \*1 (A.F. Ct. Crim. App., Aug. 11, 1997); *United States v. Carroll*, 105 F.3d 740, 742 (1st Cir. 1997); *United States v. Thomas*, 74 F.3d 701, 706-09 (6th Cir. 1996).

101. *Am. Libraries Ass'n v. Pataki*, 969 F. Supp. 160, 171 (S.D.N.Y. 1997). In fact, the judge in *Pataki* stated that "no [intrastate] communications exist." *Id.*

102. *See id.* at 173; H. Joseph Hameline & William Miles, *The Dormant Commerce Clause Meets the Internet*, BOSTON B.J., Oct. 1997, at 21-22; Blake, *supra* note 25, at 141-42; Burk, *supra* note 37, at 1125-26. *See generally* Bassinger, *supra* note 37.

103. Some critics worry that declaring that the Internet is an instrument of interstate commerce will result in the states' inability to regulate the Internet at all. *See, e.g.*, Hameline & Miles, *supra* note 102, at 22.

104. The Internet is a "conduit for transporting digitized information goods such as software, data, music, graphics, and videos . . ." Burk, *supra* note 37, at 1125-26.

105. 969 F. Supp. 160 (S.D.N.Y. 1997).

106. *Id.* at 160. The court found that the statute had extraterritorial effects and placed a burden on interstate commerce that exceeded its benefit to its local interest. *Id.* at 169.

107. *Id.* at 161.

108. 4 F. Supp. 2d 1029 (D.N.M. 1998); *aff'd*, 194 F.3d 1149 (10th Cir. 1999) (upholding an injunction against enforcing a New Mexico law that sought to restrict children from Internet pornography).

109. 55 F. Supp. 2d 737 (E.D. Mich. 1999) (stopping enforcement of a Michigan law that sought to prohibit using computers or the Internet to disseminate pornography to minors); *aff'd*, 2000 U.S. App. LEXIS 29359 (6th Cir. November 15, 2000).

Thus, spam regulation comes within the commerce power either because spam is interstate commerce or because the Internet is an instrument of interstate commerce. Since spam regulation is within the commerce power, it is subject to dormant Commerce Clause limits. The rest of the analysis addresses whether the Bowen Bill in fact violates the dormant Commerce Clause.

## **B. The Bowen Bill Violates the Dormant Commerce Clause by Imposing Inconsistent Obligations on Interstate Spam**

The Supreme Court clearly articulated the test for whether a state statute violates the dormant Commerce Clause in *Oregon Waste Systems v. Department of Environmental Quality*.<sup>110</sup> In *Oregon Waste Systems*, the Court analyzed an Oregon statute that imposed a surcharge for in-state disposal of solid waste generated out-of-state. "The first step in analyzing any law subject to judicial scrutiny under the negative [dormant] Commerce Clause is to determine whether it regulates evenhandedly with only incidental effect on interstate commerce, or discriminates against interstate commerce."<sup>111</sup> Since the surcharge depended on whether the waste was generated out-of-state,<sup>112</sup> the Court held that the statute was facially discriminatory and thus violated the dormant Commerce Clause.<sup>113</sup> Under *Oregon Waste Systems*, a court first determines whether the spam statute discriminates against interstate commerce. If it regulates evenhandedly, then the court analyzes the law's effect on interstate commerce. If it excessively burdens interstate commerce, then it may violate the dormant Commerce Clause despite its evenhandedness.

### *1. Discriminating Against Interstate Commerce and the Extraterritoriality Doctrine*

In the dormant Commerce Clause context, "discrimination" means "differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter."<sup>114</sup> State statutes that facially discriminate against interstate commerce trigger strict scrutiny and are

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110. 511 U.S. 93 (1994).

111. *Id.* at 99.

112. *Id.*

113. *Id.* at 108.

114. *Id.* at 99.

usually invalid.<sup>115</sup> The statute will be held invalid unless the state can show that it has no other way to advance a legitimate local interest.<sup>116</sup>

In the realm of spam laws, differential treatment might involve only prohibiting spam that originated *outside* the recipient's state. The Bowen Bill states that "[n]o person or entity conducting business in this state"<sup>117</sup> may send spam to "a California resident via an electronic mail service provider's service or equipment located in this state."<sup>118</sup> Since the Bowen Bill applies equally to spam that originates either outside or inside of California,<sup>119</sup> it does not feature differential treatment.<sup>120</sup>

A state also directly discriminates against interstate commerce by attempting to project its law into other states. In *Edgar v. MITE Corp.*,<sup>121</sup> the Supreme Court considered an Illinois statute that regulated tender offers for certain companies.<sup>122</sup> The statute applied to any company of which Illinois residents owned ten percent of the stock, even if the company was not located or incorporated in Illinois.<sup>123</sup> The Court held that the statute violated the dormant Commerce Clause, a plurality holding that a regulation having the "practical effect" of regulating transactions that take place extraterritorially (i.e., across state lines) exceeds the "inherent limits of the State's power," regardless of the legislators' intentions.<sup>124</sup> The Court defined the "extraterritoriality doctrine"<sup>125</sup> as follows: "The Commerce Clause . . . precludes the application of a state statute to commerce that

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115. *Maine v. Taylor*, 477 U.S. 131 (1986) (outlining the discriminatory effect test).

116. For a law that was held valid despite its being found discriminatory, see *id.* (upholding Maine's ban on the import of baitfish because Maine had no other way to prevent the spread of parasites and the adulteration of its native fish species).

117. CAL. BUS. & PROF. CODE § 17538.4(a) (West Supp. 2000).

118. *Id.* § 17538.4(d).

119. The Bowen Bill requires only that the sender conduct business in California and that the spam started from a server in California. These requirements might be needed for personal jurisdiction reasons. If the requirements favor anyone, they are more likely to favor out-of-state spammers than in-state spammers.

120. Note that it may cost more for an out-of-state spammer to operate a toll-free phone number for spam recipients to use, as is an option in the Bowen Bill. CAL. BUS. & PROF. CODE § 17538.4(a)(2) (West Supp. 2000). However, the spammer can avoid this cost by allowing the recipient to complain via e-mail. Thus, the Bowen Bill might discriminate against out-of-state spammers, but in an insignificant way.

121. 457 U.S. 624 (1982).

122. *Id.* at 626-27.

123. *Id.* at 627.

124. *Id.* at 642-43.

125. Some commentators have suggested that the holdings in the extraterritoriality cases were based on something other than dormant Commerce Clause concerns. See Gaylord, *supra* note 64 (requirement of a nexus between state interests and regulated enterprises).

takes place wholly outside of the State's borders, whether or not the commerce has effects within the state."<sup>126</sup>

In *Healy v. Beer Institute*,<sup>127</sup> the Court used the extraterritoriality doctrine to hold that a Connecticut law facially violated the dormant Commerce Clause.<sup>128</sup> The law required out-of-state beer shippers to affirm that their prices were no higher than the prices charged in the bordering states at the time of the affirmation.<sup>129</sup> The Court reiterated the extraterritorial doctrine of *Edgar*<sup>130</sup> and added that the practical effect of a statute includes both

the consequences of the statute itself [and] how the challenged statute may interact with the legitimate regulatory regimes of other States[, including] what effect would arise if not one, but many or every, State adopted similar . . . inconsistent legislation arising from the projection of one state regulatory regime into the jurisdiction of another State.<sup>131</sup>

Lastly, the intent of the legislature does not affect the validity of the statute.<sup>132</sup>

The Bowen Bill appears to comply with the extraterritoriality doctrine because it applies only to spam originating from servers located in California. However, *Healy* requires that courts also consider the practical effects of the statute; including what would happen if many states adopted similar, yet inconsistent, legislation.<sup>133</sup> The possibility of conflicting obligations exists because the Bowen Bill can apply to e-mail which travels through other states, even if the message originated in California and was sent to a California resident. This may occur in either of two ways. First, the e-mail may simply be routed through other states on its way from the

126. *Edgar*, 457 U.S. at 642-43.

127. 491 U.S. 324 (1989).

128. *Id.* at 340.

129. *Id.* at 335.

130. *Id.* at 336 (quoting *Edgar*, 457 U.S. at 642-43).

131. *Id.* at 337.

132. [A] statute that directly controls commerce occurring wholly outside the boundaries of a State exceeds the inherent limits of that State's authority, and is invalid regardless of whether the statute's extraterritorial reach was intended by the legislature. The critical inquiry is whether the practical effect of the regulation is to control conduct beyond the boundaries of the State.

*Id.* at 336.

133. This consideration is just another form of the "conflicting obligations problem" discussed earlier. *See supra* Part II.A.2.

sender to the recipient.<sup>134</sup> Second, the California resident could access the e-mail remotely from another state. Either way, the requirements of the Bowen Bill would still be met. In these situations, therefore, the e-mail could be subject to both California's law and the potentially inconsistent law of the state through which the e-mail traveled. Thus, the Bowen Bill may run afoul of the extraterritoriality doctrine.<sup>135</sup>

## 2. *Excessively Burdening Interstate Commerce*

Even if a law regulates evenhandedly and does not directly discriminate, it may still violate the dormant Commerce Clause if it places an excessive burden on interstate commerce.<sup>136</sup> In order to determine whether a state law excessively burdens interstate commerce, courts balance the local benefits conferred by the law against the burdens imposed on interstate commerce.<sup>137</sup> In *Pike v. Bruce Church, Inc.*,<sup>138</sup> the Court considered an Arizona statute that prohibited interstate shipment of cantaloupes not packed in regular compact arrangements in closed standard containers.<sup>139</sup> The Court held that the statute violated the dormant Commerce Clause, stating that even if a law "regulates evenhandedly to effectuate a legitimate local public interest," it will still be invalidated if it imposes a burden on interstate commerce which is "clearly excessive in relation to the putative local benefits."<sup>140</sup> In general, the balancing test weighs local needs against national needs. In the process, the court determines whether the area sought to be regulated should be regulated on a local or national level.<sup>141</sup> The Court has held that states may regulate those interests that are so local in nature as to demand diverse regulation, while Congress has exclusive domain over those aspects of interstate commerce that are so national in character as to demand uniform treatment.<sup>142</sup>

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134. See *supra* note 101 and accompanying text.

135. The Bowen Bill might pass this test if amended so that it applies only to spam that never leaves the state of California. However, due to the indeterminacy involved in routing e-mail, two e-mail messages that travel between the same sender and recipient could travel through different states or stay within California. Thus, spam sent on one day may be legal under the amended Bill (because it traveled outside of California), while spam sent on another day may be illegal (because it stayed within California and therefore is subject to the amended Bowen Bill).

136. In this situation, the law could be seen as "indirectly" discriminating against interstate commerce. *Kassel v. Consolidated Freightways Corp.*, 450 U.S. 662 (1981).

137. *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970).

138. 397 U.S. 137 (1970).

139. *Id.* at 138.

140. *Id.* at 142.

141. See *infra* Part III.B.2.b.

142. *Cooley v. Bd. of Wardens*, 53 U.S. (12 How.) 299, 319 (1851).

a) Local Benefits

Many factors are considered on each side of the scale in the *Pike* balancing test. First, the court examines the legitimacy of the state's interest.<sup>143</sup> If the area benefited is an area of traditional local concern (such as a police power), then it is more likely that the law will be held valid.<sup>144</sup> Thus, regulations designed to protect public health or safety probably will not be overturned unless their justifications are "illusory."<sup>145</sup>

With respect to the Bowen Bill, the state interest is mainly economic: California wants to protect its citizens and businesses from the monetary costs associated with spam.<sup>146</sup> In addition, California wants to decrease the inconveniences of receiving spam. This factor would probably weigh in favor of the statute's validity.

Next, the court considers the effectiveness of the statute. If the law is unlikely to bring about the desired beneficial effect (e.g., because of the difficulty of enforcement), then the benefit factor will be small and will probably not outweigh the burden on interstate commerce.<sup>147</sup> Also, the law is more likely to be declared unconstitutional if a reasonable alternative would cause "less of an impact" on interstate commerce.<sup>148</sup>

In this case, the Bowen Bill may be ineffective due to difficulties in enforcement. If the spammer spoofs information in the e-mail, it may be difficult for the state to find the spammer in order to prosecute him. On the other hand, it is unlikely that better alternatives exist, such as statutes that would regulate spam while placing less of a burden on interstate commerce. Thus, overall, the local benefit side of the scale is not tipped very far (if at all) in favor of finding the Bowen Bill to be constitutional.

b) Burden on Interstate Commerce

After determining the local benefit at stake, the court assesses the burden on interstate commerce, especially the possibility of inconsistent obligations.<sup>149</sup> This situation arises most often when the state seeks to address

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143. *Pike*, 397 U.S. at 142.

144. *See, e.g.*, *Kassel v. Consolidated Freightways Corp.*, 450 U.S. 662, 670 (1981).

145. *Id.*

146. Note that consumer protection against fraud is a traditional state police power. Thus, the scale may tip towards approving consumer protection laws that regulate spam by prohibiting spoofing. In *Lipsitz*, for example, a law prohibiting spoofing survived because it only "tangentially" burdened interstate commerce. *People v. Lipsitz*, 663 N.Y.S.2d 468, 475 (Sup. Ct. 1997).

147. *Am. Libraries Ass'n v. Pataki*, 969 F. Supp. 160, 178 (S.D.N.Y. 1997).

148. *Pike*, 397 U.S. at 142.

149. *See supra* Part II.A.2.

a national problem, because state regulation of national interests may impose inconsistent obligations on interstate actors. Therefore, national interests must be regulated in a uniform way, which usually can be done only at the federal level. Courts have "long held that state regulation of those aspects of commerce that by their unique nature demand cohesive national treatment is offensive to the Commerce Clause."<sup>150</sup> This factor has been determinative in cases involving transportation, communications, and taxes,<sup>151</sup> for all are areas involving national interests.

In order to determine when an aspect of interstate commerce demands uniform treatment, courts consider the hypothetical effect of every state enacting conflicting laws concerning the subject at issue.<sup>152</sup> If such regulations would excessively burden interstate commerce, then uniform treatment is required and the state law is struck down.

State regulation of instruments of interstate commerce usually places a large burden on interstate commerce, because instruments of interstate commerce are national in scope and are therefore very vulnerable to inconsistent state laws. Thus, if the Internet is an instrument of interstate commerce, then the burdens that state Internet regulation place on interstate commerce will likely outweigh any local benefits of the regulation. For example, in *Pataki*, the court stated that "[h]aphazard and uncoordinated state regulation can only frustrate the growth of cyberspace."<sup>153</sup> The court also found that the Internet "requires a cohesive national scheme of regulation so that users are reasonably able to determine their obligations."<sup>154</sup> Thus, the court concluded that the Internet is "susceptible to regulation only on a national level."<sup>155</sup> This line of reasoning suggests that virtually all state laws regulating the Internet would violate the dormant Commerce Clause.<sup>156</sup>

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150. *Am. Libraries Ass'n*, 969 F. Supp. at 169.

151. *See, e.g., S. Pac. Co. v. Arizona ex rel. Sullivan*, 325 U.S. 761 (1945) (holding that an Arizona statute that limited the length of trains within the state was unconstitutional). The court held that there are parts of "national commerce which, because of the need of national uniformity, demand that their regulation, if any, be prescribed by a single authority." *Id.* at 767.

152. *Wabash, St. Louis & Pac. Ry. Co. v. Illinois*, 118 U.S. 557, 575-76 (1886).

153. *Am. Libraries Ass'n*, 969 F. Supp. at 183.

154. *Id.* at 182.

155. *Id.* at 181.

156. *Id.* at 182; *see supra* note 103; Hameline & Miles, *supra* note 102, at 21; Burk, *supra* note 37, at 1123-34; Reynolds, *supra* note 99, at 537-42; Blake, *supra* note 25, at 141.

As discussed above,<sup>157</sup> the Bowen Bill can apply to spam that travels through states other than California. Therefore, one piece of e-mail likely can be subject to inconsistent laws. Thus, the burden that the Bowen Bill places on interstate commerce probably outweighs its local benefits, and the Bill therefore violates the dormant Commerce Clause.

#### IV. CONCLUSION

The costs that spam imposes on ISPs and recipients increase daily. Private responses to the problem, such as ISP use policies and the MAPS RBL, are inadequate. Legislation is a better choice, since the process is public and legislators are politically accountable. However, state spam legislation is subject to dormant Commerce Clause limits, and some statutes, such as the Bowen Bill, have been held to violate the dormant Commerce Clause. Because spam is sent interstate via the Internet, it must be regulated in a uniform way at the national level.<sup>158</sup>

So far, approximately seventeen federal spam bills have been introduced into Congress,<sup>159</sup> all of which have failed to become law.<sup>160</sup> Currently, only one federal spam bill is pending, the Unsolicited Commercial Electronic Mail Act of 2001 ("UCEMA").<sup>161</sup> UCEMA aims "[t]o protect individuals, families, and Internet service providers from unsolicited and unwanted electronic mail."<sup>162</sup> It is a reintroduction of the Unsolicited

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157. See *supra* note 134 and accompanying text.

158. See Bassinger, *supra* note 37, at 926; Derek D. Simmons, Comment, *No Seconds on Spam: A Legislative Prescription to Harness Unsolicited Commercial E-mail*, 3 J. SMALL & EMERGING BUS. L. 389, 409 (1999); Topping, *supra* note 64, at 237; Michael W. Carroll, *Garbage In: Emerging Media and Regulation of Unsolicited Commercial Solicitations*, 11 BERKELEY TECH. L.J. 233, 276 (1996); see also Gary S. Moorefield, Note, *SPAM—It's not Just for Breakfast Anymore: Federal Legislation and the Fight to Free the Internet From Unsolicited Commercial E-Mail*, 5 B.U. J. SCI. & TECH. L. 10 para. 35 (1999) (proposing a new federal law).

159. See Spam Laws, at <http://www.spamlaws.com/federal/index.html> (last visited Jan. 25, 2001) (current bills); Pending Federal Bills, at <http://www.jmls.edu/cyber/statutes/email/fedtable.html> (July 17, 1998) (past bills); see also Ochoa, *supra* note 49, at 459 n.4 ("Eight bills were introduced in the 105th Congress, none of which became law.").

160. *Id.*

161. Unsolicited Commercial Electronic Mail Act of 2001, H.R. 95, 107th Cong. (2001).

162. *Id.*

Commercial Electronic Mail Act of 2000,<sup>163</sup> which was passed by the House but died in the Senate.<sup>164</sup>

UCEMA contains many provisions common to state spam laws. First, it requires that spam be labeled as such and include opt-out instructions.<sup>165</sup> UCEMA also prohibits spoofing.<sup>166</sup> Lastly, UCEMA would give ISP use policies the force of law.<sup>167</sup> Specifically, if an ISP's use policy is clearly posted on a web site at the domain name included in the recipient's e-mail address, or is made available by a standard method approved by the Federal Trade Commission, then it would be illegal to use the ISP's facilities in violation of the ISP's use policy.

UCEMA has been referred to House Committees. Thus, Congress is aware of the spam problem and is trying to provide a solution. It remains to be seen whether a federal spam regulation will ever become law.

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163. Unsolicited Commercial Electronic Mail Act of 2000, H.R. 3113, 106th Cong. (1999).

164. Patrick Ross, *Technology Bills Fall Short in Congress*, CNET NEWS.COM, Oct. 20, 2000, at <http://news.cnet.com/news/0-1004-200-3244298.html>.

165. H.R. 95 § 5(a)(3). This is very similar to section 17538.4 of California's Business and Professions Code.

166. H.R. 95 § 4. This is very similar to section 17538.45 of California's Business and Professions Code.

167. H.R. 95 § 5(b).



## THE UNIFORM COMPUTER INFORMATION TRANSACTIONS ACT

By *Brian D. McDonald*

The Uniform Computer Information Transactions Act (“UCITA”)<sup>1</sup> creates a uniform commercial code for computer information transactions. The National Conference of Commissioners on Uniform State Laws (“NCCUSL”), the drafting body for UCITA, approved and recommended UCITA for enactment in all fifty states in July 1999.<sup>2</sup> UCITA provisions cover a wide variety of topics related to computer information including, but not limited to, standard software licenses, contracts for the custom development of computer programs, licenses to access online databases, website user agreements, and agreements for most Internet-based information.<sup>3</sup> The NCCUSL passed UCITA in hopes of clarifying the law governing these computer information transactions and making the law uniform among the various jurisdictions.<sup>4</sup>

Since UCITA’s inception, efforts to establish a uniform state law governing computer information transactions have been fraught with controversy.<sup>5</sup> State legislators have severely criticized UCITA provisions. As of January 2001, only two states had adopted UCITA while most other states had either refused to consider it or had tabled it indefinitely.<sup>6</sup> This Note tracks the most significant of these legislative developments and analyzes their likely effect on the future of UCITA.

Part I outlines the history of UCITA and the most salient issues surrounding its drafting. Part II discusses the three most significant responses taken by the states in response to UCITA: Virginia (nearly full adoption), Maryland (qualified adoption), and Iowa (adoption of a “bomb-shelter”

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1. UNIF. COMPUTER INFO. TRANSACTIONS ACT, *available at* <http://www.law.upenn.edu/bll/ulc/ucita/ucitaFinal00.pdf> (Sep. 29, 2000) [hereinafter UCITA].

2. *See* Carol A. Kunze, *UCITA*, at <http://www.ucitaonline.com/UCITA.html> (last revised Feb. 8, 2001).

3. *See* UCITA, *supra* note 1, Prefatory Note, at 1-2.

4. Richard Raysman & Peter Brown, *Will States Enact Uniform Software Licensing Act?*, 222 N.Y. L.J. 3 (1999).

5. *See* Laura Gasaway, *States Begin to Adopt UCITA—Model Legislation for Licensing*, INFO. OUTLOOK, June 1, 2000, at 53-54.

6. *See* Carol A. Kunze, *What’s Happening to UCITA in the States*, at <http://www.ucitaonline.com/whathap.html> (last revised Feb. 6, 2001).

statute to preempt invocation of UCITA). Finally, Part III analyzes how these three different approaches are likely to affect other states' decisions to adopt or reject UCITA-like legislation.

## I. HISTORY OF UCITA

UCITA began as a joint effort of the NCCUSL and the American Law Institute ("ALI") to adapt the Uniform Commercial Code ("UCC") to the modern needs of computer-related goods and services.<sup>7</sup> Initially entitled UCC Section 2B, it was drafted over a four-year period "after receiving input from database holders, the IT industry and a host of other interests."<sup>8</sup> The NCCUSL lost the prestigious ALI affiliation when the Institute dropped out after four years of drafting due to irreconcilable concerns and disagreements with fundamental aspects of the proposed law.<sup>9</sup> The Conference thereafter issued UCITA as its own free-standing uniform law, which was finally approved in July 1999.<sup>10</sup>

Individual state reactions to UCITA have varied, a few passing it into law,<sup>11</sup> others introducing legislation subject to future consideration,<sup>12</sup> and

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7. Charles H. Fendell & Dennis M. Kennedy, *UCITA Is Coming!!! Part Two: Practical Analysis for Licensors' Counsel*, 17 *COMPUTER LAW* 3, 3 (2000).

8. Robert MacMillan, *BSA to Press Need for Single Net Contract Law*, NEWS-BYTES NEWS NETWORK, Oct. 19, 2000.

9. See *Controversial New Rules for Computer Contracts*, TECH. COMMENTARIES, (Jones, Day, Reavis & Pogue), May 2000, at 1.

10. UCITA was written by an NCCUSL drafting committee composed of commissioners from several states in an open, public drafting process, with full participation by interested parties, including consumer representatives. The committee met in a series of 16 public drafting meetings, which occurred in major cities around the U.S. over a four-year period from 1996-1999. Interested participants from industry, trade organizations and consumer groups attended the drafting sessions, and expressed their views on all the issues. Additional interested parties submitted written comments.

Carol A. Kunze, *Who Wrote UCITA*, at <http://www.ucitaonline.com/slhpwri.html> (last revised Jan. 15, 2001). It is interesting to note that there were six states that voted against UCITA as promulgated by the NCCUSL: Alaska, Iowa, Minnesota, Nebraska, North Carolina, and Utah. See John C. Lobert, *Unwrapping All the Problems with UCITA*, *BUS. INS.*, Oct. 23, 2000, at 40.

11. Virginia was the first state to pass UCITA into law on March 15, 2000. Uniform Computer Transactions Act, S.B. 372, 2000 Va. Acts ch. 43 (Va. 2000). Maryland followed suit one month later on April 10, 2000. Maryland Uniform Computer Information Transactions Act, H.D. 19, 2000 Md. Laws ch. 11 (Md. 2000).

12. UCITA legislation has been introduced in Delaware, the District of Columbia, Hawaii, New Jersey, Illinois, Maine, and Oklahoma. Of these states, Oklahoma has come

the majority refusing to take any action whatsoever on UCITA until its effects are better understood.<sup>13</sup> The most hostile reaction has come from a few states that have contemplated “bomb shelter” statutes to prevent UCITA from governing any computer information transaction contract within their borders.<sup>14</sup> Despite these divergent reactions among the states, most states approach UCITA with an air of caution due primarily to the intense opposition of consumer advocacy groups, many academics, and state government agencies.<sup>15</sup> Although this Note does not discuss the criticisms of UCITA at length, the most salient critiques are briefly highlighted to put the legislative concerns—and subsequent statutory responses to these concerns—in context.<sup>16</sup>

Most criticism of UCITA claims that it gives too much power to the computer information industry and strips consumers of many significant rights that would be protected in non-UCITA jurisdictions. Consumer advocacy groups,<sup>17</sup> academics,<sup>18</sup> and state officials<sup>19</sup> concerned with the

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the closest to official enactment. See *What's Happening to UCITA in the States*, at <http://www.ucitaonline.com/whathap.html> (last visited Jan. 15, 2001).

13. See Kevin Washington, *Plugged In: Software Law Foes See Route to Harm; Regulation: Debate Rages Over Whether Licensing-Agreement Legislation Hurts the Public*, BALT. SUN, June 19, 2000, at 1C (presenting the different sides of the UCITA debate).

14. Iowa was the first state to pass one of these laws, and Delaware is currently considering a comparable bill alongside the UCITA legislation currently pending. Andrea L. Foster, *New Software-Licensing Legislation Said to Imperil Academic Freedom*, CHRON. HIGHER EDUC., Aug. 11, 2000, at A47.

15. See, e.g., Americans For Fair Electronic Commerce Transactions, at <http://www.4cite.org> (last updated Jan. 10, 2001).

16. For a thorough discussion of the criticisms and fears of UCITA opponents, see Cem Kaner, *Why You Should Oppose UCITA*, 17 *COMPUTER LAW* 20 (2000); Michael L. Rustad, *Making UCITA More Consumer-Friendly*, 18 *J. MARSHALL J. COMPUTER & INFO. L.* 547 (1999); Pratik A. Shah, Note, *The Uniform Computer Information Transactions Act*, 15 *BERKELEY TECH. L.J.* 85 (2000). Cf. David A.P. Neboyskey, *A Leap Forward: Why States Should Ratify the Uniform Computer Information Transactions Act*, 52 *FED. COMM. L.J.* 793 (2000); Raymond T. Nimmer, *UCITA: A Commercial Contract Code*, 17 *COMPUTER LAW* 3 (2000). See generally Symposium, *Intellectual Property and Contract Law in the Information Age: The Impact of Article 2B of the Uniform Commercial Code on the Future of Transactions in Information and Electronic Commerce*, 13 *BERKELEY TECH. L.J.* 809 (1998); Symposium, *Intellectual Property and Contract Law for the Information Age: The Impact of Article 2B of the Uniform Commercial Code on the Future of Information Commerce*, 87 *CALIF. L. REV.* 1 (1999).

17. Such consumer advocacy groups include the Consumer Federation of America, the Consumer Project on Technology, the Consumer's Union, the National Consumer League, and the United States Public Interest Research Group. See Americans For Fair Electronic Commerce Transactions, *Some Organizations That Have Opposed or Criticized UCITA*, at <http://www.4cite.org/oppose.html> (last updated Dec. 14, 2000).

nebulous type of mass-market licenses<sup>20</sup> condoned by UCITA, cite three potential problems: (1) oftentimes consumers must agree to the terms of the contract *before* they are able to review them;<sup>21</sup> (2) these agreements, as a license rather than a sale,<sup>22</sup> unavoidably reduce the rights of the con-

18. See *supra* note 16.

19. See *infra* note 30.

20. A "mass-market transaction" is defined by UCITA as (A) a consumer contract; or (B) any other transaction with an end-user licensee if: (i) the transaction is for information or informational rights directed to the general public as a whole, including consumers, under substantially the same terms for the same information; (ii) the licensee acquires the information or informational rights in a retail transaction under terms and in a quantity consistent with an ordinary transaction in a retail market; and (iii) the transaction is not: (I) a contract for redistribution or for public performance or public display of a copyrighted work; (II) a transaction in which the information is customized or otherwise specially prepared by the licensor for the licensee, other than minor customization using a capability of the information intended for that purpose; (III) a site license; or (IV) an access contract.

UCITA, *supra* note 1, § 102(45), at 13.

21. UCITA, *supra* note 1, § 209, at 122-27; John H. Minan, *Consumers May Lose to Software Industry*, SAN DIEGO UNION-TRIBUNE, July 16, 1999, at B9. Minan argues that UCITA validates the use of shrink-wrap and click-wrap mass-market licenses. Unlike most contracts where the parties know all the terms of their agreement before purchasing the product, often this is not the case with mass-market licenses of software. The terms to the license may become known only after a consumer purchases the product. When installing the program, the consumer is often greeted for the first time with the terms of the license that govern its use. Under UCITA, the purchaser may be bound by these restrictions by failing to act, so-called 'assent by silence.'

*Id.*

22. The Prefatory Note of UCITA explains that [t]ransactions in computer information involve different expectations, different industry practices, and different policies from transactions in goods. For example, in a sale of goods, the buyer *owns* what it buys and has exclusive rights in that subject matter (e.g., the toaster that has been purchased). In contrast, someone that acquires a copy of computer information may or may not own that copy, but in any case rarely obtains all rights associated with the information.

UCITA, *supra* note 1, Prefatory Note, at 1-2 (emphasis added); see also *id.* § 502, official cmt. (2), at 207; *id.* § 613(a)(2), at 259; *id.* § 613, official cmt. (4), at 262-63. Jones, *supra* note 9, at 1, argues that

[t]he basic model for a UCITA transaction is the license. A license conveys less than all of the rights in the computer information and restricts the use of that information. A license differs from a sales contract in that the value in a license may be primarily in the terms of the agreement, not the underlying subject matter. For example, in a con-

sumer;<sup>23</sup> and (3) the language of the license (drafted by the licensor) determines the law governing the license, allowing the licensor to choose the jurisdiction most favorable to its interests.<sup>24</sup> Other concerns, exacerbated by the use of mass-market licenses, include the following: “self-help” provisions, which entitle licensors to shut off or repossess the product should the licensee violate the terms of the agreement;<sup>25</sup> the ability to change the terms of the agreement without notifying the other party directly;<sup>26</sup> the right to disavow any implied warranties required by state law;<sup>27</sup> permitting contract law (in lieu of federal copyright law) to govern

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tract for the sale of a widget, typically the value is in the widget itself. But the value in a software license will vary widely depending upon whether the contract allows the software to be used by 10 people or 10,000 people, even though the intrinsic value of the underlying software itself is unchanged. Two typical business license transactions covered by UCITA are electronic commerce and mass-market licenses.

23. See John F. Rudin, *E-Business, E-Commerce and the Law*, 7 RICH. J.L. & TECH. 2, 14 (2000):

Characterization of these transactions as ‘licenses’ means use of an obscure legal category that consumers do not understand. Furthermore, today there is little doubt that consumer protection statutes, written so that they cover ‘sales’ of goods and services, apply to contracts for software and online services, but under UCITA this would be put in doubt.

24. UCITA, *supra* note 1, § 109, at 74-75. For example, [o]ne manufacturer already has selected France and another Ireland as the places to resolve disputes. While these locales are no doubt lovely places to visit, they aren’t for this purpose. The objective is, of course, to force the buyer to accept the dispute settlement offer of the manufacturer because most buyers cannot justify hiring French or Irish lawyers and spending time and more money in those countries pursuing their cases.

Lobert, *supra* note 10, at 40; cf. Kathleen Patchel, *Choice of Law and Software Licenses: A Framework for Discussion*, 26 BROOK. J. INT’L L. 117 (2000).

25. See UCITA, *supra* note 1, §§ 815-16, at 334-48; Timothy P. Heaton, Note, *Electronic Self-Help Software Repossession: A Proposal to Protect Small Software Development Companies*, 6 B.U. J. SCI. & TECH. L. 8 (2000); Robbin Rahman, Comment, *Electronic Self-Help Repossession and You: A Computer Software Vendor’s Guide to Staying Out of Jail*, 48 EMORY L.J. 1477 (1999); see also Fendell, *supra* note 7, at 12.

26. See UCITA, *supra* note 1, § 304(b), at 152; Kaner, *supra* note 16, at 28 n.51; see also Fendell, *supra* note 7, at 11.

27. See UCITA, *supra* note 1, § 406, at 193-94; Mary Jo Howard Dively, *The UCITA Revolution: The New E-Commerce Model for Software and Database Licensing*, 600 PLI/PAT 491 (2000); see also Fendell, *supra* note 7, at 10.

transactions for digital information;<sup>28</sup> and privacy concerns with the licensing of personal data.<sup>29</sup>

These criticisms—many of which have been expressed by high-level state officials, including the attorneys general of twenty-four states<sup>30</sup>—have significantly delayed both the introduction and passage of UCITA or UCITA-like legislation in most of the states.<sup>31</sup> These delays, however, are not dispositive. At the very least, UCITA will receive a cursory review in most state legislatures during the next year and a half.<sup>32</sup> Once the states begin to consider UCITA in earnest, their options will in large part be shaped by the proactive efforts of three states that have taken different approaches to the UCITA question.

## II. THREE LEGISLATIVE MODELS

Virginia, Iowa, and Maryland have taken the most legislative action in response to UCITA. Although other state legislatures are currently in the final drafting phases of similar bills,<sup>33</sup> these three states alone have completed the drafting process and have enacted—or are slated to enact—UCITA or anti-UCITA statutes. Their respective approaches represent the three likely alternatives available to states today: (1) to embrace UCITA; (2) to reject UCITA; or (3) to accept or reject specific UCITA provisions according to legislative findings and debate. As states consider these three models, their ultimate choice will be affected significantly by their respective political environments, as was the case in the highly politicized processes in Virginia, Iowa, and Maryland.

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28. See UCITA, *supra* note 1, § 103, at 41-44; see also Fendell, *supra* note 7, at 9 n.21.

29. See Pamela Samuelson, *Privacy as Intellectual Property?*, 52 STAN. L. REV. 1125 (2000); Pratik A. Shah, *UCITA's Facade: Creating a One-Size-Fits-All Information Policy Under the Guise of a Commercial Contract Statute* (2000) (unpublished manuscript, on file with author).

30. See Letter from the Attorneys General of Twenty-four states to Gene Lebrun, President, NCCUSL (July 23, 1999), available at <http://www.ucitaonline.com/docs/799agsuo.html> [hereinafter Letter from the Attorneys General].

31. See Washington, *supra* note 13, at C1.

32. Jaikumar Vijayan, *UCITA*, COMPWORLD, June 5, 2000, at 72.

33. For example, Oklahoma is considering legislation similar to Maryland, while Delaware is leaning towards Iowa's approach. Gasaway, *supra* note 5, at 53-54.

### A. Virginia: A High-Tech Mecca

On March 15, 2000, Virginia became the first state to adopt UCITA.<sup>34</sup> First submitted six months earlier, Virginia's version of UCITA did not undergo extensive legislative debate or serious review by legislative committees.<sup>35</sup> The debate that did ensue produced only a smattering of minor amendments, most of which passed largely unopposed. In the House, only two legislators opposed the amended bill in committee, one of them eventually voting for it in the general vote.<sup>36</sup> In the Senate, the vote was unanimous in both the committee and general votes.<sup>37</sup> As a result of these expeditious proceedings and sparse amendments, the final product practically reproduced the original language of UCITA as submitted to the states by the NCCUSL in 1999.<sup>38</sup>

The most significant amendment related to UCITA's choice of law provision, which allows the parties to choose which law governs the contract.<sup>39</sup> The Virginia legislature changed the language to specify that in the absence of an enforceable agreement between the parties regarding choice of law, the contract will be governed by Virginia law.<sup>40</sup> While simplifying the complex procedures for choice of law outlined by NCCUSL,<sup>41</sup> this

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34. M.J. Zuckerman, *Software Law Could Be a Hard Sell*, USA TODAY, Mar. 29, 2000, at 3D.

35. See Ed Foster, *The Gripe Line: Mid-Atlantic States Vie To Become The First To Enact The Controversial UCITA*, INFOWORLD, Mar. 6, 2000, at 93.

36. See Virginia House Legislative History, H.B. 561, 2000 Leg. (Va. 2000), available at <http://leg1.state.va.us/cgi-bin/legp504.exe?001+sum+HB561> (last visited Jan. 15, 2001).

37. See Virginia Senate Legislative History, S.B. 372, 2000 Leg. (Va. 2000), available at <http://leg1.state.va.us/cgi-bin/legp504.exe?ses=001&typ=bil&val=sb372> (last visited Jan. 15, 2001).

38. This high level of support for UCITA came not only from the legislature but from the executive branch as well. Governor Gilmore has been a staunch supporter of UCITA throughout the entire ratification process. In fact, several months before the final passage of UCITA into Virginia law, he stated, "nothing could be more basic to a free market than the right of vendors and purchasers to negotiate their respective rights and responsibilities. UCITA underscores the right of software and information vendors, and their customers, to negotiate contractual terms." James S. Heller, *The Uniform Computer Information Transactions Act: Still Not Ready for Prime Time*, 7 RICH J.L. & TECH. 2, 4 (2000).

39. UCITA, *supra* note 1, § 109, at 74-75.

40. Uniform Computer Transactions Act, S.B. 372, 2000 Va. Acts ch. 43 § 59.1-501.9 (Choice of Law) (Va. 2000).

41. See UCITA, *supra* note 1, § 109, at 74-75. UCITA holds that parties may choose the applicable law in their agreement, but in the absence of such a clause, choice of law will be determined by where the licensor was located (for access contracts), where the copy was delivered (in consumer contracts), or the location of the jurisdiction having the

change may serve to abridge rather than augment consumer welfare. By defaulting to Virginia law, which is practically identical to UCITA, this provision will prevent consumers in Virginia from escaping UCITA jurisdiction altogether, even when the license itself is silent regarding choice of law.

The other significant amendment responded to consumer concerns. Virginia senators included language providing for a study of the "impact of UCITA on Virginia business, libraries, and consumers" to be submitted to the General Assembly prior to the Act's effective date.<sup>42</sup> Virginia state officials have pledged that this study will allow the legislature to give consumer qualms due diligence prior to and directly following the Act's effective date, scheduled for July 1, 2001.<sup>43</sup> Although adopting a proposal before it is thoroughly studied is an unusual tactic, Virginia legislators claim that a year of study will provide more than enough time to iron out any concerns expressed by consumer groups.<sup>44</sup> At the same time, a year of enacted law will probably attract other technology companies to the state.

## B. Iowa: The Poison Pill

Iowa's legislature considered UCITA while concurrently evaluating the Uniform Electronic Transactions Act ("UETA"),<sup>45</sup> a similar, but more

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most significant relation to the transaction. Virginia removed this language and held that in the absence of such a clause, Virginia law will govern. Uniform Computer Transactions Act, S.B. 372, 2000 Va. Acts ch. 43 § 59.1-501.9 (Choice of Law) (Va. 2000).

42. The full text of the amendment is:

The Joint Commission on Technology and Science (JCOTS) shall study the impact of the Uniform Computer Information Transactions Act (UCITA) on Virginia business, libraries, and consumers. JCOTS shall appoint a subcommittee to advise the Commission on its work. The members of the subcommittee shall include the following: two members of the Senate, two members of the House, a representative of the Northern Virginia Technology Council, a representative of the Virginia Manufacturing Association, a representative of the insurance industry, a representative of the public libraries and a representative of the Richmond Technology Council. JCOTS shall issue a written report to the General Assembly before December 1, 2000.

Amendments Proposed by the Senate Committee on General Laws, S.B. 372, 2000 Leg. (Va. 2000) available at <http://leg1.state.va.us/cgi-bin/legp504.exe?001+amd+SB372AS> (last visited Feb. 10, 2001).

43. Michael P. Bruno, *UCITA Passes Virginia Legislature*, NEWSBYTES NEWS NETWORK, Feb. 15, 2000.

44. *Id.*

45. UNIF. ELECS. TRANSACTIONS ACT, 7A U.L.A. 17; see also Jonathan Stern, Note, *The Electronic Signatures in Global and National Commerce Act*, 16 BERKELEY TECH. L.J. 391 (2001).

limited piece of legislation related to the use of electronic modes of conducting transactions. Although Iowa ratified UETA, it flatly rejected UCITA. It thereafter amended the UETA bill to include a “bomb-shelter” provision expressly forbidding any party from enforcing UCITA as the choice of law against an Iowa citizen or business.<sup>46</sup> In short, Iowa not only rejected UCITA, but also rendered other states’ adoption of UCITA meaningless within the borders of Iowa since the provision allows Iowa consumers and businesses to override any express provision in a contract that makes UCITA the governing law.

This move is not surprising in view of the fact that Iowa’s Attorney General was one of the twenty-four in the nation strongly opposed to the model statute as it stood before the NCCUSL in July 1999.<sup>47</sup> The bomb-shelter provision followed the Attorney General’s negotiations with America Online, which forced the company to notify users in Iowa of the change in its terms of service, a requirement that could be revoked under UCITA provisions.<sup>48</sup> Such experiences help explain Iowa’s reluctance to implement UCITA as drafted by the NCCUSL.<sup>49</sup>

Iowa’s poison pill provision—the first of its kind—presents an option to states that many may not have considered. Like Iowa, states may now choose to evaluate UCITA and UETA separately. There is no compelling reason why they must be passed together; in fact, the changes proposed by

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46. The relevant section of the statute states,  
(4) A choice of law provision, which is contained in a computer information agreement that governs a transaction subject to this chapter, that provides that the contract is to be interpreted pursuant to the laws of a state that has enacted the uniform computer information transactions Act [sic], as proposed by the national conference of commissioners on uniform state laws, or any substantially similar law, is voidable and the agreement shall be interpreted pursuant to the laws of this state if the party against whom enforcement of the choice of law provision is sought is a resident of this state or has its principal place of business located in this state. For purposes of this subsection, a “computer information agreement” means an agreement that would be governed by the uniform computer information transactions Act or substantially similar law as enacted in the state specified in the choice of laws provision if that state’s law were applied to the agreement.

H.D. 2205, 2000 Leg., 78th Gen. Assem., 2d Sess. § 554D.104: Scope (Iowa 2000).

47. See Letter from the Attorneys General, *supra* note 30; see also Cem Kaner, *Software Engineering and UCITA*, 18 J. MARSHALL J. OF COMPUTER & INFO. L. 435, 439 (1999).

48. See Washington, *supra* note 13, at 1C.

49. See *id.*

the two laws address completely different spheres.<sup>50</sup> Despite the pervasive need in the states today for uniform e-commerce law and the ability of UETA and UCITA to meet this need, these changes can be achieved separately without harming the integrity or effectiveness of either law due to the different subject matter and scope covered by the two proposals. Iowa has chosen this path for the present, but claims that it will review UCITA again during the 2001 legislative session.<sup>51</sup>

### C. Maryland: UCITA-Lite

On April 10, 2000, Maryland became the second state to adopt UCITA,<sup>52</sup> appropriately entitling it "MCITA."<sup>53</sup> Unlike Virginia, the Maryland legislature refused to accept UCITA with open arms. However, unlike Iowa, it did not reject UCITA out of hand. It opted for a middle path, a form of compromise whereby the legislature reviewed UCITA for six weeks and adopted several substantial amendments to the bill.<sup>54</sup> These amendments reflected a deliberative effort to fashion UCITA to the realities of computer information transactions in Maryland.

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50. Unlike UCITA, UETA is a model law designed to help states create uniform rules for electronic transactions and signatures. See M. Michael Cramer et al., *Uniformity in State Laws*, 33 MD. B.J. 48 (2000). Its scope extends only to the conduct of electronic transactions, whereas UCITA covers all other computer information transactions. For example, when a consumer is purchasing a product over the Internet, UETA would cover the enforceability of any signature(s) sent over the Internet related to the transaction. On the other hand, UCITA would cover the remaining contract rights of the seller and the buyer as parties to the sale of the product itself. In fact, the terms of UETA expressly limit its application to transactions not within the scope of UCITA. Perhaps that is why UETA takes up a few pages while UCITA occupies a few hundred. Margaret Jane Radin, *Humans, Computers, and Binding Commitment*, 75 IND. L.J. 1125, 1140 (1999). Both UCITA and UETA are also remarkably different in their approach to the adaptation of the law to the online world. "UETA retains the contract-as-consent model and merely aims to remove specific obstacles in the way of contracting electronically; whereas UCITA moves significantly toward the contract-as-product model and aims to change the substantive law in that direction." See *id.* Unlike UCITA, UETA does not attempt to create a new substantive system of legal rules for electronic commerce, but rather codifies clear rules giving legal and binding force to transactions conducted in an electronic format. Jonathan Angel, *Electronic Signatures and Contracts Made Via PKI Are Legally Valid, but the Jury's Still Out on How Enforceable They're Going to Be—PKI and the Law*, NETWORK MAGAZINE, Oct. 1, 2000, at 48.

51. See Washington, *supra* note 48, at 1C.

52. Jeffrey W. Reyna, *Maryland Adopts Software Transaction Law*, UPSIDE TODAY, May 2, 2000, available at <http://www.upsidetoday.com/texis/mvm/story?id=390df3f00> (last visited Jan. 15, 2001).

53. See S. Keith Mouldsdale & Steven E. Tiller, *UCITA Spells Controversy*, 33 MD. B.J. 23, 23 (2000).

54. See Reyna, *supra* note 52.

Perhaps the most significant change Maryland made to UCITA relates to the UCITA provision upholding choice of law clauses in the context of a consumer contract or a mass-market license.<sup>55</sup> Under MCITA, all lawsuits regarding mass-market licenses in Maryland are governed by Maryland law, rather than the state law of the licensor's choosing (such as one that has a less adulterated version of UCITA). This is more significant than Virginia's choice of law amendment, which only defaults to Virginia law in the absence of a clear choice of law provision, regardless of the form of contract. The MCITA provision offers greater protection to consumers in Maryland than Virginia by forcing companies doing business in Maryland to operate under Maryland's revised, more consumer-friendly version of UCITA.<sup>56</sup>

The legislature also made several significant changes to UCITA's provisions regarding mass-market licenses. First, the license cannot be contrary to public policy, including fundamental public policies concerning competition or innovation.<sup>57</sup> This is a significant limitation since it gives wide latitude to courts to find the license invalid. Second, a mass-market license in Maryland that contains a provision limiting its duration<sup>58</sup> must be conspicuous.<sup>59</sup> This prevents licensors from selling licenses of limited duration without adequately notifying potential licensees. Third, regarding shrinkwrap<sup>60</sup> and clickwrap agreements,<sup>61</sup> a major concern of consumer advocacy groups,<sup>62</sup> MCITA takes the same approach as the Seventh Cir-

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55. UCITA states:

[t]he parties in their agreement may choose the applicable law. However, the choice is not enforceable in a consumer contract or a mass-market license to the extent it would vary a rule that may not be varied by agreement under the law of the jurisdiction whose law would apply under subsections (b) and (c) of this section in the absence of the agreement.

UCITA, *supra* note 1, § 109(a), at 74.

56. See Maryland Uniform Computer Information Transactions Act, H.D. 19, 2000 Md. Laws ch. 11 § 21-110(A)(2) (Contractual Choice of Forum) (Md. 2000).

57. *Id.* § 21-209(A)(2) (Mass-Market License).

58. For example, such a provision might be included in a license to use Microsoft Word declaring that the license expires in three years.

59. Maryland Uniform Computer Information Transactions Act, H.D. 19, 2000 Md. Laws ch. 11 § 21-209(D) (Mass-Market License) (Md. 2000).

60. "Shrinkwrap licenses are a special form of mass-market license. [Their terms] are not revealed until after an initial agreement to acquire a product; in other words, there is no opportunity to review terms before payment." Shah, *supra* note 16, at 91.

61. Clickwrap licenses are also a special form of mass-market license. The terms are revealed beforehand but assent is required before the consumer can use, purchase, download, or oftentimes even view the product.

62. See Minan, *supra* note 21, at B9.

cuit in *ProCD Inc. v. Zeidenberg*<sup>63</sup> and *Hill v. Gateway 2000, Inc.*<sup>64</sup> That is, MCITA implicitly acknowledges the validity of such agreements so long as the user has a reasonable opportunity to review the terms and manifests assent to such terms.<sup>65</sup> Maryland's version of UCITA, however, inserts additional language providing that the terms are only part of a license where they are available for viewing in a printed form or an electronic format both before and after a purchaser grants assent.<sup>66</sup> This language permits consumers in Maryland to ignore terms in licenses that were not available to them both before and after they granted assent to such terms.

The Maryland legislature also took another important step by reinstating a manufacturer's implied warranties of merchantability for all consumer contracts.<sup>67</sup> Under the original language of UCITA, many producers could use clickwrap or shrinkwrap agreements to explicitly disclaim all warranties of merchantability and to disavow the state's implied warranty law regarding software sales (which says that programs must do what they purport to do).<sup>68</sup> MCITA prevents vendors from disclaiming such warranties in cases of mass-market sales.<sup>69</sup> Maryland lawmakers also prohibited remote disabling in mass-market licenses, a self-help practice sanctioned by UCITA that allows manufacturers to remotely disable a user's product (typically software) by reaching in through the Internet and disabling it in the event that the user fails to abide by the license agreement.<sup>70</sup> MCITA also contains language in the statute addressing concerns voiced by preemption critics—notably regarding the effect of UCITA on fair use—that explicitly prevents UCITA from undermining, or in any way invalidating, federal copyright law.<sup>71</sup> Finally, Maryland legislators also envisioned alternative dispute resolution under Maryland's version of UCITA, an option not included in the original version of UCITA.<sup>72</sup>

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63. 86 F.3d 1447 (7th Cir. 1996).

64. 105 F.3d 1147 (7th Cir. 1997).

65. Mouldsdale & Tiller, *supra* note 53, at 25.

66. Maryland Uniform Computer Information Transactions Act, H.D. 19, 2000 Md. Laws ch. 11 § 21-209(A) (Mass-Market License) (Md. 2000).

67. *See id.* § 21-406 (Disclaimer or Modification of Warranty)

68. *See* UCITA, *supra* note 1, § 406, at 193-94.

69. *See* Maryland Uniform Computer Information Transactions Act, H.D. 19, 2000 Md. Laws ch. 11 § 21-406 (Disclaimer or Modification of Warranty) (Md. 2000).

70. *Id.* § 21-816 (Limitations on Electronic Self-Help).

71. *Id.* § 21-105 (Relation to Federal Law; Fundamental Public Policy; Transactions Subject to Other State Law).

72. *Id.* § 21-110(c) (Contractual Choice of Forum).

Although these multifarious amendments by the Maryland legislature serve to enhance consumer rights vis-à-vis the software industry, critics argue that they are purely cosmetic, leaving the dangerous UCITA provisions largely untouched.<sup>73</sup> Furthermore, the amendments incorporated into MCITA are severely limited in scope by other UCITA provisions. For example, although MCITA enhances consumer rights in mass-market licenses, according to MCITA's narrow definition of "consumer"<sup>74</sup> and "mass-market transaction"<sup>75</sup> (without which one does not have a "mass-market license") many transactions will not be provided the extra protections granted by Maryland's version of UCITA.<sup>76</sup> For instance, Internet

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73. See Ed Foster, *The Gripe Line: Maryland Legislature Caves to UCITA, But Iowa May Offer a Safe Haven from Law*, INFOWORLD, Apr. 24, 2000, at 121.

74. Although several amendments to the bill provide for specific consumer protections missing in UCITA, most businesses and those who work at home will not benefit from these changes due to the narrow definition of "consumer" in the Maryland statute:

an individual who is a licensee of information or informational rights that the individual at the time of contracting intended to be used primarily for personal, family, or household purposes. The term does not include an individual who is a licensee primarily for professional or commercial purposes, including agriculture, business management, and investment management other than management of the individual's personal or family investments.

Maryland Uniform Computer Information Transactions Act, H.D. 19, 2000 Md. Laws ch. 11 § 21-102(A)(15) (Definitions) (Md. 2000).

75. According to the Maryland statute, a "mass market transaction" is

(a) a consumer contract; or (b) any other transaction with an end-user licensee if: (i) the transaction is for information or informational rights directed to the general public as a whole, including consumers, under substantially the same terms for the same information; (ii) the licensee acquires the information or informational rights in a retail transaction under terms consistent with an ordinary transaction in a retail market; and (iii) the transaction is not: 1. A contract for redistribution or for public performance or public display of a copyrighted work; 2. A transaction in which the information is customized or otherwise specially prepared by the licensor for the licensee, other than minor customization using a capability of the information intended for that purpose; 3. A site license; or 4. An access contract.

Maryland Uniform Computer Information Transactions Act, H.D. 19, 2000 Md. Laws ch. 11 § 21-102(A)(45) (Definitions) (Md. 2000).

76. According to this definition, a New Jersey legislative commission, after studying the UCITA reporter's comment on mass-market transactions, noted that "[I]n light of the comment, it would appear that the purchase of a single shrink-wrapped copy of Microsoft Office at a mass-market retail outlet such as Staples or OfficeMax by a four-person law firm would not fall within the UCITA definition of a 'mass market transaction.'" Foster, *supra* note 35, at 93. As a result, the strict requirements and limitations issued in Maryland on such transactions will have less impact.

service providers and other access contracts are excluded from the definition of a mass-market transaction. Therefore, as one critic has pointed out, "the strongest protections afforded by MCITA to consumers are generally not available in connection with one of the most prevalent types of standard license forms directed to the general public."<sup>77</sup>

Another example of MCITA's limited scope relates to self-help. Although MCITA takes a strong stand against such practices, it does not absolutely prohibit them. In fact, outside the context of mass-market licenses, they are generally allowed so long as there is valid consent by both parties,<sup>78</sup> opportunity to cure by the breaching party,<sup>79</sup> and substantial notice by the manufacturer of intent to repossess.<sup>80</sup> Therefore, the amendments incorporated into MCITA may appear to shift the balance in favor of consumers, but other provisions will serve to limit the extent of these protections. The amendments to MCITA certainly give Maryland consumers an advantage over their neighbors in Virginia. The true magnitude of this advantage, however, is yet to be determined.

Despite Maryland's serious reservation with UCITA's original language, the uniform law became effective in Maryland before Virginia. Maryland was the first state in the country to enforce UCITA provisions on October 1, 2000.<sup>81</sup> Nevertheless, Maryland officials have insisted that the statute retain language creating a legislative oversight commission to study the act and recommend additional revisions in the near future.<sup>82</sup>

#### **D. The Political Reality behind the Statutes**

The statutes drafted in Virginia, Iowa, and Maryland envision three distinct approaches to the technological transformation of contract law prompted by UCITA. This divergence among the states has arguably resulted from pervasive lobbying by consumer advocacy and software manufacturing groups. While the software industry has concentrated their efforts in high-technology states such as Virginia and Maryland, it has less political leverage in states such as Iowa where the technology industry is not as prevalent. Nevertheless, all three states have been forced to contend with these rival forces to a certain degree, and their political interaction has shaped the outcome of UCITA enactment in all three states.

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77. Mouldsdale & Tiller, *supra* note 53, at 25.

78. Maryland Uniform Computer Information Transactions Act, H.D. 19, 2000 Md. Laws ch. 11 § 21-816(C) (Limitations on Electronic Self-Help) (Md. 2000).

79. *Id.*

80. *Id.*

81. See Vijayan, *supra* note 32, at 72.

82. Gasaway, *supra* note 5, at 53-54.

The Virginia legislature allegedly glossed over consumer concerns with UCITA in hopes of attracting high-technology industries in the near future.<sup>83</sup> Technology industries have voiced their strong support for UCITA and have indicated that they would prefer to do business in states with UCITA-friendly legislation.<sup>84</sup> By retaining most of the original UCITA language, Virginia has established a significant competitive advantage over the other states in the increasingly cutthroat industry of recruiting Internet businesses. Furthermore, Virginia has a strong interest in retaining the business it already has and not losing it to other states—such as Maryland. Northern Virginia is home to many Internet-related companies likely to be affected by UCITA, including both America Online and MCI subsidiary UUNET Technologies, two powerhouses in the world of commercial Internet service providers.<sup>85</sup>

Like Virginia, Maryland's adoption of UCITA was part and parcel of a larger plan to attract technology companies to the state by creating a technology-friendly legal climate aptly entitled the *eMaryland Agenda*.<sup>86</sup> Only hours away from the technology corridor in northern Virginia, Maryland's passage of UCITA aims at drawing many of these companies northward by providing an amicable legal environment. Although Maryland significantly amended the original UCITA language, these changes have left most of the controversial, pro-software industry provisions intact. As a result, Maryland's version of UCITA remains a highly attractive forum for technology firms.

Unlike Virginia and Maryland, Iowa does not have to appease substantial technology industries within its state borders. As a primarily agricultural state, its consumers of technology dramatically outnumber its producers. Although it might attempt to change this imbalance in the future, there is no such indication that it desires to do so at present. Consequently, Iowa lawmakers naturally focus on consumers' rights when formulating state law related to computer information transactions. Since UCITA has tremendous potential to affect citizens outside the state that enacts it (due to choice of governing law provisions), Iowa is best serving the interests

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83. See Craig Timberg, *Gilmore Signs Bill On Software: State Is First to Enact Industry-Backed Law*, WASHINGTON POST, Mar. 15, 2000, at B1; Mitch Betts & Margret Johnston, *State Passes User-Opposed Software Law, Virginia First to Pass Contested UCITA*, COMPUTER WORLD, Feb. 21, 2000, at 12.

84. See Betts & Johnston, *supra* note 83, at 12.

85. Scott W. Burt, *Controversial New Rules for Computer Contracts*, METROPOLITAN CORP. COUNSEL, June, 2000, at 10.

86. In fact, the day after signing UCITA into law, Maryland Governor Parris Glendening headed to Silicon Valley for a visit with industry heavy-hitters. Reyna, *supra* note 52.

of its constituents in the foreseeable future by enacting a bomb-shelter statute.

Nevertheless, Iowa is not advocating an antitechnology approach to future contract law. When it comes to goods and services, Iowa understands the innumerable benefits that technology and innovation can bring to a state. As discussed above, Iowa was one of several states to pass UETA this year,<sup>87</sup> indicating its support for a shift in the law governing goods and services to better fit the technological aspects of modern commerce. However, Iowa's participation in the "technological revolution" is tempered by UCITA's controversy. UETA provisions codify law that has been largely accepted by many states, unlike UCITA, which has only been adopted by two state legislatures and has been severely criticized in both the private and public sector. Until states like Iowa<sup>88</sup> view UCITA as an objectively beneficial advancement in contract law for both states with and without significant technology sectors, UCITA's chances of becoming uniform law remain small.

### III. THE FUTURE OF UCITA: TWO STEPS FORWARD, ONE STEP BACK

This Part evaluates UCITA's prospects in the remaining state legislatures following the recent developments in Virginia, Iowa, and Maryland. Using a model of state competition entitled the "race-to-the-top," this Part explores the negative perceptions held by a significant number of states and the dynamics of interstate competition that will likely result from such perceptions. The Note concludes that until a positive perception of UCITA emerges, a majority of the states will not adopt UCITA as a uniform law.

#### A. The Uniform Law Process

UCITA was created by the NCCUSL, an august body that has drafted model laws for well over a hundred years.<sup>89</sup> NCCUSL commissioners are appointed by the governors of each state and are then assigned by the NCCUSL to various drafting committees. Typically, these committees are a mixture of practicing lawyers, judges, and professors that aim to promote uniformity in the law among the states where desirable and practi-

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87. Michael Carlson, *Will E-sign Boost E-commerce?*, NW. FIN. REV., Sept. 9, 2000, at 16.

88. Most notable are Alaska, Iowa, Minnesota, Nebraska, North Carolina, and Utah, whose commissioners voted against the version of UCITA passed by the NCCUSL in the summer of 2000. Lobert, *supra* note 10, at 40.

89. See Cramer et al., *supra* note 50, at 49.

cal.<sup>90</sup> The committees generally solicit the opinions and viewpoints of numerous interested groups, which then actively participate in the exhaustive drafting process.<sup>91</sup> The final product is presented for debate to the NCCUSL. If approved, it is sent to the states for enactment as a uniform law or a model act.<sup>92</sup>

Of course, passage of a uniform law by the NCCUSL does not necessarily assure uniform adoption by the states.<sup>93</sup> Although many academics believe that uniform laws are practically guaranteed passage,<sup>94</sup> the NCCUSL has often failed to achieve uniform adoption in all fifty states.<sup>95</sup> While uniform adoption is not a prerequisite for success,<sup>96</sup> it is highly desirable<sup>97</sup> and drafters have consistently “measured the success of each uniform drafting effort by counting the number of uniform adoptions.”<sup>98</sup>

The likelihood of eventual uniformity, however, is quite difficult to assess early on in the adoption phase.<sup>99</sup> The ratification process is slow and deliberative; it takes a long time for states to review a uniform law proposal, study its provisions, determine its likely effects, and move it through the state legislature. Even the most successful uniform laws have languished in the halls of legislatures for decades before being enacted by

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90. *Id.*

91. *Id.*

92. *Id.*

93. *Id.*

94. [T]here's no greater blessing a piece of legislation can receive than to be called "uniform" or "model." Many lawmakers seem to feel that if it's one of those, then it should become the law—no questions asked. It's virtually impossible to amend one of these darlings, and once it starts moving through the legislative process, trying to stop it is like standing in front of a steamroller.

Lobert, *supra* note 10, at 40.

95. For example, the NCCUSL has drafted hundreds of acts in various fields: commercial, family, criminal, probate, real estate property law, and more, only a fraction of which have been adopted as uniform law by the states. See Cramer et al., *supra* note 50, at 49.

96. For example, the UCC is considered one of the NCCUSL's greatest achievements despite the fact that it was never fully ratified in Louisiana. See Lane H. Blumenfeld, *Russia's New Civil Code: The Legal Foundation for Russia's Emerging Market Economy*, 30 INT'L LAW. 477, 491 (1996).

97. Lobert, *supra* note 10, at 40 (arguing that “[u]niformity among the states is desirable. . . . It creates and fosters certainty that everyone will ostensibly be treated the same way on the same subject in every state”).

98. Edward J. Janger, *Predicting When the Uniform Law Process Will Fail: Article 9, Capture, and the Race-to-the-bottom*, 83 IOWA L. REV. 569, 576 (1998).

99. Such as the UCC, which was not very successful at first, but caught on over a twenty year period. Blumenfeld, *supra* note 96, at 491.

a majority of the states.<sup>100</sup> Despite these difficulties, however, there are ways of forecasting the reaction of states to a uniform law proposal early in the process based on distinct patterns that have emerged over the years in the drafting and ratification process. One such pattern is the state competition model described by Edward Janger.<sup>101</sup>

## B. The Double-Edged Sword of Federalism

Janger notes that a clear and identifiable competition exists among the states to enact uniform laws that will enhance a state's attractiveness to business.<sup>102</sup> When legislation enacted in one state serves to attract corporate charters, rival states will expedite consideration of similar legislation to increase their own attractiveness to business. In the same vein, if a uniform law in another state fails to lure business corporations, rival states will avoid similar proposals. This competition among the states can take two routes.

The first and most ideal form of competition fosters the adoption of the most efficient form of law for all sectors of society. In corporate law, this has been termed the "race-to-the-top,"<sup>103</sup> where "states compete to offer, and managers compete to use, beneficial sets of legal rules."<sup>104</sup> Although this competition aims to ease corporate rules so as to attract corporations to the state, several authors have noted that races-to-the-top generally produce laws that are beneficial for both shareholders and management

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100. For example, although the UCC was eventually adopted by all fifty states, this entire process took well over twenty years, not including the ten years required to draft it. *Id.* Others admit that UCITA is slow to be adopted in many states because "the process of adopting uniform laws usually takes several years. Virginia and Maryland got a little ahead of the game here." MacMillan, *supra* note 8 (quoting David Crane, Manager of Government Affairs and Corporate Counsel at Autodesk, Inc.).

101. Janger, *supra* note 98, at 588-94.

102. *See id.* at 578.

103. *See* Frank H. Easterbrook, *Managers' Discretion and Investors' Welfare: Theories and Evidence*, 9 DEL. J. CORP. L. 540, 571 (1984) (describing the race-to-the-top); Daniel R. Fischel, *The "Race-to-the-Bottom" Revisited: Reflections on Recent Developments in Delaware's Corporation Law*, 76 NW. U. L. REV. 913, 919 (1982) (attacking the thesis that state competition causes lax corporate standards, and arguing that interstate competition creates efficient markets); *see also* Peter Dodd & Richard Leftwich, *The Market for Corporate Charters: "Unhealthy Competition" Versus Federal Regulation*, 53 J. BUS. 259, 281-82 (1980) (arguing that federal regulation is unnecessary); Ralph K. Winter, Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251, 273-92 (1977) (questioning the conventional wisdom that federal regulation is needed to control corporate managers and to protect shareholders).

104. Easterbrook, *supra* note 103, at 545.

alike.<sup>105</sup> Moreover, despite the fact that this competition among states takes place primarily in the realm of corporate law, this theory can also be applied to other areas of state-led legislative efforts, such as the uniform law process.<sup>106</sup> UCITA is no exception to this rule.

The other model of state competition is aptly titled the “race-to-the-bottom.”<sup>107</sup> Justice Brandeis described such a race as “one not of diligence but of laxity. . . . the great industrial States yielded in order not to lose wholly the prospect of the revenue and the control incident to domestic incorporation.”<sup>108</sup> Therefore, in a race-to-the-bottom, states enact more flexible corporate laws, typically at the expense of consumer interests, not only to attract more corporate capital but also to preserve the corporate capital they already have. Such races may cause dramatic reductions in consumer welfare both inside and outside the state.<sup>109</sup>

Although races-to-the-top and races-to-the-bottom can both result in ratification by a substantial number of states, a race-to-the-top is far more likely to create efficient and effective legislation by inducing states to adopt the rule most beneficial to all sectors of society.<sup>110</sup> On the other hand, “if such competition is likely to yield a race-to-the-bottom, the effect will be to cause the promulgation and uniform adoption of an inefficient or otherwise inappropriate rule.”<sup>111</sup> Even if a majority of states enact a uniform law via a race-to-the-bottom, the process will inevitably under-

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105. See generally Fischel, *supra* note 103; Dodd & Leftwich, *supra* note 103; Winter, *supra* note 103. Analogizing the corporate system to a democratic government, legislators act like corporate directors and must report to their constituents just as much as directors must report to shareholders. At the same time, directors and legislators must attract capital to the state and the corporation respectively. Therefore, as in a corporation, there is a system of incentives and accountability requiring state legislators to pass laws which will benefit both consumers and producers alike. See JESSE H. CHOPER, JOHN C. COFFEE, JR. & RONALD J. GILSON, *CASES AND MATERIALS ON CORPORATIONS* 539-40 (2000).

106. Janger, *supra* note 98, at 591 (noting that this competition among states also takes place in environmental protection, occupational safety, child labor laws, welfare, and tort reform).

107. This phrase was first coined by William L. Cary in 1974 in *Federalism and Corporate Law: Reflections Upon Delaware*, 83 *YALE L.J.* 663, 705 (1974), although the concept may have been developed initially by Justice Brandeis as a “race of laxity.” *Liggett Co. v. Lee*, 288 U.S. 517, 557-60 (1933) (Brandeis, J., dissenting).

108. *Liggett*, 288 U.S. at 557-60 (Brandeis, J., dissenting). For a general discussion of the race-to-the-top and race-to-the-bottom theories, see Henry N. Butler, *Nineteenth Century Jurisdictional Competition in the Granting of Corporate Privileges*, 14 *J. LEGAL STUD.* 129 (1985).

109. See Janger, *supra* note 98, at 580.

110. *Id.*

111. *Id.*

mine its long-term prospects for success since a law enacted via a race-to-the-bottom is based on inefficient policy favoring one group over another.<sup>112</sup> Therefore, the preferred mode of enactment for a lasting and successful uniform law is a race-to-the-top.

### C. UCITA's Ever-Elusive "Race-to-the-Top"

Although both Virginia and Maryland raced to adopt UCITA, the rest of the states have failed to follow in their wake. A few states are currently considering UCITA bills, but most states have tabled discussion of UCITA indefinitely, not to mention states like Iowa that have taken proactive steps to pass anti-UCITA legislation. Consequently, it is safe to say that UCITA's race-to-the-top has not yet emerged.

This section argues that the primary reason why most states have failed to adopt or even consider UCITA is that they view the current race to adopt UCITA as one headed for the bottom rather than the top. Although Virginia and Maryland aggressively pursued UCITA "to claim a political prize in the race to be perceived as the most progressive state in the technology stakes,"<sup>113</sup> these efforts may have backfired as many have likely perceived the race between Virginia and Maryland to be one of laxity rather than progress. That is, states fear that the competition to adopt UCITA is primarily aimed at appeasing the software industry, promoting the adoption of inefficient rules that are unfair and harmful to consumers.

These perceptions are primarily driven by two factors: (1) the high potential for "capture" of the NCCUSL and the state legislatures in Maryland and Virginia by the software industry; and (2) the likelihood that UCITA, as drafted, is a law that unavoidably engenders a race-to-the-bottom rather than a race-to-the-top. If these suspicions prove accurate, other states will not only be highly reluctant to adopt the language as promulgated by the NCCUSL, but may in fact adopt bomb-shelter statutes to protect themselves from the language implemented in other states.

#### 1. *Capture the State*

One reason why states perceive UCITA to be a race-to-the-bottom is the possibility that the software industry heavily influenced both the drafting of UCITA by the NCCUSL and the adoption of UCITA legislation by Virginia and Maryland. Regarding the NCCUSL, the states probably suspect that the commission was "captured" by technology interest groups,

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112. *See id.* at 579-80.

113. Mouldsdale & Tiller, *supra* note 53, at 23.

which in turn influenced the drafting of key UCITA provisions.<sup>114</sup> The abandonment of the drafting process by the ALI further supports this theory. Furthermore, the NCCUSL has consistently met with criticism over the years that most uniform laws blatantly favor big business over consumers, implying that the commission has been captured from time to time.<sup>115</sup>

At first blush, it would seem that such capture is highly unlikely. The NCCUSL employs a remarkably deliberative process involving representatives from all fifty states—often prominent judges, law professors, and lawyers.<sup>116</sup> Moreover, the Commission's primary concern is to secure passage of uniform legislation in as many states as possible.<sup>117</sup> To allow the interests of one group to trump the interests of another would seriously endanger this objective. Nevertheless, capture of such a respected body is not as implausible as it might seem, particularly when lobbied by such an effective group as the software industry. In fact, some academics hold that when there is only one interest group participating heavily in the process, private legislatures such as the NCCUSL are relatively easy to capture.<sup>118</sup> Even Janger himself notes that the NCCUSL is extremely vulnerable to capture, particularly when "uniform enactment creates a rule that benefits a concentrated group at the expense of a diffuse group."<sup>119</sup>

Second, the software industry might also have captured the state legislatures in Maryland and Virginia. As one academic surmised, the technology industries "played the two off each other—they said, 'If Maryland

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114. For example, the primary drafter of UCITA, Ray Nimmer, also serves as counsel to Microsoft Corporation and has testified on its behalf. Shah, *supra* note 16, at 86 n.9. Some authors take the NCCUSL's capture as a foregone conclusion: "Is there any question that the giant software manufacturers have somehow gotten to NCCUSL? . . . Why has this been allowed to happen to such a respected body?" Lobert, *supra* note 10, at 40.

115. "Indeed, the history of the Code raises the concern that the uniform laws process simply may be unable to accommodate the interests of consumers at all because provisions protecting consumer interests routinely have been excluded to avoid the possibility that their inclusion would impair enactment." Kathleen Patchel, *Interest Group Politics, Federalism and the Uniform Law Process: Some Lessons from the Uniform Commercial Code*, 78 MINN. L. REV. 83, 124 (1993).

116. See Lobert, *supra* note 10, at 40.

117. See Cramer et al., *supra* note 50, at 49.

118. See Alan Schwartz & Robert E. Scott, *The Political Economy of Private Legislatures*, 143 U. PENN. L. REV. 595, 644-45 (1995) (presenting evidence from the drafting process of Articles 3 and 4 of the Uniform Commercial Code that private legislatures are easy to capture when one dominant interest group participates in the private legislature's law-creation process).

119. See Janger, *supra* note 98, at 586.

doesn't do it first, we'll move all the high-tech jobs to Virginia.'"<sup>120</sup> Such capture is of even greater concern to the general public since the NCCUSL only proposes laws while state legislatures enact them. Once enacted, choice of law provisions implicate the citizens of every other state. Therefore, while states are concerned with capture of the NCCUSL, they are probably even more concerned with capture of state legislatures.

As with the NCCUSL, such capture might initially appear highly unlikely due to the sheer size of the legislative bodies in the two states as well as the diversity of interests represented. Moreover, the entire legislative process is open to public scrutiny and oversight,<sup>121</sup> creating a sense of accountability that may force legislators to rebuff such attempts at capture. Nonetheless, it is a serious possibility. As Janger notes, "[l]egislatures are, from time to time, captured by the representatives of special interests who then turn the public process of legislation to their private ends."<sup>122</sup> Considering the heavy influence of the software industry in both Virginia and Maryland, coupled with the relatively expeditious passage of UCITA in both states, it is easy to understand why other states might be convinced that the legislatures were captured by the software industry.

## 2. *UCITA's Race-to-the-Bottom*

Another reason why states are hesitant to consider UCITA is that it is especially conducive to a race-to-the-bottom. Professor Lucian Bebchuck of Harvard University has identified several factors which are present in proposed legislation that tends to generate a race-to-the-bottom.<sup>123</sup> According to Bebchuck, a race-to-the-bottom is likely where the law creates both a collective action problem on the part of one interested group and the opportunity of state legislators to externalize costs of the legislation to citizens of another state.<sup>124</sup> Both of these factors are clearly present in UCITA as it currently stands. First, computer information contracts—and mass-market licenses in particular—involve a notable collective action problem on the part of consumers vis-à-vis the software industry. Although an admirable campaign has been waged against UCITA by consumer groups, academics, and government officials, they simply do not have the resources or the unity of purpose that drives the software indus-

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120. Brendan I. Koerner, *Bugging Out*, THE NEW REPUBLIC, Nov. 27, 2000, at 13.

121. See Janger, *supra* note 98, at 580.

122. See *id.* at 584.

123. See generally Lucian Arye Bebchuck, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435 (1992).

124. See *id.* at 1484.

try.<sup>125</sup> Second, regarding externalization of costs,<sup>126</sup> UCITA explicitly allows states adopting UCITA to transfer their costs onto the consumers of other states via the choice of law provision. For example, states are already complaining about the “Maryland minefield,” which is the “burgeoning practice of inserting clauses in IT contracts that call for disputes to be governed by Maryland law.”<sup>127</sup> Therefore, Maryland reaps the benefits of attracting high-tech corporations while forcing other states to bear the costs of such legislation.

### 3. *Difficult Policy Choices*

As a result of these concerns, a race-to-the-top is not likely to emerge for several years. In the interim, states will have two alternatives: to adopt a bomb-shelter statute like Iowa or to wait and see how UCITA legislation will play itself out in Maryland and Virginia. Although fears of cost-externalization such as the “Maryland minefield” might convince many states to follow Iowa’s lead, most states appear to be interested in at least giving UCITA a chance to prove itself in Virginia and Maryland.<sup>128</sup> Only

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125. The very nature of consumer interests versus those of business interests . . . makes it less likely that consumer interests will receive adequate representation, even in representative bodies, such as the state legislatures and the Congress. ‘Consumers’ is a broad category of individuals—almost as broad as the public itself. Interest group theory, however, indicates that smaller groups are those most likely to form an effective coalition to advance their collective interests.

Patchel, *supra* note 115, at 127.

126. See Bebachuck, *supra* note 123, at 1485-86.

127. *UCITA Is the Wrong Answer*, EWEEK FROM ZDWIRE, Dec. 3, 2000, at 58. For example, Horizon Blue Cross/Blue Shield of New Jersey was forced to sign a contract with an unnamed software vendor that adamantly insisted that a version of the law enacted in Maryland at the start of this month be applied to the contract. Patrick Thibodeau, *Users Look to FTC for Help on Reigning in UCITA*, INFOWORLD DAILY NEWS, Oct. 26, 2000.

128. See Holly A. Heyser, *Virginia Law Enforces Software Licensing Agreements*, VIRGINIAN-PILOT, Feb. 24, 2000, at D1. As UCITA opponent Mary Alice Baish of the American Association of Libraries saw in a consistent pattern outside of Maryland, “These things get looked at, then legislators learn about the controversy and table it.” Washington, *supra* note 48, at 1C; see also Foster, *supra* note 35, at 93.

Nevertheless, at least this gives Virginia a year to realize it’s made a mistake. And since many other states were waiting to see what Virginia would do, many of them will now wait to see what, if any, changes the advisory committee makes to the draft. After all, as a uniform state law, UCITA is supposed to be adopted in the same form by all states, but uniformity may be very difficult to achieve.

*Id.*

by testing the statutes empirically will the states be able to truly evaluate UCITA's potential—for better or for worse.<sup>129</sup>

Should the states find the law to be successful in both attracting Internet business and placating consumer concerns, UCITA will probably be adopted by a majority of the states in short order. However, should they find Iowa's concerns to be justified, even in small part, they may enact their own bomb-shelter statutes against the present draft of UCITA, significantly delaying any hopes of a race-to-the-top for UCITA. Although such poison pills will not entirely prevent future efforts to pass UCITA-like legislation, it would certainly doom the current draft of UCITA and force Maryland and Virginia to rethink seriously their "legislative achievements."

#### IV. CONCLUSION

Immediately following the release of UCITA, several states quickly snatched up the uniform law to attract technology capital while others sought to shield themselves from UCITA jurisdiction altogether. Most states, however, have not taken a position on UCITA one way or the other. Rather, they are patiently waiting on the sidelines for the dust to settle.

For UCITA to become uniform law throughout the United States, it is essential that a majority of such states move from the sidelines into a race-to-the-top. Such a race is unlikely to emerge, however, until the current fears and suspicions discussed above have been largely placated. Until states manage to overcome concerns that the NCCUSL and state legislators in Virginia and Maryland were captured by the software industry, and that efforts to enact UCITA resemble a race-to-the-bottom, UCITA will not become uniform law.

Perhaps the one development that would alleviate most of these concerns would be UCITA's success in Virginia and Maryland. If UCITA proves successful in Virginia and Maryland, adoption by most states will probably follow shortly thereafter. If, however, their suspicions prove correct, UCITA will not be adopted and contract law will continue to lack adequate means to deal with computer information transactions. Therefore, UCITA's success or failure largely depends on its performance in Virginia and Maryland. States will be watching these two states very closely over the next few years to figure out whether Iowa's bomb-shelter statute was reactionary and anachronistic or a necessary brake on the rapid and unbridled development of technology law.

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129. See Fischel, *supra* note 103, at 920.

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**ADDITIONAL DEVELOPMENTS**



# ADDITIONAL DEVELOPMENTS

## COPYRIGHT

### *A&M RECORDS, INC. v. NAPSTER, INC.*

*No. 00-16401, 2001 U.S. App. LEXIS 1941 (9th Cir. Feb. 12, 2001)*

The Ninth Circuit ruled on the preliminary injunction which had been entered by the district court, 114 F. Supp. 2d 896 (N.D. Cal. 2000), enjoining the online service from engaging in or facilitating the copying of copyrighted material. The district court had entered a preliminary injunction against Napster in copyright infringement actions brought by the plaintiffs, several large record companies. The Ninth Circuit ruled that the scope of the preliminary injunction was overbroad and granted a stay of the injunction, remanding the case to the district court for modification of the injunction in conformity with the Ninth Circuit's opinion.

Defendant Napster operates a popular online file sharing service that allows users to download and share digital files containing, primarily, copyrighted musical compositions and sound recordings. Using technology known as "peer-to-peer" file sharing, Napster allows users to share music files directly between their computers via the Internet, without having to transmit the music files through central computers operated by Napster. Plaintiff record companies allege that Napster is liable for contributory and vicarious copyright infringement. The district court preliminarily enjoined Napster from engaging in or facilitating the copying, transmitting, or distribution of plaintiff's copyrighted works without permission.

The Ninth Circuit upheld a number of the district court's rulings. First, plaintiffs had demonstrated a prima facie case of direct copyright infringement by Napster users. Second, Napster could not succeed on an affirmative defense that its users are engaged in fair use of plaintiffs' copyrighted material. The court then considered whether Napster could be liable for either contributory or vicarious copyright infringement. On the issue of contributory infringement, the court held that Napster contributes to infringement by actively encouraging and assisting its users in sharing and transmitting copyrighted material. On the issue of vicarious infringement, the court upheld the district court's finding that Napster realizes direct financial benefits from its users' infringing activity. Finally, the court agreed with the district court that Napster has the ability to police its system for infringing material. The direct financial benefit combined with Napster's ability to screen its system for infringing material led the court to hold Napster liable for vicarious infringement.

The Ninth Circuit concluded that an injunction was warranted but the district court's injunction was overbroad. The court remanded for the district court to modify the injunction to conform to the decision. First, Napster should be held liable for contributory infringement only to the extent that it knows, or should know about infringing files on its system and fails to act to prevent distribution of those files. Second, Napster should be held liable for vicarious infringement only when it fails to use its ability to police its system and remove infringing materials.

***BOUCHAT V. BALTIMORE RAVENS, INC.***

*No. 99-1617, 2000 U.S. App. LEXIS 34656 (4th Cir. 2000)*

The Fourth Circuit ruled that a copyright infringement plaintiff need not prove that the infringer actually saw the work in question; it is enough to prove that the infringer (or his intermediary) had the opportunity to see the work and that the material subsequently produced is substantially similar to the work.

Frederick Bouchat sued the Baltimore Ravens, Inc. and National Football League Properties, Inc. (collectively, "Ravens") for infringing his copyright on drawings for a shield logo that Bouchat had developed for the new Baltimore Ravens football team. Bouchat had shown the drawings to John Moag, chairman of the Maryland Stadium Authority, before the Ravens unveiled their logo, which was a raven holding a shield. After a jury verdict for Bouchat, the Ravens appealed on the grounds that Bouchat failed to prove that the Ravens had access to the work.

The Fourth Circuit affirmed. The court held that where direct evidence of copying is lacking, a plaintiff may prove copying by circumstantial evidence in the form of proof that the alleged infringer had access to the work and that the supposed copy is substantially similar to the author's original work. To prove access, the court stated that Bouchat need only show that the owner of the Baltimore Ravens had the opportunity to view the drawings; the court then ruled that Bouchat had met this burden.

In dicta, the court addressed the "strikingly similar" doctrine, which allows a jury to infer access from striking similarity between the protected work and the alleged copy. The court endorsed the approach of *Gaste v. Kaiserman*, 863 F.2d 1061, 1068 (2d Cir. 1988), explaining that "the access prong remains intact, but the level of similarity between the contested works can be used as evidence of access."

Judge King, dissenting, rejected the majority's conclusion that a reasonable jury could have found that the Ravens had access to the drawings and objected to the dicta regarding the "strikingly similar" doctrine as "contrary to a fundamental principle of copyright protection: independent creation."

***EXEMPTION TO PROHIBITION ON CIRCUMVENTION OF  
COPYRIGHT PROTECTION SYSTEMS FOR ACCESS CONTROL  
TECHNOLOGIES***

*65 Fed. Reg. 64,556 (Oct. 27, 2000) (to be codified at 37 C.F.R. pt. 201)*

The Digital Millennium Copyright Act of 1998 ("DMCA"), Pub. L. No. 105-304, 112 Stat. 2860 (codified as amended in scattered sections of U.S.C.), prohibits circumvention of access control technologies employed by or on behalf of copyright owners to protect their works. The DMCA provides that exemptions are to be granted to a class of works if users of such works "are, or are likely to be in the succeeding three-year period, adversely affected in their ability to make noninfringing uses of that particular class of works." 17 U.S.C. § 1201(a)(1)(B) (Supp. IV 1998). Which classes of works are exempted are determined periodically by the Librarian of Congress via a rulemaking procedure. 17 U.S.C. § 1201(a)(1)(C), (D) (Supp. IV 1998).

Pursuant to the statute, the Librarian of Congress issued a rule granting exceptions to two classes of works: (1) "compilations consisting of lists of websites blocked by filtering software applications," and (2) "literary works, including computer programs and

databases, protected by access control mechanisms that fail to permit access because of malfunction, damage or obsolescence.”

The exempted classes were selected after a determination that, in each case, the adverse effect on noninfringing uses outweighed the benefits of technological protection measures. The exemption of lists of blocked websites was justified by the need of persons wanting to criticize or comment on filtering software applications to know which sites the application blocks, balanced against the negligible effect on the market for or value of such software. The exemption for failure of access control mechanisms was justified because malfunctioning, damaged, or obsolete access controls can prevent authorized users from accessing the works while having little effect on the market value of the works, since in most cases the copyright owners have already received compensation.

***SONY COMPUTER ENTERTAINMENT AMERICA, INC.  
V. BLEEM LLC***

*214 F.3d 1022 (9th Cir. 2000)*

The Ninth Circuit ruled on whether the unauthorized use of a frozen image from a video game is fair use under 17 U.S.C. § 107.

Bleem developed a software emulator that allows individuals to play personal video games intended for consoles (e.g., the Sony PlayStation) on a personal computer. Users of Bleem’s emulator can play Sony PlayStation games without purchasing the console, and the improved graphics a personal computer monitor offers over a television screen can enhance the video game experience. In its advertising campaign, Bleem used unauthorized “screen shots”—small images depicting a frozen moment of a video game—of a Sony video game to compare the graphics generated by the emulator on a personal computer monitor to the graphics generated by the PlayStation on a television screen. Sony Computer Entertainment America, Inc. (“Sony”) argued that Bleem may not use unauthorized screen shots of Sony games because they are copyrighted by Sony. The U.S. District Court for the Northern District of California ruled in favor of Sony and entered a preliminary injunction against Bleem. Bleem appealed.

The Ninth Circuit reversed, finding a fair use of Sony’s copyrighted material because Bleem needed to use Sony’s copyrighted game in order to create an accurate comparison for the potential consumer. The purpose and character of Bleem’s use weighed in favor of a fair use finding since truthful comparative advertising is in consumers’ best interest. A screen shot is an insignificant portion of Sony’s copyrighted work, also supporting a finding of fair use. Additionally, although Bleem used screen shots from Sony’s video game for commercial purposes, Bleem’s use will have no effect on Sony’s ability to use its screen shots as it desires. Finally, the court reasoned that if sales of Sony’s console dropped, it would be due to consumers’ preference for Bleem’s software emulator, not because Bleem used screen shots to compare the products.

***TICKETMASTER CORP. V. TICKETS.COM, INC.***

*54 U.S.P.Q.2d (BNA) 1344 (C.D. Cal. 2000)*

The U.S. District Court for the Central District of California held that the act of deep linking does not constitute copyright infringement since basic facts, such as the time, place, venue and price of public events, are not protected by copyright.

Ticketmaster Corp. and Ticketmaster Online-CitySearch, Inc. (collectively, "Ticketmaster") operate a website that sells tickets to music concerts, sporting events, theatrical performances, and other types of entertainment. The home page contains "terms and conditions" which proscribe, among other acts, copying for commercial use. However, the customer need not view the terms and conditions to proceed straight to an event page. Tickets.com operates a similar website, but for those events to which it does not sell tickets, Tickets.com provides a hyperlink to other websites that sell tickets, including Ticketmaster.com. When customers click on the hyperlink, they are instantly transferred to an interior webpage of Ticketmaster.com, a process known as deep linking. In this manner, the customer is able to purchase a ticket from Ticketmaster for the desired event. In an effort to stop this deep linking, Ticketmaster filed a suit against Tickets.com alleging several causes of action, including copyright infringement.

Tickets.com filed a motion to dismiss. In denying the motion, the district court noted that copyright protection extends to such things as the expression, organization, and placement of data, rather than the underlying data itself. The court found in this case that the alleged copying consisted of transferring Ticketmaster's event pages to Ticket's own computer to facilitate the extraction of facts. It further noted that deep linking does not involve copying because no copy is made; a user who follows the link views "the genuine web page of the original author." The court analogized such links to a library's card catalog. The court then went on to discuss an ambiguity in the complaint regarding federal jurisdiction. Since the event pages change from day to day as old events are dropped out and new ones are added, there is a possible ambiguity as to whether the copyright as registered covers not only the home page but also each of the event pages. Since the alleged copying was only of the event pages, there was still the question for further proceedings as to the court's jurisdiction over the claim of copyright infringement of the event pages. The court then ordered that the motion to dismiss as to the copyright claim be denied.

Ticketmaster then filed a motion for a preliminary injunction. *Ticketmaster Corp. v. Tickets.Com, Inc.*, 2000 U.S. Dist. LEXIS 12987 (C.D. Cal. Aug. 11, 2000) (unpublished opinion). Although the court sympathized with Ticketmaster and pointed out that the manner of expression in presenting the facts is protectable, it found that Tickets.com had taken great care not to use that expression. The district court, therefore, concluded that there was insufficient evidence to justify a preliminary injunction and denied the motion, stating that a fundamental concept of copyright law is that ideas and knowledge may not become the property of any one person even when that person has developed the idea or knowledge. The denial of the preliminary injunction was recently affirmed by the Ninth Circuit. *Ticketmaster Corp. v. Tickets.Com, Inc.*, 2001 U.S. App. LEXIS 1454 (9th Cir. Cal. Jan. 22, 2001).

### ***UMG RECORDINGS, INC. v. MP3.COM, INC.***

*92 F. Supp. 2d 349 (S.D.N.Y. 2000)*

The U.S. District Court for the Southern District of New York considered whether copying music recordings onto a computer server for the purposes of redistributing the music to subscribers to an Internet service constitutes fair use.

MP3.com. launched its "My.MP3.com" service, which it advertised as permitting subscribers to store, customize, and listen to the recordings contained on their CDs from any place where they have an Internet connection. To make good on this offer, MP3.com purchased tens of thousands of popular CDs in which UMG Recordings, Inc. ("UMG") held the copyrights, and, without authorization, copied the recordings onto its computer

servers so as to be able to replay the recordings for its subscribers. In order to access a recording, a subscriber had to prove ownership of the CD version of the recording either by inserting it into his or her CD-ROM drive for a few seconds or by agreeing to purchase a CD from an online retailer cooperating with MP3.com. UMG moved for partial summary judgment on the grounds that MP3.com's fair use defense to copyright infringement was unfounded as a matter of law.

The district court found for UMG and granted partial summary judgment, holding MP3.com's fair use defense indefensible as a matter of law. The court found that MP3.com's use did not satisfy any of the four statutory factors of the fair use defense under 17 U.S.C. § 107: "(1) the purpose and character of the use; (2) the nature of the copyrighted work; (3) the amount and substantiality of the portion used in relation to the copyrighted work as a whole; and (4) the effect of the use upon the potential market for or value of the copyrighted work." The court found that the purpose and character of the work was entirely commercial and that for such a commercial use to be fair use, it must somehow transform the original. The court stated that mere repackaging of a copyrighted work is not transformative. Second, musical recordings, unlike factual compilations, are very near the heart of copyright protection. Third, by copying entire CDs, MP3.com ensured that the amount of material copied in relation to the whole was substantial. Fourth, MP3.com's use directly affected UMG's potential market for its copyrighted material. The court rejected MP3.com's claim that its actions enhanced the market since MP3.com only allowed access to recordings already owned by its subscribers. Finally, the court rejected the argument that MP3.com's use is fair because it provides a useful service to consumers. Copyright law protects a copyright holder's property interests, not consumer interests.

## PATENT

### *AMAZON.COM, INC. V. BARNESANDNOBLE.COM, INC.*

*73 F. Supp. 2d 1228 (W.D. Wash. 1999)*

In one of the first court decisions involving an Internet business method patent, the U.S. District Court for the Western District of Washington granted a preliminary injunction against an alleged infringer of Amazon.com's patent on a "1-click" ordering system, but the court's narrow claim construction enabled the defendant to design around the patent.

Amazon.com owns U.S. Patent No. 5,960,411 (the "'411 patent"). The '411 patent claims a method and system in which a consumer can complete a purchase order for an item via the Internet using only a single action, such as a single click of a computer mouse button, once information identifying the item is displayed to the consumer on a computer screen. The first time a consumer uses the system, she provides the personal information needed to complete the transaction; on subsequent purchases, the information is automatically retrieved from a database. This "1-click" system thus speeds and eases online purchasing. Amazon.com sued Barnesandnoble.com, alleging that Barnesandnoble.com's "Express Lane" system for web-based purchasing infringed the '411 patent and seeking a preliminary injunction against the Express Lane.

The district court granted the preliminary injunction. In construing the claims of the '411 patent, the court ruled that a click of a mouse was a single action, and that actions count for the purpose of "single action" when information identifying the product and

indicating the single action required to order it are displayed to the user. The court also rejected Barnesandnoble.com's arguments that the patent was invalid on the grounds of anticipation and obviousness.

Barnesandnoble.com's appeal to the Federal Circuit is pending. In the meantime, the company has modified its Express Lane feature by adding a "confirmation" step in which the user is asked to click a second time to verify address and billing information.

***ELEKTA INSTRUMENT S.A. v. O.U.R. SCIENTIFIC  
INTERNATIONAL, INC.***

*214 F.3d 1302 (Fed. Cir. 2000)*

In this patent case, the Federal Circuit ruled on two issues: (1) how to interpret a claim if the ordinary meaning of the words contradicts the written description and (2) the applicability of the doctrine of prosecution history estoppel in cases of a rejection for obviousness.

Elekta owns U.S. Patent No. 4,780,898 (the "898 patent"), covering "gamma units," i.e., medical devices in which multiple beams of radiation placed at various locations on a hemispherical shield are aimed at a focal point in a patient's brain to destroy abnormal brain tissue. The patent claims a specific arrangement of radiation sources and beam channels that reduces the risk of radiation scatter outside the gamma unit. The written description disclosed one embodiment, in which radiation sources were located in the region between 0 degrees and 45 degrees.

In response to a rejection for obviousness, claim 1 of the patent was changed from "[a]n arrangement in a gamma unit" having radiation sources located "within a zone extending to latitudes 30 degrees-45 degrees. . . ." to "[a]n arrangement in a gamma unit" having radiation sources located "within a zone extending between latitudes 30 degrees-45 degrees. . . ." O.U.R. Scientific International ("OSI") offered for sale a gamma unit with radiation sources positioned at latitudes ranging from 14 degrees to 43 degrees. Elekta sued for infringement of claim 1. OSI moved for summary judgment of noninfringement, and Elekta cross-moved for summary judgment of infringement. The U.S. District Court for the Southern District of New York denied OSI's motion for summary judgment and granted Elekta's cross-motion. OSI appealed.

The Federal Circuit reversed, holding that the ordinary meaning of the claim, if unambiguous, controls over any contradictory language in the written description and that prosecution history estoppel prevented Elekta from claiming a broader interpretation of the language. The court construed the claim as meaning that all radiation sources must be between 30 degrees and 45 degrees. Acknowledging that its interpretation excluded the preferred and only disclosed embodiment, the court stated that the unambiguous language of a claim controls over any contradictory language in the written description. The Federal Circuit found that the district court erred in relying on the more expansive description of the invention used in the specification rather than the unambiguous language of the claim. The court, therefore, held that OSI's device did not infringe the '898 patent.

***EMBREX, INC. V. SERVICE ENGINEERING CORP.****216 F.3d 1343 (Fed. Cir. 2000)*

The Federal Circuit ruled on the scope of protection granted by a process patent and on the applicability of infringement claims from an offer to sell a device that could be used to infringe a patent. Additional rulings were decided on procedural grounds.

Embrex held an exclusive license under the Bayh-Dole Act to U.S. Patent No. 4,458,630 (the "630 patent"), owned by the U.S. Government. The patent claimed a process of inoculating eggs during the incubation period in order to immunize chicks from diseases that typically threaten flocks of fowl raised in crowded commercial settings. Service Engineering Corporation ("SEC") had settled a previous infringement claim by Embrex when it attempted to design around the patent; the settlement required SEC not to infringe the patent again and provided triple damages for breach.

In the case at bar, SEC experimented with a method of injecting eggs that differed from the patented method. Its intent, as indicated by solicitation of orders, was to develop and market a competing egg injection device that would not infringe the '630 patent. The experiments were unsuccessful and no competing devices were sold. Embrex sued SEC for willful infringement of the '630 patent, breach of the settlement agreement, and violation of section 43(a) of the Lanham Act. The U.S. District Court for the Eastern District of North Carolina held a jury trial, and the jury returned a verdict favorable to Embrex on all causes of action except for the alleged violation of the Lanham Act. SEC appealed.

In upholding the district court's ruling that SEC's experiments had infringed the patent, the Federal Circuit reviewed the district court's construction of the claim and the ruling that SEC's use was not protected by the exception for experimental and de minimis uses of a patented process. The Federal Circuit held that the patent claim for "a method for controlling an immunizable disease" described the purpose of the process, while its recitation of the procedures required to inoculate a single egg described the protected method. Accordingly, the claims were not limited "to processes performed only on populations of birds" but applied to inoculation of one or a few eggs as well. With respect to SEC's attempt to find shelter from infringement charges under the Fourth Circuit's exemption for de minimis and experimental use of a patented process in *Roche Prods., Inc. v. Bolar Pharm. Co.*, 733 F.2d 858, (4th Cir. 1984), the Federal Circuit held that this exemption does not apply to uses for commercial purposes, which SEC's actions were. (In a concurring opinion, Judge Rader argued that the Patent Act allows no exemptions and that the harmlessness or de minimis nature of an infringement should be addressed in damages awards.)

Although SEC's experiments with egg injections infringed the patent, the Federal Circuit held that its efforts to sell injection machines did not. In reversing the district court's ruling on this point, the Federal Circuit held that offers to sell devices that "may be used to practice a patented method cannot infringe without proof of direct infringement." Since there were no actual sales, the court held that the only damages Embrex could claim was a royalty for SEC's experimental use of the patented process.

***FESTO CORP. V. SHOKETSU KINZOKU KOGYO KABUSHIKI CO.****234 F.3d 558 (Fed. Cir. 2000) (en banc)*

In this recent en banc decision, the Federal Circuit ruled that the doctrine of equivalents is no longer available when an applicant amends a claim element during prosecution for any reason related to patentability.

Festo Corp. sued Shoketsu ("SMC") in the U.S. District Court for the District of Massachusetts, alleging infringement of its two patents on magnetically coupled rodless cylinders. After initial trials and appeals, the Federal Circuit chose to consider the case en banc in light of the Supreme Court's ruling in *Warner-Jenkinson Co. v. Hilton-Davis Chemical Co.*, 520 U.S. 17 (1997). In its order granting the en banc rehearing, the Federal Circuit requested briefing on five questions, which its decision addressed.

First, the court considered whether, for prosecution history estoppel purposes, an amendment made for "a substantial reason related to patentability" (the wording used in *Warner-Jenkinson*) means only one made to overcome a rejection under § 102 or § 103, or "any reason affecting the issuance of a patent[.]" In answer, the majority held that a "substantial reason related to patentability" is not limited to overcoming prior art but instead embraces any statutory requirement for patentability, including those based on 35 U.S.C. §§ 101 and 112. Therefore, a narrowing amendment made for a reason related to any of the statutory requirements gives rise to prosecution history estoppel with respect to the amended claim element.

Second, the court considered whether "a 'voluntary' claim amendment—one not required by the examiner or made in response to a rejection by an examiner for a stated reason—should create prosecution history estoppel[.]" On that issue, the Federal Circuit ruled that a voluntary claim amendment gives rise to prosecution history estoppel, as do amendments required by a patent examiner.

Third, the court considered what range of equivalents, if any, is available to a claim element amended in such a way as to create prosecution history estoppel. In answer to this third question, the majority ruled that the application of the doctrine of equivalents to a claim element is now completely barred when an amendment creates prosecution history estoppel as to that element. In reaching this ruling, the majority acknowledged that Federal Circuit precedent includes two divergent lines of authority on this issue. One line, embodied by *Hughes Aircraft Co. v. United States*, 717 F.2d 1351 (Fed. Cir. 1983), adopted a "flexible bar" that still allowed some limited infringement by equivalence. A divergent line, represented by *Kinzenbaw v. Deere & Co.*, 741 F.2d 383 (Fed. Cir. 1984), espoused a "complete bar" that precluded any equivalence and limited the claim element to its literal terms. Although most cases have followed *Hughes*, the majority found that this "flexible bar" approach had become "unworkable" because it undermined the notice function of patent claims and weakened the certainty necessary to avoid litigation and appeals. The majority believed that the bright-line rule represented by the "complete bar" would inform the public and the patentee as to the element's exact scope of coverage, while reducing speculation or uncertainty as to the exact range of equivalents that might be available.

Fourth, the court considered what range of equivalents, if any, is available under the doctrine of equivalents for a claim element that is amended with no explanation, thus invoking the presumption of prosecution history estoppel under *Warner-Jenkinson*. Quoting from the Supreme Court's decision, the majority ruled that the doctrine of equivalents is not available for claim amendments that are not explained in the patent prosecution record.

When it reached the fifth question—would a judgment of infringement under the doctrine of equivalents in *Festo* violate the "all elements" rule formulated in *Warner-Jenkinson*?—the Federal Circuit held that it was unnecessary to decide that issue in light of the available record. The court then proceeded to apply its legal rulings to the facts in *Festo*, and reversed both the summary judgment and jury verdict of infringement by equivalence.

***INTERACTIVE GIFT EXPRESS, INC. V. COMPUSERVE, INC.***

*231 F.3d 859 (Fed. Cir. 2000)*

The Federal Circuit held that the district court erred as a matter of law when it impermissibly read limitations from the specification into the claim construction.

Interactive Gift Express, Inc. ("IGE") sued Compuserve for infringing U.S. Patent No. 4,528,643 (the "'643 patent"), which claimed a system for reproducing information in material objects at point of sale locations. The patented system permits the creation of objects containing information, such as books, tape recordings, and records, at decentralized outlets as soon as a customer requests a purchase. This allows manufacturers to avoid costs associated with centralized manufacturing facilities for these "material objects" containing information, as well as to avoid the problem of predicting demand at each retail location. IGE argued that Compuserve infringed the '643 patent when it began to sell books and media that contain an encrypted computer application over the Internet. The U.S. District Court for the Southern District of New York dedicated most of its lengthy claim construction decision to the following disputed claim limitations: (1) the meaning of "point of sale location"; (2) the meaning of "material object"; (3) the meaning of "information manufacturing machine"; (4) the meaning of "authorization code"; and (5) whether the information must be provided to and stored at the information manufacturing machine ("IMM") before the consumer requests it. Following the claim construction ruling, IGE stipulated to a judgment of noninfringement and appealed the claim construction.

In construing each of the five disputed limitations, the Federal Circuit focused on the language of the claims themselves since that was the language that the patentee had chosen to use. The Federal Circuit noted that the district court had read or imposed limitations from the patent application into the claims and found that the district court erred in at least one aspect of its construction of each of the five claim limitations upon which the judgment of noninfringement was based, thereby improperly narrowing the claims. Accordingly, it vacated and remanded the case for further proceedings consistent with the claim constructions provided in its opinion.

***ISHIDA CO. V. TAYLOR***

*221 F.3d 1310 (Fed. Cir. 2000)*

The Federal Circuit ruled on (1) whether a means-plus-function claim construction must cover all disclosed embodiments and (2) infringement of such a claim by the test of insubstantial difference.

Taylor sued Ishida Co. for infringing its U.S. Patent No. 4,663,917 (the "'917 patent"), which claimed a machine designed for packaging food products such as potato chips. In the packaging process, a tube of package material entered the machine, which sealed the bottom end of the tube and fed the product into the tube through the open end. A pair of stripper bars moved down on the two sides of the open end to "strip," i.e., to move the product towards the sealed end of the tube. Then the machine sealed the open end of the tube. The specification of the '917 patent illustrated two structurally different embodiments by means of which the machine could perform the stripping and sealing function. As required by 35 U.S.C. § 112, ¶ 6 (1994), the U.S. District Court for the Northern District of California construed the means-plus-function claims of the '917 patent by identifying the disclosed structures responsible for the claimed function. The district court held for Ishida on the ground that although the accused device, the Apex ma-

chine, performed the same stripping and sealing function as the two embodiments did, it did so in a substantially different way.

Taylor appealed, arguing that the district court erred in its method of claim construction by failing to encompass all the embodiments in a single claim construction. The Federal Circuit affirmed the district court's holding by first explaining the problem of formulating a single claim construction. According to the court, one disclosed embodiment of the '917 patent featured cam tracks, while the other embodiment did not. A single claim construction that would encompass both of the illustrated embodiments would have had to be so broad as to describe both an embodiment having a cam track as a structural element and an embodiment without such an element. Requiring the district court to formulate a single claim construction covering both embodiments would defeat the claims' ability to give notice of the limits of the patentee's rights.

The court added that an accused device infringes a claim element under § 112, ¶ 6 only if it is insubstantially different from the corresponding structure in the patent specification. In both embodiments of the '917 patent, the ends of the sealing jaws followed a circular path and contacted the tube at only one point on that path. In contrast, in the Apex machine, the ends of the sealing jaws followed a straight-line path and did not contact the tube at only one point. The Federal Circuit held that such variation in movement was not so insignificant that it constituted no substantial difference from the two embodiments.

### ***KRAFT FOODS, INC. v. INTERNATIONAL TRADING CO.***

*203 F.3d 1362 (Fed. Cir. 2000)*

The Federal Circuit ruled on the application of the doctrine of equivalents for pre-existing technology in non-means-plus-function claims.

Kraft Foods, Inc. ("Kraft") sued International Trading Company and Houston Processing Ltd. (collectively, "ITC") in the U.S. District Court for the Western District of Wisconsin, alleging infringement of its U.S. Patent No. 5,657,873 (the "'873 patent"), which describes a food package designed to eliminate some unnecessary packaging materials by having a rigid base. The rigid base protects the tray bottom, allows for display of product information with labels, and includes a plastic keel for stand-up. In contrast, a food package without a rigid base typically uses exterior cardboard packaging to perform the same functions. A flexible label could be utilized to fulfill the protective function described in the patent. Kraft utilized this packaging for its "Oscar Mayer Lunchables." Kraft alleged that ITC's packaging for its own lunch combination products violated claim 2 of Kraft's patent. The district court granted defendants' motion for summary judgment as to both of Kraft's infringement claims, ruling in part that the doctrine of equivalents could not be used to find infringement where the technology used by the accused device predates the patent. Kraft appealed.

The Federal Circuit affirmed in part and reversed in part, holding that there was a genuine issue of material fact as to whether ITC's labels served substantially the same function, in substantially the same way, to achieve substantially the same result, as Kraft's labels. The Federal Circuit noted that although the district court appropriately granted summary judgment of no literal infringement as to claim 1, it misinterpreted the Federal Circuit's earlier decision in *Chiuminatta Concrete Concepts, Inc. v. Cardinal Industries, Inc.*, 145 F.3d 1303 (Fed. Cir. 1998). The Federal Circuit held that *Chiuminatta* precluded doctrine of equivalents infringement claims for pre-existing technology *only* with respect to means-plus-function claim limitations. Since the claim at issue

was not a means-plus-function claim, there was a possibility that infringement could have been proven.

***PIONEER HI-BRED INTERNATIONAL, INC. v. J.E.M.  
AGRICULTURAL SUPPLY, INC.***

*200 F.3d 1374 (Fed. Cir. 2000)*

The Federal Circuit ruled on the patentability of seeds and seed-grown plants under 35 U.S.C. § 101 in light of the Townsend-Purnell Plant Patent Act (“PPA”) and the Plant Variety Protection Act (“PVPA”).

Pioneer brought suit against defendant J.E.M. Agricultural Supply for infringement of patents directed to new inbred and hybrid varieties of corn plants and seeds. The U.S. District Court for the Northern District of Iowa denied defendants’ motion for summary judgment, ruling that seeds and seed-grown plants—sexually reproduced plants—are patentable subject matter under 35 U.S.C. § 101.

On interlocutory appeal of the denial of summary judgment, the Federal Circuit affirmed the district court’s ruling. The Federal Circuit concurred that seeds and seed-grown plants are within the scope of patentable subject matter as defined by the Supreme Court in *Diamond v. Chakrabarty*, 447 U.S. 303 (1980), which held that living things are not excluded from the patent system under 35 U.S.C. § 101 (1994). The Federal Circuit further rejected defendants’ arguments that enactment of the PPA, which provided patent protection for asexually reproduced plants, and the PVPA, which later established a non-patent form of protection for seed-grown plants, reflected congressional intent to exclude seed-grown plants from the patent system. Although the PVPA and Title 35 provide for different rights and obligations, the Federal Circuit concluded that they are not in conflict with each other and that protection of new seed-grown plant varieties under both statutes is not irreconcilable. Therefore, the PPA and the PVPA do not affect the scope of protection provided to seeds and seed-grown plants under 35 U.S.C. § 101.

***ROTEC INDUSTRIES, INC. v. MITSUBISHI CORP.***

*215 F.3d 1246 (Fed. Cir. 2000)*

The Federal Circuit ruled on the interpretation of “offer for sale” in patent infringement suits brought under 35 U.S.C. § 271(a).

Rotec Industries, Inc. (“Rotec”) sued defendants, claiming infringement of its U.S. Patent No. 4,170,291 (the “291 patent”), which claims a tower crane-supported, articulated concrete conveyor belt system. The invention is used to carry concrete over long distances, and is useful in large construction projects. In 1995, the government of the People’s Republic of China solicited bid proposals for a concrete-placing system to be used in the Three Gorges Dam project on the Yangtze River. Mitsubishi Corp. and its codefendants, an international group of corporations and contractors, submitted a joint bid. Defendants conducted many activities connected to the agreement both inside and outside the United States. In particular, one of the agents for the defendants, C. S. Johnson, planned and designed the conveyor portion of the system in the United States, a system which concededly infringed Rotec’s ’291 patent. The issue in the suit was whether the defendants infringed the patent through an offer for sale for the device within the United States. (A problem for the plaintiff was that Rotec’s only evidence of a meeting between defendants and an agent of the purchaser in the United States was ruled inadmis-

sible hearsay.) The final purchase and sale agreement, which was signed in China, called for all components to be manufactured outside the United States. The U.S. District Court for the Central District of Illinois granted defendants' summary judgment motion after finding insufficient evidence of an offer for sale within the United States. Rotec appealed.

The Federal Circuit affirmed, stating that, absent communication with a third party, defendants' meeting, designing, and pricing activities in the United States did not constitute an "offer to sell" for the purposes of patent infringement liability. The court noted that since U.S.-based defendant C. S. Johnson's work focused only on the conveyor components, he did not offer to sell the entire invention as claimed in the patent. Relying on *Deepsouth Packing Co. v. Laitram Corp.*, 406 U.S. 518 (1972), the Federal Circuit ruled that one may not be held liable for making, selling, or offering to sell less than the complete invention. Although Congress enacted § 271(f) to close the *Deepsouth* loophole, the Federal Circuit reasoned that it could easily have amended § 271(a) as well if it wished, and its refusal to do so left § 271(a) liability unchanged. The court also agreed with the district court that Rotec's evidence of a meeting between Defendants and the purchaser was inadmissible hearsay, and that summary judgment was appropriate.

***SEMICONDUCTOR ENERGY LABORATORY CO. V. SAMSUNG  
ELECTRONICS CO.***

*204 F.3d 1368 (Fed. Cir. 2000)*

The Federal Circuit held that inequitable conduct before the PTO cannot serve as a predicate act necessary to establish a federal RICO violation.

Semiconductor Energy Laboratory Co. ("SEL") sued Samsung Electronics Co. and its affiliates (collectively, "Samsung"), alleging that Samsung's production and sales of active matrix displays infringed SEL's U.S. Patent No. 5,543,636 (the "'636 patent"). Samsung denied infringement and counterclaimed, charging SEL with federal and state RICO, antitrust, and unfair competition violations. SEL moved for summary judgment. The U.S. District Court for the Eastern District of Virginia granted the motion as to the RICO and antitrust counterclaims but denied it as to the unfair competition claim. The district court also found the '636 patent to be unenforceable because SEL had made material misrepresentations and withheld material references to prior art during prosecution before the PTO. Both parties appealed.

The Federal Circuit affirmed, stating that inequitable conduct before the PTO cannot serve as a predicate act required to establish a federal RICO violation. The court noted that the words "to defraud" commonly refer to deprivation of the property of another by means of trick, deceit, chicanery, or overreaching. It concluded that although a patent is regarded as property, a patent application has not matured to the point where it can be considered property. Therefore, the court held that Samsung failed to satisfy the predicate act requirement for its federal RICO counterclaim since SEL's inequitable conduct did not defraud the government of property as anticipated by the federal RICO statute. The Federal Circuit also affirmed the district court's dismissal of Samsung's state RICO counterclaim, holding that it was preempted by the patent laws of the United States.

***UNION OIL COMPANY OF CALIFORNIA V. ATLANTIC  
RICHFIELD CO.***

*208 F.3d 989 (Fed. Cir. 2000)*

The Federal Circuit ruled on the degree of specificity required in patent claims and found that for purposes of the written description requirement, the primary consideration is whether the applicant's description clearly allows persons of ordinary skill in the art to recognize that the inventor was in possession of the subject matter of the claims at the time of filing.

Atlantic Richfield Company ("ARCO") brought an action against patentee Union Oil Company of California ("Unocal") seeking a declaratory judgment invalidating U.S. Patent No. 5,288,393 ("the '393 patent") under 35 U.S.C. §§ 102 and 112. The '393 patent, owned by Unocal, claimed automobile gasoline compositions with reduced combustion emissions created by varying chemical properties in automobile gasoline within specified ranges. ARCO challenged the '393 patent based on anticipation, obviousness, and lack of written description. Unocal counterclaimed, alleging willful infringement of the '393 patent. The U.S. District Court for the Central District of California then construed the claims of the '393 patent, effectively converting Atlantic Richfield's declaratory judgment action into an infringement defense. A jury returned a special verdict finding that none of the forty-one asserted claims of the '393 patent was anticipated under § 102 and that each claim was supported by sufficient written description. ARCO appealed the district court's denial of its Motion for Judgment as a Matter of Law ("JMOL") which sought to overturn the jury verdicts of patent validity and willful infringement.

The Federal Circuit affirmed the district court's denial of JMOL, holding that the record contained substantial evidence to support the jury's verdict of no anticipation and sufficient written description. Because the district court construed the '393 patent to cover only standard automotive fuel, the district court correctly determined that specialty fuels having properties within the scope of the claims did not anticipate under § 102. Although the record showed that some properties of aviation and racing fuels coincided with the '393 patent, the Federal Circuit held that the record did not show the presence of each and every limitation in any single prior art reference. The Federal Circuit also rejected appellant's claim that the written descriptions of the inventive products in terms of ranges of chemical properties rather than molecular composition were insufficiently detailed. Neither the Patent Act nor case law, the Court noted, required Unocal to describe the *exact* chemical component of each fuel combination that fell within the range claims of the '393 patent.

Judge Lourie, dissenting, found the jury's verdict that the claims are not invalid for lack of written description was not supported by substantial evidence. He would have reversed the district court's denial of JMOL, held the relevant claims to be invalid, and vacated the damages and attorney fees awarded to Unocal.

## **TRADEMARK**

***A&H SPORTSWEAR V. VICTORIA'S SECRET STORES, INC.***

*57 U.S.P.Q.2d 1097 (3d Cir. 2000)*

The Third Circuit recently clarified the "disparity in commercial strength" requirement in determining a reverse confusion claim. The court held that only after the *Inter-*

*pace Corp. v. Lapp, Inc.*, 721 F.2d 460 (3d Cir. 1983), factors are used to determine that there is a likelihood of confusion does the threshold requirement for commercial disparity enter into reverse confusion analysis.

In a trademark infringement action under the Lanham Act, A&H Sportswear claimed that Victoria's Secret's mark for "The Miracle Bra" swimwear was confusingly similar to A&H's "Miraclesuit" mark. A&H, the senior registrant, contended that consumers were likely either wrongly to associate The Miracle Bra mark with A&H (the direct confusion claim) or wrongly to associate the Miraclesuit mark with Victoria's Secret (the reverse confusion claim). The U.S. District Court for the Eastern District of Pennsylvania, on remand from the Third Circuit (en banc), entered judgment for Victoria's Secret. A&H appealed the ruling.

The Third Circuit vacated judgment with respect to the reverse confusion claim and remanded to the district court with instructions regarding a proper reverse confusion analysis. The first issue on appeal was the propriety of the *Lapp* likelihood of confusion test where the goods at issue are directly competitive with each other. The court held that the ten-factor *Lapp* test can be applied to any likelihood of confusion analysis, regardless of the relationship between the goods; the existence of competition would merely serve to alter the relative weights of the individual factors. The court next addressed whether the district court erred when it required a threshold level of economic disparity between the two goods before even reaching a *Lapp* analysis. In particular, the lower court required a showing that the junior user "used [its] economic power to overwhelm the market with advertising" of its product. Looking at prior cases, the Third Circuit held that comparison of commercial strengths must not be the sole factor in a reverse confusion analysis. Instead, such a factor is an important element in the evaluation of the senior mark's strength and, taken together with the other *Lapp* likelihood of confusion factors, may or may not indicate the existence of reverse confusion.

### ***BIHARI V. GROSS***

*119 F. Supp. 2d 309 (S.D.N.Y. 2000)*

The U.S. District Court for the Southern District of New York ruled that the Anticybersquatting Consumer Protection Act ("ACPA") does not apply to the use of trademarks in metatags and refused to find that use of trademarks in metatags created a likelihood of confusion.

Plaintiff Marianne Bihari was an interior designer and worked under the name Bihari Interiors, Inc. Defendant Craig Gross and his girlfriend hired Bihari Interiors to decorate Gross' condominium. Gross and Bihari's relationship soured, and Gross acquired the Internet domain names *bihari.com* and *bihariinteriors.com*, which he used to host websites that were highly critical of Bihari and her services. These sites also provided a means by which other disappointed clients of Bihari Interiors could post comments to voice their dissatisfaction. Bihari served Gross with a complaint and motion for injunctive relief, at which point Gross relinquished both domain names. However, Gross then acquired the domain names *designscam.com* and *manhattaninteriordesign.com* which he used to house the same content. The websites used "Bihari Interiors" and "Bihari" in metatags embedded within the websites' HTML code. Such metatags enable search engines to locate the websites when users search under those queries. Bihari sought to preliminarily enjoin defendants from using her name in the domain names or metatags of any of their websites, claiming violations of the ACPA and § 43(a) of the Lanham Act.

The district court denied the motion for preliminary injunction. On the ACPA claim, the court stated that the plain language and legislative intent of the Act made clear that it did not apply to metatags nor was there any precedent for extending such protection. Accordingly, the ACPA was not a basis for preliminary injunctive relief. The court also denied the motion based on the Lanham Act trademark infringement claim. The court declined to find that the metatags created a likelihood of confusion, explaining that no reasonable viewer would believe that the disparaging comments regarding Bihari's business were endorsed by Bihari Interiors. Moreover, there was no "lengthy delay" between attempting to access the real Bihari Interiors website and learning that one has failed to do so by coming upon one of the disparaging websites. In addition, the court held that the defendants' use was fair, as the metatags were used in a descriptive context to identify the content of the websites and there was no intent to confuse customers as to website sponsorship. Because the defendants' use of plaintiff's mark in the metatags was not likely to cause confusion and was further protected as a fair use, plaintiff failed to demonstrate likelihood of success on the Lanham Act claim.

### ***BROADBRIDGE MEDIA L.L.C. V. HYPERCD.COM***

*106 F. Supp. 2d 505 (S.D.N.Y. 2000)*

In an in rem action, the U.S. District Court for the Southern District of New York held that a trademark owner can proceed against a domain owner under the Anticybersquatting Consumer Protection Act ("ACPA") and the Internet Commission for Assigned Names and Numbers' ("ICANN's") dispute resolution procedure simultaneously.

BroadBridge Media, owner of the mark HyperCD, brought suit against Barry Henderson, a Canadian resident, after he registered the domain name hypercd.com with Register.com. Henderson obtained the domain name after BroadBridge inadvertently allowed its domain name registration to lapse. Because Henderson was a resident of Canada, the court exercised the in rem jurisdiction granted to it by the ACPA.

Before reaching the substantive ACPA issues, the court addressed Henderson's motion to dismiss for lack of jurisdiction. Henderson argued that BroadBridge had waived its right to proceed in federal court while there was an ICANN administrative proceeding pending. The court denied defendant's motion, holding that parties involved in ICANN proceedings may file suit at any time, not just before or after the proceeding as Henderson had argued.

In addressing the ACPA issue, the court went through the statutory bad faith analysis but was also influenced by Henderson's repeated attempts to "hold the domain name hostage" until BroadBridge either paid him an exorbitant amount of money or shared with him the use of the mark. The court held that Henderson's actions after registration demonstrated bad faith, despite the fact that Henderson's initial registration of hypercd.com was apparently innocent and in good faith.

### ***CAESAR'S WORLD INC. V. CAESARS-PALACE.COM***

*112 F. Supp. 2d 502 (E.D. Va. 2000)*

The U.S. District Court for the Eastern District of Virginia ruled on the constitutionality of the provision for in rem jurisdiction under the Anticybersquatting Consumer Protection Act ("ACPA").

Caesar's World Inc. brought suit against Caesars-Palace.com, as well as against other similarly named companies, under the ACPA. Casares.com and Caesarcasino.com

moved to dismiss on the grounds that the in rem provisions of the Act are unconstitutional both facially and as applied. The defendants argued that under *Shaffer v. Hetner*, 433 U.S. 186 (1977), in rem jurisdiction is permitted only when the res provides the same minimum contacts that are required for personal jurisdiction. The court rejected this reading, stating that "there must be minimum contacts to support personal jurisdiction only in those in rem proceedings where the underlying cause of action is unrelated to the property which is located in the forum state." In addition, the court found that domain name registration with Network Solutions, located in Virginia, provided any necessary minimum contacts. Finally, the court noted that the limited relief afforded by the ACPA— forfeiture or cancellation—meant that the defendants suffered no due process violation.

The defendants also argued that a domain name does not qualify as a res. The court rejected this constitutional argument as well as an attack based on the statutory venue provision. Lastly, the court noted that it was undeterred by the prospect of an influx of litigation in Virginia.

### ***ELECTRONICS BOUTIQUE HOLDINGS CORP. V. ZUCCARINI***

*56 U.S.P.Q.2d 1705 (E.D. Pa. 2000)*

The U.S. District Court for the Eastern District of Pennsylvania applied the Anticybersquatting Consumer Protection Act ("ACPA") to registered domain name misspellings that were confusingly similar to famous Internet domain names.

Plaintiff Electronics Boutique ("EB") was a specialty retailer of video games and personal computer software, operating over six hundred retail stores and selling products via the Internet. EB had registered several service marks that it has continuously used and advertised since 1977, including "EB" and "Electronics Boutique," and domain names [www.ebworld.com](http://www.ebworld.com) and [www.electronicboutique.com](http://www.electronicboutique.com). Defendant Zuccarini was a "notorious cybersquatter" who had admittedly registered thousands of misspellings of names of famous Internet domains, products, television shows, and celebrities, among others. He registered five variants of EB's registered domain names, including [electronicboutique.com](http://electronicboutique.com) and [ebworl.com](http://ebworl.com). When an Internet user mistakenly typed one of Zuccarini's domain misspellings, she was barraged by up to fifteen advertising windows, from which Zuccarini earned advertising revenue of ten to twenty-five cents per click. EB filed a complaint in federal court and obtained a temporary restraining order. Despite numerous attempts, EB was unable to effect service of process on Zuccarini. The court found that Zuccarini had actual notice of the litigation, and without his presence, a preliminary injunction was granted.

At trial, EB was granted a permanent injunction against Zuccarini. The court also awarded EB maximum statutory damages and reasonable attorney's fees and costs under the ACPA, holding that Zuccarini's domain misspellings were confusingly similar to EB's domain names and that Zuccarini had a bad faith intent to profit from the infringing names. The court found that EB's service marks were "distinctive and famous" and that its multimillion-dollar advertising campaign had fostered broad-based consumer recognition. Zuccarini's domain name misspellings traded on the goodwill developed by EB and were a bad faith attempt to generate advertising revenue. The court further found that EB would suffer irreparable injury in the form of lost reputation, and that Zuccarini's deceptive practices harmed the public. Although Zuccarini neither appeared in court nor advanced any claims, the court noted that he would not be entitled to protection under the ACPA safe harbor provision because there was no evidence that Zuccarini reasonably believed his domain name misspellings were fair and lawful.

***GOTO.COM, INC. V. WALT DISNEY CO.***

*202 F.3d 1199 (9th Cir. 2000)*

The Ninth Circuit addressed “whether two remarkably similar logos used commercially on the World Wide Web are likely to confuse consumers under federal trademark law.”

Plaintiff Goto.com, Inc. was the first user of a logo featuring a green circle against a yellow background, with “GO TO” appearing in white letters within the green circle. Defendant Walt Disney Co. subsequently introduced its “Go Network,” a web portal with links to various Disney-owned websites. Sites belonging to the network were identified by a common logo, which resembled a traffic light having only a green lens, with the word “GO” appearing in white letters within the green circle. The district court granted Goto.com’s motion for a preliminary injunction, and Disney appealed.

The Ninth Circuit upheld the injunction in view of the high likelihood that web users would be confused. In analyzing the likelihood of confusion, the court focused on three of the eight factors identified in *AMF Inc. v. Sleekcraft Boats*, 599 F.2d 341, 348 (9th Cir. 1979): (1) similarity of the marks, (2) relatedness of the goods or services, and (3) use of the web as a marketing channel. With regard to the first factor, the court emphasized “the overwhelming similarity of the marks.” With regard to the second factor, the court noted “the potential for one company to provide a host of unrelated services” via the web, citing Yahoo.com as an example. The court also noted that Goto.com and Disney were direct competitors because both sites offered search engines. Finally, with regard to the use of the web, the court reiterated the position it adopted in *Brookfield Communications, Inc. v. West Coast Entertainment Corp.*, 174 F.3d 1036, 1057 (9th Cir. 1999), that the web, as a marketing channel, was more likely to create confusion because users may encounter competing marks “at the same time, on the same screen.”

The court downplayed the significance of the remaining *Sleekcraft* factors. In particular, the court stated that strength of the plaintiff’s mark was insignificant “in either the context of the Internet generally or in this case specifically, regardless of whether either logo had herculean strength.”

***LEATHERMAN TOOL GROUP, INC. V. COOPER INDUSTRIES, INC.***

*199 F.3d 1009 (9th Cir. 1999)*

The Ninth Circuit addressed “when and to what extent the overall appearance of a non-patented product is protectable ‘trade dress.’”

Plaintiff Leatherman Tool Group, Inc. was first to market with its multi-function pocket tool that sought to improve on the classic “Swiss army knife.” Subsequently, defendant Cooper Industries produced and marketed its own multipurpose pocket tool which was extremely similar to Leatherman’s tool, except for the difference in product name (which appeared on the product itself), and a few other minor and not particularly visible differences. In response, Leatherman brought an action against Cooper for trade dress infringement. After the jury’s finding of infringement, Cooper appealed.

The Ninth Circuit held that the overall appearance of an assemblage of functional parts is not protectable trade dress. Relying upon the language of *Clamp Manufacturing Co. v. Enco Manufacturing Co.*, 870 F.2d 512, 515 (9th Cir. 1989), the court reiterated that “the physical details and design of a product may be protected under the trademark

laws only if they are nonfunctional." Although trade dress must be viewed as a whole, the court made clear that "where the whole is nothing other than an assemblage of functional parts, and where the arrangement and combination of the parts is designed to result in superior performance, it is semantic trickery to say there is some sort of separate overall appearance which is nonfunctional." Noting the absence of evidence that anything about the appearance of Leatherman's tool (other than its name) existed for any nonfunctional purpose, the Court reversed the jury's finding of infringement, making clear that such a design could be protected only under patent law.

### ***LUCENT TECHNOLOGIES, INC. V. LUCENTSUCKS.COM***

*95 F. Supp. 2d 528 (E.D. Va. 2000)*

The U.S. District Court for the Eastern District of Virginia ruled on the due diligence requirement of the in rem provision under the Anticybersquatting Consumer Protection Act ("ACPA").

Lucent Technologies, Inc. owns trademarks in Lucent and Lucent Technologies. Russell Johnson registered the domain name lucentucks.com and allegedly posted pornographic photographs and advertisements on the website. Upon discovering the site, Lucent learned the name and address of the registrant of the site through Network Solutions, Inc. and sent a letter via Federal Express to Johnson requesting that he cease using Lucent's marks. When the letter was returned as undeliverable, the plaintiff sent another letter via first class mail and e-mail. The letter was successfully delivered to Johnson. Eight days after the second letter was mailed, Lucent filed an in rem action against Johnson's domain name under the ACPA, claiming trademark infringement and dilution. The defendant filed a motion to dismiss the complaint.

The court granted Johnson's motion on the grounds that Lucent did not satisfy the requirements of the in rem provision of the ACPA. The court reasoned that plaintiff did not allow a reasonable amount of time for Johnson to respond to the notice received through the second letter. The court stressed that in the absence of a specified waiting period, the due diligence requirement in the ACPA must be interpreted consistently with Due Process; eight days was held to be insufficient. The court noted that adequate notice is especially important in forfeiture proceedings such as the present case. The court also commented that in analogous circumstances, where Congress has specified a waiting period in the statute, the shortest time specified is ten days.

### ***MARKETING DISPLAYS, INC. V. TRAFFIX DEVICES, INC.***

*200 F.3d 929 (6th Cir. 1999), cert. granted, 120 S. Ct. 2715 (2000)*

The Sixth Circuit ruled on the availability of trade dress protection in conjunction with prior utility patent protection. Certiorari was granted on June 26, 2000.

Marketing Displays, Inc. ("MDI") holds a trademark on the WindMaster name, under which it produced and patented a successful wind-resistant road sign stand. The product design relies on a unique dual spring base. Five years after expiration of MDI's patent, Traffix produced a knockoff product, and marketed it under the brand name Wind-Buster. MDI immediately filed suit, claiming trademark infringement, trade dress infringement, and unfair competition. Traffix counterclaimed, alleging that MDI was pursuing sham litigation in violation of antitrust law. The district court granted summary judgment for MDI on the counterclaim and trademark infringement claim, but it ruled

against MDI on the trade dress infringement claim, finding that a design protected by a utility patent could not later receive trade dress protection. Both parties appealed.

The appellate court upheld summary judgment for MDI on the trademark infringement claim, emphasizing that a single dispositive factor among the considerations assessing possible customer confusion over the WindBuster mark indicated an absence of triable issues of material fact. The court further held that the PTO's issuance of the trademark afforded little defense, since the PTO may not have considered some evidence or may have erred in its judgment. However, PTO approval barred a finding of willful or intentional misappropriation of a mark.

On the trade dress issue, the court reversed and remanded the summary judgment ruling for Traffix, finding that protection of the product under a utility patent did not bar a claim that the trade dress of the base design was nonfunctional and thus protectable. If the trade dress is protectable without protecting the utility of the design, then a prior utility patent does not result in presumptive loss of trade dress protection. Different aspects of a product (utility or appearance) may be protected under different doctrines of intellectual property law. The court further held that the district court improperly confined the definition of the product trade dress to the dual spring base rather than the sign stand in its entirety, reasoning that a jury might find that the product as a whole had acquired secondary meaning in the marketplace. The opinion added that trade dress protection for MDI would not produce significant non-reputational disadvantages for Traffix.

The court affirmed summary judgment for MDI on the antitrust issue, finding that MDI's actions were not unreasonable in light of the other issues decided in the case. The court remanded MDI's unfair competition claim upon reversal of summary judgment on the trade dress issue.

***PLAYBOY ENTERPRISES, INC. V. NETSCAPE  
COMMUNICATIONS CORP.***

*55 F. Supp. 2d 1070 (C.D. Cal. 1999)*

The U.S. District Court for the Central District of California ruled on whether Playboy's trademark rights were violated when Netscape and Excite provided search engines which keyed banner ads displayed on search results pages to the search terms "playboy" and "playmate."

Defendants Netscape and Excite operate search engines and sell advertising space known as "banner ads" on search engine result pages. Banner ads are designed to entice Internet users to click on the ad, thus transporting users to the website of the advertiser. For a premium, defendants programmed servers to link a preselected set of banner ads to certain "key" search terms entered by users into search engines. Defendants keyed various adult entertainment ads to a group of over 450 terms related to adult entertainment, including the terms "playboy" and "playmate." Plaintiff Playboy has a trademark on "Playboy" and "Playmate." Plaintiff moved for a preliminary injunction against defendants, contending that defendants infringed and diluted its trademarks by (1) marketing and selling the key words "playboy" and "playmate" to advertisers, (2) keying banner ads to appear in response to the search terms "playboy" and "playmate," and (3) actually displaying the banner ad on the search results page. Plaintiff also argued that defendants' actions intentionally diverted Internet users from plaintiff's official website to other adult entertainment sites.

The court rejected plaintiff's infringement claim, holding that defendants did not use the terms "playboy" and "playmate" as trademark, but rather as generic words not necessarily associated only with defendants' goods and services. The court held that even if there were a trademark use, plaintiff failed to show a likelihood of confusion. Plaintiff argued that defendants' use caused initial interest confusion, relying on *Brookfield Communications, Inc. v. West Coast Entertainment Corp.*, 174 F.3d 1036 (9th Cir. 1999). The *Playboy* court described initial interest confusion as "when a user conducts a search using a trademark term and the results of the search include web sites not sponsored by the holder of the trademark search term, but rather of competitors." The court distinguished *Brookfield* on the basis that the search terms in the present case are words in the English language, unlike the words at issue in *Brookfield*. In addition, *Brookfield* involved a domain name that caused computer users to think they were entering one website when in reality they were entering another; the search terms in *Playboy* served only to trigger non-Playboy advertisements, which users could click on if they wished. The court further distinguished *Brookfield* on the basis that Playboy was not competing in the same market as Netscape and Excite.

The court also found that defendants' acts did not constitute trademark dilution because plaintiff presented no evidence that defendants' use of the words "playboy" and "playmate" caused any blurring or tarnishment of plaintiff's marks.

***TIMES MIRROR MAGAZINES, INC. V. LAS VEGAS SPORTS  
NEWS, L.L.C.***

*212 F.3d 157 (3d Cir. 2000)*

The Third Circuit ruled that niche-market fame can be sufficient to protect a mark from dilution within that market under the Federal Trademark Dilution Act ("FTDA"). The court also addressed whether a mark must be subject to separate famousness and distinctiveness tests under the FTDA.

Times Mirror Magazines, Inc. has owned and used the trademark "The Sporting News" in connection with a weekly publication since 1886. This publication provides readers with information on baseball, basketball, football, and hockey, and has a weekly circulation of approximately 540,000 in the United States and Canada. In 1997, Las Vegas Sports News ("LVSN") changed the name of its sports gaming publication from Las Vegas Sports News to Las Vegas Sporting News. After learning of the name change, Times Mirror sent LVSN a cease and desist letter. Months of settlement negotiations between the two publishers proved unsuccessful, and Times Mirror subsequently filed a complaint in district court, charging LVSN with, among other things, trademark dilution in violation of the FTDA. Concluding that Times Mirror was likely to succeed on the merits of this claim, the district court granted Times Mirror's motion for a preliminary injunction enjoining LVSN from using the phrase "Sporting News" in connection with its weekly publication.

LVSN appealed and the Third Circuit affirmed. The court followed the Seventh Circuit in holding that a trademark's niche-market fame can be a factor for famousness (an element of dilution) where the plaintiff and defendant are using the mark in the same or related markets. The court concluded that because Times Mirror and LVSN both competed in the sports periodicals market, the fame of the mark "The Sporting News" within that niche entitled Times Mirror to protection under the FTDA against LVSN's use of a similar mark in the same market. LVSN also argued that the FTDA "requires that a mark be subject to a test for fame and a separate test for distinctiveness." The court held that

section 1125(c) of the FTDA has no separate distinctiveness requirement apart from the test for famousness, and that having a separate distinctiveness requirement after there has been a finding of secondary meaning would be redundant. The court noted that its holding on this issue is in conflict with that of the Second Circuit in *Nabisco, Inc. v. PF Brands, Inc.*, 191 F.3d 208 (2d Cir. 1999).

### ***VIRTUAL WORKS, INC. v. NETWORK SOLUTIONS, INC.***

*106 F. Supp. 2d 845 (E.D. Va. 2000)*

The Eastern District of Virginia decided whether Virtual Works' registered domain name, vw.net, constituted trademark dilution and trademark infringement under a theory of cyberpiracy.

Virtual Works brought suit against Network Solutions, Inc. and against Volkswagen AG and Volkswagen of America (collectively "Volkswagen"). The suit against Network Solutions was dismissed. Virtual Works brought a claim of tortious interference with its registered domain name, vw.net, against Volkswagen. Volkswagen brought a counterclaim for cyberpiracy, trademark dilution, and trademark infringement. Both parties moved for summary judgment on their claims.

Deciding that summary judgment was appropriate, the court addressed the substantive issues. The court first addressed the cyberpiracy claim under the Anticybersquatting Consumer Protection Act ("ACPA") and found that Virtual Works had no intellectual property rights in the initials "VW," nor had Virtual Works ever conducted business under those initials. In addition, the court found that (1) there was a likelihood of confusion between vw.net and Volkswagen's trademarks; (2) by putting references to Volkswagen as Nazis using slave labor on its website at vw.net, Virtual Works was disparaging Volkswagen; (3) Virtual Works had attempted to sell back the domain name to Volkswagen at a financial gain; and (4) Volkswagen's VW symbol is a famous mark. In addition to finding for Volkswagen on the ACPA claim, the court also found that vw.net infringed Volkswagen's mark. In particular, the court stated that "[t]he holder of a domain name should give up that domain name when it is 'an intuitive domain name' that belongs to another." Addressing the dilution claim, the court cited *Panavision International v. Toeppen*, 141 F.3d 1316 (9th Cir. 1998), in holding that "internet cyberpiracy constitutes per se trademark dilution." Consequently, the court denied Virtual Works' summary judgment motion and granted Volkswagen's motion on all three counterclaims.

### ***WALTER V. MATTEL, INC.***

*31 F. Supp. 2d 751 (C.D. Cal 1998)*

In a suit involving allegations of false designation of origin and deception under the Lanham Act, as well as common law and state law unfair competition claims, the U.S. District Court for the Central District of California held that mere association between marks is not sufficient to prove reverse confusion.

Katherine Walter, also known as and doing business as "Pearl Beach" in her work as a commercial illustrator, filed a complaint against Mattel for its promotion and distribution of "Pearl Beach Barbie" dolls. According to Walter, Mattel's use of her name and her pearl and shell logo on its dolls amounted to reverse confusion, which exists when a senior user's product is wrongly associated with the junior (and allegedly infringing) user.

Walter argued that reverse confusion exists when the junior user causes the senior user's customers to believe that the senior user is "somehow associated with" the junior user. The court rejected this interpretation, requiring instead that a potential customer of the senior user must believe that she is dealing with the junior user, or that there is sponsorship among the users. In short, a court must determine whether "a reasonable consumer might mistakenly believe that the junior user is the source of the senior user's" product. The court then proceeded to use the *AMF Inc. v. Sleekcraft Boats, Inc.*, 599 F.2d 341 (9th Cir. 1979), factors for determining likelihood of confusion, concluding that the plaintiff failed to demonstrate a likelihood of reverse confusion.

### ***WESTCHESTER MEDIA V. PRL USA HOLDINGS, INC.***

*214 F.3d 658 (5th Cir. 2000)*

The Fifth Circuit ruled on a trademark infringement claim where the alleged infringement concerned a magazine title. The court upheld the lower court's decision finding infringement; however, it remanded on the issue of an appropriate remedy. In addition, the court presented its interpretation of the harm required under the Federal Trademark Dilution Act ("FTDA").

Westchester Media purchased *POLO* Magazine from Fleet Street Publishing ("FSP") in May 1997. Prior to this purchase, *POLO* was a special interest magazine, dealing specifically with the sport of polo. Its content consisted almost exclusively of technical and historical pieces on the sport of polo, and its advertising base comprised primarily horse medicines, equestrian products, and polo equipment. In 1989, while still under FSP ownership, the magazine began to run a section containing "lifestyle" content, under the title "Polo Life." Soon after the first publication of the "Polo Life" section, the trade journal *Ad Week* published an article discussing the similarity between the magazine as it then appeared and Polo Ralph Lauren's ("PRL") own advertising campaign. PRL was aware of the *Ad Week* article but continued to advertise in *POLO*, as it had done consistently for most of the magazine's existence. In 1992, FSP obtained federal registration for *POLO*, which in 1998 became uncontestable. Subsequent to Westchester's purchase, the magazine was re-launched under the name *POLO*, while Westchester began publishing a second and more technical magazine called *Polo Players Edition*. *POLO* was marketed to a customer list purchased from Neiman Marcus, and the magazine's content was described as "not about the sport, but rather about an adventurous approach to living." The model Claudia Schiffer, who was featured by PRL in an extensive advertising campaign the previous year, appeared on the cover of the magazine's first issue under Westchester ownership. The magistrate judge found that Westchester had violated the Lanham Act by infringing PRL's "Polo" trademark, and issued an injunction requiring Westchester to cease and desist publishing the magazine under the "Polo" title.

Westchester appealed. The Fifth Circuit agreed with the magistrate judge that infringement had occurred, holding that the use led to confusion over the defendant's affiliation with the magazine, but remanded for further consideration of the appropriate remedy for such an infringement, urging particular attention to the use of a disclaimer rather than injunction. The court held, following *Twin Peaks Productions, Inc. v. Publications International Ltd.*, 996 F.3d 1366 (2d Cir. 1993), that as a literary work, the magazine's title was at least partially protected by the First Amendment, and therefore particularly compelling proof of a likelihood of confusion was required. The court, however, found no reversible error in the magistrate judge's finding of such proof, citing the following: (1) Westchester's intent to trade on PRL's goodwill, as demonstrated by its

publication of a second, sport-intensive magazine and by *POLO* Magazine's shift toward affluent lifestyle content; (2) the possibility, as perceived by the consumer, that the magazine business was within PRL's zone of expansion; (3) Westchester's marketing strategy, targeting likely PRL consumers; and (4) actual consumer confusion as evidenced by PRL's survey data. Upholding the district court's finding of likelihood of confusion, the court expressed concern with the remedy imposed. The Fifth Circuit noted that First Amendment concerns should guide the choice of remedy, especially where there are reasonable alternative avenues for relief. Specifically, the court remanded for "reconsideration whether a disclaimer procedure better comports with First Amendment principles than an outright prohibition on Westchester's use of 'Polo' for the New *POLO* Magazine."

The court declined to entertain Westchester's laches defense, citing the lack of any delay on the part of PRL in bringing action, since upon re-launch *POLO* was a new product. The court also declined to entertain Westchester's defense of acquiescence, on the grounds that any approval on the part of PRL was the result of its being misled by Westchester. Finally, the court addressed the issue of whether the FTDA requires a finding of actual economic harm, as the Fourth Circuit held in *Ringling Bros. v. Utah Division of Travel Development*, 170 F.3d 449 (4th Cir. 1999), or whether the statute requires only a threat of economic harm, as the Second Circuit held in *Nabisco, Inc. v. PF Brands, Inc.*, 191 F.3d 208 (2d Cir. 1999). On this issue, the Fifth Circuit followed the Fourth Circuit, requiring a finding of actual harm for dilution actions under the FTDA.

## RIGHT OF PUBLICITY

### *LANDHAM V. LEWIS GALOOB TOYS, INC.*

*227 F.3d 619 (6th Cir. 2000)*

The Sixth Circuit ruled on whether Kentucky right of publicity law and the Lanham Act protect an actor against a film production company and toymaker that licensed and marketed a doll based on a character he played in a feature film.

William "Sonny" Landham, an actor in general audience as well as pornographic films, played a supporting role in the 1987 film *Predator*, produced by Twentieth Century Fox Corporation. Fox licensed rights to Lewis Galoob Toys, Inc. to create and sell a line of "action figures" based on the film, including a toy modeled after Landham's character. The toy was intentionally designed to bear no personal resemblance to Landham. Landham had signed a memorandum with Fox before filming started, setting forth the terms of his salary and start date; a subsequent agreement, which Landham's agent received but which Landham never signed, assigned to Fox all merchandising rights based on Landham's character in *Predator*. Landham sued Fox and Galoob in federal district court in Kentucky, claiming that the companies infringed his Kentucky state law right of publicity and his rights under the Lanham Act by marketing the action figure without his permission. The district court granted summary judgment for the defendants, finding that Landham had presented insufficient evidence that (1) consumers would associate the action figure with him and (2) the toymaker had gained commercial value by "associating an article of commerce with him."

On appeal, the Sixth Circuit upheld the district court, holding that a right of publicity analysis depends on the actor's, rather than the character's, persona and that the actor's persona must have commercial value. Before considering the substance of the case, the

court rejected Galoob's argument of Copyright Act preemption, noting that the right of publicity at issue here was distinct from a copyright claim. For the right of publicity claim, Landham relied on *White v. Samsung Electronics America, Inc.*, 971 F.2d 1395 (9th Cir. 1992), which extended protection to the television game show hostess Vanna White against an advertiser. Although the ad in *White* did not present actual images of the celebrity or attempt to mimic her personal features, it did display a robot that resembled White in its dress and pose, an act which the court found evocative of White's identity. The *Galoob* court refused to extend *White*, emphasizing that unlike Landham, White had produced evidence attesting to the commercial value of her identity. More important, though, the court found that an extension of *White* would "upset the careful balance that courts have gradually constructed between the right of publicity and the First Amendment and federal intellectual property laws . . . ." In the court's judgment, the identity of an actor is not automatically synonymous with the identity of a fictional character that the actor portrays; Galoob used the identity of the fictional character, rather than that of the actor, to market its toys.

The court also rejected Landham's false designation of origin claim under the Lanham Act. The court used an eight-factor likelihood of confusion test to guide its analysis but ultimately borrowed the reasoning from its consideration of the right of publicity claim, finding that Landham had not offered evidence as to the commercial value of his name, and thus the strength of his mark, among the toy-buying public.

## TRADE SECRET

### *CIENA CORP. V. JARRARD*

*203 F.3d 312 (4th Cir. 2000)*

The Fourth Circuit ruled on the issue of imposing an injunction where a sales executive, while bound by a noncompetition agreement, assumed a high-level position with her former employer's competitor.

Cynthia Jarrard occupied a senior sales position with CIENA Corporation, a high technology company engaged in the business of designing and manufacturing fiber optics. As Western Regional Director of sales, Jarrard was based in Missouri; CIENA's principal place of business was in Maryland. Pursuant to CIENA's desire to protect its proprietary information, Jarrard had to sign, as a condition of employment, an agreement not to accept employment with CIENA's competitors or clients for one year after leaving CIENA. After two years, Jarrard left CIENA and accepted a high-level sales position with Sycamore Networks, Inc., a start-up company and CIENA's direct competitor. The district court imposed a preliminary injunction on Jarrard's employment pursuant to the noncompetition agreement in order to prevent her from misappropriating CIENA's trade secrets.

Jarrard appealed the injunction. The Fourth Circuit affirmed the injunction but remanded the case to the district court with instructions to give Jarrard thirty days to conduct discovery and file a motion to dissolve. The Fourth Circuit held that enough factual findings were made by the district court to sustain the injunction and that the injunctive order was specific enough to be enforceable. Applying the two-part test for granting preliminary injunctions—balance of harms and likelihood of success on the merits—the court upheld the district court's decision. On the balance of harms issue, the court found that in an industry where information is an essential commodity, Jarrard's misappropriation

tion of trade secrets could result in irreparable damage to CIENA. Conversely, Jarrard's employment qualifications suggested that she could easily find another position without violating the noncompetition agreement. As to the merits of the case, the court held that as a preliminary matter, the agreement was reasonable and therefore enforceable, given the nature of the industry and the importance of protecting proprietary information.

## CONSTITUTIONAL LAW

### *CHAVEZ V. ARTE PUBLICO PRESS, INC.*

*204 F.3d 601 (5th Cir. 2000)*

The Fifth Circuit ruled on whether Congress has authority to abrogate state sovereign immunity by allowing states to be subject to suits in federal court for violations of the Copyright or Lanham Acts.

Denise Chavez asserted a cause of action for copyright infringement against the University of Houston under the Copyright Remedy Clarification Act of 1990, 17 U.S.C. §§ 501(a), 511 (1994) ("CRCA"), alleging that the university violated the Copyright Act when it continued to publish her book without her consent. Chavez also asserted that the university violated the Lanham Act by naming her, without her consent, as the selector of plays in another book it published. The university contended that because, under the Eleventh Amendment, it cannot be sued in federal court without its consent, the case must be dismissed.

The first opinion in this case followed the *Parden v. Terminal Railway of Alabama State Docks Department*, 377 U.S. 184 (1964), theory that states can impliedly waive their sovereign immunity and on that basis, held that the University could be sued in federal court for violating the two statutes. See *Chavez v. Arte Publico Press*, 59 F.3d 539, 547 (5th Cir. 1995) ("*Chavez I*"). After the Supreme Court remanded for reconsideration in light of *Seminole Tribe of Florida v. Florida*, 517 U.S. 44 (1996), the Fifth Circuit concluded that the implied waiver theory was no longer viable. See *Chavez v. Arte Publico Press*, 157 F.3d 282, 287 (5th Cir. 1998) ("*Chavez II*"). In *Chavez II*, the court held that the CRCA and the Trademark Remedy Clarification Act ("TRCA") were invalid exercises of Article I legislative power. *Chavez II* was vacated by the court's vote for en banc reconsideration, but the case was remanded in light of the United States Supreme Court decisions in *Florida Prepaid Postsecondary Education Expense Board v. College Savings Bank*, 527 U.S. 627 (1999) and *College Savings Bank v. Florida Prepaid Postsecondary Education Expense Board.*, 527 U.S. 666 (1999).

In the latest decision, the Fifth Circuit held that an action could not be maintained against the state in federal court because Congress improperly exercised its legislative power when it amended both the CRCA and the TRCA, to explicitly require states to submit to suit in federal court for violation of the provisions of the statutes. The court stated that Congress may abrogate a state's sovereign immunity when acting to enforce constitutional rights pursuant to the Fourteenth Amendment. However, when it legislates pursuant to section 5 of the Fourteenth Amendment, there must be a congruence and proportionality between the injury to be prevented or remedied and the means adopted to that end. In its analysis, the court examined three aspects of the legislation: the nature of the injury to be remedied; Congress' consideration of the adequacy of state remedies to redress the injury; and the coverage of the legislation. The court found that Congress did not demonstrate that it had responded to massive constitutional violations requiring re-

medial legislation. Further, Congress had not sought to limit the scope of coverage—in particular, by excluding unintentional infringement by states—thus making the acts at issue irreconcilable with the principle that legislation pursuant to the Due Process Clause of the Fourteenth Amendment must be proportionate to legitimate section 5 ends. The court vacated and remanded the case with instructions to dismiss.

### *JUNGER V. DALEY*

*209 F.3d 481 (6th Cir. 2000)*

The Sixth Circuit addressed whether encryption source code is sufficiently expressive in nature to warrant First Amendment protection from Export Administration Regulations, 15 C.F.R. Parts 730-74.

Peter Junger, a law professor at Case Western Reserve Law School, argued that posting of encryption language on the World Wide Web for teaching purposes constituted protected speech. Encryption, the process of converting plain text into a scrambled ciphertext, is now frequently performed by encryption software. This software can be in the form of object code, readable only by a computer, or in source code, which programmers can readily read and understand. The Export Administration Regulations created a licensing scheme to control the export of nonmilitary technology, including most forms of encryption software, and defined posting of such information on the web as an export for licensing purposes. Junger had applied to the Commerce Department for classification of his encryption software programs before posting them on his website, and was told that four of the five programs submitted were subject to licensing requirements. He then filed this action, facially challenging the regulations on First Amendment grounds and seeking declaratory and injunctive relief to allow him free distribution of encryption software through his website. The district court granted summary judgment for the defendants, holding that because the functional nature of source code outweighs its expressive characteristics, source code is not protected under the First Amendment.

The Sixth Circuit reversed, holding that since encryption software source code was used as an expressive medium for the exchange of ideas about computer programming, it was protected by the First Amendment. Although the court recognized that governmental and national security interests can on occasion outweigh the interests of protected speech, the record in the present case did not prove that national security interests would be furthered by prohibiting the free exchange of encryption source code. Since the Bureau of Export Administration had amended the regulations at issue subsequent to the district court's decision, the circuit court remanded the case to reconsider Junger's facial challenge under the revised regulations.

### *RODRIGUEZ V. TEXAS COMMISSION ON THE ARTS*

*199 F.3d 279 (5th Cir. 2000)*

The Fifth Circuit ruled on the issue of whether the Copyright Remedy Clarification Act abrogates a state's Eleventh Amendment immunity pursuant to a valid exercise of congressional power.

Rodriguez registered a design for Texas license plates with the U.S. Copyright Office, and argued that the Arts Commission infringed that design when it started selling its specialized "State of the Arts" license plates to Texas residents. The U.S. District Court for the Northern District of Texas dismissed Rodriguez's suit for lack of subject matter

jurisdiction since he did not obtain the State's consent before suing it as required by the Eleventh Amendment.

Rodriguez appealed, arguing that the district court erred in its decision because Congress's enactment of the Copyright Remedy Clarification Act of 1990, 17 U.S.C. § 511(a) (1994), validly abrogated the states' sovereign immunity from suit in copyright matters. The Fifth Circuit disagreed, stating that although it was clear that Congress expressed its intent to abrogate such immunity, Congress did not act pursuant to a valid exercise of its power. Because Congress cannot abrogate state sovereign immunity pursuant to its Article I powers, the Act can only be constitutionally justified under the Due Process Clause. The court applied the Supreme Court's ruling in *Florida Prepaid Post-secondary Education Expense Board v. College Savings Bank*, 527 U.S. 627 (1999), to this copyright case. The Fifth Circuit reasoned that because the interests and the language are substantially the same in both the Patent Remedy Act and the Copyright Remedy Act, the *Florida Prepaid* analysis applied and the Copyright Remedy Act, therefore, is not justified under the Fourteenth Amendment.

## TELECOMMUNICATIONS

### *AT&T CORP. V. CITY OF PORTLAND*

*216 F.3d 871 (9th Cir. 2000)*

The Ninth Circuit ruled that the Communications Act of 1934 prohibits a local cable franchising authority from conditioning a transfer of a cable franchise upon the cable operator's grant of unrestricted access to its cable broadband transmission facilities for Internet service providers ("ISPs") other than the operator's proprietary service.

The case arose from merger of AT&T and Telecommunications, Inc. ("TCI"). The merger allowed AT&T to combine its long-distance telephone services and ISPs with the local cable broadband internet ("CBI") access technology of TCI in certain areas. AT&T provided Internet access as part of its @Home service, which raised concerns over whether AT&T could restrict user access to CBI to the proprietary @Home service, thus eliminating competition from other ISPs. Although the U.S. Department of Justice cleared the merger on antitrust grounds and the Federal Communications Commission determined that AT&T and TCI need not allow open access to their technologies, the local franchising authority in Portland predicated its approval on the condition that AT&T and TCI open their CBI technology to competing ISPs. AT&T refused to accede to the condition, and Portland denied AT&T's request to transfer the cable franchise. AT&T then brought suit against Portland for violating the Communications Act of 1934, as amended by the Telecommunications Act of 1996. The district court granted summary judgment to Portland, rejecting all of AT&T's claims.

The Ninth Circuit reviewed the grant of summary judgment, deciding only the question of statutory interpretation. Since Portland had premised its open access condition on its position that @Home is a "cable service" governed by the franchise, the court began its review with the question of whether the @Home service truly is a "cable service" as Congress defined it in the Communications Act. According to the court, "cable service" is defined in the Act as a one-way transmission of video programming or other programming service, involving subscriber interaction only to the extent that a subscriber may select or use such video programming or other programming service. The court interpreted this to refer to one-way transmission only, distinct from the interactive service

provided by AT&T/@Home. Thus, the court concluded that a cable operator may provide CBI access without obtaining a cable service franchise.

The court then turned to the question of whether Portland could condition AT&T's provision of standard cable service upon its opening access to the CBI to competing ISPs. The court stated that AT&T/@Home's provision of Internet transmission via CBI is defined as classic "telecommunications" under the Communications Act. However, the court noted that AT&T/@Home's role as an ISP defined it as a provider of "information services," not as a telecommunications carrier and that 47 U.S.C. § 541(b)(3) states that if a cable operator is engaged in the provision of telecommunications services, it is not to be restricted or ordered to provide any service by franchising authorities. Accordingly, the court held that Portland did not have the authority to regulate AT&T's provision of @Home. Therefore, the Ninth Circuit reversed the district court, holding that Portland may not condition the transfer of the cable franchise on nondiscriminatory access to AT&T's CBI network.

## BUSINESS LAW

### *AMERICAN GUARANTEE & LIABILITY INSURANCE CO. v. INGRAM MICRO, INC.*

*No. CIV 99-185 TUC ACM, 2000 U.S. Dist. LEXIS 7299  
(D. Ariz. April 19, 2000)*

The U.S. District Court for the District of Arizona ruled that an insurance policy's coverage of "physical damage" included the loss of use or functionality of the insured's computer system.

Ingram Micro, Inc. ("Ingram") purchased an insurance policy from American Guarantee & Liability Insurance Co. ("American") that insured Ingram's "real, and personal property, business income and operations" against "[a]ll Risks of direct physical loss or damage from any cause, howsoever or wheresoever occurring." The policy included Ingram's computers as well as the Impulse System, a worldwide computer system used by Ingram to track its business activities. A power outage at Ingram's primary data processing center caused a loss of data on the local computers, as well as a loss of connection to the Impulse System that lasted eight hours. During that time, Ingram was unable to conduct business. Ingram filed a claim with American, which American denied, explaining that the computer systems in question were not physically damaged because they were still able to perform their intended function. American then filed a declaratory judgment action against Ingram; Ingram counterclaimed for breach of contract.

On cross-motions for summary judgment, the court ruled in favor of Ingram, finding that Ingram's systems did suffer physical damage. The court ruled that "'physical damage' is not restricted to the physical destruction or harm of computer circuitry but includes loss of access, loss of use, and loss of functionality." For this position, it relied on the federal computer fraud statute, 18 U.S.C.A. § 1030 (West Supp. 1999), which defines damage as including "any impairment to the integrity or availability of data, a program, a system, or information," as well as on provisions of various states' penal codes that criminalize interference with the functioning of a computer or network. According to the court, these statutes indicate lawmakers' recognition that interruptions in computer service, loss of access to data, or alterations to a computer network are forms of damage.

Therefore, the court concluded that “[r]estricting the Policy’s language to that proposed by American would be archaic.”

***EBAY, INC. V. BIDDER’S EDGE, INC.***

*100 F. Supp. 2d 1058 (N.D. Cal. 2000)*

The U.S. District Court for the Northern District of California granted eBay a preliminary injunction on a trespass to chattels claim against Bidder’s Edge, prohibiting Bidder’s Edge from using a “robot” or any similar program to access eBay’s computer systems for the purposes of copying any part of eBay’s database.

eBay is the largest online auction service, with many millions of users. In November 1998, Bidder’s Edge (“BE”) launched a website that aggregates auction data from other online auction sites using a “robot” program. The robot is designed to automatically search for, copy, and retrieve information from the websites of others. Using this robot, BE continuously downloaded eBay’s database of auctions. Because it did not have to search eBay’s site each time a customer searched its website, BE could display information faster to its customers, eBay, however, objected because such use placed a burden on its servers. When attempts to negotiate an agreement over marketing issues stalled, eBay demanded that BE cease accessing eBay’s site. BE, however, continued accessing eBay’s site and eBay filed suit, asking the district court to grant a preliminary injunction on nine possible theories, including trespass to chattels.

The court granted eBay a preliminary injunction on the theory of trespass to chattels. The court held that BE intentionally and without authorization interfered with eBay’s possessory interest in the computer system and that BE’s unauthorized use proximately resulted in damage to eBay in the form of lost data, decreased system performance, and system unavailability. The court also held that allowing BE to continue this activity would encourage the use of similar methods of searching eBay’s systems by other auction aggregators, resulting in additional damage to plaintiff. It found that plaintiff sufficiently demonstrated a likelihood of success on the merits of its trespass claim and that eBay would likely suffer irreparable injury if defendant were allowed to continue its ongoing trespass. Although the court agreed that there was little authority supporting preliminary injunctions in trespass to chattel cases, it claimed that a successful analogy could be drawn to injunctions based on trespass to real property. The court did, however, note that nothing in its order precluded BE from obtaining information from eBay’s site other than by automated query program, robot, web crawler or similar device. The court denied eBay’s request for a preliminary injunction barring access to its site based on eBay’s trademark infringement, trademark dilution, and other claims. After the court’s decision, the parties settled the case.

## FOREIGN & INTERNATIONAL LAW

***WORLD TRADE ORGANIZATION DISPUTE PANEL REPORT ON  
SECTION 110(5) OF THE U.S. COPYRIGHT ACT***

*WT/DS160/R, 2000 WL 816081 (June 15, 2000)*

In an action brought by the European Communities (“EC”), a dispute resolution panel of the World Trade Organization (“WTO”) ruled that a provision of the U.S. Copy-

right Act, 17 U.S.C. § 110(5)(B), violated the Agreement on Trade-Related Aspects of Intellectual Property ("TRIPS") and the Berne Convention.

The statutory provision at issue, 17 U.S.C. § 110(5) (Supp. IV 1998), allows certain business establishments to operate radios and televisions by exempting their transmissions from copyright infringement. Under § 110(5)(A), transmissions by a "single receiving apparatus of a kind commonly used in private homes" are exempt as long as no fee is charged and the transmission is not further broadcast to the public. Section 110(5)(B) exempts transmissions in establishments that meet certain requirements on the type of equipment used; specific requirements vary based on the size and type of establishment.

The EC complained that §§ 110(5)(A) and 110(5)(B) violated TRIPS and the Berne Convention. Pursuant to the WTO's Dispute Settlement Understanding ("DSU"), a panel was convened to decide the dispute. In its final report, the panel found that § 110(5)(A) complied with and § 110(5)(B) violated both agreements.

TRIPS and the Berne Convention require members to grant authors the exclusive right to control public performance and communication of their works. Article 13 of TRIPS allows members to make exceptions to the author's exclusive right if the exceptions (1) are confined to certain special cases; (2) do not conflict with a normal exploitation of the work; and (3) do not unreasonably prejudice the legitimate interests of the right holder.

The WTO panel applied this three-prong test to each of the two provisions of § 110(5). The panel ruled that § 110(5)(B) failed the first prong, which requires that exceptions be both well-defined and narrowly confined. Although the language of § 110(5)(B) defined the exception clearly enough, the exception was not adequately confined to "special" cases because more than half of all U.S. business establishments qualified for the exception. The panel upheld § 110(5)(A) after finding that it satisfied all three prongs. The exception was well defined and applicable to fewer than a fifth of all establishments; thus, it was confined to "certain special cases." Applying the second prong, the panel found that the exception would not interfere with normal exploitation of the work because the establishments covered were unlikely to pay rights owners to obtain licenses. Applying the third prong, the panel focused on lost revenue and found that any losses caused by § 110(5)(A) were well below the threshold of unreasonableness.

The United States has indicated that it will comply with the WTO decision and amend 17 U.S.C. § 110(5).

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