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Berkeley Technology Law Journal
U.C. Berkeley School of Law
Student Center, Ste. 3
Berkeley, California 94720-7200

(510) 643-6454 (Phone)
(510) 643-6816 (Fax)
btlj@law.berkeley.edu
www.btlj.org

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FOREWORD

By Tamar R. Gubins[†] *& Danny Prati*[‡]

The Annual Review is a yearly publication of the *Berkeley Technology Law Journal* that provides a summary of many of the major developments at the intersection of law and technology. Our aim is to provide a valuable resource for judges, policymakers, practitioners, students, and scholars. Each Note provides a primer into a particular area of law, a development in that area of law, and commentary on that development.

The twenty-two Notes in this issue continue a tradition of covering a wide range of topics. The Notes address developments in traditional intellectual property areas—patent, copyright, trademark, and tradesecret law—along with developments in cyberlaw, antitrust, and privacy. Following the Notes in each area of law, we have included Additional Developments. These are brief descriptions of important developments that were not addressed in the Notes.

I. PATENT LAW

This year's Annual Review covers a wide range of developments in the area of patent law. The first Note in this section discusses *Quanta Computer, Inc. v. LG Electronics, Inc.*, in which the Supreme Court held that patent exhaustion applies to method patents and that a product need only substantially embody an invention for its sale to trigger patent exhaustion.[1] The Note describes the history of the patent exhaustion doctrine and places the *Quanta* decision in context. The Note concludes that the Court's holding was factually specific—narrowly tied to the particularities of the contract between the parties—yet could have implications that go well beyond the facts of the case. The Note argues that *Quanta* may affect patentees' licensing practices that attempt to avoid patent exhaustion, and that post-sale restrictions on purchasers should, in many cases, be enforced through contract remedies rather than patent remedies.

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† Senior Annual Review Editor, Berkeley Technology Law Journal; J.D., 2009, University of California, Berkeley, School of Law (Boalt Hall).

‡ Senior Annual Review Editor, Berkeley Technology Law Journal; J.D., 2009, University of California, Berkeley, School of Law (Boalt Hall).

1. 128 S.Ct. 2109 (2008).

The second Note in the patent law section covers the Federal Circuit's decision in *In re Bilski*,[2] and subsequent determinations on patentable subject matter by the Board of Patent Appeals and Interferences. *In re Bilski* rejected a categorical exclusion of software as patentable subject matter and held that the true test for patentable subject matter is the "machine or transformation test." The Note traces the development of computer software as patentable subject matter and describes how the Board has implemented *Bilski*. The Note argues that the Federal Circuit's decision in *Bilski* essentially serves to exclude many software patents and requires patentees to adhere to cumbersome formalities in order to satisfy the machine or transformation test for software patents. The Note concludes that the Federal Circuit should either not encumber software patents with such formalities or should exclude software patents altogether, if such an exclusion is consistent with the statute.

The next patent Note describes ongoing royalty determinations in patent infringement cases where the district court finds infringement, but does not issue a permanent injunction. The Note describes two cases, *Amado v. Microsoft Corp.*[3] and *Paice LLC v. Toyota Motor Corp.*,[4] in which the Federal Circuit rejected the methodology the lower courts used in determining the ongoing royalty rate. The Note argues that the rejections were correct because the methodologies employed by the lower courts were too simplistic, but also observes that the Federal Circuit failed to provide a proper framework for determining ongoing royalties. The Note attempts to remedy this omission by presenting a framework to deal with the problems of quantifying forward-looking royalties that lower courts could use to determine ongoing-royalty rates.

Our next two Notes look at nonobviousness in different areas of patent law in the wake of Supreme Court's *KSR v. Teleflex*[5] decision. One Note covers jury instructions on the issue of nonobviousness. The Note describes the current state of jury instructions on the nonobviousness determination and describes the Northern District of California's approach. The Note concludes by arguing that the approach employed in the Northern Districts of California unnecessarily strips the jury of the ability to make a binding determination and that future litigants have leeway in defining the role of the jury on the issue of nonobviousness.

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2. 545 F.3d 943 (Fed. Cir. 2008).
3. 517 F.3d 1353 (Fed. Cir. 2008).
4. 504 F.3d 1293 (Fed. Cir. 2007).
5. 550 U.S. 398 (2007).

The second post-*KSR* evaluation examines the patentability of chiral drugs (molecules that exhibit particular symmetrical properties) in the wake of *KSR*. The Note argues that *KSR* has not made significant changes to nonobviousness determinations related to chiral drugs. The Note points out the importance that courts give to secondary considerations, and advises patentees to document the unpredictability of their lab results and evidence of their experimental failure.

The sixth Note in the patent law section addresses the Federal Circuit's judgment on joint infringement. Joint infringement is a theory of infringement where multiple parties collectively perform all of the steps of a method patent, yet there is no single party that performs every step. The Note discusses the Federal Circuit's "control or direction" standard and argues that the standard is unclear. The Note concludes that the Federal Circuit should adopt a vicarious liability test to determine joint infringement. Additionally, the Note identifies patent prosecution practices that may help avoid issues of joint infringement.

The next patent Note focuses on the California Supreme Court's refusal to find fiduciary duties in a contract where one party provides intellectual property to another for development, in exchange for royalties. Before delving into the specifics of *City of Hope National Medical Center v. Genentech, Inc.*,[6] the Note reviews both the jurisprudential history of fiduciary duty law and various academic conceptions of fiduciary duties. The Note concludes that the California Supreme Court reached the correct decision, favoring the right of contract over an uncertain creation of a fiduciary relationship, and posits that the decision will foster favorable agreements for businesses and nonprofit research institutions alike.

Our final Note in the patent law section concerns the field of genetic testing. Scientific advances have made many genetic testing services available to the public, and these services are often utilized without the recommendation or guidance of a physician. These so-called Direct-to-Consumer (DTC) tests raise a host of legal and consumer-safety issues. The Note argues that there is currently insufficient regulation of DTC genetic testing and offers solutions to address the risks associated with these tests.

II. COPYRIGHT LAW

Technological advances are constantly pushing the boundaries of copyright law. Our first Note in the copyright section of the Annual Review

6. 181 P.3d 142 (Cal. 2008).

analyzes one such technological advance, the centrally-located Digital Video Recorder (DVR), in which a cable provider stores recorded video on its servers and makes the video available to the user via streaming video. The Note describes the Second Circuit's decision in *Cartoon Network LP v. CSC Holdings*, and the legal issues raised by centrally-located DVRs.[7] The Note focuses on the court's holding related to the public performance right implicated by centrally-located DVRs and argues that the court's holding results in inefficient conduct to avoid liability. Finally, the Note offers judicial and legislative solutions that could help copyright protection evolve with these changes in technology, while avoiding inefficient conduct.

The second Note in the copyright section of this Annual Review discusses the Federal Circuit's *Jacobsen v. Katzer* decision.[8] *Jacobsen* confirmed the enforceability of an open source software license, the Artistic License, used by a software developer in California. The Note argues that the Federal Circuit's decision was heavily based on contract interpretation and may therefore not have a substantial effect outside of California. Nevertheless, the Note concludes that *Jacobsen* provides precedent for the enforceability, through copyright law, of an open source license, and that *Jacobsen* can be considered a victory for the free and open source community.

The next two Notes in the Annual Review examine two Second Circuit copyright decisions dealing with transfer of ownership. The first case reviewed, *Penguin Group (USA) Inc. v. Steinbeck*, dictates that renegotiating a pre-1978 grant of copyright can dispel the termination right, which effectively creates an exception to the statutory inalienability of termination of transfer rights.[9] The decision agrees with a previous Ninth Circuit stance, avoiding a feared circuit split. The Note argues that the decision is inconsistent with legislative intent to protect the heirs of authors. Furthermore, the court-suggested inquiry for future termination of transfer rights cases does not create a predictable standard and the Note anticipates an increase in litigation over this issue.

The second Note assessing a Second Circuit transfer of ownership decision allows us to explore the world of hip hop, albeit through copyright law. In *Davis v. Blige* the Second Circuit became the first court of appeals to hold that neither transfers of ownership nor nonexclusive-license conveyances could be applied retroactively to cure infringement in joint

7. 536 F.3d 121, 123-24 (2d Cir. 2008).
8. 535 F.3d 1373 (Fed. Cir. 2008).
9. 537 F.3d 193 (2d Cir. 2008).

works.[10] The Note agrees that the decision facilitates the court's stated policy goal of limiting uncertainty, but points out that the mere ability of one co-owner to unilaterally convey a nonexclusive license undermines this goal. Furthermore, the decision makes uncertain the status of common settlement agreements which have settled infringement claims with only one co-owner and relied on a retroactive nonexclusive license to immunize the defendant from liability to other co-owners.

The fifth Note in the copyright section continues the discussion of modern copyright enforcement challenges caused by advances in technology. Some websites, such as YouTube, host User Generated Content (UGC), which can sometimes include infringing copyrighted material. The Note discusses the recently proposed "Principles for User Generated Content Services," a proposal by large UGC websites to voluntarily shift the burden of policing copyright infringement to themselves through the implementation of technological filters. The Note argues that fair-use considerations are likely to be adversely affected by the technological filters because the filters are unlikely to make accurate fair-use determinations. The Note analyzes a two-stage policing system that uses technological filters and human review to reduce copyright infringement on UGC sites without eroding fair use.

The sixth Note in the copyright section analyzes the potential effect that the Supreme Court's *eBay Inc. v. MercExchange L.L.C.*[11] decision may have on injunctions in copyright infringement cases. The Note applies the *eBay* analysis to the specific circumstances of copyright cases and analyzes situations where a district court would likely grant or deny an injunction. The Note concludes that *eBay* will not affect whether injunctive relief is granted or denied in the vast majority of cases.

Our last copyright Note reviews the role and legal obstacles of digital archives. Digital archives such as The Internet Archive harbored hope that the suit against Google's Library Project would resolve uncertainty about their legal status. When the suit against Google settled it left the legality of digital archives as unresolved as ever. Digital archives are essentially libraries, compiling the evanescent digital material available on the Internet for later use by researchers and the public. In evaluating the various legal issues facing digital archives, the Note expresses concern that the legal uncertainty will discourage this valuable undertaking. The Note concludes by suggesting that Congress create a statutory exception to copyright liability for digital archives.

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10. 505 F.3d 90 (2d Cir. 2007), *cert. denied*, 129 S. Ct. 117 (2008).
11. 547 U.S. 388 (2006).

III. TRADEMARK

The only trademark Note in this Annual Review confronts the question of who should be responsible for policing the online sale of counterfeit goods—the trademark owner or the website? In *Tiffany (NJ) Inc. v. eBay, Inc.*, a district court in the Southern District of New York agreed with eBay that the onus to police the site for counterfeit goods resides with the trademark holder rather than with the site operator, rejecting Tiffany's complaint that eBay's general knowledge of counterfeiting on the site gives rise to secondary liability and that eBay could more easily monitor the products on offer.[12]

Tiffany's argument is reminiscent of the copyright context where copyright holders are frustrated by the daunting task of monitoring and enforcing their rights online at sites such as YouTube, and argue that the site operators can more easily and effectively search the content for copyright violations than can individual rights holders. This Note argues that a statutory safe harbor, similar to the one in copyright found in the DMCA safe harbor,[13] should be created for the trademark context. Such rules would clarify the responsibilities of both rights holders and online auction sites.

This Annual Review also reviews additional developments in trademark law. The PRO-IP Act of 2008,[14] signed into law in October, provides for enhanced remedies in counterfeiting and piracy cases and creates a new "IP Czar" position in the executive branch. Also, several cases evaluated trademark use in online content. For example, in *Venture Tape Corp. v. McGills Glass Warehouse*,[15] the Court of Appeals for the First Circuit affirmed summary judgment against a defendant who used a competitor's trademark in the metatags and background display of its website to attract customers.

IV. TRADE SECRET

Our sole trade secret Note cautions employers not to rely on the trade-secrets exception to the California statutory prohibition of noncompetition restrictions in employment contracts. In August 2008, the California Supreme Court rejected the "narrow-restraint" exception to the noncompete-

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12. 576 F. Supp. 2d 463 (S.D.N.Y. 2008).
13. 17 U.S.C. § 512(c) (2000).
14. Prioritizing Resources and Organization for Intellectual Property Act of 2008, Pub. L. No. 110-403, 124 Stat. 4256 (to be codified as amended in scattered sections of 15 U.S.C., 17 U.S.C., 18 U.S.C., and 42 U.S.C.).
15. 540 F.3d 56 (1st Cir. 2008).

agreement prohibition, an exception previously recognized by the Ninth Circuit.

The Note details *Edwards v. Arthur Andersen LLP*[16] and reviews the statutory history and judicial interpretations of the California Business and Professions Code section 16600[17] prohibition of noncompetition restrictions. In *Edwards* the court chose not to address the trade-secrets exception to the noncompete agreement but the Note warns that no state case has ever upheld a noncompete agreement under the supposed trade-secrets exception. In determining that the state legislature should not revise section 16600, the Note looks at how section 16600 has positively and negatively affected Silicon Valley business and business practice, determining that there is no evidence to show that the noncompetition law has hurt Silicon Valley innovation.

We review one additional development in trade secret law, *Cypress Semiconductor Corp. v. Superior Court*, a case from the Court of Appeal for the Sixth District of California.[18] In *Cypress*, the court clarified when the statute of limitations for a trade secret misappropriation claim begins to run.

V. CYBERLAW

The Annual Review has previously addressed section 230 of the Communication Decency Act (CDA), a statute designed to shield online service providers from liability for content posted by users,[19] but now revisits it after the 2008 Ninth Circuit opinion in *Fair Housing Councils v. Roommates.com*.[20] The Note covering *Roommates.com* explains how the Ninth Circuit attempted to clarify liability under the CDA, and in doing so deviated from previous section 230 jurisprudence. The Note argues that the decision actually confuses the lines of liability, basing liability on the underlying claim rather than on the status of the service provider. The resulting case-by-case determination defeats a primary benefit of the safe-harbor approach and taxes the courts. Ultimately though, the Note concludes that the *Roommates.com* decision is limited and will not change safe-harbor status for most sites.

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16. 189 P.3d 285 (Cal. 2008).
17. Cal. Bus. & Prof. Code §§ 16600 (2008).
18. 77 Cal. Rptr. 3d 685 (6th Dist. 2008).
19. Communications Decency Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (codified as amended in scattered sections of 47 U.S.C.).
20. 521 F.3d 1157 (9th Cir. 2008).

The next cyberlaw Note evaluates last year's Federal Communication Commission (FCC) decision that chastised Comcast for network neutrality violations, and required the company to publish its network management practices and cease selective interference with internet traffic.[21] Rather than evaluate the costs and benefits of a government policy promoting network neutrality, as do many other publications in this space, this Note focuses on the FCC's source of regulatory authority to issue and enforce such an order. This authority is contested in Comcast's appeal to the Court of Appeals for the D.C. Circuit. The D.C. Circuit will not only determine the extent of the FCC's agency authority to issue the order (and possibly similar future orders), but will also make a determination on the appropriate judicial review for such agency orders.

The last cyberlaw Note analyzes a business quandary that many U.S. information and communication technology companies (ITCs) such as Yahoo!, Microsoft, and Google have faced when expanding into emerging markets—being subject to authoritarian governments that sometimes require them to participate in human rights violations, while simultaneously being subject to human rights norms and expectations in their home markets. The Note discusses several responses to the quandary, in particular the Global Network Initiative, which is a voluntary code of conduct developed by ICTs, NGOs, academics, and investors. The Note concludes that the Global Network Initiative is not a perfect solution, but is the best available opportunity for ICTs to take advantage of emerging markets while adhering to their core values.

VI. ANTITRUST

The only Note in our Antitrust section analyzes the D.C. Circuit's *Rambus, Inc. v. F.T.C.* decision.[22] *Rambus* overturned an earlier FTC decision that found Rambus liable for antitrust violations stemming from its deceptive conduct while participating in a standard setting organization (SSO). The Note argues that SSOs are increasingly important to technology industries and that *Rambus* may adversely affect future participation in SSOs. The Note criticizes *Rambus* as inconsistent with previous precedent, and proposes solutions that can help deter deceptive conduct by SSO participants but will not discourage participation of non-deceptive parties.

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21. *In re* Formal Complaint of Free Press & Pub. Knowledge Against Comcast Corp. for Secretly Degrading Peer-to-Peer Applications, 23 F.C.C.R. 13028, 13078 (2008).

22. 522 F.3d 456 (D.C. Cir. 2008), *cert. denied*, 129 S. Ct. 1318 (2009).

VII. PRIVACY

This Annual Review continues looking at privacy issues raised by technology law and policy. Our sole privacy Note examines the privacy implications of laptop searches at the country's borders, where search requirements have traditionally been lenient in the furtherance of national security. The Note reviews Fourth Amendment jurisprudence regarding border searches of laptops, particularly concentrating on the recent California Court of Appeal opinion in *People v. Endacott*,[23] observing that courts have offered little privacy protection for border searches and that any future protection will need to be statutory in nature. The Note then evaluates both the border search policies promulgated by the Department of Homeland Security and the various current attempts at legislative reform. The Note concludes by proposing necessary elements of ideal legislation that would both address the national security concerns while also protecting the privacy interests of business and personal travelers alike.

In the area of privacy law, the Annual Review also highlights a 2008 Supreme Court decision upholding an Indian voter identification law in *Crawford v. Marion County Election Board*,[24] and a Ninth Circuit denial for rehearing en banc stating that a government employee can have a reasonable expectation of privacy in personal text messages sent through a work pager based on the government employer's stated policy and actual practice.

23. 79 Cal. Rptr. 3d 907 (Ct. App. 2008).
24. 128 S. Ct. (2008).

THE EXHAUSTION DOCTRINE REVIVED? ASSESSING THE SCOPE AND POSSIBLE EFFECTS OF THE SUPREME COURT'S *QUANTA* DECISION

By Andrew T. Dufresne

In *Quanta Computer, Inc. v. LG Electronics, Inc.*, the Supreme Court addressed the common law doctrine of patent exhaustion for the first time in more than sixty years.[1] The unanimous opinion rejected a categorical rule exempting method patents from exhaustion[2] and held that a product need only substantially embody an invention for its sale to trigger exhaustion.[3] But the Court passed on an opportunity to comment broadly on post-sale restrictions used to circumvent exhaustion, engaging instead in a fact-intensive analysis of the restrictions at issue that invites narrow interpretation by lower courts.[4] Nonetheless, *Quanta* signals Supreme Court disapproval of attempts to marginalize the exhaustion doctrine, and the opinion's practical effects may therefore reach beyond its limited holding.

This Note examines *Quanta* in the larger context of judicial decisions that have shaped the exhaustion doctrine. Part I considers the origins of first sale principles, traces the exhaustion doctrine's development in patent law, and explores the various limits courts have placed on the doctrine. Part II describes the facts and history of the *Quanta* litigation, and Part III describes the Supreme Court's three major holdings. First, the Court forcefully overturned the Federal Circuit's poorly supported categorical rule that had exempted method claims from exhaustion. Second, the Court held that the sale of even an incomplete product can exhaust claims to the finished article, reasserting and significantly clarifying its own standard for applying exhaustion to unfinished products. Third, and perhaps most significantly, the Court held the asserted claims exhausted because LG Electronics (LGE) technically failed to impose any effective restrictions on Quanta's purchases. Although the opinion thus reserved significant questions regarding whether or how patentees may preserve post-sale patent

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1. 128 S.Ct. 2109 (2008).
2. *Id.* at 2117-18.
3. *Id.* at 2119-21.
4. *See id.* at 2121-22.

remedies against authorized purchasers, the Court suggested in dictum that such restrictions instead might properly be enforced through contract mechanisms.

Part IV discusses *Quanta*'s potential impact on licensing practices as well as on important Supreme Court and Federal Circuit precedent. Even though the Supreme Court rejected LGE's post-sale restrictions on factually narrow grounds, the opinion could effect significant changes by implication. Finally, Part IV also argues that enforcing post-sale restrictions on purchasers through patent remedies risks overcompensating patentees and that reasonable restrictions can be implemented readily and more appropriately through contract law.

I. THE LAW OF PATENT EXHAUSTION

The Supreme Court most famously described the patent exhaustion doctrine in *Adams v. Burke*: "[W]hen the patentee, or the person having his rights, sells a machine or instrument whose sole value is in its use, he receives the consideration for its use and he parts with the right to restrict that use."[5] In other words, each legitimate sale of a patented product extinguishes the patent holder's exclusive rights over the article sold, and the purchaser takes title without further restraint or obligation under the patent laws. Patent exhaustion thus operates as an affirmative defense, shielding authorized purchasers from infringement actions.[6] Without patent exhaustion, patentees' exclusive rights over the production, use, and sale[7] of their inventions could persist beyond the first sale, allowing the patentee to exert control—and extract compensation—down the chain of ownership for the life of the patent.[8]

A. Theoretical Foundations of Patent Exhaustion

The patent exhaustion doctrine dates to the Supreme Court's 1852 decision in *Bloomer v. McQuewan*.[9] Thereafter, the doctrine became fixed in

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5. 84 U.S. 453, 456 (1873).

6. *See generally* William A. Birdwell, *Exhaustion of Rights and Patent Licensing Market Restrictions*, 60 J. PAT. OFF. SOC'Y 203 (1978).

7. 35 U.S.C. § 154(a)(1) (2006).

8. Similar concerns prompted later development of the analogous "first sale" doctrine in copyright law, *see Bobbs-Merrill Co. v. Straus*, 210 U.S. 339 (1908). Interestingly, the doctrine has since been codified in U.S. copyright laws, 17 U.S.C. § 109 (2006), but remains a common law device in the patent context.

9. *See* Bloomer v. McQuewan, 55 U.S. 539, 549 (1852) ("[W]hen the machine passes to the hands of the purchaser, it is no longer within the limits of the monopoly. It passes outside of it, and is no longer under the protection of the act of Congress.").

U.S. patent jurisprudence as a kind of axiomatic truth, "more slogan than policy," dutifully repeated but rarely explained.[10] Thus, exhaustion's theoretical underpinnings remain somewhat hazy. But the cases reveal two primary motivations for the exhaustion doctrine: (1) a desire to discourage unwarranted patentee compensation, and (2) deep misgivings about attaching permanent restrictions to personal property.

1. *Fair Compensation, But Nothing More: The* Masonite *Test*

The U.S. Constitution grants Congress the power to award patents with the expressly utilitarian aim of promoting innovation.[11] This provision recognizes that new ideas, once revealed, are easily appropriated by others, and prospective inventors might therefore decline to invest their time, energy, and resources in research without a mechanism to capture some benefit from their inventions. Thus, patents offer "the right to exclude others from making, using, offering for sale, or selling the invention" for a limited period of time.[12] The potentially lucrative right to commercialize an invention free from competition provides a powerful incentive to offset the difficulty and risk inherent in research. In short, the patent system represents a bargain—society temporarily forgoes the benefits of market competition in return for the public good provided by the inventor's efforts.

For society to reap the greatest benefit under such a bargain, "the proper goal of intellectual property law is to give as little protection as possible consistent with encouraging innovation."[13] The Supreme Court's opinions suggest a similar desire to cap patentee returns, consistently justifying exhaustion where patentees had received due consideration.[14]

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10. *See* Glen O. Robinson, *Personal Property Servitudes*, 71 U. CHI. L. REV. 1449, 1464-69 (2004).

11. U.S. CONST. art. I, § 8, cl. 8.

12. 35 U.S.C. § 154(a) (2006).

13. Mark A. Lemley, *Property, Intellectual Property, and Free Riding*, 83 TEX. L. REV. 1031, 1031 (2005).

14. *See* United States v. Univis Lens Co., 316 U.S. 241, 251 (1942) ("[T]he purpose of the patent law is fulfilled . . . when the patentee has received his reward . . . ."); Bauer & Cie v. O'Donnell, 229 U.S. 1, 16 (1913) (imposing exhaustion on items "previously bought, at a price which must be deemed to have been satisfactory"); Keeler v. Standard Folding-Bed Co., 157 U.S. 659, 666-67 (1895) ("[Exhaustion] does not deprive a patentee of his just rights, because no article can be unfettered from the claim of his monopoly without paying its tribute."); Adams v. Burke, 84 U.S. 453, 456 (1873) ("[T]he patentee [having] received all the royalty or consideration which he claims for the use of his invention in that particular machine or instrument, it is open to the use of the purchaser without further restriction . . . ."); Mitchell v. Hawley, 83 U.S. 544, 547 (1872) ("[When]

The Supreme Court made this rationale most explicit in *United States v. Masonite Corp.*, highlighting the balance of interests at stake in the patent system: "Whilst the remuneration of genius and useful ingenuity is a duty incumbent upon the public, the rights and welfare of the community must be fairly dealt with and effectually guarded."[15] In this spirit, the Court framed what came to be known as the *Masonite* Test for resolving exhaustion questions based on full patentee compensation at the time of sale. "The test has been whether or not there has been such a disposition of the article that it may fairly be said that the patentee has received his reward for the use of the article."[16] As conceived in cases like *Masonite*, patent exhaustion provides a necessary counterweight against patentee rights to safeguard the public interest in the patent system.

2. *Apprehension Over Servitudes Running with Chattels*

A second concern animates patent exhaustion—basic apprehension over servitudes running with personal property. Servitudes are covenants or restrictions that become legally embedded in property, binding all subsequent purchasers regardless of any connection to the original owner or even any awareness of the servitude. Traditional hostility toward such restraints on alienation traces through the common law to an early backlash against feudalism.[17] The ensuing blanket prohibition against servitudes has receded as to real property but largely persists in the personal property context.[18,19]

The patent system, governing what amounts to a special class of personal property, manifests this enduring aversion to personal property servitudes through the exhaustion doctrine. Without exhaustion, patentees could reserve exclusive rights under the patent laws in each patented article sold. Because patent infringement is a strict liability offense, this would create *de facto* servitudes running with the goods and binding all subsequent owners.

Patent exhaustion blocks such indefinite burdens on personal property, and the Supreme Court has often indirectly touted this function. For ex-

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the consideration has been paid to him for the thing patented, the rule as well established that the patentee must be understood to have parted . . . with all his exclusive right . . . .").

15. 316 U.S. 265, 278 (1942) (quoting Kendall v. Winsor, 62 U.S. 322, 329 (1859)).

16. *Id.*

17. Robinson, *supra* note 10, at 1480-81.

18. *See generally* Molly S. Van Houweling, *The New Servitudes*, 96 GEO. L.J. 885, 891-910 (2008).

19. The reasons behind this discrepancy remain a matter of historical speculation. *See generally* Zechariah Chafee, *Equitable Servitudes on Chattels*, 41 HARV. L. REV. 945, 977-87 (1928).

ample, the Court has emphasized that patented goods, once sold, become the purchaser's "private, individual property"[20] such that the patentee "can exercise no future control over what the purchaser may wish to do with the article."[21] Furthermore, the Court has offered blunt commentary on the likely consequences of allowing restrictions to run with patented goods: "The inconvenience and annoyance to the public . . . are too obvious to require illustration."[22]

B. Pre-*Quanta* Qualifications on Patent Exhaustion

The patent exhaustion doctrine is thus firmly rooted in Supreme Court jurisprudence dating back over 150 years. Nonetheless, the courts have carved out select circumstances under which patent owners may exert limited continuing influence over patented goods. Broadly speaking, these include reconstruction, permissible restrictions on licensees, and permissible restrictions on purchasers.

1. The Repair/Reconstruction Dichotomy

Under the patent laws, purchasers of patented products receive full title with the customary right to maintain their property in working order. But when repair of a lawfully purchased but completely worn-out patented product crosses to effective "reconstruction," the courts find infringement of the patentee's exclusive right to make the patented item.[23]

The distinction between repair and reconstruction originated in *Wilson v. Simpson*.[24] There, the defendants legally obtained a patented lumber planing machine, subsequently replacing worn cutting elements without permission from the patent owner.[25] Rejecting the ensuing infringement claim, the Supreme Court held that such replacement constituted permissible repair: "[I]t does not follow, when one of the elements has become so worn as to be inoperative, or has been broken, that the machine no longer exists . . . . When the wearing or injury is partial, then repair is restoration, and not reconstruction."[26] In contrast, the defendants in a later case reconstructed patented cotton bale ties by purchasing severed and discarded bands, riveting the cut ends back together, and reselling the ties.[27] Distinguishing *Wilson v. Simpson*, the Court held that the defendants infringed

20. Bloomer v. McQuewan, 55 U.S. 539, 550 (1852).
21. United States v. Gen. Elec. Co., 272 U.S. 476, 489 (1926).
22. Keeler v. Standard Folding-Bed Co., 157 U.S. 659, 667 (1895).
23. *See, e.g.*, Wilson v. Simpson, 50 U.S. 109, 123 (1850).
24. *Id.*
25. *Id.* at 124.
26. *Id.* at 123.
27. Am. Cotton Tie Co. v. Simmons, 106 U.S. 89, 93 (1882).

because they had not repaired worn components but wholly reconstructed ties that had been destroyed with respect to their intended use.[28]

Thus, the distinction between repair and reconstruction hinges on whether the changes "'in fact make a new article,' after the entity, viewed as a whole, has become spent. . . . it must, indeed, be a second creation of the patented entity" to constitute reconstruction.[29] Of course, this dichotomy applies only to patented items obtained through *authorized* sales—both repair and reconstruction of illicit products simply renew an existing infringement.[30]

2. *Restrictions on Licensees*

The courts have long recognized a distinction between licenses and sales, enforcing license conditions with infringement remedies where exhaustion would shield purchasers from comparable liability.[31] Patent owners may license their exclusive rights to make, use, and sell their inventions to others,[32] and the courts allow license restrictions that effectuate the choices patentees *would* make if making, using, or selling the invention themselves.[33]

a) Price Restrictions

Patentees may dictate prices charged by their licensed distributors. "The owner of a patented article can, of course, charge such price as he may choose, and the owner of a patent may assign it or sell the right to manufacture and sell the article patented upon the condition that the assignee shall charge a certain amount for such article."[34]

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28. *See id.* at 94 ("The band was voluntarily severed . . . . it could not be used again as a tie. As a tie, the defendants reconstructed it . . . . [t]he principle of [*Wilson*] was, that temporary parts wearing out in a machine might be replaced to preserve the machine . . . without amounting to a reconstruction . . . .").

29. Aro Mfg. Co. v. Convertible Top Replacement Co. (*Aro I*), 365 U.S. 336, 346 (1961) (quoting United States v. Aluminum Co. of Am., 148 F.2d 416, 425 (1925)).

30. Aro Mfg. Co. v. Convertible Top Replacement Co. (*Aro II*), 377 U.S. 476, 497 (1964).

31. *See* United States v. Gen. Elec. Co., 272 U.S. 476, 485 (1926) ("The distinction in law and fact between an agency and a sale is clear.").

32. Bauer & Cie v. O'Donnell, 229 U.S. 1, 15 (1913).

33. *See* Mark R. Patterson, *Contractual Expansion of the Scope of Patent Infringement Through Field-of-Use Licensing*, 49 WM. & MARY L. REV. 157, 164-65 (2007) ("[M]anufacturing licensees in effect stand in the shoes of the patentee, and imposing use restrictions on them can reasonably be treated as economically equivalent to individual decisions by the patentee itself . . . .").

34. Bement v. Nat'l Harrow Co., 186 U.S. 70, 93 (1902).

For example, the Supreme Court upheld a patentee's price restrictions on its manufacturing licensee in *United States v. General Electric Co.*[35] There, General Electric licensed Westinghouse to make, use, and sell its patented light bulbs, with the requirement that Westinghouse maintain prices set by General Electric.[36] The Court held that, while exhaustion prevents patentees from exerting control over purchasers, a different question arises when considering how patent holders may restrict licensees.[37] The Court reasoned that patentees should be able to dictate their licensed vendors' prices because those prices influence what price the patentee itself can charge.[38] Therefore, patentees can reasonably impose price restrictions on licensed sellers in order to protect the profit margins central to our incentive-driven patent system.[39] In short, exhaustion prevents "condition[s] running with the article in the hands of purchasers," not "restriction[s] put by a patentee upon his licensee as to the prices at which the latter shall sell" patented articles.[40]

b) Geographic Restrictions

Similarly, patent holders may restrict licensees geographically.[41] For example, a patentee may divide regional sales rights among several licensees or license only certain areas while reserving others for itself.[42] Licensees infringe by operating outside their authorized territories; they are not, however, liable for selling (even knowingly) to customers that later move the goods for extraterritorial use.[43]

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35. *Gen. Elec. Co.*, 272 U.S. 476.
36. *Id.* at 479.
37. *Id.* at 489.
38. *Id.* at 490.
39. *Id.*
40. *Id.* at 494.
41. "[Patents] shall be assignable in law by an instrument in writing . . . . [the patentee] may convey an exclusive right . . . to the whole or any specified part of the United States." 35 U.S.C. § 261 (2006). As interpreted by the courts, "assignable" incorporates licensing. *E.g.*, Miller Insituform, Inc. v. Insituform of N. Am., Inc., 605 F. Supp. 1125, 1130-31 (M.D. Tenn. 1985), *aff'd*, 830 F.2d 606 (6th Cir. 1987).
42. *See, e.g.*, Adams v. Burke, 84 U.S. 453 (1873) (concerning a license that carved out a single, exclusive sales territory within a ten-mile radius of Boston, with all remaining areas reserved for the patent holder).
43. As long as the transaction occurs within the licensed territory, licensee sales are authorized and therefore trigger exhaustion. *See* Hobbie v. Jennison, 149 U.S. 355 (1893) (finding no liability for a Michigan licensed seller that sold patented pipes in Michigan with knowledge that the customer would immediately ship the pipes for use in Connecticut).

c) Use Restrictions

Patent owners may also incorporate use restrictions into license agreements. For example, in *General Talking Pictures*, a patent owner licensed another company to manufacture and sell patented sound amplifiers only for private, noncommercial use.[44] The licensee nonetheless knowingly sold the amplifiers to a commercial user.[45] The Supreme Court explained that patentees may restrict their licensees to certain uses of licensed technology as long as the restrictions do not "extend the scope of the monopoly."[46] Because the licensee violated a field-of-use restriction that was properly within the patent grant, the Court held it liable for patent infringement.[47]

3. Restrictions on Purchasers

In contrast to licensing situations, patentees' attempts to impose restrictions on *purchasers* historically faced judicial hostility under the exhaustion doctrine. Nevertheless, the Supreme Court's approach has not been entirely consistent,[48] facilitating recent Federal Circuit decisions that have substantially eroded the exhaustion doctrine.

a) Resale Restrictions

The exhaustion doctrine prevents patent owners from restraining the resale of legitimately purchased patented goods. In *Keeler v. Standard Folding-Bed Co.*, the defendants purchased patented bed frames from a licensed seller and later resold the beds.[49] The plaintiff sought to enjoin the defendants' sales through an infringement action,[50] but the Supreme Court held that legitimately purchased patented goods become "the absolute, unrestricted property of the purchaser, with the right to sell as an essential

44. *See* Gen. Talking Pictures Corp. v. W. Elec. Co., 304 U.S. 175, 180 (1938) ("The license . . . was expressly confined to . . . radio amateur reception, radio experimental reception, and home broadcast reception. It [conferred] no right to sell the amplifiers for use in theaters . . . ."), *aff'd on reh'g*, 305 U.S. 124 (1939).

45. *Id.*

46. *Id.* at 181.

47. *Id.* at 181-82.

48. *See* 5 DONALD S. CHISUM, CHISUM ON PATENTS § 16.03[2][a][iii] (2008) ("Supreme Court decisions give apparently conflicting signals on whether a patent owner may limit exhaustion and restrict resales by imposing conditions on its sales of product or on sales by its licensees.").

49. 157 U.S. 659, 659 (1895).

50. *Id.*

incident of such ownership."[51] The Court's subsequent opinions have consistently reinforced this conclusion.[52]

b) Geographic Restrictions

In addition, exhaustion precludes patent holders from enforcing geographic restrictions on purchasers. In *Adams v. Burke*, the plaintiff had received an exclusive license to manufacture and sell patented coffin lids within a defined geographic area.[53] The defendant, an undertaker, purchased identical lids elsewhere from another licensed distributor but used them within the plaintiff's territory. The Supreme Court affirmed dismissal of the plaintiff's infringement claim on exhaustion grounds.[54]

c) Use Restrictions Imposed Through a Licensee—*General Talking Pictures*

Despite the exhaustion doctrine's general prohibition against post-sale restrictions on purchasers, one Supreme Court decision held a purchaser liable for patent infringement. In *General Talking Pictures*, the Court held that a licensed seller *and its customer* had infringed by violating a field-of-use restriction specified in the seller's license from the plaintiff.[55]

The infringing licensee in *General Talking Pictures* was licensed to sell patented amplifier tubes solely for private audio applications and attached notice of this restriction to each tube it sold.[56] The licensee sold tubes to General Talking Pictures—a commercial user—and included the customary sales notice,[57] yet both parties knew their transaction would violate the restriction.[58] The patentee subsequently accused the licensee and

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51. *Id.* at 664.

52. *See, e.g.*, United States v. Univis Lens Co., 316 U.S. 241, 250 (1942) ("[T]he patentee cannot control the resale price of patented articles which he has sold . . . by stipulating for price maintenance by his vendees."); Ethyl Gasoline Corp. v. United States, 309 U.S. 436, 457 (1940) ("[B]y the authorized sales of the fuel . . . the patent monopoly over it is exhausted, and . . . neither appellant nor the [licensees] may longer rely on the patents to exercise any control over the price at which the fuel may be resold."); Bauer & Cie v. O'Donnell, 229 U.S. 1 (1913) (rejecting minimum resale prices imposed on retailers of a patented pharmaceutical).

53. Adams v. Burke, 84 U.S. 453, 456 (1873).

54. *Id.* at 456-57 ("[W]hen [patented goods] are once lawfully made and sold, there is no restriction on their use to be implied for benefit of the patentee or his assignees or licensees.").

55. Gen. Talking Pictures Corp. v. W. Elec. Co., 304 U.S. 175, 181-82 (1938), *aff'd on reh'g*, 305 U.S. 124 (1939).

56. *Id.* at 180.

57. *Id.*

58. *Id.*

General Talking Pictures of patent infringement.[59] In defense, General Talking Pictures argued that its purchases, made through a licensed seller, compensated the patentee and thus exhausted the patents.[60]

The Supreme Court held that patentees are entitled to grant licenses "upon conditions not inconsistent with the scope of the monopoly," the asserted field-of-use restriction did not stretch the patent beyond its intended scope, and therefore any sales contravening the restriction were not legally authorized and thus did not exhaust the patentee's rights.[61] Absent exhaustion, the restriction in the license not only bound the *licensee*, but also survived its illegitimate sales to bind *purchasers*—rendering General Talking Pictures liable for patent infringement.[62]

In the wake of *General Talking Pictures*, the scale of its effect on the exhaustion doctrine was unclear in several respects: (1) the Supreme Court emphasized the purchaser's knowing violation of the field-of-use restriction but failed to state whether such knowledge was required to defeat exhaustion;[63] (2) the purchaser received and disregarded notice of the license restriction, but the Court expressly reserved comment on the legal effect of such notice;[64] (3) the case concerned restrictions imposed on the purchaser through a licensed intermediary, but the Court did not indicate whether the same result should follow similarly restricted sales made directly by a patentee; and (4) the Court did not discuss whether it would enforce field-of-use restrictions only or allow patentees to bind purchasers generally.[65]

d) Use Restrictions Imposed Directly—*Mallinckrodt*

In 1992 the Federal Circuit expanded on *General Talking Pictures*, broadly empowering patentees to impose binding sales conditions on purchasers with its decision in *Mallinckrodt, Inc. v. Medipart, Inc.*[66] The plaintiff patent owner, Mallinckrodt, manufactured patented medical devices for controlled delivery of hazardous aerosolized therapeutics and sold them directly to hospitals.[67] In addition, Mallinckrodt affixed "single

59. *Id.* at 179.
60. *Id.* at 180.
61. *Id.* at 181.
62. *Id.* at 182.
63. *See id.* at 180, 182.
64. *Id.* at 182.
65. Later Supreme Court exhaustion cases continued to block resale price restrictions imposed on purchasers. *E.g.*, United States v. Univis Lens Co., 316 U.S. 241 (1942).
66. 976 F.2d 700 (Fed. Cir. 1992).
67. *Id.* at 701-02.

use only" labels to the devices and their packaging.[68] Many hospitals, however, ignored this restriction—instead shipping used devices to Medipart for reconditioning.[69] Medipart sterilized, repackaged, and returned the devices for reuse.[70]

Mallinckrodt filed suit against Medipart, claiming that Medipart's activities violated its single-use restriction and thus constituted patent infringement.[71] By analogy to *General Talking Pictures*, Mallinckrodt characterized its restrictive labeling as a patent license that bound purchasers to a defined field-of-use—single use.[72] At summary judgment, the district court held that Mallinckrodt's sales exhausted its patent rights, rendering the single-use restriction unenforceable through patent remedies.[73] Furthermore, the district court noted the apparent discrepancy between *General Talking Pictures* and the Supreme Court's earlier exhaustion cases[74] and read *General Talking Pictures* as precluding exhaustion only as to sales made by a licensed distributor in violation of express license terms.[75] In contrast, Mallinckrodt sold its devices to hospitals directly—distinguishing *General Talking Pictures* and exhausting its patent rights in the district court's view.[76]

On appeal, the Federal Circuit reversed.[77] The Federal Circuit refused to limit *General Talking Pictures* to sales made through licensed intermediaries: "We decline to make a distinction for which there appears to be no foundation."[78] Rejecting such "formalistic line drawing," the Federal Circuit held that use restrictions may survive sales regardless of the form of the transaction, and courts should evaluate all such restrictions consistently.[79] Next, the opinion surveyed Supreme Court precedent on exhaustion, concluding that exhaustion applies only where (1) the sale carries no explicit conditions, or (2) the asserted condition independently "violates

68. *Id.* at 702.
69. *Id.*
70. *Id.*
71. *Id.*
72. *Id.* at 703.
73. Mallinckrodt, Inc. v. Medipart, Inc., No. 89 C 4524, 1990 U.S. Dist. LEXIS 1974, at *28-29 (N.D. Ill. Feb. 15, 1990), *rev'd*, 976 F.2d 700 (Fed. Cir. 1992).
74. *Id.* at *17 ("There clearly is some tension between General Talking Pictures and the earlier cases: General Talking Pictures might be read to say that post-sale restrictions can be enforced against purchasers . . . while the earlier exhaustion on sale cases would otherwise seem to say that that was not possible . . . .").
75. *Id.* at *19-20.
76. *Id.* at *19.
77. *Mallinckrodt, Inc.*, 976 F.2d at 709.
78. *Id.* at 705.
79. *Id.*

some other law or policy," most commonly antitrust policy.[80] The Federal Circuit thus reversed the district court's holding that exhaustion nullified Mallinckrodt's sales conditions as a matter of law.[81] The opinion remanded with instructions that Mallinckrodt's explicit sales conditions should be enforced under the patent laws unless they had "an anticompetitive effect not justifiable under the rule of reason."[82]

In effect, the Federal Circuit framed patent exhaustion as a mere default rule, one that patentees can contract around, at their discretion, to retain specified rights over their products beyond the first sale. *Mallinckrodt* created a presumption that such arrangements would be binding and enforceable through infringement actions so long as they remained "within the scope of the patent grant."[83]

Numerous cases upholding post-sale patent restrictions followed *Mallinckrodt*. For example, the Federal Circuit has upheld conditions restricting the use of genetically modified agricultural seeds to one growing season.[84] Such restrictions were held valid and enforceable in view of *Mallinckrodt*, even where the farmer received notice only through product labeling.[85] In another example, the Ninth Circuit relied on *Mallinckrodt* to enforce restrictions prohibiting purchasers from refilling patented printer cartridges.[86] In short, *Mallinckrodt* significantly expanded the realm of post-sale restrictions on purchasers of patented products enforced under the patent laws.

II. FACTS AND HISTORY OF THE *QUANTA* LITIGATION

Quanta arose as an infringement action over several computer technology patents that LGE had licensed to Intel Corporation.[87] Under the license, Intel made computer components reading on LGE's patents and sold them to various computer manufacturers, including Quanta.[88] Subsequently, LGE brought suit against Quanta, claiming that Quanta used the

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80. *Id.* at 706-08.
81. *Id.* at 709.
82. *Id.* at 708-09.
83. *Id.* at 709.
84. *E.g.*, Monsanto Co. v. Scruggs, 459 F.3d 1328 (Fed. Cir. 2006); Monsanto Co. v. McFarling, 302 F.3d 1291 (Fed. Cir. 2002).
85. *Scruggs*, 459 F.3d at 1336.
86. Ariz. Cartridge Remfrs. Ass'n v. Lexmark Int'l Inc., 421 F.3d 981, 986-88 (9th Cir. 2005).
87. Quanta Computer, Inc. v. LG Elecs., Inc., 128 S.Ct. 2109, 2114 (2008).
88. *Id.*

parts in a manner not authorized by LGE's agreement with Intel.[89] In defense, Quanta argued that Intel's licensed sales exhausted LGE's patent rights.[90] The case thus turned on patent exhaustion issues as it wound its way to the Supreme Court.

A. Factual Background

In 1999, LGE acquired a computer technology patent portfolio that contained, among others, three patents claiming systems and methods for managing and synchronizing data transfers between computer components.[91] In September 2000, LGE signed a licensing agreement with Intel,[92] a major producer of computer microprocessors and chipsets.[93] The main License Agreement permitted Intel to "make, use, sell (directly or indirectly), offer to sell, import, or otherwise dispose of" products reading on LGE's computer patents.[94] The License Agreement also explicitly withheld any right for Intel's customers to combine licensed products with components from sources other than Intel or LGE.[95] In addition to the License Agreement, a separate Master Agreement required Intel to notify its customers that the License Agreement did not authorize combinations between licensed Intel products and other non-Intel components.[96] Accordingly, Intel provided written notice to its customers, including Quanta, as required by the Master Agreement.[97]

Under its license, Intel made and sold parts that could neither perform the patented methods nor participate in the patented systems until incorpo-

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89. *Id.*

90. LG Elecs., Inc. v. Asustek Computer, Inc., No. C 01-00326 CW, 2002 U.S. Dist. LEXIS 25956, at *8 (N.D. Cal. Aug. 20, 2002).

91. *Quanta Computer, Inc.*, 128 S.Ct. at 2113. LGE asserted system claims 1, 5-9, and 14 of U.S. patent 4,939,641, Brief for Respondent at 5 n.4, Quanta Computer, Inc. v. LG Elecs., Inc., 128 S.Ct. 2109 (2008) (No. 06-937), 2007 WL 4244683; system and method claims 1, 7, 22, and 23 of U.S. Patent 5,379,379, *id.*; and method claims 15-19 of U.S. Patent 5,077,733, LG Elecs., Inc. v. Bizcom Elecs., Inc., 453 F.3d 1364, 1375 (Fed. Cir. 2006).

92. LG Elecs., Inc. v. Asustek Computer, Inc., 248 F. Supp. 2d 912, 914 (N.D. Cal. 2003).

93. Intel is the world's largest semiconductor chipmaker, averaging $35 billion in yearly revenue from 2003 to 2007. *See* INTEL CORP., 2007 ANNUAL REPORT 1, 22 (2007), http://media.corporate-ir.net/media_files/irol/10/101302/2007annualReport/common/pdfs/intel_2007ar.pdf.

94. *Quanta Computer, Inc.*, 128 S.Ct. at 2114 (quoting language provided by the parties from the sealed License Agreement).

95. *Id.*

96. *Id.*

97. *Id.*

rated into a functioning computer.[98] Quanta did just that, combining the Intel parts with components not authorized under Intel's License Agreement with LGE.[99] In response, LGE brought an infringement suit against Quanta.[100] LGE asserted that Quanta's finished computers practiced its patented methods and systems without authorization.[101,102]

B. The District Court

On motion for summary judgment, the district court held LGE's patents exhausted as to the parts sold by Intel.[103] The court interpreted the License Agreement as "equivalent to a 'sale' for purposes of the patent exhaustion doctrine" due to the sweeping rights it granted Intel.[104] LGE argued that since Intel's products could not infringe until placed in a completed computer, their sale as isolated parts could not exhaust the method or system claims.[105] The court disagreed, holding that exhaustion applies to even unfinished products if they have "no substantial use" except as the eventual finished, patented article.[106] Rejecting LGE's proposed alternative non-infringing uses,[107] the court found that Quanta purchased the parts for their "intended and sole purpose," therefore exhausting LGE's patent rights.[108]

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98. *See* LG Elecs., Inc. v. Asustek Computer, Inc., No. C 01-00326 CW, 2002 U.S. Dist. LEXIS 25956, at *7 (N.D. Cal. Aug. 20, 2002) ("LGE's claim charts reveal that the licensed Intel products meet many of the limitations of the patents and, when combined with other components in the accused devices, infringe five of its patents.").

99. *Quanta Computer, Inc.*, 128 S.Ct. at 2114.

100. LGE originally sued more than ten computer manufacturers, *Asustek Computer, Inc.*, 2002 U.S. Dist. LEXIS 25956, at *1. All but Quanta and two of its subsidiaries settled with LGE before the case reached the Supreme Court (hence the evolving caption as the case progressed through appeals), Brief for Petitioners at iii, 9-10, Quanta Computer, Inc. v. LG Elecs. Inc., 128 S.Ct. 2109 (2008) (No. 06-937), 2007 WL 3276505.

101. LG Elecs., Inc. v. Bizcom Elecs., Inc., 453 F.3d 1364, 1368 (Fed. Cir. 2006).

102. The licensed components likely also read on related apparatus claims, but "LGE did not assert patent rights in the microprocessors or chipsets themselves," *id.*, effectively conceding exhaustion of claims to the parts themselves "because LGE had expressly authorized Intel to sell the microprocessors to its customers," Brief for Respondent at 5 n.4, Quanta Computer, Inc. v. LG Elecs. Inc., 128 S.Ct. 2109 (2008) (No. 06-937), 2007 WL 4244683.

103. *Asustek Computer, Inc.*, 2002 U.S. Dist. LEXIS 25956, at *41-42.

104. *Id.* at *12.

105. *Id.* at *13.

106. *Id.* at *21 (quoting Cyrix Corp. v. Intel Corp., 846 F. Supp. 522, 540 (E.D. Tex. 1994)).

107. LGE suggested the components could, without infringing, be used outside of the United States, as replacement parts, or after expiration of the patents. *See id.* at *35-39.

108. *Id.* at *41.

On reconsideration,[109] the district court reaffirmed its prior ruling except as to LGE's method claims.[110] The court emphasized that *Mallinckrodt* allowed patentees to impose binding sales conditions but maintained that LGE failed to actually do so.[111] Quanta's purchases were "in no way conditioned on their agreement not to combine the [components] with other non-Intel parts" and therefore generally exhausted LGE's patents.[112] However, LGE argued for the first time that a preexisting Federal Circuit rule precluded exhaustion of *method* claims.[113] Accordingly, the district court held LGE's method claims exempt from exhaustion and granted summary judgment to LGE regarding infringement of its methods.[114]

C. The Federal Circuit

On appeal, the Federal Circuit reversed-in-part, holding that Intel's sales were conditional and thus did not exhaust LGE's system claims,[115] and affirmed-in-part, agreeing that LGE's method claims were not exhausted.[116]

First, the court held that the LGE-Intel licensing arrangement prevented exhaustion of LGE's system claims, relying on its *Mallinckrodt* line of cases for the premise that exhaustion "does not apply to an expressly conditional sale or license."[117] As conditions on Intel's sales, the court highlighted not only the License Agreement's prohibition on third parties combining licensed products with non-Intel components, but also the Master Agreement's corresponding notice requirement.[118] Furthermore, the court read the Master Agreement into the License Agreement, citing § 2-202 of the New York Uniform Commercial Code as "allowing contracts to be supplemented by consistent additional terms unless the writing is in-

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109. Originally, only three defendants requested and received summary judgment. *Id.* at *2 n.1. The remaining defendants immediately followed suit, asking the court to extend its summary judgment order to include them as well. LGE opposed, raising new arguments that warranted reconsideration of the earlier decision. LG Elecs., Inc. v. Asustek Computer, Inc., 248 F. Supp. 2d 912, 913-14 (N.D. Cal. 2003).

110. LG Elecs., Inc. v. Asustek Computer, Inc., 248 F. Supp. 2d 912, 918 (N.D. Cal. 2003).

111. *Id.* at 916-17.

112. *Id.* at 917-18.

113. *Id.* at 918.

114. *Id.*

115. LG Elecs., Inc. v. Bizcom Elecs., Inc., 453 F.3d 1364, 1369-70 (Fed. Cir. 2006).

116. *Id.* at 1370.

117. *Id.* at 1369 (quoting B. Braun Med., Inc. v. Abbott Labs., 124 F.3d 1419, 1426 (Fed. Cir. 1997)).

118. *Id.* at 1370.

tended to be complete and exclusive."[119] Second, the Federal Circuit noted that Intel's sales "involved a component of the asserted patented invention, not the entire patented system," implicitly rejecting the district court's application of exhaustion to incomplete products.[120] Finally, the Federal Circuit affirmed the lower holding that LGE's method claims were categorically inexhaustible.[121]

D. The Supreme Court

The Supreme Court granted certiorari[122] and reversed the Federal Circuit, holding that Intel's licensed sales exhausted LGE's patents.[123]

The Court identified three errors in the Federal Circuit's decision. First, the Federal Circuit erred by declaring method claims categorically exempt from exhaustion.[124] Second, the Federal Circuit viewed Intel's licensed products too narrowly. Although Intel's components did not literally practice LGE's patented systems and methods until incorporated into a computer, the parts nonetheless "substantially embodie[d]" LGE's claims at the time of sale—thus triggering exhaustion.[125] Finally, the Federal Circuit misinterpreted the licensing arrangement between LGE and Intel. The Court viewed the License Agreement alone as controlling and held that it placed "[n]o conditions" on Intel's sales of licensed products.[126] On these grounds, the Court held that Intel's authorized sales exhausted LGE's patents.[127]

III. DISCUSSION

In general terms, *Quanta* adheres to several trends evident in the Supreme Court's recent patent decisions. For one, the opinion should revitalize exhaustion as a shield against infringement claims—representing another move by the Court to reign in patentee rights.[128] Second, *Quanta*

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119. *Id.*

120. *Id.*

121. "[T]he sale of a device does not exhaust a patentee's rights in its method claims." *Id.*

122. LG Elecs., Inc. v. Bizcom Elecs., Inc., 453 F.3d 1364 (Fed. Cir. 2006), *cert. granted*, Quanta Computer, Inc. v. LG Elecs., Inc., 128 S.Ct. 28 (2007).

123. Quanta Computer, Inc. v. LG Elecs., Inc., 128 S.Ct. 2109, 2122 (2008).

124. *Id.* at 2117-18.

125. *Id.* at 2118-21.

126. *Id.* at 2121-22.

127. *Id.* at 2122.

128. *See* Microsoft Corp. v. AT&T Corp., 550 U.S. 437 (2007) (restricting infringement claims under 35 U.S.C. § 271(f)); KSR Int'l Co. v. Teleflex Inc., 550 U.S. 398 (2007) (making patents easier to invalidate for obviousness); MedImmune, Inc. v. Genen-

fits the Court's continuing focus on restoring the primacy of its own jurisprudence in patent law.[129] From the question posed on certiorari[130] to the published opinion,[131] the Court approached *Quanta* entirely in terms of its own precedent. Accordingly, the opinion restores the exhaustion doctrine—long marginalized by the Federal Circuit—to greater, more traditional practical relevance. Finally, the Court once again emphasized equity over predictability,[132] rejecting the Federal Circuit's categorical approach to exhaustion of method claims.[133]

Also noteworthy are the different approaches the Court applied to different issues in the case. On one hand, the Court delivered unmistakably broad holdings on exhaustion of method claims and exhaustion by incomplete articles.[134] In contrast, *Quanta* reveals a distinctly minimalist approach[135] to the enforceability of post-sale restrictions—on this issue, the Court narrowly tied its holding to particularities of the LGE-Intel licensing

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tech, Inc., 549 U.S. 118 (2007) (easing restrictions on licensees seeking to obtain declaratory judgments of non-infringement, invalidity, or unenforceability); eBay Inc. v. MercExchange, L.L.C., 547 U.S. 388 (2006) (tightening standards for injunctive relief in patent infringement cases); Merck KGaA v. Integra Lifesciences, 545 U.S. 193 (2005) (expanding the 35 U.S.C. § 271(e)(1) safe harbor for use of patented materials in biomedical research and development). *But see* Festo Corp. v. Shoketsu Kinzoku Kogyo Kabushiki Co., 535 U.S. 722 (2002) (removing the Federal Circuit's rigid application of prosecution history estoppel in doctrine of equivalents cases).

129. *See KSR Int'l Co.*, 550 U.S. 398 (rejecting the Federal Circuit's rigid TSM test in favor of renewed flexibility in obviousness determinations based on Graham v. John Deere Co., 383 U.S. 1 (1966)); *eBay, Inc.*, 547 U.S. 388 (rejecting the Federal Circuit's presumption favoring injunctive relief in patent infringement cases as inconsistent with established equitable principles governing injunctions); *Festo Corp.*, 535 U.S. 722 (correcting the Federal Circuit's departure from Warner-Jenkinson Co. v. Hilton Davis Chem. Co., 520 U.S. 17 (1997)).

130. *See* Petition for Writ of Certiorari at I, Quanta Computer, Inc., v. LG Elecs., Inc. 128 S.Ct. 2109 (2008) (No. 06-937), 2006 WL 3877339 ("Whether the Federal Circuit erred by holding, *in conflict with decisions of this Court* and other courts of appeals, that respondent's patent rights were not exhausted . . . .") (emphasis added).

131. Apart from recounting the direct history, *Quanta* does not cite a single lower court decision, *see Quanta Computer, Inc.*, 128 S.Ct. 2109, even where obviously and directly overruling specific Federal Circuit caselaw, *see* discussion *infra* Section III.A.

132. *See* Rochelle Cooper Dreyfuss, *In Search of Institutional Identity: The Federal Circuit Comes of Age*, 23 BERKELEY TECH. L.J. 787, 796-800 (2008).

133. *Quanta Computer, Inc.*, 128 S.Ct. at 2117-18.

134. *See id.* at 2117-21.

135. *See generally* Cass R. Sunstein, *Leaving Things Undecided*, 110 HARV. L. REV. 4 (1996).

agreement[136] and thus relegated several much-anticipated questions to future litigation.[137]

A. Exhaustion Applies to Method Claims

Quanta invalidated a Federal Circuit rule that had categorically immunized method claims from exhaustion.[138] Because the rule lacked doctrinal support, conflicted with Supreme Court precedent, and crippled patent exhaustion in practical terms, this outcome was both reasonable and predictable.

The rule against exhaustion of method claims, followed by the trial court[139] and the Federal Circuit,[140] arose from *Bandag, Inc. v. Al Bolser's Tire Stores, Inc.*, an early Federal Circuit case.[141] In *Bandag*, the Federal Circuit considered infringement claims over a patented tire treading method. Although the defendant carried out the patented method using equipment specially made for that purpose by the plaintiff patentee,[142] the Federal Circuit ruled out exhaustion of the method claims: "[Exhaustion] is inapplicable here, because the claims . . . are directed to a 'method of retreading' and cannot read on the equipment . . . ."[143] The court offered no support for this sweeping conclusion,[144] yet thereafter adopted it as controlling precedent.[145] In effect, the Federal Circuit built a one-sentence

136. *See Quanta Computer, Inc.*, 128 S.Ct. at 2121-22.

137. *See, e.g.*, Mark R. Patterson, *Reestablishing the Doctrine of Patent Exhaustion*, 2007 PATENTLY-O PATENT L.J. 38, 38-40, http://www.patentlyo.com/lawjournal/quanta.patterson.pdf (speculating whether *Quanta* would delineate permissible restrictions imposed through sales versus licenses); *Court Hears Challenge on Patent Exhaustion*, 75 PAT. TRADEMARK, & COPYRIGHT J. 330 (Feb. 1, 2008) (suggesting *Quanta* might clarify whether patentees can structure licenses to compel royalties at multiple points in the supply chain).

138. *See Quanta Computer, Inc.*, 128 S.Ct. at 2117-18 ("We therefore reject LGE's argument that method claims, as a category, are never exhaustible.").

139. LG Elecs., Inc. v. Asustek Computer, Inc., 248 F. Supp. 2d 912, 918 (N.D. Cal. 2003).

140. LG Elecs., Inc. v. Bizcom Elecs., Inc., 453 F.3d 1364, 1370 (Fed. Cir. 2006).

141. 750 F.2d 903 (Fed. Cir. 1984).

142. *See id.* at 923-24.

143. *Id.* at 924.

144. Though juxtaposed with citations to *Masonite* and *Univis Lens*, the conclusion that exhaustion was "inapplicable" to method claims lay unsubstantiated because these references applied only to an earlier prosaic description of first sale principles. *See id.*

145. *See Bizcom Elecs., Inc.*, 453 F.3d at 1370 ("[T]he sale of a device does not exhaust a patentee's rights in its method claims.") (citing Glass Equip. Dev., Inc. v. Besten, Inc., 174 F.3d 1337, 1342 n.1); *Glass Equip. Dev., Inc.*, 174 F.3d at 1342 n.1 (Fed. Cir. 1999) ("[Where the] issue concerns GED's right to exclude concerning the *method* pa-

presumption into a *per se* rule exempting an entire class of patent claims from exhaustion.

Furthermore, the Federal Circuit's position conflicted with established Supreme Court precedent.[146] The Court had found method claims exhausted by the sale of related products in numerous earlier cases. For example, *Masonite* held that the sale of a patented lumber product exhausted the patentee's rights under claims covering "both hardboard and the *processes* for making it."[147] In *Ethyl Gasoline Co. v. United States*, the Court held that sales of a patented fuel additive exhausted all related patents,[148] including one that claimed methods for using treated fuel in combustion motors.[149] Similarly, the Court applied exhaustion to method claims in *United States v. Univis Lens Co*.[150] In short, the Supreme Court had "repeatedly held" method claims exhausted long before *Quanta*.[151]

Finally, a rule exempting method claims from exhaustion would, in practice, marginalize the entire doctrine by allowing patent applicants to easily preclude future adverse exhaustion defenses[152] because virtually any invention can be cast as a method using simple claim drafting techniques.[153] Thus, although method claims carry some drawbacks,[154] their

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tent, not the *apparatus* patent, the first sale doctrine is inapplicable . . . .") (citing *Bandag, Inc.*, 750 F.2d at 924).

146. *See* John W. Osborne, *A Coherent View of Patent Exhaustion: A Standard Based on Patentable Distinctiveness*, 20 SANTA CLARA COMPUTER & HIGH TECH. L.J. 643, 681 (2004); William P. Skladony, *Commentary on Select Patent Exhaustion Principles in Light of the LG Electronics Cases*, 47 IDEA 235, 296-98 (2007).

147. United States v. Masonite Corp., 316 U.S. 265, 268, 278-79 (1942) (emphasis added).

148. Ethyl Gasoline Corp. v. United States, 309 U.S. 436, 457 (1940).

149. *Id.* at 446.

150. *See* United States v. Univis Lens Co., 316 U.S. 241, 249-50 (1942); Osborne, *supra* note 146, at 681 ("One of the patents held exhausted, U.S. Patent No. 1,879,769 to Silverman, was directed to a method for eliminating prismatic imbalance and contained no apparatus claims.").

151. Quanta Computer, Inc. v. LG Elecs., Inc., 128 S.Ct. 2109, 2117 (2008).

152. *See* Amber Hatfield Rovner, *Practical Guide to Application of (or Defense Against) Product-Based Infringement Immunities Under the Doctrines of Patent Exhaustion and Implied License*, 12 TEX. INTELL. PROP. L.J. 227, 237 (2004) ("[I]f it is possible to draft method claims covering the invention, this is one way to 'plan ahead' against exhaustion.").

153. Even the *Bandag* opinion acknowledged this reality: "It is commonplace that the claims defining some inventions can by competent draftsmanship be directed to either a method or an apparatus." Bandag, Inc. v. Al Bolser's Tire Stores, Inc., 750 F.2d 903, 922 (Fed. Cir. 1984); *see also* John R. Thomas, *Of Text, Technique, and the Tangible: Drafting Patent Claims Around Patent Rules*, 17 J. MARSHALL J. COMPUTER & INFO. L. 219,

categorical exclusion from exhaustion would reduce the doctrine to a matter of preference and, as the Court recognized, "seriously undermine" it.[155]

Not surprisingly, *Quanta* unequivocally abolished the Federal Circuit's bar on method claim exhaustion.[156] Thus, even though "a patented method may not be sold in the same way as an article or device," exhaustion still applies after "the sale of an item that embodied the method."[157] Of course, this holding raises the critical issue of whether a given product legally "embodies" a claimed method—a question the Court addressed in the next section of the opinion.[158]

B. Exhaustion by Incomplete Products: Polishing *Univis Lens*

Although Intel's products could not literally read on LGE's claims as sold, the Supreme Court determined that they sufficiently embodied the patents to trigger exhaustion. The Court again invoked its own precedent, clarifying and extending the two-pronged test from *Univis Lens*[159] for patent exhaustion by the sale of incomplete products.[160]

In *Univis Lens*, the Supreme Court considered resale price restrictions imposed by a patentee selling unfinished "lens blanks" that, when ground and polished, would yield patented multifocal lenses for prescription eyeglasses.[161] The patentee manufactured and sold the blanks to wholesalers and retailers, which would in turn grind and polish the blanks to create the finished lenses claimed in the patents.[162] Assuming the lens blanks did not practice the patents as sold, the Supreme Court nonetheless held that their

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252 (1998) ("Even the most novice claims drafter would encounter scant difficulty in converting a patent claim from artifact to technique and back again.").

154. For example, method patents are infringed only by performing the protected process—not by making or selling a device used to carry it out. In contrast, apparatus claims would enable a direct infringement action against a competitor making or selling the same device. Thus, an inventor choosing method over apparatus claims to avoid exhaustion might compromise enforceability—with future options limited to an indirect infringement suit against the competitor (requiring proof of knowledge or intent, *see* 35 U.S.C. § 271(b),(c) (2006)) and/or potentially unattractive direct infringement suits against end users.

155. *Quanta Computer, Inc.*, 128 S.Ct. at 2117.

156. *See id.* at 2118 ("We therefore reject LGE's argument that method claims, as a category, are never exhaustible.").

157. *Id.* at 2117.

158. *See id.* at 2118-21.

159. United States v. Univis Lens Co., 316 U.S. 241 (1942).

160. *Quanta Computer, Inc.*, 128 S.Ct. at 2118-21.

161. *Univis Lens Co.*, 316 U.S. at 243-44.

162. *Id.* at 244.

sale exhausted all patent rights in the finished lenses.[163] *Univis Lens* held that the sales occurred under the patents because each lens blank both (1) lacked "utility until . . . ground and polished as the finished lens" and (2) "embodie[d] essential features" of the patents.[164] In *Quanta*, the Supreme Court returned to this two-part framework for evaluating patent exhaustion by incomplete products.[165]

First, *Quanta* held that Intel's products had "no reasonable use" other than practicing LGE's patents in the combinations with non-Intel parts that LGE sought to prohibit.[166] In addressing this prong of the test, *Quanta* clarifies inconsistent language in *Univis Lens*. In *Univis Lens*, the Supreme Court described the "reasonable noninfringing use" inquiry using at least four related but distinct formulations—subtle differences that could affect the outcome of a close case.[167] In contrast, *Quanta* establishes a consistent expression of the standard, holding that incomplete products can trigger exhaustion where their only reasonable use is in practicing the patent at issue.[168] Applying this standard, the Court rejected LGE's two suggested alternatives: (1) disabling patented features of Intel's chips before use failed because it was unreasonable, and (2) using the chips outside the United States failed because such use "would still be *practicing* the patent, even if not infringing it."[169]

Second, *Quanta* held that, like the lens blanks in *Univis Lens*, "[e]verything inventive about each [LGE] patent is embodied in the Intel products."[170] This holding formally extends *Univis Lens* from unfinished products to encompass combination products.[171] LGE had attempted to

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163. *Id.* at 249-52.

164. *Id.* at 249.

165. *See Quanta Computer, Inc.*, 128 S.Ct. at 2119 (stating that incomplete products triggered exhaustion "because their only reasonable and intended use was to practice the patent and because they 'embodie[d] essential features of [the] patented invention.'" (quoting *Univis Lens Co.*, 316 U.S. at 249-51)).

166. *Id.*

167. *Univis Lens* used the terms "the only use," "without utility," "capable of use only in practicing the patent," and "destined . . . to be finished by the purchaser in conformity with the patent" to describe the same inquiry. *Univis Lens Co.*, 316 U.S. at 249, 251-52; s*ee also* Skladony, *supra* note 146, at 275-76.

168. The Court first recapitulated the standard from *Univis Lens*, and then applied it to the facts in *Quanta*: "LGE has suggested *no reasonable use* for the Intel products *other than* incorporating them into computer systems that *practice the LGE Patents*." *Quanta Computer, Inc.*, 128 S.Ct. at 2119 (emphasis added).

169. *Id.* at 2119 n.6 (emphasis in original).

170. *Id.* at 2120.

171. *Quanta* thus essentially affirms the application of *Univis Lens* to combination products in *Cyrix Corp. v. Intel Corp.*, 846 F. Supp. 522 (E.D. Tex. 1994). In *Cyrix*, the

distinguish *Univis Lens*, arguing that the Intel chips required addition of extraneous parts to practice their claims—unlike lens blanks needing only independent refinement.[172] But the Court viewed the form of the finishing step as irrelevant; incomplete lens blanks and detached computer chips can both trigger exhaustion because "[i]n each case, the final step to practice the patent is common and noninventive."[173] Thus, the Supreme Court held that incomplete articles can exhaust closely related patents "where the only step necessary to practice the patent is the application of common processes or the addition of standard parts."[174]

Thus, *Quanta* reaffirmed and fine-tuned the two-part *Univis Lens* test, holding that the authorized sale of an incomplete product triggers patent exhaustion when (1) the product's only reasonable use lies in practicing the patent, and (2) the product embodies everything inventive about the patent, requiring only familiar steps to formally practice the claims. By reasserting the two-pronged *Univis Lens* framework, *Quanta* may affect business planning and litigation related to incomplete articles produced under patents. In particular, pre-*Quanta* district court decisions had tended to focus their exhaustion analyses on possible non-infringing uses, while glossing over or ignoring the second element of the test.[175] *Quanta* will likely refocus attention on the novelty of the remaining required steps and may prompt patentees to try to reserve inventive finishing processes until after the first sale as a way to perpetuate control over incomplete products.

C. Authorized Sales Exhaust Patent Rights

Finally, the Court considered the effect of license conditions on exhaustion of LGE's patents. Given the restrictions in LGE's license to Intel, significant questions regarding the legitimacy of both *General Talking Pictures* and *Mallinckrodt* and the effect of notice on exhaustion were potentially before the Supreme Court in *Quanta*. LGE had prevailed before the Federal Circuit by arguing that Intel's sales were expressly conditional, such that LGE's conditions survived exhaustion and remained enforce-

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district court applied *Univis Lens* to hold computer technology patents exhausted by the sale of products that embodied but could not practice the claims until combined with ancillary components: "Cyrix's microprocessors, although complete in and of themselves, are unfinished in the sense that they need to be combined with external memory to be used. Cyrix's microprocessors thus are like the lens blanks in [*Univis Lens*]." *Id.* at 540.

172. *Quanta Computer, Inc.*, 128 S.Ct. at 2120.

173. *Id.*

174. *Id.*

175. *See, e.g.*, LG Elecs., Inc. v. Asustek Computer, Inc., No. C 01-00326 CW, 2002 U.S. Dist. LEXIS 25956, at *33-39 (N.D. Cal. Aug. 20, 2002); *Cyrix Corp.*, 846 F. Supp. at 537-41.

able through post-sale infringement remedies.[176] Therefore, many expected the *Quanta* opinion to directly endorse or prohibit post-sale controls established through sales conditions.[177] In fact, the Supreme Court never reached this question, instead reversing on a relatively narrow issue of contract interpretation.[178]

LGE argued that *General Talking Pictures* should preclude exhaustion of its patents.[179] In *General Talking Pictures*, the licensee sold to a customer that knowingly used patented products in violation of a license restriction. The Court held that the sale was not authorized, so exhaustion did not apply—rendering the purchaser liable for infringement.[180] By analogy, LGE argued that exhaustion did not insulate Quanta from infringement because Intel was licensed to sell only for use with other Intel parts, and Quanta used the parts in prohibited combinations despite notice of the restriction.[181] In short, LGE's arguments relied heavily on *General Talking Pictures* and essentially mirrored the Federal Circuit's opinion,[182] except that the Federal Circuit cited its own *Mallinckrodt* line of cases (instead of *General Talking Pictures*) for the crucial proposition that expressly conditional sales preclude exhaustion.[183] Thus, both LGE and the Federal Circuit reasoned that (1) the agreement between LGE and Intel imposed express conditions on the licensed products, and (2) Quanta had express notice that Intel's sales were conditional, so (3) the conditions survived exhaustion under *General Talking Pictures* and *Mallinckrodt*.

Quanta stopped short of the second and third issues, however, by seizing on the first. The Court held that details of the License and Master

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176. LG Elecs., Inc. v. Bizcom Elecs., Inc., 453 F.3d 1364, 1369-70 (Fed. Cir. 2006).

177. *See* John C. Paul et al., *US Patent Exhaustion: Yesterday, Today, and Maybe Tomorrow*, 3 J. INTELL. PROP. L. & PRAC. 461, 468-69 (2008).

178. *Quanta Computer, Inc.*, 128 S.Ct. at 2121-22.

179. *Id.* at 2121.

180. Gen. Talking Pictures Corp. v. W. Elec. Co., 304 U.S. 175, 180-82 (1938), *aff'd on reh'g*, 305 U.S. 124 (1939).

181. Brief for Respondent at 39, *Quanta Computer, Inc.*, 128 S.Ct. 2109 (No. 06-937), 2007 WL 4244683.

182. *See* LG Elecs., Inc. v. Bizcom Elecs., Inc., 453 F.3d 1364, 1370 (Fed. Cir. 2006) ("Although Intel was free to sell its microprocessors and chipsets, those sales were conditional and Intel's customers were expressly prohibited from infringing LGE's combination patents.").

183. *Mallinckrodt* built on *General Talking Pictures* but expanded its application to *all* sales, not just those made through licensed vendors. "Medipart offers neither law, public policy, nor logic, for the proposition that the enforceability of a restriction to a particular use is determined by whether the purchaser acquired the device from a manufacturing licensee or from a manufacturing patentee." Mallinckrodt, Inc. v. Medipart, Inc., 976 F.2d 700, 705 (Fed. Cir. 1992).

Agreements between LGE and Intel were determinative.[184] In contrast to the Federal Circuit, which read the Master Agreement's terms into the License Agreement,[185] the Supreme Court interpreted the contracts as distinct, independent instruments. Thus, although LGE required that Intel notify its customers of use restrictions, this provision "appeared only in the Master agreement"[186] and did not affect Intel's rights under the governing License Agreement.[187] Furthermore, the License Agreement itself imposed no conditions on Intel's sales.[188] In short, the Court found that these documents, as drafted, broadly authorized Intel to sell licensed products free of restrictions. Therefore, "[b]ecause Intel was authorized to sell its products to Quanta, the doctrine of patent exhaustion prevents LGE from further asserting its patent rights with respect to . . . those products."[189]

In summary, the Court never examined how exhaustion would have affected LGE's intended license restrictions because its decision turned on preliminary, perfunctory contract interpretation.[190] Instead of deciding whether and to what extent patentees can restrict purchasers, *Quanta* concluded that LGE's peculiarly structured licensing arrangements simply failed to impose any restrictions. As a result, the ostensibly narrow holding rests heavily on the facts of the particular transactions among LGE, Intel, and Quanta. Even so, *Quanta* may have broader practical implications.

IV. MIGHT *QUANTA* HAVE BROADER REACH BY IMPLICATION?

How will *Quanta* influence patentees' future sales and licensing practices? The opinion will almost certainly promote more clarity and preci-

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184. *See* Quanta Computer, Inc. v. LG Elecs., Inc., 128 S.Ct. 2109, 2121 (2008) ("LGE overlooks important aspects of the structure of the Intel-LGE transaction.").

185. *Bizcom Elecs., Inc.*, 453 F.3d at 1370.

186. *Quanta Computer, Inc.*,128 S.Ct. at 2122.

187. *See id.* ("LGE does not suggest that a breach of [the Master Agreement] would constitute a breach of the License Agreement. Hence, Intel's authority to sell its products . . . was not conditioned on the notice to Quanta or Quanta's decision to abide by LGE's directions in that notice.").

188. "Nothing in the License Agreement restricts Intel's right to sell its microprocessors and chipsets to purchasers who intend to combine them with non-Intel parts." *Id.* at 2121.

189. *Id.* at 2122.

190. In fact, the Court's straightforward analysis lacked even a single reference to precedent. *See id.* at 2121-22.

sion in license instruments.[191] But larger questions remain unanswered. What post-sale restraints still escape patent exhaustion, if any? Can patentees still establish restrictions on purchasers through carefully crafted license agreements? Are such restrictions enforceable if the patentee manufactures and sells its products directly? Is there a distinction between conditions in sales and license agreements?[192] How do customer notice and acquiescence impact enforceability of such restrictions? These questions formally await further litigation after *Quanta*.

Despite its narrow holding in *Quanta*, the Supreme Court hinted at a broader agenda regarding post-sale restrictions on patented products.[193] The Court suggested that LGE, its patent rights exhausted, might instead seek *contract* damages:

> Whether a patentee may protect himself and his assignees by special contracts brought home to the purchasers is not a question before us, and upon which we express no opinion. It is, however, obvious that such a question would arise as a question of contract, and not as one under the inherent meaning and effect of the patent laws.[194]

This somewhat enigmatic footnote suggests skepticism toward enforcing post-sale restrictions on customers through patent remedies. *Quanta* could thus shift licensing practice toward contract enforcement models

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191. This conclusion has been universal among patent licensing practitioners consulted by the author. *See also Patent Practitioners Diverge Sharply on Impact, Merit of Exhaustion Opinion*, 76 PAT., TRADEMARK, & COPYRIGHT J. 207 (Jun. 13, 2008); *cf.* Transcript of Oral Argument at 8, *Quanta Computer, Inc.*, 128 S.Ct. 2109 (No. 06-937) (comment by Roberts, J., describing the license between Intel and LGE) ("[T]here's a lot of uncertainty, uncertainty that could have been cured by how the contract was drafted, and people prefer to live with that uncertainty and litigate rather than clear it up in the contract.").

192. *See generally* Elizabeth I. Winston, *Why Sell What You Can License? Contracting Around Statutory Protection of Intellectual Property*, 14 GEO. MASON L. REV. 93 (2006) (discussing the practical implications of the often purely formalistic choice to characterize a transaction as a license rather than a sale).

193. It is interesting to speculate on the Court's motivation for granting certiorari in *Quanta*. The first two holdings broadly correct Federal Circuit digressions from Supreme Court precedent. Perhaps the Court viewed the case as an appropriate vehicle for directly correcting these issues only, *see* Rebecca S. Eisenberg, *The Supreme Court and the Federal Circuit: Visitation and Custody of Patent Law*, 106 MICH. L. REV. FIRST IMPRESSIONS 28, 29 (2007), with the last holding necessarily limited as a means to that end because LGE's convoluted licensing scheme did not lend itself to clean, general statements on the boundaries of post-sale restrictions.

194. *Quanta Computer, Inc.*, 128 S.Ct. at 2122, n.7 (quoting Keeler v. Standard Folding-Bed Co., 157 U.S. 659, 666 (1895)).

depending on how lower courts and private actors interpret this message. *Quanta* should, at a minimum, prompt questions about the long-term viability of patent-based enforcement of restrictive sales conditions, particularly in view of the Supreme Court's recent willingness to review patent decisions. This Note will examine *Quanta*'s potential impact on sales and licensing conditions in several important contexts and argue that post-sale restrictions might best be regulated and enforced using contract, not patent, principles.

A. Restrictions on Licensees

As discussed, longstanding Supreme Court precedent upholds restrictions imposed on licensed sellers of patented goods.[195] As the Court has recognized, patentees may choose to commercialize their innovations themselves or license other parties to do so, but this decision should not impinge on their exclusive rights to control the invention.[196] Therefore, the Court has generally allowed patentees to enforce conditions on licensed sellers through infringement actions, and these rights will likely remain undisturbed after *Quanta*.

The *Quanta* opinion did not question the propriety of LGE's license conditions on Intel. LGE brought suit against Intel's customers, not Intel itself, so the enforceability of license terms against Intel was not at issue. However, the opinion suggests that LGE could properly impose binding conditions on Intel as its licensee.[197] In short, *Quanta* does not affect patentees' established rights to restrict their licensed vendors.

B. Qualcomm-Style Vertical Licensing

According to *Quanta*, LGE's licensing structure did not "limit[] Intel's authority to sell products substantially embodying the patents."[198] Consequently, Intel's authorized sales exhausted LGE's patent rights, precluding LGE's efforts to collect royalties from customers like Quanta. But, as

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195. *See, e.g.*, Gen. Talking Pictures Corp. v. W. Elec. Co., 304 U.S. 175 (1938), *aff'd on reh'g*, 305 U.S. 124 (1939) (patentee could enforce a field-of-use license restricting licensee's sales to a single segment of the commercial market); United States v. Gen. Elec. Co., 272 U.S. 476 (1926) (patentee could dictate licensed distributors' pricing of patented light bulbs); Adams v. Burke, 84 U.S. 453 (1873) (patentee could license sellers to operate in a limited geographic territory).

196. *See* Bement v. Nat'l Harrow Co., 186 U.S. 70, 93 (1902) ("The owner of a patented article can, of course, charge such price as he may choose, and the owner of a patent may assign it or sell the right to manufacture and sell the article patented upon the condition that the assignee shall charge a certain amount for such article.").

197. *See Quanta Computer, Inc.*, 128 S.Ct. at 2121 ("To be sure, LGE did require Intel to give notice to its customers . . . .").

198. *Id.* at 2122.

LGE argued,[199] patent licensors may have reasonable motivations for splitting their compensation between licensed manufacturers and purchasers—for example, to allow price discrimination across distinct markets or to offset bargaining power disparities with large manufacturing licensees like Intel. After this decision, by what means, if any, can patentees partition their compensation between licensees and end users?

Though *Quanta* rejected LGE's license restrictions, the opinion seems to leave closely related licensing strategies unscathed—such as that of Qualcomm, Inc. Qualcomm is a successful innovator in wireless communications technologies[200] that both manufactures and licenses others to manufacture chips incorporating its patented technologies.[201] Qualcomm uses a two-tiered licensing format in which licensed chipmakers receive rights to make and sell chips using licensed technology but may only sell such chips to buyers separately licensed by Qualcomm.[202] In turn, authorized buyers—generally telephone handset manufacturers—may broadly use and sell Qualcomm technology in completed handsets such that their eventual sales to consumers exhaust Qualcomm's patents.[203]

Thus, the relative positions of Qualcomm, its chipmaker-licensees, and its authorized buyers mirror those of LGE, Intel, and Quanta, respectively.[204] But Qualcomm uses licensing practices crucially absent from LGE's agreements with Intel. First, Qualcomm executes licensing agreements indentifying authorized buyers for its licensed chipmakers *in advance*.[205] Second, Qualcomm's license agreements unequivocally limit manufacturers' sales rights to include only authorized purchasers, providing "that if the chipmaker-licensee sells [chips] to entities that are not Authorized Purchasers, the licensee has materially breached" its license.[206] Third, Qualcomm separates the right to make patented chips from the right to use

199. Brief for Respondent at 31-35, *Quanta Computer, Inc.*, 128 S.Ct. 2109 (No. 06-937), 2007 WL 4244683.

200. Qualcomm pioneered code division multiple access ("CDMA") technology widely used in commercial cellular telephones. *See* Brief for Qualcomm, Inc. as Amicus Curiae in Support of Respondent at 2-6, *Quanta Computer, Inc.*, 128 S.Ct. 2109 (No. 06-937), 2007 WL 4340879.

201. *Id.* at 5-7.

202. *Id.* at 7-9.

203. *Id.* at 8-9.

204. *Compare id.* at 7-9 (Qualcomm licenses chipmaker-licensees both to make products reading on Qualcomm's patents and to sell such products to authorized buyers), *with Quanta Computer, Inc.*, 128 S.Ct. at 2114 (LGE licensed Intel both to make products reading on LGE's patents and to sell such products to customers like Quanta).

205. Brief for Qualcomm, Inc. as Amicus Curiae in Support of Respondent at 8-9, *Quanta Computer, Inc.*, 128 S.Ct. 2109 (No. 06-937), 2007 WL 4340879.

206. *Id.* at 8.

them in finished products between its licensee-manufacturers and authorized purchasers, respectively.[207]

As a result, Qualcomm-style licensing arrangements lack the problems that the Supreme Court found dispositive in holding LGE's patents exhausted. Where LGE's license "broadly permits Intel to 'make, use, [or] sell' products free of LGE's patent claims,"[208] Qualcomm explicitly reserves use rights from licensed manufacturers. Where LGE only required notice and presumed customers like Quanta would take independent steps—outside of Intel's control—to seek accommodation from LGE, Qualcomm limits licensee sales based on objective, pre-defined lists of approved customers with license agreements already in place. And where LGE placed its notice provision in a peripheral agreement with no effect on Intel's license even if breached, Qualcomm's comprehensive chipmaker license clearly defines any sale to unauthorized customers as a material breach. Collectively, these differences should insulate Qualcomm-style licensing arrangements from *Quanta*-based exhaustion defenses.

Allowing Qualcomm-style arrangements makes sense, because they allow patentees without manufacturing capacity to achieve through licensing what patentee-manufacturers can do directly—control the initial sale of their patented technology.[209] Furthermore, these agreements facilitate price discrimination and efficient allocation of risks among the parties. On the other hand, negotiating separate license agreements for manufacturers and purchasers increases total transaction costs, and such arrangements create a risk of "double dipping," where patentees—especially those, like Qualcomm, with considerable bargaining power—might extract unwarranted compensation in the aggregate.[210] Market forces should generally minim-

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207. *Id.*

208. *Quanta Computer, Inc.*, 128 S.Ct. at 2121 (modification in original).

209. *See* United States v. Gen. Elec. Co., 272 U.S. 476, 489-90 (1926). The Court reasoned:

> [W]here a patentee makes the patented article and sells it, he can exercise no future control over what the purchaser may wish to do with the article after his purchase. . . . But the question is a different one which arises when we consider what a patentee who grants a license to one to make and vend the patented article may do . . . . [M]ay he limit the selling by limiting the method of sale and the price? We think he may do so, provided the conditions of sale are normally and reasonably adapted to secure pecuniary reward for the patentee's monopoly.

Id.

210. In general, licensee-manufacturers will pay less for a license to make and sell only to certain customers than for an unrestricted sales right license. But this may not always hold true. "[T]he total license fees paid in such arrangements logically would be, and in practice *commonly* are, lower than the total license fees that would be paid if the

ize double recovery, but failing that, patent misuse and the antitrust laws also serve to check abuses.[211]

Interestingly, Qualcomm's licensing strategy may soon be tested against *Quanta*. Broadcom Corporation filed suit against Qualcomm in October 2008, alleging double recovery and seeking a declaratory judgment that Qualcomm's licensing structure is illegal on grounds of patent exhaustion and misuse.[212] Broadcom's arguments rely heavily on *Quanta*,[213] so this litigation could indicate how broadly the lower courts will read *Quanta* in licensing situations.

C. *General Talking Pictures*-Type Restrictions on Purchases Made Through Licensees

Quanta could affect the practice of passing license restrictions through licensed sellers and onto customers. LGE attempted to restrict a downstream purchaser, Quanta, through its sales license with Intel, relying heavily on *General Talking Pictures*.[214] The patentee in *General Talking Pictures* imposed a field-of-use restriction prohibiting its licensee from selling patented sound amplification tubes to commercial users. The licensee nonetheless sold to a commercial customer, and the Court affirmed findings of infringement against the licensed seller *and* the purchaser, emphasizing that both parties disregarded actual knowledge that their transaction would violate terms of the license.[215] LGE argued that Quanta's use similarly fell outside of Intel's authority to sell, rendering its purchase unauthorized and thus infringing. As discussed, the Court avoided judging the merits of this argument,[216] so *General Talking Pictures* formally remains good law after *Quanta*. Even so, there are reasons to question its

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component manufacturer were forced to obtain an unrestricted and unconditional license . . . ." *See* Brief for Qualcomm, Inc. as Amicus Curiae in Support of Respondent at 24, *Quanta Computer, Inc.*,128 S.Ct. 2109 (No. 06-937), 2007 WL 4340879 (emphasis added).

211. *See* Harry First, *Controlling the Intellectual Property Grab: Protect Innovation, not Innovators*, 38 RUTGERS L. J. 365, 390 (2007) ("[A]ntitrust enforcement is necessary to curb the excessive claims of intellectual property rights holders. It is an antidote to the intellectual property grab.").

212. Complaint at 8-12, Broadcom Corp. v. Qualcomm Inc., No. 3:08cv1829 (S.D. Cal. Oct. 7, 2008).

213. *See id.*

214. Gen. Talking Pictures Corp. v. W. Elec. Co. (*Gen. Talking Pictures I*), 304 U.S. 175 (1938), *aff'd on reh'g*, 305 U.S. 124 (1939).

215. *See id.* at 181-82 (holding that the licensee infringed by "knowingly making the sales . . . outside the scope of its license," and that the purchaser infringed by having acted "with knowledge of the facts [of the license].").

216. *See supra* Section III.C.

long-term viability as far as it allows restrictions on licensees to reach purchasers: (1) the case is, at best, in tension with other Supreme Court decisions, (2) it creates practical difficulties for courts and inefficiencies for private parties, and (3) the current Supreme Court may harbor doubts about whether it was correctly decided.

As Justice Black noted in dissent, *General Talking Pictures* created tension with the Supreme Court's precedent on exhaustion.[217] Until then, the Court had consistently held that restrictions on licensed sellers did not pass to purchasers of patented goods. For example, conditions confining licensees to defined sales prices or geographic territories could not similarly restrict their customers' freedom to resell[218] or move[219] purchased goods. In addition, *General Talking Pictures* stretched *Mitchell v. Hawley* to derive the critical proposition that the private-field licensee "could not convey to [its purchaser] what both knew it was not authorized to sell."[220] But *Mitchell* involved materially different facts. There, the Court held that exhaustion did not apply because the licensed products were not to be sold,[221] unlike the amplifier tubes licensed specifically for sale in *General Talking Pictures*. Finally, the Court repeatedly emphasized that the purchaser in *General Talking Pictures* knowingly violated the license restriction, suggesting that this knowledge was significant to its decision. But the Supreme Court had already found customer knowledge of license restrictions irrelevant to patent exhaustion in an earlier decision.[222]

Second, *General Talking Pictures* creates practical difficulties and inefficiencies by enforcing restrictions against purchasers not represented in

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217. Gen. Talking Pictures Corp. v. W. Elec. Co. (*Gen. Talking Pictures II*), 305 U.S. 124, 128-33 (1939), *aff'g* 304 U.S. 175 (Black, J., dissenting) ("[T]his Court again reasserted that commodities—once sold—were not thereafter 'subject to conditions as to use' imposed by patent owners. In result, the judgment here is a . . . departure from the traditional judicial interpretation of the patent laws.").

218. Bauer & Cie v. O'Donnell, 229 U.S. 1 (1913); United States v. Univis Lens Co., 316 U.S. 241 (1942).

219. Adams v. Burke, 84 U.S. 453 (1873); Keeler v. Standard Folding-Bed Co., 157 U.S. 659 (1895).

220. *Gen. Talking Pictures I*, 304 U.S. at 181 (citing Mitchell v. Hawley, 83 U.S. 544 (1873)).

221. In *Mitchell*, the infringing purchaser bought a patented machine from a party licensed only to make a patented machine and license others to use it. But the license specified that the licensee "shall not in any way or form dispose of [or] sell" the machine. Mitchell v. Hawley, 83 U.S. 544, 548-49 (1873).

222. In *Hobbie v. Jennison*, 149 U.S. 355 (1893), a distributor of patented pipes, licensed only in Michigan, knowingly sold to a buyer that knew of the territorial restriction yet used the pipes elsewhere. The Court found the patents exhausted and thus unenforceable against the purchaser.

the license negotiations. Allowing infringement actions against *purchasers* over sales that violate the *seller's* contractual obligations creates potentially unforeseeable liability risks for purchasers,[223] confuses courts' legal analyses under patent and contract law,[224] and presents a seemingly paradoxical opportunity for patentees to attach—through licensed intermediaries—post-sale restrictions on purchasers that exhaustion would prevent in analogous direct sales.[225]

Finally and despite the foregoing criticisms, *General Talking Pictures* has stood since 1939, and *Quanta* did not directly challenge its reasoning. Thus, *General Talking Pictures* probably still stands. *Quanta* does suggest, however, that *General Talking Pictures* may be less secure going forward. Though explicitly reserving the issue, the Court suggested that it might look critically at future attempts to enforce restrictions on purchasers through patent remedies.[226]

D. *Mallinckrodt*-Type Restrictions On Direct Sales

The Federal Circuit's controversial *Mallinckrodt* decision also likely survives after *Quanta*. First, the Supreme Court's holding that LGE's license failed to restrict Intel's sales[227] leaves open the possibility that clearer, more carefully drafted conditions—like those in *Mallinckrodt*—would prevent exhaustion.[228] Second, *Mallinckrodt* dealt with restrictions on direct sales, which can be distinguished from LGE's attempt to reach pur-

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223. *See* Patterson, *supra* note 33, at 209.

224. *See id.* at 185-91.

225. In *Mallinckrodt*, both the District Court and the Federal Circuit acknowledged this apparent consequence of *General Talking Pictures*. The District Court concluded: "There is clearly some tension between General Talking Pictures and the earlier cases," Mallinckrodt, Inc. v. Medipart, Inc., No. 89 C 4524, 1990 U.S. Dist. LEXIS 1974, at *17 (N.D. Ill., Feb. 15, 1990). In contrast, the Federal Circuit explicitly rejected any distinction between manufacturing licensees and manufacturing patentees as baseless, "[W]e discern no reason to preserve formalistic distinction of no economic consequence." Mallinckrodt, Inc. v. Medipart, Inc., 976 F.2d 700, 703 (1992); *see also* Brief for the United States as Amicus Curiae at 12-14, Quanta Computer, Inc. v. LG Elecs., Inc., 128 S.Ct. 2109 (2008) (No. 06-937), 2007 WL 2425785 ("Although there is a seeming anomaly in allowing a patentee to achieve indirectly—through an enforceable condition on a licensee—a limitation on use or resale that the patentee could not itself impose on a direct purchaser, the distinction is a necessary and explicable result of . . . *General Talking Pictures*.").

226. *See* Quanta Computer, Inc. v. LG Elecs., Inc., 128 S.Ct. 2109, 2122, n.7 (quoting Keeler v. Standard Folding-Bed Co., 157 U.S. 659, 666 (1895)).

227. *See id.* at 2121-22 ("No conditions limited Intel's authority to sell products substantially embodying the patents.").

228. In *Mallinckrodt*, each product was clearly marked "Single Use Only," *Mallinckrodt, Inc.*, 976 F.2d at 702.

chasers through its licensees. Third, LGE's requirement that purchasers use only Intel secondary components—standard items otherwise cheaply available from a variety of sources—muddies any discord between *Quanta* and *Mallinckrodt* because it borders on the type of anticompetitive restriction[229] that *Mallinckrodt* might condemn as reaching "beyond the patent grant."[230] Finally, even considering its recent habits, the Supreme Court so rarely takes patent cases that another decision on the exhaustion doctrine anytime soon would be remarkable.[231] Thus, the Federal Circuit can probably "design around" *Quanta* to uphold *Mallinckrodt*.

Though *Quanta* may not affect *Mallinckrodt* directly, the opinion should nevertheless sound alarms for patent owners relying on *Mallinckrodt*-type sales restrictions. As noted, the near-term odds of another Supreme Court patent exhaustion case are low.[232] But several observations suggest the Supreme Court may disfavor using patent law to enforce post-sale restraints on purchasers.

First, one interpretation of *Quanta*'s comment on possible contract remedies against purchasers[233] would suggest general Supreme Court skepticism about policing post-sale restrictions on purchasers via patent remedies. Next, the Solicitor General's Office—increasingly influential[234] on Supreme Court patent decisions—submitted a brief expressly rebuking *Mallinckrodt*.[235] Moreover, the Justices' questions at oral argument evinced concerns about the implications of allowing servitudes to run with

229. *See, e.g.*, Motion Picture Patents v. Universal Film Mfg. Co., 243 U.S. 502, 516 (1917).

230. *Mallinckrodt, Inc.*, 976 F.2d at 708.

231. *Cf.* Eisenberg, *supra* note 193, at 32 ("In theory, all of these [Federal Circuit] decisions are subject to review by the Supreme Court, but it is hard to imagine that the Supreme Court plans to review nonobviousness decisions more than sporadically.").

232. But successive cases in the same area of patent doctrine would not be unprecedented. For example, the Supreme Court recently examined the doctrine of equivalents twice in five years, *see* Festo Corp. v. Shoketsu Kinzoku Kogyokabushiki Co., 535 U.S. 722 (2002); Warner-Jenkinson Co. v. Hilton Davis Chem. Co., 520 U.S. 17 (1997).

233. Quanta Computer, Inc. v. LG Elecs., Inc., 128 S.Ct. 2109, 2122 n.7 (2008).

234. *See* Eisenberg, *supra* note 193, at 29 ("[W]henever in recent years the Solicitor General has urged the Supreme Court to grant certiorari in a patent case, it has done so, and the Court has ultimately resolved the case in accordance with the Solicitor General's advice.").

235. Brief for the United States as Amicus Curiae at 14-15, *Quanta Computer, Inc.*, 128 S.Ct. 2109 (No. 06-937), 2007 WL 2425785 ("In the decades since this Court last interpreted the first-sale doctrine, the doctrine has evolved in the Federal Circuit in a manner that appears to depart from this Court's cases.").

chattels,[236] and counsel for LGE pointedly declined to endorse *Mallinckrodt*.[237] Finally, and most fundamentally, the *Mallinckrodt* line of cases vitiates patent exhaustion in practical terms by allowing patentees to avoid its effects as a matter of preference.[238] The Federal Circuit's indifference to the exhaustion doctrine stands in stark contrast to the meticulous attention the Supreme Court paid to first sale principles in *Quanta*—a potentially significant schism that that could require additional harmonization. And even absent direct Supreme Court review, the Federal Circuit may perceive vulnerability in *Mallinckrodt* and temper its treatment of sales restrictions accordingly, attempting to head off another reversal.[239] In short, *Quanta* could marginalize *Mallinckrodt* simply by implication.

In summary, *Mallinckrodt* seems formally untouched by *Quanta*'s narrow approach to LGE's post-sale restriction. Although the Federal Circuit probably will not drastically change its established approach in the near future, *Quanta* at least clouds *Mallinckrodt*'s long-term viability.

E. Seed Cases and Other Replicable Technologies

Patented, genetically modified agricultural crops have spawned a significant line of legal disputes over post-sale use restrictions on transgenic seeds.[240] These cases share a distinctive central question: How should patent exhaustion apply to self-perpetuating technologies? *Quanta*'s narrow holding—concerning use restrictions on non-reproducible technology—presumably has no immediate impact on this issue. Looking ahead after *Quanta*, Federal Circuit precedent in this specialized arena appears more secure than *Mallinckrodt*.

First, these "seed cases" present a difficult factual scenario neither anticipated nor easily resolved by the Supreme Court's decades-old exhaustion precedent. Cases like *Adams v. Burke*, *Univis Lens*, and *Keeler* dealt

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236. Transcript of Oral Argument at 21-22, 29, *Quanta Computer, Inc.*, 128 S.Ct. 2109 (No. 06-937).

237. *Id.* at 34.

238. *See, e.g.*, James B. Kobak, Jr., *Contracting Around Exhaustion: Some Thoughts About the CAFC's* Mallinckrodt *Decision*, 75 J. PAT. & TRADEMARK OFF. SOC'Y 550, 559-62 (1993); Richard H. Stern, *The Unobserved Demise of the Exhaustion Doctrine in US Patent Law*, 15 EUR. INTELL. PROP. REV. 460, 465 (1993).

239. The Federal Circuit sought to temper its approach to nonobviousness issues between the Supreme Court's grant of certiorari and opinion in *KSR*. S*ee, e.g.*, Pfizer, Inc., v. Apotex, Inc., 480 F.3d 1348, 1365-67 (Fed. Cir. 2007); Dippin' Dots, Inc. v. Mosey, 476 F.3d 1337, 1343-44 (Fed. Cir. 2007); Dystar Textilfarben GmbH & Co. Deutschland KG v. C.H. Patrick Co., 464 F.3d 1356, 1361, 1367 (Fed. Cir. 2006).

240. *See, e.g.*, Monsanto Co. v. Scruggs, 459 F.3d 1328 (Fed. Cir. 2006); Monsanto Co. v. McFarling (*McFarling I*), 302 F.3d 1291 (Fed. Cir. 2002).

with static, discrete goods conceptually interchangeable with today's medical device or semiconductor chip but very different from a patented soybean that, once sold, can yield essentially unlimited copies of itself over successive generations.[241] Second, the unusual features of self-replicating technologies shift the equities underlying traditional exhaustion policy. Without any post-sale control over straightforward second-generation production, competition from derivative producers would rapidly render such technologies unprofitable for inventors. Owners of such technologies would face a near-impossible balancing act, needing to set prices high enough to appropriate their entire return in the first few sales but not so high as to exclude their entire market. And if such innovators could no longer afford to innovate, the public would lose out entirely on the benefits of their work.

These unique circumstances warrant a limited exception to the exhaustion doctrine, and the Federal Circuit has taken a two-pronged approach to seed cases. First, it has relied on *Mallinckrodt* to bind purchasers to post-sale restrictions on replanting second-generation seeds.[242] Second, it has reasoned that patentees' original sales should not exhaust their rights over user-derived seeds, which "have never been sold."[243] Therefore, even if *Quanta* undermines *Mallinckrodt* as a foundation for the Federal Circuit's holdings, its "never sold" line of reasoning vitiates exhaustion independently of *Mallinckrodt*.[244] Furthermore, growing crops from the second-generation seeds could arguably also be cast as an unauthorized "making" of the invention[245] or as impermissible reconstruction.[246]

Thus far, the Supreme Court seems satisfied with the Federal Circuit's approach to seed cases. It has repeatedly denied review in the past,[247] and

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241. *See* Monsanto Co. v. McFarling (*McFarling II*), 363 F.3d 1336, 1347 (Fed. Cir. 2004) ("[A] farmer planting one bag of soybeans in year one would reap . . . 46,656 bags to replant in year four.").

242. *McFarling I*, 302 F.3d at 1298.

243. *Id.* at 1299.

244. *See Scruggs*, 459 F.3d at 1336.

245. *Cf.* 35 U.S.C. § 271(a) (2006) (imposing liability on "whoever without authority makes . . . any patented invention"); Amgen, Inc. v. Elanex Pharms., Inc., No. C93-1483D, 1996 U.S. Dist. LEXIS 22015, at *8-9 (W.D. Wash. Feb. 6, 1996) ("According to Amgen, 'make' should be interpreted in its ordinary sense; thus, when Elanex 'grew up' its cells it made more cells, thereby infringing the [patent].").

246. *See* Brief for the American Seed Trade Association as Amicus Curiae in Support of Neither Party at 18, Quanta Computer, Inc. v. LG Elecs., Inc., 128 S.Ct. 2109 (2008) (No. 06-937), 2007 WL 3353100.

247. *E.g.*, *Scruggs*, 459 F.3d 1328 (Fed. Cir. 2006), *cert. denied*, 127 S.Ct. 2062 (2007); *McFarling I*, 302 F.3d 1291 (Fed. Cir. 2002), *cert. denied*, 537 U.S. 1232 (2003).

this pattern seems unlikely to change post-*Quanta*.[248] Moreover, the Solicitor General's Office has supported the Federal Circuit's holdings in the context of self-replicating technologies.[249] In short, Supreme Court review after *Quanta* appears unlikely, and post-sale restrictions on self-replicating patented products appear secure.

F. Contract-Based Enforcement of Restrictions on Patented Goods

Finally, this Note argues that societal interests might be best served by addressing post-sale restraints on patented goods through a contract framework, as the Supreme Court alluded to in *Quanta*.[250] Resorting to contract mechanisms would preserve flexibility in private dealings yet secure important consumer protections and restore the patent system's emphasis on fostering innovation, not maximizing profit.[251]

Typical patent infringement wholly appropriates a patentee's intellectual property "without authority,"[252] providing no compensation for the patentee's efforts. Infringement may occur without notice, at any time, anywhere in the country and immediately begin degrading an inventor's anticipated returns. As such, outside infringement is inherently difficult to control, posing a genuine danger to innovation itself. The consequent societal risks warrant the patent laws' powerful devices—such as strict liability and treble damages—both to deter infringement and reassure prospective inventors.[253] In contrast, policing conditions on legitimate sales takes the patent laws, and their harsh enforcement mechanisms, outside of their appropriate and intended context. First, patentees voluntarily authorize legitimate transactions and know or can presumably learn of each purchaser. Thus, authorized purchasers pose little risk of undetected misappropriation. Second, in the case of an authorized sale, the patentee has, by definition, negotiated and received compensation for the articles sold.

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248. Since *Quanta*, the Supreme Court has denied certiorari in another seed case. Monsanto Co. v. David, 516 F.3d 1009 (Fed. Cir. 2008), *cert. denied*, 129 S.Ct. 309 (2008).

249. Brief for the United States as Amicus Curiae, *McFarling II*, 363 F.3d 1336 (Fed. Cir. 2004), *cert. denied*, 545 U.S. 1139 (2005) (No. 04-31), 2005 WL 1277857.

250. *See Quanta Computer, Inc.*, 128 S.Ct. at 2122 n.7 (2008).

251. *See generally* First, *supra* note 211.

252. 35 U.S.C. § 271(a) (2006).

253. *See* 35 U.S.C. § 284 (2006) (stating that "the court may increase the damages up to three times the amount found or assessed"); *In re* Seagate Tech., L.L.C., 497 F.3d 1360, 1368 (Fed. Cir. 2007) (noting that "patent infringement is a strict liability offense").

Rational patentees, with leverage provided by their exclusive rights, will ordinarily negotiate sales to obtain the maximum reward available—thus satisfying the *Masonite* Test and triggering exhaustion. Some patentees may seek purely financial compensation in return for their intellectual property; others may negotiate a reduced price in exchange for a purchaser's promise of certain post-sale behavior.[254] By accepting such conditions in lieu of additional payment, these patentees plainly acknowledge the value inherent in the purchaser's promise to comply.[255] In short, full compensation—regardless of its elected composition—renders continuing patent rights inappropriate, for it fulfills the inventor's reward, and in so doing, fulfills the goals of the patent system. Patent exhaustion is, therefore, the logical result of conditioned sales.

Of course, only enforceable sales conditions have value. Fundamentally, conditional sales of goods (patented or not) represent *bargains*, the traditional purview of contract law.[256] Both buyer and seller furnish consideration for the agreement—most commonly a promise to use the goods only as specified in return for a proportionally reduced sale price. Once executed, such agreements leave the parties with obligations and expectations related to the sale. The result, in short, is a contract. And under basic contract principles, breach results in liability up to the other party's reasonably expected benefit from full performance. Therefore, where a customer breaches a contractual promise as part of a purchase exhausting the seller's patent rights, contract remedies are well suited to restore the expected reward—and thus preserve the innovation incentives underlying the patent system. In contrast, *Mallinckrodt* and progeny decisions overcompensate patentees by supplementing market-defined rewards with valuable, ongoing patent rights.[257] The added benefits are substantial: automatic entry into the federal courts, potential for duplicative recovery against the buyer *and* all secondary purchasers due to strict liability, the possibility of treble damages for willful violation of the condition, and added negotiat-

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254. *See* B. Braun Med., Inc. v. Abbott Labs., 124 F.3d 1419, 1426 (Fed. Cir. 1997) ("In a [conditional sale], it is more reasonable to infer that the parties negotiated a price that reflects only the value of the 'use' rights conferred by the patentee.").

255. For example, a patentee might reasonably expect a single-use restriction to augment repeat sales and thus offset reductions in price per unit.

256. *See* 1 ARTHUR LINTON CORBIN ET AL., CORBIN ON CONTRACTS § 1.1 (Joseph M. Perillo ed., 2008) ("[T]he law of contracts attempts realization of reasonable expectations that have been induced by the making of a promise.").

257. *See* First, *supra* note 211, at 387-88 ("The only plausible explanation for [*Mallinckrodt* is] the view that the best approach to patent licensing is to allow the patentee to impose whatever restrictions will maximize its returns, without regard to whether those excess returns are necessary to incentivize innovation . . . .").

ing leverage from the plausible threat of infringement liability. Thus, enforcing sales conditions through patent infringement actions can yield patentee windfalls that reach beyond social justifications for patent rights.[258] In contrast, contract law remedies would protect full, negotiated compensation but nothing more.

This is not to say that patentees lack any good reasons for seeking post-sale conditions on patented goods. Sales restrictions give sophisticated parties freedom and flexibility to craft arrangements suited to their specific needs. For example, such conditions may address valid health or safety concerns,[259] facilitate sustainable pricing,[260] or permit price discrimination between distinct market segments.[261] But these same ends may be readily achieved through contract enforcement—with its built-in safeguards concerning notice, acquiescence, privity, and reasonable terms.

Finally, exhaustion applies only to sales of patented goods, not licenses to make, use, or sell them. "Treating sales and licences to manufacture as legally equivalent is contrary to a vast body of case law . . . . Licences create relational interests; sales create property rights. The legal consequences are very different."[262] Of course, courts must have effective mechanisms to make this distinction for it to hold meaning. Patentees must not be allowed to evade exhaustion simply by designating as a license what is functionally a sale,[263] and courts have begun developing standards to distinguish between the two.[264]

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258. This is to say nothing of the attendant societal burden of uncertainty created by restrictions that could run indefinitely with patented products under exhaustion-defeating post-sale agreements. "The inconvenience and annoyance to the public . . . are too obvious to require illustration," Keeler v. Standard Folding-Bed Co., 157 U.S. 659, 667 (1895); *see generally* Chafee, *supra* note 19, at 953, 999-10,005.

259. *See* Mallinckrodt, Inc. v. Medipart, Inc., 976 F.2d 700, 703 (Fed. Cir. 1992).

260. *See* Monsanto Co. v. Scruggs, 249 F. Supp. 2d 746, 753-54 n.4 (N.D. Miss. 2001).

261. *See* Gen. Talking Pictures Corp. v. W. Elec. Co., 304 U.S. 175, 179 (1938), *aff'd on reh'g*, 305 U.S. 124 (1939) ("Amplifiers having these inventions are used in different fields. . . . a number of manufacturers [held] non-exclusive licenses limited to the manufacture and sale of the amplifiers for private use, as distinguished from commercial use.").

262. Stern, *supra* note 238, at 465.

263. *See generally* Winston, *supra* note 192.

264. *See, e.g.*, Vernor v. Autodesk, Inc., 555 F. Supp. 2d 1164 (W.D. Wash. 2008) (holding that copyrighted computer software had been sold, not licensed, because the buyer was not required to return the physical copies).

V. CONCLUSION

In conclusion, *Quanta* broadly reestablished the exhaustion doctrine's application to method claims and clarified its application to incomplete products while reserving direct comment on the permissible scope of post-sale restrictions on purchasers under the patent laws. Nevertheless, the Supreme Court's allusion to alternative contract remedies suggests that existing frameworks for enforcing post-sale restrictions on purchasers, based on *General Talking Pictures* and *Mallinckrodt*, may need to be rethought. These issues remain for further litigation, but *Quanta* should signal patentees to take greater care in licensing and to be wary of relying on patent remedies to reach downstream customers.

THE BOARD BITES BACK: *BILSKI* AND THE B.P.A.I.

By Justin M. Lee

After a period of considerable expansion in subject-matter eligibility,[1] the Federal Circuit announced in *In re Bilski* that a process patent claim can be patentable only if: (1) it is tied to a particular machine or apparatus, or (2) it transforms a particular article into a different state or thing.[2]

The patent at issue claimed processes for hedging risks in commodities trading. Because the applicants conceded that their claims were not limited to any specific machine or apparatus, the opinion focused on the eligibility of Bilski's claim under the transformation prong of the court's test. It held that the required transformation must be of a physical article, or of data that represents a physical article. The court also rejected a slew of past and proposed tests, clarified that subject matter is a requirement of patentability separate from nonobviousness and other statutory sections, and affirmed that field-of-use limitations and extra-solution activity alone will not suffice for section 101.

Although the Federal Circuit specifically rejected categorical exclusions on domains of inventions (like software or business methods), the Board of Patent Appeals and Interferences (Board) has issued several opinions since *Bilski* severely curtailing the subject-matter eligibility of software patents. The Board has clearly rejected the "new machine" theory of *In re Alappat* and is split on whether it will allow software-on-media

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1. *See In re* Beauregard, 53 F.3d 1583 (Fed. Cir. 1995) (mooting a case because the PTO Commissioner agreed to withdraw objection to a software method claim when claimed on physical media); *In re* Alappat, 33 F.3d 1526, 1544 (Fed. Cir. 1994) (en banc) (allowing software methods when claimed on a general purpose computer); State Street Bank & Trust Co. v. Signature Fin. Group, Inc., 149 F.3d 1368, 1373 (Fed. Cir. 1998) (allowing patents on business methods); AT&T v. Excel Comm'ns, 172 F.3d 1352 (Fed. Cir. 1999) (holding the scope of subject matter eligibility to be the same regardless of the form of the claim); ROBERT P. MERGES & JOHN F. DUFFY, PATENT LAW AND POLICY: CASES AND MATERIALS 154 (4th ed. 2007) (describing the "floodgates" of software patents starting in the mid-1990s).

2. *In re* Bilski, 545 F.3d 943 (Fed. Cir. 2008).

claims of *In re Beauregard*.[3] These opinions have yet to make their way to the Federal Circuit, but they will inevitably force the court to decide how software patents should be treated.

This Note traces the early stages of this revival of Section 101 limitations on the patentability of computer software. Part I traces the background of the *Bilski* case. Part II examines its reasoning. Part III shows how the Board is applying *Bilski* to reject a large class of software patents and how some district courts have already rejected some business method patents. This Note concludes in Part IV by suggesting that the real bite in the new subject-matter rules are more categorical than they appear. It also suggests that the Federal Circuit should not adopt rules on software patents that encourage cumbersome formalities or that disallow protection for software inventions that may well be as innovative as technology in other fields.

I. BACKGROUND OF THE CASE

Bilski's application claimed a method of hedging risks in commodities trading. The broadest claim was a "method for managing the consumption risk costs of a commodity."[4] The steps included techniques for "identifying market participants" and "initiating transactions" using "historical averages" of the market and the "risk position" of the market participants.[5] Neither that claim nor any dependent claim had any reference to a computer or other machine. Indeed the claims specified no mechanism at all for performing the steps.

The examiner rejected the claims on section 101 grounds, stating that they were "not implemented on a specific apparatus," that they "merely manipulate[] [an] abstract idea," and that they were "not directed to the technological arts."[6] On administrative appeal, the Board rejected this "technological arts" test out of hand as unsupported by the case law.[7] It also rejected the idea that a specific apparatus was necessarily required for subject-matter eligibility, noting that chemical methods do not need to be tied to any specific apparatus.[8] But it affirmed the examiner because the claims were too abstract—the claims "preempt any and every possible

3. *In re* Alappat, 33 F.3d 1526, 1544 (Fed. Cir. 1994) (en banc); *In re* Beauregard, 53 F.3d 1583 (Fed. Cir. 1995); *see infra* Section III.A (discussing brief history of software claims).

4. *Bilski*, 545 F.3d at 949.

5. *Id.*

6. *Id.* at 950.

7. *Id.*

8. *Id.*

way of performing the steps of the claimed process, by human or by any kind of machine or by any combination thereof."[9] Finally the Board held that the claims did not pass the useful-concrete-and-tangible test of *State Street*.[10]

Bilski appealed to the Federal Circuit, and after arguments to a panel, the court sua sponte ordered a hearing en banc.[11] The Federal Circuit ordered briefing on five questions about subject-matter eligibility. These questions included whether *State Street* and *AT&T* should be reconsidered and what standard of subject-matter eligibility should be used. One of the questions pointedly asked "[w]hether a method or process must result in a physical transformation of an article or be tied to a machine . . . to be [patentable]?"[12] The Federal Circuit answered this question in the affirmative by settling on the machine-or-transformation test.

II. THE FEDERAL CIRCUIT OPINION

Federal Circuit affirmed en banc the Board's rejection of Bilski's patent application on section 101 subject-matter grounds. Nine members joined the majority, and two of the three dissenters dissented from the opinion but agreed with the judgment. Only one dissenter, Judge Newman, would have held the claims allowable under section 101.

A. The Machine-or-Transformation Test and Its Corollaries

Under 35 U.S.C. § 101, there are four patentable subject-matter areas: processes, machines, manufactures, and compositions of matter. At issue in *Bilski* was how to define the limits of the "process" category.[13] The court has long held that laws of nature, natural phenomena, and abstract ideas are not patent-eligible subject matter.[14] Dubbing these three subject-matter exceptions "fundamental principles," the Federal Circuit sought to determine what test should be used to distinguish between these fundamental principles and patent-eligible subject matter.[15]

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9. *Id.* (citations omitted) (internal quotations omitted).

10. State St. Bank & Trust Co. v. Signature Fin. Group, 149 F.3d 1368 (Fed. Cir. 1998).

11. *In re* Bilski, 264 Fed. Appx. 896 (Fed. Cir. 2008).

12. *Id.* at 897.

13. *Bilski*, 545 F.3d at 951. The Federal Circuit recently discussed the "manufacture" category in *In re Nuijten*, 500 F.3d 1346 (Fed. Cir. 2007).

14. *Bilski*, 545 F.3d at 952 (citing Diamond v. Diehr, 450 U.S. 175 (1981); Parker v. Flook, 437 U.S. 584 (1978); Gottschalk v. Benson, 409 U.S. 63 (1972)).

15. *Bilski*, 545 F.3d at 952.

The mere presence of a fundamental principle does not make a claim ineligible since patented technology often applies the laws of science and mathematics. Therefore the court held, citing the Supreme Court in *Diamond v. Diehr*, that the principal question of whether something is a fundamental principle is whether the claim completely *preempts* all uses of the principle or whether it is merely one *application* of that principle.[16] *Diehr* itself was a good example. In that case, the patent claimed a process for curing rubber. One of the steps in the process used the Arrhenius equation to calculate the time needed to cure the rubber. Because only one application of the Arrhenius equation was claimed, it did not preempt all uses of it.[17] Others were free to use the equation for any purpose as long as they did not use it with all the other steps described in the claim. The application of the equation within a broader process yielded eligible subject matter.

The Federal Circuit contrasts *Diehr* with *Gottschalk v. Benson*, where the Supreme Court held the use of a software algorithm on a computer was subject-matter ineligible.[18] There, the Court held that because the algorithm had no practical application other than on a computer, the patent claim preempted all uses of the algorithm.[19] Thus, the patent claim was in effect a claim on the fundamental principle itself.

To determine whether use of a fundamental principle is an application or a preemption, courts must use the machine-or-transformation test: "A claimed process is surely patent-eligible under § 101 if: (1) it is tied to a particular machine or apparatus, or (2) it transforms a particular article into a different state or thing."[20] The Federal Circuit extracted this test from four Supreme Court opinions.[21]

The test is exclusive. In *Benson*, the Supreme Court stated, "Transformation and reduction of an article 'to a different state or thing' is the clue to the patentability of a process claim that does not include particular machines."[22] Because the Court described this as "the clue" rather than "a

16. *Id.* at 953 (citing Diamond v. Diehr, 450 U.S. 175 (1981)).
17. Diamond v. Diehr, 450 U.S. 175, 187 (1981)
18. Gottshalk v. Benson, 409 U.S. 63 (1972).
19. *Id.* at 71-72.
20. *Bilski*, 545 F.3d at 954.
21. Diamond v. Diehr, 450 U.S. 175, 192 (1981); Parker v. Flook, 437 U.S. 584, 589 n.9 (1978); Gottshalk v. Benson, 409 U.S. 63, 70 (1972); Cochrane v. Deener, 94 U.S. 780 (1876).
22. Gottshalk v. Benson, 409 U.S. 63, 70 (1972) (quoting Cochrane v. Deener, 94 U.S. 780, 780 (1876)).

clue," the Federal Circuit read an imperative to make the machine-or-transformation test the *exclusive* test for subject-matter eligibility.[23]

The Federal Circuit, however, does hedge this position. The Supreme Court itself was initially equivocal when it stated the machine-or-transformation test in *Benson*.[24] And the Federal Circuit spent some space of its opinion to acknowledge what is surely always true: either that the Supreme Court might alter the test, or that the Federal Circuit may "in the future refine or augment the test or how it is applied."[25] Given the general universality of these facts, the court may not be finished opining on the test for eligible subject matter.

The Federal Circuit articulated two corollaries to the machine-or-transformation test from *Diehr*. First, "field-of-use limitations" are "generally" insufficient to satisfy subject-matter eligibility.[26] The concern here appears to be that simply limiting a claim on a fundamental principle to a particular "technological environment" does not do enough to address the fact that the claim may only cover an abstract principle or that it is a preemption rather than a specific application.[27]

Second, adding insignificant post-solution activity to a fundamental principle will not satisfy the subject-matter requirement.[28] In formulating this rule, the Supreme Court had in mind claims that would preempt abstract formulas by adding a nominal post-solution concrete step. For example, one could not avoid preemption by simply noting in the claim that the Pythagorean theorem could be used in surveying techniques.[29] The Federal Circuit has since expanded the rule to include any insignificant extra-solution activity, regardless of when performed.[30] The court also added that a data-gathering step, even if a physical step, will not by itself be enough to make a claim subject-matter eligible.[31]

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23. *Bilski*, 545 F.3d at 956 n.11.

24. After establishing the machine-or-transformation test, the *Benson* Court stated, "We do not hold that no process patent could ever qualify if it did not meet the [machine-or-transformation test]." Gottshalk v. Benson, 409 U.S. 63, 71 (1972). By *Diehr*, however, the Court seemed to have accepted this as *the* appropriate test. *Bilski*, 545 F.3d at 956.

25. *Bilski*, 545 F.3d at 956.

26. *Id.* at 957.

27. *Id.*

28. *Id.* (citing Diamond v. Diehr, 450 U.S. 175, 191-92 (1981)).

29. *Id.* (citing Parker v. Flook, 437 U.S. 584, 590 (1978)).

30. *Id.* (citing *In re* Schrader, 22 F.3d 290, 294 (Fed. Cir. 1994); *In re* Grams, 888 F.2d 835, 839-40 (Fed. Cir. 1989)).

31. *Id.* at 963 (Fed. Cir. 2008); *In re* Grams, 888 F.2d 835, 840 (Fed. Cir. 1989).

B. Overruled and Rejected Tests

The Federal Circuit considered and specifically rejected a number of tests.[32] The court also settled a couple of collateral issues and potential confusions about its earlier precedents.

The *State Street* useful-concrete-and-tangible-result test is no longer valid.[33] The Federal Circuit noted that while a claim that satisfies the machine-or-transformation test "will generally produce a 'concrete' and 'tangible' result" and may provide "useful indications" of whether the claim is subject-matter eligible, it is nonetheless "insufficient."[34] Though the precise deficiency of the test is not spelled out, the opinion seems to regard the test as both over-inclusive and under-inclusive.

The *Freeman-Walter-Abele* test for subject-matter eligibility is also no longer valid.[35] That test first examined whether a claim recites an algorithm, then determined whether that algorithm was "applied in any manner to physical elements or process steps."[36] The Federal Circuit criticized this test because it appeared to dissect the claim into elements in a way foreclosed by *Flook* and because it appeared to conflict with other precedent.[37]

The Federal Circuit also summarily rejected several amici's calls to adopt the "technological arts" test.[38] "[T]he meanings of the terms 'technological arts' and 'technology' are both ambiguous and ever-changing."[39] As an example, the court cited two conflicting amicus briefs that applied the test yet came to opposite conclusions. One brief considered business methods to be technological due to their kinship to economics, while the other would limit patents to applications of science and mathematics.[40] The Federal Circuit apparently saw this as evidence that this test is more easily linguistically manipulated than the machine-or-transformation test.

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32. Since *Bilski*, the Federal Circuit has also rejected a test that would ask whether the claim "has more than a scintilla of interaction with the real world in a specific way." *In re* Ferguson, No. 2007-1232, 2009 WL 565074, at *4 (Fed. Cir. Mar. 6, 2009).

33. *Bilski*, 545 F.3d at 958; *see* State Street Bank & Trust Co. v. Signature Fin. Group, Inc., 149 F.3d 1368, 1373 (Fed. Cir. 1998); *In re* Alappat, 33 F.3d 1526, 1544 (Fed. Cir. 1994) (en banc).

34. *Bilski*, 545 F.3d at 959.

35. *Id.* at 958; *see In re* Freeman, 573 F.2d 1237 (C.C.P.A. 1978); *In re* Walter, 618 F.2d 758 (C.C.P.A. 1980); *In re* Abele, 684 F.2d 902 (C.C.P.A. 1982).

36. *In re* Abele, 684 F.2d 902, 905-07 (C.C.P.A. 1982).

37. *Bilski*, 545 F.3d at 958 (citing *In re* Grams, 888 F.2d 835, 838-39 (Fed. Cir. 1989)).

38. *Id.* at 960.

39. *Id.*

40. *Id.* at 960 n.21.

The Federal Circuit also denied having created a new test in *Comiskey*.[41] After *Comiskey*, some argued that the Federal Circuit had created a new test that barred any claim reciting a mental process that lacked significant "physical steps."[42] Citing language from that opinion, the Federal Circuit clarified that *Comiskey* should be understood as an application of the machine-or-transformation test of *Bilski*.[43] In particular, *Comiskey*'s statement that a claim is subject-matter eligible when "it is embodied in, operates on, transforms, or otherwise involves another class of statutory subject matter"[44] is no different than the standard announced in *Bilski*.[45]

The court also settled a couple of collateral issues. First, *Bilski* states clearly that neither novelty nor nonobviousness have anything to do with subject matter.[46] Although section 101 refers to "new and useful" subject matter, the legislative history shows that this was not intended as a distinct novelty or nonobviousness requirement from that laid out in sections 102 and 103.[47] Second, the court reemphasized that the claim should be examined as a whole—one element examined alone cannot cause a claim to be ineligible under section 101.[48] For example, the fact that one claim element in *Diehr* solely dealt with an abstract equation did not render the entire claim subject-matter ineligible.

III. EXAMINING THE MACHINE-OR-TRANSFORMATION TEST

A. Background on Software Patents

Most of the post-*Bilski* Board decisions that address subject-matter eligibility are on software claims. This Section lays out a brief background on the legalities of software patents.

Patents on software can be claimed in several different ways. They are typically claimed either as process claims or manufacture claims. Among manufacture claims, claims can be drafted as software as embodied on a medium (called *Beauregard* claims) or as general purpose computer loaded with software. Each type of claim has a different legal pedigree.

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41. *In re* Comiskey, 499 F.3d 1365 (Fed. Cir. 2007).
42. *Bilski*, 545 F.3d at 960.
43. *Id.* at 960-61.
44. *Comiskey*, 499 F.3d at 1376.
45. *Bilski*, 545 F.3d at 961 n.24.
46. *Id.* at 958.
47. *Id.*
48. *Id.* (citing *In re* Alappat, 33 F.3d 1526, 1543-44 (Fed. Cir. 1994) (en banc)).

Since 1995, one technique for software has been to claim the software embodied on a software readable medium—an example originally would have been a floppy disk. This type of claim is considered a manufacture. It is called a *Beauregard* claim, after the case *In re Beauregard*.

One important aspect of *Beauregard* is that the Federal Circuit did not in fact hold these types of claims to be valid. The opinion actually dismissed the case as lacking a case or controversy after the PTO Commissioner withdrew his objection to the claims, stating to the Federal Circuit, "[C]omputer programs embodied in a tangible medium, such as floppy diskettes, are patentable subject matter under 35 U.S.C. § 101. . . ."[49] This statement was later adopted by the PTO in a formal written policy[50] and added to the Manual of Patent Examining Procedure.[51] Another important aspect is that *Beauregard* claims are considered manufactures, not processes.[52] This has significance because *Bilski* purports to ascertain the appropriate test for evaluating process claims.

The "new machine" theory has in the past provided another justification to avoid the abstraction problem in software. The drafter claims an apparatus that is programmed to perform a series of steps, adding a limitation explaining that the steps of the method operate "on a processor" or some other similar physical limitation. This can be done, for example, in the preamble, as a single extra claim element, or as a clause added in each claim element. *In re Alappat* justified these types of manufacture claims, even on general purpose computers, by considering software on a processor to be a new kind of machine.[53]

Under this precedent, the software steps of a given invention could potentially be drafted under *Beauregard* as embodied on a medium or drafted under *Alappat* as a general purpose computer programmed to perform those same steps. A few years later, in *State Street*, the Federal Circuit made it clear that applicants could simply claim those software steps as a process.[54] First, it held that manufacture claims and method claims should both be analyzed in the same way for subject-matter eligibility.[55]

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49. *In re* Beauregard, 53 F.3d 1583 (Fed. Cir. 1995).

50. Patent and Trademark Office, *Examination Guidelines for Computer-Related Inventions*, 61 F.R. 7478 (1996).

51. U.S. PATENT AND TRADEMARK OFFICE, MANUAL OF PATENT EXAMINING PROCEDURE § 2106.01 (8th ed. 2008).

52. *See, e.g.*, *Ex parte* Mazzara, 2008-4741 slip op. at 20 (B.P.A.I. Feb. 5, 2009).

53. *In re* Alappat, 33 F.3d 1526, 1545 (Fed. Cir. 1994).

54. Of course, there may well have been practical reasons to draft the manufacture claims, such as the ability to sue on direct infringement theories.

55. State Street Bank & Trust Co. v. Signature Fin. Group, Inc., 149 F.3d 1368, 1375 (Fed. Cir. 1998).

Second, *State Street* held that algorithms could be subject-matter eligible as long as they were not mathematical algorithms.[56] After these holdings, a major patent drafting treatise wrote, "[a physical] element might be unnecessary in view of *State Street Bank*, so long as the process steps together are transformative."[57] In other words, it appeared that software could be claimed as a series of steps without any clear reference in the claim that the steps be performed on a processor or some other piece of hardware.

It is helpful to remember that the machine prong of the *Bilski* test is not connected to the legal theories underlying the two manufacture theories discussed here. Nor is the transformation prong limited to process claims. A process claim can be found subject-matter eligible by meeting the machine prong *or* the transformation prong, as can a manufacture claim. Though Bilski conceded that his process did not meet the machine prong, the cases from the Board, discussed *infra*, show that the Board considers both prongs of the test regardless of the form of the claim.

Since *Bilski*, the PTO has issued a memorandum informing examiners that they should use the machine-or-transformation test until the MPEP can be revised.[58] The memorandum instructs examiners to look for field-of-use limitations and insignificant extra-solution activity. In particular, it states that "reciting a specific machine or a particular transformation of a specific article in an insignificant step, such as data gathering or outputting, is not sufficient to pass the test."[59]

Under *Bilski*, software and business methods are not *categorically* excluded. The Federal Circuit specifically rejected calls for any categorical exclusions except "the exclusion of claims drawn to fundamental principles set forth by the Supreme Court."[60] All process claims are subject to the same machine-or-transformation test.

B. The Transformation Prong

1. The Doctrine

The basic test of transformation is whether the process "transforms an article into a different state or thing."[61] As the discussion of field-of-use

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56. *Id.*

57. ROBERT C. FARBER, LANDIS ON MECHANICS OF PATENT CLAIM DRAFTING 4-21 (Release 5 2007).

58. Memorandum from John J. Love, Deputy Commissioner for Patent Examination Policy to Technology Center Directors (January 7, 2009), www.uspto.gov/web/offices/pac/dapp/opla/documents/bilski_guidance_memo.pdf.

59. *Id.*

60. *In re* Bilski, 545 F.3d 943, 960 n.23 (Fed. Cir. 2008).

61. *Id.* at 954.

limitations and extra-solution activity demonstrates, the transformation cannot be nominal or insubstantial.[62] "[T]ransformation must be central to the purpose of the claimed process."[63]

The test is not strictly a "physical steps" test.[64] Even if a claim cites physical steps it might not be patentable, particularly if every step can be carried out in the human mind.[65] Thus, according to the Federal Circuit, it is "simply inapposite" to ask if performance on a computer is sufficiently physical.[66] In the case of Bilski's hedging process, Bilski argued that the hedging process could only be accomplished by a series of physical steps—someone had to execute the trades. For the court, this argument demonstrated the difference between a pure physical-steps test and the machine-or-transformation test—although the hedging process required physically buying and selling the commodities options, the articles being transformed were neither physical nor did they represent physical articles. Therefore, even though the steps were physical, there was no transformation that could make the claim subject-matter eligible.

The term "article" clearly applies to physical objects or substances. But it also applies—in some circumstances—to intangible things that represent or have some other connection to a physical article.[67] The Federal Circuit, reexamining *Abele*, expanded on the kind of intangibles that can qualify. That case concerned two claims, only one of which was held subject-matter eligible. The ineligible claim was for "a process of graphically displaying variances of data from average values."[68] This claim was insufficient because it failed to: (1) specify the type of data, (2) specify the nature of the data, (3) specify where the data was obtained, or (4) specify what the data represented. The eligible claim specified that the data was produced by a CAT scan. Because this data "represented physical and tangible objects" and the data was transformed into a visual display, that claim qualified for subject-matter eligibility. The court further clarified that the underlying physical objects need not be transformed—only the data representing them.

Bilski's claim concerned manipulations of commodities trades. "Purported transformations or manipulations simply of public or private legal

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62. *See supra* Section II.B.
63. *Bilski*, 545 F.3d at 962.
64. *Id.* at 960.
65. *Id.* at 960 n.26.
66. *Id.* at 960 n.25. The court also suggests that a subject-matter eligible claim could be "tied" to a machine without citing physical steps. *Id.*
67. *Id.* at 962.
68. *Id.*

obligations or relationships, business risks, or other such abstractions cannot meet the test because they are not physical objects or substances, and they are not representative of physical objects or substances."[69] This spelled the end of Bilski's patent application, and it would seem to foreclose many business method patents and patent applications. Interestingly, the court distinguishes between options for commodities and the commodities themselves. Arguably, an option for a commodity *represents* the commodity in some way, but the court drew the line here: it characterized options as being "simply legal rights."[70]

Thus, an important qualification to the transformation test is that a claim may be patentable if it manipulates an intangible, but only if that intangible *represents* something physical. It is left to future decisions to further explain what "representing" means.

2. *The Board Rejects Software Patents Under the Transformation Prong*

In several post-*Bilski* decisions, the Board has denied patent protection to several kinds of software claims under the transformation prong. This Section deals with method claims that may or may not make some reference to a computer. Under these decisions, it appears not to matter how specifically or clearly a method claim makes reference to a general purpose computer: the Board is rejecting them all.

Even claims that make specific reference to special-purpose parts of a processor (like a floating point unit) do not suffice. In *Ex parte Cornea-Hasegan*, the Board affirmed an examiner's rejection of a patent on subject-matter grounds.[71] The patent claimed a method for manipulating floating point numbers in software.[72] The examiner rejected the claims as not producing a "real-world result."[73]

Citing *Bilski*, the Board noted that "incidental transformations or extrasolution activity" do not suffice to make a method claim subject-matter eligible.[74] The Board reiterated *Bilski*'s admonition that the key to subject-matter eligibility for patent claims that involve a fundamental principle is to determine if the claim preempts the principle or is merely an application of that principle.[75]

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69. *Id*. at 963.
70. *Id*.
71. *Ex parte* Cornea-Hasegan, 89 U.S.P.Q.2d 1557 (2009).
72. *Id*. at 1558.
73. *Id*.
74. *Id*. at 1559.
75. *Id*.

Claim 1 was a method claim. Each and every claim element included "by the processor," emphasizing that each step was to be performed on a computer.[76] Under the transformation prong, the floating point numbers being manipulated did not qualify as physical objects, nor did they represent physical objects. "Rather, the data represent[ed] information about an abstract floating-point number, which is intangible."[77] Use of a generic processor did not qualify the claim under the transformation prong either. "The recitation of a processor in combination with purely functional recitations of method steps, where the functions are implemented using an unspecified algorithm, is insufficient" for subject-matter eligibility under the transformation prong.[78] The Board considered this a field-of-use limitation of the type rejected by *Bilski* and *Diehr*.[79]

Bilski allows patents on method claims that transform data where the data "represents" a physical article, but the Board has not been generous in interpreting this concept. In *Ex parte Gutta*, the Board sua sponte rejected software patent claims for a "computerized method performed by a data processor" that manipulated user history and made recommendations based on that history.[80]

The Board rejected the claims on the transformation prong "because the data [did] not represent physical or tangible objects."[81] According to the Board, the claim manipulated data that represented user history, not anything physical. Arguably, there is at least some connection to a physical act—the user presumably took a physical action to select the items and generate the history. That data, "representing" past physical action, is in fact manipulated by the claimed process, though of course nothing physical is transformed as an "output" of the process.

The Board was similarly unwilling to stretch the representation theory in *Ex parte Atkin*. There, the Board sua sponte rejected claims covering a method to "convert between logical and display order of domain names."[82] These claims appear to be directed at the problems presented by displaying internet domain names in languages that display right-to-left.[83]

The Board rejected the method claim under the transformation prong. Though the Board admitted that a "domain . . . represent[s] the address of

76. *Id.* at 1558-59.
77. *Id.* at 1560.
78. *Id.* at 1560-61.
79. *See In re* Bilski, 545 F.3d 943, 962 (Fed. Cir. 2008).
80. *Ex parte* Gutta, 2008-3000, slip op. at 5-6 (B.P.A.I. Jan. 15, 2009).
81. *Id.*
82. *Ex parte* Atkin, 2008-4352 slip op. at 11 (B.P.A.I. Jan. 30, 2009).
83. *See id.* at 5.

a resource, such as a server" it did not find this to be a physical article. The opinion did not address the fact that a domain name arguably represents a physical device (a server).

The Board similarly rejected the system claim. Though *Bilski* purported to address the test for processes,[84] here the Board held that for purposes of section 101 the nominal addition of the word "system" in the preamble made no difference, because the claim read on methods as well as systems.[85]

In *Ex parte Zybura*, the Board wrote one of the clearest statements of its understanding of the transformation test.[86] The Board stated that the transformation of an article into a different state or thing must be "central to the purpose of the claimed process."[87] The transformation is of an "article" if it is a "chemical or physical transformation of physical objects or substances."[88] But "transformation of data is sufficient to render a process patent-eligible if the data represents physical and tangible objects, i.e., transformation of such raw data into a particular visual depiction of a physical object on a display."[89] On the other hand, data transformation does not suffice if the claim does not "specify any particular type or nature of data and does not specify how or where the data was obtained or what the data represented."[90]

The claims in *Zybura* addressed "namespaces" in software—technology for dealing with difficulties in software systems where many entities might have conflicting names. One claim was a "method" for accomplishing the task, and the other was written as a "technique."[91] The Board first held the technique to be a method and then held both claims to be subject-matter ineligible. Though the Board acknowledged that both claims transformed the "namespace," it held that "the entity being transformed is not a physical object," and therefore the claims failed under the transformation prong.[92]

In *Ex parte Scholl*, the Board rejected a "computer-based method for production" because the claimed method did not actually transform any-

84. *See, e.g.*, *In re* Bilski, 545 F.3d 943, 951 n.2 (Fed. Cir. 2008) (declining to address *Nuijten* because it was a manufacture, not a process).

85. *Ex parte* Atkin, 2008-4352 slip op. at 18 (B.P.A.I. Jan. 30, 2009).

86. And it is repeated verbatim in *Ex parte Nawathe*, 2007-3360 slip op. at 7 (B.P.A.I. Feb. 9, 2009).

87. *Ex parte* Zybura, 2008-2195 slip op. at 6 (B.P.A.I. Feb. 3, 2009).

88. *Id.* at 6-7.

89. *Id.*

90. *Id.* at 7.

91. *Id.* at 3.

92. *Id.* at 7.

thing.[93] Most of the Board's recent opinions concede that there is an entity being transformed but disagree that the article is physical or represents something physical. In this case, however, the Board focused on what it means to transform something, regardless of its physicality. Scholl's claimed steps included "receiving a hierarchical process flow description" and "associating a first item description" with a "first process element." The *Scholl* Board held that these elements did not transform an article into a different state or thing.[94] Evidently the Board did not consider "association" enough to qualify for transformation. The article itself must change in some way other than merely being associated with another article.

In *Ex parte Nawathe*, the Board rejected claims for a "computerized method" that read several XML computer files, formed an internal representation of those files, and reduced redundancy among them.[95] Though the Board rejected the claims under the transformation prong, it did acknowledge that the XML data was being transformed. The Board stated, somewhat confusingly, "[W]e find that the documents are not an article (i.e. physical entities). Rather they are mere data that represent such entities."[96] If "such entities" refers to "physical entities" then the documents here would appear to satisfy the transformation prong. Presumably, the Board meant that though the XML files represent *documents*, documents are not considered physical articles. If this is the case, then *Nawathe* may stand for the presumably practical proposition that software claims are not subject-matter eligible for merely operating on computer files.

The Board did accept one of Nawathe's claims, however.[97] Below is a comparison of the rejected claim and the accepted claim:

> A computerized method comprising: [*rejected by the board*]
>
> > inputting multiple extensible Markup Language (XML) documents;
> > creating a data representation of said multiple XML documents; and
> > reducing redundancy across said multiple XML documents via a fixed set of tables.
>
> An apparatus comprising: [*accepted by the board*]

93. *Ex parte* Scholl, 2008-2308 slip op. at 2 (B.P.A.I. Feb. 4, 2009).
94. *Id.* at 13.
95. *Ex parte* Nawathe, 2007-3360 slip op. at 2-3 (B.P.A.I. Feb. 9, 2009).
96. *Id.* at 8.
97. Claim 25.

> means for creating a graph based data structure representing multiple standard XML tree structures;
> means for transforming said graph based data structure to a fixed set of tables; and
> means for using said fixed set of tables.

The Board was swayed by Nawathe's argument that the different means-plus-function limitations in the apparatus claim "correspond to the different modules in the computer for performing the recited functions." Therefore, according to the Board, "the claim recites a different physical apparatus with physical modules for transforming a data structure into a fixed set of tables." The Board was not interested in a "new machine" theory of software; it seems to have been solely interested in the idea that different parts of the software were to execute in different parts of hardware.

Unfortunately, it is difficult to further understand the Board's reasoning. A close examination of the briefing cited in the opinion reveals little to support the Board's conclusion. The various parts of the specification used to support this characterization actually emphasize that these claims "may be implemented using computer software" and executed on a "variety of hardware platforms."[98] As shown above, there is little difference in the claim language itself, except that the allowed claim is an "apparatus" claim and it is in means-plus-function form.

The Board will also not grant patents when the physical steps appear incidental to the beginning or ending of the process. In *Ex parte Barnes*, the Board sua sponte rejected claims on a method for identifying geological faults using seismic data.[99] The claims were remarkably simple, comprising a generic data gathering step followed by mathematical analysis. The Board rejected the claims on subject matter grounds because they "call for the gathering, analyzing and displaying of data without any details as to how the data is gathered, analyzed or displayed."[100] Addressing the display of the data, the Board held this to be insignificant postsolution activity, and therefore insufficient. Thus, this case shows that data gathering and data display will not necessarily make a patent claim subject-matter eligible.

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98. U.S. Patent Application No. 10/112,147 col.25 l.3-5; Appellant's Appeal Brief Under 37 C.F.R. § 41.37 at 33, *Ex parte* Nawathe, 2007-3360 slip op. at 2-3 (B.P.A.I. Feb. 9 2009) (citing U.S. Patent Application No. 10/112,147 figs. 2, 5, 6, 7, 8, 15, 16, 17, col.16 l.13-17, col.13, col.20 l.3-23, col.21 l.1-8, col.24 l.3-13, col.25 l.8-12).

99. *Ex parte* Barnes, 2007-4114, slip op. at 11-13 (B.P.A.I. Jan. 22, 2009).

100. *Id.* 12.

This opinion also picks up on part of the *Bilski* opinion that takes pains to emphasize that the machine-or-transformation test is not a physicality test. The data gathering and display do involve physical actions, but the article being transformed (the seismic data) is not itself physical, and therefore—according to the Board—the article is not transformed into a different state or thing. Similarly in *Bilski*, the commodities trades had to be performed physically, but the thing being transformed was an intangible legal right, not a physical article. The Board opinion does not address whether the seismic data could be held to be representative of a physical article. In fact, a plausible analogy could be made to the rubber-curing process in *Diehr*, though here the Earth's crust that the seismic data represents is not physically changed as an output of the process, unlike the rubber in the *Diehr* process. This opinion may provide a more interesting case to test the boundaries of the "representation" theory of transformation.

C. Machine Prong Examined

Bilski left open the question: "Are the 'specific' machines of *Benson* required, or can a general purpose computer qualify?"[101] After oral arguments in *Bilski* but before the decision was published, the Board had begun to say to say no, general purpose computers alone cannot qualify.[102] Since *Bilski* was published, the Board has generally—but not consistently—hewed to this position.

1. Software Method Claims

As discussed above, some software claims drafted as methods make some reference to a computer or a processor. In the most generic form, this manifests as a reference to a general purpose processor in the preamble of the claim. Other drafting forms might specify that each step in the method is limited to execution on a processor. Even more specific claims might specify on what part of the processor or what kind of processor a given step is to be performed.

For example, in *Cornea-Hasegan*, the Board rejected one of these types of software claims under the machine prong of *Bilski*. The claimed process predicted the results of a floating point operation in software so that it could avoid using floating point hardware when possible.[103] As dis-

101. *In re* Bilski, 545 F.3d 943, 1015 (Fed. Cir. 2008) (Rader, J., dissenting).

102. *See Ex parte* Wasynczuk, 2008-1496, slip op. (B.P.A.I. June 2, 2008); *Ex parte* Langemyr, 2008-1495, slip op. (B.P.A.I. May 28, 2008); *see also* John F. Duffy, *The Death of Google's Patents?*, PatentlyO.com (2008).

103. *Ex parte* Cornea-Hasegan, 89 U.S.P.Q.2d 1557, 1558 (B.P.A.I. Jan. 13, 2009).

cussed earlier, each and every claim element either included "by the processor" or "using floating-point hardware," emphasizing that the claim only read on steps performed on a computer.[104] Citing *Comiskey*, the Board noted that mere use of a computer for data collection is not enough for the "machine" prong of the *Bilski* test.[105] The Board also noted that "[n]ominal recitations of structure in a method claim" do not suffice to make a method claim subject-matter eligible.[106] This is a very broad view of "nominal" recitations, given that different steps ran on different types of specific hardware. Indeed, depending on the outcome of the claimed process, floating point hardware would or would not be used to perform a calculation—an arguably physical effect. Nonetheless, the Board held that the "recitation of a 'processor' performing various functions fails to impose any meaningful limits on the claim's scope."[107] The Board went on to explain that this would mean the inclusion of "nothing more than a general purpose computer" and that to allow the claim would "exalt form over substance and would allow pre-emption of the fundamental principle present in the non-machine implemented method by the addition of the mere recitation of a 'processor.'"[108]

In *Gutta*, the Board also explored the machine prong when it rejected several software patent claims.[109] The claim was for a "computerized method performed by a data processor" that manipulated user history and made recommendations based on that history. The Board repeated that a recitation of a general-purpose processor is a field-of-use restriction and therefore insufficient to qualify for subject-matter eligibility under the machine prong.[110]

The claims in *Gutta* also displayed the results of the calculation to the user. This did not, however, qualify for the machine prong either because "the step of 'displaying' need not be performed by any particular structure. It may be accomplished simply by writing the resulting score on a piece of paper."[111] Characterizing this as insignificant post-solution activity, the Board held that displaying a result does not satisfy the machine prong.

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104. *Id.* 1558-59.
105. *Id.* 1559.
106. *Id.*
107. *Id.* 1560-61.
108. *Id.*
109. *Ex parte* Gutta, 2008-3000, slip op. at 5-6 (B.P.A.I. Jan. 15, 2009).
110. *See also Ex parte* Becker, 2008-2064, slip op. at 10-11 (B.P.A.I. Jan. 26, 2009) (rejecting pure software claims because they do "not require a particular machine or apparatus").
111. *Gutta*, 2008-3000 at 5-6.

In *Scholl*, the Board rejected a "computer-based method for production" under the machine prong for similar reasons.[112] The patent generally dealt with using a computer to incorporate safety information into manufacturing techniques.[113] But aside from the "computer-based" language in the preamble, there were no other references to a machine or apparatus in the claim language. The Board held that the broadest reasonable construction[114] of the claim does not "require [a] computer or machine implementation," nor was the claim "directed to a machine, manufacture, or composition of matter."[115] The Board therefore held that the claim did not meet the machine prong.[116]

One general theme throughout these cases is that the Board simply is not granting patents on software method claims that run on general purpose computers, no matter how the software method is claimed. It is irrelevant if the claim limitation is in the preamble or in the claim elements—it does not even matter if different parts of the processor are specified for different steps. Another theme is that the Board is inclined to interpret claims to read on performance of the method in the absence of a computer. This is so even when the claims explicitly include a computer or when they specify steps that seem intended to run on a computer, such as displaying data on an output device.

2. *Beauregard Claims*

The Board appears split on whether *Beauregard* claims survive *Bilski*. One line of cases expressly recognizes the PTO's traditional recognition of these claims and grants claims written in this form even while denying claims written in method form. The other line combines *State Street*'s admonition to treat manufacturing and method claims the same with the test from *Bilski*. This line of cases denies all software claims, regardless of form.

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112. *Ex parte* Scholl, 2008-2308 slip op. at 2 (B.P.A.I. Feb 4, 2009).

113. *See* U.S. Patent Application No. 10/261,163 at Summary ¶¶ 5-10.

114. This is required during examination. *In re* Zletz, 893 F.2d 319, 321 (Fed. Cir. 1989).

115. *Scholl*, 2008-2308 at 11.

116. The Board has rejected similar claims for similar reasons under several other opinions. *Ex parte* Barnes, 2007-4114, slip op. at 11-13 (B.P.A.I. Jan. 22, 2009); *Ex parte* Atkin, 2008-4352 slip op. at 15-16 (B.P.A.I. Jan. 30, 2009); *Ex parte* Zybura, 2008-2195 slip op. at 5-11 (B.P.A.I. Feb. 3, 2009); *Ex parte* Nawathe, 2007-3360 slip op. at 2-3 (B.P.A.I. Feb. 9 2009); *Ex parte Mitchell*, 2008-2012 slip op. at 11 (B.P.A.I. Feb. 23, 2009).

One early Board decision actually reversed the examiner's *State Street* rejection.[117] In *Ex parte Li*, the Board reversed subject-matter rejections on two different claims, both *Beauregard* claims. The claims involved generating reports using several software "modules," such as a "logic processing module, a configuration fill processing module, a data organization module," and so forth. It is clear that the claims covered ordinary data processing software intended to run on a general purpose computer. One claim referred to the computer readable medium in the preamble, and the other referred to it in a claim element. Neither claim made any specific reference to a processor or other type of computing hardware.

The Board's analysis proceeded by rejecting the *State Street* arguments of the examiner and the applicant. Instead, the Board stated, "It has been the practice for a number of years that a 'Beauregard Claim' of this nature be considered statutory at the USPTO as a product claim. (MPEP 2105.01, I)." The Board also noted that *Beauregard* claims were consistent with *In re Nuijten*.[118] In *Nuijten*, the Federal Circuit rejected a claim on an electromagnetic signal as subject-matter ineligible, but it repeatedly noted that Nuijten successfully claimed the same signal as embodied in a medium—though those claims were not in fact in front of the court.[119] Next, citing the several "software components" in the patent's written description, the Board held the claim to be subject-matter eligible under *In re Lowry*.[120] In *Lowry*, the Federal Circuit reversed the Board's rejection of a software claim on a data structure. "More than mere abstraction, the data structures are specific electrical or magnetic structural elements in a memory."[121]

In *Ex parte Mazzara*, the Board offered a more detailed explanation of *Beauregard* claim eligibility.[122] The Board addressed the subject-matter eligibility of "computer software recorded on a storage media [sic]."[123] Noting that the PTO had long allowed *Beauregard* claims as a subject-matter-eligible manufacture, the question for the Board to answer is whether the claim element describing the computer media, read in light of

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117. *Ex parte* Li, 2008-1213 slip op. at 2-4 (B.P.A.I. Nov. 6, 2008).

118. *Id.* at 9; *In re* Nuijten, 500 F.3d 1346 (Fed. Cir. 2007). *But see Nuijten*, 500 F.3d at 1366 (Linn, J., dissenting) ("As a matter of principle, there is little reason to allow patent claims to otherwise unpatentable, deemed abstractions just because those deemed abstractions are stored in a tangible medium, while rejecting the same inventions standing alone.").

119. *Nuijten*, 500 F.3d at 1351, 1356 n.6.

120. *Li*, 2008-1213 at 9; *In re* Lowry, 32 F.3d 1579 (Fed. Cir. 1994)

121. *Lowry*, 32 F.3d at 1583.

122. *Ex parte* Mazzara, 2008-4741 slip op. (B.P.A.I. Feb. 5, 2009).

123. *Id.* at 20.

the specification, is to be read so broadly as to include clearly subject-matter ineligible scope.[124] The Board cited to two examples. In one decision the specification expressly defined the computer readable media to include paper, which is not subject-matter eligible.[125] Another decision had claims that included intangible media, like a carrier wave.[126] This is not a separate test for *Beauregard* claims—the board is simply looking to see if the claim scope includes traditionally subject-matter ineligible areas, like printed matter and carrier waves.

The claim in *Mazzara* specified that it was for software embodied on a "computer usable medium," but the specification did not expressly define that term. Refusing to categorically invalidate all *Beauregard* claims that failed to make such a definition, the Board held that any subject-matter ineligible scope that the term might cover was "incidental."[127] The Board accordingly held the claim eligible.

Some other decisions have apparently followed this line of reasoning. For example, the *Zybura* Board rejected Claim 24, a *Beauregard* claim, but only because the "claims recite a storage medium that encompasses a carrier wave or signal"—the specification specifically so defined it.[128] Thus the *Zybura* Board did not categorically reject *Beauregard* claims, but rejected only those that include in their scope general network transmission as "computer-readable media." And in *Atkin*, the Board did not address the subject-matter eligibility of Claim 5, which was a *Beauregard* claim, though it sua sponte raised subject-matter objections on other non-*Beauregard* software methods and held them ineligible.[129]

Other Board decisions are in direct conflict with these decisions. In *Ex parte Mitchell*, the board squarely rejected the idea that limiting software to a computer-readable medium made it subject-matter eligible. The Board, having already held another claim in method form to be subject-matter ineligible, refused to allow the *Beauregard* claim:

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124. *Id.*

125. *Id.* at 21 (citing *Ex parte* Shealy, 2006-1601 slip op. (B.P.A.I. Apr. 23, 2007)). Printed matter has long been subject-matter ineligible. *See, e.g.*, *In re* Rice, 132 F.2d 140 (C.C.P.A. 1942) (holding a method of writing music subject-matter ineligible).

126. *Mazzara*, 2008-4741 at 21 (citing *Ex Parte* Casazza, 2006-2228 slip op. (B.P.A.I. Sept. 6, 2007)). Electromagnetic signals are also ineligible. *See, e.g.*, *In re* Nuijten, 500 F.3d 1346 (Fed. Cir. 2007).

127. *Mazzara*, 2008-4741 at 21 (citing *In re* Warmerdam, 33 F.3d 1354, 1359 (Fed. Cir. 1994)).

128. *Ex parte* Zybura, 2008-2195 slip op. at 9 (B.P.A.I. Feb. 3, 2009).

129. *Ex parte* Atkin, 2008-4352 slip op. at 15-16 (B.P.A.I. Jan. 30, 2009).

> We see no reason why a "computer readable medium" containing "instructions" for the otherwise ineligible method should be treated any differently from the [other ineligible method claim]. Although a "computer readable medium" may nominally fall within the statutory class of "manufacture," [the *Beauregard* claim] would effectively pre-empt the abstract idea represented by [the other ineligible method claim].[130]

A footnote omitted in this passage directly conflicts with *Mazzara*'s default-rule analysis: "A computer readable 'medium' that comprises 'instructions' as recited in [the *Beauregard* claims] does not *necessarily* fall within any statutory class."[131] Thus, where the *Mazzara* Board was prepared to assume that media limitations by default create eligible subject-matter, *Mitchell* assumes precisely the opposite.

Two other Board decisions agree with *Mitchell*. In *Ex parte Isaacson*, the Board rejected a *Beauregard* claim where the computer-readable medium limitation had no definition in the specification.[132]

> The broadly claimed "medium" in the [claim preamble] is not necessarily required to be embodied in a tangible computer-readable medium. Indeed, the subject matter is so broadly disclosed that there is no discussion of what the claimed "medium" is supposed to be . . . .[133]

The Board accordingly held the claim scope to include general carrier waves in violation of *Nuijten*.

The Board also cited *AT&T* and *State Street* for the proposition that manufacture claims are to be analyzed the same as process claims. The Board used similar reasoning on the *Beauregard* claims in *Cornea-Hasegan*, where the Board also invalidated similar method claims.[134] In this way, the board turned the liberalizing effect of *State Street* on its head—before *Bilski*, *State Street* could be used to avoid the formalities of claiming software on a computer-readable medium, but after *Bilski*, *State Street* is being used to eliminate subject-matter eligibility on both types of claims.

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130. *Ex parte* Mitchell, 2008-2012 slip op. at 8 (B.P.A.I. Feb. 23, 2009) (footnote omitted).

131. *Id.* at 8 n.3 (emphasis in original).

132. *Ex parte* Isaacson, 2008-1884 slip op. (B.P.A.I. Feb. 26, 2009).

133. *Id.* at 10.

134. *Ex parte* Cornea-Hasegan, 89 U.S.P.Q.2d 1557, 1561-62 (B.P.A.I. Jan. 13, 2009).

Note that there is as yet no case following *Mitchell* that has affirmed a *Beauregard* claim where the specification specifically defined the medium limitation. Thus, at least some members of the Board may be willing to hold all *Beauregard* claims ineligible, regardless of the claimed medium. The Board is free to do so, as the Federal Circuit has never specifically ruled on this matter.[135]

3. Apparatus Claims

In addition to method claims and *Beauregard* claims, there are also general apparatus claims, potentially justified under the "new machine" theory of *Alappat*. Though some Board cases examine apparatus claims, there seems little distinct in their analysis.[136] One exception is the apparatus claim in *Nawathe*, discussed *supra* Section III.B.2. There an apparatus claim was allowed even though the corresponding method claim was denied. But as already discussed, the justification for *Nawathe*'s holding is opaque.

D. Business Methods

A recent order from the Central District of California provides an example of how courts may use *Bilski* to invalidate a class of business method and tax patents that manipulate solely legal and financial obligations. The independent claims in *Fort Properties, Inc. v. American Master Lease, LLC*, recited various manipulations of deedshares and other real estate and tax mechanisms.[137] The patent holder conceded that the machine prong of *Bilski* did not apply.[138] The district court then invalidated the patent by using the transformation prong. All of the independent claims "transform or manipulate legal ownership interests in real estate" and therefore failed the transformation prong of the *Bilski* test.[139]

Addressing the patent holder's argument that some of the claims manipulated "deedshares," the court noted that the deedshares are not physical objects or substances.[140] Analogizing to *Bilski*'s rejection of options as physical objects, the court ruled that the deedshares represented only legal ownership in physical property. This seems consistent with *Bilski*'s interpretation of when an article does not "represent" a physical object: a legal

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135. *See Ex parte* Mazzara, 2008-4741 slip op. at 20 (B.P.A.I. Feb. 5, 2009).

136. *See Ex parte* Mitchell, 2008-2012 slip op. (B.P.A.I. Feb. 23, 2009); *Ex parte* Becker, 2008-2064, slip op. (B.P.A.I. Jan. 26, 2009).

137. Fort Props., Inc., v. Am. Master Lease, LLC, No. SACV07-365 AG (JCx), 2009 WL 249205, at *1 (C.D. Cal. Jan. 22, 2009).

138. *Id.* at *4.

139. *Id.*

140. *Id.*

interest in a physical object does not represent that physical object for the purposes of the machine-or-transformation test.

Since *Bilski*, the Federal Circuit has invalidated a "method of marketing a product" and a "paradigm for marketing software" on subject-matter grounds.[141] The method claims dealt with establishing a "shared marketing force." The Federal Circuit held that the method claims did not satisfy the machine prong because a marketing force cannot be a machine, in the sense that a shared marketing force is not "tied to any concrete parts, devices, or combination of devices."[142] The claim did not qualify under the transformation prong because the claims were "directed to organizing business or legal relationships in the structuring of a sales force (or a marketing company)."[143]

These cases undoubtedly spell the end for a large category of business method patents. Though *Bilski* clearly held that there are no categorical prohibitions against business methods, in order for the claim to be upheld, it needs to be more than a how-to manual for conducting a business or executing a financial or legal transaction.

IV. CONCLUSION: ABSTRACTION BY ANOTHER NAME?

Judge Rader dissented in *Bilski* from the machine-or-transformation test, writing that the entire opinion could have been written in one line: "Because Bilski claims merely an abstract idea, this court affirms the Board's rejection."[144] Rader criticizes the majority's reading of Supreme Court decisions because of the statement in *Diehr* that the Supreme Court holdings on subject matter are merely restatements of the traditional rules against patenting abstractions or natural phenomena.[145] Rader would focus on the abstractness of the claim and whether the claim "would appear in a form that is not even susceptible to examination against prior art under the traditional tests of patentability."[146]

Indeed, the post-*Bilski* Board opinions use both tests side by side. For example, *Ex parte Scholl* seems to use the two tests almost interchangeably.[147] And in *Ex parte Nawathe* the examiner rejected the claims as ab-

141. *In re* Ferguson, No. 2007-1232, 2009 WL 565074 (Fed. Cir. Mar. 6, 2009).
142. *Id.* at *3.
143. *Id.* at *4.
144. *In re* Bilski, 545 F.3d 943, 1011 (Fed. Cir. 2008) (Rader, J., dissenting).
145. *Id.* at 1013 (Rader, J., dissenting).
146. *Id.* (Rader, J., dissenting).
147. *Ex parte* Scholl, 2008-2308 slip op. at 12 (B.P.A.I. Feb 4, 2009).

stract and the Board affirmed after applying the machine-or-transformation test.[148]

Under *State Street*, a patent claim was subject-matter eligible if it produced a useful, concrete, and tangible result. Given that patent law has a separate utility requirement, "useful" is probably redundant. What is left is the requirement that there be a result which is concrete and tangible. It is unclear exactly how different this test actually is from the traditional prohibitions against abstract claims—that which is concrete and tangible would seem to be by definition not abstract.

Perhaps the problem is that the *State Street* test focuses on the result, not the process itself. So though Bilski's claim generated a concrete result in the real world as a result of executing the trades, it still operated using abstract principles. It is not, however, all that clear that the verbal formulation of the test is what really curtails potential patent claims. On the contrary, the real teeth of the test is what the Federal Circuit (and the Board) considers "concrete" or what it considers "representative" of an article. Arguably, importing this limitation into the *State Street* test would have accomplished a similar effect.

The Federal Circuit claims not to have created any categorical exclusions. But "patent claims that operate on legal obligations" is a fairly workable definition of "business method patents." Pragmatically speaking, *Bilski* will invalidate a substantial portion of business method patents. The rejection of categorical exclusions should, however, reassure some patent holders, because it at least makes clear that technological solutions to business problems will not be excluded because of some vague connection to "business."

The *Bilski* majority held that transformations of "public or private legal obligations or relationships, business risks, or *other such abstractions* cannot meet the test."[149] If abstraction is the objection, then it is unclear just how much this new test departs from the traditional rules. In a certain sense, the real clarification of the law is that legal obligations are abstract and methods that simply manipulate legal obligations are not eligible subject matter.

As far as software patents go, the Federal Circuit will have to resolve the *Beauregard* split one way or the other. Regardless of how it turns out, it seems unfortunate that an administrative body that resolves not to "exalt

148. *Ex parte* Nawathe, 2007-3360 slip op. at 5 (B.P.A.I. Feb. 9 2009).
149. *Bilski*, 545 F.3d at 963 (emphasis added).

form over substance"[150] has done much to return software patents to formalities that require "new machine" theories, cumbersome hardware specifications, or distinctions between software that is on a disk and software that is downloaded over the Internet. It is unclear why the validity of a software innovation might depend on whether the steps of that innovation were claimed as an embodiment on a medium, as a general purpose computer programmed to perform those steps, or as a method claim on a processor. There may well be policy reasons for not allowing patents on software or business methods.[151] If those reasons are consistent with the statute, it may be more helpful to say what they are, rather than hiding that change in policy behind a linguistic reformulation of the test. If software is too abstract to be patented, then the Federal Circuit should say so.

Of course, as these PTO decisions make their way through the appeals process, the Federal Circuit will have its chance.

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150. *See, e.g.*, *Ex parte* Cornea-Hasegan, 89 U.S.P.Q.2d 1557, 1560 (B.P.A.I. Jan. 13, 2009).

151. *See, e.g.*, Pamela Samuelson, *Benson Revisited: The Case Against Patent Protection for Algorithms and Other Computer Program-Related Inventions*, 39 EMORY L.J. 1025 (1990).

PAICE YOURSELVES: A BASIC FRAMEWORK FOR ONGOING ROYALTY DETERMINATIONS IN PATENT LAW

By Stephen M. Ullmer

In the wake of the Supreme Court's landmark decision overturning the rule of automatic injunctions in patent cases, *eBay Inc. v. MercExchange, LLC*, district courts and the Federal Circuit must now consider how best to grant prospective damages.[1] Lower courts are still working out the details of this standard, and many post-*eBay* patent cases have denied the patentee a permanent injunction.[2] In *Amado v. Microsoft Corp.*[3] and *Paice LLC v. Toyota Motor Corp.*,[4] the Federal Circuit reviewed two separate ongoing royalties.[5] Though the Federal Circuit generally approves of ongoing royalties as a form of remedy, it vacated and remanded both decisions

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1. eBay Inc. v. MercExchange, LLC, 547 U.S. 388, 394 (2006); *see also* Jake Phillips, Note, eBay*'s Effect on Copyright Injunctions: When Property Rules Give Way to Liability Rules*, 24 BERKELEY TECH. L. J. _ (2009).

2. As of January 7, 2009, 23 post-*eBay* cases have denied a permanent injunction. Injunction Rulings to 1-7-09, http://www.patstats.org/Injunction_rulings_post-ebay_to_1-7-09.xls (last visited Jan. 25, 2009). Prior to *eBay* injunctions issued automatically, as the Federal Circuit employed an automatic injunction rule for more than twenty years. *See* Jeremy Mulder, Note, *The Aftermath of* eBay*: Predicting When District Courts Will Grant Permanent Injunctions in Patent Cases*, 22 BERKELEY TECH. L.J. 67, 68 (2007); *see also* Richardson v. Suzuki Motor Co., 868 F.2d 1226, 1247 (Fed. Cir. 1989); W.L. Gore & Assocs. v. Garlock, Inc., 842 F.2d 1275, 1281 (Fed. Cir. 1988).

3. 517 F.3d 1353 (Fed. Cir. 2008).

4. 504 F.3d 1293 (Fed. Cir. 2007).

5. This Note focuses primarily on ongoing royalties as a form of future damages. *See infra* Part II. An ongoing royalty is different from a reasonable royalty, in the sense that a reasonable royalty is for *past* infringement while an ongoing royalty compensates a patent holder for *future* infringement. Because an ongoing royalty permits future infringement, it is similar to a compulsory license. *Compare Paice*, 504 F.3d at 1313 n.13 (distinguishing ongoing royalties from compulsory licenses because an ongoing royalty permits *only* a single infringer, rather than any future infringers, to continue its infringing conduct at a predetermined price), *with id.* at 1316 (Rader, J., concurring) ("[C]alling a compulsory license an 'ongoing royalty' does not make it any less a compulsory license.").

with instructions on what royalty-setting methodology the lower courts should use.[6]

This Note analyzes the Federal Circuit's decisions in *Paice* and *Amado*, paying particular attention to the application of ongoing royalties in cases of patent infringement. Following *eBay*, the lower courts deny injunctive relief more frequently and will likely compensate aggrieved patent owners with prospective liability-rule relief.[7] This Note focuses on what rules and procedures courts should use to properly determine prospective relief and sets forth a framework for ongoing royalties. This framework addresses the Federal Circuit's concerns with ongoing royalties, and provides lower courts with a workable standard for future damages. In formulating this framework, this Note considers the differences between backward- and forward-looking royalties, which include market changes, design-around options, and technological advances that affect the damages calculus. This Note concludes by suggesting that a court must explicitly acknowledge these factors when setting an ongoing royalty.

Part I examines the legal landscape that led up to recent cases in the Federal Circuit involving ongoing royalties. This Part summarizes the Supreme Court's decision in *eBay*, paying particular attention to a form of damages known as "ongoing royalties." Part II reviews two cases, *Paice* and *Amado*, and their impact on the law of ongoing royalties. Part II describes how the Federal Circuit approved the concept of using an ongoing royalty, and concludes that the Federal Circuit appropriately remanded the cases for further explanation of how the lower courts determined the ongoing royalty rate. Part III considers the impact of these Federal Circuit decisions and suggests a new framework for ongoing royalties. This framework deals with the problems of forward-looking royalties by analogizing to the *Georgia-Pacific*[8] factors for pre-verdict damages.

I. BACKGROUND

Section I.A briefly describes the pre-*eBay* prevalence of permanent injunctions. Section I.A also demonstrates that only a few rare exceptions led courts to deny a permanent injunction to a victorious patentee. Section

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6. *Amado*, 517 F.3d at 1362; *Paice*, 504 F.3d at 1315.

7. *See* Yixin H. Tang, *Recent Development: The Future of Patent Enforcement After* eBay v. MercExchange, 20 HARV. J.L. & TECH. 235, 236 (2006) ("[T]he Court effectively made it much harder for patent holders who do not practice their patented inventions to obtain a permanent injunction . . . ."); Injunction Rulings to 1-7-09, *supra* note 2.

8. *See* Mark A. Lemley, *Intellectual Property Rights and Standard-Setting Organizations*, 90 CALIF. L. REV. 1889, 1915 n.84 (2002) ("The fifteen *Georgia-Pacific* factors have become a standard measure of reasonable royalties in patent cases.").

I.B then describes the *eBay* decision and its ramifications for ongoing royalties. Part I then concludes with Section I.C, which describes two Federal Circuit cases in which each court remanded the improperly set ongoing royalty that followed each court's denial of a permanent injunction.

A. The Evolution of the Permanent Injunction

Traditionally, a determination of patent infringement led to an automatic permanent injunction.[9] In the pre-*eBay* era, the Federal Circuit held that 35 U.S.C. § 235 meant that a court could only deny injunctive relief in rare circumstances in order to protect the public interest.[10] The Federal Circuit denied injunctive relief infrequently, typically denying one only for inventions critical to public health and safety.[11] Otherwise, injunctions issued as a matter of course.[12]

The Federal Circuit typically connected the patent laws with traditional property laws, where remedies in equity were the norm. The court held that "[t]he patent right is but the right to exclude others, the very definition of 'property.'"[13] Under this presumption, many pre-*eBay* cases required a defendant to demonstrate that their case was exceptional in order to avoid a permanent injunction.[14] The Federal Circuit in *eBay* hewed to its case

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9. *See, e.g.*, Rite-Hite Corp. v. Kelley Co., 56 F.3d 1538, 1547 (Fed. Cir. 1995) (suggesting that injunctive relief is denied only in rare circumstances); Richardson v. Suzuki Motor Co., 868 F.2d 1226, 1246-47 (Fed. Cir. 1989) ("Infringement having been established, it is contrary to the laws of property, of which the patent law partakes, to deny the patentee's right to exclude others from use of his property."); W.L. Gore & Assocs., Inc. v. Garlock, Inc., 842 F.2d 1275, 1281 (Fed. Cir. 1988) ("[I]njunctive relief against an adjudged infringer is usually granted.").

10. *Rite-Hite Corp.*, 56 F.3d at 1547.

11. *See* Hybritech Inc. v. Abbott Labs., 4 U.S.P.Q.2d (BNA) 1001 (C.D. Cal. 1987) (denying part of an injunction concerning medical supply kits that the patentee did not market) *aff'd*, 849 F.2d 1446 (Fed. Cir. 1988). Historically, the circuit courts followed a similar approach, which the Federal Circuit later cited favorably in *Rite-Hite Corp. See, e.g.*, Vitamin Technologists, Inc. v. Wis. Alumni Research Found., 64 U.S.P.Q. (BNA) 285 (9th Cir. 1945) (denying injunction concerning irradiation of oleomargarine); City of Milwaukee v. Activated Sludge, Inc., 21 U.S.P.Q. (BNA) 69 (7th Cir. 1934) (denying an injunction that would cover a sewage treatment plant).

12. *See Richardson*, 868 F.2d at 1247 ("It is the general rule that an injunction will issue when infringement has been adjudged . . . ."); *W.L. Gore*, 842 F.2d at 1281.

13. Schenck v. Nortron Corp., 713 F.2d 782, 786 n.3 (Fed. Cir. 1983); *see* Connell v. Sears, Roebuck & Co., 722 F.2d 1542, 1548 (Fed. Cir. 1983) ("[A] patent is a form of property right, and the right to exclude recognized in a patent is but the essence of the concept of property.").

14. *See* eBay Inc. v. MercExchange, LLC, 547 U.S. 388, 393-94 (2006) ("The court articulated a 'general rule,' unique to patent disputes, 'that a permanent injunction will issue once infringement and validity have been adjudged.'").

law when it reversed the district court's denial of a permanent injunction.[15] In reversing, the Supreme Court undermined the authority of the Federal Circuit's long-standing precedent.

B. Relief in Patent Infringement Cases After *eBay*

Justice Thomas's opinion in *eBay* ushered in a new era for lower courts handling patent law remedies. Rather than issue an injunction automatically, courts must now engage in the traditional four-factor equitable analysis:

> A plaintiff must demonstrate: (1) that it has suffered an irreparable injury; (2) that remedies available at law, such as monetary damages, are inadequate to compensate for that injury; (3) that, considering the balance of hardships between the plaintiff and defendant, a remedy in equity is warranted; and (4) that the public interest would not be disserved by a permanent injunction.[16]

Simply put, patent cases no longer receive special treatment, and injunctions only issue when the balance of equities favors injunctive relief.[17] Though cases decided in the aftermath of *eBay* may issue permanent injunctions less frequently, courts must still follow the tenants of section 284 of the Patent Act:

> [T]he court shall award the claimant damages adequate to compensate for the infringement, but in no event less than a reasonable royalty for the use made of the invention by the infringer . . . .[18]

This section of the Patent Act indicates that a court must award relief somewhere on the spectrum between reasonable royalties and a permanent injunction. Courts now have more discretion over the remedies in a patent infringement case. Justice Kennedy suggested in his *eBay* concurrence that courts deserve this extra discretion because "[a]n industry has developed in which firms use patents not as a basis for producing and selling goods but, instead, primarily for obtaining licensing fees."[19] In Kennedy's view, monetary relief may sufficiently compensate such nonpracticing entities—

15. MercExchange, LLC v. eBay, Inc., 401 F.3d 1323, 1339 (Fed. Cir. 2005).
16. eBay Inc. v. MercExchange, LLC, 547 U.S. at 391.
17. *Id.* at 390.
18. Patent Act § 284, 35 U.S.C. § 284 (2006).
19. *eBay*, 547 U.S. at 396 (Kennedy, J., concurring).

thereby preventing holdup[20]—as well as holders of suspect business method patents, and justify a court's denial of a permanent injunction.[21] Both *eBay* and Kennedy's concurrence have influenced several recent cases where the court denied injunctive relief in favor of an ongoing royalty.

C. POST-*EBAY* DISTRICT COURT CASES DENYING A PERMANENT INJUNCTION

1. *Amado v. Microsoft Corp.*

a) Facts and Procedural History

Carlos Amado owned a patent covering a software program that combined the functionalities of spreadsheets and databases.[22] Amado filed suit against Microsoft, alleging that some versions of Microsoft Office infringed his patent.[23] A jury determined that his patent was valid and infringed and awarded Amado damages of $0.04 per infringing sale.[24] The district court also granted a permanent injunction, but stayed the injunction until seven days after any appeals were resolved or abandoned and required Microsoft to deposit $2.00 per infringing sale in an escrow account.[25] While on appeal, the Supreme Court issued its decision in *eBay*, which prompted Microsoft to challenge Amado's permanent injunction.[26] The district court dissolved the permanent injunction and awarded Amado $0.12 per infringing unit for sales made during the period of the stay.[27] It calculated this value by trebling the jury-set damages award, reasoning that continued infringement was willful.[28] Both Amado and Microsoft appealed.

b) The Federal Circuit's Analysis

Microsoft argued that Amado deserved no more than the $0.04 jury-set royalty.[29] The Federal Circuit dismissed this claim because the jury award derived the value from past infringing conduct, not the conduct that oc-

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20. Holdup occurs when a patent holder is able to seek rents above the value of its patent. This can happen, for example, when the patent comprises but one small part of an already developed and deployed product.
21. *eBay*, 547 U.S. at 396-97.
22. Amado v. Microsoft Corp., 517 F.3d 1353, 1356 (Fed. Cir. 2008).
23. *Id.*
24. *Id.*
25. *Id.*
26. *Id.*
27. *Id.*
28. 35 U.S.C. § 284 (2006).
29. *Amado*, 517 F.3d at 1361.

curred after the verdict.[30] The Federal Circuit noted that after infringement, there are "change[s] in the parties' bargaining positions, and the resulting change in economic circumstances," and that these changes require a reconsideration of post-verdict damages calculation.[31]

The Federal Circuit also disagreed with the district court's $0.12 royalty.[32] It was calculated by simply trebling the jury-set damages award. But just as it rejected Microsoft's request for a $0.04 royalty, the Federal Circuit required a more nuanced inquiry into the post-verdict economic circumstances.[33] Furthermore, the court held that "willfulness, as such, is not the inquiry when the infringement is permitted by a court-ordered stay."[34] The Federal Circuit vacated the $0.12 award and remanded the matter to the district court because the district court failed to reconsider the full economics of the parties' positions.[35] The court did not dictate a precise award other than to say that the damage award set by the district court on remand should logically fall between the $0.04 jury-set royalty and the $2.00 escrow amount.[36]

2. *Paice LLC v. Toyota Motor Corp.*

a) Facts and Procedural History

Paice LLC v. Toyota Motor Corp. dealt with three patents on drive trains for hybrid vehicles.[37] Paice asserted that certain Toyota hybrid drive trains were accused of infringing a controllable torque transfer unit (CTTU), a patented type of clutch, and other patented drive train technology.[38]

Paice sued for both compensatory damages and a permanent injunction.[39] Paice contended that Toyota's hybrid drive trains in the Highlander,

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30. *Id.*
31. *Id.* at 1362. For further explanation of these circumstances, see *infra* Section III.
32. *Amado*, 517 F.3d at 1362.
33. *Id.*
34. *Id.* at 1361. The willfulness issue is examined *infra* Section II.C.
35. *Amado*, 517 F.3d at 1362. Recall that the $0.12 was essentially based on a willfulness theory that the Federal Circuit rejected. Thus, the Federal Circuit needed to determine if, on other grounds, the $0.12 award was adequately justified; it was not.
36. *Id.* at 1362 n.2. The court set this range because the district court awarded a reasonable royalty of $0.04 per infringing unit for past infringement and set the escrow rate at $2.00 per infringing unit, while specifying that the $2.00 amount was for temporary holding.
37. Paice LLC v. Toyota Motor Corp., 504 F.3d 1293, 1296 (Fed. Cir. 2007).
38. *Id.* at 1299 n.2.
39. *Id.* at 1301.

Lexus RX 400h, and Prius II models infringed Paice's patents.[40] The jury found the Toyota drive trains to infringe under the doctrine of equivalents[41] and awarded Paice $4,269,950 in damages.[42]

The district court, however, denied Paice's request for a permanent injunction using the four-factor *eBay* test.[43] Instead, the district court determined that Paice was a nonmanufacturing entity that would not lose name recognition, had not established any irreparable injury, and for whom monetary damages were a sufficient remedy.[44]

The district court ordered an ongoing royalty of $25, the approximate per-vehicle amount that the jury awarded for past infringement, for each infringing sale by Toyota during the life of Paice's patent.[45] Paice appealed.[46]

b) The Federal Circuit's Analysis

The Federal Circuit first examined whether an ongoing royalty was a valid form of relief at all. The court looked to 35 U.S.C. § 283, which provides that injunctions granted under the patent laws must "prevent the violation of any right secured by patent,"[47] and held that an ongoing royalty can indeed "prevent" the violation of patent rights.[48] While the Federal Circuit found support for the use of ongoing royalties in both patent and antitrust cases,[49] the court warned that an ongoing royalty should not issue as a matter of course.[50]

Though the Federal Circuit acknowledged that an ongoing royalty could adequately compensate an aggrieved patent holder, the court was unsatisfied with the methodology used to determine the rate. According to the Federal Circuit, the district court provided no reasoning for its $25 ongoing royalty, though it seems clear that it must have been based on the jury award—it was virtually identical.[51] Accordingly, the Federal Circuit remanded the case to the district court with instructions to reevaluate the

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40. *Id.* at 1300.
41. *Id.* at 1302.
42. *Id.*
43. *Id.* at 1302-03.
44. *Id.*
45. *Id.* at 1303.
46. *Id.*
47. 35 U.S.C. § 283 (2006).
48. *Paice*, 504 F.3d at 1314.
49. *See, e.g.*, United States v. Glaxo Group Ltd., 410 U.S. 52, 59 (1973); Shatterproof Glass Corp. v. Libbey-Owens Ford Co., 758 F.2d 613, 628 (Fed. Cir. 1985).
50. *Paice*, 504 F.3d at 1314-15.
51. *Id.*

ongoing royalty rate.[52] Judge Rader's concurring opinion suggests that the Federal Circuit needed to remand the case because "pre-suit and post-judgment acts of infringement are distinct, and may warrant different royalty rates given the change in the parties' legal relationship and other factors."[53]

II. DISCUSSION

Part II takes a closer look at the Federal Circuit's decisions in *Paice* and *Amado*. Section II.A determines that ongoing royalties sufficiently compensate a patent holder when a court denies a patent holder a permanent injunction. Section II.B asks whether a jury-set royalty rate for past infringement can be used as the ongoing-royalty rate and concludes that such a practice is procedurally inadequate. Section II.C then suggests that the *Amado* court properly rejected the use of the willfulness doctrine as a multiplier for past infringement royalties.

Conversely, Section II.D argues that some of the reasoning in *Amado* and *Paice* was erroneous. Though these aspects of the case did not affect the outcome they may compound the difficulties that lower courts face when setting ongoing royalties.

A. In Absence of a Permanent Injunction, Ongoing Royalties Provide an Appropriate Remedy

Now that permanent injunctions no longer automatically issue, the question of whether an ongoing royalty actually does adequately compensate an aggrieved patent holder has increased relevance. On its face, an ongoing royalty is a logical replacement for permanent injunctions and finds support even in pre-*eBay* Federal Circuit cases. For example, in *Shatterproof Glass Corp. v. Libbey-Owens Ford Co.*,[54] the Federal Circuit affirmed an extension of a 5% royalty for past infringement, based on product sales, to future sales.[55] There is additional case support in both antitrust[56] and nuisance[57] suits.

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52. *Id.* at 1315.

53. *Id.* at 1317 (Rader, J., concurring).

54. 758 F.2d at 628 (upholding an ongoing royalty in a method patent case involving a sputter coating process for glass sheets).

55. *Id.* The Federal Circuit likely would not approve a similar award today without further justification and conspicuous analysis of future market conditions and altered bargaining positions. *See infra* Section II.B.

56. United States v. Glaxo Group Ltd., 410 U.S. 52, 59 (1973) (demonstrating that reasonable royalty licensing is a well-accepted remedy in antitrust cases, especially when patents play a significant part in antitrust violations).

In their well-known 1972 article, Professors Calabresi and Malamed[58] examined when a particular entitlement is more appropriately protected by a property rule or a liability rule.[59] Calabresi and Malamed prefer liability rules when high transaction costs make buying out other parties difficult or even impossible.[60] In their view, liability rules are best (1) when the value of an initial entitlement is so great that even a mutually beneficial transfer of the entitlement would not occur,[61] (2) when market valuations of an entitlement are "either unavailable or too expensive compared to a collective valuation,"[62] and (3) when distributional concerns suggest that producers ought to be rewarded over nonproducers.[63] As Justice Kennedy illustrated in his *eBay* concurrence, these conditions sometimes occur in patent cases.[64] In particular, patent trolls fit the Calabresi and Malamed formulation because, by definition, they are nonproducers who engage in exploitive bargaining.

While Calabresi and Malamed's formulation suggests that liability rules may be preferable in some patent cases, Professor Robert Merges suggests that injunctive relief is the proper remedy in most patent law cases.[65] Many patent cases involve only two parties, thus keeping transaction costs low, and the parties themselves are well-equipped to set the price

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57. Boomer v. Atl. Cement Co., 26 N.Y.2d 219, 228 (1970) (approving permanent damages in lieu of an injunction after plaintiffs won a nuisance case against the defendant cement plant).

58. Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089 (1972).

59. *Id.* at 1092. For entitlements protected by a property rule, "someone who wishes to remove the entitlement from its holder must buy it from him in a voluntary transaction." *Id.* Conversely, liability rule protection is characterized by the ability to destroy an entitlement by paying an objectively determined value.

60. *Id.* at 1119.

61. *Id.* at 1106; *see also* ROGER D. BLAIR & THOMAS F. COTTER, INTELLECTUAL PROPERTY: ECONOMIC AND LEGAL DIMENSIONS OF RIGHTS AND REMEDIES 40 (2005) (asserting that liability rules "make sense if, for example, the transaction costs of bargaining are unusually high and the likelihood of voluntary solution to this problem unusually low"); Robert P. Merges, *Of Property Rules, Coase, and Intellectual Property*, 94 COLUM. L. REV. 2655, 2664 (1994) ("Other factors indicate that a liability rule might better effectuate the bargain: many parties (especially when one party has the power to 'holdup' the entire enterprise), the likelihood of strategic bargaining, and otherwise high transaction costs.").

62. Calabresi & Melamed, *supra* note 58, at 1110.

63. *Id.*

64. eBay Inc. v. MercExchange, LLC, 547 U.S. 388, 396-97 (Fed. Cir. 2006) (Kennedy, J., concurring); *see generally* Mulder, *supra* note 2.

65. Merges, *supra* note 61, at 2664.

and terms of a license.[66] Indeed, Merges suggested that judicially administered compulsory licensing schemes might place an overly cumbersome burden on judges, who would need to be educated on a case-by-case basis about various industries, market valuations, and other concerns.[67] However, Merges made these arguments while focusing on the prevalence, in certain industries, of an immense confluence of patent rights that overlap and block access to potential entrants.[68] With this particular focus in mind, Merges suggested that compulsory licensing schemes like ASCAP, BMI and patent pools will develop naturally, without legislative intervention.[69]

Merges also differentiated his preferred approach regarding legislative licensing schemes from the Calabresi and Malamed focus on compulsory licenses created by judicial intervention.[70] Because Merges's article predates *eBay*, Merges assumed that judicial valuations that the court can specifically tailor to each case are unrealistic.[71] But the *eBay* decision permits, and essentially demands, a judge to issue such specific, tailored valuations, at least in cases without permanent injunctions.[72] While Merges recognized the benefits of naturally created licensing schemes, his pre-*eBay* reasoning should only apply in situations where a court grants the patentee a permanent injunction. When a court denies a patentee's permanent injunction request, Merges's preferred natural compulsory licensing schemes carry little to no weight with the patentee. Such schemes carry little weight because such patentees, typically non-practicing entities or patent trolls, do not compete directly, if at all, in the infringer's marketplace. In these cases, there exist no mutually beneficial grounds upon which the patentee wants to engage in a cross-licensing agreement or other form of cooperative agreement such as a patent pool. In a court's judgment, monetary relief adequately compensates these patentees because they typically seek large monetary settlements, rather than intellectual property *protection*, market share preservation, or product development. As a result, the specifically-tailored nature of judicially crafted compulsory license schemes appropriately compensates the patentee while preventing the patentee from exerting undue leverage on the infringer.

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66. *Id.*

67. Robert P. Merges, *Contracting into Liability Rules: Intellectual Property Rights and Collective Rights Organizations*, 84 CALIF. L. REV. 1293, 1317 (1996).

68. *Id.* at 1295.

69. *Id.* at 1308.

70. *Id.* at 1307.

71. *Id.* at 1308.

72. eBay Inc. v. MercExchange, LLC, 547 U.S. 388, 396-97 (Fed. Cir. 2006) (Kennedy, J., concurring).

In another, earlier article, Merges claimed that the Calabresi and Malamed framework suggests that property rule relief makes sense in the patent law context because:

> (1) there are only two parties to the transaction; (2) the costs of a transaction between the parties are otherwise low; and, most importantly, (3) a court called on to set the terms of the exchange would have a difficult time doing so quickly and cheaply, given the specialized nature of the assets and the varied and complex business environments in which they are deployed.[73]

As Chief Justice Roberts's concurrence in *eBay* points out, these are typically the conditions of a patent case.[74] But recently there has been a rise in patent trolls who have the ability to extort settlements worth far more than the actual economic value of their patent.[75] The ability of the patent holder to holdup a producing entity in violation of the second prong of the four-factor test warrants a liability rule over a property rule.[76]

B. The Federal Circuit Wisely Required a Post-Trial Reexamination of Facts for Ongoing Royalties

In both *Paice* and *Amado*, the district courts evidently took the damages award and turned it into an ongoing royalty. The Federal Circuit was right to reject this approach. For example, in *Paice*, the Federal Circuit rejected the district court's decision because the district court arrived at an ongoing royalty of $25 per infringing vehicle without examining any of the post-verdict economic factors.[77] The $25 ongoing royalty award in *Paice* was approximately the per-vehicle jury-set damages award.[78] Similarly, the district court in *Amado* calculated its ongoing royalty by (erroneously) trebling the pre-verdict infringement award of $0.04 per infringing unit.[79]

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73. Merges, *supra* note 61, at 2664.

74. *eBay*, 547 U.S. at 394-95 (Roberts, C.J., concurring).

75. *Id.* at 396-97 (Kennedy, J., concurring).

76. Merges alludes to this argument but elected to focus on the more general case for intellectual property relief, as opposed to the more limited cases in which a court finds that the four-factor balancing test for injunctive relief weighs against an injunction. *See supra* note 61 and accompanying text.

77. Paice LLC v. Toyota Motor Corp., 504 F.3d 1293, 1315 (Fed. Cir. 2008).

78. *Id.* at 1303.

79. Amado v. Microsoft Corp., 517 F.3d 1353, 1356 (Fed. Cir. 2007). As Part III *infra* makes clear, this Note advocates the use of the reasonable royalty for past infringement as a starting point for the ongoing royalty. Thus, the *Amado* district court's use of the reasonable royalty as a basis for an ongoing royalty is not a per-se violation of the framework in this Note. The true fault in the *Amado* ongoing royalty revolves around the

In these cases, the Federal Circuit departed from precedent upholding similar awards. For example, in *Shatterproof Glass*, the Federal Circuit upheld a 5% ongoing royalty, which was simply an extension of the jury's 5% award.[80] But the *Paice* and *Amado* courts were correct to require a more comprehensive method of royalty calculation for several reasons.

First, ongoing royalties equivalent to pre-verdict royalties might deny the parties the opportunity to negotiate between themselves. The *Paice* court suggested that "the district court may wish to allow the parties to negotiate a license amongst themselves . . . before issuing an ongoing royalty."[81] Additional instructions from the Federal Circuit suggested that the district court should reevaluate the ongoing royalty rate and take additional evidence if necessary to sufficiently analyze the ongoing royalty rate.[82]

In his *Paice* concurrence, Judge Rader warned of the potential problems regarding court-imposed monetary damage awards, believing that the Federal Circuit should require district courts to cede negotiations over the final value of the ongoing royalty to the parties.[83] The district court had issued its ongoing royalty to the parties without providing the parties a meaningful chance to present "evidence and argument on royalty rates" for future infringing acts by Toyota.[84] Although the parties fully vetted the issues of monetary damages for past infringement, Rader emphasized that post-judgment infringement may differ from pre-suit infringement.[85] Additionally, Rader cautioned that the parties possessed greater expertise regarding the inherently speculative ongoing royalty projection than that

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court's arbitrary enhancement of the reasonable royalty through the willfulness doctrine. Thus, the district court in *Amado* apparently considered only the reasonable royalty and the willfulness doctrine, which ignores the other considerations established by the framework established *infra* in Section III.C.

80. Shatterproof Glass Corp. v. Libbey-Owens Ford Corp., 758 F.2d 613, 628 (Fed. Cir. 1985). Similarly, albeit in a case of state nuisance law rather than patent law, the Court of Appeals in New York in *Boomer* upheld a permanent damages calculation that ignored future considerations and based its damages on the difference in property values prior to the cement plant construction and the property values after the plant was completed. Boomer v. Atl. Cement Co., 26 N.Y.2d 219, 228 (1970); *see also* Boomer v. Atl. Cement Co., 287 N.Y.S.2d 112, 115-16 (N.Y. Sup. Ct. 1967).

81. *Paice*, 504 F.3d at 1315.

82. *Id.*

83. *Id.* at 1316 (Rader, J., concurring).

84. *Id.* In fact, the district court in *z4 Techs., Inc. v. Microsoft Corp.* implemented essentially what Judge Rader advocated when the court instructed the parties to submit new information concerning monetary damages. 434 F. Supp. 2d 437, 444 (E.D. Tex. 2006).

85. *Paice*, 504 F.3d at 1317 (Rader, J., concurring).

possessed by the court, because the parties involved in licensing agreements are far more aware of the business objectives implicated by any licensing agreement than are the courts.[86]

Following the Rader concurrence, the *Amado* court reasoned that a judgment of validity and infringement in a patent case markedly changes the calculus involved in a royalty determination.[87] In other words, once certain claims of a patent have been found valid, the uncertainty that exists over the validity of all claims in the patent is greatly reduced. The jury is supposed to consider the fact that the validity of the patent would have been uncertain before the lawsuit when making their damages calculations.[88] In theory, the patent, having been judged valid, is worth more to the patent holder than before the judicial determination of validity. The Federal Circuit took issue with the district court's $0.12 royalty because the district court relied directly on the jury's $0.04 award for infringement that occurred prior to the verdict in the case and simply trebled the amount because it held the post-judgment infringement willful.[89] Specifically, the Federal Circuit admonished the district court for ignoring the change in the parties' bargaining positions and economic circumstances, and for generally ignoring the circumstances of the case.[90]

In sum, the Federal Circuit acknowledged that the parties possess a strong interest in negotiating an ongoing royalty and airing concerns over future market conditions and altered bargaining positions. The individual parties involved in a lawsuit possess greater knowledge of their products and the marketplace than the court, and can analyze future market conditions and concerns more efficiently than a court of law. However, in situations where the parties fail to arrive at an agreeable post-trial licensing agreement, the court should, and according to the Federal Circuit may, step in and determine an ongoing royalty itself. In negotiations that involve non-practicing entities attempting to extract money through patent holdup, reasonable bargaining is least likely to occur and a court should not issue a permanent injunction. The appropriate time frame for a court's intervention should differ on a case by case basis—to limit the negotiation time frame for the parties involved ignores, needlessly, the varying levels of complexity that may be involved in any particular negotiation.

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86. *Id.*

87. Amado v. Microsoft Corp., 517 F.3d 1353, 1361-62 (Fed. Cir. 2007).

88. *See* Roger D. Blair & Thomas F. Cotter, *Rethinking Patent Damages*, 10 TEX. INTELL. PROP. L.J. 1, 42-43 (2001).

89. *Amado*, 517 F.3d at 1362.

90. *Id.*

C. The Federal Circuit Sensibly Rejected the Application of Willfulness Doctrine for Infringement During a Stay

In *Amado*, the district court determined that continued infringement during the stay of the permanent injunction was willful, and trebled damages during that period. The Federal Circuit's decision in *Amado* correctly rejected the district court's use of a willful infringement damage enhancement and appropriately rejected the district court's $0.12 damage award based on this theory.[91] Damages in patent infringement cases serve a compensatory purpose.[92] The patent laws direct the court to award damages that adequately compensate the patentee for infringement.

Certain circumstances may call for enhanced damages, up to triple the assessed damage amount, in situations involving willful infringement.[93] Willful infringement depends on an examination of the totality of the circumstances that considers such aspects of the case as deliberate copying, good-faith beliefs, closeness of the case, duration of misconduct, and attempted concealment.[94] In *Amado*, the Federal Circuit aptly ruled that the district court mistakenly applied a theory of willful infringement because the district court based its determination on the fact that Microsoft intentionally infringed Amado's patent during a stayed injunction and would continue to do so during the life of the court-ordered ongoing royalty.[95]

Because willful infringement serves a deterrent function intended to punish unscrupulous and malicious infringers,[96] it made little sense for the Federal Circuit to apply the doctrine to Microsoft in *Amado*.[97] A stayed

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91. *Id.*

92. *See* 35 U.S.C. § 284 (2006).

93. *Id.*

94. Read Corp. v. Portec, Inc., 970 F.2d 816, 827 (Fed. Cir. 1992); *see also* ROBERT P. MERGES & JOHN F. DUFFY, PATENT LAW AND POLICY: CASES AND MATERIALS 1029-39 (4th ed. 2006) (exploring in more detail the scope of willfulness doctrine and its unpredictable nature).

95. *Amado*, 517 F.3d at 1362.

96. 7 DONALD S. CHISUM, CHISUM ON PATENTS § 20.03[4][b][v] ("The Federal Circuit's decisions have reenforced the notion that multiple damages is primarily a punitive provision to deter willful infringement of patents."); *see* Danny Prati, Note, In re Seagate Technology LLC*: A Clean Slate for Willfulness*, 23 BERKELEY TECH. L.J. 47, 49-50 (2008) (describing the punitive, as opposed to the compensatory, nature of willfulness damages). *But see In re* Seagate Tech., LLC, 497 F.3d 1360, 1378-79 (Fed. Cir. 2007) (Gajarsa, J., concurring) ("We have recognized a remedial aspect of such damages in at least three precedential opinions.").

97. *See* Benjamin Peterson, Note, *Injunctive Relief in the Post-*eBay *World*, 23 BERKELEY TECH. L.J. 193, 206-07 (2008) ("[T]he call for an increase in damages awards rests upon the assumption that courts will habitually undervalue patents, an assumption that has not been proven.").

injunction and ongoing royalty *intentionally* permit an infringer like Microsoft to continue its infringing conduct, but only at a fairly-determined price. Thus, applying an admittedly punitive damage multiplier to Microsoft fails to serve the punitive function of the willfulness doctrine and instead provides a windfall to the patentee. While future bargaining circumstances and market forces may require that a court determine the cost of post-verdict infringement separately from the cost of pre-verdict infringement, a court can sufficiently determine the value of infringing conduct and appropriately compensate the patent holder.[98] To rule otherwise and permit a court to treble the damages awarded by a court for pre-verdict infringement suggests that an arbitrary multiplier more accurately determines the proper value of an ongoing royalty than a specific court determination. This strips a court of the ability to accurately determine an appropriate ongoing royalty in favor of an arbitrary multiplier that applies despite the fact that the infringer received permission to continue its infringing actions in the future. A court can and should set the ongoing royalty on a case-by-case basis; if a particular case merits a higher ongoing royalty rate than the pre-verdict infringement reasonable royalty rate, courts may set the rate accordingly without the sway of the willfulness doctrine.

D. The Federal Circuit Should Have Provided Less Misleading Reasoning When it Rejected the Ongoing Royalties in *Amado* and *Paice*

While the Federal Circuit in both *Amado* and *Paice* correctly remanded each case because the ongoing royalties were based directly on the jury award for pre-verdict infringement, the court applied questionable reasoning in each case. Section II.D.1 indicates that the *Paice* court mistook the district court's ongoing royalty as entirely arbitrary, rather than simply as a copy of the reasonable royalty for past infringement. Similarly, Section II.D.2 demonstrates that the *Amado* court mistakenly analyzed the procedural assumptions involved in a reasonable royalty determination.

98. Note that this argument assumes that the parties themselves have failed to negotiate their own agreement and that the decision making power is now back in the court's hands.

1. *The District Court's Royalty Calculation Was Not in Fact "Arbitrary"*

The district court in *Paice* awarded an ongoing royalty of $25 per infringing vehicle, which the Federal Circuit rejected as "arbitrary."[99] However, this award approximately equaled the reasonable royalty awarded to *Paice* for the infringing vehicles Toyota sold pre-verdict.[100] The district court likely reasoned that the distinction between pre- and post-verdict infringement altered the parties' bargaining positions in an insignificant way. Judge Rader's concurrence provided more appropriate reasoning for remanding the case to the district court. Specifically, Rader suggested that "pre-suit and post-judgment acts of infringement are distinct, and may warrant different royalty rates given the change in the parties' legal relationship and other factors."[101] Rader also emphasized the speculative nature of ongoing royalty calculations, regardless of the companies' particular market or technology space, and suggested that licenses rely on business objectives and market knowledge of which the parties possess a far greater understanding than the court.[102] Thus, *Paice* should be understood for more than the mere concept that an arbitrary royalty rate is erroneous, but also for the principle that a pre-verdict award cannot be directly copied for an ongoing royalty without considering the post-verdict economic circumstances.

2. *Commentary on Rate Methodology in Amado Contradicts Federal Circuit Precedent and Is Internally Inconsistent*

The Federal Circuit in *Amado* declared that "[t]here is a fundamental difference, however, between a reasonable royalty for pre-verdict infringement and damages for post-verdict infringement."[103] Though the court cited Judge Rader's concurrence, it provided its own independent

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99. Paice LLC v. Toyota Motor Corp., 504 F.3d 1293, 1314-15 (Fed. Cir. 2007).

100. Amado v. Microsoft Corp., 517 F.3d 1353,1362 (Fed. Cir. 2008).

101. *Paice*, 504 F.3d at 1317.

102. *Id.* at 1317. However, some scholars believe that court-awarded royalty rates systematically exceed, unfairly, the rates that the parties would negotiate on their own. Mark A. Lemley & Carl Shapiro, *Patent Holdup and Royalty Stacking*, 85 TEX. L. REV. 1991, 2020 (2007) ("As a result, royalty rates awarded in court under Georgia-Pacific properly should systematically exceed the rates that parties would negotiate out of court."); *see also* BLAIR & COTTER, *supra* note 61, at 231-32 (suggesting that in certain circumstances a reasonable royalty should logically exceed the infringer's expected profits). *But see* John M. Golden, *"Patent Trolls" and Patent Remedies*, 85 TEX. L. REV. 2111, 2133 (2007) (refuting the assumptions of Lemley and Shapiro and claiming that the patent holder may be disadvantaged in royalty negotiations).

103. *Amado*, 517 F.3d at 1361.

analysis. The court stated, "[p]rior to judgment, liability for infringement, as well as the validity of the patent, is uncertain, and damages are determined in the context of that uncertainty."[104] But this is inconsistent with the hypothetical negotiation that the Federal Circuit supposedly used for damages calculations. The court undertook a hypothetical negotiation in order to assess what license terms the parties would have agreed to at the time infringement began had the parties been willing to negotiate and known the patent to be valid and infringed.[105] Thus, the uncertainties of patent litigation should play no role in the determination of a reasonable royalty, and the *Amado* court oddly implied that the reasonable royalty depended on the inherent uncertainty of litigation.[106]

The court also stated that the ongoing royalty award should logically fall between the $0.04 awarded by the jury for pre-verdict infringement and the $2.00 requested by Amado.[107] This does not seem internally consistent with the Federal Circuit's own opinion. To constrain the ongoing royalty award in this way neglects the full breadth of economic concerns regarding bargaining positions and changes in circumstance that the majority in *Paice*, Judge Rader in *Paice*, and the *Amado* court so strongly emphasized. If the bargaining positions truly change, then surely circumstances exist where an ongoing royalty determination should be lower than the jury's original award. For instance, changes in inflation rates, design-around options, consumer supply and demand, or third party competition may drive down an appropriate ongoing royalty award below the jury's award for pre-verdict infringement. Thus, the *Amado* court ought to have remanded the case to the district court to determine a proper ongoing royalty in light of any changes in circumstance or bargaining position, without artificially limiting the award and effectively penalizing Microsoft by instructing the court to award an amount no lower than the original reasonable royalty in the case.[108]

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104. *Id.* at 1362.

105. Lemley & Shapiro, *supra* note 102, at 2019 ("[T]he Georgia-Pacific factors assume that the parties know the patent is valid and infringed.").

106. *Amado*, 517 F.3d at 1362.

107. *Id.* at 1362 n.2.

108. Similarly, in theory the economic circumstances could change to the point where the $2.00 upper limit requested as relief by Amado is *too low* to adequately compensate the patent holder.

III. A PROPOSAL FOR AN ONGOING ROYALTY CALCULATION

This Part proposes a framework for calculating an ongoing royalty. First, it compares lump sum awards with ongoing royalties and concludes that ongoing royalties are the more appropriate form of future damages. Next, it establishes the essential considerations that a court must examine in order to determine a proper ongoing royalty. Finally, it sets forth the basic framework that a court should use to set an ongoing royalty rate.

A. Comparing Lump Sum and Ongoing Royalty Awards

Once a court denies an injunction, it should then permit the parties to negotiate an ongoing royalty. In the event that these negotiations fail, the court must determine the form of the ongoing royalty. This Section examines the two principal forms that prospective damages typically take: lump sum awards and ongoing royalties.[109] Each form of prospective damage has significant drawbacks,[110] but in the majority of cases an ongoing royalty is the more appropriate form of prospective relief. Because court-awarded prospective relief will invariably be of a nonexclusive variety, a lump sum award to a nonexclusive compulsory licensee increases the average costs of production without affecting the marginal cost, thus motivating socially suboptimal production increases.[111] In a competitive industry, this behavior distorts supply and demand by decreasing the price

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109. *See* Douglas Ellis et al., *The Economic Implications (and Uncertainties) of Obtaining Permanent Injunctive Relief After* eBay v. MercExchange, 17 FED. CIR. B.J. 437, 470 (2008). A related discussion occurs in the nuisance literature, where a court may decide to award damages periodically or in one lump sum. RICHARD A. EPSTEIN, CASES AND MATERIALS ON TORTS 634 (8th ed. 2004); *see also* Boomer v. Atl. Cement Co., 257 N.E.2d 870 (N.Y. 1970) (electing a lump sum damage award in a nuisance case regarding a cement plant and surrounding property values). In nuisance cases involving real property, lump sum awards make sense because such an award ends the court's role in the dispute and losses in property value are more concrete and ascertainable than the values of a given patent.

110. For instance, lump sums motivate inefficient production, *infra* note 111, while ongoing royalties may require a court to step in and adjudicate disputes over the payment or accounting procedures prescribed by the royalty agreement. Some scholars argue that ongoing royalties may also disrupt a patent holder's attempts to regain control of its patent and successfully manage a licensing program. Ellis, *supra* note 109, at 470. However, this concern is significantly mitigated by the willfulness doctrine, as infringers of a patent previously found to be valid and infringed are more likely to pay enhanced damages in an infringement suit than receive a bargain based on a previous, court-awarded compulsory license agreement.

111. For a detailed description of the inefficient effects of lump-sum fees in the nonexclusive licensee context, see BLAIR & COTTER, *supra* note 61, at 198-99 & fig.7.5.

due to the increase in available quantity.[112] This harms the infringer because its profits decrease. In a transitive fashion, this decrease in profits for the infringer may also lower the lump sum amount because a court assessing the proper value of the patent may take into account the overall value of the patent to the infringer. Additionally, the increased production by the compulsory licensee decreases the available profits for any other licensees of the patent, which again may harm the patentee.[113]

While both lump sum awards and ongoing royalties require a court to predict the future,[114] an ongoing royalty creates a more optimal production incentive structure because the royalty affects the marginal costs of production, therefore avoiding the inefficient levels of production promoted by a lump sum.[115] A court and the parties to a lawsuit can also structure an ongoing royalty to track sales, revenues, or other appropriate metrics as the facts of a particular case may dictate. This grants a more appropriate level of control over the license, beyond the simple rate determined by a judge and permits the parties to negotiate the license terms more fully than in the lump sum case. The parties may also avoid, or at least minimize, the high chance of error associated with lump sum awards while simultaneously permitting a patent holder to recoup the full value of the patent.[116] While lump sum payments can be quickly and easily administered without an ongoing contractual relationship between the parties, their accuracy requires a nearly impossible prediction of the future market, technological developments, and noninfringing alternatives. Ongoing royalties deal with these complex issues in a simple fashion—when, and only when, an infringer sells infringing products or services, they must pay a preset price.[117] If the market changes or new technology develops, previously sunk costs in the form of a lump sum payment will not distort the infringer's behavior. Therefore, a court faced with awarding prospective relief should elect an ongoing royalty rather than a lump sum award.

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112. *Id.*

113. *Id.*

114. For both types of prospective relief, a court must assess the future marketplace, costs, revenues, likely advances in technology, noninfringing alternatives, and other mutual concerns.

115. BLAIR & COTTER, *supra* note 61, at 199-201 & fig. 7.6.

116. *Id.* at 199.

117. At the same time, administrative and legal costs may increase if products change and the parties end up back in court. However, this problem is not unique to ongoing royalties. This problem is also implicated when an infringer attempts to design around a patent in order to evade an injunction, or even when a new design might create uncertainty regarding the terms of a voluntary licensing agreement.

B. What Must the Court Consider When Setting Ongoing Royalties?

This Section begins by briefly describing the policy suggestions advocated by other scholars. Recent work on this subject maintains that an ongoing royalty confers an inappropriate benefit on an infringer, and suggests alternatives including enhanced damages regimes and even complete inaction.[118] For instance, Bernard Chao suggested that courts could simply do nothing, and future infringement would lead to future lawsuits.[119] Such a policy decision has several negative effects. First, it clogs the court system with further, unnecessary lawsuits. Second, this policy acts like a permanent injunction because future infringement by an infringer who knows the patent is both valid and infringed would invoke the willfulness doctrine. Under *In re Seagate*, a patentee establishes willful infringement when an "infringer act[s] despite an objectively high likelihood that its actions constitute[] infringement of a valid patent."[120] A previous case establishing both validity and infringement clearly satisfies this objective awareness requirement for willfulness, and any further infringement would likely lead to punitive damages. As a result, even in cases where an injunction is not warranted, an infringer must pay an arbitrarily enhanced royalty for continued use of the patent. Michael Brandt advocated an approach with a similar result that essentially tracks the district court's approach in *Amado*, where a reasonable royalty is simply multiplied up to three times because the continued infringement is in some sense willful.[121] These approaches ignore some economic concerns. In particular, patent damages serve a compensatory function, and a court must do more than arbitrarily enhance the reasonable royalty for past infringement to determine the proper compensatory ongoing royalty rate.[122]

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118. *See, e.g.*, Bernard H. Chao, *After* eBay, Inc. v. MercExchange*: The Changing Landscape for Patent Remedies*, 9 MINN. J.L. SCI. & TECH. 543, 568-69 (2008) (suggesting that a do-nothing regime would allow patent holder to file new lawsuits for continuing infringement and potentially invoke willful infringement and enhanced damages); Michael C. Brandt, Note, *Compulsory Licenses in the Aftermath of* eBay Inc. v. MercExchange, L.L.C.*: The Courts' Authority to Impose Prospective Compensatory Relief for Patent Infringement*, 17 FED. CIR. B.J. 699, 712-13 (2008) (claiming that precedent prevents ongoing royalty awards and that the parties should be left to themselves to negotiate a license while maintaining the threat of treble damages for future infringement).

119. Chao, *supra* note 118, at 568-69.

120. *In re* Seagate Tech. LLC, 497 F.3d 1360, 1371 (Fed. Cir. 2007).

121. Brandt, *supra* note 118, at 712-13.

122. *See* 7 CHISUM, *supra* note 96, § 20.03 ("The basic theory of damages is to make the patent owner whole for losses caused by the infringer's illicit activity.").

In recognition of the compensatory function of patent damages, this Section now turns to the considerations that a court should undertake to determine an ongoing royalty. For pre-verdict infringement, courts typically look to fifteen factors outlined in *Georgia-Pacific Corp. v. United States Plywood Corp.*[123] that Mark Lemley and Carl Shapiro contended essentially boil down to three important considerations: "the significance of the patented invention to the product and to market demand, the royalty rates people have been willing to pay for this or other similar inventions in the industry, and expert testimony as to the value of the patent."[124] While the essential *Georgia-Pacific* factors are also relevant for ongoing royalty determinations, a court must consider them in a slightly different fashion in order to set a fair ongoing royalty.

First, courts will often turn to ongoing royalties in cases where the metric for past damages is a reasonable royalty rather than lost profits.[125] Courts can therefore skip the complicated analysis of third-party royalty rates, and can work directly from the reasonable royalty determined for the case at hand. The reasonable royalty should act as a baseline value for the courts, which can then alter the reasonable royalty in accordance with the other essential *Georgia-Pacific* considerations.[126]

Second, courts must reconsider the significance of the patented invention in the product as well as market demand, and must do so with an eye to the future. This analysis is by no means simple, and courts must require the parties to brief this issue and provide expert testimony.[127] Because the parties are uniquely situated to present competing views on the importance of the patented invention and future market demand, the burden to prove

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123. 318 F. Supp. 1116, 1120 (S.D.N.Y. 1970).

124. Lemley & Shapiro, *supra* note 102, at 2018-19; *see also* BLAIR & COTTER, *supra* note 61, at 228-29 ("In any given case, however, a court is likely to focus on only a small number of factors . . . .").

125. Lemley & Shapiro, *supra* note 102, at 2017 (arguing that not only are lost profits difficult to prove, but patent owners that do not "sell goods in competition with the defendant will be unable to demonstrate lost profits from infringement."). In cases involving lost profits, courts will likely issue permanent injunctions, rather than ongoing damages. Darryl J. Adams & Victoria Wicken, *Permanent Injunctions After* eBay v. MercExchange*: The Year in Review*, 15 TEX. INTELL. PROP. L.J. 417, 422 & n.36 (2007) (citing "loss of market share, lost profits, loss of brand name recognition, price erosion, and loss of reputation as a market leader or innovator" as the primary reasons that courts issue permanent injunctions).

126. Lemley & Shapiro, *supra* note 102, at 2018-19.

127. Judge Clark took this approach in *Finisar Corp. v. DirecTV Group, Inc.* by instructing the parties to brief the ongoing royalty issue. Finisar Corp. v. DirecTV Group, Inc., No. 1:05-CV-264, 2006 WL 2709206 (E.D. Tex. Sept. 1, 2006). Judge Clark awarded the plaintiffs an ongoing royalty of $1.60 per infringing set-top box. *Id.*

any differences between the pre-verdict royalty and an ongoing royalty must fall to the parties.[128] The elusive "other factors" that Rader refers to in his *Paice* concurrence should include considerations such as whether the infringer can easily design around the patent and use noninfringing alternatives, or if the relevant markets have changed or will change in the future.[129] For instance, a reasonable ongoing royalty may be lower than a reasonable pre-verdict royalty if it would be particularly easy for the infringer to design around the patent using new, freely available technologies.

Suppose, for example, that a court sitting in 2008 set a reasonable royalty of $1 per infringing widget for an infringement period between 1998 and 2008. Also suppose that during those years no equivalent, noninfringing alternatives were available, but that in 2008 a noninfringing equivalent entered the public domain. If other considerations hold constant and the cost to the infringer to implement this noninfringing equivalent is lower than $1 per infringing widget over the remaining life of the patent, the court should set the ongoing royalty rate at a rate lower than $1. Ideally, an ongoing royalty will not benefit the patent holder more than the value of the patent, and at the same time economics will not motivate the infringer to implement the freely available design around because such action would be wasteful.

A court may also deal with substantial changes in the relevant markets for the patented technology. This leads to an additional market consideration for courts that involves market expansion. For instance, a patent holder may only seek to exert or license its patents in a particular market, while another party infringes the patent in an alternate market that, perhaps, the infringer created. Such situations require case-by-case analysis, but should nevertheless affect a court's ongoing royalty calculus.

Consider, for example, that the value for past-infringement of e-commerce patents during the early days of the Internet would carry substantially less valuable than the value of the same patents after immense e-commerce markets emerged. If a party can sufficiently prove these kinds of market changes, a court setting royalty rates may set an ongoing royalty higher than reasonable royalty for pre-verdict infringement in order to reflect the market changes.

Finally, courts must again consider expert testimony regarding ongoing royalties. Of course this leads to the familiar battle-of-the-experts

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128. *See* Paice LLC v. Toyota Motor Corp., 504 F.3d 1293, 1316-17 (Fed. Cir. 2007) (Rader, J., concurring).

129. *Id.*

problem,[130] but because most cases present far greater challenges and proof problems than the simple examples described above, experts represent one of the more reasonable ways for courts and juries to analyze the aforementioned market conditions and noninfringing alternatives.

C. A Basic Framework for Ongoing Royalty Determinations

Courts should reevaluate ongoing royalty determinations on a case-by-case basis using the basic framework described in this Section. To begin, a court must first determine the particular form that prospective relief will take. Most cases should use ongoing royalties instead of lump sums.[131] Additionally, because most cases involving noninjunctive prospective relief employ a reasonable royalty as the measure of past damages, a court can use this information as a convenient starting point for prospective relief.[132] Thus, a court issuing an ongoing royalty should start with the reasonable royalty rate as a baseline. The court must then consider each of the following five factors in order to fully vet the ongoing royalty:

> 1. The market for the patent has, or is substantially certain to, expand or contract;
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> 2. The likelihood that the infringer would explore other markets;
>
> 3. The availability and cost of noninfringing alternatives;
>
> 4. The capacity of the infringer to design around the patented technology, and the cost at which the infringer could do so; and
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> 5. The expert testimony of qualified experts.

When combined with a court's reasonable royalty determination, these factors accurately guide the court and the parties to examine the future

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130. *See* Albert W. Alschuler & Andrew G. Deiss, *A Brief History of the Criminal Jury in the United States*, 61 U. CHI. L. REV. 867, 926 (1994) ("[Courtroom experts] sometimes are called 'saxophones' because they play tunes for those who pay them."); Arti K. Rai, *Engaging Facts and Policy: A Multi-Institutional Approach to Patent System Approach*, 103 COLUM. L. REV. 1035, 1099 (2003) ("It is by no means clear . . . a 'battle of the experts' represent[s] the best mechanism for educating lay persons about the relevant science.").

131. *See* BLAIR & COTTER, *supra* note 61, at 198-99 & fig.7.5; Section III.A.

132. Reasonable royalties are often used because lost profits are so difficult to prove, especially in the type of case where injunctive relief will be denied, including those cases with non-practicing and non-competing patent holders. *See supra* note 125 and accompanying text.

markets for the patented invention as well as the capabilities of the infringer to design around. Similarly, these factors should assuage the Federal Circuit's worries concerning ongoing royalties because they force a court to thoroughly explain an ongoing royalty determination. This prevents the unsatisfying opinions of the district courts in *Paice* and *Amado*, where the district courts simply used the past damages award for the ongoing royalty rate without considering any forward-looking economic factors. In the footsteps of Judge Rader's *Paice* concurrence, these factors also force a court to examine the potential ways in which a reasonable royalty differs from an ongoing royalty.[133]

IV. CONCLUSION

The Federal Circuit's decisions in *Paice* and *Amado* show the uncertainty involved in an ongoing royalty determination. Though the court in each case acknowledged the potential validity of an ongoing royalty, neither decision set forth a comprehensive framework for the lower courts to follow. Rather, the Federal Circuit seemed to indicate three main points: (1) a court may not simply copy a reasonable royalty and apply the same rate, without further explanation, to future infringement; (2) a court cannot invoke the willfulness doctrine as a general enhancement to the reasonable royalty for purposes of future infringement; and (3) a proper ongoing royalty must take into account any changes in bargaining positions and economic conditions that may affect the damages inquiry. This Note explains (1) and (2), while setting forth the essential factors that a court should consider in order to satisfy (3). Even with these essential factors in hand, there is no simple solution or formula that can quickly and easily dispense of a particular case. Rather, ongoing royalties must be determined on a case-by-case basis because the ongoing royalty inquiry is not a static, formulaic determination. Instead, the determination requires a nuanced and fully-reasoned approach. The framework suggested in Section III.C facilitates this approach, while avoiding the overly simplistic analyses that the Federal Circuit admonished in *Paice* and *Amado*.

133. *Paice*, 504 F.3d at 1317 (Rader, J., concurring).

MODEL JURY INSTRUCTIONS ON NONOBVIOUSNESS IN THE WAKE OF *KSR*: THE NORTHERN DISTRICT OF CALIFORNIA'S APPROACH

By Tolga S. Gulmen

Following the Supreme Court's decision in *KSR International Co. v. Teleflex Inc.*,[1] the Northern District of California's model patent jury instruction committee revised the jury instructions for nonobviousness.[2] The model jury instructions reflect the Court's reaffirmation that the determination of nonobviousness is a matter of law by recommending that the judge determine the ultimate question of nonobviousness based upon a jury's determination of the underlying facts. Towards that end, the model jury instructions suggest two alternative means. The first charges the jury to decide the factual underpinnings without addressing whether the patent was nonobvious. The second provides for an expanded role for the jury in deciding the issue of nonobviousness. However, under the Northern District's approach, the jury may only make a nonbinding advisory verdict freeing the trial judge to make the ultimate determination of nonobviousness irrespective of the jury's determination on the issue.

The Northern District's model jury instructions also reflect the Court's holding that the teaching-suggestion-motivation (TSM) test need not be satisfied for a determination of obviousness. In fact, the 2007 revision to the advisory verdict jury instructions suggests that the jury may find such a teaching or suggestion to motivate the combination of prior art, but finding a teaching or suggestion is not necessary. However, where the jury only makes factual determinations, all such language is removed from the jury instruction leaving it in the hands of the trial judge to make the necessary determination.

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1. 127 S. Ct. 1727 (2007).

2. Claudia Wilkin, *Model Patent Jury Instructions for the Northern District of California*, *in* DEVELOPMENTS IN PHARMACEUTICAL AND BIOTECH PATENT LAW 2008, at 335 (PLI Patents, Copyrights, Trademarks, & Literary Prop., Course Handbook Series No. 17180, 2008).

This Note will first provide background in nonobviousness jurisprudence in the wake of *KSR* and case law on the jury verdicts on nonobviousness. The Note will then investigate the Northern District's model jury instructions and compare them to the later-proposed National Jury Instruction Project's model jury instructions. Finally, the Note will conclude by suggesting that neither *KSR*, nor previous precedent, mandates the Northern District's approach to strip the jury of a binding determination on the issue of nonobviousness, and that consequently litigants and trial judges have room to shape the scope of the jury's role in the nonobviousness determination.

I. NONOBVIOUSNESS IN THE WAKE OF *KSR*

The doctrine of nonobviousness has its roots in equity. In 1851 the Supreme Court held in *Hotchkiss v. Greenwood* that a doorknob patent was invalid because it did not require any more "ingenuity and skill" than would be possessed by an "ordinary mechanic" familiar with the industry, thereby expanding the requirements for patentability.[3] The patent at issue concerned a doorknob with a porcelain handle connected to a metal shank by a dovetail joint.[4] Each of the elements was known in the prior art, but the combination of the elements could not be found in the prior art.[5] The Court for the first time addressed whether the combination of known elements in a new way showed significant "ingenuity and skill" to merit a patent monopoly when viewed through the eyes of the ordinary mechanic familiar with the industry.[6] The Court used its powers in equity to establish the precedent that not all innovations are worthy of the grant of the patent monopoly.

A century later, Congress codified the judicial requirement of nonobviousness in the 1952 Patent Act.[7] The statute states that no patent shall be granted where "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."[8]

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3. Hotchkiss v. Greenwood, 52 U.S. 248, 267 (1851).
4. *Id.* at 264-67.
5. *Id.* at 264-67.
6. *Id.* at 267.
7. Patent Act of 1952, Pub. L. No. 593, § 103, 66 Stat. 792, 798 (codified as amended at 35 U.S.C. § 103 (2006)).
8. *Id.*

Over a decade later, the Supreme Court in *Graham v. John Deere Co. of Kansas City*[9] enumerated the factors that needed to be considered for the determination of nonobviousness. Following *Graham*, the Federal Circuit developed the two-pronged test for the legal conclusion on the issue of nonobviousness. The first prong was the TSM test, while the second prong considered whether there was a reasonable expectation of success in combining familiar elements. The Supreme Court in *KSR* held that the TSM test may be sufficient, but was not necessary, for a determination of obviousness. The Supreme Court stressed equitable considerations in contrast to the Federal Circuit's rigid adherence of the TSM test.

A. *Graham*

First, the Supreme Court in *Graham* held that the 1952 Patent Act did not undercut the Court's line of cases on nonobviousness.[10] Rather, the codification of nonobviousness simply continued the line of nonobviousness jurisprudence that had its genesis in 1851 with the Court's *Hotchkiss* decision.[11]

The Court's second holding outlined the framework by which nonobviousness was to be determined. The Court held that there are three factual inquiries that need to be evaluated. The first inquiry discerns what is the scope and content of the prior art.[12] The second determines the differences between the prior art and the claims at issue.[13] The third ascertains the level of ordinary skill in the art.[14] Against this backdrop, secondary considerations, such as commercial success or long felt need, may be presented to shed light onto the circumstances surrounding invention.[15]

Finally, the Court held that the obviousness determination is a matter of law.[16] While the ultimate conclusion of the issue of validity is legal, the *Graham* framework requires many factual inquires to be determined. Thus, nonobviousness is a mixed question of law and fact. The tension between the legal and factual nature of the nonobviousness analysis implicates the role of juries. Therefore, one may well be concerned with the best means of utilizing the jury towards that end.

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9. 383 U.S. 1 (1966).
10. *Id.* at 17.
11. *Id.* at 12-17.
12. *Id.* at 17.
13. *Id.*
14. *Id.*
15. *Id.* at 17-18.
16. *Id.* at 17.

B. Between *Graham* and *KSR*

While the Supreme Court in *Graham* enumerated the factual inquiries to be considered, the legal determination was not as well settled. Over the years, courts have shaped the legal determination of obviousness with various tests.[17] The Federal Circuit ultimately created a two-part test for the legal conclusion of obviousness: "whether a person of ordinary skill in the art would have been motivated to combine the prior art to achieve the claimed invention and whether there would have been a reasonable expectation of success in doing so."[18]

Federal Circuit case law also had a long history of requiring a teaching or suggestion to motivate the combination of prior art references,[19] which became known as the TSM test. Like the *Graham* framework, the TSM test was itself highly factual. The test was essentially limited to the four corners of the prior art, requiring a prior art reference to explicitly teach, suggest, or motivate a combination of elements in order to support a finding of obviousness.[20] Thus the TSM test was essentially devoid of any conception of a person having ordinary skill in the art. In sum, the TSM test relegated the person having ordinary skill in the art to nothing more than a careful reader without any inherent creativity or ability to make either deductive or inductive inferences.

C. *KSR*

Reversing the Federal Circuit, the Supreme Court in *KSR* held that the patent at issue was invalid as obvious.[21] The Court's decision in *KSR* reaffirmed its line of nonobviousness jurisprudence while also holding that the factual inquiry required to satisfy the TSM test as a necessary condition to find a patent obvious was in contradiction to Supreme Court jurisprudence.[22]

First, the Supreme Court reaffirmed that the conclusion of nonobviousness is a legal determination supported by the factual *Graham* inquiries.[23] However, the majority of the Supreme Court's decision concerned

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17. Justin Lee, Note, *How KSR Broadens (Without Lowering) the Evidentiary Standard of Nonobviousness*, 23 BERKELEY TECH. L.J. 15, 19-23 (2008) (discussing various legal tests employed for the determination of obviousness).

18. DyStar Textilfarben GmbH & Co. Deutschland KG v. C. H. Patrick Co., 464 F.3d 1356, 1360 (Fed. Cir. 2006).

19. Lee, *supra* note 17, at 23-32.

20. *In re* Gartside, 203 F.3d 1305, 1319 (Fed. Cir. 2000).

21. KSR Int'l Co. v. Teleflex Inc., 127 S.Ct. 1727 (2007).

22. *Id.* at 1739-41.

23. *Id.*

the rejection of the Federal Circuit's "rigid" application of the TSM test.[24] The Court held that the patent at issue was obvious even though the Federal Circuit's TSM test had not been satisfied.[25] Put differently, the TSM test may be sufficient to show obviousness, but is not necessary to show obviousness. The Court stated, "neither the particular motivation nor the avowed purpose of the patentee controls. What matters is the objective reach of the claim.[26]

The Supreme Court cited three flaws in the Federal Circuit's approach. First, the Federal Circuit erroneously concluded "that courts and patent examiners should look only to the problem the patentee was trying to solve."[27] Instead, the Court emphasized that obviousness should be objectively evaluated through the eyes of a person having ordinary skill in the art, not from the patentee's perspective.[28] Thus, "any need or problem known in the field of endeavor at the time of invention" may provide the requisite motivation to combine.[29] The Court effectively opened up the available evidence to be considered in an obviousness determination by explaining that a person having ordinary skill in the art would be more knowledgeable then previous Federal Circuit precedent would allow.[30] In sum, when presenting evidence to juries, the alleged infringer may have a wider array of references and prior art that can be presented as evidence of obviousness.

The second flaw was in the Federal Circuit's "assumption that a person of ordinary skill attempting to solve a problem will be led only to those elements of prior art designed to solve the same problem."[31] The Supreme Court explained that by using "common sense" a person having ordinary skill in the art would "be able to fit the teachings of multiple patents together like pieces of a puzzle."[32] Further, the person having ordinary skill in the art also has "ordinary creativity" so as not to be bound by rigid rules of where and how to select from teachings in the field.[33] The Court highlights that "[w]hen there is a design need or market pressure to solve a problem and there are a finite number of identified, predictable solutions, a person of ordinary skill has good reason to pursue the known

24. *Id.* at 1739.
25. *Id.* at 1734-35.
26. *Id.* at 1741-42.
27. *Id.* at 1742.
28. *Id.*
29. *Id.*
30. Lee, *supra* note 17, at 38-40.
31. *KSR*, 127 S. Ct. at 1742.
32. *Id.*
33. *Id.*

options within his or her technical grasp."[34] The Supreme Court reasoned that this process is not innovation, but "ordinary skill and common sense."[35] The Court effectively expanded a person having ordinary skill in the art's ability to creatively solve problems. Thus, nonobviousness must be determined from the vantage of a person having ordinary skill in the art.

This expanded creativity and knowledge of a person having ordinary skill in the art may be too easily exploited to combine references through the use of hindsight.[36] However, the Court dismissed this worry by concluding that the Federal Circuit's third error was that it "drew the wrong conclusion from the risk of courts and patent examiners falling prey to hindsight bias."[37] While factfinders should be aware of the potential bias that hindsight may cause, "[r]igid preventative rules that deny factfinders recourse to common sense, however, are neither necessary under [the Court's] case law nor consistent with it."[38] Thus juries and judges also possess "common sense," which gives them ever greater flexibility in evaluating nonobviousness.

The Supreme Court in *KSR* appears to be steering lower courts back to the equitable roots of the nonobviousness doctrine, eschewing bright line tests for common sense. The return to common sense not only applies to the legal determination but also to the abilities of the person having ordinary skill in the art. The Court never held that the TSM test has no place in the determination of nonobviousness. However, common sense allows one to look past the four corners of the prior art and consider the context of the situation, similar to how a court might consider context when evaluating the terms of a contract agreement.[39]

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34. *Id.*
35. *Id.*
36. *In re* Dembiczak, 175 F.3d 994, 996 (Fed. Cir. 1999).
37. *KSR*, 127 S. Ct. at 1742.
38. *Id.* at 1742-43.
39. *See* Markman v. Westview Instruments, Inc., 52 F.3d 967, 998 (Fed. Cir. 1995) (Mayer, J., concurring). Judge Mayer stated:

> The principle that documentary interpretation is a matter of law has become a basic tenet of modern contract law. Equally established, however, is the caveat that extrinsic evidence, such as custom and usage of the trade and course of dealing between the parties, akin to prior art, level of skill in the art, and events in the Patent Office, may be introduced to inform the meaning of the terms in the contract. And when such evidence is brought in and creates a real conflict, it results in a question of fact for the jury.

Id.

II. IMPLEMENTING THE DETERMINATION OF NONOBVIOUSNESS AT TRIAL

The admixture of equitable and factual concerns inherent in the doctrine of nonobviousness creates a potential quandary at trial. How does one find the necessary facts as prescribed by *Graham*, while also keeping the equitable approach outlined in *KSR*? While juries are ideally suited to determine facts, judges are ideally suited to determine issues in equity. Thus, the nonobviousness jurisprudence creates a tension between the two.

The following sections examine the historical usage of juries for patent trials, showing that the number of juries utilized for patent cases is much more extensive today than even as recently as when *Graham* was decided in 1966. Even though there is much doubt as to a jury's ability to implement well reasoned verdicts, the Federal Circuit has not gone so far as to mandate the use of any particular type of jury verdict. Finally, a comparison of the possible verdict types will be presented.

A. Patent Trials Before Juries

Historically, there have been very few patent trials in front of juries even though the Patent Act of 1790 provided for damages to be assessed by juries for patent infringement.[40] The Patent Act of 1870 gave power to the courts of equity to award common law damages.[41] This revision to patent law ushered in an era where patent cases were almost exclusively decided by a judge.[42] Further amendments permitted courts sitting in equity to use advisory jury verdicts at the court's discretion.[43] Even with the union of the common law and equity courts in 1875,[44] patent trials before juries were rare. In 1940 only 2.5 percent of patent cases were tried before a jury.[45] By the late 1960's that percentage remained largely unchanged.[46] Use of a jury rose dramatically by the end of the millennium as the courts witnessed a nearly twentyfold increase to 59 percent of patent trials tried before a jury.[47] Despite this increase in the use of juries for patent trials, courts remain relatively inexperienced in managing patent trials.[48] The

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40. Kimberly A. Moore, *Judges, Juries, and Patent Cases - An Empirical Peek Inside the Black Box*, 11 FED. CIR. B.J. 209, 210 (2001).

41. *Id.*

42. *Id.*

43. *Id.*

44. *Id.*

45. *Id.*

46. *Id.*

47. *Id.*

48. The inexperience of the courts also arises because few patent suits reach trial. *See id.* at 231. Efforts are underway to help courts gain greater understanding of the is-

increased use of juries also highlights the importance of the proper utilization of juries in patent trials.

Graham was decided in 1966, during the period in which almost all of the patent trials were determined by the bench and not by the jury.[49] Thus the Supreme Court in *Graham* may have been less concerned with the fact-law distinction. The Federal Circuit, on the other hand, would have routinely faced the issue of the fact-law distinction before juries following its inception in 1982.

B. No Mandate from the Federal Circuit

The Federal Circuit does not mandate the use of a particular set of jury instructions or verdict forms.[50] Instead the court chooses to bind itself to the regional circuit court precedent, but, naturally, the court is bound by the Federal Rules of Civil Procedure.[51] At best, the Federal Circuit suggests that general jury verdicts should be avoided without mandating the use of more detailed verdict forms.[52] Thus, the Federal Circuit creates a situation where each district, or even each bench, may utilize substantially different jury instructions and verdict forms.

Further, the Federal Circuit will not prohibit the use of any of the verdict options available under the Federal Rules.[53] The Federal Circuit notes that patent cases are not so distinct in their complexity from other types of cases, like antitrust cases, as to warrant a blanket prohibition against a particular type of jury verdict.[54] However, the Federal Circuit has also stressed that when obviousness is at issue, special verdict forms or interrogatories on the *Graham* factors should be employed.[55]

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sues involved in patent litigation. *See* PETER S. MENELL ET. AL., PATENT CASE MANAGEMENT JUDICIAL GUIDE, (UC Berkeley Public Law Research, Working Paper No. 1328659), *available at* http://papers.ssrn.com=1328659 (providing extensive coverage of all aspects of patent case management issues). Further, proposed legislation seeks to direct patent trials to experienced trial courts. S. 299, 111th Cong. (1st Sess. 2009); H.R. 628, 111th Cong. (1st Sess. 2009).

49. Graham v. John Deere Co. of Kansas City, 383 U.S. 1 (1966).

50. R.R. Dynamics, Inc. v. A. Stucki Co., 727 F.2d 1506 (Fed. Cir. 1984).

51. *Id.* at 1516-17.

52. *See generally*, Structural Rubber Prods. Co. v. Park Rubber Co., 749 F.2d 707 (Fed. Cir. 1984).

53. *R.R. Dynamics*, 727 F.2d at 1514-25.

54. *Id.* at 1514-15.

55. *Id.* at 1516-17.

The Federal Circuit has stated that the form of the jury verdict is a matter of discretion for the trial court.[56] However, the Federal Circuit suggests the use of detailed verdicts by specifically noting that the jury's factual findings are beneficial.[57] The Federal Circuit further notes that "'failure to utilize [a verdict form detailing factual findings] in a patent case places a heavy burden of convincing the reviewing court that the trial judge did not abuse his discretion.'"[58]

The Federal Circuit also defers to the regional circuit's precedent on procedural matters.[59] The Federal Circuit adopted this position in an effort to minimize confusion between the district courts.[60] The Federal Circuit also held that it does not have supervisory power over the general business of the trial court.[61] However, the Federal Circuit does reserve the ability to decide procedural issues in relation to substantive matters when those matters are "unique" to patent law.[62]

The Supreme Court, while reviewing a doctrine of equivalents appeal, has signaled that the Federal Circuit may be able to "implement procedural improvements to promote certainty, consistency, and reviewability" at least in certain cases.[63] It is unclear if the Supreme Court was distinguishing the determination of the doctrine of equivalents as particularly unique to patent law. However, the Supreme Court has also stated that it lacks "the benefit of the Federal Circuit's informed opinion on the complex issue of the degree to which the obviousness determination is one of fact."[64]

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56. Am. Hoist & Derrick Co. v. Sowa & Sons, Inc., 725 F.2d 1350, 1361 (Fed. Cir. 1984).

57. *Id.*

58. *Id.* (quoting A.B. Baumstimler v. Rankin, 677 F.2d 1061, 1071-72 (5th Cir. 1982)).

59. Panduit Corp. v. All States Plastic Mfg. Co., 744 F.2d 1564, 1574-75 (Fed. Cir. 1984).

60. *Id.*

61. *In re* Innotron Diagnostics, 800 F.2d 1077, 1082 (Fed. Cir. 1986).

62. *Panduit*, 744 F.2d at 1574-75.

63. Warner-Jenkinson Co. v. Hilton Davis Chem. Co., 520 U.S. 17, 39 n.8 (1997). The Court explained:

> With regard to the concern over unreviewability due to black-box jury verdicts, we offer only guidance, not a specific mandate . . . . Finally, in cases that reach the jury, a special verdict and/or interrogatories on each claim element could be very useful in facilitating review, uniformity, and possibly postverdict judgments as a matter of law. We leave it to the Federal Circuit how best to implement procedural improvements to promote certainty, consistency, and reviewability to this area of law.

Id.

64. Dennison Mfg. Co. v. Panduit Corp., 475 U.S. 809, 811 (1986).

Therefore, the Federal Circuit may be able to do more than merely suggest that detailed jury verdicts be used.[65] Indirectly, the Federal Circuit could repeatedly hold that failure to use a detailed verdict form with all factual determinations made by the jury clearly laid out is an abuse of discretion by the trial court.[66] Directly, the Federal Circuit could hold that the substance of the verdict form is a matter "unique" to patent law and, thereby, demand that a certain type of jury verdict be used.[67]

C. Comparison of Verdict Types

The Federal Rules of Civil Procedure provide for a number of ways of obtaining a jury verdict. Notably there are four possible types of verdict forms: (1) general verdict, (2) general verdict with interrogatories,[68] (3) special verdict,[69] and (4) advisory verdict.[70] Each type of verdict has its own particular strengths and weaknesses. The first and second options would charge the jury with the ultimate conclusion of nonobviousness, which would be binding on the court. The third option, the special verdict, would charge the jury to determine only the factual inquiries relevant to the *Graham* analysis. Finally, the advisory verdict would charge the jury with making a determination of the ultimate question of nonobviousness. However, the advisory opinion would not be binding on the court.

1. Naked General Verdicts

General verdicts are the quintessential black box; they ask merely for a legal conclusion without any concern for stating the underpinnings of the conclusion.[71] Their simplicity is their greatest strength. However, these verdicts are virtually unreviewable. Since there is no record of jury deliberation beyond the ultimate conclusion, a reviewing court assumes all necessary findings were in favor of the verdict unless there was substantial evidence to the contrary.[72] In practice general jury verdicts are infrequent, which mitigates the risk of faulty jury decisions on the issue of obviousness.[73]

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65. *See* Kimberly A. Moore, *Juries, Patent Cases, & a Lack of Transparency*, 39 HOUS. L. REV. 779 (2002).

66. *Id.* 797-98.

67. *Id.* 798-99.

68. FED. R. CIV. P. 49(b).

69. FED. R. CIV. P. 49(a).

70. FED. R. CIV. P. 39(c).

71. Moore, *supra* note 40, at 213.

72. *See* Am. Hoist & Derrick Co. v. Sowa & Sons, Inc., 725 F.2d 1350, 1361 (Fed. Cir. 1984).

73. Moore, *supra* note 65, at 783.

While infrequent in practice, the Federal Circuit stated in *Connell v. Sears, Roebuck & Co.* that a jury may return a "naked general verdict" just like in any other civil suit.[74] However, the Federal Circuit disfavors this approach by noting that general verdicts "leav[e] a wide area of uncertainty on review."[75] The court lists other procedural safeguards to defend against an "unruly or 'rogue elephant' jury":[76] general verdict with interrogatories,[77] special verdicts,[78] directed verdicts,[79] judgment as a matter of law,[80] jury instructions to guide the legal conclusions,[81] advisory juries,[82] and grant of new trial.[83]

The court suggests that the following elements be present when the court submits the question of obviousness to the jury: (1) detailed special interrogatories designed to determine the factual underpinnings of the *Graham* framework; and (2) appropriate instructions on the law that, at a minimum, the jury must consider the invention as a whole through the eyes of one having ordinary skill in the art at the time the invention was made.[84] Thus, the Federal Circuit has not mandated the use of other types of verdict options. The Federal Rules of Civil Procedure bind the court, and as long as the general verdicts are contained within the rules, there can be no prohibition against them.[85] The Federal Circuit refuses to accept the notion that patent cases substantially differ from other types of cases.[86]

However, in *American Hoist & Derrick Co. v. Sowa & Sons, Inc.*, the Federal Circuit criticized the trial court for submitting the question of obviousness as a general verdict.[87] The verdict asked for a check if the following was true: "The subject matter of claim 7 would have been obvious to one of ordinary skill in the art at the time the claimed invention was made."[88] The court recognized that the form of the jury verdict was nor-

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74. Connell v. Sears, Roebuck & Co., 722 F.2d 1542, 1546 (Fed. Cir. 1983).
75. *Id.*
76. *Id.*
77. FED. R. CIV. P. 49(b).
78. FED. R. CIV. P. 49(a).
79. FED. R. CIV. P. 50(a).
80. FED. R. CIV. P. 50(b).
81. FED. R. CIV. P. 51.
82. FED. R. CIV. P. 52.
83. FED. R. CIV. P. 59.
84. Connell v. Sears, Roebuck & Co., 722 F.2d 1542, 1547 (Fed. Cir. 1983).
85. *See* R.R. Dynamics, Inc. v. A Stucki Co., 727 F.2d 1506, 1514-15 (Fed. Cir. 1984).
86. *Id.* at 1515.
87. Am. Hoist & Derrick Co. v. Sowa & Sons, Inc., 725 F.2d 1350, 1361 (Fed. Cir. 1984).
88. *Id.* at 1357.

mally within the discretion of the trial court.[89] The court, however, stated that special interrogatories should have been made.[90] The court suggested that it might be possible to find an abuse of the trial court's discretion to submit the obviousness question to a jury as a general verdict because "'failure to utilize [special interrogatories] in a patent case places a heavy burden of convincing the reviewing court that the trial judge did not abuse his discretion.'"[91]

2. *General Verdicts with Interrogatories*

Interrogatories are designed to provide an understanding of how the jury arrived at its final verdict. When submitting interrogatories to the jury, the judge must provide instruction so that the jury can both answer to the interrogatories and render a general verdict.[92]

The Supreme Court echoes praise for non-general verdict forms. "[I]n cases that reach the jury, a special verdict and/or interrogatories on each claim element could be very useful in facilitating review, uniformity, and possibly postverdict judgments as a matter of law."[93]

The Federal Circuit speaks with similar appreciation for non-general jury verdicts. The Federal Circuit has suggested, but not mandated, that general verdicts "should . . . be accompanied by detailed special interrogatories designed to elicit responses to at least all of the factual inquires enumerated in *Graham*."[94] The court also notes that special interrogatories facilitate appellate and trial review for judgment as a matter of law.[95] Additionally, interrogatories make review less onerous for the reviewing court because the reviewing court does not have to consider every possible basis for the jury's decision.[96]

Others echo these beneficial traits, claiming that devices such as general verdicts with interrogatories and special verdicts are superior to general verdicts because they check the jury, facilitate judicial review, depreciate bias in decision-making, and simplify jury instructions.[97] "By compelling a jury to consider factual issues individually, special verdicts and

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89. *Id.* at 1361.
90. *Id.*
91. *Id.* (quoting Baumstimler v. Rankin, 677 F.2d 1061, 1071-72 (5th Cir. 1982)).
92. FED. R. CIV. P. 49(b)(1).
93. Warner-Jenkinson Co. v. Hilton Davis Chem. Co., 520 U.S. 17, 39 n.8 (1997).
94. Connell v. Sears, Roebuck & Co., 722 F.2d 1542, 1547 (Fed. Cir. 1983).
95. *Am. Hoist & Derrick*, 725 F.2d at 1361.
96. *Id.*
97. Moore, *supra* note 65, at 783.

interrogatories may improve the consistency of jury verdicts as well as the underlying decision-making processes that produce them."[98]

However, the use of interrogatories has potential problems. First, the Federal Circuit notes that the "precise language in which [interrogatories] are couched can have an untoward effect on a verdict."[99] The court warns about elements of the trial or evidence that may be over emphasized in the juror's minds, thus tainting the verdict.

Another problem with general verdicts with special interrogatories lies in the possibility that the interrogatories will be inconsistent with each other or with the final verdict. If the answers are consistent with each other but inconsistent with the verdict, the judge may enter judgment in line with the answers, direct the jury to further deliberation, or order a new trial.[100] However, when the answers are inconsistent with each other and the verdict, the judge shall not enter a verdict.[101] The judge has two options: order the jury to continue deliberation or order a new trial.[102]

In resolving inconsistencies between answers to interrogatories, the Federal Circuit follows the regional circuit's case law on procedural matters.[103] However, the Federal Circuit evaluates inconsistent verdicts by the Supreme Court's standard that appellate courts have a duty to attempt to resolve potentially inconsistent jury verdicts.[104] To that end, the Federal Circuit has held that if there is a view of a case that makes the jury's answers to the interrogatories consistent, a court must resolve them in that way.[105]

A third problem with a general verdict with special interrogatories lies in the fact that the judge still has to instruct the jury on how to make the legal conclusion on the issue of obviousness.[106] Otherwise, a general ver-

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98. Paul J. Zegger & Peter Lee, *The Paper Side of Patent Jury Trials: Jury Instructions, Special Verdict Forms, and Post-Trial Motions*, *in* PATENT LITIGATION 2007, at 701, 716 (PLI Patents, Copyrights, Trademarks, and Literary Prop. Course Handbook Series 2007), *cited with approval in* Agrizap, Inc. v. Woodstream Corp., 520 F.3d 1337, 1343 n.3 (Fed. Cir. 2008).

99. Weinar v. Rollform Inc., 744 F.2d 797, 809 (Fed. Cir. 1984).

100. FED. R. CIV. P. 49(b)(3)(C).

101. FED. R. CIV. P. 49(b)(4).

102. *Id.*

103. Bradford Co. v. Jefferson Smurfit Corp., No. 00-1511, 2001 U.S. App. LEXIS 25205, at *10 (Fed. Cir. Oct. 30, 2001).

104. Gallick v. Baltimore & Ohio R.R., 372 U.S. 108, 119 (1963).

105. Mycogen Plant Sci., Inc. v. Monsanto Co., 243 F.3d 1316, 1326 (Fed. Cir. 2001).

106. *See* Structural Rubber Prods. Co. v. Park Rubber Co., 749 F.2d 707, 724 (Fed. Cir. 1984) (noting that special verdict forms have a particular advantage of not having to

dict by the jury cannot be obtained with any reliability. However, one may be able to essentially direct a jury to its conclusion of nonobviousness. For example, Judge Nies stated that it was error to instruct a jury on the defendant's burden to show invalidity by clear and convincing evidence.[107] Nies defends this statement, citing the proposition that the determination of obviousness is a matter of law.[108] When a general verdict with interrogatories is used, the jury should be instructed that if it finds facts in a particular way then it must find for one of the parties.[109] Otherwise, the jury should find for the other party. By this rigid construction, Judge Nies would effectively, but not formally, strip the jury of its ability to decide the issue of obviousness.

While the problem of inconsistency haunts the use of general verdicts with interrogatories, the advantage of transparency is preserved. By requiring that the jury submit answers to the special interrogatories, the decisions may be reviewed and anomalies corrected.

3. Special Verdict

Special verdicts relieve the jury of the duty to determine the ultimate legal question. Thus, the jury in its capacity of factfinder merely answers questions about the factual underpinnings of the obviousness question. If the court proceeds under this device, the court "must give the instructions and explanations necessary to enable the jury to make its findings on each submitted issue."[110]

On the one hand, using special verdicts "greatly simplifies the instructions which must be given and clearly separates the respective functions of judge and jury."[111] Moreover, the use of special verdict forms is a "particularly useful tool in conserving judicial resources and in effectuating the Congressional policy expressed in patent laws."[112] Special verdicts have the same advantage of transparency as the general verdict with special interrogatories since the jury's findings are explicitly stated. However, they do not suffer from the potential inconsistency in the jury's application of the facts to the legal standards of nonobviousness. Any potential inconsis-

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instruct the jury on the legal issues unlike where the jury has to deliver a verdict with or without interrogatories).

107. Hilton Davis Chem. Co. v. Warner-Jenkinson Co., 62 F.3d 1512, 1556-58 (Fed. Cir. 1995) (en banc) (Nies, J., dissenting), *rev'd*, 520 U.S. 17 (1997).

108. *Id.*

109. *Id.*

110. FED. R. CIV. P. 49(a)(2).

111. *Structural Rubber*, 749 F.2d at 724.

112. *Id.*

tency would lie with the trial judge's legal application of the jury-determined facts.

However, special verdicts remove the ability of the jury to decide the legal outcome. Special verdicts also place an increasing burden on the trial judge to issue a holding on the legal question of obviousness after the jury returns its answers to the court. That said, nonobviousness is a legal determination,[113] and it may be more logical to ask the jury to submit a special verdict form instead of a general verdict with interrogatories.

4. Advisory Verdict

Rule 39(c) allows for the court to use an advisory verdict, at the court's discretion or upon motion by the parties, for suits not triable as a matter of right by a jury.[114] The advisory verdict is not binding on either the trial court or reviewing court. In practice, however, the trial bench may overly rely on the jury's advisory verdict.

Support exists for the notion that nonobviousness falls outside of a suit triable by right of jury. Where the court has only the legal issue of obviousness before it, a jury is not required as a matter of right.[115] If the facts have been established, the judge must resolve the nonobviousness issue.[116]

The Ninth Circuit, one month before the formation of the Federal Circuit, sanctioned the use of advisory verdicts.[117] The court held that a trial court must determine obviousness as a matter of law based upon the findings required by *Graham*, but may submit the question of obviousness to an advisory jury for guidance.[118] The Ninth Circuit's decision held that the court has the duty to determine obviousness independent of the jury's conclusion.[119] The en banc panel specifically disapproved of a comment in a previous opinion that appeared to approve leaving the ultimate question of obviousness to the jury.[120]

The Federal Circuit reviewed the Ninth Circuit's holding allowing for advisory juries and refused to follow the suggestion about utilization of advisory juries.[121] Where the Federal Circuit was faced with a trial judge's

113. KSR Int'l Co. v. Teleflex Inc., 127 S. Ct. 1727, 1745 (2007).
114. FED. R. CIV. P. 39(c).
115. Newell Co. v. Kenney Mfg. Co., 864 F.2d 757, 763 (Fed. Cir. 1988).
116. *Id.*
117. *See* Sarkisian v. Winn-Proof Corp., 688 F.2d 647 (9th Cir. 1982) (en banc).
118. *Id.* at 650.
119. *Id.*
120. *Id.* at 650-51 (criticizing Hammerquist v. Clarke's Sheet, Inc., 658 F.2d 1319 (9th Cir. 1981)).
121. Perkin-Elmer Corp. v. Computervision Corp., 732 F.2d 888, 895 n.5 (Fed. Cir. 1984).

use of an advisory verdict, the court characterized such use as a "discredited procedure."[122] The court ultimately treated the advisory verdict as an ordinary verdict and upheld it under the substantial evidence standard.[123]

III. THE NORTHERN DISTRICT'S MODEL PATENT JURY INSTRUCTIONS

The Northern District of California issued a revised set of model patent jury instructions on October 9, 2007. While the model jury instructions are revised every couple of years,[124] the newest revision took into account the *KSR* decision, which had been decided approximately five months beforehand. The working committee's[125] revisions to the model jury instructions were dramatically influenced by the *KSR* decision and they repeatedly emphasized that the determination of nonobviousness is a legal one.

The committee discarded both the general verdict and the general verdict with interrogatories.[126] Instead, the committee opted to provide, in the alternative, either instructions for a special verdict where the jury only determines the underlying factual *Graham* inquiries, or instructions for an advisory verdict where the jury makes the determination of nonobviousness but that determination has no binding effect on the trial judge.[127] There are also minor changes to the scope and content of the prior art *Graham* factors and the secondary considerations to be considered.[128] The differences between the prior art and the patent[129] and the level of skill in the art[130] *Graham* factors are unchanged.

A. Verdict Options

The Northern District's model jury instructions provide for either an advisory verdict or a special verdict. The comments to both instructions emphasize that nonobviousness is a legal conclusion that should be rendered by the court.[131] The advisory verdict charges the jury with answer-

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122. Richardson v. Suzuki Motor Co., 868 F.2d 1226, 1234 (Fed. Cir. 1989).
123. *Id.* at 1240.
124. The two previous editions were in 2004 and 2002.
125. The working committee consisted of Judge Ronald Whyte of the Northern District of California, Professor Mark Lemley, and practioners Martin Fliesler, David McIntyre, James Pooley, Matthew Powers, and James Yoon. Wilkin, *supra* note 2, at 337.
126. *Id.* at 374-77.
127. *Id.*
128. *Id.* at 374-78.
129. *Id.* at 379.
130. *Id.* at 380.
131. *Id.* at 374-76 nn.9 & 10.

ing special interrogatories about the underlying factual inquires and to make a nonbinding determination on the conclusion of obviousness. The special verdict charges the jury only with answering interrogatories to the factual inquires.

One revision to the instructions is common to both of the alternatives. The revised model jury instructions start by saying: "Not all innovations are patentable."[132] Starting the instructions with that sentence should grab a juror's attention. On one hand, such a statement may seem to undercut the presumption of patent validity that requires clear and convincing evidence for invalidation.[133] But on the other hand, such a statement may be seen as a way to ameliorate a perceived pro-plaintiff bias of jurors.[134]

1. Advisory Verdict

The first alternative provides for an advisory verdict and determination of the *Graham* factual inquiries by the jury. The first paragraph has three components: (1) not all innovations are patentable, (2) a paraphrase of language from 35 U.S.C. § 103(a), and (3) distinguishing between the use of prior art in the context of nonobviousness from anticipation and statutory bars by stating that not all of the requirements of the claim need to be found in a single piece of prior art.[135] Except for the statement that not all innovations are patentable, this language is almost identical to the beginning of the 2004 model jury instructions.[136]

The second paragraph discusses nonobviousness. There is additional discussion of the use of prior art by pointing out that a claim is not held obvious merely because all of the limitations are known in the prior art.[137] Rather, the jury "may consider" whether there is some "reason" for a person having ordinary skill in the art to combine the "elements or concepts" to form the claimed invention.[138] The 2007 model jury instructions state that a patent is not obvious "*unless* there was something in the prior art or within the understanding of a person of ordinary skill in the field that would *suggest* the claimed invention."[139]

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132. *Id.* at 374, 376.
133. 35 U.S.C. § 282 (2006).
134. Moore, *supra* note 40, at 231-32.
135. Wilkin, *supra* note 2, at 374-77.
136. Martin Fliesler et al., *Model Patent Jury Instructions for the Northern District of California*, *in* TRIAL OF A PATENT CASE 2004, at 357, 392 (Amer. Law Inst.-Amer. Bar Assoc. Continuing Legal Educ., Course Handbook, 2004).
137. Wilkin, *supra* note 2, at 376-77.
138. *Id.*
139. *Id.* (emphasis added).

First, the language of the 2007 model jury instructions makes finding a "reason" to combine permissive since the jury "may consider" whether there was a reason to combine.[140] This may actually be reading too much into *KSR*, which, if read narrowly, only rejected the notion that the TSM test as applied by the Federal Circuit had to be satisfied for a patent to be deemed obvious.[141] The Supreme Court in *KSR* actually went to great lengths to provide a reason for the components of the patent at issue to be combined.[142] This permissiveness may be in contradiction with Federal Circuit precedent that requires a reason to combine for a finding of obviousness after *KSR*.[143] Second, the revision to the 2007 model jury instructions strikes the requirement that there needs to be something to "suggest" the claimed invention within the prior art, which is more in line with the language of *KSR*.[144]

However, several sentences later, the model jury instructions state that it is permissible to consider whether there is some "teaching or suggestion" in the prior art to motivate the "modification or combination of elements claimed in the patent."[145] This part of the instruction not only touches upon combination of elements, but also modification. Nowhere in the 2004 model jury instructions is there any mention of modification of elements, but it certainly harkens back to *Hotchkiss* and the modification of the material for the doorknob.[146]

The intervening sentences of the second paragraph continue by distinguishing "true inventiveness . . . (which is patentable)" from the "application of common sense and ordinary skill to solve a problem . . . (which is not patentable)."[147] The instruction also tries to distinguish between "innovation" as recited in the first sentence of the instruction and "invention,"

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140. *Id.*

141. *See* KSR Int'l Co. v. Teleflex Inc., 127 S.Ct. 1727, 1741 (2007) ("There is no necessary inconsistency between the idea underlying the TSM test and the *Graham* analysis.").

142. *See id.* at 1735-37.

143. PharmaStem Therapeutics, Inc. v. Viacell, Inc., 491 F.3d 1342, 1360 (Fed. Cir. 2007) (stating that the defendant must show by clear and convincing evidence "[1] that a person of ordinary skill in the art would have had reason to attempt to make the composition or device, or carry out the claimed process, and [2] would have had a reasonable expectation of success in doing so.").

144. *See KSR*, 127 S.Ct. at 1741 ("[T]he analysis need not seek out precise teachings directed to the specific subject matter of the challenged claim, for a court can take account of the inferences and creative steps that a person of ordinary skill in the art would employ.").

145. Wilkin, *supra* note 2, at 376.

146. Hotchkiss v. Greenwood, 52 U.S. 248, 266 (1851).

147. Wilkin, *supra* note 2, at 376-77.

but states that "[t]here is no single way to define the line between" the two.[148] "Common sense" comes directly from the language of *KSR*,[149] and the instruction continues to recite more of *KSR* by giving the examples that "market forces or other design incentives may be what produced a change, rather than true inventiveness."[150] There is no corresponding language in the 2004 version of the model jury instructions that approximates this language.

The second paragraph concludes by warning against hindsight bias by instructing the jurors to place themselves into the shoes of a person having ordinary skill in the art at the time the invention was made.[151] The instructions specifically state that the juror should not consider "what is known today or what is learned from the teaching of the patent."[152] This language is nearly verbatim to the 2004 model jury instructions.[153] However, the 2007 version adds that "many true inventions might seem obvious after the fact."[154]

The third paragraph of the 2007 model jury instructions states: "The ultimate conclusion of whether a claim is obvious *should* be based upon your determination of several factual decisions."[155] This language seems innocuous, yet when compared to the 2004 model jury instructions it reveals its true nature as an advisory verdict. The 2004 model jury instruction, in contrast, states: "Your ultimate conclusion about the question whether a claim is obvious *must* be based on several factual decisions that you must make."[156] The distinction between the 2007 and 2004 instructions is subtle, but the distinction reveals the fundamental difference as to who makes the ultimate conclusion of nonobviousness. The 2007 model jury instruction takes away the jury's power to make the ultimate conclusion. The 2007 model jury instruction also makes a determination of nonobviousness permissibly dependent on the factual inquires, i.e. the *Graham* factors. In contrast, the 2004 model jury instructions require use of the *Graham* factors. The permissive nature of the 2007 model jury instructions is curious since *KSR* never challenged the use of *Graham*.[157] Instead,

148. *See id.*
149. *KSR*, 127 S. Ct. at 1742.
150. Wilkin, *supra* note 2, at 376; *KSR*, 127 S. Ct. at 1742.
151. Wilkin, *supra* note 2, at 376.
152. *Id.*
153. Fliesler, *supra* note 136, at 392.
154. Wilkin, *supra* note 2, at 376-77.
155. *Id.* (emphasis added).
156. Fliesler, *supra* note 136, at 392 (emphasis added).
157. *See* KSR Int'l Co. v. Teleflex Inc., 127 S. Ct. 1727, 1734 (2007).

the Court in *KSR* specifically reaffirmed the use of the *Graham* inquiries.[158]

The third paragraph concludes by listing the *Graham* factors and secondary considerations.[159] The 2004 model jury instructions conclude in the same way.[160] The 2007 model jury instructions include all of the secondary considerations of the 2004 version: commercial success, long-felt need, unsuccessful attempts by others, copying, unexpected superior results, acceptance by others, and independent invention.[161] The 2007 model jury instructions, however, include two catchall secondary considerations for "other evidence tending to show" obviousness and nonobviousness.[162] Simply put, the new instructions considerably expand what parties may be allowed to introduce into evidence to determine the circumstances surrounding the time of invention.

2. *Special Verdict*

The alternative jury instruction charges the jury to make specific findings but no determination of nonobviousness.[163] Because the jury needs only to make factual findings, these instructions tend to be simpler than the advisory verdict. The special verdict instruction tracks the beginning and end of the advisory verdict essentially by using the first and last sentences of the advisory verdict.

The special verdict instructions state that "not all innovations are patentable."[164] The model jury instructions paraphrase the language of 35 U.S.C. § 103(a).[165] The third sentence is the only one that deviates from the advisory verdict instructions; here the advisory verdict instructions expressly state that the judge is charged with the ultimate conclusion of obviousness based upon the jury's factual finding.[166] The model jury instructions conclude by listing the *Graham* factors and secondary considerations.[167]

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158. *Id.*
159. Wilkin, *supra* note 2, at 376-77.
160. Fliesler, *supra* note 136, at 392.
161. Wilkin, *supra* note 2, at 377; Fliesler, *supra* note 136, at 392.
162. Wilkin, *supra* note 2, at 377.
163. *Id.* at 376 n.10.
164. *Id.* at 376.
165. *Id.* ("A patent claim is invalid if the claimed invention would have been obvious to a person of ordinary skill in the field at the time the application was filed . . . .").
166. *Id.* at 374.
167. *Id.* at 374, 376-77.

The main distinguishing feature of the special verdict instruction comes from the comment.[168] Since the jury is only determining facts, the instruction should be curtailed to only seek answers to factual issues in dispute at trial.[169] For example, if the only contested factual issue is whether a reference qualifies as prior art, then that is the only *Graham* factor for which the jury should receive instruction.[170]

B. The *Graham* Factors

In the model jury instructions, the *Graham* factors are listed separately and are used with either the advisory or the special verdict where needed.[171]

1. Scope and Content of the Art

The instructions for the scope and content of the prior art are largely unchanged between the 2004 and 2007 revisions.[172] Both instructions state that the prior art reference needs to be "reasonably related to the claimed invention of [the] patent."[173] Both sets also provide a two pronged test that determines whether the prior art reference is "reasonably related": the prior art either needs to be from the same field or from another field to which a person having ordinary skill in the art would look to solve a known problem.[174] The one change between 2004 and 2007 occurs in the second prong of the reasonably related test. The 2004 wording "the problem the named inventor was trying to solve"[175] has been replaced with "a known problem."[176] This language is taken from *KSR* where the Court noted that it was error by the Federal Circuit to require that the only combinable prior art was art specifically intended to solve the patentee's problem.[177]

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168. *Compare id.* at 374 n.9 ("This instruction provides the jury with an instruction on the underlying factual questions it must answer to enable the court to make the ultimate legal determination of the obviousness question."), *with id.* at 374 n.10 ("This instruction provides the jury with an instruction on how to analyze the obviousness question and reach a conclusion on it in the event that the Court decides to allow the jury to render an advisory verdict on the ultimate question of obviousness.").
169. *Id.*
170. *Id.*
171. *Id.* at 374, 376.
172. Compare *id.* at 378, *with* Fliesler, *supra* note 136, at 394.
173. Wilkin, *supra* note 2, at 378; Fliesler, *supra* note 136, at 394.
174. Wilkin, *supra* note 2, at 378; Fliesler, *supra* note 136, at 394.
175. Fliesler, *supra* note 136, at 394.
176. Wilkin, *supra* note 2, at 378.
177. KSR Int'l Co. v. Teleflex Inc., 127 S. Ct. 1727, 1742 (2007).

2. *Differences Over the Prior Art*

The model jury instructions for analyzing differences between the prior art and the claimed invention simply instruct the jury to "consider any difference or differences between the [prior art] and the claimed requirements."[178] There are no changes between the 2007 and 2004 versions of the model jury instructions,[179] and the authorities listed do not reference *KSR*.[180]

3. *Level of Ordinary Skill in the Art*

As with the prior art factor, there are no changes from the 2004 model jury instructions for determining the skill level of ordinary skill in the art.[181] The instruction tells the jury that they should "consider all the evidence introduced at trial" including the level of ordinary skill and experience, the types of problems encountered in the field, and the sophistication of the technology.[182] While *KSR* was silent regarding the determination of the level of skill in the art, it did offer guidance on how a person having ordinary skill in the art may apply their knowledge, creativity, and common sense.[183] This language from *KSR* has been incorporated into the advisory verdict instruction.[184] However, it was unnecessary to incorporate the Supreme Court's language within the special verdict since the jury does not determine obviousness.

C. Verdict Forms

The 2007 model jury instructions provide two sets of sample verdict forms for the alternate advisory and special verdict.[185] The comment to the sample verdict form instructs that the issues presented to the jury should be as specific as possible.[186] Both sample verdict forms are "designed to focus the parties and the court on the factual disputes on the obviousness

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178. Wilkin, *supra* note 2, at 379.
179. *Compare id.*, *with* Fliesler, *supra* note 136, at 395.
180. Wilkin, *supra* note 2, at 379.
181. *Compare id.* at 380, *with* Fliesler, *supra* note 136, at 396.
182. Wilkin, *supra* note 2, at 380.
183. KSR Int'l Co. v. Teleflex Inc., 127 S. Ct. 1727, 1742 (2007).
184. *Compare id.* ("Common sense teaches, however, that familiar items may have obvious uses beyond their primary purposes, and in many cases a person of ordinary skill will be able to fit the teachings of multiple patents together like pieces of a puzzle."), *with* Wilkin, *supra* note 2, at 380 ("You may consider whether the change was merely the predictable result of using prior art elements according to their known functions, or whether it was the result of true inventiveness.").
185. Wilkin, *supra* note 2, at 399-401.
186. *Id.* at 394.

question."[187] The sample verdict form utilized at trial "should require the jury's finding on each factual issue so that the trial judge may make the final determination on the obviousness question."[188] The use of general verdicts is not recommended, and the court should not defer to the jury for the ultimate question of nonobviousness.[189] While not expressly stated, the model jury instructions impliedly recommend against the use of a general verdict with interrogatories.

The two sample verdict forms are nearly identical. They both include detailed questions of the three *Graham* factors and the secondary considerations.[190] The sample verdict forms ask the jury to determine the level of ordinary skill in the art. There are three check boxes: one corresponds to the patentee's contention, the second to the defendant's contention, and the third is a catch-all "other" requiring that the jury describe the level of ordinary skill in the art.[191] Similarly, there are three check boxes for choosing the differences over the prior art that correspond to the parties' contentions and another "other" catch-all that requires the jury to write out the differences they find.[192] The secondary considerations section on both verdict forms simply lists each consideration letting the jury check off all that apply.[193] The catch-all "other" secondary considerations tending to show obviousness or nonobviousness require the jury to describe the "other factors" that they found relevant.[194]

While both the advisory and special sample verdict forms specifically ask the jury to find the scope and content of the art, the two sample verdict forms do so in different ways. For the advisory verdict, each disputed prior art reference is listed separately and the jury can check off those that they find are reasonably related.[195] However, the special verdict uses a form similar to the level of ordinary skill form and difference over the prior art form. Namely, each party's contention is listed and a third "other" category is also supplied.[196] Thus, each party groups what they contend to be the combination of prior art that includes both prior art references, e.g. pa-

187. *Id.*
188. *Id.*
189. *Id.* at 394-95.
190. *See id.* at 399-401.
191. *Id.*
192. *Id.*
193. *Id.*
194. *Id.*
195. *Id.* at 400-01.
196. *Id.* at 399.

tents, but also general knowledge in the field and common knowledge of a layperson.[197]

The only other distinction between the two sample verdict forms is that the advisory verdict asks the jury to make the ultimate conclusion on nonobviousness.[198]

D. Comparison to the National Jury Instruction Project

Like the Northern District of California, the National Jury Instruction Project (NJIP) also suggests the use of two different verdict options: a special verdict and a general verdict.[199] Unlike the Northern District, the NJIP does not provide for an advisory verdict.[200] Instead, the NJIP provides for a sample verdict form where the conclusion of obviousness may be made a general verdict.[201] The NJIP sample verdict form goes further by suggesting that all issues of validity be lumped into a single question,[202] which is in stark contradiction to the Northern District's approach.

At the request of Federal Circuit Judge Michel, a committee was convened to draft a set of patent model jury instructions, which were published on December 5, 2008.[203] The model jury instructions put forth are neither endorsed by the Federal Circuit nor are they official instructions.[204] But the goal was to collect the wisdom from members of the bench and bar to create an easier-to-understand and streamlined set of instructions.[205]

The committee suggests that the "best approach" is for the parties and judge to tailor the jury instructions and form to the particular facts of the case.[206] The committee further suggests that where the parties and judge desire to submit the underlying factual question to the jury, they should look to the Northern District's model jury instructions and sample verdict form that asks the jury to determine each *Graham* factor as well as the

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197. *Id.*

198. *Id.* at 401.

199. MODEL PATENT JURY INSTRUCTIONS 42-47 (Nat'l Jury Instruction Project, Draft for Comment 2008), *available at* http://www.patentlyo.com/patentjuryinst.pdf.

200. *Id.*

201. *Id.* at 62-67.

202. *See id.* at 62-63.

203. *Id.* at 1. Committee members include: Judges Patti Saris, T. John Ward and Ronald Whyte, and attorneys Kenneth Bass III, Donald Dunner, Pamela Krupka, Roderick McKelvie, Teresa Rea, and Edward Reines. *Id.* Judge Whyte was also a committee member of the Northern District of California's model jury instructions committee.

204. *Id.*

205. *Id.*

206. *Id.* at 48.

secondary considerations.[207] However, the NJIP committee departs from the Northern District's approach since it has reservations about the use of special interrogatories because of the burden of proof problem.[208]

The NJIP committee explains why they have provided the nonobviousness instructions for both a general verdict and a special verdict; the committee was "unable to reach a consensus on an instruction and a verdict form for those cases where the court submits the underlying factual issues to the jury and reserves for itself the determination of obviousness."[209] The committee explains that there exists no "case law that provides guidance on how to implement the burdens of proof a party has with regard to either the statutory factors or the secondary considerations."[210]

The committee provides an example when considering the differences between the scope and content of the art and the claimed invention. The jury is charged with determining "what difference, if any, existed between the claimed invention and the prior art."[211] The committee found it difficult to craft instructions and verdict-form questions with an evidentiary standard for the individual findings required by a jury in the *Graham* analysis.[212] Similarly, the committee "ha[s] not been able to agree on the patent owner's burden of proof in establishing commercial success or agree on a form by which the jury reports its finding on commercial success."[213]

Issued patents have the presumption of validity.[214] Therefore, the burden of proof that an alleged infringer needs to establish must be that of clear and convincing evidence.[215] The Northern District's and the NJIP's jury instructions translate the clear and convincing evidentiary standard into "highly probable."[216]

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207. *Id.*

208. *Id.*

209. *Id.*

210. *Id.*

211. *Id.*

212. *Id.* ("[The committee] find[s] it difficult to translate that instruction into a finding an alleged infringer must establish is 'highly probable' and then into a question or questions a jury answers on a verdict form.").

213. *Id.*

214. 35 U.S.C. § 282 (2006).

215. Buildex Inc. v. Kason Indus., Inc. 849 F.2d 1461, 1463 (Fed. Cir. 1988) ("[A]n attack on [the patent's] validity requires proof of facts by 'clear and convincing evidence' . . . . The 'clear and convincing' standard of proof of facts is an intermediate standard which lies somewhere between 'beyond a reasonable doubt' and a 'preponderance of the evidence.") (citations omitted).

216. Wilkin, *supra* note 2, at 366; Nat'l Jury Instruction Project, *supra* note 199 at 30. In contrast, the preponderance of evidence standard is described in the Northern District's instructions as "more likely than not." Wilkin, *supra* note 2, at 352.

The Northern District's advisory opinion asks the jury whether "it is highly probable that the claim of the Patent Holder's patent would have been obvious."[217] The NJIP verdict form similarly asks whether the alleged infringer has "proven that it is highly probable that the following claim is invalid as obvious."[218] For the factual inquiries required by *Graham*, the Northern District's sample verdict form does not possess language concerning a particular type of evidentiary standard. For example, the sample verdict form asks: "What was the level of ordinary skill in the field that someone would have had at the time the claimed invention was made?"[219]

The lack of evidentiary standard for the underlying factual inquiries in the Northern District's instructions is mirrored in the sample verdict form's questioning on whether the patent was invalid because of anticipation or a statutory bar.[220] In both inquiries there must be a showing that it is highly probable that the patent is invalid.[221] Where the jury determines that invalidity is highly probable because of anticipation or a statutory bar, the jury is charged with checking the reason for such a finding.[222] However, the list of reasons that may anticipate the patent have no evidentiary standard.[223] For example, the sample verdict provides a possible reason for anticipation: "The named inventor was not the first inventor of the claimed invention."[224] Perhaps when the question of anticipation is read in conjunction with the reason for anticipation it can be assumed that it was highly probable that the named inventor was not the first inventor, since anticipation is found from only a single anticipating event.

However, obviousness is more complicated than anticipation, requiring the three *Graham* factors and the secondary considerations to be evaluated individually and collectively. While the Northern District's sample verdict form is silent on the evidentiary standard for the individual *Graham* factors, the instructions do imply a burden of proof for *Graham's* secondary considerations. The sample verdict form asks "[w]hich of the following [secondary considerations] has been *established by the evidence*

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217. *Id.* at 401.
218. Nat'l Jury Instruction Project, *supra* note, 199 at 66.
219. Wilkin, *supra* note 2, at 399-400.
220. *Id.*
221. *Id.*
222. *Id.*
223. *See, e.g.*, *id.* at 399 ("The claimed invention was already publicly known or publicly used by others in the United States before the date of conception of the claimed invention.").
224. *Id.* at 398.

with respect to the claimed invention."[225] This language also appears in the special verdict jury instruction.[226] However, the advisory verdict instruction contains slightly different language; the language is "shown by the evidence" rather than "established by the evidence."[227] Nowhere, however, is "established by the evidence" or "shown by the evidence" defined in the instructions. There is some measure of ambiguity in what must be established to meet this standard or whether a standard was even intended by the drafters.

IV. CHOOSING BETWEEN VERDICT OPTIONS

The Northern District clearly intends for the model jury instructions to restrict the jury's role exclusively to that of a factfinder and to take the ultimate conclusion on nonobviousness away from the jury.[228] The NJIP's model jury instructions similarly allow for the parties and the judge to limit the jury to factfinding. But the NJIP instructions also allow for the parties and judge to opt for a naked general verdict.[229] As the Federal Circuit seems unwilling to mandate the use of a particular type of jury verdict,[230] litigants and judges are still free to use their discretion. That said, the Federal Circuit has taken a dim view of general verdicts and advisory verdicts.[231]

A. Differences Between Judges and Juries

The Northern District's approach to take the nonobviousness determination away from the jury makes pragmatic sense. Juries may be incapable of rendering reliable verdicts on the issue of nonobviousness. The common usage of the word and the legal usage of the word as a term of art require complicated instructions because there is no single test that captures obviousness in innovation.[232] Moreover, as implied in *KSR*, the doctrine of nonobviousness is equitable.[233] Judges excel at this inquiry, and this is

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225. *Id.* (emphasis added).
226. *Id.* at 376-77.
227. *Id.* at 374-75.
228. *See id.* at 374 n.9, 376 n.10.
229. Nat'l Jury Instruction Project, *supra* note 199, at 42-48.
230. *See* R.R. Dynamics, Inc. v. A Stucki Co., 727 F.2d 1506, 1514-25 (Fed. Cir. 1984).
231. *See* Part II, *supra*.
232. Moore, *supra* note 40, at 213-14; Lee, *supra* note 17, at 19-23.
233. *See* KSR Int'l Co. v. Teleflex Inc., 127 S. Ct. 1727, 1739 (2007) ("*Graham* recognized the need for 'uniformity and definiteness.' Yet the principles laid down in *Graham* reaffirmed the 'functional approach' of *Hotchkiss*."). (citation omitted).

perhaps the best reason to take the determination of nonobviousness away from juries.

There is also the fear of invalidating patents through the use of hindsight.[234] One may question whether a juror can really view the world through the eyes of a person having ordinary skill in the art at the time that the invention was made. Jurors may be unable to comprehend the technology or understand the legal standards.[235] However, judges may be no better at evaluating the patent through the eyes of a person having ordinary skill in the art because they also lack the requisite scientific background.[236]

Moreover, juries possess a demonstrable propatentee bias,[237] suggesting that juries find too many patents valid. While the stakes of the individual patent litigation are probably quite high, the paucity of trials that reach a jury verdict mitigates the damage to the system as a whole. But a propatentee bias may suggest that the jury collectively deems the terms of the bargain acceptable; juries may require a lesser standard for nonobviousness in consideration for a patent monopoly for a limited term.

Whether *KSR* has a demonstratably disproportionate affect on nonobviousness decisions by judges as compared to juries remains an open question that may take some time to adequately sample. Assuming that *KSR* will increase the number of invalidity findings, one may consider the possible effect on the perceived propatentee bias. In the absence of any disproportionate reaction to *KSR*, the propatentee bias will remain in effect with a similar difference as currently observed, but with a net vertical shift downward. If the downward change in judges' validity findings is greater than that for juries, the propatentee bias will become magnified. Only if the downward change in juries' validity findings is greater than that for judges will the evidence of a propatentee bias decrease. Since it has been suggested that part of the reason that juries side with patentees is the image of the noble inventor,[238] a disproportionately greater increase in jury invalidity findings following the case law seems dubious. Thus, the last scenario may be the least likely, further suggesting that the propatentee bias will persist.

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234. *See* Graham v. John Deere Co. of Kansas City, 383 U.S. 1, 36 (1966).

235. Moore, *supra* note 40, at 213-14.

236. Markman v. Westview Instruments, Inc., 52 F.3d 967, 993 (Fed. Cir. 1995) (Mayer, J., concurring).

237. *See* Moore, *supra* note 40, at 239.

238. *Id.* at 217-18.

B. Party Interests

Since there is still discretion, litigants will seek jury instructions that favor their side. Patent owners will likely opt for jury verdicts in order to take advantage of the propatentee bias. Defendants, conversely, will likely opt for the judge to determine the ultimate conclusion of nonobviousness. A judge's interest may be more particularized. Judges may opt to embrace their expanded role or conserve their judicial resources and grant wider authority to juries.

Forum shopping could become even more important if the judges in a particular district were more likely to extensively follow one approach over the other.[239] Patentees would tend to submit complaints in districts where the jury makes the conclusion, and alleged infringers would have greater incentive to seek declaratory relief in districts where judges make the ultimate conclusion. Were the Federal Circuit to mandate a particular type of jury verdict, uniformity would remove this potential incentive to forum shop.

If the Federal Circuit were to mandate the use a particular type of verdict form, the court would likely adopt either the general verdict with special interrogatories or a special verdict where the jury's sole role consists of factfinding; the Federal Circuit has already suggested that the factual underpinnings should be enumerated by the jury.[240] Conversely, the Federal Circuit has criticized the use of naked general verdicts as bordering on an abuse of discretion by the trial court[241] and considers advisory verdicts discredited,[242] making it unlikely that the Federal Circuit would mandate either of these options.

V. CONCLUSION

While the Supreme Court's decision in *KSR* was a rejection of the Federal Circuit's rigid application of the TSM test, the decision cannot be cited as a rejection of the use of juries for the determination of obviousness. Furthermore, no case law exists that would indicate that any of the Federal Rules of Civil Procedure sanctioned verdict forms are barred from use. Thus, the Northern District's rejection of both general verdicts and

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239. *See generally* Kimberly A. Moore, *Forum Shopping in Patent Cases: Does Geographic Choice Affect Innovation?*, 79 N.C. L. REV. 889 (2001).

240. Connell v. Sears, Roebuck & Co., 722 F.2d 1542, 1547 (Fed. Cir. 1983).

241. Am. Hoist & Derrick Co. v. Sowa & Sons, Inc., 725 F.2d 1350, 1361 (Fed. Cir. 1984).

242. Richardson v. Suzuki Motor Corp., 868 F.2d 1226, 1234 (Fed. Cir. 1989).

general verdicts with special interrogatories is merely a suggestion of preferred trial practice that is in contrast to the general interests of patentees.

THE PATENTABILITY OF CHIRAL DRUGS POST-*KSR*: THE MORE THINGS CHANGE, THE MORE THEY STAY THE SAME

By Miles J. Sweet

Perhaps more than most, the pharmaceutical industry is dependent on patent protection. The commercialization of discoveries and inventions related to new drugs and therapeutics must necessarily operate within the regulatory frameworks governing health and safety. This inherently public disclosure precludes protection of valuable intellectual property by alternative means such as trade secret. Consequently, there is a rich history of jurisprudence related to patentability in the chemical arts, as the issues surrounding novelty and obviousness often serve as central points of contention in patent infringement litigation.

This Note examines the Federal Circuit's approach to the patentability of an important class of pharmaceutical products known as chiral drugs—drugs based on enantiomers—particularly in view of the standard for determining nonobviousness expressed by the Supreme Court in *KSR International Co. v. Teleflex Inc.*[1] Part I introduces the basic concept of chirality and its significance to the pharmaceutical industry.

Part II addresses the doctrines of novelty and nonobviousness related to enantiomers, focusing on the touchstone of structural similarity and the requirements related to motivation established in pre-*KSR* case law. The cases show that an enantiomer is patentable over its previously disclosed racemate with respect to novelty, but that there is no easy conclusion with respect to nonobviousness.

Part III considers the lessons stemming from a number of recent post-*KSR* decisions on the obviousness of chiral drugs. First, the difficulties associated with resolving racemic mixtures and unexpected properties are critical to preserving the nonobviousness of enantiomers. Second, the mere desirability and knowledge of the potential therapeutic advantages that single-enantiomer drugs may hold have not been held as adequate motivation to employ known separation techniques on disclosed racemic mix-

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1. 127 S. Ct. 1727 (2007).

tures. Even in the face of mounting market and regulatory pressure to resolve racemates to their constituent enantiomers, courts have upheld chiral drugs as nonobvious where a patentee effectively demonstrates secondary considerations to overcome a challenge of invalidity based on a prima facie case under 35 U.S.C. § 103.

Part IV concludes that *KSR* has not resulted in a major change in the substantive standard of nonobviousness related to enantiomers, but that patentees should be vigilant in documenting the unpredictability of their work and the evidence of experimental failure in order to rebut an assertion of obviousness.

I. THE CHEMISTRY OF CHIRAL DRUGS

This Part provides a technical primer on the basics of stereochemistry and the concept of chirality, including its biological implications and significance to the pharmaceutical industry.

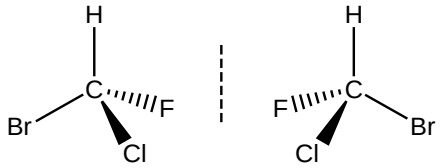
A. Stereochemistry

Chirality is a property of asymmetry related to three-dimensional structure. Human hands represent a special illustration of chirality because they are related to each other by a reflection: they are non-superimposable mirror images of each other.[2] Hands are chiral because there is no way to rotate the left hand so that it looks like the right hand.

In chemistry, stereoisomers are molecules that have the same molecular formula or atomic composition, but which are arranged differently in space.[3] One type of stereoisomer of particular interest to this Note is called an enantiomer. An enantiomer contains the same type and the same number of atoms as its mirror image and the atoms are all connected in the same order.[4] The only structural difference between one enantiomer and the other is the geometry of the spatial arrangement of the atoms. Again, visualize the left and right hands: four fingers, one thumb, a forehand, and backhand all with the same order of connectivity, but the thumbs point in opposite directions. In organic chemistry, enantiomeric pairs include compounds that have one or more stereogenic centers, or carbon atoms (C) with four different substituent atoms or groups of atoms.[5] These molecules

2. *See generally* JONATHAN CLAYDEN ET AL., ORGANIC CHEMISTRY 381-404 (2001).
3. *Id.* at 384.
4. *Id.* at 382.
5. *Id.* at 385.

are thus said to be chiral. For example, the enantiomers of the chemical compound bromochlorofluoromethane are displayed in Figure 1.



(*R*)-enantiomer (*S*)-enantiomer

Figure 1. The enantiomers of bromochlorofluoromethane are non-superimposable mirror images of each other; like left and right hands, they are "chiral." A solid wedge is used to indicate that the chlorine atom (Cl) is projecting out of the page, while a hashed line indicates that the fluorine atom (F) is behind the page.[6]

Chemists use various naming conventions to distinguish between different enantiomers of the same compound. If one enantiomer is labeled "(+)" or "(d)," then its counterpart is labeled "(–)" or "(l)."[7] A racemate, or racemic mixture, is an equal mixture of two enantiomers. Under these schemes, a racemate is labeled "(±)" or "(dl)." Another naming system labels biochemical molecules "(D)" or "(L)," although these are unrelated to the labels "(d)" and "(l)" described above. Yet another nomenclature system labels each stereogenic center "(R)" or "(S)" according to a set of rules.[8] Racemates are designated "(RS)" because they are comprised of both (R)-enantiomers and (S)-enantiomers.[9]

B. Biological Activities and Chiral Resolution

Purified enantiomers often exhibit very different biological activity. Just as a left hand does not fit into a right-handed glove, the (R)-enantiomer may not fit into the active site of an enzyme, whereas the (S)-enantiomer will, or vice-versa.[10] Consequently, one enantiomer may have a substantially different pharmacology and toxicology than the other

6. *See also* Pfizer, Inc. v. Ranbaxy Labs. Ltd., 457 F.3d 1284, 1286 (Fed. Cir. 2006).

7. *Id.*; *see also* CLAYDEN, *supra* note 2, at 389.

8. (R) and (S)-descriptors, according to Cahn-Ingold-Prelog rules, will be used preferably herein when possible. *See* CLAYDEN, *supra* note 2, at 387.

9. *Id.*; *see also Pfizer*, 457 F.3d at 1286-87.

10. Jonathan J. Darrow, *The Patentability of Enantiomers: Implications for the Pharmaceutical Industry*, 2 STAN. TECH. L. REV. 1, 3 (2007).

enantiomer.[11] Familiar examples include the compounds limonene, where the (R)-enantiomer is responsible for orange scent and the (S)-enantiomer is lemon scent, and ketamine, where the (S)-enantiomer is an anesthetic, but the (R)-enantiomer is a hallucinogen. The drug thalidomide is another well-known example: the (S)-enantiomer is a sedative that is effective against morning sickness, but the (R)-enantiomer causes birth defects.

When these types of compounds are produced in a laboratory under normal conditions, the racemic mixture obtained is comprised of 50% (R) and 50% (S).[12] Because of the different activity of each enantiomer, it is important to separate a racemic mixture into its constituents and to evaluate the properties of each one.[13] This very difficult separation process is called chiral resolution and is technically challenging because enantiomers have the same chemical properties, but not necessarily the same pharmacological properties. Consequently, traditional separation methods such as fractional distillation or chromatography may not work.[14] There is no way of predicting the properties of one enantiomer versus the other without resolving them from the racemate and testing each individually.[15] In recent decades, there has also been significant research and development toward generating new methodologies for the synthesis of one or the other enantiomer in excess, with an aim to preclude the need for resolution.[16]

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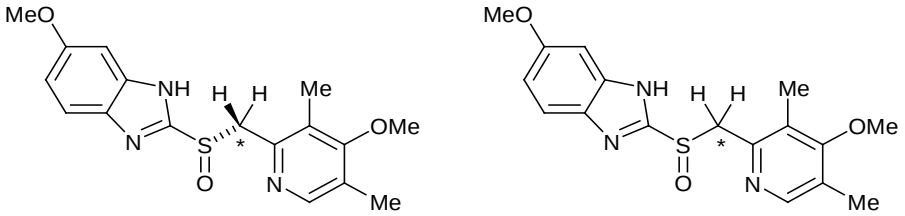
11. *Id.*
12. *See* CLAYDEN, *supra* note 2, at 399-404.
13. *Id.*
14. *Id.*
15. *Id.*
16. *See generally* Stephen G. Davies et al., *Oxazinanones as chiral auxiliaries: synthesis and evaluation in enolate alkylations and aldol reactions*, 4 ORGANIC & BIOMOLECULAR CHEMISTRY 2753 (2006); Stephen G. Davies et al., *Kinetic resolution and parallel kinetic resolution of methyl (RS)-5-alkyl-cyclopentene-1-carboxylates for the asymmetric synthesis of 5-alkyl-cispentacin derivatives*, 3 ORGANIC & BIOMOLECULAR CHEMISTRY 2762 (2005); Stephen G. Davies et al., *Double asymmetric induction as a mechanistic probe: conjugate addition for the asymmetric synthesis of a pseudotripeptide*, 9 CHEMICAL COMM. 1128 (2004); Stephen G. Davies et al., *Parallel kinetic resolution of* tert-*butyl (RS)-3-alkyl-cyclopentene-1-carboxylates for the asymmetric synthesis of 3-alkyl-cispentacin derivatives*, 2 ORGANIC & BIOMOLECULAR CHEMISTRY 3355 (2004); Stephen G. Davies et al., *Preparation of methyl (1R,2S,5S)- and (1S,2R,5R)-2-amino-5*-tert-*butyl-cyclopentane-1-carboxylates by parallel kinetic resolution of methyl (RS)-5*-tert-*butyl-cyclopentene-1-carboxylate*, 19 CHEMICAL COMM. 2410 (2003).

C. Enantiomeric Pharmaceuticals

Many chiral drugs were initially sold in racemic form because of the difficulty in separating the enantiomers from one another.[17] Single enantiomers can present significant advantages in potency, efficacy, and safety over the corresponding racemate, but this varies by case and is not a general rule.[18] Nevertheless, in recent years, as patents covering the racemic drugs began to expire, pharmaceutical companies started marketing the single-enantiomer versions of their drugs in order to extend product life and market monopoly.[19] This strategy is known as a "chiral switch," and is best exemplified by AstraZeneca's "purple pill" omeprezole (Figure 2).[20] The company saved their market share from erosion by generic competitors by selling the gastrointestinal drug as the single (S)-enantiomer Nexium® before the patent covering the (RS)-racemate Prilosec® expired.[21]



(S)-enantiomer
Nexium

(RS)-racemate
Prilosec

Figure 2. The purple pill chiral switch: Nexium® (left) is the (S)-enantiomer of the (RS)-racemate Prilosec® (right), but is it nonobvious? The stereogenic center is indicated by an asterisk.

Chiral molecules are big business for the pharmaceutical industry. Five of the six top-selling drugs worldwide in 2007 are all single enantiomers: Lipitor®, Advair®, Plavix®, Nexium®, and Diovan®.[22] Accordingly, this

17. Darrow, *supra* note 10, at 3.

18. Chris P. Miller & John W. Ullrich, *A Consideration of the Patentability of Enantiomers in the Pharmaceutical Industry in the United States*, 20 CHIRALITY 762, 762 (2008).

19. *See generally* A. Maureen Rouhi, *Chirality at Work: Drug Developers Can Learn Much from Recent Successful and Failed Chiral Switches*, CHEMICAL & ENGINEERING NEWS, May 5, 2003, at 56-61.

20. *Id.*

21. *Id.*

22. Top Ten Best-selling Drugs Worldwide 2007 (Nov. 15, 2008), http://qsarcenter.com/?p=9.

new trend of developing single-enantiomer therapeutics versus racemates, or introducing a single-enantiomer medicament to the market following the development and commercialization of a racemic mixture, has focused serious attention on the patentability of drug enantiomers.[23]

II. NOVELTY AND NONOBVIOUSNESS IN CHEMISTRY

Section II.A addresses the doctrine of novelty related to enantiomers, which is a relatively settled area of law. The nonobviousness of enantiomers is then analyzed in Section II.B as first considered in pre-*KSR* case law, focusing on the touchstone of structural similarity and the requirements related to motivation.

A. The Novelty of Enantiomers

Is an enantiomer novel where the racemate is known or disclosed in the art? With respect to novelty under 35 U.S.C. § 102, the issue of enantiomer patentability is whether a claim to a genus anticipates a claim to a species of that genus, where the racemate is a genus and the enantiomer is the species.[24]

A genus does not always anticipate a species within that genus.[25] Indeed, the effect of the disclosure of a genus on the patentability of a species depends on the size of the genus and the disclosure of any preferred sub-genera or species. A chiral molecule with only one stereogenic center gives rise to only two enantiomers. However, many chiral molecules have more than one stereogenic center, resulting in 2^n possible structural formulas, where n is the number of stereogenic centers. For example, as depicted in Figure 3, the racemic structure of atorvastatin (right) has two stereogenic centers, which gives rise to four ($2^2 = 4$) possible species. Pfizer's blockbuster drug Lipitor®—the biggest selling single-enantiomer drug in the world—is the (R,R)-species of this atorvastatin genus.[26]

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23. Miller & Ullrich, *supra* note 18, at 1 ("In 2003, not a single drug was brought into the US market as a racemic. . . mixture and 2004 saw the introduction of only one racemate . . . .").

24. *See* 35 U.S.C. § 102 (2006).

25. *See* Corning Glass Works v. Sumitomo Elec. U.S.A., Inc., 868 F.2d 1251, 1262 (Fed. Cir. 1989); *see also In re* Meyer, 599 F.2d 1026, 1031 (C.C.P.A. 1979) (finding that prior art genus did not "identically disclose or describe, within the meaning of *§ 102*" the claimed species "since the genus would include an untold number of species").

26. *See* Top Ten Bestselling Drugs Worldwide, *supra* note 22.

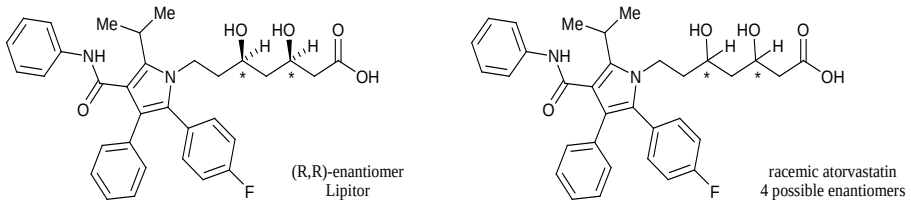

Figure 3. The top-selling drug in the world: Lipitor® (left) is the specific (R,R)-enantiomer within a genus of four possible isomers based on the structure of racemic atorvastatin (right). The stereogenic centers are indicated by astericks.

A genus of sufficiently limited and defined substituents may anticipate its species.[27] Put more plainly, a genus will anticipate a species within that genus that is not otherwise expressly disclosed if one of ordinary skill would immediately envisage the claimed compound from the disclosed genus.[28]

The patentability of a single enantiomer was first addressed by a court in *In re Williams*.[29] In that case, the Board of Patent Appeals and Interferences rejected a claim to a single-enantiomer compound both for lack of novelty and for obviousness.[30] The novelty rejection was based on a prior art reference that disclosed the production of a racemic compound with an identical formula to the claimed compound, although the reference did not indicate that it was racemic.[31] The Board of Patent Appeals held that the enantiomer could not be novel because it necessarily existed as part of the disclosed racemate.[32] The Court of Customs and Patent Appeals reversed, holding that "[t]he existence of a compound as an ingredient of another substance does not negative novelty in a claim to the pure compound, al-

27. *See In re* Schaumann, 572 F.2d 312, 316-17 (C.C.P.A. 1978) (finding that prior art disclosure embraces such a limited number of compounds closely related to one another in structure that it "provides a description of those compounds just as surely as if they were identified in the reference by name"); *In re* Petering, 301 F.2d 676, 682 (C.C.P.A. 1962) (finding that a genus of 20 compounds describes each species within the meaning of § 102(b)).

28. *Schaumann*, 572 F.2d at 316-17; *Petering*, 301 F.2d at 682.

29. 80 U.S.P.Q. (BNA) 150 (C.C.P.A. 1948). Note that the Court of Customs and Patent Appeals (C.C.P.A.) was the predecessor to the Court of Appeals for the Federal Circuit.

30. *Id.* at 151.

31. *Id.*

32. *Id.*

though it may, of course, render the claim unpatentable for [obviousness]."[33]

The rule from *In re Williams* that an enantiomer is not necessarily unpatentable over its previously disclosed racemate has since been applied consistently,[34] although it has produced some interesting results. For example, U.S. Patent No. 5,114,714 claims that using the (R)-enantiomers of the anesthetics isoflurane and desflurane is better than using the racemate, and U.S. Patent No. 5,114,715 claims that using the (S)-enantiomers of the same anesthetics is better than using the racemate. The patents are worded almost identically, except for the (R) and (S) descriptors.[35]

B. The Nonobviousness of Enantiomers

The question of whether an enantiomer is nonobvious in light of its disclosed racemate is far more difficult to answer. Compared to the novelty requirement, nonobviousness is a much bigger hurdle toward patentability, especially for enantiomers.

> A patent may not be obtained . . . 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 . . . .[36]

The analytical framework for an obviousness inquiry was set forth in *Graham v. John Deere Co.* and proceeds with the following steps: (1) determine the scope and content of the prior art; (2) ascertain the differences between the claimed invention and the prior art; (3) assess the level of ordinary skill in the art; and (4) evaluate evidence of secondary considerations, such as commercial success, long felt but unresolved need, and the failure of others, which are all sometimes called indicia of nonobvious-

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33. *Id.*

34. *In re* May, 574 F.2d 1082, 1090 (C.C.P.A. 1978) ("The novelty of an [enantiomer] is not negated by the prior art disclosure of its racemate."); Pfizer, Inc. v. Ranbaxy Labs. Ltd., 405 F. Supp. 2d 495, 519 (D. Del. 2005) ("[C]ourts considering issues related to racemates and their individual isomers have concluded that a prior art disclosure of a racemate does not anticipate the individual isomers of the racemate. . . ."); Brenner v. Ladd, 247 F. Supp. 51, 56 (D.D.C. 1965) ("[I]t should be noted that plaintiffs' [enantiomer] is not considered by this court to be anticipated by the solution of [the racemate] disclosed in [the prior art]."); Sterling Drug Inc. v. Watson, 135 F. Supp. 173, 176 (D.D.C. 1955) ("[I]t matters not that [the enantiomer] in some form in combination may exist in nature, if it cannot be reduced to a form in which it can be used. It is this product which has been so reduced or resolved that it can be used that is here claimed.").

35. *See* Rouhi, *supra* note 19.

36. 35 U.S.C. § 103(a) (2006).

ness.[37] Even though the case dealt with a mechanical invention, these *Graham* factors apply regardless of the art in question.[38]

With respect to the second *Graham* factor, the Federal Circuit reiterated in *Eisai Co. v. Dr. Reddy's Laboratories* that structural similarity is the touchstone of the nonobviousness inquiry for patents claiming a novel chemical compound.[39] Under this scheme, a compound in the prior art is identified as a starting reference point and then an assertion of obviousness must be demonstrated based on how similar in structure a compound at issue is to that prior art disclosure, along with some motivation for having selected the known compound and then modifying it to achieve the claimed compound.[40] For example, consider Prilosec® and Nexium® as described above[41] and depicted in Figure 2. One might easily make the case that the chiral drug Nexium®, which is the (S)-enantiomer, is prima facie obvious in view of the racemic mixture Prilosec®. The single (S)-enantiomer is 50% of the racemic mixture because there is only one stereogenic center. The racemate Prilosec® is the logical starting reference point in an analysis of structural similarity because the two drugs have the same connectivity by definition; Nexium® is only differentiated from Prilosec® by the three-dimensional arrangement of the atoms around the stereogenic center. Thus, the critical prong of the obviousness test for chiral drugs concerns the motivation to arrive at the single-enantiomer compound.

Although the motivation to modify the prior art could come from many different fields, some teaching, suggestion, or motivation (TSM) was needed in a formal pre-*KSR* analysis.[42] In chemical cases, this motivation may be proved by showing a "sufficiently close relationship" between the prior art and the claimed compound that would "create an expectation . . . that the [new compound] would have similar properties [to the old]."[43]

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37. 383 U.S. 1, 17-18 (1966); s*ee also* Hybritech, Inc. v. Monoclonal Antibodies, Inc., 802 F.2d 1367, 1380 (Fed. Cir. 1986) (requiring that secondary considerations be considered before making an obviousness determination).

38. *See* KSR Int'l Co. v. Teleflex Inc., 127 S. Ct. 1727, 1739 (2007) (reaffirming the *Graham* framework).

39. Eisai Co. v. Dr. Reddy's Labs., 533 F.3d 1353, 1356-57 (Fed. Cir. 2008). Although a post-*KSR* decision, *Eisai* offers a good review of the tests at issue.

40. *Id.* at 1357.

41. *See supra* text accompanying note 21.

42. See Rebecca S. Eisenberg, *Pharma's Nonobviousness Problem*, 12 LEWIS & CLARK L. REV. 375, 395-413 (2007), for a thorough review examining the development of case law in chemical obviousness from flexibility to rigid formalism pre-*KSR*. *See also KSR*, 127 S. Ct. at 1734.

43. *In re* Dillon, 919 F.2d 688, 692 (Fed. Cir. 1990).

In other words, an obvious substitution would have to be predictable.[44] The unpredictable nature of the chemical arts thus allows an assertion of similarity to be rebutted by a sufficient demonstration of nonobviousness that employs secondary considerations or objective indicia. Indeed, one of the most important secondary considerations is evidence of unexpected or superior results. Such results may prove that the enantiomer refutes the normal expectation that a compound with similar structure will have similar properties.

Before *KSR*, the courts held that mere knowledge of a previously disclosed racemic mixture, such as the drug Prilosec®, did not provide adequate motivation to prompt one of ordinary skill in the art to resolve the racemate to its constituent enantiomers.[45] Absent any teaching or suggestion in the prior art to derive the single-enantiomer, the chiral drug Nexium® would likely have been held nonobvious over Prilosec®. Indeed, a district court in one pre-*KSR* case found that no motivation existed in the prior art to resolve racemic atorvastatin into its constituent enantiomers as late as 1991, and thus the (R,R)-enantiomer of atorvastatin—the chiral drug Lipitor®—was held nonobvious over the racemate.[46]

The case in *Ortho-McNeil Pharmaceutical, Inc. v. Mylan Laboratories, Inc.*[47] addressed the alleged invalidity of a patent covering the antibiotic Levaquin® and presented a very different, now more common, set of facts. The active pharmaceutical ingredient in Levaquin® is levofloxacin, which is the (S)-enantiomer of the racemic antibiotic ofloxacin (Floxin®).[48] Mylan challenged the patented claims to the single-enantiomer levofloxacin as obvious in view of prior art that both disclosed the racemate and, as early as the mid-1980s, provided "ample motivation to separate the optical isomers" of the racemate.[49] Patent holder Ortho-McNeil provided evidence of unexpected results that showed that the single-enantiomer levofloxacin is approximately ten times more soluble than the racemic mixture.[50] The court noted that, prior to the discovery of levofloxacin, the largest reported difference in solubility between an enantiomer and its racemate was only fivefold.[51] The court indicated that this difference alone

44. Ortho-McNeil Pharm., Inc. v. Mylan Labs., Inc., 520 F.3d 1358, 1364 (Fed. Cir. 2008) ("[E]asily traversed, small and finite number of alternatives. . . might support an inference of obviousness.").

45. Pfizer Inc. v. Ranbaxy Labs. Ltd., 405 F. Supp. 2d 495, 517 (D. Del. 2005).

46. *Id.*

47. 348 F. Supp. 2d 713 (N.D.W. Va. 2004).

48. *Id.* at 721.

49. *Id.* at 752. Enantiomers are also called optical isomers.

50. *Id.* at 755.

51. *Id.*

was an unexpected result and presumably sufficient by itself to rebut the prima facie case of obviousness, but nonetheless further noted that the single-enantiomer is approximately two times more potent than the racemate.[52] While the greater potency alone might not have been persuasive,[53] the court was persuaded by a showing that the (S)-enantiomer is less toxic than the racemate, which appeared to contradict the conventional scientific wisdom in the art.[54] Thus, taken altogether, the district court found that the unexpected and superior results put forth for the single-enantiomer levofloxacin were sufficient to overcome a prima facie challenge of obviousness in view of the racemate and the motivation to resolve it.[55] Accordingly, the district court upheld the validity of the patent claims.[56] The Federal Circuit affirmed without written opinion.[57]

Although the Lipitor® and Levaquin® cases reached the same result, holding the respective single-enantiomer drugs nonobvious, the difference in the application of the motivation element between them underscores that obviousness is a fact-specific inquiry.[58] Nevertheless, the patent bar and commentators expected that, in the absence of any rigid TSM requirement post-*KSR*, it would be easier to invalidate patent claims as obvious or for the U.S. Patent and Trademark Office to deny patent protection.[59] It is known that enantiomers exhibit different activities[60] and it has been described in the literature that companies actively engage in the practice of separating racemic mixtures in order to determine which compo-

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52. *Id.*

53. The court reasoned that resolution into component enantiomers could at best be expected to yield a two-fold increase in activity: presumably, the two-fold limit is imposed by the fact that if even 100% of the activity level results from only one enantiomer, and the other is completely inactive, then removing the inactive enantiomer will simply have the effect of doubling the activity level per unit of compound remaining; if both enantiomers are somewhat active, then removing the less active one would increase the activity level by something less than 100%.

54. *Ortho-McNeil*, 348 F. Supp. 2d at 755.

55. *Id.* at 755, 760.

56. *Id*.

57. Ortho-McNeil Pharm., Inc. v. Mylan Labs., Inc., 161 F. App'x 944 (Fed. Cir. 2005).

58. Recall that the court in *Pfizer*, in considering Lipitor®, found that there was no motivation to resolve the racemate. Pfizer Inc. v. Ranbaxy Labs. Ltd., 405 F. Supp. 2d 495, 517 (D. Del. 2005). The court in *Ortho-McNeil*, in considering Levaquin®, found that "ample motivation" to resolve the racemate was overcome by unexpected results. *Ortho-McNeil*, 348 F. Supp. 2d at 752.

59. Calvert D. Crary, *Impact of* KSR v. Teleflex *on Pharmaceutical Industry*, LITIG. NOTES, May 2, 2007, at 1.

60. *See supra* text accompanying note 10.

nent to market.[61] It follows that an ordinarily skilled artisan may generally be considered to be aware of the benefits of chiral drugs and the techniques to develop them. Even before *KSR*, the Federal Circuit indicated that such common knowledge can be a source of motivation to combine references.[62] Thus, a looming question for pharmaceutical companies has been how the *KSR* decision will impact chemical patents.

III. POST-*KSR* OBVIOUSNESS OF ENANTIOMERS

A. Lessons from *KSR*

One of the major shifts resulting from *KSR* concerned the type of evidence that can be marshaled to support a finding of obviousness.[63] The Supreme Court rejected the rigid application of the TSM test for patent obviousness, but did not abolish it.[64] Chiral drugs are desirable and broad general knowledge of traditional technologies for isolating single-enantiomers from racemic mixtures exists.[65] As knowledge of enantiomers continues to increase and techniques for chiral resolution continue to improve, less innovation will be required to make a single enantiomer from its racemate, and thus prospective inventors will have more motivation to pursue that aim. Yet, to be obvious under § 103, there must still be some articulated reason why a person of ordinary skill in the art would combine the prior art elements to arrive at the claimed invention.[66] Critically, secondary considerations are still significant evidence to rebut a prima facie case of obviousness.[67]

The Supreme Court was careful to note that *KSR* simply mandated flexibility and reminded courts that the requisite motivation for the invention need not originate from the words of written references, but can arise instead from the application of common sense to an apparent market need.[68] This would seemingly spell trouble for the nonobviousness of pharmaceutical patents directed toward single-enantiomer drugs. Yet, in response, the Federal Circuit has seemingly established a framework for

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61. *See* Rouhi, *supra* note 19.

62. *In re* Rouffet, 149 F.3d 1350, 1357 (Fed. Cir. 1998).

63. *See* Justin Lee, Note, *How* KSR *Broadens (Without Lowering) the Evidentiary Standard of Nonobviousness*, 23 BERKELEY TECH. L.J. 15, 15 (2008).

64. KSR Int'l Co. v. Teleflex Inc., 127 S. Ct. 1727, 1741 (2007).

65. *See* CLAYDEN, *supra* note 2, at 399-404.

66. *See* Letter from Margaret A. Facarino, Deputy Comm'r for Patent Operations, U.S. Patent & Trademark Office, to Tech. Ctr. Dirs., U.S. Patent & Trademark Office (May 3, 2007) (on file with the U.S. Patent and Trademark Office).

67. *Id.*

68. *KSR*, 127 S. Ct. at 1742.

assessing nonobviousness of enantiomeric pharmaceutical products based on the unpredictability of their properties and success in the separation process itself, which does not mark a substantive departure from pre-*KSR* jurisprudence.

B. Analysis of Post-*KSR* Cases

1. Enantiomer Found Obvious—Patent Claims Invalid

Aventis Pharma Deutschland GmbH v. Lupin, Ltd.[69] is instructive as a pre-*KSR* trial court case reviewed by the Federal Circuit post-*KSR*. The district court held valid patent claims to a single-enantiomer of the hypertension drug ramipril (Altace®) with five (S)-configured stereogenic centers.[70] The Federal Circuit reversed, holding the claims invalid as obvious in light of the prior art disclosure of a mixture of just two of the thirty-two possible isomers.[71]

On the question of nonobviousness, the Federal Circuit first noted that the district court had found that Lupin had "failed to meet its burden of proof . . . that a person of skill in the art would have been motivated to purify 5(S) ramipril into a composition substantially free of other isomers."[72] However, the Federal Circuit further noted that since the district court's decision, the *KSR* opinion counseled that it would be sufficient to show that the claimed compound and the prior art compounds are closely enough related so as to create an expectation that the new compound would have similar properties to the old one.[73] In this case, the record showed that the inventor understood that the 5(S)-enantiomer was the therapeutically active ingredient in the mixture.[74] Nevertheless, a purified form of a mixture that existed in the prior art is not always prima facie obvious over the mixture.[75]

The *Aventis* court held that no explicit teaching to purify or to concentrate a particular ingredient that is known to impart desirable properties on a mixture is required to sustain a finding of obviousness.[76] If a person of ordinary skill in the art has reason to believe that the particular constituent has special benefits, then the purified compound is prima facie obvious

69. 499 F.3d 1293 (Fed. Cir. 2007).
70. *Id.* at 1294.
71. *Id.* at 1295.
72. *Id.* at 1300.
73. *Id.* at 1301.
74. *Id.*
75. *Id.*
76. *Id.*

over the mixture.[77] Thus, the Federal Circuit found that in this case the "the prior art provides a sufficient reason to look to the 5(S) configuration" and noted that "Aventis's protestations notwithstanding, there is no evidence that separating the 5(S) and (SSSSR) ramipril [mixture] was outside the capability of an ordinarily skilled artisan."[78]

Aventis attempted to rebut the prima facie finding of obviousness by arguing that the purified 5(S)-ramipril exhibited unexpected increased potency when compared with the next most potent isomer, the (RRSSS) isomer.[79] However, the court was not persuaded, finding instead that Aventis was making the wrong comparison: "Aventis must show that the 5(S) ramipril had unexpected results not over all of its stereoisomers, but over the mixture [of 5(S) and (SSSSR)], which did not contain the (RRSSS) form."[80] Failing such a demonstration, Aventis could not rebut the prima facie case. Owing to this lack of any real evidence of secondary indicia of nonobviousness in light of the prior art teaching of a mixture of two enantiomers already isolated from the thirty-two possible based on the racemate, it is unlikely that this result would have been different even if the appeal was heard pre-*KSR*.

The court also distinguished the *Aventis* case from *Forest Laboratories, Inc. v. Ivax Pharmaceuticals, Inc.*,[81] which had been decided one week earlier, and where the prima facie case of obviousness was rebutted because the particular enantiomer at issue showed unexpected benefits and evidence indicated that the racemic mixture would have been difficult for a person of ordinary skill in the art to separate.[82]

2. *Enantiomers Found Nonobvious—Patent Claims Valid*

Forest Labs is an important case in the "new" understanding of obviousness. Interestingly, in its multi-page discussion of nonobviousness, the appellate panel did not mention *KSR* even though the Supreme Court had decided it almost half a year earlier. Forest held an expired patent on a racemic form of the selective serotonin reuptake inhibitor citalopram.[83] After considerable effort, Forest's scientists doubled the strength of the drug by isolating the (+)-stereoisomer—which turned out to be the only

77. *Id.*
78. *Id.* at 1302.
79. *Id.*
80. *Id.*
81. 501 F.3d 1263 (Fed. Cir. 2007).
82. *Id.* at 1269.
83. *Id.* at 1266.

active isomer—and patented that isomer in a "substantially pure" form.[84] A prior art pharmacologic paper had suggested that the (–)-enantiomer would be the potent isomer, but the reference did not describe the preparation of the enantiomer.[85] Thus, while the prior art reference did suggest isolation of a stereoisomer to create a more potent drug, it did not enable the process of isolation.[86] As the *Ortho-McNeil* court had done in the face of ample prior art motivation to resolve the racemate in the pre-*KSR* Levaquin® decision,[87] the *Forest* court considered the totality of circumstances in concluding that the chiral drug was nonobvious.[88] Specifically, the *Forest* court focused on secondary indicia such as the difficulty in isolating the stereoisomer without undue experimentation, the unexpected results of the single-enantiomer product, and commercial success.[89]

This principle that a prima facie case of obviousness for chiral drugs is still rebuttable post-*KSR* by demonstrating objective indicia of nonobviousness was again addressed recently in *Sanofi-Synthelabo v. Apotex, Inc*.[90] In that case, the Federal Circuit upheld a district court ruling that the patent claims to the (d)-enantiomer of clopidogrel bisulfate—marketed as Plavix® for preventing heart attacks and strokes by reducing platelet aggregation—were not obvious in view of the prior art racemate.[91] The court reasoned that that an earlier patent covering the racemate did not disclose to a skilled artisan how the enantiomers of the racemate could be separated.[92] The evidence showed that the patentee had expended a considerable amount of time and effort trying to resolve the enantiomers.[93] Furthermore, the (d)-enantiomer (Plavix®) exhibited good platelet inhibition, whereas the (l)-enantiomer was completely ineffective, and this difference in biological properties was unexpected in light of the prior art.[94] The toxicity also differed: the (l)-enantiomer was significantly more lethal than the (d)-enantiomer, and the (l)-enantiomer was neurotoxic while the (d)-

84. *Id*. at 1268.
85. *Id.*
86. *Id.* at 1268-69.
87. Ortho-McNeil Pharm., Inc. v. Mylan Labs., Inc., 348 F. Supp. 2d 713 (N.D.W. Va. 2004), *aff'd* 161 F. App'x 944 (Fed. Cir. 2005).
88. *Forest*, 501 F.3d at 1269.
89. *Id.*
90. 550 F.3d 1075 (Fed. Cir. 2008).
91. *Id.*
92. *Id.* at 1088.
93. *Id.* at 1081, 1088.
94. *Id.* at 1081 ("The experts for both sides agreed that while it was generally known that enantiomers can exhibit different biological activity, this degree and kind of stereoselectivity is rare, and could not have been predicted.").

enantiomer was not.[95] Thus, the patent was held nonobvious because the properties of the enantiomer were truly unexpected.

The *Sanofi* court purported to assess the so-called unexpected properties of the enantiomer product at issue on a spectrum between the facts presented in *Forest* and those in *Aventis*.[96] In *Forest*, the court had affirmed that the (+)-enantiomer of citalopram would not have been obvious in light of the known racemate because it was demonstrated that the therapeutic properties of the (+)-enantiomer were unexpected, along with other secondary considerations.[97] In contrast, the *Aventis* court held that the potency of the ramipril isomer was precisely as expected compared to the mixture.[98] The *Sanofi* court thus concluded that the evidence of unexpected properties and the totality of secondary indicia were closer to *Forest* (à la *Ortho-McNeil*) than to *Aventis*.[99] Accordingly, between the facts of these two post-*KSR* cases—*Aventis* and *Forest*—the Federal Circuit has established a framework for analyzing nonobviousness in single-enantiomer products. This scheme for evaluating the unexpected and unpredictable properties of the single-enantiomer products is similar to that followed pre-*KSR*, and the court further cautioned against hindsight bias and ex post reasoning in an obviousness determination concerning the separation of an enantiomer with desirable properties from a selected racemate.[100]

The *Sanofi* court explicitly rejected a number of arguments asserted by Apotex that one of ordinary skill in the art would have been motivated to separate the enantiomers from the racemic mixture.[101] The court found that, even though at the time of the invention the level of ordinary skill was such that there were many well-known processes for separating enantiomers, the level of difficulty experienced by the inventor was expository of the inherent unpredictability in this field and the unexpected results of the chiral drug product.[102] Additionally, knowledge that such separation was desirable and would lead to allocation of favorable properties in the

95. *Id.*

96. *Id.* at 1089.

97. Forest Labs., Inc. v. Ivax Pharms., Inc., 501 F.3d 1263, 1269 (Fed. Cir. 2007).

98. Aventis Pharma Deutschland GmbH v. Lupin, Ltd., 499 F.3d 1293, 1302 (Fed. Cir. 2007).

99. *Sanofi*, 550 F.3d at 1089.

100. *Id.* at 1088 ("The application of hindsight is inappropriate where the prior art does not suggest that [the] enantiomer could reasonably be expected to manifest the properties and advantages that were found. . .") (citing KSR Int'l Co. v. Teleflex Inc., 127 S. Ct. 1727, 1742 (2007); Graham v. John Deere Co., 383 U.S. 1, 36 (1996)).

101. *Id.* at 1087-88.

102. *Id.*

enantiomer components of the mixture was also not found to be persuasive enough motivation to be deemed obvious.[103] The court also rejected Apotex's argument that Sanofi only resolved the racemate in response to a market need for single-enantiomer products imposed by the possibility of future regulatory requirements to separate enantiomers.[104]

This growing body of post-*KSR* case law cautions practitioners to be proactive about documenting and preserving proof of the unpredictability of their work. The lesson of these cases is that if the separation process of chiral resolution itself is particularly difficult, and the properties of the resulting products are unpredictable, especially compared to the mixture, then the nonobviousness of the enantiomer is enhanced.

3. "Obvious-To-Try" Standard

The Supreme Court's decision in *KSR* did not discuss the patentability of enantiomers, but it did address the obvious-to-try test, which is implicated directly in evaluating the validity of claims covering a single enantiomer.[105] In discussing the test, the Court stated that if a finite number of identified, predictable solutions exist, then a person of ordinary skill in the art has good reason to pursue known options.[106] Some practitioners have thus asserted that:

> As applied to enantiomers, a finite number of identified solutions always exists—exactly two if there is a single [stereogenic] center, as in Plavix®. Moreover, it is always a known option to separate a racemate into its two enantiomers, especially where a process for doing so was disclosed in the prior art . . . design need or market pressure is indirectly supplied because it is generally known that a single enantiomer will be superior to the racemate in at least some respects. If the patent on the racemate will soon expire, market pressure to obtain a patent on an enantiomer may well exist—the 'chiral switch.'"[107]

The premise is that given enough time and resources, a person of ordinary skill would be able to try all possible prior art combinations, including the patented one.

This echoes Apotex's argument in *Sanofi* (1) that there were a discreet set of known enantiomer products that could potentially be isolated from

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103. *Id.*
104. *Id.* at 1089.
105. KSR Int'l Co. v. Teleflex Inc., 127 S. Ct. 1727, 1742 (2007).
106. *Id.*
107. Brian D. Coggio & Steven N. Hird, *The Patentability of Drug Enantiomers*, N.J.L.J., Oct. 2007, at 2.

the disclosed racemic mixture, (2) that there were at least ten well-known techniques that were the state of the art at the time to affect a chiral resolution, and (3) that all that was required to arrive at the patented combination was experimentation.[108] However, the court rejected Apotex's argument based largely on evidence of the inventor's own failed attempts over five months testing thirty compositions with various acids at various concentrations in various solvents before finding one that yielded a result.[109] The language of *KSR* itself reiterated the pre-*KSR* obvious-to-try doctrine that one must have a reasonable expectation of success for a finding of obviousness.[110]

In addition to refining *KSR* in *Eisai*,[111] the Federal Circuit again recently emphasized the lack of predictability in the field of pharmaceutical chemistry by rejecting the obviousness attack on the active pharmaceutical ingredient in Takeda's anti-diabetic drug Actos®.[112] Enantiomer patents likely will survive obviousness challenges provided that (1) there was no understanding in the art that one enantiomer was expected to be more active than the other, and (2) no drug in the prior art, having similar chemistry, was shown to have differential activity. The *KSR* language will not render a single-enantiomer claim obvious because, although there will be only two "choices" for the skilled artisan to make when a compound has one stereogenic center, the question of whether the two enantiomers can be separated is not trivial, and there is no expectation either way of successfully showing differential activity. Unless the test of "it might work" is enough, these claims should remain valid under *KSR* in such an unpredictable area as the pharmaceutical arts.

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108. *Sanofi*, 550 F.3d at 1087-88.

109. *Id.* at 1088.

110. *KSR*, 127 S. Ct. at 1742.

111. Eisai Co. v. Dr. Reddy's Labs., 533 F.3d 1353, 1359 (Fed. Cir. 2008) (concluding that assumptions about the prior art landscape found in *KSR* often do not apply to cases concerning chemical compounds).

112. Takeda Chem. Indus., Ltd. v. Alphapharm Pty., 492 F.3d 1350, 1359 (Fed. Cir. 2007) ("Thus, this case fails to present the type of situation contemplated by the [Supreme] Court when it stated that an invention may be deemed obvious if it was 'obvious to try.' The evidence showed that it was not obvious to try."); *see also* Andrew V. Trask, *"Obvious to Try": A Proper Patentability Standard in the Pharmaceutical Arts?*, 76 FORDHAM L. REV. 2625, 2649-57 (2008) (advocating a rejection of the Federal Circuit's application of "obvious-to-try" for pharmaceutical inventions).

IV. CONCLUSIONS

Although a decrease in the number of new chiral switches is likely, it is just as likely that the pharmaceutical industry will continue to bring more single-enantiomer drugs to market in lieu of racemic mixtures. Accordingly, issues related to the patentability of enantiomers will be of ongoing interest. Enantiomers may also be the subject of patent claims to specific therapeutic indications or pharmaceutical formulations that are not disclosed or suggested by the art, presenting separate issues of patentability to which the principles discussed herein should still apply. In the past, the level of unpredictability in the pharmaceutical sciences has served as a firewall to protect chiral drug patents from being found obvious. This will likely not change in the foreseeable future, even as chiral resolution technologies give way to a next-generation focus on direct asymmetric synthesis. A critical lesson from post-*KSR* cases is that, in terms of rebutting charges of obviousness, evidence of experimental failures may be as important as proof of technological and commercial success.

FINDING VICARIOUS LIABILITY IN U.S. PATENT LAW: THE "CONTROL OR DIRECTION" STANDARD FOR JOINT INFRINGEMENT

By Alice Juwon Ahn

The Patent Act is designed to address infringement claims that are primarily based on the actions of a single actor. The traditional rule in patent law has been that one must practice every limitation of a method or a process claim to infringe it.[1] For example, if a patent claims a method of performing multiple steps and no single party performs each step of the patented invention (even though multiple parties, collectively, might perform all of the steps), then the patent statutes provide no clear guidance as to whether any or all of the actors can be found liable. These patents, where infringement can only be found by combining the conduct of more than one actor, commonly called "joint" or "divided"[2] infringement, create significant problems for courts. Rather than referring to liability of more than one infringer, the term "joint infringement" refers to situations where one party is liable for infringement of a multiple step claim that is infringed upon by multiple parties, each performing different steps. The viability and scope of that theory of liability has been the subject of considerable debate.[3] In the field of computer networking and e-commerce, where a patented process may involve several parties interacting by operating

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1. 35 U.S.C. § 271 (2006). § 271 requires an accused infringer to perform each and every element of the patent claim to be liable under § 271(a).

2. Mark A. Lemley et al., *Divided Infringement Claims*, 33 AIPLA Q.J. 255 (2005).

3. See Kristin E. Gerdelman, Subsequent Performance of Process Steps by Different Entities: Time to Close Another Loophole in U.S. Patent Law, 53 EMORY L.J. 1987 (2004); Lemley, supra note 2; Long Truong, After BMC Resources, Inc. v. Paymentech, L.P.: Conspiratorial Infringement as a Means of Holding Joint Infringers Liable, 103 NW. U. L. REV. (forthcoming 2009), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1121947 (last visited Feb. 1, 2009); Sriranga Veeraraghavan, Joint Infringement of Patent Claims: Advice for Patentees, 23 SANTA CLARA COMPUTER & HIGH TECH L.J. 211 (2006); Harold C. Wegner, E-Business Patent Infringement: Quest for a Direct Infringement Claim Model (Nov. 21, 2001), available at http://www.softic.or.jp/symposium/open_materials/10th/en/wegner-en.pdf (prepared for the SOFTIC 2001 Symposium).

different computers, the question of who directly infringes when separate, independent actors perform some, but not all, steps of the claimed method has become an increasingly important enforcement issue.

The standard for finding direct infringement of a multi-step method or process patent claim under 35 U.S.C. § 271(a) where no single entity performs each and every step of the claim has been extensively debated for years. Although there is no statutory prohibition on joint infringement in 35 U.S.C. § 271, courts struggled with its application in these types of cases. In *BMC Resources, Inc. v. Paymentech, L.P.*[4] and *Muniauction, Inc. v. Thomson Corp.*,[5] the Federal Circuit, for the first time, determined the standard under which joint infringement would be a viable cause of action. Under this standard, when an accused infringer performs some, but not all, of the steps of a patented method and other parties perform the remaining steps, the patent owner can establish infringement only if the other parties operated under the "control or direction" of the accused infringer (the "mastermind").[6] Consequently, a patentee whose claim depends on the combined actions of multiple actors faces a high burden of proof to establish joint infringement of method claims.

Part I of this Note traces the statutory and jurisprudential development of joint infringement. After introducing the concept of direct and indirect patent infringement, this Note examines the various court-developed joint infringement theories.

Part II summarizes the *BMC* and *Muniauction* cases. In Part III, this Note summarizes district court decisions after *BMC* and *Muniauction* that explore the necessary amount of "control or direction" between the parties who perform the method claim steps.

In Part IV, this Note argues that the Federal Circuit's decision in *Muniauction* was incorrect, and that it makes the parameters of the "control or direct" standard set forth in *BMC* unclear. This Note proposes that the court adopt a new vicarious liability test. The new test should provide a clear standard for determining whether the amount of control or direction exercised by an accused direct infringer over another party is sufficient to hold the accused infringer liable for joint infringement. This Note concludes with an overview of patent prosecution strategies that deal with the joint infringement standards set forth in *BMC* and *Muniauction*.

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4. 498 F.3d 1373 (Fed. Cir. 2007).

5. 532 F.3d 1318 (Fed. Cir. 2008), *cert. denied*, No. 08-847, 2009 U.S. LEXIS 1925 (U.S. Mar. 9, 2009).

6. *See BMC*, 498 F.3d 1373; *Muniauction*, 532 F.3d 1318.

I. JUDICIAL DEVELOPMENT

Patent infringement is normally divided into two categories: direct and indirect. Direct infringement requires that a party perform each and every step or element of a claimed method or process. Indirect infringement is found when a defendant participates in or encourages infringement, but does not directly infringe the patent. Indirect infringement requires a finding of direct infringement by at least one party.

A. Direct Infringement

Section 271(a) imposes liability on "whoever without authority makes, uses, offers to sell or sells any patented invention. . . ." Generally, in order to infringe a patent, the infringer must perform every element of the claimed invention.[7] In the case of an invention consisting of a process or method, a patent infringer must perform every step of the patented process.[8] Direct infringement is a strict-liability offense; a patent holder need not prove that an accused infringer knew of the patent or the infringement in order to prevail.[9]

B. Indirect Infringement

There are two types of indirect infringement: (1) active inducement and (2) contributory infringement.[10] 35 U.S.C. § 271(b) states that, "whoever actively induces infringement of a patent shall be liable as an infringer." To prove active inducement, the patentee must demonstrate that the accused indirect infringer knew or should have known the act would induce actual infringement.[11] To prove contributory infringement, a patentee must show: (1) the accused indirect infringer sold or supplied a component of the claimed invention, (2) the component was material to the patented invention, (3) the alleged infringer knew that the component was especially made or especially adapted for use in the infringing process, (4) the component is not a staple or commodity article, and (5) the component was actually used to infringe the patent at issue.[12]

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7. Joy Tech., Inc. v. Flakt, Inc., 6 F.3d 770, 773 (Fed. Cir. 1993).
8. Hutchins v. Zoll Med. Corp., 492 F.3d 1377, 1380 (Fed. Cir. 2007).
9. *See In re* Seagate Tech., LLC, 497 F.3d 1360, 1368 (Fed. Cir. 2007).
10. *See* 35 U.S.C. § 271(b-c) (2006).
11. *See* DSU Med. Corp. v. JMS Co., 471 F.3d 1293, 1303 (Fed. Cir. 2006) ("[T]he requirement that the alleged infringer knew or should have known his actions would induce actual infringement *necessarily includes the requirement that he or she knew of the patent*.") (emphasis added).
12. 35 U.S.C. § 271(c). For parts relevant to patented processes:

> within the United States . . . a material or apparatus for use in practicing a patented process, constituting a material part of the invention, know-

Generally, indirect infringement is harder for the patent holder to prove, because both types of indirect infringement require proving the existence of underlying direct infringement.[13] Additionally, both types of indirect infringement require a showing that the accused indirect infringer had some level of knowledge of the patent.[14]

C. Pre-*BMC* Joint Infringement

The "all elements rule" and the requirement of proving direct infringement in both direct and indirect infringement cases create a loophole in joint infringement situations where no single party performs every step. One commentator noted that there are two fact patterns to this potential loophole: (1) where a company performs all but the last of the patented steps and the customers then perform the last step (Company/Customer Fact Pattern), and (2) where a selling company performs some of the patented steps and the buyer company performs the remaining steps (Company/Company Fact Pattern).[15] The Federal Circuit largely remained silent until discussing joint infringement in its *On Demand Machine Corp. v. Ingram Industries, Inc.*[16] decision, followed by its *BMC Resources* decision.[17]

1. General Rule of No Infringement

Courts traditionally ruled against claims of joint infringement when one party performed only some steps of a claim and a second party performed the remaining steps.[18] Exceptions to this general rule were often

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> ing the same to be especially made or especially adapted for use in an infringement of such patent, and not a staple article or commodity of commerce suitable for substantial non-infringing use, shall be liable as a contributory infringer.

Id.

13. *See DSU Med. Corp.*, 471 F.3d at 1303 ("[T]he patentee always has the burden to show direct infringement for each instance of indirect infringement.") (citing Dynacore Holdings Corp. v. U.S. Philips Corp., 363 F.3d 1263 (Fed. Cir. 2004)).

14. *See* Aro Mfg. Co. v. Convertible Top Replacement Co., 377 U.S. 476, 488-91 (1964) (holding that contributory infringement requires knowledge that the combination for which a component was especially designed was both patented and infringing); *DSU Med. Corp.*, 471 F.3d at 1304 (en banc in relevant part) (holding that inducement of infringement requires knowledge of the patent).

15. Gerdelman, *supra* note 3, at 2004.

16. 442 F.3d 1331 (Fed. Cir. 2006).

17. *BMC*, 498 F.3d at 1378.

18. *See, e.g.*, Fromson v. Advance Offset Plate, Inc.,720 F.2d 1565 (Fed. Cir. 1985); Cross Med. Prods., Inc. v. Medtronic Sofamor Danek, Inc., 424 F.3d 1293 (Fed. Cir. 2005). In 1974, the Ninth Circuit expressed doubts on whether these multi-actor method claims would ever be infringed when one does not control the other's activities. Mobil

limited to situations in which one party performing a subset of the steps of the claim did so as an agent of the principal party. Usually, if one party practices less than all of the steps or elements of a claim, then there is only partial performance of the patented invention or process, and therefore no direct infringement. In *Fromson v. Advance Offset Plate, Inc.*, for example, the holder of a process patent for making photographic printing plates sued a company that performed several steps in the process and then sold the resulting product to customers who performed the remaining steps.[19] The Federal Circuit held that "because Advance's customers, not Advance, [performed the remaining steps of the patented process], Advance cannot be liable for direct infringement with respect to those plates."[20] The court suggested, however, that Advance could be liable for contributory infringement.[21] Yet, the court did not address how contributory infringement could be found, despite the lack of underlying direct infringement.

Similarly, in *Cross Medical Products v. Medtronic Sofamor Danek*, the court rejected the patentees' efforts to combine the acts of surgeons with those of a medical device manufacturer for the purpose of establishing a direct infringement of an apparatus claim.[22] The court found that a medical device manufacturer did not infringe even though its personnel appeared in an operating room with surgeons and identified instruments for the surgeons to assemble. The court ruled against infringement because the manufacturer's personnel did not direct the surgeons' actions in assembling the claimed apparatus.[23]

2. *Agency Theory*

A few courts have imposed liability for direct infringement where a person acts as an agent of the infringer, in effect aggregating the conduct of defendants acting in concert for liability purposes.[24] In *Crowell v. Bak-*

Oil Corp. v. Filtrol Corp., 501 F.2d 282, 291-92 (9th Cir. 1974) ("We question whether a method claim can be infringed when two separate entities perform different operations and neither has control of the other's activities.").

19. *Fromson*, 720 F.2d 1565.

20. *Id.* at 1568.

21. *Id.*; *see also*, Engate, Inc. v. Esquire Deposition Servs., LLC, No. 01-C 6204, 2003 WL 22117805, at *3 (N.D. III. Sept. 10, 2003) (questioning "joint tortfeasor" theory and limiting it to contributory, not direct infringement).

22. *Cross Med. Prods.*, 424 F.3d 1293.

23. *Id.* at 1311 ("[I]f anyone makes the claimed apparatus, it is the surgeons, who are, as far as we can tell, not agents of Medtronic. Because Medtronic does not itself make an apparatus with the 'interface' portion in contact with bone, Medtronic does not directly infringe.").

24. *See* Mobil Oil Corp. v. W.R. Grace & Co., 367 F. Supp. 207, 253 (D. Conn. 1973); *see also* E.I. DuPont De Nemours & Co. v. Monsanto Co., 903 F. Supp. 680, 735

er Oil Tools,[25] for instance, the Ninth Circuit stated that "[i]t is obvious that one may infringe a patent if he employ[s] an agent for that purpose or ha[s] the offending articles manufactured for him by an independent contractor."[26] Another example can be found in *Mobil Oil Corp. v. W.R. Grace & Co.*, where the patent claimed a method for preparation of a hydrocarbon conversion catalyst.[27] The defendant performed all of the steps of the claimed method except for the heating step, which was intended to be completed by its customers.[28] Although there was no control or direction by the defendants, the district court ruled that the "defendant, in effect, made each of its customers its agents in completing the infringement step, knowing full well that the infringement step would in fact be promptly and fully completed by those customers."[29] In these cases, the courts have imposed liability on the alleged infringers by holding that their business partners and customers acted as their agents.

3. *"Some Connection" Theory*

Some courts have adopted another theory of joint infringement where proof of a sufficient connection between alleged joint infringers exists. Under this view a defendant may be liable for direct infringement, despite not practicing all steps of the patented method, when: (1) the steps of the patented method are performed, and (2) the defendant has sufficient connection to, or control over, the entity or entities performing the remaining steps.[30] For example, in *Faroudja Laboratories, Inc. v. Dwin Electronics,*

(D. Del. 1995) ("[A person] cannot avoid liability for infringement of [a] process patent by paying [another] to practice step (a) of the patented process for it."); Hill v. Amazon.com, Inc., No. Civ.A.2:02-CV-186, 2006 WL 151911 (E.D. Tex. Jan. 19, 2006) ("Proof of an agency relationship or concerted activity would be sufficient to impose liability in circumstances where one party does not perform all the steps of the claimed method."). *But see* Lemley, *supra* note 2, at 256 (noting that this is more the exception than the rule).

25. 143 F.2d 1003 (9th Cir. 1944).

26. *Id.* at 1004.

27. *Mobil Oil Corp.*, 367 F. Supp. at 253.

28. *Id.*

29. *Id.*

30. *See, e.g.*, Marley Mouldings Ltd. v. Mikron Indus., Inc., No. 02C 2855, 2003 U.S. Dist. LEXIS 7211, at *9-10 (N.D. Ill. Apr. 29, 2003) (denying motion for summary judgment of non-infringement where two entities collectively performed a patented process); Shields v. Halliburton Co., 493 F. Supp. 1376, 1389 (W.D. La. 1980), aff'd, 667 F.2d 1232 (5th Cir. 1982) (finding defendants liable for infringement of a patent that claimed a method of preparing an offshore oil rig based on the combined actions of two entities who assisted one another at the same location to perform the method by adopting the "participation and combined action" standard); Free Standing Stuffer, Inc. v. Holly Dev. Co., 187 U.S.P.Q. 323, 335 (N.D. Ill. 1974) (finding defendant liable for direct in-

Inc., the patent claimed a four-step method for converting file frames to television signals and then doubling the number of scan lines.[31] The defendants manufactured and sold "line doublers" that performed the remaining last three steps of Faroudja's patent.[32] Television studios performed the first step of the method, "transferring each film frame to a television signal."[33] Defendant's customers, who connected the line doublers to their televisions, doubled the number of scan lines, thereby completing the last three steps of the method.[34] After reviewing prior decisions by other courts, the court suggested that joint infringement required a showing of "some connection between the different entities."[35] The court also suggested that "some connection" could be shown where the entities "worked in concert . . . to complete the process" or were in "direct contact."[36] In this case, however, the court concluded that there was no direct infringement because Faroudja could not prove a *sufficient* connection between the television studios and the customers.[37] The court held that the only connection between the entities was a copyright license, which was not enough to support a finding of joint infringement.

Several courts adopted the *Faroudja* standard. In *Condis Corp. v. Medtronic AVE, Inc.*, a district court in Delaware found a sufficient connection between the defendant, a medical device corporation that produced stents, and the physicians that used the stents, despite the defendant's urgings to adopt the "work in concert" standard.[38] Similarly, in *Marley Mouldings Ltd. v. Mikron Industries*, the court found "some type of connection" resulting in infringement where a company first custom-ordered materials prepared by another company using the first step of a claim, then performed the remaining steps of the claim itself.[39] Conversely, in *Classen*

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fringement where it instructed its advertising agency to perform certain steps of the patented process); Metal Film Co. v. Melton Corp., 316 F. Supp. 96, 110 (S.D.N.Y. 1970) (finding defendant liable for direct infringement because it hired a third party to perform the first step of the patented method); *Hill*, 2006 WL 151911, at *2 (denying motion for summary judgment of non-infringement where a vendor "directed" its customers to perform the remaining step of the patented method).

31. No. 97-20010 SW, 1999 WL 111788, at *1 (N.D. Cal, Feb. 24, 1999).
32. *Id.* at *2.
33. *Id.* at *1.
34. *Id*.
35. *Id*. at *5.
36. *Id.* at *6.
37. *Id.*
38. 194 F. Supp. 2d. 323, 350 (D. Del. 2002).
39. No. 02C 2855, 2003 U.S. Dist. LEXIS 7211 (N.D. Ill. Apr. 29, 2003). *See also* Applied Interact, LLC v. Vt. Teddy Bear Co., No. 04 Civ. 8713(HB), 2005 U.S. Dist. LEXIS 19070 (S.D.N.Y. Sept. 6, 2005), regarding a method comprising the steps of pro-

Immunotherapies, Inc. v. King Phamaceuticals, Inc., the court, applying the "some connection" standard, found non-infringement, despite the presence of a contract for sale between the two entities that required an ongoing royalty payment.[40]

The court in *Hill v. Amazon.com* analyzed the "some connection" theory in depth.[41] The court held that a website retailer infringed a patent method involving a main computer and a remote computer where the remote computer was operated by a customer. The court stated "a showing of 'agency' or 'working in concert' is not necessarily required" in order to establish a sufficient connection between the defendant and the third party or parties performing the steps of the patented method.[42] Instead, the court held that "some connection between the parties is required to make out a case of direct infringement of a method claim when one party does not perform all of the steps of the method."[43] When evaluating whether a defendant has sufficient connection to, or control over, the entity or entities performing part of the patented method, courts looked to the inventions claimed in the patent and the relationships described therein.[44] In determining whether there was sufficient connection or control, courts could consider whether the patent described the relationship between the allegedly infringing parties.[45]

4. *Dictum in On Demand*

In *On Demand Machine Corp. v. Ingram Industries, Inc.*, the Federal Circuit seemed to suggest approval of the joint infringement doctrine, where combined actions of multiple parties may infringe a patent.[46] The patent at issue claimed a method of: (1) storing on a computer the text of a book, book reviews, and best seller information; (2) providing a means for a customer to review the information; (3) commanding a computer to print the text of the book in response to a customer's selection; and (4) binding

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viding individuals access to coupons, dispensing the coupons, cashing in the coupons, and organizing the success of the coupon program. The court denied the defendant's motion for summary judgment for non-infringement where the two entities hosted a website that provided coupons to users of the website. The court stated that there was "some connection" because when users of the website searched for and printed the coupons, they did so "according to the instructions on [the host's] website."

40. 403 F. Supp. 2d 451 (D. Md. 2005).

41. No. Civ.A.2:02-CV-186, 2006 WL 151911 (E.D. Tex. Jan. 19, 2006).

42. *Id.* at *2 (stating that the "agency" theory was a mere subset of the "some connection" theory).

43. *Id.*

44. *Id.*

45. *Id.* at *3.

46. 442 F.3d 1331 (Fed. Cir. 2006).

the pages together with a cover.[47] The plaintiff argued that Amazon.com and the book printer were jointly liable for patent infringement because the actions of Amazon, by providing information on the Internet, and the printer, by printing the book ordered by the Amazon.com customer, combined to infringe the claim.[48] The jury returned a finding of infringement in response to the following instruction:

> It is not necessary for the acts that constitute infringement to be performed by one person or entity. When infringement results from the participation and combined action(s) of more than one person or entity, they are all joint infringers and jointly liable for patent infringement. Infringement of a patented process or method cannot be avoided by having another perform one step of the process or method. Where the infringement is the result of the participation and combined action(s) of one or more persons or entities, they are joint infringers and are jointly liable for the infringement.[49]

The Federal Circuit reversed the district court's claim construction, necessarily reversing the infringement verdict. But the court acknowledged there was "no flaw in this [jury] instruction [on joint infringement] as a statement of law."[50] It seemed as if the Federal Circuit replaced years of precedent with a much looser standard of mere "participation and combined action."

II. TOWARD A NEW STANDARD FOR JOINT INFRINGEMENT LIABILITY: *BMC* AND *MUNIAUTION*

In *BMC Resources, Inc. v. Paymentech, L.P.*[51] and *Muniauction, Inc. v. Thomson Corp.*,[52] the Federal Circuit took a step towards clarifying the standard for joint infringement. Under this standard, when an accused infringer performs some, but not all, of the steps of a patented method, while other parties perform the remaining steps, the patent owner can establish infringement only if the other parties operated under the control or direction of the accused infringer (the mastermind).[53]

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47. *Id.* at 1334.
48. *Id.* at 1344.
49. *Id.* at 1344-45.
50. *Id.* at 1335.
51. 498 F.3d 1373 (Fed. Cir. 2007).
52. 532 F.3d 1318 (Fed. Cir. 2008), *cert. denied*, No. 08-847, 2009 U.S. LEXIS 1925 (U.S. Mar. 9, 2009).
53. *See id.*; *BMC*, 498 F.3d 1373.

A. The *BMC* Case

1. *Facts and Procedural History*

In *BMC*, BMC Resources (BMC) brought an infringement suit against Paymentech based on two method patents for processing debit transactions over a telephone line without a personal identification number.[54] The methods required, among other things, prompting a customer who calls a merchant (or the merchant's agent) to enter certain payment information, having a financial institution verify the availability of credit or funds, and, if sufficient funds existed, charging the credit or debit card account and reflecting the payment in the relevant billing account.[55] The claims expressly required the combined actions of at least four different actors—a payee's agent, a remote payment network, the card-issuing financial institution, and a caller—to perform the various steps of the claimed invention for infringement to occur.[56]

Paymentech, who acted as the merchant's agent by collecting payment information from the customer and forwarding it to a debit network, moved for summary judgment. The district court granted summary judgment of non−infringement based on the fact that Paymentech did not perform all steps of the claimed method, and that there was insufficient connection between it and the other actors to trigger joint liability under § 271(a).[57] A magistrate judge recommended granting Paymentech's motion because Paymentech's process only performed one of the four steps of the patented method.[58] The district court agreed with Paymentech that the Federal Circuit's statement in *On Demand*—that there was no flaw in the jury instruction on joint infringement—was dicta.[59] The district court noted that, in *On Demand*, the Federal Circuit had not considered the relationship between the parties who purportedly performed the steps of the claimed invention, because their actions otherwise did not amount to infringement.[60] Therefore, approval of the jury instruction was not directly necessary to its decision in *On Demand*.[61] The district court agreed that BMC must prove that Paymentech directed or controlled the actions of the

54. *BMC*, 498 F.3d at 1377.
55. *Id.*
56. *See id.* at 1375, 1377.
57. *See* BMC Res., Inc. v. Paymentech, L.P., No. 3:03-CV-1927-M, 2006 U.S. Dist. LEXIS 37746 (N.D. Tex. May 24, 2006).
58. *Id.* at *12-13.
59. *Id.* at *11 n.3.
60. *Id.*
61. *Id.*

other entities performing the steps of the process patent.[62] The district court also stated that Paymentech did not jointly infringe the method claim because there was not even "some connection" between Paymentech and the other parties.[63] Because there was no evidence of Paymentech's control over the other parties, the district court granted Paymentech's motion.[64] Insistent that the "control or direct" standard is too demanding, and that it is also inconsistent with *On Demand*, BMC appealed.[65]

2. *The Federal Circuit's Analysis*

On September 20, 2007, the Federal Circuit affirmed the district court judgment that Paymentech did not infringe.[66] First, the court noted that an accused infringer must perform each and every element of the patent claim to be liable under § 271(a).[67] Nevertheless, citing fairness concerns, the court further stated that § 271(a) cannot be avoided "simply by contracting out steps of a patent process to another entity."[68] Yet, the court refused to extend liability under § 271(a) to each of multiple, independent actors merely because their collective actions recited every element of the claim.[69] In fact, the court stated that doing so would "subvert the statutory scheme of indirect infringement" under §§ 271(b) and (c), which requires knowledge and/or intent for liability.[70] The court reasoned that if participation alone triggered liability under § 271(a), then "a patentee would rarely, if ever, need to bring a claim for indirect infringement."[71] Instead, the Federal Circuit agreed with the district court that for a party to be liable for joint infringement under § 271(a), it must "control or direct" the actions of others who are performing the step(s) the party itself is not performing.[72] BMC argued that because Paymentech provided the required information to the financial institutions, the requisite control or direction should be inferred.[73] The court disagreed, however, citing *Fromson* and

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62. *Id.* at *21-22.
63. *Id.*
64. *Id.* at *24.
65. BMC Res., Inc. v. Paymentech, L.P., 498 F.3d 1373, 1378 (Fed. Cir. 2007).
66. *Id.*
67. *Id.* at 1378 (citing Warner-Jenkinson Corp. v. Hilton Davis Corp., 520 U.S. 17 (1997); Canton Bio-Med., Inc. v. Integrated Liner Techs., Inc., 216 F.3d 1367, 1370 (Fed. Cir. 2000); Joy Techs. v. Flakt, Inc., 6 F.3d 770, 773 (Fed. Cir. 1993)).
68. *Id.* at 1381.
69. *Id.*
70. *Id.*
71. *Id.*
72. *Id.* at 1382.
73. *Id.* at 1381.

Cross Medical to illustrate the amount of control necessary to trigger such liability.[74]

The court noted that a "party cannot avoid infringement . . . simply by contracting out steps" of the patented process, because such contracting would constitute the required control or direction.[75] On the other hand, the Federal Circuit acknowledged that the "control or direction" standard may allow parties to avoid infringing method claims by acting cooperatively through arms-length transactions. This implicates a problem where companies can enter into a contract, without one directing or controlling another, to split up the steps of a patent and avoid infringement.[76] However, the court suggested that these potential issues were outweighed by "concerns over expanding the rules governing direct infringement" and the fact that this risk can be "offset by proper claim drafting."[77] Because the patentee chose to draft "ill-conceived" patent claims requiring the combined actions of multiple parties, the court declined to "unilaterally restructure" those claims or the standards for joint infringement.[78]

Applying these standards to the case at hand, the court held BMC could not establish direct infringement because Paymentech did not perform all of the steps of the method claim and did not control the parties performing the other steps.[79] Moreover, BMC presented no evidence to support its argument that Paymentech gave instructions to the other parties on how to perform the steps.[80] Therefore, Paymentech's actions combined with the other parties' actions did not constitute joint infringement.[81]

B. The *Muniauction* Case:

1. *Facts and Procedural History*

In *Muniauction*, MuniAuction Inc. brought suit against Thomson Corp. and I-Deal LLC for infringement of U.S. Patent No. 6,161,099 ('099

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74. *Id.* at 1380 (citing Fromson v. Advance Offset Plate, Inc., 720 F.2d 1565, 1568 (Fed. Cir. 1985); Cross Med. Prods. v. Medtronic Sofamor Danek, Inc., 424 F.3d 1293 (Fed. Cir. 2005)). See supra Section I.C.1 for a discussion of *Fromson* and *Cross Medical*.

75. *Id.* at 1381 ("A party cannot avoid infringement, however, simply by contracting out steps of a patented process to another entity. In those cases, the party in control would be liable for direct infringement. It would be unfair indeed for the mastermind in such situations to escape liability.").

76. *Id.*

77. *Id.*

78. *Id.*

79. *Id.*

80. *Id.*

81. *Id.*

patent).[82] The patent at issue was directed to "electronic methods for conducting 'original issuer auctions of financial instruments,'" or web-based methods for performing auctions for original-issuer municipal bonds over the Internet.[83] In an original-issuer auction, a municipality offers the bond to "bidders" (underwriters) who purchase the entire bond offering on an "all or nothing" basis.[84] The winner then resells the bonds to the public.[85] The bonds typically comprise a variety of debt instruments having different maturity dates and principal amounts, so the bidder must offer a price based on these amounts and maturity dates.[86]

The patent referenced an earlier bidding system, known as the Parity electronic bid submission. Parity resembled the claimed system, but used proprietary software instead of a web-based system in order for bidders to participate in the bond auctions.[87] Thomson modified Parity so that issuers could view bids over the Internet using a web browser.[88] The use of a web browser allowed bidders to monitor the auction and the status of the best bid.[89]

In October 2006, a jury found that the asserted claims were not obvious and, relying on the joint infringement theory, found willful infringement damages of $38.4 million.[90] After the jury reached its verdict, but before the district court ruled on the defendant's motion for judgment as a matter of law, the Supreme Court decided *KSR International Co. v. Teleflex Inc.,* which altered the patent nonobviousness standard.[91] Thomson filed motions for a new trial and for judgment as matter of law. Upon review the district court considered *KSR*, but denied Thomson's motions, holding that substantial evidence supported the jury's conclusion of nonobviousness in part based on secondary indicia.[92] The court granted a permanent injunction prohibiting the future use and sale of the infringing Thomson/iDeal Parity electronic bid submission system, doubled the jury's damage award, and added $7.6 million in prejudgment interest. This

82. MuniAuction, Inc. v. Thomson Corp., No. 01-1003, 2006 U.S. Dist. LEXIS 57461 (W.D. Pa. Aug. 11, 2006).

83. Muniauction, Inc. v. Thomson Corp., 532 F.3d 1318, 1321 (Fed. Cir. 2008), *cert. denied*, No. 08-847, 2009 U.S. LEXIS 1925 (U.S. Mar. 9, 2009).

84. *Id.*

85. *Id.*

86. *Id.*

87. *Id.* at 1323.

88. *Id.*

89. *Id.*

90. *Id.*

91. *See* KSR Int'l Co. v. Teleflex Inc., 127 S. Ct. 1727, 1739 (2007).

92. Muniauction, Inc. v. Thomson Corp., 502 F. Supp. 2d 477, 490 (W.D. Pa. 2007).

brought the total judgment to $84.6 million based on the finding of willful infringement, and Thomson appealed.[93]

2. *The Federal Circuit's Analysis*

On appeal, the Federal Circuit reversed the district court's permanent injunction and denial of judgment as a matter of law.[94] The Federal Circuit found several claims of the asserted the '099 patent obvious, and also held that Thomson did not infringe the remaining claims.[95] The Federal Circuit also vacated the district court's award of $84.6 million.[96]

The Federal Circuit first addressed the question of obviousness of the broader asserted claims. The court evaluated MuniAuction's patent and found six of the claims of the asserted '099 patent obvious under *KSR* and *Leapfrog*.[97] The court held that the browser modification to Parity represented a combination of two well-known prior art elements to a person of ordinary skill in the art. Therefore, Thomson had clearly and convincingly established a prima facie case that the broader claims of the patent were obvious as a matter of law.[98]

The court next took up the issue of infringement of the remaining dependent claims that were not obvious. Because the purported infringement involved multiple parties, MuniAuction sought to proceed under the theory of joint infringement. The joint infringement issue presented was "whether the actions of at least the bidder and the auctioneer may be combined so as to give rise to a finding of direct infringement by the auctioneer."[99] While the appeal was pending, the Federal Circuit decided *BMC*, clarifying the standard for joint infringement.[100] The Federal Circuit cited *BMC* in its *Muniauction* opinion, acknowledging that "a defendant cannot . . . avoid liability for direct infringement by having someone else carry out one or more of the claimed steps on its behalf," but a "claim is directly infringed only if one party exercises control or direction over the entire process such that every step is attributable to the controlling party."[101] Acknowledging that the district court's denial of Thomson's motion for judgment as a matter of law occurred before *BMC* issued, the Federal Circuit found the jury instruction on joint infringement to have been based on

93. *Id.*
94. *See Muniauction*, 532 F.3d 1318.
95. *Id.*
96. *Id.*
97. *Id.* at 1326-28.
98. *Id.*
99. *Id.* at 1329.
100. *Id.* at 1323.
101. *Id.* at 1329.

an interpretation of the Federal Circuit's *On Demand* standard that was no longer viable under *BMC*.[102] The court found that, under *BMC*, the "control or direction standard is satisfied in situtations where the law would traditionally hold the accused direct infringer *vicariously liable* for the acts committed by another party that are required to complete performance of a claimed method."[103] Although MuniAuction argued that Thomson controls access to its system and provides instruction to bidders on how to use it, the court held that this was not sufficient to meet the standard for joint infringement.[104] MuniAuction had not offered a theory on how Thomson might be vicariously liable for the actions of the bidders, and Thomson had neither performed every step of the claimed methods nor had another party perform the steps "on its behalf."[105] As a result, the court held that Thomson did not infringe with respect to the valid patent claims.[106] Supreme Court denied a petition for certiorari[107] to review the application of the "control or direction" standard in *Muniauction*.[108]

III. CURRENT CASES EXAMINING JOINT INFRINGEMENT LIABILITY

Several district court cases decided after *BMC* dealt with the question of direction or control in the joint infringement context.[109] In finding the necessary direction or control, the cases seem to require that the accused infringer at least knew of the patented method. Although pre-*Muniauction* cases seem to require a finding of direction or control when the alleged

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102. *Id.* at 1329-30.

103. *Id.* at 1330 (citing Int'l Rectifier v. Samsung Elecs. Co., 361 F.3d 1355, 1361 (Fed. Cir. 2004)) (emphasis added).

104. *Id.* at 1330.

105. *Id.*

106. *Id.*

107. Muniauction, Inc. v. Thompson Corp., No. 08-847, 2009 U.S. LEXIS 1925 (U.S. Mar. 9. 2009).

108. Petition for Writ of Certiori, Miniauction, Inc. v. Thompson Corp., No. 08-847 (U.S. Dec. 22, 2008), 2008 WL 5467602.

109. *See, e.g.*, Friday Group v. Ticketmaster, No. 4:08CV01203 JCH, 2008 U.S. Dist. LEXIS 100529 (E.D. Mo. Dec. 12, 2008); Fisher-Barton Blades, Inc. v. Blount, Inc., 584 F. Supp. 2d 1126 (E.D. Wis. 2008); Alloc, Inc. v. Pergo, Inc., No. 02-C-736, 2008 U.S. Dist. LEXIS 35944 (E.D. Wis. May 1, 2008) (finding that the jury could have concluded that the Alloc Parties included instructions with the accused products as a matter of convenience for their end user customers, not to control the conduct of the customers); TGIP, Inc. v. AT&T Corp., 527 F. Supp. 2d 561, 569 (E.D. Tex. 2007); Gammino v. Gellco P'ship, 527 F. Supp. 2d 395 (E.D. Pa. 2007); Privasys, Inc. v. Visa Int'l, No. C 07-03257 SI, 2007 U.S. Dist. LEXIS 86838, at *1 (N.D. Cal. Nov. 14, 2007).

infringer provides specific instructions, post-*Muniauction* cases suggest otherwise.

A. Pre-*Muniauction* District Court Cases Evaluating the "Control or Direction" Standard After *BMC*

1. *A Court Finds No Material Issues of Fact on the Question of Control or Direction When the Accused Infringer Had No Knowledge of the Patented Method*

In *Gammino v. Cellco Partnership*, the court found no issue of material fact on the question of direction and control despite the existence of a contract between the alleged joint infringers, and granted the defendant's motion for summary judgment.[110] The patents at issue involved processes for blocking international phone calls, including evaluating dialed digits and preventing operation of the device if certain digits were international.[111] The accused infringer, Davel, owned and operated pay telephones, some of which blocked international phone calls.[112] Although Davel admitted to having a contractual relationship with service providers, it asserted that it did not provide instructions to the service providers for blocking calls, nor did it know how the service provider blocked the calls.[113] The court concluded that Davel did not control or direct the step in question, because Davel did not even know of the providers' methods.[114]

2. *Courts Find Fact Issues on the Question of Control or Direction Based On Contractual Relationships and Instructions*

In contrast to *Gammino*, in *TGIP, Inc. v. AT&T Corp.*[115] and *Privasys, Inc. v. Visa International*[116] the courts found that there were issues of fact partly based on a contractual relationship. In *TGIP*, for instance, TGIP sued for infringement of a patented prepaid calling card system having a remote terminal to provide on-site activation and recharging of calling cards.[117] The accused infringer, AT&T, had contracted with some third

110. 527 F. Supp. 2d 395.
111. *Id.* at 397.
112. *Id.*
113. *Id.*
114. *Id.* at 398.
115. 527 F. Supp. 2d 561, 569 (E.D. Tex. 2007).
116. No. C 07-03257 SI, 2007 U.S. Dist. LEXIS 86838, at *1 (N.D. Cal. Nov. 14, 2007).
117. *TGIP*, 527 F. Supp. 2d at 569.

parties to provide an activation platform and other third parties to provide data terminals.[118] In addition, an AT&T corporate representative testified that one of the third parties was acting "on behalf of" AT&T.[119] TGIP presented evidence that AT&T provided specifications to the third parties that directed the process for sending an activation message to AT&T.[120] Citing *BMC*, the court denied AT&T's summary judgment motion, concluding that an issue of material fact existed as to whether AT&T controlled or directed the companies that provided the activation platform and data terminals.[121]

In *Privasys, Inc. v. Visa International*, PrivaSys sued Visa for infringing a patented method for providing credit card security by generating a unique code with each credit card transaction that fraudulent cards would not generate.[122] Visa allegedly had a contractual relationship with banks that performed some of the steps of the claimed method. PrivaSys also asserted that Visa provided instructions to these banks and merchants on how to carry out these steps.[123] The court held that the alleged relationship between the banks and the entities that carried out the additional steps in the patented method was stronger than the relationship at issue in *BMC*.[124] Thus, the court permitted PrivaSys to amend its complaint to claim infringement against additional parties.[125]

B. District Court Cases Evaluating the "Control or Direction" Standard After *Muniauction*

District court cases decided after *Muniauction* follow the *Muniauction* conclusion that instructions for completing the steps of a patented method alone do not support the finding of control or direction.[126] Post-*Muniauction* cases seem to require a contractual relationship between the alleged infringer and a third party who completes the patented steps in order to find the requisite direction or control necessary for a showing of

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118. *Id*. at 577.
119. *Id*. at 578.
120. *Id*.
121. *Id*.
122. No. C 07-03257 SI, 2007 U.S. Dist. LEXIS 86838, at *1 (N.D. Cal. Nov. 14, 2007).
123. *Id.*
124. *Id.* at *2 ("Both pieces of evidence tend to show that Visa exercised 'direction or control' over the customer--merchant interaction as well as over the banks, and thus perform[ed] or cause[d] to be performed each and every element of the claims.").
125. *Id.*
126. *See* Emtel, Inc. v. LipidLabs, Inc., 583 F. Supp. 2d 811 (S.D. Tex. 2008); Rowe Int'l Corp. v. Ecast, Inc., 586 F. Supp. 2d 924 (N.D. Ill. 2008); Global Patent Holdings, LLC v. Panthers, 586 F. Supp. 2d 1331 (S.D. Fla. 2008).

direct infringement.[127] However, the cases seem to indicate that even a contractual relationship satisfies the requisite direction or control for direct infringement only when: (1) the alleged infringer provides specific instructions, and (2) a third party acts as the alleged infringer's agent in completing the infringing steps.[128] Although it is too early to judge the consequences of *Muniauction*, the post-*Muniauction* cases seem to suggest no finding of infringement where companies perform some of the patented steps and instruct their customers to perform the last step.[129]

1. *Mere Instruction is Insufficient to Establish Direction or Control*

In *Global Patent Holdings, LLC v. Panthers*, the plaintiff alleged infringement of a method patent for downloading material from a remote server in response to a query.[130] The method in question required both a website server and a remote computer user to complete all of the method's steps.[131] The plaintiff asserted that the remote user's actions were controlled by the defendant because the defendant supplied javascript programs on the remote user's computer to allow the process to begin.[132] The court held that this relationship does not establish direction or control.[133] The court noted that the remote user was not contractually bound to visit the website, that the user was not visiting the website within the scope of an agency relationship with the defendant, and that the defendant was not otherwise vicariously liable for the acts of the remote user.[134] Citing both *BMC* and *Muniauction*, the court stated that "it appears that the level of 'direction or control' the Federal Circuit intended was not mere guidance or instruction in how to conduct some of the steps of the method patent." Instead, the court stated that "the third party must perform the steps of the patented process by virtue of a contractual obligation or other relationship

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127. *Rowe Int'l Corp.*, 586 F. Supp. 2d 924; *Global Patent Holdings*, 586 F. Supp. 2d 1331; *see also Emtel*, F. Supp. 2d at 835 ("The cases also generally refer to a contractual agency relationship between the 'mastermind' and the third party performing some of the steps necessary to show infringement.").

128. *See Emtel*, 583 F. Supp. 2d 811; *see also* Keithley v. Homestore.com, Inc., No. C 03-4447 SI, 2008 U.S. Dist. LEXIS 94235 (N.D. Cal. Nov. 19, 2008) (finding no control or direction where the defendant website provider supplied the real estate information to the end users who performed another step in the patented method).

129. *See, e.g., Keithley*, 2008 U.S. Dist. LEXIS 94235; *Global Patent Holdings*, 586 F. Supp. 2d 1331.

130. 586 F. Supp. 2d 1331.

131. *Id.* at 1335.

132. *Id.* at 1333.

133. *Id.* at 1335.

134. *Id.*

that gives rise to vicarious liability in order for a court to find 'direction or control.'"[135]

2. *Providing Instructions in a Contractual Relationship is Insufficient to Establish Direction or Control*

In *Emtel, Inc. v. LipidLabs, Inc.*, the court analyzed the control or direction standard in depth.[136] The court held that the telemedicine support providers did not infringe a method patent for providing telemedicine using a video-conferencing system, which allows physicians to communicate with medical caregivers and patients in remote healthcare facilities.[137] The providers were under contract with physicians who remotely diagnosed medical conditions and instructed local medical caregivers about treating patients. After analyzing *BMC*, *Muniauction*, *Cross Medical*, and some post-*BMC* cases, the court stated that "[g]iving instructions or prompts to the third party in its performance of the steps necessary to complete infringement, or facilitating or arranging for the third-party's involvement in the alleged infringement, are not sufficient."[138] The court suggested that vicarious liability under *BMC* and *Muniauction* "generally refers to a contractual agency relationship between the 'mastermind' and the third party performing some of the steps necessary to show infringement."[139] Yet, the court emphasized that the mere fact that there is a contract is not sufficient.[140] In order for liability to attach, "the 'mastermind' must so control the third party in its performance of the infringing steps that the third party does so as the defendant's agent."[141]

Based on this analysis, the court concluded that the contractual relationship did not suffice for "control and direction" such that every step of the claimed method was attributable to the telemedicine support providers.[142] The court held that the contracts set basic parameters for the physicians but did not set limits on or assert control over the physicians' medical work, judgment, or skill.[143] Because the providers did not control the

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135. *Id.*
136. 583 F. Supp. 2d 811 (S.D. Tex. 2008).
137. *Id.* It is worthwhile to note that the fact pattern is similar to that of *Cross Medical*.
138. *Id.* at 834.
139. *Id.* at 835.
140. *Id.* at 839.
141. *Id.*
142. *Id.*
143. *Id.* at 838.

physicians' work, and the physicians were not agents or servants of the provider, the providers did not infringe the patent claims.[144]

3. *One District Court Finds the Necessary Direction or Control*

In *Rowe International Corp. v. Ecast, Inc.*, the patent at issue involved a computer jukebox that had a central management station that could distribute digital music to multiple jukeboxes.[145] Ecast contracted third parties to manufacture jukebox hardware specifically designed to operate with Ecast's network service, along with technical specifications.[146] The court concluded that there was evidence from which a jury could reasonably find that the other parties manufactured jukebox hardware subject to Ecast's direction and control.[147] The court specifically found that "[t]he indicia of direction and control go beyond what was present in BMC Resources, Cross Medical Products, and other cases in which patentees failed to establish 'mastermind'-level direction of participants in the alleged infringing activities."[148]

IV. DISCUSSION

In *BMC* and *Muniauction*, the Federal Circuit took a step toward establishing a clear rule regarding joint infringement by applying the "control or direct" standard to method claims. However, it is still not clear how much control or direction is necessary to trigger liability.[149] Moreover, the *Muniauction* decision raises fairness concerns as well as confusion. To promote fairness and consistency, and thereby increase predictability, the court should further clarify the joint infringement standard by developing a test to determine the amount of control or direction that is necessary for a court to find joint infringement.

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144. *Id.*
145. 586 F. Supp. 2d 924 (N.D. Ill. 2008).
146. *Id.* at 930.
147. *Id.* at 933.
148. *Id* at 932.
149. As stated in kSolo, Inc. v. Catona, No. 07-5213-CAS (AGRx), 2008 U.S. Dist. LEXIS 95107, at *11 (C.D. Cal. Nov. 10, 2008), neither *BMC* nor *Muniauction* provides a standard for control or direction. Instead, the *Muniauction* court only set out a 'spectrum' of multiple-party relationships. *Id.* "At one end is 'mere arms-length cooperation,' which is insufficient to establish infringement. At the other end is 'control or direction over the entire process such that every step is attributable to the controlling part, i.e., the mastermind,' which is sufficient to establish infringement." Emtel, Inc. v. LipidLabs, Inc., 583 F. Supp. 2d 811, 826 (S.D. Tex. 2008).

A. The Virtues and Vices of the Federal Circuit's Decisions

In the wake of *BMC,* the court in *Muniauction* affirmed existing case law that a multistep process claim is jointly infringed only if the accused infringer controls or directs other parties that perform the steps not performed by the accused party. This decision eliminates an inconsistency in the treatment of multi-actor method claims and clarifies the doctrine of joint infringement to some extent.

The Intellectual Property Owners Association (IPO), in its amicus brief calling on the Federal Circuit to rehear a panel decision or conduct a rehearing en banc to reconsider the *Muniauction* decision, argued that "not all process patents can be reliably parsed at the claiming stage in order to predict whether or how the claimed steps might be practiced by multiple entities."[150] As the Federal Circuit noted, the problems in *BMC* and *Muniauction* could have been easily avoided by drafting their claims to focus on one entity. However, it may be more natural for some inventions to be written in a multi-actor claims form, considering the current stage of development of technology.[151]

IPO's brief also suggested that the decisions in *BMC* and *Muniauctio*n may be read to be inconsistent interpretations of control or direction. In applying the "control or direction" standard, the *BMC* court found no control or direction between Paymentech and debit networks because of the lack of evidence that Paymentech provided any "instructions or directions" regarding the use of data to debit networks.[152] In *Muniauction*,

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150. Brief for Intellectual Property Owners Association as Amicus Curiae in Support of Petition for Panel Rehearing and Rehearing En Banc at 5, Muniauction, Inc. v. Thomson Corp., 532 F.3d 1318 (Fed. Cir. 2008) (No. 2007-1485), 2008 WL 3992446.

151. Although the patentee would be able to get around this by drafting method claims from the perspective of a single entity in a way that the single entity performs every step of a method claim, some claims may make more sense when describing an invention in multi-entity forms if the invention necessarily involves multiple parties.

152 . BMC Resources, Inc. v. Paymentech, L.P., 498 F.3d 1373, 1378 (Fed. Cir. 2007). The court stated:

> Specifically, the magistrate and district court found BMC's evidence that Paymentech provides data (debit card number, name, amount of purchase, etc.) to the debit networks, absent any evidence that Paymentech also provides *instructions or directions* regarding the use of those data, to be inadequate. BMC argues that *instructions or directions* can be inferred from the provision of these data, or that the data themselves provide *instructions or directions*. But, having presented no evidence below to support either theory, BMC is not entitled to such an inference with respect to the debit networks that would allow it to survive summary judgment.

Id. (emphasis added).

however, Thomson controlled access to its system and provided "instruction" to user-bidders on how to use it, but the *Muniauction* court held that it was not sufficient to meet the standard for control or direction necessary for joint liability.[153] One might reconcile the two cases by noting that the term "instruction" might have been used to mean "direction" in *BMC*, and "teaching" in *Muniauction*. However, this argument cannot be reconciled with the *Muniauction* court's statement on the trial court's jury instruction. The jury instruction on joint infringement read as follows:

> Consider whether the parties are acting jointly or together in relation to the electronic auction process. Are they aware of each other's existence and interacting with each other in relation to the electronic auction process? Is there one party *teaching, instructing, or facilitating* the other party's participation in the electronic auction process? These are the types of questions that you should ask in making your decision on this issue. If you find that there is a sufficient connection between Thomson and the bidders and the issuers that used Thomson's process, then you could find Thomson liable for direct infringement.[154]

On this jury instruction, the court stated that "none of the questions identified by the jury instruction are relevant to whether Thomson satisfies the 'control or direction' standard of *BMC Resources*."[155] Here, the court effectively provided bewildering guidance to lower courts that "teaching, instructing or facilitating" are not relevant to the standard for "control or direction." The *Muniauction* court further justified its conclusion by interpreting the *BMC* ruling as affirming a reading of *On Demand* as "not in any way rely[ing] on the relationship between the parties."[156] To be precise, the *BMC* court did not state that the relationship between parties is irrelevant to the "control or direction" standard.

The flawed reasoning by the panel in *Muniauction* lets masterminds escape liability. The alleged infringer in *Muniauction* knew and intended that the issuers and bidders would complete the patented process, provided directions to the issuers and bidders for completing the steps, and received the financial benefit of the patented process. Unlike the post-*BMC* cases that were decided before *Muniauction*, the post-*Muniauction* cases seem to

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153. *Muniauction*, 532 F.3d at 1330 ("[N]one of the questions identified by the jury instruction are relevant to whether Thomson satisfies the "control or direction" standard of *BMC Resources.* That Thomson controls access to its system and *instructs* bidders on its use is not sufficient to incur liability for direct infringement." (emphasis added)).

154. *Id.* at 1229 (emphasis added).

155. *Id.* at 1330.

156. *Id.* at 1229.

show that the *Muniauction* decision lets companies evade liability when they perform all but the last of the patented steps and instruct customers to perform the last step.[157] This can encourage clever infringers to act as enterprising masterminds who know and intend the patented process be performed and benefit from the performance of the method. By reading the "direction" element out of the "control or direction" standard outlined in *BMC*, the opinion in *Muniauction* severely restricts mastermind liability.

As the IPO noted, many thousands of patents may become worthless[158] under the stringent "control or direction" standard set forth in the *Muniauction* decision. Furthermore, denying protection of all multi-actor method claims may be contrary to the public notice function guaranteed by the due process clause of the Fifth Amendment. Technically, there is no statutory provision or case law that explicitly prohibits multi-actor method claims or a finding of joint infringement. In addition, denying protection of all multi-actor method claims may raise a fairness issue since some new and useful inventions would be denied protection. Therefore, to resolve the remaining confusion created by the *Muniauction* court and to prevent the unfair situation where all multi-participant claims are denied protection, the court should further clarify how much control or direction is necessary to trigger liability.

B. Vicarious Liability Test for Determining Whether the Degree of Control or Direction is that of a Mastermind

In *BMC*, the court refused to extend liability under § 271(a) to multiple, independent actors merely because their collective actions practiced every element of the claim. The court was correct in doing so because finding infringement in such cases could result in the harsh outcome that a party who is unaware of what others are doing may be found to infringe. Specifically, the court refused to infer the requisite control or direction from the fact that Paymentech provided the required information to the financial institutions.[159] The court's main concern was that doing so would "subvert the statutory scheme of indirect infringement" under §§ 271(b) and (c), which require knowledge and/or intent for liability.[160] Indeed, as

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157. *See, e.g.,* Keithley v. Homestore.com, Inc., No. C 03-4447 SI, 2008 U.S. Dist. LEXIS 94235 (N.D. Cal. Nov. 19, 2008); Global Patent Holdings, LLC v. Panthers, 586 F. Supp. 2d 1331 (S.D. Fla. 2008).

158. Brief of *Amicus Curiae* Intellectual Prop. Owners Assoc., *supra* note 150, at 5.

159. BMC Resources, Inc. v. Paymentech, L.P., 498 F.3d 1373, 1381 (Fed. Cir. 2007).

160. *Id.* A finding of indirect infringement also requires a finding of direct infringement. *See* DSU Med. Corp. v. JMS Co., 471 F.3d 1293, 1305 (Fed. Cir. 2006) ("The patentee always has the burden to show direct infringement for each instance of indirect

Professor Lemley noted, permitting "individual, non-infringing acts of unrelated parties together to add up to infringement would render both §271(b) and 271(c) meaningless."[161] On the other hand, as the *BMC* court noted, "the standard requiring control or direction for a finding of joint infringement may in some circumstances allow parties to enter into arms-length agreements to avoid infringement."[162] Although the Federal Circuit pointed out that the potential problems could be avoided by proper drafting, the loopholes need to be closed.[163] In situations where a remedy is needed, the solution should be a "minimally intrusive" one.[164]

To resolve uncertainty regarding what type and degree of control or direction are necessary, this Note proposes that the courts adopt a vicarious liability test, based on copyright vicarious liability requirements, for finding a joint infringement liability that captures mastermind liability as the *BMC* court intended.

1. Copyright Vicarious Liability

Vicarious liability, a form of indirect copyright infringement, is found where one has (1) the right and ability to control the infringing activity, and (2) receives a direct financial benefit from the infringing activity.[165]

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infringement."). It is not clear whether a finding of indirect infringement would require a direct infringement of a single party. However, it is likely from the plain reading of cases that a finding of any direct infringement, whether joint or not, would be sufficient. If this is the case, the court's concern is valid, since inducing parties and contributors would be strictly liable as joint infringers without having to show any knowledge or intent.

161. Lemley, *supra* note 2, at 262.

162. *BMC*, 498 F.3d at 1381.

163. Some commentators have proposed a new form of patent infringement. *See* Gerdelman, *supra* note 3 (suggesting a statutory standard to determine the liability of separate entities that successively perform steps of a patented process); Truong, *supra* note 3 (proposing a new cause of action for conspitorial infringement that would require a mens rea requirement similar to that of inducement instead of requiring a single controlling entity).

164. Lemley, *supra* note 2, at 284 ("But if the distribution is unavoidable—if it results from the inherently global nature of computer networks—the law should seek minimally intrusive solutions designed to prevent those inventions from losing all protection.").

165. Shapiro, Bernstein & Co. v. H.L. Green Co., 316 F.2d 304, 307 (2d Cir. 1963) (holding that a company that leased floor space to a phonograph record department was liable for record department's sales of "bootleg" records, even though the company had no actual knowledge of infringement, because of the company's beneficial relationship to the sales).

> [A]lthough vicarious liability was initially predicated upon the agency doctrine of respondeat superior . . . , even in the absence of an employer-employee relationship one may be vicariously liable if he has the

Under the doctrine of vicarious liability, one may be found liable even without specific knowledge of infringing acts.[166] The best known copyright cases involving vicarious liability are the "dance hall" cases, where courts found vicarious liability when dance hall owners allowed the unauthorized public performance of musical works by the bands they hired, even when the owners had no knowledge of the infringements and had even expressly warned the bands not to perform copyrighted works without a license from the copyright owners.[167] Although the vicarious liability standard of patent law did not originate from copyright law, it is worthwhile to note that the financial benefit element serves as a settled standard for judging vicarious liability in copyright law.

2. *The Elements of the New Vicarious Liability Test in the Joint Infringement Context*

The *BMC* court appeared to establish one standard for showing joint infringement—the "vicarious liability" standard: "the law imposes *vicarious liability* on a party for the acts of another in circumstances showing that the liable party controlled the conduct of the acting party."[168] The court also suggested that it would be unfair for the mastermind to escape liability.[169] In *Muniauction*, the court reaffirmed the importance of vicarious liability in determining joint infringement, stating, "the control or

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> right and ability to supervise the infringing activity and also has a direct financial interest in such activities.

Gershwin Publ'g Corp. v. Columbia Artists Mgmt, Inc., 443 F.2d 1159, 1162 (2d Cir. 1971).

166. *Id.*

167. *See, e.g.*, Famous Music Corp. v. Bay State Harness Horse Racing & Breeding Ass'n, 554 F.2d 1213 (1st Cir. 1977); Dreamland Ball Room, Inc. v. Shapiro, Bernstein & Co., 36 F.2d 354 (7th Cir. 1929); KECA Music, Inc. v. Dingus McGee's Co., 432 F. Supp. 72 (W.D. Mo. 1977).

> [The] cases are legion which hold the dance hall proprietor liable for the infringement of copyright resulting from the performance of a musical composition by a band or orchestra whose activities provide the proprietor with a source of customers and enhanced income. He is liable whether the bandleader is considered, as a technical matter, an employee or an independent contractor, and whether or not the proprietor has knowledge of the compositions to be played or any control over their selection.

Shapiro, Bernstein & Co., 316 F.2d at 307 (citing some ten cases).

168. BMC Res, Inc. v. Paymentech, L.P., 498 F.3d 1373, 1379 (Fed. Cir. 2007) (emphasis added). *See also*, Muniauction, Inc. v. Thomson Corp., 532 F.3d 1318 (Fed. Cir. 2008), *cert. denied*, No. 08-847, 2009 U.S. LEXIS 1925 (U.S. Mar. 9, 2009); Emtel, Inc. v. LipidLabs, Inc., 583 F. Supp. 2d 811 (S.D. Tex. 2008).

169. *BMC*, 498 F.3d at 1381.

direction standard is satisfied in situations where the law would traditionally hold the accused direct infringer *vicariously liable* for the acts committed by another party that are required to complete the performance of a claimed method."[170] As noted above, the vicarious liability standard proffered in *Muniauction* fails to capture infringement where an enterprising mastermind enlists non-agents, like a customer or a business partner, to complete a patented process. Moreover, as seen in the historical development of both agency theory and the "some connection" standard, neither test determines the degree of control or direction necessary to trigger joint infringement liability in such a way as to result in consistent decisions.

The new vicarious liability test for determining the degree of control or direction would require that the accused infringer: (1) have taught or instructed the other party, and (2) derived an obvious and direct financial benefit. The two requirements will ensure that an enterprising mastermind who knew and intended that the patented process would be performed by another party, and benefited from the performance of the method, would be liable. The first requirement of the test is necessary to avoid situations where "individual, non-infringing acts of unrelated parties together add up to infringement."[171] The second element of the new test adopts the financial interest element of copyright vicarious liability. Although the financial benefit element is borrowed from vicarious liability requirements, which is one form of indirect infringement of copyright, the element is appropriate for finding direct infringement of a patent. While one would need to have a financial benefit from allowing performance of the *complete* infringing act in copyright, the accused infringer would only need to receive a direct financial benefit from allowing the *remaining steps* to be performed in order to satisfy the element here proposed. The requirement of the rights and ability to control the infringing acts would not be necessary in this case since it would defeat the purpose of closing the loophole where a company performs all but the last of the patented steps and the customers then perform the last step.

Applying the test to the fact pattern in *BMC*, the result will be the same as the ruling by the Federal Circuit since there was no evidence of instruction. On the other hand, application of the test to the fact pattern in

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170. *Muniauction*, 532 F.3d at 1330 (emphasis added).

171. Lemley, *supra* note 2, at 262. This requirement assumes knowledge of the patent because one would not be able to teach or instruct the other party without knowledge. This would be consistent with the finding in Gammino v. Cellco P'ship, 525 F. Supp. 2d 395 (E.D. Pa. 2007), which is a post-*BMC* case. There the district court held that there was no control or direction because the defendant did not even know the plaintiff's method. *Id.*

Muniauction, where there was evidence of instruction and a financial benefit, will result in the desirable outcome where Thomson is liable for joint infringement for acting as a mastermind.

The "vicarious liability test" will close the current loophole without subverting the basis for indirect infringement. The new scheme is broad enough to cover the loophole described in *BMC*, where a mastermind can escape liability,[172] and narrow enough to avoid findings of infringement of inadvertent non-infringing acts of unrelated parties. By adopting this vicarious liability test the courts will be able to promote consistency and increase predictability.

C. Strategies to Deal with the Current Joint Infringement Standard

In the interim, the decisions in *BMC*[173] and *Muniauction* illustrate the importance of proper claim drafting and provide guidance to patent prosecutors and litigators on how to protect patentees from being left with claims that cannot be enforced against a single entity. Certainly, some, if not all, of the problems that are faced today, including in *BMC* and *Muniauction*, could have been avoided with better draftsmanship. Patent holders of recently-granted patents should consider amending claims that have yet to issue, or filing a reissue request for patents that have already issued.[174] With respect to future patents, prosecutors should draft method claims from the perspective of a single entity in a way that the single entity performs every step of a method claim.[175] If the prosecutor decides to write a multi-actor multi-step claim, the number of required actors should be limited as the likelihood of proving direct infringement decreases with each additional actor, due to the need to show that one party is exercising control over the others. In addition, when possible, prosecutors should consider including apparatus claims with multiple elements that can be directly infringed by a single entity.[176]

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172. The new scheme covers both the Company/Customer Fact Pattern and the Company/Company Fact Pattern noted by one commentator. *See* Gerdelman, *supra* note 3, for discussion of the two patterns.

173. *BMC*, 498 F.3d at 1381 ("The concerns over a party avoiding infringement by arms-length cooperation can usually be offset by proper claim drafting. A patentee can usually structure a claim to capture infringement by a single party.").

174. 35 U.S.C. § 251 (2006). § 251 prescribes a two-year limit for filing applications for broadening reissues.

175. *See* Lemley, *supra* note 2, at 272-75.

176. In *NTP, Inc. v. Research In Motion, Ltd.* the Federal Circuit noted that "the concept of 'use' of a patented method or process is fundamentally different from the use of a patented system or device." 418 F.3d 1282, 1317 (Fed. Cir. 2005). The court explained

When naming parties in a patent infringement action, the patent holder may want to name more than one defendant to make better use of the joint infringement doctrine. At the discovery stage, litigators should explore ways to establish control or direction, and seek discovery to explore the amount of control or direction between the parties who perform the method claim steps. Examples of evidence that may help establish control or direction include: evidence of contracting out a certain step, instructions on how to perform a certain step, knowledge of performance of a certain step by a party, and/or ability to control another entity's activities.

V. CONCLUSION

In *BMC Resources, Inc. v. Paymentech, L.P.*[177] and *Muniauction, Inc. v. Thomson Corp.*,[178] the Federal Circuit determined the standard under which joint infringement would be allowed. Under this standard, when an accused infringer performs some of the steps of a patented method and other parties perform the remaining steps, the patent owner can establish infringement only if the other parties operated under the control or direction of the accused infringer. Although the Federal Circuit, in *BMC* and *Muniauction,* took steps towards establishing a clear rule, it is still not clear how much control or direction is necessary to trigger joint infringement liability. Although the Federal Circuit acknowledged a loophole that the current framework of patent infringement allows, the *Muniauction* court's misinterpretation of the ruling in *BMC* led to a decision that may weaken the patent system by leaving many patent holders of multi-participant claims without remedy. To promote fairness, the court should develop a new joint infringement test. The vicarious liability test proposed here is broad enough to cover the loophole in protection and narrow enough to avoid findings of infringement by inadvertent non-infringing acts of unrelated parties. By adopting the vicarious liability test, the courts will be able to better serve the patent holders and the public by providing a simple, clear way of determining whether one is liable for joint infringement. In the interim, patent prosecutors and litigators need to keep the two decisions in mind in order to properly draft claims and provide better pro-

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that "the use of a process necessarily involves doing or performing each of the steps recited. This is unlike use of a system as a whole, in which the components are used collectively, not individually." *Id.* at 1318.

177. 498 F.3d 1373.

178. 532 F.3d 1318 (Fed. Cir. 2008), *cert. denied*, No. 08-847, 2009 U.S. LEXIS 1925 (U.S. Mar. 9, 2009).

tection to patent holders by avoiding situations where patent holders are left with claims that cannot be enforced.

CITY OF HOPE V. GENENTECH: KEEPING FIDUCIARY DUTIES WHERE THEY BELONG

By Reed C. McBride

Scholars have called the law of fiduciary duties "messy,"[1] "atomistic,"[2] and "elusive."[3] It is an area of law in which courts have used ad hoc approaches[4] and have often imposed fiduciary duties through "analogy to contexts in which the obligation[s] conventionally appl[y]"[5] rather than reasoned analysis, which has led to great "confusion and uncertainty in applying the fiduciary principle to disparate fact situations."[6] This uncertainty and the "jurisprudence of analogy"[7] that followed often resulted in undisciplined application of the law, but in *City of Hope v. Genentech*, the California Supreme Court took a bold and important step toward rectifying the situation.[8] The court protected parties' rights to design their relationships through contract and ensured that fiduciary duties would be confined to those relationships with which they truly belong.[9]

This Note will demonstrate why the *City of Hope* decision was correct in view of the history of fiduciary duties, the case law, the academic literature, and sound policy for the business community and nonprofit research institutions of California. Part I of this Note will describe the relevant legal background, while Part II will recount the California Supreme Court's decision in *City of Hope*. Part III will analyze the decision with reference to the legal history, the academic literature, and the impact on the business community and nonprofit research institutions of California. Part III will

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1. D. Gordon Smith, *The Critical Resource Theory of Fiduciary Duty*, 55 VAND. L. REV. 1399, 1400 (2002).
2. Deborah A. DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988 DUKE L.J. 879, 915.
3. Karen E. Boxx, *The Durable Power of Attorney's Place in the Family of Fiduciary Relationships*, 36 GA. L. REV. 1, 15 (2001).
4. Smith, *supra* note 1, at 1400.
5. DeMott, *supra* note 2, at 879.
6. J.C. SHEPHERD, LAW OF FIDUCIARIES 7 (1981).
7. DeMott, *supra* note 2, at 879.
8. City of Hope Nat'l Med. Ctr. v. Genentech, Inc., 181 P.3d 142 (Cal. 2008).
9. *Id.*

also examine the current state of the law and how contracting parties should proceed in the wake of *City of Hope*. Part IV concludes that, according to the law of fiduciary duties and in order to promote sound policy, the California Supreme Court's decision was correct.

I. LEGAL BACKGROUND

A. Introduction to the Law of Fiduciary Duties

1. The Problem Fiduciary Duties are Intended to Solve

Fiduciary duties are intended to solve the problem of an "open-ended delegation of power" to another.[10] To describe the factual setting in the abstract, actors enter into a "long-term agency-type"[11] relationship in which one party—the fiduciary—accepts a responsibility to act for the benefit of the other—the beneficiary—but for which it would be too costly, burdensome, or otherwise inefficient to define all the details and acceptable courses of action applicable throughout the term of the relationship. In place of contracted duties, fiduciary duties define the fiduciary's standard of behavior—a "duty of unselfishness"—and allow the relationship to be formed efficiently even though not every contour can be defined by contract.[12]

In modern law, "fiduciary duty" refers to "the duty owed by one who is trusted toward the one (or ones) who trust in him."[13] Put simply, a person who has a fiduciary relationship to another "is under a duty to act for the benefit of the other as to matters within the scope of the relationship."[14] All fiduciary relationships are characterized by the fiduciary's duty to put the beneficiary's interests above his own.[15]

Historically, several categories of relationships have been recognized to impose fiduciary duties as a matter of law, the most common examples

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10. *See* Larry E. Ribstein, *Are Partners Fiduciaries?*, 2005 U. ILL. L. REV. 209, 214-15, 217. *See also* Tamar Frankel, *Fiduciary Law*, 71 CALIF. L. REV. 795, 797, 808-16 (1983) (examining fiduciary relationships and their common characteristics and concluding that relationships that are fiduciary "pose the problem of abuse of delegated power").

11. Ribstein, *supra* note 10, at 215.

12. *Id.* at 217. *See also* RESTATEMENT (THIRD) OF TRUSTS, § 2 cmt b. (2003); RAFAEL CHODOS, THE LAW OF FIDUCIARY DUTIES, at LIV (2000); Smith, *supra* note 1, at 1439-40("[T]he most interesting behavior occurs in the absence of explicit instructions.").

13. CHODOS, *supra* note 12, at LIII.

14. RESTATEMENT (THIRD) OF TRUSTS § 2 cmt. b (2003).

15. Ribstein, *supra* note 10, at 217. *See also* RESTATEMENT (THIRD) OF TRUSTS § 2 cmt. b. (2003); CHODOS, *supra* note 12, at LIV; Smith, *supra* note 1, at 1439-40.

being partnerships, joint ventures, and agency relationships. Fiduciary duties are also found in other contexts, with fiduciary obligations being directed from officers and directors of a corporation to that corporation, trustees to beneficiaries, lawyers and other professionals to their clients, certain associations to their membership (retirement associations and labor unions, for example), guardians to wards, public officials to constituents, and members of advisory boards to nonprofit organizations.[16] As mentioned above, all of these relationships are characterized by the fiduciary's duty to put the beneficiary's interests above his own.[17] In general, each of these relationships fit into one or more of the following characterizations: partnerships, agency relationships, or trusts. When at least one of the three characterizations describes the relationship in question, fiduciary duties generally arise.[18]

Although confidential relationships are often assumed to be fiduciary, the two are not equivalent. A confidential relationship "refers to an unequal relationship between parties in which one surrenders to the other some degree of control because of the trust and confidence which he reposes in the other."[19] A confidential relationship can exist without a fiduciary relationship,[20] and vice versa.[21] In California, the law clearly divides causes of action for violation of a fiduciary duty existing within a confidential relationship from causes of action for a breach of confidence, in which "an idea, offered and received in confidence, is later disclosed without permission."[22] Thus, a confidential relationship does not itself impose fiduciary duties, but it can lead to liability for breach of confidence even in the absence of fiduciary duties.[23]

As will be discussed in this Note,[24] parties to an agreement will often seek to contract out of or around fiduciary duties, bargaining to block fiduciary obligations from arising in situations in which, given no contractual provision to the contrary, fiduciary duties may arise. This Note will also review the academic literature regarding whether parties should be able to contract around fiduciary duties. For now, one should simply note

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16. CHODOS, *supra* note 12, §§ 1:6-1:18.
17. *See id.* at LIV; and Smith, *supra* note 1, at 1439-40.
18. CHODOS, supra note 12, § 1:19, at 42.
19. *Id.* § 1:21.
20. *Id.*; RESTATEMENT (THIRD) OF TRUSTS § 2 cmt. b(1) (2003).
21. *See* Vai v. Bank of Am. Nat'l Trust & Sav. Ass'n, 364 P.2d 247, 252-53 (Cal. 1961) (holding that a confidential relationship can end while fiduciary obligations remain).
22. Davies v. Krasna, 535 P.2d 1161, 1166 (Cal. 1975).
23. *See id.*
24. *See* discussion *infra* Section I.B.2. *See also* discussion *infra* Section III.A.2.b).

that courts do generally leave parties' bargains undisturbed,[25] but on rare occasions courts have stated that they do have the authority to find fiduciary obligations despite a contractual provision to the contrary.[26] Thus, while courts usually respect the parties' bargain, the contractual language is not necessarily dispositive. A holding that fiduciary duties are applicable despite contractual language to the contrary is only likely if the relationship is inherently fiduciary (i.e., one of agency, partnership, or joint venturers), the contract states otherwise, and the court finds that equity requires its intervention.

2. Case Law

The general rules of fiduciary duties are better understood in the context of cases. This Section will review several cases that were important to the *City of Hope* parties' arguments and the court's decision.

a) *Committee on Children's Television v. General Foods Corporation*

In *Children's Television*, the California Supreme Court made it clear that California law recognizes two distinct sources of fiduciary duties: the actor either (i) "knowingly undertake[s] to act on behalf and for the benefit of another," or (ii) "enter[s] into a relationship which imposes that undertaking as a matter of law."[27] This is the framework that the court employed in *City of Hope*.[28]

b) *Wolf v. Superior Court*

Wolf v. Superior Court[29] is a 2003 California Court of Appeal decision that the California Supreme Court looked to with approval in deciding

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25. *See generally* Larry E. Ribstein, *Fiduciary Duty Contracts in Unincorporated Firms*, 54 WASH. & LEE L. REV. 537, 570-93 (1997) (explaining that a careful review of the case law demonstrates that parties' rights to alter or waive fiduciary duties through contract "is, in fact, nearly universally accepted by state statutes and courts"). *See also* CHODOS, supra note 12, § 1:23, at 57.

26. *See* Universal Sales Corp. v. Cal. Press Mfg. Co., 128 P.2d 665, 673-74 (Cal. 1942) (holding that in determining whether the parties formed a joint venture, "[t]he acts and conduct of the parties engaged in the accomplishment of the apparent purposes may speak above the expressed declarations of the parties to the contrary"); April Enters. v. KTTV, 195 Cal. Rptr. 421, 428 (Ct. App. 1983) ("[T]he conduct of the parties may create a joint venture despite an express declaration to the contrary.").

27. Comm. on Children's Television, Inc. v. Gen. Foods Corp., 673 P.2d 660, 675-76 (Cal. 1983).

28. *See* City of Hope Nat'l Med. Ctr., 181 P.3d 142, 150 (2008).

29. 130 Cal. Rptr. 2d 860 (Ct. App. 2003).

City of Hope.[30] In *Wolf*, the plaintiff "repose[d] an element of trust" in the defendant in interest, Walt Disney Pictures and Television, by transferring his intellectual property rights to a novel in return for a share of future profits from Disney's commercialization of the story.[31] Wolf alleged that Disney breached its contractual obligation to pay royalties and thereby violated certain fiduciary duties.[32] However, the California Court of Appeal refused to find that a fiduciary relationship had been created, holding that "[e]very contract requires one party to repose an element of trust and confidence in the other to perform."[33] The court further emphasized that the implied covenant of good faith and fair dealing "cannot create a fiduciary relationship; it affords basis for redress for breach of contract and that is all."[34] Thus, simply reposing trust and confidence in another party cannot create a fiduciary relationship automatically, because otherwise virtually all contractual relationships would be fiduciary, which is clearly not the case.[35] Finally, the *Wolf* court made it clear that concerns of equity will not make a relationship fiduciary when it would not be otherwise, stating that "[w]hether the parties are fiduciaries is governed by the nature of the relationship, not the remedy sought,"[36] and concluding that "[c]onsiderations of fairness and practicality . . . cannot serve to create a fiduciary relationship where one does not otherwise exist."[37]

c) *Stevens v. Marco*

In *Stevens v. Marco*, a 1956 California Court of Appeal held that fiduciary duties can arise from a confidential relationship. In 1942 plaintiff Stevens, an inventor and high-school dropout, entered into a royalty contract to assign an aircraft indicator light system to defendant Marco, an attorney and officer of a company that manufactured aircraft parts.[38] Marco was to oversee patent prosecution, manufacturing, and sale of the plaintiff's invention. In exchange, Stevens was entitled to a percentage of gross sales of the device and later devices embodying improvements thereof.[39] Marco later told Stevens that other patents had preempted his idea, which

30. *See City of Hope*, 181 P.3d at 151-54.
31. *Wolf*, 130 Cal. Rptr. 2d at 862-63.
32. *Id.* at 864.
33. *Id.*
34. *Id.* at 865.
35. *See* CHODOS, *supra* note 12, § 1:21 (clarifying that relationships of trust and confidence should not be thought of as synonymous with fiduciary relationships).
36. *Wolf*, 130 Cal. Rptr. 2d at 867.
37. *Id.* at 868.
38. *See* Stevens v. Marco, 305 P.2d 669, 672 (Cal. Ct. App. 1956).
39. *See id.* at 672-74.

led Stevens to sign an agreement releasing Marco from their contract.[40] Unbeknownst to Stevens, Marco continued to prosecute the invention, founded a company to manufacture it, and sold millions of units.[41] When Stevens discovered this, he believed he was not receiving the royalty payments he was entitled to and sued for an accounting under claims of fraud and breach of contract.[42]

The Court of Appeal ruled that the lower court's dismissal of Stevens's case based on nonsuit was erroneous.[43] The appellate court seemingly equated confidential relationships to fiduciary ones, reasoning that "[w]here an inventor entrusts his secret idea or device to another under an arrangement whereby the other party agrees to develop, patent, and commercially exploit the idea in return for royalties to be paid the inventor, there arises a confidential or fiduciary relationship between the parties."[44] Quoting a case decided in 1916, the court further suggested that fiduciary obligations arise in every case "'where there has been a confidence reposed which invests the person trusted with an advantage in treating with the person so confiding.'"[45]

While the language of *Stevens v. Marco* seems quite advantageous for a plaintiff who licensed or assigned his technology in exchange for royalties, several legitimate points undermine it. First, the decision has questionable precedential authority, as it is a Court of Appeal rather than a California Supreme Court case. Furthermore, the case was decided more than fifty years ago, and it is hard to reconcile with more recent decisions such as *Wolf v. Superior Court*.[46] In addition, the California Supreme Court severely limited the scope of *Stevens* as a case of "an inventor reveal[ing] his concept to a patent lawyer" and contrasted the facts of the case to "ideas . . . be[ing] transmitted in the course of arms length negotiations between businessmen who can profit from its exploitation."[47]

Second, the underlying reasoning of the *Stevens* court is not convincing. As suggested by *Wolf* and developed by the literature,[48] if the contract adequately outlines the terms of the relationship and can itself make the

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40. *Id.* at 676.
41. *Id.* at 676-77.
42. *Id.* at 677-78.
43. *Id.* at 686.
44. *Id.* at 679.
45. *Id.* (quoting Cox v. Schnerr, 156 P. 509, 513 (Cal. 1916)).
46. Wolf v. Superior Court, 130 Cal. Rptr. 2d 860 (Ct. App. 2003) (holding that exchange of confidential information does not by itself create a fiduciary obligation).
47. Davies v. Krasna, 535 P.2d 1161, 1166 (Cal. 1975).
48. *See infra* Section I.B.

proposed beneficiary whole, then fiduciary duties should not come into play. This is because fiduciary duties act as efficient gap-fillers for undefined portions of relationships. Thus, if a relationship is amply defined through contract, acceptable remedies are already available and the contractual duty of good faith leaves no need for fiduciary obligations to protect the plaintiff from the defendant's capacity for opportunism.

Third, the *Stevens* decision never stated that the parties attempted to contract out of fiduciary obligations (for example, by explicitly stating that their relationship was not one of joint venturers, agency, or partnership). In designing their relationships, contracting parties often insert such a clause to signify their intent that the relationship will not create fiduciary obligations. Making such declarations as part of the bargain discourages courts from invading the contract of sophisticated parties to find fiduciary duties. The *Stevens* court mentions no such clause, which it likely would have done if such a clause existed, because the court clearly viewed Stevens and Marco's relationship as that of "joint venturers."[49]

Finally, *Stevens* involved a high school dropout who had no prior experience with patents or patent applications and was clearly taken advantage of by a person who was not only an attorney, but an executive officer of an aerospace manufacturing company.[50] *Stevens* was clearly not a case of two sophisticated entities, both represented by counsel, contracting at arm's length, and in that context the California Supreme Court has cast doubt upon *Stevens*'s applicability.[51] While one may presume that a court could be sympathetic to the plaintiff in the former case involving an unsophisticated party contracting with a sophisticated one, concerns of equity should carry little weight in the latter case as far as imposing fiduciary obligations upon a defendant is concerned.

B. Academic Literature

The case law is helpful in characterizing relationships and determining whether the relationship between the parties is, in fact, fiduciary. By contrast, much of the academic literature has focused on finding the scope of fiduciary duties already held to exist rather than determining whether a specific relationship is actually fiduciary. In recent years, however, there have been several novel articles regarding the identification of fiduciary relationships, as well as the interaction of contract and fiduciary law.

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49. *See Stevens*, 305 P.2d at 679-81.
50. *Id.* at 672.
51. *See Davies*, 535 P.2d at 1166.

1. *Fiduciary Duties as a Narrow Category of Relationships*

One school of thought characterizes the category of fiduciary relationships as quite narrow, with the duty of unselfishness being an indispensable component.

a) The Critical Resource Theory

With his "critical resource theory," corporate law scholar D. Gordon Smith contends that the main focus of fiduciary duty cases is the "potential for opportunism," which courts balance against the proposed beneficiary's capacity for self-help.[52] The duty of loyalty, which is meant to protect beneficiaries against opportunistic behavior by their fiduciaries, is at the heart of fiduciary duty.[53] According to the critical resource theory, there are three requirements that comprise the duty of loyalty and distinguish fiduciary relationships from non-fiduciary ones: (1) the fiduciary must act on behalf of the beneficiary, (2) the fiduciary must exercise discretion, and (3) that discretion must relate to a critical resource of the beneficiary.[54]

Expanding on these requirements, Smith suggests that the phrase "on behalf of" is a functional synonym for the Restatement's "primarily for the benefit of."[55] This first requirement "distinguishes fiduciary relationships from [other] relationships in which one person exercises discretion over critical resources belonging to another, such as . . . exclusive licenses,"[56] but this requirement alone cannot always "distinguish fiduciary relationships from many arm's-length contracts because mutual benefit is a central feature in most contracting relationships."[57] This first requirement is particularly helpful when a relationship fulfills both the "critical resource" and "discretion" requirements, but still is not clearly fiduciary or non-fiduciary. However, Smith says a "fiduciary relationship differs from a relationship based on a transfer of rights . . . specifically, a relationship between a licensor and an exclusive licensee," where both parties act primarily for their own benefit.[58] Furthermore, Smith points out that courts have generally not found fiduciary duties in close cases in which the plaintiff fails to prove that the proposed fiduciary "'undertook to act primarily

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52. Smith, *supra* note 1, at 1443-44.
53. *Id.* at 1402.
54. *Id.*
55. *Id.* at 1438-39 (citing the RESTATEMENT (THIRD) OF AGENCY § 1.01 cmt. g (Discussion Draft 2000)).
56. *Id.* at 1438.
57. *Id.* at 1438-39.
58. *Id.* at 1438-40.

for the benefit of the plaintiff'" and fails to demonstrate the "special trust" required to form a fiduciary relationship.[59]

Smith's "discretion" requirement denotes "the power to use or work with the critical resource in a manner that exposes the beneficiary to harm that cannot reasonably be evaded through self-help."[60] He points out that his theory further separates contract from fiduciary duty because a "contracting party exercises discretion with respect to *performance of the contract*," whereas a "fiduciary exercises discretion with respect to *a critical resource belonging to the fiduciary*."[61]

Smith conceptualizes the proposed beneficiary's "critical resource" as an abstract concept, flexible in application, but at the same time clarifying that "*something* resides at the core of the fiduciary relationship."[62] The critical resource is one that can potentially provide the fiduciary with an occasion to act opportunistically.[63] It can be conventional property, confidential information, or even personal data in which the beneficiary has residual control rights. However, since the potential for opportunism is central to his critical resource theory, Smith notes that the argument for finding fiduciary duties is weak "where self-help protection of the critical resource is strong . . . and vice versa."[64]

Whether or not all fiduciary relationships can truly be characterized by one "unified" theory, as Smith proposes, his theory creates a clear framework to help decide whether a relationship in question maps to the elements needed to constitute a fiduciary relationship. His theory is also appealing because it favors disciplined, objective analysis over more subjective approaches to applying and extending the fiduciary label. As Professor Tamar Frankel noted, courts have a habit of looking to prototypical fiduciary relationships (agency and trust relationships) and then deciding whether to extend the fiduciary label by relying on analogy or metaphor instead of a structured analytical framework.[65] Smith's theory applies to relationships that are currently agreed to be fiduciary and also creates a useful, flexible framework for discerning whether a given relationship can properly be classified as fiduciary.

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59. *Id.* at 1450 (citing Hi-Ho Tower, Inc. v. Com-Tronics, Inc., 761 A.2d 1268, 1280 (Conn. 2000)).

60. *Id.* at 1449.

61. *Id.* at 1448 (emphasis added).

62. *Id.* at 1443 (emphasis in original).

63. *Id.* at 1444.

64. *Id.* at 1443.

65. Frankel, *supra* note 10, at 804.

b) Fiduciary Duties as Duties of Unselfishness

Professor Larry Ribstein, agreeing with Smith that fiduciary relationships are a distinct category that can be distinguished from other relationships, defines fiduciary relationships even more narrowly than Smith.[66] Whereas Smith's theory posits that fiduciary relationships have three essential characteristics, Ribstein focuses on only one—that the relationship is structured such that one must act primarily for the benefit of another, which he terms the "duty of unselfishness."[67] Ribstein contends that fiduciary relationships are solely a product of this structure and not of any equitable notions resulting from one party's vulnerability as a function of the relationship.[68] In this respect, his theory aligns with the *Wolf* court's position.[69]

Ribstein primarily attempts to clarify the law of fiduciary duties, for he contends that although courts' dicta can imply a judicial view that fiduciary duties are applicable in a wide range of circumstances, the actual case law concerning fiduciary duties lends itself to only narrow application.[70] One of Ribstein's core motivations for demonstrating that the case law's real approach is narrow is that "[a]pplying fiduciary duties broadly threatens to undermine parties' contracts by imposing obligations the parties do not want or expect."[71] He further asserts that when courts limit fiduciary duties to only the most appropriate situations, contractual relations are made more predictable, thereby serving contracting parties better.[72]

2. Interaction of Contract and Fiduciary Duties

Beyond questions of whether fiduciary duties arise in certain relationships, the literature also features a rich discussion pertaining to the interaction of contract and fiduciary duties. Much of this discussion has focused on comparisons of contract's duty of good faith and fair dealing with the

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66. Ribstein, *supra* note 10, at 212 n.15. This article focused primarily on the partnership context, but evolved from a working paper that focused on the structure of fiduciary relationships in a broader set of contexts. *See* Larry E. Ribstein, *The Structure of the Fiduciary Relationship* (Ill. Law & Econ. Working Papers Series, Working Paper No. LE03-003, 2003), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=397641 [hereinafter Ribstein, *Structure*].

67. *See* Ribstein, *supra* note 10, at 214-15.

68. *Id.* at 212.

69. *See* discussion *supra* Section I.A.2.b) (citing Wolf v. Superior Court, 130 Cal. Rptr. 2d 860, 868 (Ct. App. 2003)).

70. *See* Ribstein, *supra* note 10, at 213.

71. *See id.*

72. *Id.*

fiduciary's duty of loyalty, and questions regarding whether parties should be allowed to contract around fiduciary duties.

Parties often try to contract around fiduciary duties. They attempt this either by limiting the scope of their duty of loyalty[73] or by expressly contracting that their relationship does not constitute a partnership or joint venture, which serves as a strong indication that the parties do not intend for their relationship to give rise to fiduciary obligations.

Some academics argue that when fiduciary duties would arise in a given relationship they should govern, regardless of contractual terms to the contrary.[74] However, this opinion is not shared by many scholars who contend that such a regime would be an unwelcome impedance on the freedom to contract, particularly between sophisticated parties. Professor Tamar Frankel, while conceding that so-called "anti-contractarian"[75] arguments can have some appeal, writes that the better approach is to view fiduciary duties, when they would arise, as default rules that parties should be free to bargain around when they wish to.[76] Frankel contends that: (1) if parties wish to deviate from these default rules, freedom of contract should give them the ability to bargain around them within their contract;[77] (2) if a fiduciary relationship were to arise in conjunction with another legal relationship, the bargain concerning the relationship must be governed initially by the law governing the underlying relationship (e.g., if the relationship is created by contract, the law of contract governs and the contractual provisions therefore trump any fiduciary obligations that have been contracted around);[78] (3) if the parties are sophisticated, courts are likely to refrain from examining the content or sufficiency of their bargains and to uphold what the parties agreed to;[79] (4) parties should be free to "design their relationships as they wish, unless there is a good reason to

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73. *See* REVISED UNIF. P'SHIP ACT §§ 103(b)(3), 404(a)-(b) (1992).

74. *See, e.g.*, Lawrence E. Mitchell, *The Puzzling Paradox of Preferred Stock (And Why We Should Care About It)*, 51 BUS. LAW. 443, 458-59 (1996) (contending, not entirely clearly, that because the fiduciary's duty of loyalty differs from contractual good faith and can require the fiduciary to act in a way that defeats his own expectation from the contract, fiduciary duties trump contract when they apply).

75. "Anti-contractarian" meaning they do not believe parties should be free to contract around fiduciary obligations that would apply to a given relationship by default.

76. Tamar Frankel, *Fiduciary Duties as Default Rules*, 74 OR. L. REV. 1209, 1231-32 (1995).

77. *Id.* at 1232.

78. *Id.* at 1233 (suggesting that if the relationship arises due to any underlying contract, the law of contract should be the first guide in how to navigate disputes that arise in the context of that relationship).

79. *Id.* at 1240 (noting also that new academic theories are not likely to change how courts have operated for long periods of time).

prevent them from doing so," and there is less of a "good reason" if the party can provide its own self-help through contract;[80] and finally (5) if a given situation makes it truly necessary, courts will still hold powers to call a fundamentally fiduciary relationship (which has been labeled otherwise by contract) fiduciary should equity require it.[81] Under Frankel's conceptions, sophisticated entities that contract to expressly denounce the labels of fiduciary relationships should have their bargains respected, not invaded by the court. Frankel's reasoning is most compelling when the parties have ample power to protect themselves through contract, and fiduciary duties are unnecessary to make them whole. Frankel contends that fiduciary law should not be forced into cases that would invade the contract of sophisticated entities that are capable of self-protection through contract.

Like Professor Frankel, Judge Frank Easterbrook and Professor Daniel Fischel are proponents of the freedom to contract. They write that fiduciary relationships are not entirely distinct from contract law, but should be viewed as "merg[ing] into" contract law "with a blur and not a line."[82] Under their theory, a fiduciary duty is a contractual one with very high costs of specification and monitoring, whereby the duty of loyalty acts as a "gap-filler," taking the place of detailed contractual terms. Thus, the duty of loyalty allows parties to bargain efficiently, because fleshing out all the terms in detail would make bargaining prohibitively expensive.[83] Easterbrook and Fischel assert that "when transaction costs are too high, courts establish the presumptive rules that maximize the parties' joint welfare,"[84] filling in the gaps of the bargain where high costs of bargaining would otherwise make reaching an agreement inefficient. In their view, the duty of good faith concerns carrying out the contract as defined, whereas the duty of loyalty concerns how the fiduciary behaves when terms have not

80. *Id.* at 1247 (explaining that there is less of a "good reason" if the party can provide its own self-help by enforcing the terms of the contract in a court of law).

81. *Id.* at 1248. For example, if a relationship is a partnership in every way, but the parties contract to say they are not partners, a court can nonetheless find that the relationship is a partnership.

82. Frank H. Easterbrook & Daniel R. Fischel, *Contract and Fiduciary Duty*, 36 J.L. & ECON. 425, 438 (1993). Easterbrook and Fischel's theory contrasts somewhat with Smith's unified theory, which contends that fiduciary relationships are a completely distinct class of relationships.

83. *Id.* at 427.

84. *Id.* at 446.

been defined for the given situation.[85] The reason they believe that contract and fiduciary duty share a continuum is because, in practice, fiduciary duties do not and should not trump contract as they are mere gap-fillers—efficient tools of contract—and if the contract addresses the situation at hand, courts respect parties' bargains.[86] Thus, if the parties use their contract to show they do not intend to be subject to the court's "presumptive rules," or the parties have filled the relevant gaps themselves and have not left room for presumptive rules to be applied, fiduciary duties have no application.[87]

Disagreeing with these scholars, Professor Melvin Eisenberg applies his well-known "limits of cognition" arguments concerning actors' limited rationality, undue optimism, inability to appreciate negative future contingencies, and consistent underestimation (or complete ignorance) of risk. He asserts that core duty of loyalty principles should not be subject to a general waiver, because the waiving party is likely making an irrational choice.[88] However, Eisenberg's arguments necessarily carry less weight when the parties are not simple natural persons, but rather sophisticated organizations represented by counsel, as the latter are far less susceptible to irrational decision-making.[89] Furthermore, it has been said that anti-contractarian[90] scholars such as Eisenberg tend to view individual clauses in a vacuum when agreements and relationships are more properly viewed

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85. *Id.* at 427 ("The duty of loyalty replaces detailed contractual terms, and courts flesh out the duty of loyalty by prescribing actions the parties themselves would have preferred if bargaining were cheap and promises fully enforced.").

86. *Id.* at 446 ("When actual contracts are reached, courts enforce them . . . ."). *See also* discussion *supra* note 25.

87. *See generally* Ribstein, *supra* note 25 (arguing for the freedom to contract with respect to fiduciary duties, refuting arguments against this freedom, and demonstrating the courts' agreement with the freedom-of-contract theorists); J. Dennis Hynes, *Freedom of Contract, Fiduciary Duties, and Partnerships: The Bargain Principle and the Law of Agency*, 54 WASH. & LEE L. REV. 439, 441-43 (1997) (focusing on partnership law and RUPA and adding that, in general, "contracts addressing fiduciary duties should enjoy the same treatment as contracts on other matters," and "the special status of fiduciary duties . . . should be of a default nature only"); DeMott, *supra* note 2, at 879 (warning that courts should be careful in using contract principles to define and discuss fiduciary relationships, particularly when a formal agreement between the parties defines terms of their relationship). DeMott does not attack the central premise of having the freedom to contract around default fiduciary duties, but she is concerned about using contract law's terminology and concepts to decide issues primarily related fiduciary duty. *Id.*

88. *See generally* Melvin Aron Eisenberg, *The Limits of Cognition and the Limits of Contract*, 47 STAN. L. REV. 211, 212-13 (1995).

89. One could argue that a major reason parties hire counsel while contracting is so the counsel can give due consideration to risk and negative contingencies.

90. *See* discussion *supra* note 75.

holistically, taking account of all the protections that are afforded to the proposed beneficiary.[91] So framed, allowing a party to shrug off fiduciary obligations in exchange for concessions elsewhere in the agreement may very well be rational.

II. *CITY OF HOPE NATIONAL MEDICAL CENTER V. GENENTECH, INC.*

A. Facts

The background of *City of Hope National Medical Center v. Genentech, Inc.*[92] began in the 1970s, when Drs. Arthur Riggs and Keichi Itakura, scientists at the City of Hope National Medical Center, developed a revolutionary process for genetic engineering of human proteins.[93] Their discovery had the potential for great medicinal and commercial success, and a well-known figure in the field of genetic engineering, Dr. Herbert Boyer, showed great interest in the new technology.[94] Soon after Riggs and Ikatura filed their grant application, Dr. Boyer and venture capitalist Robert Swanson founded Genentech, Inc., hoping to commercialize biotechnology.[95]

After a few months of negotiations, City of Hope and Genentech executed a contract whereby Genentech would obtain and be assigned any patents based on City of Hope's discovery and commercialize the technology in exchange for payment to City of Hope of a two percent net royalty on sales derived from the discovery.[96] The contract further provided that if Genentech were to license the technology to a third party, City of Hope would receive a royalty as if Genentech had itself used the technology.[97] In addition, if Genentech were to succeed in a patent infringement suit against a third party for using the patented subject matter from the technology, then the winnings or settlement amount, less reasonable expenses pertaining to the lawsuit, were to be treated as "net sales" for the purposes of the contract.[98] Both sides were free to transfer their rights under the contract, and Genentech was to keep sufficiently detailed records and

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91. *See, e.g.*, Henry N. Butler & Larry E. Ribstein, *Opting out of Fiduciary Duties: A Response to the Anti-Contractarians*, 65 WASH. L. REV. 1, 32 (1990).

92. City of Hope Nat'l Med. Ctr. v. Genentech, Inc., 181 P.3d 142 (Cal. 2008).

93. *Id.* at 146-47.

94. *Id.* at 147.

95. *Id.*

96. *Id.* at 147-48.

97. *Id.* at 148.

98. *Id.*

grant City of Hope audit rights.[99] Finally, the parties included a clause stating that their relationship was not an "agency, joint venture or partnership" and that City of Hope was to be considered an "independent contractor" for purposes of the agreement.[100]

In the years that followed, Genentech engaged in patterns of behavior that could be construed as less than complete good faith and fair dealing with respect to its performance of the contract. While directly informing City of Hope about some license agreements related to the technology, Genentech was not forthcoming regarding others that arguably related to the same technology.[101] During a 1986 inspection of Genentech's documents, an attorney for City of Hope was allowed to review patent applications, but Genentech's general counsel ordered a subordinate not to allow inspection of any third party license agreements.[102] Furthermore, while City of Hope received royalties on some products and licenses related to the technology, others employing the same technology did not generate royalties because the parties disagreed regarding interpretation of the contractual language.[103] Finally, on at least two occasions, Genentech sued and received large settlement amounts from other parties for accusations of patent infringement relating to the technology, and in both instances Genentech resisted paying royalties to City of Hope.[104] The first time this occurred, Genentech and City of Hope reached an agreement.[105] The second time, in 1999, City of Hope sued Genentech for breach of fiduciary duty and breach of contract.[106]

B. Procedural History

The first trial ended with a hung jury.[107] Upon retrial, the new jury found in City of Hope's favor for both counts and awarded City of Hope a total of $500 million, of which $300 million was for compensatory damages for unpaid royalties and $200 million was for punitive damages on the finding that Genentech had breached its fiduciary duty toward City of Hope.[108] On appeal, the California Court of Appeal affirmed both judg-

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99. *Id.*
100. *Id.*
101. *See generally id.* at 148-149. Whether the contract covered these other drugs or processes was at issue in the contract portion of the court's review.
102. *Id.* at 149.
103. *Id.*
104. *See id.*
105. *Id.*
106. *Id.*
107. *Id.*
108. *Id.* at 150.

ments.[109] The California Supreme Court then granted Genentech's petition for review.[110]

C. Decision

The court split its review into two portions, the first pertaining to the alleged breach of fiduciary duties and the second pertaining to the breach of contract claim.

1. Fiduciary Duty Issue

Looking to the two sources from which fiduciary duties can arise under California law,[111] the court quickly disposed of the first possibility, that Genentech might have "knowingly undertake[n] to act on behalf and for the benefit"[112] of City of Hope, as there was "no indication in the contract that Genentech entered into it with the view of acting primarily for the benefit of City of Hope. . . . [N]othing in the contract indicates that Genentech was to subordinate its interest to those of City of Hope, a point conceded by City of Hope."[113]

As to the second possibility, that the parties might have "enter[ed] into a relationship which imposes [a fiduciary duty] as a matter of law,"[114] the court began by noting that the contract expressly stated that the relationship was not one of joint venture, partnership, or agency.[115] Conceding that point, City of Hope argued that Genentech had fiduciary obligations under a different, non-traditional category of fiduciary relationship—that of *Stevens v. Marco*,[116] where "an inventor entrusts his secret idea or device to another under an arrangement whereby the other party agrees to develop, patent and commercially exploit the idea in return for royalties to be paid the inventor."[117] City of Hope had earlier asserted that *Stevens* was its "one theory" and the sole basis of its fiduciary duty claim against Ge-

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109. *Id.*

110. *Id.*

111. *See* discussion *supra* Section I.A.2.a).

112. Comm. on Children's Television, Inc. v. Gen. Foods Corp., 673 P.2d 660, 675-76 (Cal. 1983).

113. *City of Hope*, 181 P.3d at 150 (internal citations removed).

114. *Children's Television*, 673 P.2d at 675-76.

115. *Id.* The court neglected to discuss this contractual provision that expressly disclaimed traditional fiduciary relationships and declared that City of Hope was an independent contractor, but clearly this clause demonstrates intent that the parties' relationship not be fiduciary.

116. *See* discussion *supra* Section I.A.2.c).

117. *City of Hope*, 181 P.3d at 151 (quoting Stevens v. Marco, 305 P.2d 669, 679 (Cal. Ct. App. 1956)).

nentech, and it identified and submitted a four-factor test to characterize fiduciary relationships.[118]

The California Supreme Court did not agree. It refused to adopt the reasoning of *Stevens* and called its language "overbroad" while favoring the much more recent California Court of Appeal decision in *Wolf*.[119]

Agreeing with *Wolf*, the court held that "fiduciary obligations are not necessarily created when one party entrusts valuable intellectual property to another for commercial development in exchange for the payment of compensation contingent on commercial success."[120] The court thus implicitly overturned *Stevens v. Marco* by holding that a fiduciary relationship is not necessarily created "when a party, in return for royalties, entrusts a secret idea to another to develop, patent, and commercially develop."[121] With the Supreme Court's endorsement of *Wolf*, City of Hope's "one theory" behind its fiduciary duty claim had failed, and the order for Genentech to pay $200 million in punitive damages was reversed.[122]

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118. *Id.*

119. *See id.* at 151-52; *see also* discussion *supra* Section I.A.2.b).

120. *City of Hope*, 181 P.3d at 154 (citing Wolf v. Superior Court, 130 Cal. Rptr. 2d 860, 864-65 (Ct. App. 2003)).

121. *Id.*

122. City of Hope also tried to rely on two older California Supreme Court cases, which the court distinguished. In the first, Hollywood Motion Picture Equip. Co. v. Furer, 105 P.2d 299 (Cal. 1940), the defendant bailee breached an oral contract and misappropriated the plaintiff bailor's invention. The 1940 court held that "[w]here a bailee of an article has accepted it under definite terms to hold it and to use it for the benefit of the bailor, a confidence has been reposed which should remain inviolate," *id.* at 301, but the *City of Hope* court rejected this argument because the court of 1940 never addressed the issue of whether bailment necessarily creates fiduciary duties. *City of Hope*, 181 P.3d at 152-53. Furthermore, Chodos's 2001 treatise states "the law is clear that a mere bailee is not a fiduciary." CHODOS, *supra* note 12, § 1:19, at 42-43. In the second case, Schaake v. Eagle Automatic Can Co., 67 P. 759 (Cal. 1902), the plaintiff employee entered into an agreement to assign various patents to his employer in exchange for profits if either the company was sold or the inventions were used outside of San Francisco. *Id.* at 760. In holding that the defendant company did breach its agreement with the plaintiff and the plaintiff was entitled to payment, the court stated in dicta that "[t]he relationship thus created was fiduciary, and as to plaintiff's share or part of the profits realized the corporation was a trustee." *Id.* Also rejecting this argument, the *City of Hope* court characterized this language as mere dicta and noted that the court of 1902 offered no substantive discussion regarding whether the relationship in question was actually fiduciary. *City of Hope*, 181 P.3d at 153. *Schaake* turned on the contract, and its plaintiff was made whole thereby. The *City of Hope* court stated that the *Schaake* court's language was mere dicta that was not necessary to *Schaake*'s holding, and therefore it lacked precedential value in deciding whether relationships other cases are fiduciary. *Id.* (citing Hassan v. Mercy Am. River Hosp., 74 P.3d 726, 729 (Cal. 2003) ("[The Court of Appeal] viewed the statement as mere dictum because it was not necessary for the resolution of the case . . . we agree

2. *Contract Issue*

After concluding the fiduciary duty question in favor of Genentech, the court rejected all of Genentech's arguments as to the breach of contract claims.[123] The entire $300 million judgment of compensatory damages for breach of contract was thereby affirmed, and with six years of interest the compensatory damages award was reported to have grown to $475 million by the time of the California Supreme Court's decision.[124]

III. DISCUSSION

In light of the court's decision, this Note will now argue that the holding of *City of Hope* was correct and will examine the current state of the law. Section III.A will demonstrate why *City of Hope* was decided correctly according to fiduciary and contract law, the academic literature, and sound policy for both the business community and nonprofit research institutions. Section III.B will summarize the state of the law and explore the practical implications of *City of Hope*.

A. Analysis of the *City of Hope* Decision

Viewed from the vantage points of law, theory, and policy, there is a strong justification for the court's decision. Section III.A.1 will demonstrate that *City of Hope* was correct according to the law and stands as a prudent clarification that fiduciary relationships in California constitute a narrow category. Section III.A.2 will explain why the court's unanimous opinion is in accord with the theories of several leading scholars. Finally, Section III.A.3 will demonstrate that the court's decision, on a macro scale, was the better policy choice for both California's business community and its nonprofit research institutions.

1. City of Hope *and the History of Fiduciary Law*

Because City of Hope was made whole by its contract, an additional remedy derived from fiduciary law would be extra-compensatory and therefore punitive to Genentech. The relationship was one fully defined by contract, and basic contract law teaches that mere breach of contract gen-

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with the Court of Appeal here that it was 'mere dictum, thus lacking in precedential force.'")).

123. *See generally City of Hope*, 181 P.3d at 154-59.

124. Karen Gullo, *Genentech Must Pay $300 Million Award, Court Rules*, BLOOMBERG.COM, last updated April 24, 2008, *available at* http://www.bloomberg.com/apps/news?pid=20601103&sid=aNNMNMPFBFFw (last visited Dec. 18, 2008).

erally cannot lead to punitive damages.[125] In fact, even in the case of insurance contracts, the commonly recognized exception to this rule, the California Supreme Court recently held that "[t]he insurer-insured relationship . . . is not a true fiduciary relationship."[126] Thus, *City of Hope*'s holding is consistent with the court's denial of fiduciary duties or other sources of tortious damages in contract cases.[127]

An award of punitive damages also would have been error because Genentech's interpretation of the contract, though not agreed to by the court, was objectively reasonable, and its conduct was based in reliance on this interpretation. Genentech's subjective intent should have been irrelevant as long as the contractual interpretation it relied on was objectively reasonable.[128] If a reasonable claim existed, City of Hope could have pursued punitive damages for Genentech's conduct under a claim of fraud, but, notably, fraud was neither pled nor proved. Under contract alone, Genentech's conduct was grounded in its objectively reasonable position with respect to the contract, standing as yet another reason why punitive damages would have been improper.

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125. *See, e.g.*, LON L. FULLER & MELVIN ARON EISENBERG, BASIC CONTRACT LAW 215 (8th ed. 2006).

126. Vu v. Prudential Prop. & Cas. Ins. Co., 33 P.3d 487, 492 (Cal. 2001) (internal quotation marks omitted).

127. *See generally* Freeman & Mills, Inc. v. Belcher Oil Co., 900 P.2d 669, 674-80 (Cal. 1995) (overturning Seaman's Direct Buying Serv., Inc. v. Standard Oil Co. 686 P.2d 1158 (Cal. 1984), and clearly denying tort recovery even for bad faith breach of contract); Applied Equip. Corp. v. Litton Saudi Arabia Ltd., 869 P.2d 454, 460-61 (Cal. 1994). The court argued that limiting contract breach damages to those within the reasonably foreseeable contemplation of the parties when the contract was formed:

> serves to encourage contractual relations and commercial activity by enabling parties to estimate in advance the financial risks of their enterprise. . . . [P]unitive or exemplary damages, which are designed to punish and deter statutorily defined types of wrongful conduct, are available only in actions for breach of an obligation *not* arising from contract. In the absence of an independent tort, punitive damages may not be awarded for breach of contract even where the defendant's conduct in breaching the contract was wilful, fraudulent, or malicious.

Id. (citations omitted) (internal quotation marks omitted).

128. *See* Safeco Ins. Co. of Am. v. Burr, 551 U.S. 47, 127 S. Ct. 2201, 2216 n.20 (2007) (subjective bad faith cannot be held against a party whose position is objectively reasonable); *Applied Equip.*, 869 P.2d at 461 ("[T]he law generally does not distinguish between good and bad motives for breaching a contract."); Christina J. Imre, *Blurring the Distinction Between Contract and Tort: the Resurrection of* Seaman's*?*, 27 CAL. CONTINUING EDUC. OF THE BAR CIV. LITIG. REP. 18 (2005) (illustrating that even in the insurance context, "California courts uniformly hold that, as a matter of law, the carrier's reasonable, though mistaken, interpretation of its contract is an absolute defense to 'bad faith' tort liability").

Furthermore, in its arguments for breach of fiduciary duty, City of Hope pushed the concept of fiduciary duty to its breaking point, arguing that "Genentech's fiduciary obligation required merely honesty," not putting City of Hope's interests ahead of its own.[129] City of Hope could not credibly argue that Genentech was to put City of Hope's interests above its own, so it argued that the extent of fiduciary duties are not the same in all fiduciary relationships, and then jumped to a conclusion that the relationship at issue could be fiduciary even though it "required no subordination of Genentech's interests to City of Hope's."[130] If such an argument were accepted by the court, it would erase a major line between the realms of arm's-length and fiduciary relationships, clouding one of the very foundations of fiduciary duties: one party undertaking to act primarily for the benefit of, or with a duty of unselfishness to, the other.

City of Hope's arguments for the existence of fiduciary duties also looked to Genentech's "superior position,"[131] but such a consideration should have been immaterial to City of Hope's case. First, *Wolf* held that concerns of equity cannot create fiduciary duties where they would not otherwise exist.[132] Second, *Wolf* aside, at the time the agreement in question was signed, City of Hope was a large medical research center and Genentech was a brand new start-up company consisting of little more than its two founders and a charter.[133] Therefore, any "superior position" held

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129. Answer to Brief of Amici Curiae, at *17, City of Hope Nat'l Med. Ctr. v. Genentech, Inc., 20 Cal. Rptr. 3d 234 (No. B161549) 2004 WL 1080617 [hereinafter City of Hope Answer Brief].

130. *Id.* at *17.

131. *Id.*

132. *See* Wolf v. Superior Court, 130 Cal. Rptr. 2d 860, 866-68 (Ct. App. 2003); *see also* discussion *supra* Section I.A.2.b).

133. At the time the agreement was negotiated, Robert Swanson was only twenty-eight years old, and "Genentech was Swanson and Boyer, period. And that's what it was." Sally Smith Hughes, *Arthur D. Riggs: City of Hope's Contribution to Early Genetic Research* 39, 58-63, Reg'l Oral History Office, The Bancroft Library, Univ. of Cal., Berkeley (2006). Because Genentech had no laboratories and no office space, Dr. Boyer's workplace was simply his lab at UCSF, and, in fact, "[o]ne of the criticisms was that there was no separation between Genentech and Boyer's lab at UCSF." *Id.* Swanson had recently been let go by the venture capital firm Kleiner Perkins (KP), but until he found what he was to do next, he was allowed to use the KP office space and negotiations took place at KP. *Id.*; Sally Smith Hughes, *Robert A. Swanson: Co-Founder, CEO, and Chairman of Genentech, Inc.* 9-10, Reg'l Oral History Office, The Bancroft Library, Univ. of Cal., Berkeley (2001); Sally Smith Hughes, *Keiichi Itakura: DNA Synthesis at City of Hope for Genentech* 29, Reg'l Oral History Office, The Bancroft Library, Univ. of Cal., Berkeley (2006). Thus, if superior bargaining power was held by either party, it was City of Hope, as evidenced by KP named partner and famed venture capitalist Tom Perkins attempting to persuade City of Hope that Genentech would be a suitable collaborator

by Genentech that became a focus of City of Hope's arguments necessarily must have come about after the entities had formed their agreement. Even if one accepted City of Hope's contention that a party's "superior position" can make it a fiduciary, City of Hope never explained how a party that was not in a superior position when the agreement was formed could be transformed into a fiduciary ex post by virtue of its growth and commercial success. City of Hope failed to cite a theory in law or equity that can transform a contracting party that is fully at arms-length on the effective date into a fiduciary simply because of its post-execution success.[134] Viewing City of Hope and Genentech most properly (i.e., at the time of the agreement's formation), it is clear that the court's decision that Genentech did not owe City of Hope any fiduciary duty issue was correct.[135]

City of Hope also emphasized its vulnerability to, and dependence upon, Genentech concerning honesty and the fair payment of royalties as motivations for imposing fiduciary duties upon Genentech, but these "[c]onsiderations of fairness and equity"[136] were also rightly ignored by the court. City of Hope had express contractual rights to audit Genentech

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and assuring the research center that Perkins and his investors would be backing Genentech. Glenn E. Bugos, *Thomas J. Perkins: Kleiner Perkins, Venture Capital, and the Chairmanship of Genentech* 5-6, Reg'l Oral History Office, The Bancroft Library, Univ. of Cal., Berkeley (2002) (Perkins: "I did go down to visit the City of Hope and meet with their management . . . to persuade them to do it. They had other things they could have done instead. We wanted their cooperation.").

134. Rather, the proper time for analyzing whether or not the relationship is fiduciary is the time of formation, for only then do the parties manifest their intents and decide how to structure the relationship in the context of an arm's-length bargain. Unless the bargain is materially changed after the formation point, there is no legitimate reason why factors such as post-formation growth and financial success would impose fiduciary obligations upon a previously non-fiduciary party.

135. The California Healthcare Institute (CHI), a nonprofit, public policy research and advocacy organization for California's biomedical industry of which both Genentech and City of Hope are members, submitted an amicus brief to the California Supreme Court in support of Genentech. In its brief, CHI noted that at the time of the agreement, City of Hope "had been in existence for 63 years" while "Genentech was a startup company in an industry . . . that did not yet really exist." CHI argued that "Genentech's stature and financial health today should not obscure the fact that in the spring and summer of 1976, Genentech was a fragile infant of a company whose future was speculative at best. If either party occupied a superior bargaining position in 1976 . . . it was [City of Hope], not Genentech." Brief of Amicus Curiae Cal. Healthcare Inst. in Support of Defendant and Appellant, at *9, City of Hope Nat'l Med. Ctr. v. Genentech, Inc., 181 P.3d 142 (No. S129463) 2006 WL 951479 [hereinafter CHI Amicus Brief].

136. *Wolf*, 130 Cal. Rptr. 2d at 868.

and receive periodic accountings.[137] Therefore, it needed nothing of a fiduciary nature to protect itself in this manner. Furthermore, *Wolf*, which the California Supreme Court cited favorably in *City of Hope*, made it clear that contractual rights to an accounting do not create a fiduciary relationship.[138] Additionally, California law has long found an implicit contractual right to an accounting in any contract for division of profits or payment of royalties, even if the contract does not expressly provide for one.[139] Therefore, at least in California, when contractual parties agree to divide profits or revenues, contract law provides a means to audit and renders fiduciary duties unnecessary in obtaining such a right.

City of Hope also looked to the exchange of confidential information as grounds for the existence of a fiduciary relationship, but the California Supreme Court has long distinguished confidential relationships from fiduciary relationships.[140] Had Genentech publicly disclosed City of Hope's confidential information and harmed the collaboration's acquisition of intellectual property rights, California would have recognized a cause of action for breach of confidence. However, the possibility of such an action would have ended when the related patents issued or the patent applications were made public, and City of Hope did not suggest that Genentech had breached its confidence. Thus, California distinguishes confidential relationships from fiduciary ones, and after the intellectual property rights were secured, any possible action for breach of confidence would have expired.

Finally, the court's decision was correct because mere confidentiality or the exchange of confidential information, in and of itself, does not make the relationship fiduciary.[141] Even assuming, arguendo, that the initial granting of information to Genentech did create a fiduciary relationship,

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137. *See City of Hope*, 181 P.3d at 148 ("In Article 8, Genentech agrees to compute and pay royalties to City of Hope quarterly, 'to keep regular books of account in detail to permit the royalties payable hereunder to be determined,' and to permit City of Hope to inspect Genentech's books and records."). Although it is true that enforcing audit rights is quite costly, under *Wolf* the cost of protective measures such as audits cannot create a fiduciary obligation where one would not otherwise exist. *Wolf*, 130 Cal. Rptr. 2d at 866-68.

138. *See id.* ("[T]he parties do not dispute that the contract itself calls for an accounting. That contractual right, however, does not itself convert an arm's length transaction into a fiduciary relationship.").

139. *See* Nelson v. Abraham, 177 P.2d 931, 934 (Cal. 1947).

140. *See* Davies v. Krasna, 535 P.2d 1161, 1166 (Cal. 1975) ("Plaintiff's argument confuses a cause of action for breach of confidence with a cause of action for violation of a duty arising from a confidential relationship. . . . 'A confidential relation may exist although there is no fiduciary relation . . . .'").

141. *See* discussion *supra* Section I.A.1.

there is no logical reason why the fiduciary duty created thereby would live on after the patents were prosecuted and the information was publicized through patent. If secrecy or confidentiality was the source of the duty, there would be no reason for Genentech to remain a fiduciary many years after the issuance of patents disclosing the information to the public. Thus, under California law, City of Hope's claim that a fiduciary relationship existed due to confidentiality was tenuous at best, and even if such a relationship had formed there would be no justification for Genentech to remain a fiduciary simply because the information had been secret at one time.

2. City of Hope *and the Academic Literature*

Within the academic literature, some scholars have focused on demonstrating that fiduciary relationships actually form a relatively narrow category, while others have focused on the interaction of fiduciary and contract law.[142] This Section will demonstrate why both groups of theorists would agree with the *City of Hope* result.

a) Fiduciary Duties as a Narrow Category of Relationships

City of Hope was correct because the relationship at issue would satisfy neither Smith's critical resource theory[143] nor Ribstein's duty of unselfishness.[144] In the eyes of both scholars, it would have been error to define the relationship as anything more than contractual and ignore evidence of the parties' intent to that end.

Smith's primary consideration in imposing fiduciary obligations is how the proposed fiduciary's potential for opportunism balances against the proposed beneficiary's capacity for self-help. In *City of Hope*, Genentech concededly did have the potential for opportunism, but City of Hope had full capacity for self-help through the contract itself. City of Hope contracted for audit and accounting rights (and California courts would have found such rights regardless[145]), and was made completely whole through the award of compensatory damages. City of Hope lost no relief because the compensatory damages were sufficient to restore the research center to its rightful condition, and thus the court's decision comports with Smith's theory.

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142. *See* discussion *supra* Section I.B.
143. *See* discussion *supra* Section I.B.1.a).
144. *See* discussion *supra* Section I.B.1.b).
145. *See* Nelson v. Abraham, 177 P.2d 931, 934 (Cal. 1947).

In addition, Smith's "on behalf of" requirement, which is synonymous with the Restatement of Agency's phrase "primarily for the benefit of,"[146] is a necessary component of fiduciary relationships according to both Smith and Ribstein. City of Hope conceded that "nothing in the contract indicates that Genentech was to subordinate its interests to those of City of Hope," instead contending that Genentech's fiduciary duty only imposed a duty of honesty.[147] As discussed above, such an argument stretches the concept of the fiduciary relationship beyond its breaking point,[148] and thus the court was also in agreement with Ribstein and Smith's narrow conception of fiduciary duties.

Furthermore, Smith points out that in a close case (regarding whether the relationship was fiduciary or not), courts will look to whether the proposed beneficiary demonstrated the requisite "special trust." Beyond merely "reposing a trust," as a great number of contracting parties do, City of Hope demonstrated no special trust in Genentech when the relationship was formed. As noted,[149] at the time the agreement in question was executed, City of Hope was a national medical center and Genentech was a four-month-old start-up company consisting of only Robert Swanson and Dr. Boyer. Both sides were represented by counsel, but even if the Genentech of today is a multibillion dollar, publicly traded company, at the time that the agreement was formed City of Hope held the bargaining advantage if either of the parties did. In fact, Thomas Perkins worked to persuade City of Hope that Genentech would be an acceptable collaborator and assured the research center that he and his investors would be backing Genentech.[150] In this light, the unreasonableness of City of Hope's argument is apparent, for it asserted that an established national medical research center placed a beneficiary's "special trust" in a four-month-old start-up company, the viability of which had to be assured to City of Hope. Thus, the court's decision sits readily with Professor Smith's "special trust" requirement, as the record makes clear that City of Hope did not place such a trust in Genentech when the agreement was formed.

Smith further asserts that a contracting party exercises discretion with respect to performance of the contract, while a fiduciary exercises discretion with respect to a critical resource belonging to the fiduciary. In this case, the critical resource arguably no longer even "belonged" to City of Hope, as it had assigned all intellectual property from Drs. Riggs and Ita-

146. *See* discussion *supra* Section I.B.1.a).
147. City of Hope Nat'l Med. Ctr. v. Genentech, Inc., 181 P.3d 142, 150 (Cal. 2008).
148. *See* discussion *supra* Section III.A.1.
149. *See* discussion *supra* note 133.
150. *See id.*

kura's discovery to Genentech in exchange for a contractual right to royalties.[151] Beyond that, Genentech did not misappropriate a critical resource in the way a disloyal fiduciary does, such as a partner or agent exploiting their respective partnership or principal's rightful business opportunities. Genentech's failure was not in terms of being disloyal in carrying out those opportunities (misappropriating opportunities that should have benefited City of Hope), but rather in terms of its performance of the contract itself. Phrased another way, Genentech did not fail City of Hope in exercising discretion with respect to City of Hope's critical resource; rather, Genentech failed with respect to its performance of the contract.[152]

The California Supreme Court's decision also comports with Ribstein's "duty of unselfishness" theory of fiduciary relationships.[153] Moreover, the court's decision, like Ribstein's analysis, cut through past dicta and clarified that the category of fiduciary relationships is narrow. City of Hope itself conceded that Genentech had no obligation to put the research center's interests above its own.[154] Ribstein's analysis demonstrates that the fiduciary's duty of unselfishness—putting the beneficiary's interests above its own—is the very core of fiduciary duties, and by arguing that Genentech's fiduciary duty required "merely honesty" and "only good faith, fair dealing, and full disclosure,"[155] City of Hope was asking the court to recognize a murky fiduciary duty that would allow hundreds of millions of dollars in punitive damages while looking dangerously indistinguishable from the central duties of contract law.[156] Despite dicta regarding fiduciary duties, Ribstein argues that "a careful analysis of how courts have applied fiduciary duties shows that the law is largely consis-

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151. Under the terms of the agreement, Genentech was the only party that could pursue patent protection. City of Hope could only seek patents if Genentech failed to do so or if it abandoned an application. *See City of Hope*, 181 P.3d at 147.

152. *See also* discussion *supra* Section I.A.1 (relating to California's recognition of claims for breach of confidence and delineation of confidential and fiduciary relationships).

153. *See* discussion *supra* Section I.B.1.b); *see generally* Ribstein, *supra* note 10.

154. *See* City of Hope Answer Brief, *supra* note 129, at *17 ("Genentech's fiduciary obligation required merely honesty, not self-sacrifice. . . . [T]he relevant jury instruction required no subordination of Genentech's interests to City of Hope's . . . ."). *See also City of Hope*, 43 Cal. 4th at 386 ("There is no indication in the contract that Genentech entered into it with the view of acting primarily for the benefit of City of Hope. . . . [N]othing in the contract indicates that Genentech was to subordinate its interests to those of City of Hope, a point conceded by City of Hope.").

155. City of Hope Answer Brief, *supra* note 129, at *17.

156. *See* Aas v. Superior Court, 12 P.3d 1125, 1135 (Cal. 2000) ("A person may not ordinarily recover in tort for the breach of duties that merely restate contractual obligations.").

tent with the narrow view."[157] In *City of Hope*, the court established an important guidepost that fiduciary duties should be applied sparingly.

b) *City of Hope* and the Interaction of Contract and Fiduciary Law

Professors Frankel, Easterbrook, and Fischel focus more on the interaction of fiduciary and contract law than on defining and categorizing fiduciary relationships,[158] but their work also provides support for the court's decision.

i) Fiduciary Duties as Default Rules

Under Frankel's conception, fiduciary duties arise in fiduciary relationships by default, but parties have the freedom to contract around fiduciary obligations. Thus, fiduciary relationships are not unlike many other relationships in that there are defaults that can be altered by contracting parties.[159] Though the court did not discuss whether the language of the contract demonstrated intent to avoid fiduciary obligations, the parties did expressly shrug off the titles of the traditional fiduciary relationships and stated that they were independent contractors. That is a clear demonstration of such intent. The Genentech-City of Hope relationship did not fit any established category of fiduciary relationship, but even if the relationship would have been fiduciary by default, Frankel's conception of fiduciary duties would say that the parties removed any possibility for fiduciary obligations when they showed intent to, and did, contract out of any fiduciary duties that would have existed by default.

ii) Fiduciary Duties as Efficient Gap-Fillers

Easterbrook and Fischel's characterization of fiduciary duties also provides support to the California Supreme Court's decision. According to them, fiduciary duties act as gap-fillers[160] that allow for efficient drafting

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157. Ribstein, *supra* note 10, at 213; Ribstein, *Structure*, *supra* note 66, at 6.

158. *See* discussion *supra* Section I.B.2.

159. *See* Frankel, *supra* note 76, at 1231-32.

> There are good reasons for viewing fiduciary rules as default rules and for enforcing the parties' bargain around them . . . . [P]eople ought to be free to govern their relationship unless good reasons exist to impose mandatory rules upon them . . . . [Default] rules are presumed to represent the terms to which most parties would agree had they negotiated the terms. If the particular parties wish to deviate from the default rules, they should be free to bargain around them.

Id.

160. Easterbrook and Fischel's characterization may be quite similar to Frankel's; perhaps they are addressing the same subject from alternative perspectives. Indeed, both

when drafting for every possible situation would be too resource-intensive.[161] Therefore, fiduciary duties impose a certain standard of acceptable behavior in those situations for which parties cannot draft efficiently.

The court's decision in *City of Hope* comports with this model. Beyond patenting and commercialization, the relationship itself was not at all complex, and the events that took place were easily foreseeable. Royalties were defined by the terms of the contract, and that Genentech would attempt to pay less than the rightful amount of royalties was assuredly a foreseeable circumstance. Most likely, this was precisely why City of Hope required an audit clause be placed in the contract. Therefore, Genentech's breach of contract was not a situation for which the parties needed a "gap-filler," for the terms of the contract filled any potential gap. Genentech was to pay certain royalties to City of Hope, and when Genentech failed to do this, it merely breached the terms of the contract. Since Easterbrook and Fischel view fiduciary duties as efficient gap-fillers, the duties do not apply when the parties have filled the gaps themselves by contract and demonstrated intent not to be subject to fiduciary obligations. Thus, the court's decision comports with their theory, as well.

3. City of Hope *and the Business and Research Communities*

The *City of Hope* decision will have broad effects on the research and business communities of California. Furthermore, the court's refusal to find fiduciary duties could impact California's business community and affect the formation of future deals similar to that between Genentech and City of Hope. This Section will describe why, from a policy perspective, *City of Hope* was most likely the correct decision for both for the business community and nonprofit research institutions.

a) Business Community

Regarding the business community in California, and specifically the high technology and biotechnology companies that are pillars of the state's economy, the court's decision regarding fiduciary duties was sound from a

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theories advocate liberal freedom of contract in designing relationships, even relationships with fiduciary characteristics. Moreover, in contract law (e.g., the U.C.C.), the default rules generally serve as gap-fillers. Thus, Easterbrook & Fischel and Frankel's theories are in agreement, and may actually be quite uniform.

161. This is clear when one thinks about how complicated the agreements between partners, trustees and trusts, directors and corporations, officers and corporations, or actors in other fiduciary-beneficiary relationships would be if the parties had to think of and draft an acceptable course of action for every possible contingency. Assuming this is possible, it would still be inefficient and consume a great deal of resources.

policy perspective. Sophisticated entities prefer certainty and predictability in their deals.[162] Parties want to be able to assess risk and possible future liability. Defining their relationships through contract allows both sides to have full knowledge of their obligations and potential liabilities. Were the California Supreme Court to affirm a holding that effectively inserts open-ended liability and unpredictable, undefined obligations into relationships that were previously defined through precise negotiations and exacting language, the result would grant undeserved windfalls for some parties while depriving others of the benefit of their bargain. *City of Hope* reassured the business community that entities can define their relationships through contract and have their bargains respected by the courts without fear of extra-contractual fiduciary obligations that the parties did not intend to bear.

The California Healthcare Institute (CHI), despite holding both City of Hope and Genentech in its membership, still felt the need to submit an amicus brief in support of Genentech, warning the court that imposing fiduciary duties in cases such as these would harm California's biotechnology industry.[163] CHI further warned that the court should be wary of "judicial attempts to make fiduciaries out of entrepreneurs."[164] This warning is especially powerful when one remembers that doing so would likely impose fiduciary duties ex post based on later success even if no fiduciary duties existed at the time the agreement was formed. Such a conception of fiduciary duties would no doubt harm California's entrepreneurial business culture.

b) Nonprofit Research Institutions

Two of the briefs put forth by amici warned that ruling for Genentech as to the fiduciary duties issue would be detrimental to nonprofit research institutions.[165] These assertions are incorrect for several reasons.

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162. *See, e.g.*, Lee C. Buchheit, *Law, Ethics, and International Finance*, 70 LAW & CONTEMP. PROBS. 1, 2 (2007) ("Parties entering into a commercial contract want predictability in its interpretation and enforcement . . . . [W]hat commercial parties find intolerable is the prospect of locking themselves into a contractual arrangement that may subsequently be interpreted or enforced in a manner inconsistent with their presigning intentions.").

163. CHI Amicus Brief, *supra* note 135 at *16.

164. *Id.* at *18.

165. *See generally* Brief for Mem'l Sloan-Kettering Cancer Ctr., et al. as Amicus Curiae Supporting Respondent, City of Hope Nat'l Med. Ctr. v. Genentech, Inc., 181 P.3d 142 (No. S129463), 2006 WL 951480, at *6-16 [hereinafter Sloan-Kettering Amicus Brief]; and Brief for the Acad. of Applied Sci. as Amicus Curiae Supporting Respon-

In their briefs, the nonprofit research institutions (or representative groups thereof) acting as amici paint themselves as vulnerable entities that do not have the same expertise or personnel of private companies when it comes to licensing deals, and therefore, they feel there is a great probability they will be "cheated and taken advantage of."[166] However, this assumes that research institutions and universities will not retain adequate counsel to prevent their being taken advantage of, which is unlikely, and furthermore is not an issue with which a court must concern itself.[167] In addition, all across the nation, nonprofit research institutions serve as the birthplaces of venture-backed start-ups and spin-offs, as well as the homes of zealous technology transfer offices.[168] In contrast to the amici's arguments, there is concern that nonprofit research institutions are actually too focused on commercialization and are being distracted from other goals, such as education and conducting less lucrative (but still often publicly funded) research for the public good.[169] In the face of the amici's argument, there is a great deal of evidence to suggest that nonprofit research institutions are quite capable of protecting their interests in pursuits of commercialization.[170]

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dent, City of Hope Nat'l Med. Ctr. v. Genentech, Inc., 181 P.3d 142 (No. S129463), 2006 WL 951477, at *5-13.

166. *See generally* Sloan-Kettering Amicus Brief, *supra* note 165, at *7-9.

167. In a civil action between two large entities, this author does not see why a court would concern itself with a party's choice of counsel or that counsel's competence.

168. This has been especially true since the 1980 passing of the Bayh-Dole Act, 35 U.S.C. §§ 200-212 (2007) (allowing universities and other nonprofits to own intellectual property that resulted from government funding).

169. *See, e.g.*, SHELDON KRIMSKY, SCIENCE IN THE PRIVATE INTEREST: HAS THE LURE OF PROFITS CORRUPTED BIOMEDICAL RESEARCH? 1-7 (2004) ("[U]niversity science becomes entangled with entrepreneurship; knowledge is pursued for its monetary value; and expertise with a point of view can be purchased." Furthermore, "[a]s universities turn their scientific laboratories into commercial enterprise zones and as they select their faculty to realize these goals, fewer opportunities will exist in academia for public-interest science—an inestimable loss to society."); s*ee also* MICHAEL CRICHTON, NEXT, Author's Note § 5 (2006) ("As a result of [the Bayh-Dole Act], most science professors now have corporate ties—either to companies they have started or other biotech companies. Thirty years ago, there was a distinct difference in approach between university research and that of private industry. Today, the distinction is blurred, or absent."). For more on the results of the Bayh-Dole Act, see Bernadette Tansey, *The Building of Biotech: 25 Years Later, 1980 Bayh-Dole Act Honored as Foundation of an Industry*, S.F. CHRON., June 21, 2005 at D1 (explaning that "critics made a case that the 1980 act has had devastating, if unintended, consequences on the integrity of the scientific enterprise" and suggesting that the Bayh-Dole Act led to higher healthcare costs and entangled university researchers in bureaucratic paperwork).

170. *See, e.g.*, Press Release, Royalty Pharma, Royalty Pharma Acquires a Portion of New York University's Royalty Interest in Remicade(R) for $650 Million (May 4, 2007),

In addition, CHI, whose membership also includes Stanford University and the University of California, warned the court that ruling against Genentech on the fiduciary duties issue could actually harm universities and other nonprofits by diverting research money that would otherwise be awarded to those research institutions.[171] CHI's concerns are sound, for if cooperative agreements formed between corporations and nonprofit research institutions expose corporations to high levels of risk and open-ended liability, efficient deals will either come together at a smaller dollar amount or a lower royalty rate for the institution, or they will be pushed outside of the settlement gap and will not come together at all. When corporations can cap liability and bargain to diminish risk factors with greater certainty, nonprofit research institutions will benefit with enhanced ability to commercialize because the lowered risk will mean more deals will be deemed efficient and thus will come together more easily. Furthermore,

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available at http://www.prnewswire.com/cgi-bin/stories.pl?ACCT=ind_focus.story-&STORY=/www/story/05-04-2007/0004581241&EDATE=FRI+May+04+2007,+02:01+PM (last visited Nov. 17, 2008) (announcing NYU's sale of the rights to the anti-inflammitory agent Remicade in exchange for $650M in cash up-front plus rights to additional royalties based on drug sales); Press Release, Emory Univ., Emory Is Top-Ranked Univ. in Latest Survey of Commercialized Research (Feb. 26, 2007), *available at* http://whsc.emory.edu/press_releases2.cfm?announcement_id_seq=9180 (last visited Nov. 17, 2008) (announcing Emory's sale of its future royalty rights for the HIV/AIDS drug Emtriva to Gilead Sciences and Royalty Pharma for a one-time payment of $525M); *Stanford Reaps Windfall from Google Stock Sale*, L.A. TIMES, Dec. 2, 2005, at C-2 (announcing Stanford University's $336M profit from the sale of Google stock received for allowing the company to use internet search technology developed by Google's founders while they were students at the university—technology that Stanford licenses to Google). *See also* Association of University Technology Managers, *FY 2006 AUTM U.S. Licensing Activity Survey*, *available at* http://www.autm.net/AM/ Template.cfm?Section=FY_2006_Licensing_Activity_Survey&Template=/CM/ContentDisplay.cfm&ContentID=1804 (last visited Jan. 31, 2009) (listing the single-year 2006 technology licensing revenue for several select universities as follows: University of California System, $193.5M; New York University, $157.4M; Stanford University, $61.3M; Wake Forest University, $60.6M; University of Minnesota, $56.2M; Massachusetts Institute of Technology, $43.5M; University of Florida, $42.9M; University of Wisconsin-Madison, $42.4M; University of Rochester, $38.0M; University of Washington, $36.2M; Northwestern University, $30.0M; University of Massachusetts, $27.2M; University of Colorado, $21.2; Harvard University, $20.8M; University of Michigan, $20.4M); Columbia Univ., *Columbia Univ. Sci. and Tech. Ventures Annual Report 2005*, *available at* http://stv.columbia.edu/assets/2004-2005_annual_report.pdf (last visited Nov. 17, 2008) (announcing Columbia University's $159.7M in technology licensing revenues for fiscal year 2005).

171. *See* CHI Amicus Brief, *supra* note 135, at *17-18. *See also* Cal. Healthcare Inst., *CHI Member List*, *available at* http://chi.org/uploadedFiles/CHI%20Member%20List%20for_print%20on%20Ltrhd.pdf (last visited Jan. 31, 2009).

those deals that would have been efficient even with the added risk of fiduciary liability will now likely come together at a higher point in the settlement gap, with the lowered risk to corporations meaning higher royalty rates can be bargained for by the research institutions.[172]

Thus, while it is highly unlikely that the fiduciary duties ruling of *City of Hope* would keep nonprofit research institutions from entering into licensing agreements, the opposite ruling likely would have had a net negative financial impact on such institutions. Such a result would surely have benefited City of Hope itself in the short term, but corporations would have become more conservative in making deals with research institutions. This would have resulted in fewer deals being formed for less money per deal,[173] creating an overall negative impact on research institutions.[174]

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172. *See* CHI Amicus Brief, *supra* note 135, at *17-18 (arguing that "[i]mposing fiduciary duties on sponsored research could push research dollars away from universities and nonprofits," because "[i]f contracting with such institutions becomes risky or uneconomic, businesses may look for alternatives," since "[p]otential exposure to punitive damages significantly increases the risk of contracting with academic institutions. Such risk could result in fewer technology transfer agreements, hence fewer new medicines for patients. Academic science can only benefit patients when companies agree to commercialize it."). *See also* Michael Dorff, *Attaching Tort Claims to Contract Actions: An Economic Analysis of Contort*, 28 SETON HALL L. REV. 390, 404 (1997).

> Awarding nonpecuniary damages could also inhibit commercial transactions. Parties may be more reluctant to enter into transactions knowing that they could face liability for large nonpecuniary losses if they breached the contract. Increasing the expected damages for breach would reduce the expected value of the transaction and commensurately reduce parties' willingness to commit themselves to a contract. . . . This uncertainty becomes even more problematic once risk aversion is taken into account. Parties who would be relatively risk-neutral when faced with limited damages for breach may become more risk-averse when faced with expanded liability. Even a small chance of a disproportionately large nonpecuniary loss award could deter parties from entering into socially beneficial transactions.

Id.

173. Meaning less money than would have been obtained without the added risk of fiduciary liability.

174. *See* Easterbrook & Fischel, *supra* note 82, at 428 ("Such a decision might produce a windfall for the plaintiff today. What of tomorrow? Prices and practices would adjust."). This Note assumes that despite any criticisms of the Bayh-Dole Act, nonprofit research institutions themselves believe that obtaining more research money—even from corporate actors—is in their own best interests. The policy arguments do not take a position regarding the desirability of retaining Bayh-Dole, they simply assume that the research centers and universities themselves desire whichever policy will result in a larger number of research-funding agreements for larger amounts of money per agreement. Whether it is sound public policy for nonprofit research institutions to maximize their funding in this manner is beyond the scope of this Note.

B. Looking Forward

In the wake of *City of Hope*, California courts will likely be hesitant to find fiduciary duties if the relationship does not fit a clearly established category of fiduciary relationships.[175] Beyond that, if the relationship is founded on a contractual agreement and the agreement was reached at arms-length, *City of Hope* and its endorsement of *Wolf* will likely deter courts from finding fiduciary obligations even in cases which appeal to one's sense of fairness and equity. This has implications for both technology licensing agreements and questions about fiduciary issues that arise in other settings.

After *City of Hope*, if a contracting party wants the relationship to be fiduciary, the party's counsel should ensure that the agreement has express language to that end. Otherwise, courts in California will likely be reluctant to find any fiduciary obligations arose from the contractual relationship.

IV. CONCLUSION

In *City of Hope*, the California Supreme Court took an important stand to provide much-needed clarity for this area of law, stopping fiduciary duty "creep" and, perhaps more broadly, the "tortification" of contract law.[176]

City of Hope reaffirmed the freedom of sophisticated parties to define their relationships through contract. It also avoided imposing punitive measures upon a party whose position concerning its breach, though wrong in the eyes of the court, was objectively reasonable. Furthermore, and perhaps most importantly for the efficiency that contract law provides to the marketplace, the court chose not to cloud contract law by finding fiduciary duties very similar to those imposed by contract.

The court's unanimous decision was also in agreement with some of the leading scholars in this field, including Professors Easterbrook, Fischel, Frankel, and Ribstein. At the very core of fiduciary relationships is

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175. The California Supreme Court is quite influential to courts in other states. As such, the court's holding in *City of Hope* may have legal implications outside of California. Furthermore, many corporations and universities that are not based in California but conduct business and enter into cooperative agreements with entities that are residents of California will also be affected by *City of Hope*, so the decision's financial impact will almost assuredly reach outside of California. The decision's importance was evidenced by national interest in the case, which spurred amicus activity from non-California entities such as Microsoft Corp. and the University of Illinois.

176. *See* Imre, *supra* note 128.

the concept of one party undertaking a duty of unselfishness to work for the benefit of the other. City of Hope itself conceded that it had never expected unselfish behavior from Genentech. Furthermore, freedom of contract allows parties to contract out of fiduciary duties and, as the great majority of sophisticated entities do, rely on contract alone to make them whole. In this case, the parties showed clear intent to be free of fiduciary obligations. In addition, if fiduciary duties are properly viewed as default provisions, or "gap-fillers," then the agreement in question left no "gap" to be filled—Genentech breached the contract itself, not some extra-contractual duty.

Finally, if the court had not decided the fiduciary issue as they did, *City of Hope* would have had dangerous policy implications, both for business in California and, in the broader scope, for nonprofit research institutions like City of Hope. Deciding in favor of City of Hope on the fiduciary issue would have found (or perhaps created) a heretofore unknown duty that did not exist at the time the agreement was formed, but rather came into being as a result of the entrepreneur's later success and stature. Such a precedent would clearly be dangerous in a state that depends on technology, start-up companies, and a culture of entrepreneurship to act as one of its major economic engines. Furthermore, judicial action to add so much uncapped and unknown risk to contracting with nonprofit research institutions such as medical research centers and universities would certainly move many otherwise efficient deals out of parties' settlement gaps. This would result in fewer agreements to fund nonprofit research. In addition, the uncapped risk of fiduciary liability for corporations would mean that deals that still did come together would provide appreciably less money for the research institutions than the same deals without the added risk.

Therefore, in terms of case law, the literature, and sound policy, *City of Hope* was a benchmark decision in which the California Supreme Court held correctly. In doing so, the court provided clarity to the law and rightly chose to keep fiduciary duties where they belong—in that narrow class of relationships for which they are most efficient and appropriate.

TAKING RESPONSIBILITY: REGULATIONS AND PROTECTIONS IN DIRECT-TO-CONSUMER GENETIC TESTING

By Andrew S. Robertson

Starting in November 2007, the New York State Department of Health mailed "cease and desist" letters to thirty-one companies, ordering them to stop providing genetic tests directly to consumers without the involvement of a licensed physician.[1] In June 2008, the California Department of Public Health sent similar letters to thirteen genetic testing companies, also involved in direct-to-consumer (DTC) genetic testing services.[2] These cease-and-desist letters echo public concern regarding laboratory testing standards, the need for physician involvement, and the use of misleading advertising.[3] California has since granted licenses to a number of these companies,[4] but discussions regarding the concerns of DTC testing continue. Among these concerns are the lack of standards used to demonstrate the validity of different genetic tests, uncertainty as to whether healthcare professionals must always be involved in the ordering of such tests to protect patients, and lack of consumer understanding regarding the use of genetic testing.[5]

This Note aims to address the debate surrounding genetic testing within the context of the DTC market. Part I describes the potential for genetic testing in the clinical setting as a result of recent scientific advances. Part II provides an introduction to the DTC genetic testing industry, including the business models being employed by various firms. Part II also pro-

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1. Sarah Lynch, *Should Genetic Testing be Regulated?*, TIME, July 22, 2008, *available at* http://www.time.com/time/health/article/0,8599,1825539,00.html.

2. *Id.*

3. *Id.*

4. *See e.g.*, Andrew Pollack, *California Licenses 2 Companies to Offer Gene Services*, N.Y. TIMES, Aug. 19, 2008, at C3.

5. Andrew Pollack, *Gene Testing Questioned by Regulators*, N.Y. TIMES, June 26, 2008, at C1.

vides a more detailed account of the DTC genetic testing debate, with particular focus on the lack of adequate regulations, the lack of required involvement from a licensed physician or genetic counselor, and the lack of adequate consumer protection. Part III discusses solutions to address the risks associated with DTC genetic testing through clarified scientific standards, targeted regulations surrounding the quality of genetic testing, industry self-standardization regarding genetic test reliability and results, and assumption by DTC companies of a duty to warn consumers about potential risks of genetic testing.

I. OVERVIEW OF GENETIC TESTING

Who we are as individuals is a result, primarily, of two principal factors: genetics and environment.[6] Understanding the influence these factors have on a particular trait, behavior, or as the basis for diseases such as cancer, has been a central theme of biological research for decades.[7] While strategies such as twin studies have led to key insights to the interaction between genetics and environment, until recently our understanding has been limited by technology.[8] However, with the completion of the human genome project and modern advances in genetic analytical techniques, rapid progress is being made in identifying which genes, and to what extent genetics guide who we are as individuals.[9]

Translating gene-trait association studies towards healthcare has become a cornerstone of what is termed "personalized medicine," or the tailoring of medical treatments, both responsive and anticipatory, based in-part on an individual's genes.[10] The growing understanding of how our genetics influence us as people has also led to the marketing of genetic tests to consumers directly over the Internet.[11] This DTC commercial ge-

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6. *See generally* Muin J. Khoury et al., *Do We Need Genomic Research for the Prevention of Common Diseases with Environmental Causes?*, 161 AM. J. EPIDEMIOLOGY 799, 800 (2005) (discussing the importance of understanding genetic risk factors with known environmental causes).

7. *See id.*

8. Alan E. Guttmacher & Francis S. Collins, *Welcome to the Genomic Era*, 349 NEW ENG. J. MED. 996, 996-98 (2003).

9. *Id.*

10. *See generally* John Bell, *Predicting Disease Using Genomics*, 429 NATURE 453 (2004) (discussing the use of genetics in predicting disease, drug discovery, disease monitoring, and clinical practice).

11. Gail H. Javitt, *Policy Implications of Genetic Testing: Not just for Geneticists Anymore*, 13 ADV. CHRONIC KIDNEY DISEASE 178, 179 (2006).

netic testing industry has seen rapid growth in recent years, preceding not only federal regulations, but often the science itself.

A. The Science of Genetic Testing Has Advanced Rapidly in Recent Years

While a number of scientific events have advanced our understanding of human genetics, two in particular—the completion of the human genome and the increase of gene-trait association studies—have laid the groundwork for genetic testing as it is used today. The completion of the human genome in 2001 marked a landmark achievement in understanding human biology by providing a list of the genes and intergenic regions within human chromosomal DNA.[12] Subsequent drafts and annotations of the genome have given a refined list of 20,000-25,000 protein-coding genes and just over 3 billion nucleotide basepairs.[13] This completion provided researchers and doctors with a reference sequence from which further genetic study could take place.[14]

Following the completion of the human genome, researchers increasingly studied how genetic variation contributes to heritable traits and diseases.[15] Most aspects of human biology stem from either genetic (hereditary) or environmental (non-hereditary) factors. While some genetic traits, such as height and eye color, have little influence from environmental factors, others, such as obesity and some forms of cancer, only manifest in combination with certain environmental conditions.[16]

Identifying genetic variations and understanding their physiological manifestation (termed "phenotype") has become a centerpiece in this new age of genetics. There are many different kinds of DNA sequence variations, ranging from complete, extra, or missing chromosomes down to single nucleotide changes.[17] Most studies of human genetic variation have focused on single nucleotide polymorphisms (SNPs), which are substitutions in individual bases along a chromosome.[18] Experts estimate that

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12. Guttmacher & Collins, *supra* note 8, at 996.

13. Int'l Human Genome Sequencing Consortium, *Finishing the Euchromatic Sequence of the Human Genome*, 431 NATURE 931, 943 (2004).

14. Guttmacher & Collins, *supra* note 8, at 996.

15. *See* Bell, *supra* note 10.

16. Khoury, *supra* note 6, at 802 (discussing approaches to identifying gene-environment interaction).

17. *See* Nicholas Wade, *Genetic Catalog May Aid Search for Roots of Disease*, N.Y. TIMES, Oct. 27, 2005, at A20.

18. *Id.*

SNPs occur on average somewhere between every 1 in 100 and 1 in 1,000 base pairs in the human genome.[19] By conducting familial studies or larger "genome-wide association studies," researchers look to link genetic variation to phenotypes with statistical significance.[20] The linkage serves as the scientific basis for genetic tests: by testing for specific genetic variations, physicians can determine risk for disease, understand behavioral characteristics, or identify genetic causes of existing conditions.[21] These studies have led to genetic tests for approximately 1,400 genetic variations, with more than 1,000 additional tests currently in development.[22]

B. Advances in Genetic Testing Has Brought the Promise of "Personalized Medicine"

Genetic testing represents a key component of the use of new methods of molecular analysis and bioinformatics to better manage a patient's disease or predisposition to disease, otherwise known as "personalized medicine." In a medical context, information about a patient's genes, gene expression profile, or "genotype" could be used to tailor medical care to an individual's needs.[23] Understanding the genetic profile of an individual would, in theory, assist clinicians in identifying predisposition for disease, carriers for disease, or drug sensitivities; would make newborn screening and prenatal testing more effective; and might even facilitate the drug design process. Already, for example, genetic testing has allowed for huge inroads in oncology, both in understanding the genetic makeup of cancer cells to allow for better prognosis and treatment, as well as screening individuals thought to be at risk for hereditary forms of cancer.[24]

C. Better Technology Has Led to Direct-to-Consumer Marketing of Genetic Tests

Along with the advance of our understanding of genetics and heredity, there has been a recent proliferation of commercially available tests mar-

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19. Int'l HapMap Consortium, *A Haplotype Map of the Human Genome*, 437 NATURE 1299, 1301 (2005).

20. Thomas A. Pearson & Teri A. Manolio, *How to Interpret a Genome-Wide Association Study*, 299 JAMA 1335, 1335 (2008).

21. *Id.*; *see also* Khoury, *supra* note 6.

22. *See* Charles Schmidt, *Regulators Weigh Risks of Consumer Genetic Tests*, 26 NATURE BIOTECH. 145, 145 (2008) (quoting Steve Gutman, FDA's director for *in vitro* diagnostics).

23. Khoury, *supra* note 6.

24. *See American Society of Clinical Oncology Policy Statement Update: Genetic Testing for Cancer Susceptibility*, 21 J. CLINICAL ONCOLOGY 2397, 2397-406 (2003) (discussing the use of genetic testing in clinical oncology).

keted directly to consumers. One manner of DTC genetic testing advertises to consumers but still requires the prescription of a physician. This is similar to the DTC advertising of prescription pharmaceuticals. For example, Myriad Genetics' BRACAnalysis test for susceptibility to hereditary breast and ovarian cancer became extensively advertised in 2002 using a variety of media outlets.[25] This advertisement saw a marked rise of sales among women within the age group of twenty-five to fifty-four years, despite being appropriate for only a small percentage of patients with a strong family history of breast cancer.[26]

Many DTC companies are marketing and selling genetic tests directly to consumers, completely circumventing the involvement of a trained physician. These companies provide genetic testing not only for health-related purposes, but also to provide information about a person's ancestry, behavior and personality, and for paternity testing and employment screening services. For example, one Internet-based dating service, genepartner.com, works to "match men and women by analyzing specific genes in their DNA."[27]

There are three principal, nonexclusive business models used by the DTC genetic testing market. The first model profits through the sale of the tests themselves. Costing between approximately $400[28] and $250,000,[29] these tests analyze a consumer's DNA, assess variability at 500,000 to 1 million SNP sites, or completely sequence the full genome of a customer.[30] These services typically store the data in an online private account, compare the results with "phenotype databases"[31] maintained by the com-

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25. Bryn Williams-Jones, *'Be Ready Against Cancer, Now': Direct-to-Consumer Advertising for Genetic Testing*, 25 NEW GENETICS & SOCIETY 89, 92 (2006).

26. Andrew Pollack, *A Genetic Test That Very Few Need, Marketed to the Masses*, N.Y. TIMES, Sept. 11, 2007, at C3; *see also* Melanie F. Myers, et al., *Genetic Testing for Susceptibility to Breast and Ovarian Cancer: Evaluating the Impact of a Direct-to-Consumer Marketing Campaign on Physicians' Knowledge and Practices*, 8 GENETICS & MEDICINE 361, 365-67 (2006).

27. Gene Partner Home Page, http://www.genepartner.com (last visited Dec. 10, 2008).

28. *See* 23andMe Home Page, https://www.23andMe.com (last visited Feb. 4, 2009).

29. *See* Knome Home Page, https://www.knome.com (last visited Feb. 4, 2009).

30. David J. Hunter, Muin J. Khoury, & Jeffrey M. Drazen, *Letting the Genome out of the Bottle—Will We Get Our Wish?*, 358 NEW ENG. J. MED. 105, 105 (2008).

31. "Phenotype" refers to any observable characteristic or trait of an organism: such as its morphology, development, biochemical or physiological properties, or behavior.

pany, and provide the consumer with updated readouts of his or her level of risk for specific conditions, often as a subscription service.[32] In many instances, DTC companies do not conduct the tests themselves, but instead outsource the testing services and act as the consumer-friendly intermediary.[33] Because operational costs required for performing these testing services often remain a trade secret, it is unclear if selling genetic tests is the main source of revenue for many companies.

The second business model is based on the value of the aggregate genetic data collected from customers. As described in Section I.B, gene-trait association studies are an important tool in understanding how genetic factors impact disease and behavior.[34] By collecting genetic information from hundreds of thousands of individuals, DTC firms hope to develop a valuable resource for drug development, discovery of rare genetic markers and rare carriers, and identification of target populations for clinical trials.[35] While specific dollar prices would be determined by the size and scope of the databases, this collection of genetic profiles—and customer contact information—holds significant financial value.[36]

DTC companies also look to a third model for developing revenue—using genetic testing as a form of targeted marketing. Using this approach, DTC companies would combine their testing with the sale of products or treatments. For example, the sale of a vitamin regimen "tailored" to an individual consumer based on their genetic tests.[37] 23andMe, a Google-backed leader in DTC genetic testing reserves the right to enter into commercial arrangements to provide products and services to individual users and to collect fees from these referrals.[38] The financial value of such ser-

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"Phenotype databases" utilize a standardized lexicon of phenotypes, phenotypic descriptions and known causes.

32. *Id*.

33. *See* 23andMe, *supra* note 28.

34. David Gurwitz, Jeantine E. Lunshof, & Russ B. Altman, *A Call for the Creation of Personalized Medicine Databases*, 5 NATURE REVS. DRUG DISCOVERY 23, 24 (2006).

35. *Id*.

36. *Id*.

37. *At Home DNA Tests: Marketing Scam or Medical Breakthrough?: Hearing Before the S. Spec. Comm. on Aging*, 109th Cong. 13-25 (2006) [hereinafter *Hearing*] (testimony of Gregory Kutz, U.S. Gov. Accountability Office [GAO]).

38. 23andMe Privacy Statement, https://www.23andme.com/about/privacy (last modified Nov. 11, 2007).

vices is unclear, and the benefit to customers has been openly questioned.[39]

II. THE INDUSTRY-WIDE DEBATE ON MARKETING GENETIC TESTS DIRECTLY TO CONSUMERS

As genetics has become more prominent in healthcare, issues surrounding privacy, consumer-patient protection, and discrimination have come to the forefront of the healthcare debate. The recently passed Genetic Information Nondiscrimination Act of 2008 (GINA),[40] highlighted the urgency in developing proper federal regulations surrounding genetic testing, stating:

> The early science of genetics became the basis of State laws that provided for the sterilization of persons having presumed genetic ''defects'' such as mental retardation, mental disease, epilepsy, blindness, and hearing loss, among other conditions. The first sterilization law was enacted in the State of Indiana in 1907. By 1981, a majority of States adopted sterilization laws to ''correct'' apparent genetic traits or tendencies. Many of these State laws have since been repealed, and many have been modified to include essential constitutional requirements of due process and equal protection. However, the current explosion in the science of genetics, and the history of sterilization laws by the States based on early genetic science, compels Congressional action in this area.[41]

The emergence of direct to consumer genetic testing in particular has drawn further attention from a broad range of industry and nongovernmental stakeholders as well as a number of government regulatory agencies. In November 2004, the Secretary's Advisory Committee for Genetics Health and Society (SACGHS), an advisory panel established to broadly consider and advise the Secretary of Health and Human Services on the impact of genetic technologies, formally urged then-Secretary Tommy Thompson to conduct an analysis of the public health impact of DTC advertising and access to genetic tests.[42] In a 2007 draft report titled "U.S. System of

39. *Hearing*, *supra* note 37 (testimony of Gregory Kutz, GAO).

40. Genetic Information Nondiscrimination Act of 2008, Pub. L. No. 110-233, 122 Stat. 881 (to be codified in scattered sections of 29 and 42 U.S.C.).

41. *Id.* § 2(2).

42. Letter from Reed V. Tuckson, Chair of Sec'y's Advisory Comm. on Genetics, Health & Soc'y, Nat'l Inst. of Health, to Tommy G. Thompson, Sec'y of Health & Hu-

Oversight of Genetic Testing: A Response to the Charge of the Secretary of HHS," SACGHS identified a number of concerns, such as: the risk that tests used by DTC companies which have no clinical relevance would have a negative impact on public perception of genetics in medicine generally, the increasing burden on patients who must interpret complicated genetic data without the guidance of a medical professional, and the increasing strain on physicians who are not trained in genetics.[43] To further examine the possible negative consequences of DTC genetic testing, SACGHS recommended that HHS should increase efforts through collaborations among relevant federal agencies,[44] states, and consumer groups to assess the implications of DTC advertising and consumer-initiated genetic testing and, as necessary, propose strategies to protect consumers from potential harm.[45]

While the consequences of DTC genetic testing are still being assessed, most of the issues have been identified. Critics of the industry focus on the lack of comprehensive regulatory oversight of genetic tests, the need for trained physicians to properly understanding the results, and the need for consumer protection to ensure that individuals are properly informed as to the significance of their genetic results.[46] Proponents of the industry, however, claim that DTC genetic testing allows consumers to take control of their own health and that, on a fundamental level, consumers have the right to know about their own genetic makeup.[47]

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man Serv. (Dec. 8, 2004), *available at* http://oba.od.nih.gov/oba/sacghs/reports/DTCletter.pdf.

43. *See* SEC'Y'S ADVISORY COMM. ON GENETICS, HEALTH & SOC'Y [SACGHS], U.S. SYSTEM OF OVERSIGHT OF GENETIC TESTING: A RESPONSE TO THE CHARGE OF THE SECRETARY OF HEALTH & HUMAN SERVICES (2008), http://oba.od.nih.gov/oba/SACGHS/reports/SACGHS_oversight_report.pdf.

44. Relevant federal agencies include the Food and Drug Administration (FDA), the National Institutes of Health (NIH), the Centers for Disease Control and Prevention (CDC), and the Federal Trade Commission (FTC).

45. SACGHS, *supra* note 43, at 9.

46. Gail H. Javitt & Kathy Hudson, *Federal Neglect: Regulation of Genetic Testing*, 22 ISSUES SCI. & TECH. 59, 63 (2006) (discussing the potential harms of direct-to-consumer genetic testing).

47. 23andMe Policy Forum: Direct to Consumer Genetic Testing, https://www.23andme.com/about/policy/ (last visited Dec. 10, 2008).

A. Direct-to-Consumer Genetic Testing Raises Three Central Criticisms

The rise of the DTC genetic testing industry has brought with it many benefits, concerns, and much debate. Three central criticisms comprise the bulk of the debate. First, federal regulation of genetic tests is not clearly defined, regardless of whether the tests are used in healthcare or through DTC genetic testing services. The inadequacy of regulation has resulted in no oversight or assurances as to the validity of genetic tests. Second, concern exists over administration of the tests without the counsel of trained healthcare professionals, such as doctors, nurses, or genetic specialists. This concern stems from the varying complexity of genetic tests, many of which require proper interpretation from a licensed professional. Finally, little active regulation exists to prevent false or misleading advertisement by DTC companies, such as making exaggerated or misleading claims as to the efficacy of particular genetic analyses. This concern is complicated by the lack of approved methods for determining the utility and accuracy of genetic tests coupled with the evolving scientific understanding of gene-trait associations.

1. Federal Regulations of Genetic Tests Are Poorly Defined

At present, regulatory oversight of genetic testing, both within the DTC and healthcare context, is shared between three authorities: the Centers for Medicaid and Medicare Services (CMS) under the Clinical Laboratory Improvement Amendments of 1988 (CLIA),[48] the Food and Drug Administration (FDA), and state health agencies.[49] However, no single body has clear authority over the accuracy, design and application of many genetic tests being used today.[50]

The authority that each agency has over genetic testing depends on how the genetic test in question is marketed, produced, performed, and interpreted.[51] For example, Laboratory Developed Tests (LDTs)—genetic tests that are designed and produced within a clinical laboratory—must be compliant with CMS regulations.[52] In contrast, test kits—genetic tests

48. Clinical Laboratory Improvement Amendments of 1988, 42 U.S.C. § 263a (2006).

49. Javitt & Hudson, *supra* note 46, at 59-62 (discussing the various forms of regulatory oversight).

50. *Id.* at 61.

51. *Id.*

52. *Id.* at 60.

which are produced, marketed, and sold by a manufacturer—fall under FDA regulation.[53] However, in some instances FDA authority extends to LDTs, while some test kits can only be conducted in a CLIA compliant laboratory.[54] Due to this patchwork of regulations, a number of regulatory gaps exist that have allowed questionable tests to be directly marketed to consumers without physician involvement.

a) Regulations of Genetic Testing Under CLIA

Laboratories that perform genetic testing for health-related purposes must be certified by the CMS under the Clinical Laboratories Improvements Amendments of 1988 (CLIA).[55] Congress enacted CLIA to ensure that medical testing within clinical laboratories is consistently executed in a valid and reliable manner;[56] the validity of the tests themselves, however, is not under CLIA authority. The stringency of CMS oversight under CLIA depends on the complexity of the test. "High complexity" tests are generally grouped according to "specialty areas" and are subject to additional requirements to ensure safety.[57] In particular, they are subject to specified "proficiency testing" standards, where they must show their ability to accurately perform their tests.[58] There is at present no CLIA specialty area for genetic testing, and in 2007, over the protests of industry and public policy stakeholders, the CMS announced its intent to not create such a specialty.[59] The result is that, although clinical laboratories must meet specific requirements regarding the accuracy of genetic tests, there is no requirement under CLIA for genetic tests to meet standards for validity or utility regarding the interpretation of the genetic test result.[60]

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53. *Id.* at 61.

54. *Id.*

55. 42 U.S.C. § 263a.

56. *See id.*

57. *See* 42 C.F.R. § 493 (describing requirements for "high complexity" tests as well as specialty areas).

58. *See, e.g.*, Testimony of Judy Yost, Sec'y's Advisory Comm. on Genetics, Health & Soc'y, Nov. 13, 2006, http://www4.od.nih.gov/oba/SACGHS/meetings/Nov2006/transcripts/Genetic_Tech-Hamilton-Yost.pdf.

59. *See* Petition for Rulemaking from Kathy Hudson et al., Genetics & Pub. Policy Ctr., to Mark McClellan, Ctr. for Medicare & Medicaid Serv. (Sept. 26, 2006), *available at* http://www.dnapolicy.org/resources/Petition_For_Rulemaking_September_2006.pdf; Reply from Dennis Smith, Ctr. for Medicare & Medicaid Serv., to Kathy Hudson, Genetics & Pub. Policy Ctr., *available at* http://www.dnapolicy.org/resources/CMSresponse 8.15.07.pdf.

60 . *See* GENETICS & PUB. POLICY CTR., WHO REGULATES GENETIC TESTS?, (2006), http://www.dnapolicy.org/images/issuebriefpdfs/Who_Regulates_Genetic_Tests_Issue_Brief.pdf.

b) Regulation of Genetic Testing Under the FDA

While CLIA regulations cover proficiency standards of genetic-testing laboratories, the Medical Device Amendment of the Federal Food, Drug, and Cosmetic Act (FDCA) grants the FDA authority to regulate the genetic tests themselves.[61] FDA regulation categorizes genetic tests as "medical devices," which include an "article" that is "intended for use in the diagnosis of disease or other conditions, or in the cure, mitigation, treatment, or prevention of disease."[62] Medical devices that are used in laboratory analysis of human specimens are termed "in vitro diagnostic devices" (IVDs).[63] At present, the FDA regulates genetic tests as IVDs (also called "test kits") if the components of a genetic test are bundled, labeled and sold to a laboratory as a unit.[64] Under FDA regulations, IVDs must undergo successful premarket review of safety, accuracy, and utility before they may be distributed commercially.[65]

But most of the 1,400 genetic tests available today are not available as test kits. Instead, they are derived or assembled within the clinical laboratories themselves. Known as "laboratory developed tests" (LDTs), these genetic tests are developed in-house using either commercial or custom components or components laboratories create themselves. With one exception,[66] the FDA exercises "enforcement discretion" with respect to

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61. 21 U.S.C. § 360k (2006).

62. 21 U.S.C. §§ 201(h), 321(h) (2006).

63. *See* GENETICS & PUB. POLICY CTR, FDA REGULATION OF GENETIC TESTS (2006), http://www.dnapolicy.org/images/issuebriefpdfs/FDA_Regulation_of_Genetic_Test_Issue_Brief.pdf (discussing how IVDs are defined as "reagents, instruments, and systems intended for use in the diagnosis of disease or other conditions, including a determination of the state of health, in order to cure, mitigate, treat, or prevent disease or its sequelae").

64. *Id.*

65. *Id.*

66. In September 2006, the FDA released a draft guidance document addressing a subset of LDTs that the agency termed in vitro diagnostic multivariate index assays (IVDMIAs). These tests use laboratory data and an algorithm (analytical tool) to generate a result for the purpose of diagnosing, treating, or preventing disease. Examples of IVDMIA tests include those used to diagnose and guide treatment decisions for breast cancer, prostate cancer recurrence, cardiovascular disease, and Alzheimer disease. The draft guidance stated that the FDA considered IVDMIAs to be medical devices and that the FDA would require them to undergo premarket review before being marketed. The FDA issued a revised draft guidance document in July 2007. *See* FDA, DRAFT GUIDANCE FOR INDUSTRY, CLINICAL LABORATORIES, AND FDA STAFF: IN VITRO DIAGNOSTIC MULTIVARIATE INDEX ASSAYS (2007), *available at* http://www.fda.gov/cdrh/oivd/guidance/1610.pdf.

LDTs; as a result, many LDTs do not have to undergo any prior review to assess their clinical validity before clinical use. It is left to the discretion of the manufacturer or laboratory to determine whether a test will be developed as a test kit or as an LDT. As a result, about twelve of the nearly 1,400 available genetic tests have undergone FDA review as of 2008.[67] Further, the FDA has not yet officially substantiated the claimed accuracy of the majority of DTC genetic tests.[68] The absence of a cohesive regulatory system for genetic tests has left consumers vulnerable to genetic tests that have unproven medical value.

c) State Regulation of Genetic Testing

CLIA licensure was delegated by the CMS to state authorities, although some states, namely New York and Washington, have adopted standards more stringent than those required for CLIA compliance and have therefore received waivers from CLIA.[69] States also have the authority to regulate who may order genetic tests from laboratories and who may receive the results of those tests, which is particularly relevant to DTC genetic testing.[70] CLIA regulations stipulate that tests can only be ordered by and results reported to an "authorized person," though states can define for themselves who is an "authorized person."[71] Often, consumers themselves are considered "authorized persons."[72]

As of 2007, twenty-five states and the District of Columbia permit DTC testing without restriction, meaning a consumer can order a genetic test and receive his or her results directly, while thirteen states specifically prohibit it.[73] Other states are silent on the issue, effectively allowing DTC testing.[74] In states requiring a physician to order a test and receive the results, companies marketing DTC genetic testing commonly have an ar-

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67. *See id.* For a current list of clinically used genetic tests, see GeneTests Home Page, http://www.genetests.org (last visited Feb. 2, 2009).

68. *Id.*

69. Gail H. Javitt, et al., *Direct-to-Consumer Genetic Tests, Government Oversight, and the First Amendment: What the Government Can (and Can't) Do to Protect the Public's Health*, 57 OKLA. L. REV. 251, 274 (2004).

70. *Id.*

71. Aruna Prabhala, *Center Releases Analysis of State DTC Laws*, GENETICS & PUB. POL'Y CENTER NEWSL., July 2007, http://www.dnapolicy.org/news.enews.article.nocategory.php?action=detail&newsletter_id=24&article_id=100.

72. *Id.*

73. *Id.*

74. GENETICS & PUB. POLICY CTR., DIRECT-TO-CONSUMER GENETIC TESTING: EMPOWERING OR ENDANGERING THE PUBLIC? (2006), http://www.dnapolicy.org/images/issuebriefpdfs/2006_DTC_Issue_Brief.pdf .

rangement with a physician whose name is used to order tests and report results to the consumer.[75] This practice is also widespread among DTC companies selling tests over the Internet so that requirements under state regulations are met.[76] However, an affiliation with a physician does not necessarily mean that the patient receives any counseling from that physician about the meaning of the results and about future health plans.

At least two state health agencies are trying to regulate DTC genetic testing by asserting that consumers in their state can only take a genetic test with the advice of a doctor.[77] In June 2008, thirteen genetic-testing companies received warning letters from the California Department of Public Health (CDPH) ordering them to stop marketing their genetic tests to California residents without a state license or the involvement of a state-licensed physician.[78] The CDPH's letters followed similar cease-and-desist orders that the New York State Department of Health sent to thirty-one DTC genomics-services and genetic-testing companies in April.[79]

2. *Critics Argue for Physician Involvement*

The variation in state regulations of genetic testing highlights a concern that consumers are not able to interpret the results of genetic tests without the involvement of trained counselors or physicians. A 2002 report published in the Journal of American Medical Association (JAMA) argued that the complexity of the information involved in genetic tests, the lack of consensus about the clinical utility of some tests, and the complicated social context surrounding genetics all affect the appropriateness of DTC genetic testing.[80] An underlying element of these concerns is that consumers lack the requisite knowledge to make appropriate decisions on whether a test is necessary or how to interpret test results. Even clinically available tests that provide legitimate information as to an individual's ge-

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75. Adam J. Wolfberg, *Genes on the Web—Direct-to-Consumer Marketing of Genetic Testing*, 355 NEW ENG. J. MED. 543, 545 (2006).

76. *Id.*

77. *See* Pollack, *supra* note 5.

78. *Id.*

79. *Id.*

80. Sarah E. Gollust, Sara Chandros Hull & Benjamin Wilfond, *Limitations of Direct-to-Consumer Advertising for Clinical Genetic Testing*, 288 JAMA 1762, 1763 (2002).

netic predisposition can be difficult to interpret without the assistance of trained genetics specialists.[81]

The American Medical Association (AMA) voiced this concern in its 2008 position against DTC genetic testing without the personal involvement of a physician.[82] In its resolution, the AMA claimed that the complexity of many of these tests warrants proper interpretation by medical professionals.[83] Unlike a simple pregnancy test that yields a "positive" or "negative" result, or even a more complicated cholesterol test that references a "normal range" but requires interpretation in the context of other factors, results of a genetic test can be much more challenging to interpret.[84] For example, a "positive" result of a genetic test may not necessarily indicate a clinical diagnosis, but instead only reflect an increased risk for developing a disease or condition. The AMA found that DTC companies have the potential to mislead patients into thinking that the results hold significant meaning for their health.[85] Without the proper pre- and post-genetic-test counseling from a health care provider, many of these tests are at best a waste of consumers' money and at worst could lead consumers into making ill-informed health decisions.

Similar recommendations for the restriction of DTC genetic testing have been made by other groups and professional organizations. In 2007, the American College of Medical Genetics (ACMG) reaffirmed a 2004 policy that "genetic testing should be provided to the public only through the services of an appropriately qualified health care professional," and warned that "due to the complexities of genetic testing and counseling, the self-ordering of genetic tests by patients over the telephone or the Internet, and their use of genetic 'home testing' kits, is potentially harmful."[86] Even the DTC companies themselves recommend that customers consult licensed practitioners, although their recommendations often fall short of making such a consultation a prerequisite for testing.

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81. Nat'l Human Genome Research Inst., Direct to Consumer Marketing of Genetic Tests, Mar. 23, 2004, http://www.genome.gov/12010659.

82. EDWARD LANGSTON, CHAIR, AM. MED. ASS'N, REPORT OF THE BOARD OF TRUSTEES: DIRECT-TO-CONSUMER ADVERTISING AND PROVISION OF GENETIC TESTING (2008), www.ama-assn.org/ama1/pub/upload/mm/471/bot7.doc.

83. *Id.*

84. *Hearing*, *supra* note 37 (statement of Dr. Kathy Hudson, Dir. Genetics & Pub. Policy Ctr.).

85. *See* LANGSTON, *supra* note 82.

86. Am Coll. of Med. Genetics Bd. of Dir., *ACMG Statement on Direct-to-Consumer Genetic Testing*, 6 GENETICS MED. 60 (2004).

3. *Consumer Protections: Ensuring Accurate Marketing of DTC Genetic Tests*

Concern over accuracy in advertising focuses on claims surrounding the interpretation of genetic results, rather than the results themselves. This concern arises from a broad range of underlying causes, starting with poorly understood or exaggerated scientific findings and ranging all the way to consumer fraud. The complexity of gene-trait associations and the lack of concise federal regulations add to this issue, as there is no industry standard to determine when a genetic test is considered "valid."[87]

In July 2006, the Senate Special Committee on Aging held a hearing based on a year-long Government Accountability Office (GAO) investigation of DTC marketing of genetic tests, part of which involved submitting profiles to various DTC companies for diagnosis.[88] While researching four separate DTC companies, investigators posed as fourteen individual consumers, but used DNA from only two people, a forty-eight-year-old man and a nine-month-old girl.[89] Despite this, investigators received test results that were contradictory and warned of risks for various conditions for diseases such as cancer, heart disease, and "brain aging."[90] One DTC company further recommended consumers purchase "personalized" nutritional supplements at $1,200 per year, although the ingredients of such supplements were valued at only $35 per year.[91] Alan Guttmacher, deputy director of the U.S. National Human Genome Research Institute in Bethesda, Maryland, stated that "it's clear [the DTC companies] went way out ahead of the science."[92]

Issues regarding misleading or fraudulent advertising fall under the jurisdiction of the Federal Trade Commission (FTC).[93] The FTC is charged with protecting consumers against unfair or deceptive trade practices, such as false or misleading advertising claims, as authorized by the Federal

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87. Gollust, *supra* note 80.
88. *Hearing*, *supra* note 37 (testimony of Gregory Kutz, GAO).
89. *Id.*
90. *Id.*
91. *Id.*
92. Gene Russo, *Home Health Tests Are 'Genetic Horoscopes'*, 443 NATURE 497 (2006).
93. 15 U.S.C. §§ 45(a) 52 (2006); *see also* FTC Policy Statement on Deception, *appended to* In re Cliffdale Associates, Inc., 103 F.T.C. 110, 174 (1984), *available at* http://www.ftc.gov/bcp/policystmt/ad-decept.htm.

Trade Commission Act of 1914.[94] This charge has a specific relevance in DTC genetic testing, where companies advertise their products directly to consumers without a health-care intermediary.[95] Under such authority, the FTC is in the position to check the accuracy and scientific support of DTC companies' advertising claims.[96]

The FTC has asserted jurisdiction against manufacturers of a variety of purported health products available without a prescription, including companies claiming to sell products that can result in hair re-growth, cure cancer, or cause weight loss.[97] As many DTC genetic testing services are sold over the Internet, the FTC has asserted its jurisdiction to take action against genetic test advertising that is false or misleading. The FTC conducts periodic sweeps of the Internet to detect fraudulent health claims and sends warnings to those companies in violation.[98] The FTC also initiated a joint effort with the FDA and NIH to identify appropriate targets for legal action.[99] Finally, in 2006, the FTC released a consumer alert titled "At Home Genetic Tests: A Healthy Dose of Skepticism May Be the Best Prescription."[100] This alert warned consumers about companies that claim they can measure the risk for specific diseases, offer "customized" dietary or health recommendations, suggest that certain consumers may be able to withstand certain risks such as smoking or diet, or give information about how a patient may respond to certain prescription drugs.[101]

The FTC's ability to enforce the Federal Trade Commission Act is limited by a few factors. First, the relatively small size of the agency and its scarce resources have forced the FTC to use enforcement discretion in identifying which advertising claims to pursue.[102] The agency has restricted its pursuits to blatantly false claims and health products whose false advertising would cause concrete harm to a large number of people. Operation Cure.all, an FTC enforcement and consumer education campaign, conducted periodic sweeps of the Internet to detect fraudulent

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94. Federal Trade Commission Act of 1914, 15 U.S.C. §§ 41-58 (2006).
95. GENETICS & PUB. POLICY CTR., *supra* note 71.
96. *Id.*
97. Javitt & Hudson, *supra* note 46 at 65.
98. *Id.*
99. *Id.*
100. FTC, AT-HOME GENETIC TESTS: A HEALTHY DOSE OF SKEPTICISM MAY BE THE BEST PRESCRIPTION (2006), *available at* http://www.ftc.gov/bcp/edu/pubs/consumer/health/hea02.pdf.
101. *Id.* at 3.
102. Javitt & Hudson, *supra* note 46 at 65.

health claims and sent warnings to companies in violation.[103] Until now, however, the FTC appears to have taken no legal action against any genetic test advertisements, even those that would appear clearly false and misleading on their face.

In addition, the FTC's ability to enforce the Federal Trade Commission Act is limited since the boundary between what is truthful and what is misleading is not clear. The First Amendment provides broad protection for commercial speech,[104] and the government bears a high burden in proving that speech is harmful and that restrictions are needed to mitigate or prevent such harms.[105] First Amendment protection is afforded only to truthful commercial speech about a lawful activity, but the Supreme Court has provided little guidance in determining what constitutes misleading commercial speech.[106] Even in circumstances in which the Court has identified commercial speech as potentially misleading, the remedy is usually additional disclosure, such as warning labels, instead of an entire ban on the speech.[107]

B. The DTC Companies' Responses

Criticisms discussed in this Note—lack of clear regulatory authority, importance of physician involvement, and accuracy in advertising claims—have been met with a broad range of responses from DTC genetic testing companies. In the absence of clear federal regulations, many DTC companies have made efforts to comply with state CLIA certification requirements and some have instituted a grading system to reflect the scientific confidence in genetic tests.[108] Further, many DTC companies have employed a trained genetic counselor to either assist with the interpretation of test results or to help guide consumers in understanding the significance of their outcomes.[109] Finally, many companies take a caveat emp-

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103. Press Release, FTC, "Operation Cure.all" Targets Internet Health Fraud (June 24, 1999), *available at* http://www.ftc.gov/opa/1999/06/opcureall.shtm.

104. *See* 44 Liquormart, Inc. v. Rhode Island, 517 U.S. 484 (1996); Florida Bar v. Went For It, Inc., 515 U.S. 618 (1995); Rubin v. Coors Brewing Co., 514 U.S. 476 (1995).

105. Javitt et al., *supra* note 69 at 287.

106. *Id.* at 254.

107. *Id.* at 298.

108. *See* discussion *infra* Sections II.B.1-2.

109. *Id.*

tor stance, stating that they have fulfilled their duty to disclose, and that consumers actually have a right to know their genetic information.[110]

1. *Many DTC Companies Institute Their Own Genetic Test Rating System*

While many DTC genetic testing services operating today are CLIA compliant, CLIA itself does not explain how to determine which genetic tests are scientifically valid.[111] DTC services have met this concern in varying manners. Some services, such as 23andME, take an all-inclusive, transparent approach by disclosing the limits of genetic testing, accompanied by a reliability rating or a "research confidence" index, based upon the number and size of the cohort studies.[112] The highest possible rating is "4-stars" and requires multiple cohort studies of 1000 individuals or more.[113] Other DTC services take a "black-box" strategy, exemplified by deCODEme's enigmatic statement in their FAQ section, that "[t]he information provided by the deCODEme website is as reliable as the statistics of the scientific studies that our calculations are based on."[114] But deCODEme augments this black-box approach by employing a higher level of selectivity in what it reports to the consumer, stating that it "only reports risk based on well-validated genetic variants" and that "[t]o include risk estimates based on unverified variants, that have only marginal evidence behind them, is unjustified and scientifically unsound."[115]

The measures taken by these DTC companies do not address the underlying lack of an industry-wide threshold for what constitutes a "scientifically sound" gene-trait association. Issues such as multi-gene factors, rarity of alleles, and population sampling[116] can make it hard to understand gene-trait associations.[117] In 2007, for example, an independent advisory board to the CDC studied the interaction between CYP450 and the metabolism of a class of antidepressant drugs, the selective seratonin reuptake inhibitors (SSRIs). As there was an established interaction between CYP450 and SSRIs, medical professionals understood that genetic testing of the CYP450 genes should help determine the effectiveness and dosage

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110. *Id.*
111. GENETICS & PUB. POLICY CTR., *supra* note 60.
112. 23andMe Home Page, *supra* note 28.
113. *Id.*
114. *See* deCODEme Frequently Asked Questions, https://www.decodeme.com/faq (last visited Feb. 22, 2009).
115. *Id.*
116. For example, all members of a cohort might be eastern European.
117. Khoury, *supra* note 6, at 803.

requirements of certain prescriptions.[118] But the advisory committee, going against conventional understanding, found no evidence "showing that the results of CYP450 testing influenced SSRI choice or dose and improved patient outcomes".[119] At present, at least fifteen businesses continue to offer CYP450 genotyping services, with four companies making specific claims about the benefit of such testing for SSRI prescribing or dosing.[120] In the absence of an agreed upon and scientifically derived standard for describing the value of a particular genetic test, consumers will not be able to appreciate the uncertainty surrounding many gene-trait associations.

2. *Some DTC Companies Involve a Physician or Trained Genetics Expert*

DTC genetic testing services also differ in how they involve a licensed physician. Navigenics and DNA Direct, two industry leaders in the DTC genetic testing field, include a live genetic counselor to discuss results with customers.[121] They market it as a service to help consumers understand the results of their genetic tests. It is unclear, though, whether this is sufficient to inform consumers.[122]

In contrast, many companies, following state law, put the responsibility on the consumer to seek proper consultation from third-party medical professionals. DeCODEme complies with state law so that "unless the Genetic Scan is ordered under the supervision of a physician who provides appropriate counseling, the deCODEme service may omit certain genetic risk information to residents of states where providing such information is restricted."[123] When there is no state law, deCODEme informs its customers that they "must seek the advice of [their] physician or other qualified

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118. S. H. Katsanis et al., A *Case Study of Personalized Medicine*, 320 SCIENCE 53, 53-54 (2008).

119. *Id.*

120. *Id.* Inconsistencies regarding which specific CYP450 genes should actually be genotyped for each of the five SSRIs were also observed. This finding demonstrates the lack of consensus within the genetic testing community as to what genes are actually relevant to test for each SSRI. *Id.*

121. DNA Direct Home Page, http:// www.dnadirect.com; Navigenics Home Page, http://www.navigenics.com. (last visited Dec. 10, 2008).

122. *See* M. K. Cho, M. Arruda & N. A. Holtzman, *Educational Material About Genetic Tests: Does It Provide Key Information for Patients and Practitioners?*, 73 AM. J. MED. GENETICS 314 (1997).

123. deCODEme Service Agreement, http://www.decodeme.com/information/service_agreement (last visited Dec. 10, 2008).

health provider with any questions [regarding medical matters and] must not disregard professional medical advice or delay in seeking it because of the results of [the consumer's] Genetic Scan or anything [the consumer has] read on the deCODEme Site."[124]

Encouraging customers to seek a physician's advice may help DTC genetic testing companies avoid liability through the "learned intermediary" tort law defense.[125] Used primarily with prescription drugs and medical devices, the duty of care falls on the physicians, or "learned intermediaries," who are in the position to apply their prescribing power to determine whether a drug, treatment, or procedure is appropriate for a patient.[126] The Fifth Circuit stated the policy behind the doctrine as follows:

> Prescription drugs are likely to be complex medicines, esoteric in formula and varied in effect. As a medical expert, the prescribing physician can take into account the propensities of the drug, as well as the susceptibilities of his patient. . . . The choice he makes is an informed one. . . . Pharmaceutical companies then, who must warn ultimate purchasers of dangers inherent in patent drugs sold over the counter, in selling prescription drugs are required to warn only the prescribing physician, who acts as a "learned intermediary" between manufacturer and consumer.[127]

Manufacturers of prescription drugs and medical devices similarly meet their duty of care to patients by providing warnings to the prescribing physicians.[128]

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124. *Id.*

125. The learned intermediary doctrine is included within RESTATEMENT (THIRD) OF TORTS § 6(d) (1997). The learned intermediary doctrine provides that:

A prescription drug or medical device is not reasonably safe due to inadequate instructions or warnings if reasonable instructions or warnings regarding foreseeable risks of harm are not provided to:

> (1) prescribing and other health-care providers who are in a position to reduce the risks of harm in accordance with the instructions or warnings; or
>
> (2) the patient when the manufacturer knows or has reason to know that health-care providers will not be in a position to reduce the risks of harm in accordance with the instructions or warnings.

Id.

126. Pilar N. Ossario, *Product Liability for Predictive Genetic Tests*, 41 JURIMETRICS J. 239, 255 (2001).

127. Reyes v. Wyeth Labs., 498 F.2d 1264, 1276 (5th Cir. 1974).

128. *Id.*

Since the increase of DTC advertising of pharmaceuticals in the 1990s, the learned intermediary defense has been weakened by the courts as the duty to warn has been partially shifted back to drug manufacturers. In *Perez v. Wyeth Laboratories, Inc.*, a group of women sued Wyeth for injuries suffered while using the contraceptive Norplant.[129] They contended that the manufacturer failed to adequately warn them of the drug's side effects.[130] The trial court dismissed their claim under the learned intermediary doctrine, but the New Jersey Supreme Court reversed.[131] The state supreme court held that Wyeth engaged in a nationwide DTC advertising campaign targeting women, not physicians.[132] Because Wyeth had marketed their drug directly to consumers, they had a duty to properly warn consumers of the drug's adverse effects.[133]

Though still an unsettled question, a duty to inform—as well as the learned intermediary defense—may well apply to DTC genetic testing. While many DTC genetic testing services are available without a prescription, these tests are still highly complex, individualized by nature, and their results can significantly influence the health and lifestyle choices of a consumer. Many of the more severe concerns discussed by medical ethicists, such as undergoing an abortion based on prenatal genetic testing,[134] typically require a physician to administer the procedure. But lesser harms, such as consumers using genetic test results to alter their own drug regimen, can be conducted independent of a doctor's orders. Further, most practicing physicians are poorly trained in medical genetics and may be unable to effectively determine the appropriateness of a genetic test for a particular patient.[135] By marketing directly to consumers without the in-

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129. 734 A.2d 1245 (N.J. 1999).

130. *Id.* at 1248.

131. Perez, 734 A.2d 1245.

132. *Id.* at 1262.

133. *Id.*

134. Victoria Colliver, *Home DNA Tests: When You Just Have to Know*, S.F. CHRON., Aug. 21, 2007, at C1.

135. *See* Louise Wilkins-Haug et al., *Gynecologists' Training, Knowledge and Experiences in Genetics: A Survey*, 95 OBSTETRICS & GYNECOLOGY 421, 424 (2000) (reporting that 65% of gynecologists responded that they had received no formal training in the use of molecular genetic tests); *see also* A. Hunter et al., *Physician Knowledge and Attitudes Towards Molecular Genetic (DNA) Testing of Their Patients*, 53 CLINICAL GENETICS 447, 450 (1998) (finding that 57% of physicians were neutral or uncertain about their ability to counsel patients about cystic fibrosis risks based on genetic test results, and that over half of physicians surveyed were neutral or uncertain about their abilities to counsel patients about risks for common genetic disorders).

volvement of a physician or trained counselor, the duty to warn of the risks associated with genetic testing could fall to the DTC companies themselves.

At least one industry leader has taken a publicly defiant approach regarding the ability of consumers to interpret their own genetic test results. 23andMe, a leader in the DTC industry, has argued that individual autonomy has made knowledge of one's own genes a right.[136] In their public policy statement, 23andMe states:

> Genetic information is a fundamental element of a person's body, identity and individuality. As such, the rights that people enjoy with regard to financial, medical and other forms of personal information should apply to genetic information as well. . . . We believe our customers are capable of understanding the context of the information we provide them. We also think the benefits our customers accrue in accessing their genetic information outweigh potential risks.[137]

This argument, however, is only partially valid in the given context. As discussed above in Section I.I.C, DTC companies not only report on a customer's genes but also interpret the results for them. Customers receive not only their specific genetic makeup but also receive indices describing their risk for heart attack, cancer, and a host of other genetically-linked diseases.[138] This service goes beyond providing information for consumers and ventures into the realm of medical advice.

III. DISCUSSION

This Note has so far discussed three core concerns around DTC genetic testing. First, regulatory gaps offer little control over scientific standards on how to determine which genetic tests should and should not be marketed to individuals.[139] Second, administering test results without proper guidance from a trained health-care practitioner could lead to misapplication of the results, increasing the risk to the consumer.[140] Third, consumer protections are ineffective against false or misleading advertising and are ineffective at ensuring consumers understand the limits to genetic tests.[141]

136. 23andMe Policy Forum, *supra* note 47.
137. *Id.*
138. *See* 23andMe, *supra* note 28.
139. *See supra* Section II.A.1.
140. *See supra* Section II.A.2.
141. *See supra* Section II.A.3.

These issues not only pose risks to individuals, but also create an environment that could threaten the growth of an industry with powerful health and scientific potential. DTC testing companies have taken steps toward meeting the concerns of critics, but these efforts have been incomplete and ad hoc.

There are at least two approaches for safeguarding against these risks. The first is through improving government oversight of both medical genetic testing and DTC genetic testing. A fundamental element of this strategy is developing a transparent method for assessing and communicating the scientific validity of available genetic tests. Adopting validity standards would facilitate the development of comprehensive regulations, whether through existing authorities or new legislation. The second approach is through industry self-regulation. In this approach, industry must adopt scientific standards for genetic tests and improve communication with consumers. These two approaches are not mutually exclusive and can be used in conjunction with one another. Thus, it may be in the best interest of the DTC industry itself to impose reasonable regulation in the near future in order to limit its tort liability.

A. Improving Government Oversight of DTC Genetic Testing

The role of relevant government authorities—CMS, FDA and FTC—in the regulation of genetic testing is poorly defined. A number of stakeholder groups and the authors of pending legislation have all expressed the need for a transparent and robust approval process for genetic tests. But no regulatory authority can effectively develop an approval process without a uniform mechanism for assessing the accuracy, quality, and utility of genetic tests.

1. Developing Standards in Genetic Testing: the ACCE Framework

At present, the scientific support for many gene-trait associations is weak due to limited data.[142] Because of the observational nature of gene-trait association studies, the association between a single gene variant and disease state can be confounded by a number of factors, including variation in other genes, environmental exposures, population stratification, and

142. Joel N. Hirschhorn et. al., *A Comprehensive Review of Genetic Association Studies*, 4 GENETICS MED. 45, 60 (2002).

other individual differences between cases and controls.[143] Even if replicated, association studies do not necessarily imply causality.[144]

In 2004, the Centers for Disease Control and Prevention (CDC) initiated a pilot project titled "Evaluation of Genomic Applications in Practice and Prevention" (EGAPP), an independent expert panel, to expand and contextualize the term "clinical utility."[145] The project's goal is "to establish and evaluate a systematic, evidence-based process for assessing genetic tests and other applications of genomic technology in transition from research to clinical and public health practice."[146] Out of this mission, EGAPP developed a framework to evaluate the overall benefit of genetic tests based upon four criteria: (1) "the analytic utility"—the accuracy of test identifying the biomarker, (2) "the clinical validity"—the relationship between the biomarker and clinical status, (3) "the clinical utility"—the likelihood that test will lead to an improved health outcome, and (4) "the ethical, legal and social implications." This four-factor test is known as the "ACCE" framework.[147] Each of the four components contained a series of specific criteria, from which the overall benefit of the genetic tests could be determined.

Adopting the ACCE model or a similar framework to communicate the quality and validity of a genetic test is an important first step. The current oversight system does not ensure the analytic validity, clinical validity, or the clinical utility of genetic tests.[148] The development of such standard criteria would increase consumer understanding of test quality, protect consumers from erroneous results, and assist in properly conveying the nature of understanding behind a gene-trait association. Further, the adoption of such standards is likely a prerequisite for the government or industry to be able to regulate the industry.

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143. John D. Potter, *At the Interfaces of Epidemiology, Genetics and Genomics*, 2 NATURE REV. GENETICS 142-147 (2001).

144. CDC, Genetic Testing, http://www.cdc.gov/genomics/gtesting.htm (last visited Dec. 10, 2008).

145. CDC, Evaluation of Genomic Applications in Practice and Prevention Home Page, http://www.cdc.gov/genomics/gtesting/EGAPP/about.htm (last visited Dec. 10, 2008).

146. *Id.*

147. CDC, ACCE Framework, http://www.cdc.gov/genomics/gtesting/ACCE.htm (last visited Dec. 10, 2008).

148. GENETICS & PUB. POLICY CTR., *supra* note 60.

B. Enforcing Accuracy Standards in Genetic Testing Through CLIA

Once a standard for assessing test validity has been established, the development of effective federal regulation would require two measures. First, CMS must develop a CLIA specialty area for genetic testing to ensure proficiency testing of genetic tests, appropriate quality control standards, and to maintain accuracy in testing.[149] The failure of CMS to create a genetic testing specialty has resulted in inadequate federal oversight of the laboratories conducting genetic tests.[150] As the number of new genetic testing technologies continues to increase, the need to ensure that laboratories properly use these advances grows.[151] By creating a CMS genetic test specialty focused on key quality requirements[152] and proficiency standards for laboratory personnel, CMS would help ensure that both medical and DTC genetic testing are conducted accurately and consistently.

This approach is not without support. In May 2000, CMS published a Notice of Intent in the Federal Register regarding the development of a genetic specialty area under CLIA.[153] Of the fifty-seven responses received, 93% supported the recommendation.[154] In September 2006, three nonprofit centers, Johns Hopkins University's Genetics & Public Policy Center, Public Citizen, and Genetic Alliance, filed a Citizen Petition asking CMS to strengthen its oversight of genetic tests by creating a genetic testing specialty, concluding:

> Making sure that laboratories can accurately and reliably perform genetic tests is a fundamental requirement for the success of genetic medicine, and a fundamental obligation of CMS under CLIA . . . [B]ecause of CMS' inattention regarding laboratories performing genetic tests, neither health care providers nor consumers can be confident in the oversight mechanisms in place to

149. JULI MURPHY, GAIL JAVITT & KATHY HUDSON, CREATING A GENETIC TESTING SPECIALTY UNDER CLIA: WHAT ARE WE WAITING FOR? (Genetics & Pub. Policy Ctr. 2006), http://www.dnapolicy.org/resources/McClellanpaper.pdf.

150. *Id.* at 3.

151. *Id.*

152. For example, test accuracy and clinical validity criteria would be similar to the criteria described under the ACCE framework.

153. Notice of Intent, 65 Fed. Reg. 25928 (May 4, 2000).

154. *Id.*

> ensure that laboratories performing genetic tests provide accurate and reliable test results.[155]

Despite the community support, however, CMS stated it no longer intends to create such a specialty. In its response to the citizen petition, issued August 15, 2007, CMS cited both technical challenges and cost-effectiveness as justifications for not developing standards for genetics proficiency testing.[156]

C. Enforcing Validity and Utility Standards of Genetic Testing Through the FDA

In addition to creating a CMS specialty area for genetic testing, effective federal regulation must involve the FDA. FDA oversight should extend to LDTs as medical devices, including both pre- and post-market evidence made available to the public, but should set separate standards for tests with medical purposes and those with nonmedical purposes.[157] The FDA could classify a submission as deficient if it relies on unverified science or does not adequately summarize the peer-reviewed literature. Although very few genetic tests on the market or currently under development have been regulated as medical devices,[158] the FDA's current—and still evolving—policy shows that previously unregulated diagnostics could require FDA approval before marketing.[159] This requirement would address the uncertain scientific evidence behind most genetic tests, dealing with both the clinical validity and clinical utility considerations under the ACCE framework.

FDA standards should consider the complexity and the intended use of the results of any given test. In particular, tests that provide medical information should be held to a higher standard than those that provide nonmedical information. Standards should be determined with the input of both industry experts and professional organizations, and should aim to minimize both the time and cost of review. To avoid overly cautious regulatory burdens, higher review standards should only apply to those tests which may convey a medical outcome, but not for those for which the ap-

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155. Petition for Rulemaking from Kathy Hudson, *supra* note 59, at 17.

156. Reply from Dennis Smith, *supra* note 59.

157. "Nonmedical" purposes in this context refers to genetic testing that convey no direct health risks or implications, such as ancestral DNA testing, paternity testing, and genotyping for certain personality or physical characteristics such as eye color.

158. *See e.g.*, GeneTests Home Page, http://genetests.org (last visited Dec. 10, 2008).

159. *See* FDA, DRUG-DIAGNOSTIC CO-DEVELOPMENT CONCEPT PAPER (2005), *available at* http://www.fda.gov/Cder/genomics/pharmacoconceptfn.pdf.

plication is education, nonmedical, or entertainment.[160] For example, DTC genetic tests which describe predisposition for hypertension should meet a higher standard of validity and utility, while a genetic test that conveys information such as ancestry may be required to meet a more relaxed standard.

The adoption of this tiered approach to genetic testing standards would assist the FTC in pursuing claims of false or misleading advertising in genetic testing. The FTC's limited personnel poses a practical concern, however: the FTC does not have the in-house expertise able to properly understand the nuances of technical claims. This challenges its ability to prioritize possible transgressors and pursue them.[161] By developing targeted scientific standards and clear-cut regulation requirements through the FDA and CMS/CLIA, the FTC will more easily be able to identify DTC companies that are making claims unsupported by scientific understanding.

D. Proposed Legislation for Further Regulation of DTC Genetic Testing

In instances where regulatory agencies are unable or unwilling to act, legislation may be necessary. Two bills currently proposed in Congress could significantly mitigate the concerns regarding genetic testing. The Genomics and Personalized Medicine Act of 2007,[162] introduced by then-Senator Obama, and the Laboratory Test Improvement Act of 2007,[163] introduced by Senator Kennedy, both call upon CMS to create a CLIA specialty category for genetic testing. This would mark an important change in current regulations, as current CLIA requirements only provide oversight to the laboratories themselves but do not require specific proficiency requirements for genetic tests. Creating a specialty category for genetic tests within CLIA would ensure that genetic testing is carried out in a reli-

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160. Karl V. Voelkerding, *Finding a Workable Balance: Regulation of Genetic Testing in the Human Genome Era*, 2 J. MOLECULAR DIAGNOSTICS 57 (2000)

161. Nat'l Human Genome Inst., Workshop Summary: Direct to Consumer (DTC) Advertising of Genetic Tests, Welcome and Introductions (Mar. 23, 2004), http://www.genome.gov/12010660.

162. S. 976, 110th Cong. (2007) (proposing the creation of an interagency working group, the development of a national biobank for the collection of genomic data, and an increase in genetics and genomics training).

163. S. 736, 110th Cong. (2007) (deeming laboratory tests to be devices for the purposes of regulation, requiring public disclosure concerning the tests, and requiring reporting of direct-to-consumer genetic tests under 21 U.S.C. § 360k).

able and consistent manner, thereby enhancing the significance of the test results.

Outside of alterations to CLIA, the two bills take markedly different approaches towards genetic testing oversight. The first and more comprehensive one is the Kennedy Laboratory Improvement Act, which would require laboratories performing LDTs to be registered with the FDA and to submit data demonstrating the analytical and clinical validity of the tests.[164] Some tests under the bill would only be obtainable through a licensed physician, posing a strict regulation on many DTC firms.[165] In addition, the impact of the bill would be much broader than current regulations, affecting *any* test performed by a laboratory, including LDTs.[166] To date, the Senate has not taken action on this measure.

Taking a more reserved approach, the Genomics and Personalized Medicine Act would create a formalized working group to first solicit outside expert advice before finalizing any specific regulation.[167] The bill authorizes a new interagency working group and the Institute of Medicine to study issues including analytic validity, clinical validity, and clinical utility. They would then make recommendations to Congress on these key issues.[168] Once the report is submitted, the Secretary is to develop and propose a decision matrix to help labs and other test makers know which types of tests require which level of review and who is responsible for the review—CMS, the FDA, or both.[169] The bill also requests a study by the National Academies of Sciences on incentives to stimulate advances in designing and developing new genetic testing technologies.[170] This measure could take great strides in developing a framework to assess the scientific and clinical value of genetic tests, an area not fully covered by CMS or FDA regulation.

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164. *Id.*
165. *Id.*
166. *Senator Kennedy introduces the Laboratory Test Improvement Act*, GENETICS & PUB. POL'Y CENTER NEWSL., Mar. 2007, *available at* http://www.dnapolicy.org/news.enews.article.nocategory.php?action=detail&newsletter_id=20&article_id=78.
167. S. 976, 110th Cong. (2007).
168. *Id.*
169. *Id.*
170. *Id.*

E. Instituting Industry Self Regulation to Diminish Consumer Risk

Consumer risk can also be significantly decreased through appropriate industry self regulation. Such regulation would first need an agreed-upon standard for communicating the quality and risks of genetic tests. As discussed above in Section II.II.B.1, current DTC testing services employ varying methods to communicate the scientific confidence behind genetic tests, ranging from a community-based review to a "black box" standard. DTC companies should inform consumers in an understandable fashion as to the sensitivity, specificity, and predictive value of a genetic test, including the scientific evidence on which any claims of benefit are based.

Coordinated efforts at self-regulation in this area may convince legislators that overt regulation is unnecessary.[171] But more formal regulation would eventually be required to resolve regulatory confusion of LDTs and test kits—particularly in the area of DTC genetic testing.[172] Industry self-regulation only provides preliminary protection of consumer privacy of personal information; it does not foster standards that would ensure the accuracy of marketing claims and the efficacy of tests. Proper policing is best addressed through government agency regulation.

The argument for self regulation is, in part, one of industry self protection as well. As discussed above in Section II.II.B.2, DTC companies have not acknowledged a duty to warn customers. For two reasons, the duty to warn may well fall on the shoulders of the DTC genetic testing companies. First, the learned-intermediary rule contains an exception in the case of over-the-counter drugs. Under this exception, the duty to warn the consumer of any hazards or recommended precautions associated with over-the-counter drugs rests with the manufacturer.[173] Similarly, as DTC genetic tests are made available directly to the consumers without a trained intermediary, the duty to warn customers of potential hazards may rest with the DTC genetic testing service.

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171. Bryn William-Jones, *Where There's a Web, There's a Way: Commercial Genetic Testing and the Internet*, 6 COMMUNITY GENETICS 46, 53 (2003).

172. *Id.*

173. *E.g.*, Plummer v. Lederle Laboratories, 819 F.2d 349, 355-56 (2d Cir. 1987) (applying California law); *In re* Rezulin Prod. Liab. Litig., 133 F. Supp. 2d 272, 282 (S.D.N.Y. 2001) (applying Mississippi law); Stone v. Smith, Kline & French Lab., 447 So.2d 1301, 1305 (Ala. 1984); Torsiello v. Whitehall Lab., 398 A.2d 132, 138 (N.J. Super. App. Div. 1979).

Second, internet-based DTC genetic testing undermines the health professional's role as gatekeeper and mediator of complex health technologies. Because there is little or no opportunity for the type of personalized support typically provided by physicians or genetic counselors, consumers may be left psychologically unprepared to deal with potentially traumatizing genetic test results.

While the physical risks associated with genetic testing are small, there are other risks, such as privacy, confidentiality, and security threats, and these could lead to emotional, social, and financial consequences. For example, while recently passed legislation prohibits the use of genetic information for discriminatory purposes by health insurers and employers,[174] no regulations currently prevent the use of genetic information in life insurance policies or for the purposes of law enforcement. Further, while DTC companies who compile genetic databases claim to "de-identify" genetic information before disclosing that information to a third party for research purposes,[175] whether that is in fact possible is unclear.[176] Finally, the physical security of the genetic information is also at risk of theft, just like social security numbers or credit card information.[177]

For its part, one leader in the DTC genetic testing industry has taken a proactive stance in developing industry-wide standards.[178] On April 8, 2008, Navigenics announced that it will develop a set of industry standards for consumer genomic testing services, and that it will consult with the many stakeholders involved.[179] Among the ten standards for performance criteria were validity, accuracy and quality, clinical relevance, actionability, and access to genetic counseling.[180] These criteria address

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174. Genetic Information Nondiscrimination Act of 2008, Pub. L. No. 110-233, 122 Stat. 881 (to be codified in scattered sections of 29 and 42 U.S.C.).

175. *See, e.g.*, 23andMe Privacy Statement, *supra* note 38.

176. *See* Amy L. McGuire & Richard A. Gibbs, *Genetics: No-Longer De-Identified*, 312 SCIENCE 370-371 (2006) (discussing challenges in de-identifying genetic material); *see also DNA Databases Shut After Identities Compromised*, NATURE NEWS, Sept. 3, 2008, http://www.nature.com/news/2008/080903/full/455013a.html?s=news_rss.

177. Victoria Lambert, *DNA Database: Will Your DNA Get Lost, Too?*, DAILY TELEGRAPH, Nov. 28, 2008, at 27; *see also* David Migoya, *Stolen State Database Puts 1.4 Million at ID-Theft Risk*, DENVER POST, Nov. 3, 2006, at 1.

178. *Navigenics Proposes Standards for Personal Genomics Services, Coupled With Prospective Outcomes Studies, to Safeguard Consumers Company Acts to 'Ensure the Integrity of This Critical Step Toward Personalized Health Care,'* REUTERS, Apr. 8, 2008, http://www.reuters.com/article/pressRelease/idUS100153+08-Apr-2008+PRN20080408.

179. *Id.*

180. *Id.*

many concerns of DTC testing and could serve as the foundation for effectively reducing consumer risk.

IV. CONCLUSION

The science of genetic testing is advancing at a rapid pace, but the lack of regulation in this field could put individuals at risk. Marketing genetic tests directly to consumers allows companies to bypass what little oversight exists, avoid accountability for their advertising claims, and provide consumers with genetic information without counseling from doctors. The first step in reducing this risk is to develop scientific standards that communicate the quality and value of particular genetic tests. Tighter government oversight requires clear regulatory authority by CLIA or the FDA. In addition, industry self-regulation could address these concerns and protect the DTC companies from possible liability. Responsible regulations will help ensure that the DTC industry does not move at a faster pace than the science can support and will promote the growth of this exciting field.

ADDITIONAL DEVELOPMENTS—PATENT LAW

PROVERIS SCIENTIFIC CORP. V. INNOVASYSTEMS, INC.

536 F.3d 1256 (Fed. Cir. 2008)

The United States Court of Appeals for the Federal Circuit held that the manufacture, marketing, or sale of a device used in the development of Food and Drug Administration (FDA) regulatory submissions, but not itself subject to FDA pre-market approval, is not immune from patent infringement under the "safe harbor" provision of the Hatch-Waxman Act. The court also affirmed the district court's findings of patent infringement and validity as a matter of law.

Proveris Scientific Corp. (Proveris) held U.S. Patent No. 6,785,400 (the '400 patent), which claimed an apparatus for measuring the properties of aerosol sprays widely used in drug delivery devices, such as inhalers or nasal spray pumps. Innovasystems, Inc. (Innova) manufactured a device that analyzed aerosol sprays by optical methods, and Proveris sued Innova for infringement of the '400 patent. In its defense, Innova argued that because third parties used its device to obtain data for FDA submissions, Innova was therefore protected from infringement claims under the 35 U.S.C. § 271(e)(1) Hatch-Waxman safe harbor provision. Innova also claimed that the Proveris patent was invalid. The district court disagreed, ruling as a matter of law that (1) the '400 patent was valid, (2) Innova infringed, and (3) the safe harbor did not immunize Innova's activities from patent infringement suits.

Innova appealed to the Federal Circuit. The section 271(e)(1) safe harbor provides that:

> It shall not be an act of infringement to make, use, offer to sell, or sell within the United States or import into the United States a patented invention . . . solely for uses reasonably related to the development and submission of information under a Federal law which regulates the manufacture, use, or sale of drugs or veterinary biological products.

The court explained that Congress intended section 271(e)(1) to correct the "de facto extension" of a patent term that necessarily occurs when a patentee's competitors cannot even begin the often lengthy

regulatory approval process until the patent term expires. Section 156(f) of the Hatch-Waxman Act corrects the "de facto reduction" of a patent term when the regulatory process delays the patentee's product coming to market.

The Federal Circuit therefore reasoned that a "perfect 'product' fit" between these two provisions was necessary for a party to claim the safe harbor for use of the product. Because Innova's device was not a product which required FDA pre-market approval under section 156(f), it did not constitute a "patented invention" under section 271(e)(1) and could not benefit from immunity.

Innova also failed to persuade the Federal Circuit to overturn the district court's judgment of infringement and validity as a matter of law. Innova argued that Proveris had not met its burden of proof with respect to infringement, but the court pointed out that the plaintiff and Innova's own witness had made statements during trial which Innova had not disputed, and held that Innova had therefore conceded infringement. The court also rejected Innova's argument that the testimony of its expert with regard to validity of the patent had been improperly excluded, noting that the expert had not submitted a written report.

IN RE TS TECH USA CORP.

551 F.3d 1315 (Fed. Cir. 2008)

The District Court for the Eastern District of Texas has been one of the most popular courts for patent owners to file patent infringement suits, but the Federal Circuit's ruling in *TS Tech* may lead to a decrease in the number of patent cases that the Eastern District of Texas hears. The Federal Circuit held that the Eastern District of Texas erred when it denied defendant's motion to transfer venue to a more convenient district court. The Federal Circuit reached its decision by applying recent Fifth Circuit precedent from *In re: Volkswagen.*

The patent owner, Lear Corporation, filed suit against its competitor, TS Tech, in the Eastern District of Texas, alleging infringement of a patent relating to pivotally attached vehicle headrest assemblies. Lear asserted that TS Tech induced Honda Motor Co. to infringe the patent by selling headrest assemblies throughout the United States, including in the Eastern District of Texas. Lear was a Delaware corporation with its principal place of business in Southfield, Michigan. TS Tech's offices were incorporated and had principle places of business in Ohio and Ontario, Canada.

TS Tech filed a motion to transfer venue to Southern District of Ohio pursuant to 28 U.S.C § 1404(a), which gives the district-court judge discretion to transfer the civil action to another district for the convenience of parties and witnesses and in the interest of justice. Judge T. John Ward of the Eastern District of Texas denied the motion, and TS Tech subsequently filed a petition with the Federal Circuit for a writ of mandamus.

The Federal Circuit held that the district court clearly abused its discretion because it incorrectly applied the "public" and "private" factors for determining *forum non conveniens* when deciding a § 1404(a) venue transfer question. The Federal Circuit held that the district court incorrectly evaluated the recently established Fifth Circuit factorial test in several ways. First, the district court erred by giving too much weight to plaintiff's choice of venue. The Federal Circuit stated that the plaintiff's choice of venue was not a distinct factor in the analysis because the plaintiff's choice was already taken into account via the high burden of proof on the moving party. Second, the district court ignored the cost of attendance for witnesses. The Federal Circuit stated that all of the witnesses were in Ohio, Michigan, and Canada, and that traveling 900 miles to Texas weighed in favor of transferring. Third, the district court minimized the weight of the ease of access to sources of proof. The

Federal Circuit stated that the vast majority of physical evidence was located closer to the Ohio venue, and that factor therefore weighed in favor of transferring. Finally, the district court incorrectly held that the public interest factor disfavored transfer. The Federal Circuit reasoned that the citizens of the Eastern District of Texas had no more of a meaningful connection with the case than any other venue since the alleged infringement was national.

Accordingly, the Federal Circuit held that the Eastern District of Texas abused its discretion by denying the motion to transfer to the substantially more convenient forum of Ohio. However, whether this decision gives patent infringement defendants a better opportunity to get out of certain venues remains to be seen. It will most likely depend on whether the other circuits adopt the Fifth Circuit's factorial test, and whether other courts will follow the *TS Tech* calculus in situations where the convenience of venue issue presents a closer case.

KYOCERA WIRELESS CORP. V. INTERNATIONAL TRADE COMMISSION

545 F.3d 1340 (Fed. Cir. 2008)

The United States Court of Appeals for the Federal Circuit vacated a ban against Qualcomm and third-parties from importing all products containing cell phone chips infringing upon Broadcom's patents, on the basis that the United States International Trade Commission (ITC) lacked authority under the circumstances to issue a limited exclusion order that affected third parties.

The action began when Broadcom filed a complaint in the ITC against Qualcomm alleging unfair acts in violation of section 337 of the Tariff Act of 1930, alleging that Qualcomm's chipsets infringe several of Broadcom's patents. Although the ITC determined that Qualcomm's chips did not infringe two of Broadcom's patents, an issue subject to a separate appeal, the ITC found that after the chips were programmed with battery-saving software by third-party manufacturers, Qualcomm's chips infringed Broadcom's '983 patent. Furthermore, the ITC determined that Qualcomm was liable for inducing the third-party manufacturers, who were not respondents in Broadcom's complaint, to incorporate the battery-saving software and Qualcomm's chips into their mobile devices. Accordingly, the ITC issued a limited exclusion order prohibiting the importation of handheld wireless communications devices containing Qualcomm's chipsets that are programmed to enable the power-saving features covered by the '983 patent.

Under 35 U.S.C. § 271(b), "[w]hoever actively induces infringement of a patent shall be liable as an infringer." Inducement requires the patentee to show "first that there has been a direct infringement, and second that the alleged infringer knowingly induced infringement and possessed specific intent to encourage another's infringement." The inducer must have more than just a general intent to cause the acts that produce direct infringement. It must have an affirmative intent to cause the direct infringement.

On appeal, the Federal Circuit found the ITC's finding of intent insufficient because the ITC applied the general intent standard, rather than a specific intent standard, when it determined that Qualcomm intended to induce infringement by providing its customers with the system determination code. In reaching this conclusion, the Federal Circuit concluded that Qualcomm's actions only showed that Qualcomm generally intended to cause acts that produced infringement. Accordingly,

the Federal Circuit remanded the case to the ITC to determine if Qualcomm's actions satisfied the specific intent requirement.

The Federal Circuit also determined that the ITC's limited exclusion order was inappropriate because it excluded imports of articles made by downstream manufacturers who were not named as respondents in Broadcom's initial complaint. Limited exclusion orders can only exclude articles manufactured by respondents. General exclusion orders can exclude articles manufactured by non-respondents, but the Federal Circuit found that Broadcom never attempted to prove the heightened requirements necessary to obtain a general exclusion order. A general exclusion order requires a showing of: (1) circumvention of an existing limited exclusion order, or (2) a pattern of unfair acts in import trade and a difficulty in identifying the source of infringing products. Accordingly, the Federal Circuit vacated the limited exclusion order because it affected non-respondents.

PATENT MALPRACTICE AND FEDERAL JURISDICTION

In a pair of 2007 cases, the Federal Circuit expanded its federal subject matter jurisdiction to cover state malpractice claims that hinge on issues of patent law. In *Air Measurement Technologies, Inc. v. Akin Gump Strauss Hauer & Feld, L.L.P* (*AMT*), and *Immunocept, LLC v. Fulbright & Jaworski, LLP* (*Immunocept*), the Federal Circuit reasoned that, because these malpractice claims would require the court to decide substantial issues of patent law, "arising under" jurisdiction was warranted under 28 U.S.C. § 1338. Two subsequent cases, however, have refused to find federal subject matter jurisdiction in malpractice cases. In *Eddings*, the Northern District of Texas distinguished the cases and found that a malpractice claim did not raise a substantial question of patent law. In *Singh*, the Fifth Circuit refused to follow the decisions in a trademark malpractice claim.

AIR MEASUREMENT TECHNOLOGIES, INC. V. AKIN GUMP STRAUSS HAUER & FELD, L.L.P

504 F.3d 1262 (Fed. Cir. 2007)

In *AMT*, the Federal Circuit evaluated a state malpractice claim involving the patent prosecution and subsequent litigation of a safety device for supplemental breathing apparatuses used by firefighters. In 1989, Air Measurement Technologies, Inc. (AMT) retained the law firm Akin Gump Strauss Hauer & Feld, L.L.P. (Akin Gump) to prosecute patents for the safety device technology, and concurrently marketed the prototype of the invention. In 1991, Akin Gump filed the first application for a patent on the technology, and subsequently prosecuted continuation applications on four additional patents. Beginning in 2000, AMT asserted the patents in six infringement suits in the Western District of Texas. AMT settled all six suits and collected a total of approximately $10 million.

In 2003, AMT filed a malpractice claim against Akin Gump and several other law firms in Texas state court. The claim alleged that, due to Akin Gump's negligence in prosecuting and litigating the AMT patents, AMT was forced to settle the six infringement suits for lower amounts than it would otherwise have because the patents were vulnerable to defenses of invalidity and unenforceability. Akin Gump removed the case to federal court, where AMT filed a motion to remand back to state court for lack of subject matter jurisdiction. The Western District of Texas

denied the motion in an interlocutory decision. Subsequently, Akin Gump and AMT reversed their positions, with Akin Gump moving to remand the case to state court and AMT opposing. The district court denied the motion on the ground that federal jurisdiction was appropriate under section 1338. Akin Gump appealed the decision to the Federal Circuit.

In an opinion authored by Chief Judge Paul Michel, the Federal Circuit affirmed the district court decision, holding that federal jurisdiction was appropriate because the malpractice claim required a determination of patent infringement. First, the court looked at AMT's complaint to determine whether it raised legal issues warranting federal jurisdiction. The court found that the complaint, which enumerated seven allegations of erroneous patent prosecution and litigation, warranted federal jurisdiction. In doing so, the court employed the Supreme Court's application of section 1338 in *Christianson v. Colt Industrial Operating Corp.*, which stated that federal jurisdiction applies to cases "in which a well-pleaded complaint establishes either that federal patent law creates the cause of action or that the plaintiff's right to relief necessarily depends on resolution of a substantial question of federal patent law, in that patent law is a necessary element of one of the well-pleaded claims."

Second, the court observed that, to prevail in their state malpractice claim, AMT was required to show that it would have won the six prior infringement suits but for Akin Gump's negligence. Therefore, the district court would be required to try a "case within a case" to determine the validity of the malpractice allegations. The Federal Circuit reasoned that, because the patent infringement cases presented substantial questions of patent law and the resolution of these cases weighed substantially in the determination of the malpractice case, federal jurisdiction was appropriate under section 1338 and the *Christianson* decision.

Third, the court discounted Akin Gump's argument that the Supreme Court's decision in *Grable & Sons Metal Products, Inc. v. Darue Engineering & Manufacturing* required remanding the malpractice case to state court to preserve the balance between state and federal jurisdiction. The court observed that *Grable* held that federal jurisdiction was limited to cases that involve "determining whether a 'state law claim necessarily raise[s] a stated federal issue, actually disputed and substantial, which a federal forum may entertain without disturbing any congressionally approved balance of federal and state judicial responsibilities.'" The court applied the *Grable* analysis, and found that: (1) the patent infringement cases were actual disputes involving federal issues, (2) the fact that patents are issued by a federal agency indicated a strong interest in favor of federal jurisdiction, and (3) the expertise of the federal courts in

adjudicating patent disputes suggested a compelling interest in keeping the case in federal court. Thus, the court affirmed the district court's denial of the motion to remand, and the malpractice claim remained in federal court.

IMMUNOCEPT, LLC V. FULBRIGHT & JAWORSKI, LLP
504 F.3d 1281 (Fed. Cir. 2007)

The *Immunocept* decision, published the same day and heard by the same judges as *AMT*, employed much of the same reasoning used in *AMT*. In *Immunocept*, the Federal Circuit held that, while Immunocept's state malpractice claim was barred by the statute of limitations, federal jurisdiction was appropriate because the claim was based on allegations of negligent patent prosecution. The three original inventors of Immunocept's claimed subject matter, a blood-filtration device, hired Fulbright to secure patent protection for their invention in 1996. The inventors subsequently assigned their patent rights to Immunocept, which then hired a separate attorney, Thomas Felger, to pursue additional patents based on the filtration device. Felger reviewed the original patent and file history, and, in 1999, discussed his analysis with Immunocept. In 2002, Immunocept entered negotiations with Therakos, Inc., a subsidiary of Johnson & Johnson, to bring the device to market. However, during these negotiations, Johnson & Johnson's patent attorneys determined that the closed construction of one of the patent's independent claims compromised the protection offered by the patent, and made the patent vulnerable to competing products. As a result, Therakos ended negotiations with Immunocept in April 2002.

Immunocept subsequently filed a state malpractice claim in the Western District of Texas in May 2005. Fulbright moved for summary judgment in March 2006, asserting that the claim was barred by the statute of limitations and that, as a matter of law, the damage remedy was too speculative. The district court granted this motion, and Immunocept appealed. The Federal Circuit agreed to hear the case, and instructed the parties to brief the question of federal jurisdiction under section 1338. Both Immunocept and Fulbright agreed that, under section 1338, federal jurisdiction is proper for state malpractice claims based on alleged errors in patent prosecution.

The court held that federal jurisdiction extended to Immunocept's claim, but that Immunocept's claim was barred by the statute of limitations. In the opinion, Chief Judge Michel addressed the *Christianson* and *Grable* tests for federal jurisdiction under section 1338, and found that the allegations of negligent patent prosecution satisfied these tests. The

court observed that the analysis of the scope of a patent claim involved a substantial question of patent law, and that this analysis was necessary to determine if Fulbright was negligent in drafting the claim. The court noted that, because patent infringement cases warrant federal jurisdiction under section 1338, and an evaluation of claim scope is the initial step in deciding a patent infringement claim, cases based on errors in defining a patent claim's scope must also fall under federal jurisdiction. As in *AMT*, the court noted the policies supporting the recognition of federal jurisdiction in state law claims that are based on patent law. Specifically, the court noted that the expertise of federal judges in adjudicating patent cases benefits the litigants, and that steering patent cases to the Federal Circuit is consistent with Congressional intent to standardize the application of patent law.

EDDINGS V. GLAST, PHILLIPS & MURRAY

3:07-CV-1512-L, 2008 WL 2522544 (N.D. Tex., Jun. 25, 2008)

In *Eddings v. Glast, Phillips & Murray*, the United States District Court for the Northern District of Texas held that federal jurisdiction was not appropriate for state malpractice claims. The plaintiffs sued Glast in Texas state court for negligent representation in a prior suit. Among other claims, the plaintiffs alleged that Glast had failed to timely produce evidence pertaining to development and production costs, which would have reduced the damages in the prior suit. Glast removed the case to federal court in September 2007 and the plaintiffs moved to remand to state court shortly thereafter.

The district court granted the plaintiffs' motion and remanded the case to Texas state court. The court noted that the burden of establishing federal subject matter jurisdiction rests on the party seeking to invoke it. The court held that Glast, who removed to federal court, failed to meet that burden, in part, because it completely failed to address the plaintiffs' first theory of liability—the failure to timely produce evidence pertaining to development and production costs.

The court distinguished *AMT* and *Immunocept* by stating that the plaintiffs in this case "are not required to prove that they would have succeeded on their parent infringement claims" and that the malpractice claims relate to procedural errors. In addition, the court highlighted a portion of the Federal Circuit's holding in *AMT* that stated, "[i]f there is a theory upon which [plaintiffs] can prevail on their malpractice claim that does not involve a substantial patent law question, then patent law is not essential to the malpractice claim, and § 1338 jurisdiction is lacking." The

court held that because "Plaintiff's claims do not each involve a substantial question of patent law . . . the court does not have jurisdiction. . . ."

SINGH V. DUANE MORRIS LLP

538 F.3d 334 (5th Cir. 2008)

In *Singh v. Duane Morris LLP*, the Fifth Circuit declined to adopt *AMT*'s reasoning in a trademark malpractice dispute. While the court noted that *AMT*, a patent malpractice case, was distinguishable from the *Singh* trademark malpractice case, the court admonished the Federal Circuit's *AMT* opinion for not considering the detrimental effects of its holding on federalism.

Singh, the owner of a test preparation company, sued Test Masters Educational Services, Inc. (Test Masters) over the use of the mark "Testmasters." Duane Morris represented Singh in the lawsuit. In finding for Singh, the jury determined that Singh's mark was descriptive and that he had established secondary meaning. However, despite the finding of infringement, Test Masters was not held liable because it was an innocent prior user. Both Singh and Test Masters appealed, and the Fifth Circuit reversed, holding that Singh had produced insufficient evidence to establish secondary meaning.

Singh subsequently sued Duane Morris for malpractice in Texas state court. Singh alleged that Duane Morris erred in not presenting available evidence that would have sufficiently solidified his mark's secondary meaning. Duane Morris removed the case to federal court and Singh moved to remand the case back to state court. The district court denied this motion, holding that federal jurisdiction was warranted under sections 1331, 1338, and 1651 (the All Writs Act). The court granted partial summary judgment to Duane Morris and dismissed Singh's malpractice claims on grounds of collateral estoppel and failure to supplement the evidence of secondary meaning with a Federal Rule of Civil Procedure 60(b) motion after the trademark infringement trial. Singh subsequently appealed the decision.

The Fifth Circuit vacated the district court's judgment and dismissed the appeal for lack of subject matter jurisdiction. The court held that federal jurisdiction was not appropriate under sections 1331, 1338, or 1651 because the federal issue—the secondary meaning of a mark—was not substantial. The court reasoned that the absence of any federal remedy for trademark malpractice expressed a lack of federal substantial interest in regulating attorney malpractice in trademark cases. Additionally, the

court observed that the case hinged on a question of fact—whether Singh could produce sufficient evidence of secondary meaning—rather than a federal issue of law. The court warned that the *AMT* precedent "would sweep innumerable state-law malpractice claims into federal court," disturbing "the balance between federal and state judicial responsibilities." The court refused to endorse such a "substantial usurpation of state authority" for trademark law, but acknowledged that perhaps, in patent cases, the federal interest was sufficiently substantial to require federal jurisdiction.

THE FUTURE OF BIOSIMILAR PATENT LITIGATION

As patents for commercial biologic drugs expire, new legislation is needed to establish regulations for their therapeutic equivalents to come to market. The Hatch-Waxman Act of 1984, which established the approval guidelines for generic "small-molecule" drugs, did not similarly amend the Public Health Service Act to establish the approval process for follow-on biologic products, also termed "biosimilars." There are currently four proposed pieces of legislation seeking to establish a pathway for biosimilar approval. Each of these bills contains provisions on patent litigation that would make biosimilar proceedings different than "small-molecule" generic litigation under the rules of Hatch-Waxman.

Under Hatch-Waxman, a generic company must first serve the brand manufacturer with notice 45 days before challenging non-expired patents. The brand company can decide to initiate infringement proceedings during this 45-day window. If the brand company does initiate litigation, the generic company will not be allowed to market its product until a court invalidates the patent in question or 30 months have passed since serving the notice.

This 30-month stay period is noticeably missing from all four proposed pieces of legislation on biosimilar approval. Further differences between most of the proposed pieces of legislation and Hatch-Waxman include the exchange of patent information between the brand and applicant companies and limitations on actions for declaratory judgment.

Three of the proposed biosimilar statutes would provide a system for the exchange of patent information. The Access to Life-Saving Medicine Act, introduced by Rep. Waxman, would require the brand manufacturer to provide a list of all patents relevant to the brand product at the request of a biosimilar applicant. The Pathway for Biosimilars Act, introduced by Rep. Eshoo, would mandate the exchange of patent information after the FDA submission of a biosimilar application. The Biologics Price Competition and Innovation Act of 2007, introduced by Sen. Kennedy, would also mandate exchange of patent information. Furthermore, the Kennedy bill would require good faith patent negotiations between the two parties before the brand company can file an infringement action. In all of these bills the biosimilar applicant would provide the brand manufacturer notice explaining the factual and legal basis as to why the biosimilar would not infringe the brand patents.

The proposed laws would also add limitations to declaratory judgment actions in different ways. In the Waxman bill, the brand manufacturer

could not, prior to the marketing of the biosimilar drug, bring a declaratory judgment action for any patent that was not identified in the initial notice. The Eshoo bill states that the biosimilar applicant may not bring a declaratory judgment action for any patent until at least 120 days after giving notice to the brand company. Under the Kennedy bill, neither the biosimilar applicant nor the brand manufacturer can bring a declaratory judgment action prior to the notice; the brand manufacturer, however, can bring a declaratory judgment action if the biosimilar applicant fails to perform certain actions.

Any new biosimilar law will likely incorporate some of the elements from these four proposed bills. As a result, there will likely be substantially different patent-litigation procedures for biosimilars than there are for small molecule drugs under Hatch-Waxman.

NEW PTO RULES OF ETHICS

Fed. Reg. Vol. 73, No. 158 (Aug. 14 2008)

The Patent and Trademark Office (PTO) recently promulgated new rules governing disciplinary investigations, disciplinary proceedings, and reinstatement to the Patent Bar. The new rules took effect on September 15, 2008.

Congress granted express authority to the PTO under 35 U.S.C. § 2(b)(2)(D) to establish regulations to govern the conduct of patent agents and attorneys who represent parties before the PTO.

The PTO published its proposed rule changes in the Federal Register on December 12, 2003. After receiving and reviewing over one hundred and sixty comments, the PTO decided to revise a number of the previously presented rules and it published a Supplemental Notice of Proposed Rule Making on February 28, 2007.

The new rules are located at 37 C.F.R. § 11 and replace a number of rules previously located at 37 C.F.R. § 10. Of particular importance to patent agents is section 11.5(b)(1), which makes clear that PTO registration alone does not authorize one to prepare opinions of validity or infringement for litigation. Also noteworthy is section 11.18(c), which provides a non-exhaustive list of sanctions the PTO Director may impose on parties that violate the duty of candor when submitting documents. For example, sanctions exist for presenting a paper for improper purpose, making frivolous legal contentions, and making factual assertions that lack evidentiary support. Practitioners should also note the new rules contained in §§ 11.19-11.61, which lay out in detail various aspects of disciplinary investigations and proceedings, including jurisdiction, sanctions, settlement, evidence, burdens of proof, and reinstatement.

The PTO announced that the purpose of adopting the new rules included affording practitioners due process, protecting the public, preserving the integrity of the Office, and maintaining high professional standards. The rules apply only prospectively.

DECLARATORY JUDGMENT DEVELOPMENTS

SONY ELECTRONICS, INC. V. GUARDIAN MEDIA TECHNOLOGIES, LTD.

497 F.3d 1271 (Fed. Cir. 2007)

CAT TECH LLC V. TUBEMASTER, INC.

528 F.3d 871 (Fed. Cir. 2008)

The United States Court of Appeals for the Federal Circuit issued two decisions addressing the standard for declaratory judgment in patent cases. These cases follow *MedImmune, Inc. v. Genentech, Inc.*, 549 U.S. 118 (2007), which held that the Federal Circuit's reasonable apprehension of suit test was not the proper standard for determining whether there is actual controversy under the Declaratory Judgment Act. Rather than fashioning a precise test, the Supreme Court in *MedImmune* required only that the facts alleged, under all the circumstances, show that there is a substantial controversy, between parties having adverse legal interests, of sufficient immediacy and reality to warrant relief.

In *Sony*, the Federal Circuit addressed whether in light of the Supreme Court's decision in *MedImmune*, a "threat of immediate litigation" is necessary for subject matter jurisdiction in declaratory judgment cases. Guardian Media Technologies, Inc. (Guardian) held patents claiming methods and devices for blocking access to certain programs on television sets. Sony Electronics, Inc., and several other electronics manufacturers (collectively "the plaintiffs"), manufactured TV sets and DVD products equipped with parental rating control technology. Guardian initiated independent licensing discussions with each of the plaintiffs, claiming that each of the manufacturer's television sets and DVD products equipped with the parental rating control technology infringed its patents. Before reaching a licensing agreement, the plaintiffs each sued Guardian for declaratory relief, and the district court consolidated the declaratory judgment actions. However, the district court dismissed the consolidated case for lack of subject matter jurisdiction, finding no "actual controversy" under the Declaratory Judgment Act because Guardian had not threatened to sue any of the plaintiffs for patent infringement and none of Guardian's actions or correspondence amounted to an implicit threat of immediate litigation.

On appeal, the Federal Circuit reversed, holding that the "actual controversy" standard was satisfied with respect to Guardian and each of the plaintiffs because the parties had taken "adverse positions" regarding infringement and validity of the patents. In particular, the Federal Circuit determined that Guardian took the position that the plaintiff manufacturers' products infringed their patents while the manufacturers took the position that they had the right to sell their products without a license from Guardian. Furthermore, the Federal Circuit held that Guardian's willingness to conduct negotiations did not prevent the plaintiffs from bringing a declaratory judgment suit.

In *Cat Tech*, the Federal Circuit examined whether the "meaningful preparation" test, the second prong of the Federal Circuit's reasonable apprehension of suit test, was still valid following *MedImmune*. Under that test, although a party need not have engaged in the actual manufacture or sale of a potentially infringing product to obtain a declaratory judgment of non-infringement, there must be a showing of "meaningful preparation" for making or using that product.

Cat Tech LLC (Cat Tech), the owner of a patent claiming a method for loading chemical reactors, sued TubeMaster, Inc. (TubeMaster) for patent infringement. TubeMaster counterclaimed, requesting declaratory judgment of noninfringement, invalidity, and unenforceability of Cat Tech's patent for certain configurations of its product, including configurations of its product not subject to the original infringement suit and not yet commercially implemented. The district court granted the motion, finding a live controversy that supported jurisdiction because TubeMaster was prepared to produce devices using those configurations as soon as it received an order with the appropriate dimensions. Cat Tech appealed, claiming that no controversy existed with regards to the configurations that were not commercially implemented, because none of those configurations had been disclosed to actual or potential customers and therefore there was no evidence that preparations had been made to advertise or sell a potentially infringing device.

The Federal Circuit affirmed the district court's jurisdiction of the declaratory judgment counterclaim, reasoning that the proper rule for determining "controversy" after *MedImmune* was to examine "all the circumstances" rather than rely on the two-prong test of "reasonable apprehension" of suit and "meaningful preparation" towards infringing activity. Acknowledging that *MedImmune* had rejected the "reasonable apprehension" prong of that test, the court ruled that the "meaningful preparation" element remained useful in considering the totality of circumstances, a factor in determining whether a declaratory judgment is

appropriate. In particular, if a declaratory judgment plaintiff has not taken significant, concrete steps to conduct infringing activity, the dispute is neither "immediate" nor "real" and the requirements for justiciability have not been met. Although TubeMaster had not manufactured any actual products, the court held that the immediacy requirement was satisfied because TubeMaster was prepared to ship such products upon receipt of customer orders. The court also found that TubeMaster did not expect to make substantial modifications to its product design, thus meeting the "reality" requirement of the test. Accordingly, the Federal Circuit concluded that the district court had not abused its discretion in allowing the declaratory counterclaim to proceed.

THE PUBLIC PERFORMANCE RIGHT IN THE DIGITAL AGE: *CARTOON NETWORK LP V. CSC HOLDINGS*

By Vivian I. Kim

Technological innovations test the boundaries and enforceability of copyright protection. New digital technologies are expanding the well-established content-providers' market for broadcast media and creating opportunities for additional revenue for distributor-provided on-demand services. The latest battle between content providers and distributors involves the introduction of centrally housed Digital Video Recorder (DVR) technology. Cablevision Systems Corporation's (Cablevision) proposed remote storage DVR (RS-DVR) would allow customers to record broadcast programming at central servers maintained by Cablevision, rather than on in-home DVR boxes which operate much like a standard video cassette recorder (VCR).[1] RS-DVR customers would access their stored programming at the central facility through a cable box equipped with the RS-DVR software.[2]

Plaintiffs, owners of copyrights in various movies and television programs, brought suit for declaratory judgment that Cablevision's RS-DVR would infringe their copyrights and for an injunction barring the implementation of the RS-DVR system.[3] The plaintiffs alleged direct infringement of their reproduction and public performance rights.[4] The parties expressly declined to raise issues of fair use or contributory infringement,[5]

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1. Cartoon Network LP v. CSC Holdings, Inc., 536 F.3d 121, 123-24 (2d Cir. 2008).

2. *Id.*

3. *See* Twentieth Century Fox Film Corp. v. Cablevision Sys. Corp., 478 F. Supp. 2d 607, 609 (S.D.N.Y. 2007), *rev'd*, *Cartoon Network*, 536 F.3d 121.

4. *Id.* at 617. The plaintiffs alleged infringement of their rights "to reproduce the copyrighted work in copies" and "to perform the copyrighted work in public," as codified in 17 U.S.C. § 106(1), (4) (2006).

5. *Id.* at 616 (stating that plaintiffs agreed by stipulation that they were asserting "only claims of direct copyright infringement, and defendants agreed that they would not assert a 'fair use' defense"). For more on the "fair use" defense, see 17 U.S.C. § 107 (2006).

which would entail proving that the end-users were the copyright infringers.[6] It appears that the plaintiffs' decision to only pursue a direct infringement claim was influenced by desires to avoid the Sony Betamax precedent and prevent the type of backlash experienced by the music industry for targeting end-users.[7]

The plaintiffs filed a complaint in the Southern District of New York in May of 2006.[8] On cross-motions for summary judgment, the trial court found in favor of the plaintiffs.[9] On August 4, 2008, the Second Circuit reversed and held Cablevision's proposed RS-DVR would not directly infringe the copyrights in broadcast programs.[10] Content providers filed for certiorari in October of 2008.[11] In January of 2009, the Supreme Court invited the Solicitor General to file a brief in this case.[12]

While it is uncertain whether the Supreme Court will grant certiorari in this case, the issues raised in *Cartoon Network LP v. CSC Holdings* (*Cartoon Network*) warrant review. The case highlights the challenges of policing copyright's traditional protections in an era of ever-more sophisticated digital technologies. Part I of this Note explains the technical features of the proposed RS-DVR system, the business model of the content industry, the relevant legal principles and judicial precedent regarding the Copyright Act. Part II outlines the district court's opinion and the Second Cir-

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6. *See* Sony Corp. of Am. v. Universal City Studios, Inc., 464 U.S. 417, 435 (1984) ("[C]ontributory infringement is merely a species of the broader problem of identifying the circumstances in which it is just to hold one individual accountable for the actions of another.").

7. *See id* at 442-56 (1984) (holding no contributory liability for manufacturer of VCR that was capable of "substantial non-infringing uses" and allowed consumers to "time-shift" programming, which constituted fair use of copyrighted television programming); *see generally* Peter S. Menell & David Nimmer, *Unwinding Sony*, 95 CALIF. L. REV. 941 (2007) (arguing that the same result could have been achieved by reliance on traditional tort principles, which would have resulted in a more sound jurisprudential framework for new technologies).

The music industry's attempts to curtail internet peer-to-peer sharing of copyrighted music by initiating suits against private individuals has led to public backlash. John Schwartz, *In Chasing Movie Pirates, Hollywood Treads Lightly*, N.Y. TIMES, Dec. 25, 2003, at C1. *See* Metro-Goldwyn-Mayer Studios Inc. v. Grokster, Ltd., 545 U.S. 913, 963 (2005) (referring to the "thousands of suits" filed by the recording industry against private individuals).

8. *Twentieth Century Fox*, 478 F. Supp. 2d at 616.

9. *Id.* at 609.

10. Cartoon Network LP v. CSC Holdings, Inc., 536 F.3d 121, 123 (2d Cir. 2008).

11. Petition for a Writ of Certiorari, Cable News Network, Inc. v. CSC Holdings, Inc., No. 08-448, 2008 WL 4484597 (U.S. Oct. 6, 2008).

12. Cable News Network, Inc. v. CSC Holdings, Inc., No. 08-448, 2009 WL 56992 (U.S. Jan. 12, 2009).

cuit's reversal. It reflects on the treatment of three key issues addressed in Section I.C: fixation, volition in regards to automated systems, and public performance. Part III focuses on the public performance right, the least well-settled of the three issues. The Part explores how the Second Circuit's public performance analysis allows Cablevision to skirt copyright liability by designing a duplicative and inefficient process. In order to avoid sending a transmission "to the public," Cablevision's system makes multiple copies, each of which can only be decrypted by *one* cable-box. Part III also identifies the source of the disjunctive logic in the Copyright Act's ambiguous definition of the word "public." It discusses two possible resolutions, one judicial and the other legislative, while warning against possible pitfalls.

I. BACKGROUND

RS-DVR technology provides the customer with the same experience as a set-top DVR box. Section I.A distinguishes the technology and operations of the proposed RS-DVR system from the standard DVR service already offered. Section I.B explores the content providers' business model in order to highlight the particular threat RS-DVR poses to their revenue stream. Section I.C discusses the three key legal issues in *Cartoon Network*: whether buffer copies are sufficiently fixed to constitute a valid copy, whether the automated buffering process qualifies as a volitional act by Cablevision or its customers, and whether the playback of individualized copies to customers' homes constitutes a public transmission.

A. Digital Video Recorder Technology

ReplayTV and TiVo introduced set-top DVR technology in 1999 at the Consumer Electronics Show in Las Vegas.[13] DVRs enable customers to record programming from an on-screen program guide, to view one channel while recording another, to watch recorded programming at a later time of their choosing, and to use special features ("trick modes") such as fast-forward, to control playback.[14] Unlike a VCR, which captures pro-

13. *See ReplayTV Wins CES 1999 'Best of Show' Award; Honor Establishes Replay Networks, Inc. as Leader in Personal Television*, BUSINESS WIRE, Jan. 6, 1999; *TiVo to Unveil 1999's Hottest Consumer Electronics Breakthrough at CES with First Public Demo of Personal Television*, BUSINESS WIRE, Jan 7, 1999.

14. *Twentieth Century Fox*, 478 F. Supp. 2d at 612. One such "trick mode," the Automatic Commercial Advance feature, resulted in legal action against ReplayTV, *see* Paramount Pictures Corp. v. ReplayTV, 298 F. Supp. 2d 921 (C.D. Cal. 2004); Press Release, ReplayTV, ReplayTV Introduces New 5500 Series with Four New Powerful Fea-

gramming from television signals and stores this data on removable magnetic tape, DVRs digitally store the captured content as data on a hard-drive.[15]

Cablevision's proposed RS-DVR offers customers the same abilities as a set-top DVR, without the need for a box in the home to store content.[16] Instead, content is remotely stored on servers at Cablevision's central facility.[17] Cablevision customers access their stored programming remotely through a standard cable box equipped with the RS-DVR software. The RS-DVR can be likened to Video-on-Demand (VOD) service, in that the subscriber uses the remote and cable equipment to request transmission of content held at the cable company's facility. The difference between RS-DVR and VOD is that RS-DVR users can only play what they have previously recorded, whereas VOD customers have access to all programs the cable company licenses specifically for VOD use.[18]

With the RS-DVR, Cablevision splits the incoming data stream containing all programming into two.[19] One stream is routed immediately from content providers to customers subscribing to that channel.[20] This stream is available for customers to view shows at the regularly scheduled time.[21] It also allows customers to record requested programming on set-top DVRs. The RS-DVR recordings are made from the second data stream.[22] This stream flows into a Broadband Media Router which buffers data while reformatting it for storage on high-capacity hard disks at Cablevision's central facility.[23]

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tures (June 10, 2003) (addressing concerns of content owners by removing the Automatic Commercial Advance feature from the 5500 series of DVR).

15. *Twentieth Century Fox*, 478 F. Supp. 2d at 611.

16. Cablevision currently offers set-top DVR service for their cable customers for an additional monthly fee. Cablevision's DVR service, "Interactive Optimum", offers recording space for 100 hours of standard definition television for an additional $9.95 a month. Optimum, Interactive Optimum, http://www.optimum.com/io/dvr/index.jsp (last visited Nov. 13, 2008).

17. *Twentieth Century Fox*, 478 F. Supp. at 612.

18. It is noteworthy that content providers have not brought suit for Video-on-Demand services, which involve similar technology, because they are already receiving additional licensing fees. This highlights the reality that the purpose of the Cablevision litigation is to prevent "value skimming" by cable companies of this new stream of revenue.

19. *Twentieth Century Fox*, 478 F. Supp. 2d at 613.

20. *Id.*

21. *Id.*

22. *Id.*

23. *Id.*

The RS-DVR system involves a series of buffers before a requested program is placed on a customer's allotted remote hard drive storage space. The first buffer, referred to as the primary ingest buffer, automatically inquires as to whether any customers have requested a particular program.[24] The primary ingest buffer holds no more than a tenth of a second of each channel's programming at any moment, which amounts to approximately three frames of video.[25] Thus, the primary ingest buffer is constantly erasing and replacing three frames of programming from each channel carried by Cablevision automatically.[26] If a customer has chosen to record a particular program, the RS-DVR system will transfer content data for that program from the primary ingest buffer to a secondary ingest buffer before being placed on the customer's hard drive storage space.[27] An individual copy of the program is made for each request, and all copies are "uniquely associated by identifiers with the set-top box of the requesting customer."[28] Thus, the recording can only be retrieved through the requesting customer's cable box, preventing other customers from gaining access to the recorded programming.[29]

Although RS-DVR technology is more complex, the customer perceives no difference between an RS-DVR and a standard DVR unit when recording or playing-back requested content. To request recording on either system, customers use the remote control to (1) navigate an on-screen program guide to schedule future programming, or (2) record programming as it is being aired.[30] To watch a recorded program, the RS-DVR customer uses the remote control and the cable box to communicate with Cablevision's playback management server.[31] Once the customer chooses a recorded program to playback, a command is sent to the customer's allocated hard-drive space where the recorded program is read into the "streaming buffer" memory.[32] The stream containing the recorded program is then "transmitted to every home in the node where the requesting customer is located, but only the requesting set-top box is provided the

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24. *Id.* at 614. Cablevision's RS-DVR "buffer" copies are equivalent to Random Access Memory (RAM) reproductions that are constantly overwritten by new data as it is processed and transmitted. *Id.* at 613; *see* David L. Hayes, *Advanced Copyright Issues on the Internet*, 7 TEX. INTELL. PROP. L.J. 1, 6-7 (1998).

25. *Twentieth Century Fox*, 478 F. Supp. 2d at 614.

26. *See id.*

27. *Id.* at 615.

28. *Id.*

29. *Id.* at 612.

30. *Id.* at 612, 614.

31. *Id.* at 615-16.

32. *Id.*

key for decrypting the stream for viewing."[33] During playback, the RS-DVR customer can use the same trick modes as set-top DVRs: pause, fast-forward, and rewind.[34]

There are some notable differences between DVR and RS-DVR systems. Unlike some set-top DVRs, the RS-DVR customer's data is limited in mobility. The RS-DVR system does not allow the recorded program to be copied onto an attached external disk drive or VCR.[35] A benefit to the set-top DVR is the local storage of recorded content. With the RS-DVR, a customer might not be able to watch their recorded programming at their desired time if there are too many customers requesting recorded content in the same node.[36] If Cablevision's system is in excess of capacity, it will send out an error message to customers.[37] Time-shifting is a central feature of any DVR service, a benefit that is lost if capacity restrictions prevent playback on-demand.

B. Effects on the Business Model of the Content Industry

The Copyright Act of 1976 aided the growth and development of cable television. The 1976 revision bill came after an impasse in 1967 over the question of copyright liability for cable companies.[38] By addressing the copyright issues attendant to the rapid growth of cable systems and developing a compulsory licensing model, Congress allowed cable television to grow without the chilling effects of uncertain copyright liability. Congress recognized the undue burden of requiring each cable system to negotiate with every copyright owner, and thus chose to create a compulsory licensing scheme.[39] In doing so, Congress was careful to avoid creating a scheme that did not comport with the rules and regulations already enforced by the FCC.[40]

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33. *Id.* "Nodes" are "smaller cable systems connecting a group of homes." *Id.* at 611.

34. *Id.* at 612, 616.

35. *Id.* at 615. If content was downloaded to a portable media player, it would implicate issues of "space-shifting," the ability to enjoy content in any desired location, in addition to "time-shifting." For a discussion of "space-shifting," see generally Adi Schnaps, *Do Consumers Have the Right to Space-Shift, as They do Time-Shift, Their Television Content? Intellectual Property Rights in the Face of New Technology*, 17 SETON HALL J. SPORTS & ENT. L. 51 (2007).

36. *Twentieth Century Fox*, 478 F. Supp. 2d at 616.

37. *Id.*

38. H.R. REP. NO. 94-1476, at 89 (1976).

39. *Id.*

40. *See id.*(noting that the amendments were not intended to affect "communications policy," such as "pay cable regulation or increased use of imported distant signals," and

At the time of enactment, Congress understood cable television systems as "commercial subscription services that pick up broadcasts of programs originated by others and retransmit them to paying subscribers."[41] The legislative history identified cable companies as "commercial enterprises whose basic retransmission operations are based on the carriage of copyrighted program material and that copyright royalties should be paid . . . to the creators of such programs."[42]

Today, however, cable television is no longer limited to homes that are beyond the reach of broadcast signals; it is found in over 58% of homes with a television set.[43] Data shows hard-drive based DVRs are gaining great popularity and DVR customers are choosing not to watch regularly scheduled programming.[44] When watching recorded shows, DVR users fast-forward or skip through commercials at a much higher rate than VCR users.[45] If this phenomenon is considered in the aggregate, it could abolish the "special market value of primetime."[46]

The ability to time-shift and use trick modes to skip commercials shakes the foundation on which television was built.[47] Content owners

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only imposed a compulsory copyright license on the signals that the FCC authorized cable systems to carry).

41. H.R. REP. NO. 94-1476, at 88.

42. H.R. REP. NO. 94-1476, at 89. The House Report recognized that cable television systems were increasingly becoming involved in content, charging additional fees for "pay-cable." H.R. REP. NO. 94-1476, at 88. Today, much of the most popular copyrighted television content is produced by cable networks. *See* Gary Levin, *Cable Shows Prove Able*, USA TODAY, Sept. 22, 2008, at 1D (noting the rise of awards received by television programs produced by cable networks); Lisa de Moraes, *Basic Ingredients: Cable Shows Join Emmy Elite*, WASH. POST, Sept. 21, 2008, at M3.

43. Introduced in the 1940s as community antenna television (CATV), cable television in the United States began as "a way of bringing broadcast signals to remote areas where they would not reach directly." Shyarmkrishna Balganesh, *The Social Costs of Property Rights in Broadcast (and Cable) Signals*, 22 BERKELEY TECH L.J. 1303, 1333 (2007) (stating that the National Cable & Telecommunications Association estimates national cable penetration levels at 58.9% as of September 2006).

44. At the end of 2007, approximately 65 million households subscribed to cable and 11 million of these subscribers used a DVR. National Cable & Telecommunications Association, 2008 Industry Overview, at 4-5, *available at* http://i.ncta.com/ncta_com/PDFs/NCTA_Annual_Report_05.16.08.pdf. *See* Matthew W. Bower, *Replaying the Betamax Case for the New Digital VCRs: Introducing Tivo to Fair Use*, 20 CARDOZO ARTS & ENT. L.J. 417, 424 (2002); *see also* Bagley & Brown, *supra* note 48, at 625 (noting TiVo has more than three million subscribers).

45. Bower, *supra* note 44, at 424.

46. Bower, *supra* note 44, at 424 (quoting Michael Lewis, *Boom Box*, N.Y. TIMES, Aug. 13, 2000, § 6 (Magazine), at 36).

47. When television technology was nascent, the network system was not "commercial" in the way we understand it today. The National Broadcasting Company (NBC) was

have shown great concern that the commercial skip and fast-forwarding features available in some of the new DVR technology could negatively affect advertising revenues.[48] However, the DVR could actually become a beneficial tool for advertisers. DVRs are part of a network which records and stores users' viewing habits. As discussed by Matthew Bower, this information could be used to provide a very complete and detailed profile of each individual user, giving advertisers the "Holy Grail" of market research.[49] Although viewers can use DVRs to skip commercials they do not like, they might willingly watch commercials perfectly tailored to their wants and needs.[50] Perhaps the development of alternative products and future income to supplant decreasing advertising revenue will prove fears about commercial skipping technology to be unfounded.[51]

Cablevision's proposed RS-DVR raises content owners' concerns that cable providers alone are capturing the value created by on-demand programming. Whatever revenue content owners sought to recapture through licensing agreements for VOD content, cable companies usurp through proliferation of DVR technology by foregoing any additional licensing agreements for those services. Advances in digital technology make RS-DVRs user-friendly and cost-effective for many cable subscribers. With increased memory capacity, RS-DVR users could potentially create a library of recorded programming which they could access on-demand.

At the heart of the litigation against Cablevision are the implications of RS-DVR on several important copyright issues. Since DVR technology undoubtedly involves digital data streams, the *Cartoon Network* decision may also have wider implications for digital content on other media channels (e.g., the Internet). The following section addresses the three central issues of fixation, volition, and public performance.

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started to encourage sales of equipment sold by its parent company, the Radio Corporation of America (RCA). Advertising was not included until the Columbia Broadcasting System (CBS), which was not in RCA's business of manufacturing and selling equipment, developed the current model: selling audiences to advertisers. *See* Steven S. Lubliner, Note, *I Can't Believe I Taped the Whole Thing: The Case Against VCRs That Zap Commercials*, 43 HASTINGS L.J. 473, 480 (1992).

48. It is noteworthy that Sonic Blue's ReplayTV 4000 generated controversy over its commercial-skip and digital-video redistribution capabilities, with 27 companies filing suit. *See* Andrew W. Bagley & Justin S. Brown, *The Broadcast Flag: Compatible with Copyright Law & Incompatible with Digital Media Consumers*, 47 IDEA 607, 632 (2007) ("One point of contention in today's DVR debate centers on consumers' new-found ability to bypass commercials during the playback of digital recordings.").

49. *Id.* at 425 (quoting Michael Lewis, *Boom Box*, N.Y. TIMES, Aug. 13, 2000, § 6 (Magazine), at 36).

50. *Id.*

51. *See* Lubliner, *supra* note 47, at 480.

C. Copyright Issues: Fixation, Volition, and Public Performance

The underlying purpose of the Copyright Act is to promote progress in the arts by granting exclusive rights to new works.[52] Section 106 of the Copyright Act grants copyright holders five exclusive rights: reproduction, adaptation, public distribution, public performance, and public display.[53] The statute assigns liability to those who infringe any of the copyright owners' exclusive rights.

Cablevision's RS-DVR technology raises three copyright questions: (i) Are the temporary copies in the buffers adequately "fixed" to constitute a violation of the copyright owner's exclusive right of reproduction? (ii) If volition is a requirement for liability, does the automated process of buffering qualify as a volitional act? (iii) Does the transmission of individualized copies to customers' homes constitute a transmission "to the public" in violation of the public performance right?

1. Fixation

A copyrighted work can be infringed by "reproducing it in whole or in any substantial part, and by duplicating it exactly or by imitation or simulation."[54] A reproduction must be sufficiently fixed to be considered a copy under the Copyright Act.[55] The fixation requirement was first expressly included in the Copyright Act of 1976, and defined as an "embodiment in a copy . . . sufficiently permanent or stable to permit it to be perceived, reproduced, or otherwise communicated for a period of more than transitory duration."[56] Congress intended to "exclude from the concept [of fixation] purely evanescent or transient reproductions such as those projected briefly on a screen, shown electronically on a television or other cathode ray tube, or captured momentarily in the 'memory' of a computer."[57]

In the digital era, it is difficult to define exactly what constitutes a sufficiently fixed copy. Digital devices must copy information into transient

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52. U.S. CONST. art. I, § 8, cl. 8.

53. 17. U.S.C. § 106 (2006). These five enumerated rights are referred to as the exclusive "bundle of rights" which comprises a copyright. The owner of a copyright can perform or authorize the activities in the bundle. *See* H.R. REP. NO. 94-1476, at 61 (1976).

54. H.R. REP. NO. 94-1476, at 61; *see also* 17 U.S.C. § 501(a) (2006) (stating that "[a]nyone who violates any of the exclusive rights of the copyright owner as provided in sections 106 through 122 . . . is an infringer").

55. 17 U.S.C. § 101 (2006).

56. 17 U.S.C. § 101.

57. H.R. REP. NO. 94-1476, at 53.

buffers in random access memory (RAM) in order to process that information.[58] If those buffer copies are considered sufficiently fixed, many digital devices could be found to be infringing copyrights.

The central fixation case for modern computer technology is *MAI Systems v. Peak Computer Inc.*, which has been widely followed although it has been criticized for its deviation from Congressional understanding of "fixation."[59] In *MAI*, a third-party computer repair service appealed an injunction preventing it from repairing computer systems when turning on the computer required copying copyrighted system software.[60] The Ninth Circuit found that loading MAI's copyrighted program to repair a customer's computer created a "copy" in the computer's RAM which amounted to a violation of copyright.[61]

In contrast, the leading treatise on copyright would have had the *MAI* court hold differently:

> In order to constitute an infringing copy . . . the embodiment of the plaintiff's work must be not only tangible (a "material object"); it must also be of some permanence. These are two separable concepts, which are not necessarily wedded. Writing in sand is tangible in form even if the next wave will erase it forever. The image that appears on a television or theater screen is embodied in a material object, but is evanescent.[62]

If transient reproductions, such as those created in RAM buffers, were considered to be sufficiently "fixed" to constitute "copies," it would radically expand copyright protection. Digital works would be subject to purposeless protection, which might chill technological innovation.[63]

In 2004, the Fourth Circuit in *CoStar Group, Inc. v. LoopNet, Inc.* held that an Internet service provider (ISP) did not create fixed copies even though temporary RAM copies were made in its service.[64] CoStar owned

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58. Brief of Amici Curiae Law Professors in Support of Defendants-Counterclaimants-Appellants and Reversal at 1, Cartoon Network LP v. CSC Holdings, Inc., 536 F.3d 121 (2d Cir. 2008) (NO. 07-1480).

59. MAI Sys. Corp. v. Peak Computer, Inc., 991 F.2d 511, 513-14 (9th Cir. 1993); Jessica Litman, *The Exclusive Right to Read*, 13 CARDOZO ARTS & ENT. L.J. 29, 40 (1994) (arguing that reading a work into computer RAM is too transitory to satisfy the definition of copy in the Copyright Act).

60. *MAI*, 991 F.2d at 513-14.

61. *Id.* at 518-19.

62. 2 MELVILLE B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT § 8.02[B][2] (2008).

63. *See* Brief of Amici Curiae Law Professors, *supra* note 58, at 2.

64. 373 F.3d 544, 550-51 (4th Cir. 2004).

copyrights to numerous photographs of commercial real estate, which customers agree not to post on their own or third-party websites.[65] LoopNet is a web hosting service that allows customers to post listings of commercial real estate on the Internet.[66] LoopNet customers must agree to "Terms and Conditions" which prohibit posting copyrighted photos without authorization.[67] In the process of uploading photos, the image file is transferred to RAM in one of LoopNet's computers for a cursory review by an employee.[68] The court stated that "[e]ven if the information and data are 'downloaded' onto the owner's RAM . . . as part of the transmission function, that downloading is a temporary, automatic response to the user's request . . . [which] would appear not to be 'fixed' in the sense that they are 'of more than transitory duration.'"[69]

For over a decade, courts and academics have debated the issue of whether fixations in RAM for ordinary computer uses are legally cognizable copies under copyright law.[70] Although lower federal courts that have considered the issue have found fixation in RAM, there is no consensus among the circuits, and the Supreme Court has yet to address the issue.[71] Due to the unsettled nature of the fixation issue, it is not clear if the copies made in Cablevision's transient primary ingest buffer constitute sufficiently "fixed" copies violating the content owners' exclusive right to reproduction. The lower court in the case answered in the affirmative, but the Second Circuit disagreed.

2. *Volition*

Copyright infringement is a strict liability tort that "does not require intent or any particular state of mind."[72] Only a party who violates the

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65. *Id.* at 546.
66. *Id.* at 546-47.
67. *Id.* at 547.
68. *Id.*
69. *Id.* at 551.
70. *Compare* MAI Sys. Corp. v. Peak Computer Inc., 991 F.2d 511, 518-19 (9th Cir. 1993) (holding RAM copies fixed), *and* Twentieth Century Fox Film Corp. v. Cablevision Sys. Corp., 487 F. Supp. 2d 607, 621-22 (S.D.N.Y. 2007) (holding RAM copies fixed), *and* Advanced Computer Servs., Inc. v. MAI Sys. Corp., 845 F. Supp. 356, 362-64 (E.D.Va. 1994) (holding RAM copies fixed), *with* Litman, *supra* note 59. *See also* Matt Jackson, *From Broadcast to Webcast: Copyright Law and Streaming Media*, 11 TEX. INTELL. PROP. L.J. 447 (2003).
71. *See generally MAI Sys. Corp.*, 991 F.2d at 511; *Twentieth Century Fox*, 487 F. Supp. 2d at 607; *Advanced Computer Servs., Inc.*, 845 F. Supp. at 356.
72. Religious Tech. Ctr. v. Netcom On-line Commc'n Servs., Inc., 907 F. Supp. 1361, 1367 (N.D. Cal. 1995).

copyright holder's exclusive rights can be a direct infringer.[73] In determining liability, courts often consider who possessed requisite volition to cause the infringing act. "Providing consumers the means by which they implement their choice[]" to copy or publicly perform unauthorized copyrighted material cannot constitute grounds for direct liability.[74]

Religious Technology Center v. Netcom On-Line Communication Services, Inc. was one of the first cases dealing with digital networks.[75] The ISP Netcom faced a direct infringement suit for hosting a customer's copyright-infringing material on their bulletin board service (BBS).[76] The court recognized that Netcom did not create or control the content available to its subscribers or monitor posted messages.[77] Netcom's activities were categorized as passive: "Where the BBS merely stores and passes along all messages sent by its subscribers and others, the BBS should not be seen as causing these works to be publicly distributed or displayed."[78] The court held that some element of volition or causation is necessary for a finding of direct infringement.[79] The requisite volition was found "lacking where a defendant's system is merely used to create a copy by a third party."[80] The court distinguished *MAI* on the grounds that Netcom's systems operate without any human intervention, thus they could not find that Netcom "caused" the temporary copying of data.[81]

The Fourth Circuit in *CoStar* also dealt with a suit against an ISP.[82] CoStar brought suit against LoopNet for infringement of CoStar's exclusive rights, regardless of whether LoopNet was acting actively or passively.[83] The court endorsed the *Netcom* decision and required volition:

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73. *See* Sony Corp. of Am. v. Universal City Studios, Inc., 464 U.S. 417, 433 (1984); *see also* Hoehling v. Universal City Studios, Inc., 618 F.2d 972 (2d Cir. 1980) (holding that a historical hypothesis was not protectable, and thus defendant was not a direct infringer).

74. Brief of Amici Curiae Center for Democracy & Technology et. al. at 9, Cartoon Network LP v. CSC Holdings, Inc., 536 F.3d 121 (2d Cir. 2008) (NO. 07-1480); *see also Sony Corp. of Am.*, 464 U.S. at 434-35.

75. *See Religious Tech. Ctr.*, 907 F. Supp. at 1365.

76. *Id.* at 1365, 1367.

77. *Id.* at 1368.

78. *Id.* at 1372.

79. *Id.* at 1370.

80. *Id.*

81. *Id.* at 1368-69.

82. The facts of this case are discussed in the "fixation" section. *See supra* Section II.C.3.

83. CoStar Group, Inc. v. LoopNet, Inc., 373 F.3d 544, 546-47 (4th Cir. 2004).

> [T]o establish direct liability . . . something more must be shown than mere ownership of a machine used by others to make illegal copies. There must be actual *infringing conduct* with a nexus sufficiently close and causal to the illegal copying that one could conclude that the *machine owner himself trespassed* on the exclusive domain of the copyright owner. . . . [A service provider] who owns an electronic facility that responds automatically to users' input is not a direct infringer.[84]

The *CoStar* court interestingly alluded to *Sony*[85] for the proposition that manufacturers of machines capable of copying are not strictly liable for infringement, even though they possess "constructive knowledge that purchasers of its machine may be using them to engage in copyright infringement."[86]

Cablevision's proposed RS-DVR involves technology designed to "automatically and uniformly" create temporary copies of all data sent through it as in *Netcom*.[87] The primary ingest buffer temporarily holds three frames of every channel sent to cable customers without the need for any human volition. Under the *Netcom* and *CoStar* precedent, Cablevision could be considered an indirect infringer who provides nothing more than a service which may have infringing uses.

3. Public Performance

The difficulty with public performance analysis is the lack of clarity in the Copyright Act as to how to determine when a performance is public.[88] Although the 1976 Act defines what constitutes a performance, the definition of a public place "has been left obfuscated by statute, legislative history, and case law."[89]

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84. *Id.* at 550 (emphasis added).

85. Sony Corp. of Am. v. Universal City Studios, Inc., 464 U.S. 417 (1984). *See also* text accompanying *supra* note 7.

86. *CoStar Group, Inc.*, 373 F.3d at 549. *See also* Metro-Goldwyn-Mayer Studios Inc. v. Grokster, Ltd., 545 U.S. 913, 960 (2005) (Breyer, J., concurring) ("[T]he producer of a technology which *permits* unlawful copying does not himself *engage* in unlawful copying.") (emphasis in original); *Sony Corp of Am.*, 464 U.S. at 439-442 ("[T]he sale of copying equipment, like the sale of other articles of commerce, does not constitute contributory infringement if the product is widely used for legitimate, unobjectionable purposes. Indeed, it need merely be capable of substantial noninfringing uses.").

87. *See* Religious Tech. Ctr. v. Netcom On-line Commc'n Servs., Inc., 907 F. Supp. 1361, 1369 (N.D. Cal. 1995).

88. *See generally* John Kheit, *Public Performance Copyrights: A Guide to Public Place Analysis*. 26 RUTGERS COMP. & TECH. L.J. 1, 11-57 (1999).

89. *Id.* at 18.

During the 1976 revision, the definition of "perform" was modified to delete the term "represent" which appeared in earlier drafts. This specific deletion excluded from the definition of "performance" the reproduction of copies within computer systems.[90] A "performance" has a communicative element that must be met to establish an infringing act: the "mere act of input into a computer or other retrieval system would not appear to be a performance, nor would other internal operations of a computer, such as the scanning of a work to determine whether it contains material the user is seeking."[91]

The growth of cable television systems raised questions about the impact on content providers' exclusive right of public performance.[92] Two cases involving suits by copyright holders to assert their exclusionary rights against cable operators served as the direct impetus for the 1976 revision:[93] *Fortnightly Corp. v. United Artists Television, Inc.*[94] and *Teleprompter Corp. v. Columbia Broadcasting System, Inc.*[95]

In *Fortnightly*, owners of copyrights in motion pictures brought suit for violation of the exclusive right to public performance against Fornightly, the owner of community antenna television (CATV) systems.[96] Fortnightly's CATV system retransmitted signals from five television stations that had obtained licenses for certain copyrighted movies.[97] However, Fortnightly itself had not entered into any licensing deals with the copyright owners and some of the licenses obtained by the stations expressly prohibited carriage of the broadcasts by CATV systems.[98] The Supreme Court rejected the Second Circuit's "quantitative contribution" standard, which considered the central question to be how much the petitioner did to bring about the viewing and hearing of a copyrighted work.[99] Rather, the Court saw the television experience as resulting from the joint activities of

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90. *See* REGISTER OF COPYRIGHTS, 89TH CONG., SUPPLEMENTARY REPORT ON THE GENERAL REVISION OF THE U.S. COPYRIGHT LAW: 1965 REVISION BILL, at 22 (House Comm. Print 1965); *see also* NIMMER & NIMMER, *supra* note 62, § 8.14[B][1], n. 29 (noting that Congress removed "represent" to clarify that imperceptible "internal operations of a computer" were not performances).

91. NIMMER & NIMMER, *supra* note 62, §8.14[B]; *see also* 2 RAYMOND T. NIMMER, LAW OF COMPUTER TECHNOLOGY §15:54 (2008).

92. *See* 17 U.S.C. §111(f) (statutory definition of "cable system"); *see also* H.R. REP. NO. 94-1476 at 99 (1976).

93. Balganesh, *supra* note 43, at 1337-40.

94. 392 U.S. 390 (1968).

95. 415 U.S. 394 (1974).

96. *Fortnightly Corp.*, 392 U.S. at 391-92, 395.

97. *Id.* at 393.

98. *Id.*

99. *Id.* at 396-97.

two groups, drawing a distinction between the broadcasters who actively perform and the passive viewers who are passive beneficiaries.[100] Likening Fortnightly to passive viewers, the Court held that defendant was not liable under the 1909 Copyright Act because CATV systems simply carry unedited programming chosen by the broadcasters.[101] CATV systems were not found to "perform" the retransmission of content, but only to do "no more than enhance[] the viewer's capacity to receive the broadcaster's signals."[102]

Six years later in *Teleprompter*, the Court again found for the defendant cable operator, holding that retransmission of distant signals did not violate content provider's copyright.[103] In this case, copyright holders of television programs brought suit against CATV systems for intercepting broadcast transmissions and retransmitting them. The Supreme Court held that importation of distant signals from one community to another did not constitute a performance under the 1909 Act.[104]

In response to the decisions in *Fortnightly* and *Teleprompter*, Congress gave copyright holders rights against cable operators in the 1976 Act. The Act's legislative history expressly addresses cable television: "[A] cable television system is performing when it retransmits the broadcast to its subscribers."[105] However, the legislative history recognizes that there is no actionable infringement unless this performance is to the public.[106] The 1976 revision defines public performance of a work as:

> (1) to perform or display it at a place open to the public or at any place where a substantial number of persons outside of a normal circle of a family and its social acquaintances is gathered; or
>
> (2) to transmit or otherwise communicate a performance or display of the work to a place specified by clause (1) or to the public, by means of any device or process, whether the members of the public capable of receiving the performance or display receive it in the same place or in separate places and at the same time or at different times.[107]

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100. *Id.* at 397-99.
101. *Id*. at 395-402.
102. *Id.* at 399-401.
103. Teleprompter Corp. v. Columbia Broad. Sys., Inc., 415 U.S. 394, 408-09 (1974).
104. *Id.* at 411-13.
105. H.R. REP. NO. 94-1476, at 63 (1976).
106. *Id.*
107. 17 U.S.C. § 101 (2006).

The legislative history reflects Congressional intent to "cover not only the initial rendition or showing, but also any further act by which that rendition or showing is transmitted or communicated to the public."[108]

Two cases illustrate the conflicting views of what constitutes a performance in the context of television. In *National Football League v. PrimeTime 24 Joint Venture*, the professional football league brought suit against a satellite carrier making unauthorized retransmissions of NFL broadcasts to their customers in Canada.[109] The satellite carrier only had statutory licenses to retransmit to customers in the United States who did not have adequate over-the-air broadcast reception.[110] PrimeTime claimed to be free from liability because U.S. copyright laws could not reach any "public" performance in Canada.[111] The Second Circuit disagreed. The court held that "a public performance or display includes each step in the process by which a protected work wends its way to the audience."[112] Therefore, PrimeTime was liable in the United States for the uplinked transmission of signals.[113]

The Ninth Circuit held the opposite in *Allarcom Pay Television, Ltd. v. General Instrument Corp.*[114] Allarcom, the exclusive provider of English-language subscription television in Western Canada, brought suit against the manufacturer of a satellite signal descrambler that allowed customers in Allarcom's service area to receive American signals.[115] The court in *Allarcom* held that copyright infringement did not occur until the signal is received by the viewing public.[116] Without a Supreme Court decision on the matter, there is no definitive resolution to the circuit split.

In addition to ambiguities about what constitutes a "performance," there is no clear definition of what constitutes a performance "to the pub-

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108. H.R. REP. NO. 94-1476, at 63.

109. 211 F.3d 10, 11 (2d Cir. 2000).

110. *Id.*

111. *Id.*

112. *Id.* at 13 (internal quotations omitted) (quoting David v. Showtime/The Movie Channel, Inc., 697 F. Supp. 752, 759 (S.D.N.Y. 1988)); *see also* Sara K. Stadler, *Performance Values*, 83 NOTRE DAME L. REV. 697, 700 (2008) (claiming that "the reach of the performance right has become so broad that it now gives copyright owners the ability to charge for access to their works . . . at each step of the process") (internal quotations omitted).

113. *Nat'l Football League*, 211 F.3d at 13.

114. 69 F.3d 381, 387 (9th Cir. 1995); *see* 1 HOWARD B. ABRAMS, LAW OF COPYRIGHT § 5:196 (2008) (stating that *Allarcom* expresses the minority view); *infra* Section III.A for a discussion of who constitutes the "public."

115. *Allarcom*, 69 F.3d at 383-84.

116. *Id.*

lic." The statutory definition of public performance lacks a physical description of a public place, instead depending on amorphous conditions which results in inconsistent interpretation by the courts. Comparing *Columbia Pictures Industries v. Redd Horne, Inc.*,[117] *Columbia Pictures Industries v. Aveco, Inc.*,[118] and *Columbia Pictures Industries v. Professional Real Estate Investors, Inc.*,[119] public place analysis appears to be more related to the court's value judgments than statutory interpretation.[120]

The Third Circuit in *Redd Horne* found that small rental booths in video stores, seating up to four, were "open to the public" for purposes of public performance analysis.[121] Customers rented the private booths for a fee but defendant's employees operated the VCRs in the front of the store. The court determined that for purposes of public place analysis, the relevant location was not the private booth but rather the entire establishment.[122]

The Third Circuit in *Aveco* found more public performances under the *Redd Horne* reasoning, this time in a video store where customers controlled the VCRs in the private rented rooms.[123] The court stated, "[the Copyright Act] does not require that the public place be actually crowded with people. A telephone booth, a taxi cab, and even a pay toilet are commonly regarded as 'open to the public,' even though they are usually occupied only by one party at a time."[124]

In contrast, *PREI* involved a hotel which rented video laser discs to hotel patrons for use with disc players located in the guest rooms.[125] Copyright owners relied on *Redd Horne* for the proposition that the relevant "place" was the entire hotel which is held "open to the public."[126] The Ninth Circuit distinguished *Redd Horne* on the ground that the nature of a hotel is the provision of living accommodations, and individuals in rented guest rooms "enjoy a substantial degree of privacy, not unlike their own homes."[127] The differing results in *PREI* and *Redd Horne* can be attributed to how the courts determine the scope of the public place and the value judgments of how much privacy one is due in certain locations.

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117. 749 F.2d 154 (3d Cir. 1984).
118. 800 F.2d 59 (3d Cir. 1986).
119. 866 F.2d 278 (9th Cir. 1989) [hereinafter *PREI*].
120. *See* Kheit, *supra* note 88, at 20-23.
121. *Redd Horne*, 749 F.2d at 157-59.
122. *Id.* at 158-59.
123. *Aveco*, 800 F.2d at 63-64.
124. *Id.* at 63.
125. *PREI*, 866 F.2d at 279.
126. *Id.* at 280-81.
127. *Id.* at 281.

The amount of flexibility in judicial interpretation of the statutory public performance right could be seen as contrary to the legal values of fairness and predictability. Part III further discusses the issues raised by the ambiguities in public performance analysis, suggesting possible judicial and legislative remedies. In order to better understand the infirmities discussed in Part III, Part II examines the lower court and Second Circuit decisions in the *Cablevision* litigation.

II. *CARTOON NETWORK LP V. CSC HOLDINGS*

Cablevision operates primarily in the New York City metropolitan area, providing customers with a variety of copyrighted programs pursuant to negotiated and statutory licenses or affiliation agreements.[128] Cablevision, like most cable companies, offers customers set-top DVR service and VOD service.[129] In March of 2006, Cablevision announced its intention to launch a RS-DVR system for its cable customers.[130] Content owners challenged the legality of the proposed service and defendants agreed not to launch the RS-DVR service pending resolution of the suit.[131]

A. Southern District of New York

Owners of copyrighted programs brought suit in the Southern District of New York for declaratory judgment that Cablevision's RS-DVR would violate copyrights and an injunction preventing them from launching the service without proper licensing.[132] On cross-motions for summary judgment, the court granted plaintiffs' motion.[133] Plaintiffs agreed to only try the direct infringement claim, and defendants agreed to not assert fair use.[134] In declaring its holding, the court evaluated two central claims raised by the plaintiffs: (1) the making of unauthorized copies, and (2) the making of unauthorized transmissions.[135]

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128. Twentieth Century Fox Film Corp. v. Cablevision Sys. Corp., 478 F. Supp. 2d 607, 610 (S.D.N.Y. 2007).

129. Cablevision receives programming for VOD pursuant to licenses negotiated with program owners. VOD content is delivered on extra channel frequencies for each customer so they can communicate with the company to control playback. *Id.* at 611.

130. *Id.* at 609.

131. *Id.* at 616.

132. *Id.* at 609.

133. *Id.*

134. *Id.* at 616.

135. *Id.* at 617.

1. Fixation

Cablevision argued that the temporary buffering was not sufficiently fixed to constitute a "copy" under the Copyright Act.[136] The district court disagreed. Noting that buffer memory was capable of being copied into the hard drive, the court found that buffer memory met the statutory requirement of fixation by being sufficiently stable to allow for reproduction.[137] Thus, the court found the buffer copies, temporary copies in RAM, sufficiently fixed to constitute a "copy."[138] In holding Cablevision liable, the court declared that "[t]he aggregate effect of the buffering that takes place in the operation of the RS-DVR can hardly be called de minimis."[139]

2. Volition

The court found that "Cablevision, and not just its customers, would be engaging in unauthorized reproductions and transmissions of plaintiffs' copyrighted programs under the RS-DVR."[140] In enjoining Cablevision's RS-DVR system, the court relied on the "ongoing relationship between Cablevision and its customers," Cablevision's ownership and maintenance of the RS-DVR equipment, and the monthly fees received by Cablevision as indicators of direct infringement.[141]

Cablevision argued that the pertinent question was not whether copies were made, but rather *who* made the copies.[142] The judge agreed with the plaintiffs' characterization of RS-DVR as a service which "requires the continuing and active involvement of Cablevision."[143] By providing the service, the court found Cablevision had the requisite volition to be held directly liable.[144] The court distinguished *Sony* by the fact that the customer did not own the equipment and using the service required a continuing relationship with Cablevision.[145] The court found "little in common" be-

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136. *Id*. at 621.

137. *Id.*; *see also* 17 U.S.C. §101 (2006) (defining "copies" as works "fixed" such that "the work can be perceived, *reproduced*, or otherwise communicated").

138. *Twentieth Century Fox*, 478 F. Supp. 2d at 621-22 (discussing MAI Sys. Corp v. Peak Computer, Inc., 991 F.2d 511, 519 (9th Cir. 1993) and its progeny, as well as U.S. COPYRIGHT OFFICE, DMCA SECTION 104 REPORT, at xxii, 110-11 (2001)).

139. *Twentieth Century Fox*, 478 F. Supp. 2d at 621.

140. *Id.* at 609.

141. *Id.*

142. *Id.* at 617.

143. *Id.* at 618.

144. *Id.*

145. *Id.* at 618-19.

tween a VCR and a RS-DVR apart from their time-shifting capabilities.[146] Instead, the court analogized Cablevision to copy centers which were directly liable for assembling copyrighted material into "coursepacks" at the behest of professors:

> Cablevision would have a similarly active role. Cablevision, through its RS-DVR, would not merely house copying machinery on its premises for customers to engage in copying. Rather, Cablevision would be "doing" the copying, notwithstanding that the copying would be done at the customer's behest, and Cablevision would provide the content being copied.[147]

The court also rejected Cablevision's reliance on cases brought against ISPs. Cablevision's "unfettered discretion in selecting programming" made available for recording was antithetical to the characterization of an ISP as a "passive conduit."[148]

3. *Public Performance*

The issue of public performance was also resolved in favor of the plaintiffs. The court held Cablevision would violate plaintiffs' public performance right by transmitting the recorded content from its central servers to the customer.[149] The court found that Cablevision's "operation of an array of computer servers at the head-end . . . actually make the retrieval and streaming . . . possible."[150]

The court rejected Cablevision's argument that any performance would be private and exclusively viewed by the customer at home.[151] Instead, the court relied on the transmit clause of section 101 of the Copyright Act to find that Cablevision transmitted the same program to "members of the public" who received the transmission at different times.[152]

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146. *Id*. at 618.

147. *Id*. at 620 (citing Basic Books, Inc. v. Kinko's Graphics Corp., 758 F. Supp. 1522 (S.D.N.Y. 1991), and Princeton Univ. Press v. Michigan Document Servs., Inc., 99 F.3d 1381 (6th Cir. 1996)).

148. *Id.*

149. *Id.* at 622-24.

150. *Id.* at 622.

151. *Id.* at 622-23.

152. 17 U.S.C. § 101 (2006) states:

> To perform or display a work "publicly" means . . . to transmit or otherwise communicate a performance or display of the work . . . to the public, by means of any device or process, whether the members of the public capable of receiving the performance or display receive it in the same place or in separate places and at the same time or at different times.

This interpretation, in addition to the commercial relationship between Cablevision and its customers, convinced the court that the transmission was one made "to the public."[153]

The court relied on *On Command Video Corp. v. Columbia Pictures Industries*,[154] for the proposition that a commercial relationship was determinative in finding a public performance.[155] In *On Command*, plaintiffs sought a declaratory judgment that their computer-controlled electronic delivery system of movies in hotels did not infringe the content provider's copyrights.[156] The centrally located bank of video cassette players (VCPs) acted as a switch and was connected by wires to televisions in every hotel room.[157] The televisions were equipped with a special microchip and allowed hotel guests to use a remote control to navigate an on-screen menu of available movies.[158] Each VCP contained a particular copyrighted work which would only be available to one guest at a time.[159] During the showing, the guest could not use any trick modes available on the VCP itself (i.e. rewind, fast-forward, or pause).[160] The court held that no public performances occurred under the public place clause of section 101 because hotel rooms were not public places, although it stated "[t]he non-public nature of the place of performance has no bearing . . . under the transmission clause."[161] Finding the lack of control over transmissions immaterial, the court held that the right to public performance was violated "because the relationship between the transmitter of the performance, On Command, and the audience, hotel guests, is a commercial, 'public' one regardless of where the viewing takes place."[162]

However, the legislative history addresses the performing rights and the "for profit" limitation.[163] Unlike the performing rights provisions in the 1909 Act which provided an outright exemption for "nonprofit" organizations, the legislative history to the 1976 Act expressly states that it "is not limited by any 'for profit' requirement."[164] The history noted blurring of the line between commercial and "nonprofit" organizations, due to the

153. *See Twentieth Century Fox*, 478 F. Supp. 2d at 623.
154. 777 F. Supp. 787 (N.D. Cal. 1991).
155. *Twentieth Century Fox*, 478 F. Supp. 2d at 623.
156. *On Command*, 777 F. Supp. at 788.
157. *Id.*
158. *Id.*.
159. *Id.*
160. *Id.*
161. *Id.* at 789-90.
162. *Id.*
163. H.R. REP. NO. 94-1476 at 62 (1976).
164. *Id.*

fact that many "nonprofit" organizations are highly subsidized and capable of paying royalties.

The district court therefore found for content providers on all three copyright issues: fixation, volition, and public performance. The court found the RS-DVR's temporary buffer memory was sufficiently fixed to meet the statutory requirement of "copy." Cablevision had sufficient volition to be directly liable, as evinced through the ongoing relationship between Cablevision and its customers, ownership and maintenance of RS-DVR equipment at Cablevision's head-end, and the monthly fees received by Cablevision. For the public performance right, the court relied on the transmit clause to find Cablevision transmitted the same program to members of the public who could view it at different times.

B. Second Circuit

Cablevision appealed the district court's grant of summary judgment to the Second Circuit, which reversed.[165] Cablevision made three arguments: (1) the brief storage during the buffering process did not qualify as a "copy" under the Copyright Act and thus did not infringe respondent's exclusive right of reproduction; (2) Cablevision did not directly infringe plaintiffs' reproduction right when the copy was played back because Cablevision did not do the copying; and (3) Cablevision did not directly infringe respondent's exclusive right of public performance by transmitting the data from the hard disks to customers.[166] The Second Circuit addressed each in turn.

1. Fixation

The Second Circuit overturned the district court's finding of infringement as to the buffer copies on the basis of fixation. The Second Circuit interpreted "copies" to have two necessary features: (1) the work must be embodied in a medium, and (2) must remain thus embodied "for a period of more than transitory duration."[167] The district court's determination that the work was "fixed" as a copy when buffered was primarily a result of limiting the analysis to the first feature.[168]

The Second Circuit disavowed *MAI*[169] and its progeny for failure to address the second requirement of fixation.[170] According to the Second

165. Cartoon Network LP v. CSC Holdings, Inc., 536 F.3d 121, 123 (2d Cir. 2008).
166. *Id.* at 125.
167. *Id.* at 127 (quoting 17 U.S.C. § 101 (2006)).
168. *Id.*
169. MAI Sys. Corp v. Peak Computer, Inc., 991 F.2d 511 (9th Cir. 1993).
170. *Cartoon Network*, 536 F.3d at 127.

Circuit, *MAI* holds that loading a program into a computer's RAM *can* result in copying but it does not necessarily always result in a copy.[171] The court similarly disregarded the Copyright Office's *DMCA Report*, which states that an embodiment is fixed "[u]nless a reproduction manifests itself so fleetingly that it cannot be copied, perceived, or communicated."[172]

Although the recording was admittedly embodied in the buffer, the Second Circuit found that the embodied works were not "fixed" as required to qualify as a "copy" under the Copyright Act because it failed to meet the duration requirement.[173] The court focused on the fact that Cablevision's buffers do not hold data for more than "a fleeting 1.2 seconds" before it is automatically overwritten.[174] The court held that any other interpretation would read the "transitory duration" language out of the Copyright statute, which would not logically explain why Congress included such language.[175]

2. *Volition*

The key question for the second challenge involving the hard drive copies was *who* made the copy.[176] The Second Circuit rejected the notion that it was Cablevision that made the copy, because it was the end-user's "volitional conduct that causes the copy to be made."[177] The only volitional conduct attributed to Cablevision was in "designing, housing, and maintaining a system that exists only to produce a copy."[178] The court analogized the Cablevision customer to the VCR user who supplies the necessary volition when pushing the record button.[179] The Second Circuit did not find "an RS-DVR customer [to be] sufficiently distinguishable from a VCR user to impose liability as a direct infringer on a different party for copies that are made automatically upon that customer's command."[180]

Similarly, the court distinguished Cablevision from copy shops assembling coursepacks.[181] A command directly issued to a system which automatically obeys was found not to be analogous to the volitional conduct of

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171. *Id.* at 128.
172. *Id.* at 129 (quoting U.S. COPYRIGHT OFFICE, DMCA SECTION 104 REPORT 111 (2001)).
173. *Id.* at 129-30.
174. *Id.* at 130.
175. *Id.* at 128-29.
176. *Id.* at 130.
177. *Id.* at 131-33.
178. *Id.* at 131.
179. *Id.*
180. *Id.*
181. *Id.*

copying by a human employee.[182] Cablevision's discretion in selecting the available programming was not deemed "sufficiently proximate" to displace the customer's volition in making the copies for liability under the Copyright Act.[183] The discretion was limited to the channels made available and not the actual programming carried by the channels or the scheduling of the programming.[184] The court referenced section 271 of the Patent Act,[185] stating that if Congress had intended to assign direct liability not only to parties that commit the infringing act, but to those that actively induce it, they had the tools to do so.[186] As the Supreme Court in *Sony* held, the lack of such language in the Copyright Act indicated that the doctrine of indirect infringement, not direct infringement, would control in these situations.[187]

3. Public Performance

Cablevision raised two arguments to counter the allegation of unauthorized public performance: (1) the customer requests the RS-DVR playback, thus it is his volition that causes the transmission and resulting performance; and (2) the transmission is not one made "to the public" under the transmit clause.[188] The Second Circuit agreed with Cablevision's second argument and held that the RS-DVR playback did not infringe the public performance right.[189]

The court did not address whether Cablevision was the volitional actor in the first proffered argument because the transmission did not constitute a public performance under the transmit clause. However, the court did note that the RS-DVR playback was a transmission of a performance copied by the customer, but this fact did not "dictate a parallel conclusion that the customer, and not Cablevision, 'performs' the copyrighted work."[190] Instead, the court found it relevant to consider who is "capable of receiving" the transmitted performance when making a determination

182. *Id.* at 131-32.
183. *Id.* at 132.
184. *Id.*
185. 35 U.S.C. § 271(a)-(c) (2006).
186. *Cartoon Network*, 536 F.3d at 133.
187. Sony Corp. of Am. v. Universal City Studios, Inc., 464 U.S. 417 (1984). *But see generally* Menell & Nimmer, *supra* note 7 (arguing that the same result could have been achieved by reliance on traditional tort principles, which would have resulted in a more sound jurisprudential framework for new technologies).
188. *Cartoon Network*, 536 F.3d at 134.
189. *Id.* at 135-39.
190. *Id.* at 134.

of whether it was made "to the public."[191] Since each RS-DVR transmission is made using a single copy of a work, made by a single subscriber, exclusively through that subscriber's cable box, the court found only that one subscriber could receive any given RS-DVR transmission.[192] According to the Second Circuit, the error of the lower court was considering the potential audience of the underlying work, not the single copy of that work, in determining the individuals who might compose the viewing public.[193]

The Second Circuit's decision does not definitively resolve the public performance issue. Part III further explores the flaws in the court's analysis and offers some possible solutions.

III. PUBLIC PERFORMANCE ANALYSIS

As technology changes, "so have the ways in which people experience copyrighted works."[194] With the 1976 revision of the Copyright Act, Congress intended to "preserve the traditional privilege of the owner of a copy to display it directly, but to place reasonable restrictions on the ability to display it indirectly in such a way that the copyright owner's market for reproduction and distribution of the copies would not be affected."[195] The plaintiffs in *Cartoon Network* contend that the court's interpretation of the 1976 Act does not adequately protect their exclusive rights of reproduction and distribution. Digital technology allows consumers to make a perfect digital copy while decreasing the difficulty and cost related to mass infringement at exact or near exact quality as the original.[196] The fear for content providers is that these infringing copies will supplant the market for their authorized content and cut them out of the value created by new technologies:

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191. *Id.* (quoting 17 U.S.C. § 101 (2006)).
192. *Id.* at 135.
193. *Id.* at 135-36.
194. Stadler, *supra* note 112, at 700.
195. H.R. REP. NO. 94-1476, at 80 (1976).
196. Schnaps, *supra* note 35, at 54-55; *see also* Bagley & Brown, *supra* note 48, at 615-17 ("Hollywood has come to fear the possibility of end-users utilizing digital video recorders . . . to produce carbon copies of over-the-air content . . . . The digital dilemma of carbon copies proliferating online threatens next-generation home movie sales, broadcast network ratings, and television content availability."). Congress had mandated that the transition from analog to digital television be completed by Feb. 17, 2009. However, the House recently voted to delay the digital transition. Brian Stelter, *House Votes to Delay Switch to Digital TV*, N.Y. TIMES, Feb. 4, 2009 (TV Decoder Blog), http://tvdecoder.blogs.nytimes.com/2009/02/04/house-votes-to-delay-switch-to-digital-tv/.

> Content owners claim the right to control (and charge for) this new application of their material. Consumers claim that it is their right to change the way in which they consume the content they have already purchased. In the end, the resolution of these competing claims will depend on balance, control, and money.[197]

It is questionable if content owners can reach a balance through the workings of the free market. Despite consumer desire for greater freedom in receiving content, "the major copyright owners do not seem to be competing among themselves to offer less restrictive terms."[198]

Cable companies are in the middle of the distribution stream between content providers and consumers. With the popularity of third-party DVR services, the only reason for cable companies to stay out of the DVR market is the fear of possible copyright liability. Under the liability scheme of the 1976 Act, a system like the RS-DVR would be liable for great sums of money if found to be infringing the content owners' copyrights. The Copyright Act provides for either actual damages and profits, or statutory damages.[199] Under the statutory scheme, there could be a penalty of up to $30,000 per infringing work or $150,000 per willful infringement.[200] In addition, the court could allow recovery of full costs and reasonable attorney's fees.[201] In the face of large penalties, companies might pursue further licenses simply to avoid possible liability. This would raise operating costs, which would likely be passed on to consumers. The greater threat is the possible chilling of innovation for new time and space-shifting technologies in the face of uncertain liability.[202]

Analysis of the public performance right in the *Cartoon Network* context centers on the ambiguity of the word "public." The judiciary or legislature can act to provide predictability in an area of copyright law with conflicting precedents. This Part discusses the pros and cons of two op-

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197. Schnaps, *supra* note 35, at 55.

198. Julie E. Cohen, *Copyright and the Perfect Curve*, 53 VAND. L. REV. 1799, 1811 (2000) (referring to the Recording Industry Association of America's aggressive litigation strategy and the Secure Digital Music Initiative which it hopes will supply perfect metering capability for digital music files).

199. 17 U.S.C. § 504 (2006).

200. 17 U.S.C. § 504(c) (2006). In the 1976 Act, the maximum penalties were $10,000 and $50,000 respectively. The Berne Convention Implementation Act of 1988 increased those maximums to $20,000 and $100,000. The Digital Theft Deterrence and Copyright Damages Improvement Act of 1999 set the current maximum amounts.

201. 17 U.S.C. § 505 (2006).

202. Jonah M. Knobler, *Performance Anxiety: The Internet and Copyright's Vanishing Performance/Distribution Distinction*, 25 CARDOZO ARTS & ENT. L.J. 531, 577 (2007).

tions to resolve the ambiguity in the 1976 Act. The judiciary could provide a definitive interpretation of the scope of the word "public," through use of essential factors such as privacy, control, and nature of the location. Alternatively, the legislature could support the use of Digital Rights Management by content owners to limit the transmission and dissemination of copyrighted content to the public. The discussion of possible solutions begins with a study of the current ambiguities in understanding who constitutes the "public."

A. Identifying the Ambiguity: The Meaning of "Public"

The legislative report for the Copyright Act of 1976 states that cable operators "perform" when transmitting a broadcast to subscribers.[203] The definitions of the words "perform," "publicly," and "transmit" make "any reception and retransmission of a copyrighted work a performance."[204] Thus, the analysis of the public performance right for Cablevision turns on the question: What makes a transmission one *to the public*? A public performance merely requires that such performance be open or available to a substantial number of people, it is not necessary that they in fact attend or receive the performance:

> [I]f a transmission is only available to one person, then it clearly fails to qualify as 'public.' For it neither directly reaches 'a substantial number of persons' nor is it transmitted to a place where such a grouping is congregated. As such it does not implicate the copyright owner's rights.[205]

The public performance framework is limited in its applicability to the digital age because it was drafted at a time when today's wide dissemination of content through digital technology was unfathomable.[206] The legal categories present in the 1976 Act do not apply to the digital age, causing difficulties in meaningful regulation of the increasingly popular markets for time and space shifting.[207] Although the applicability of the existing framework has not yet been tested for cable television, it is instructive to examine similar difficulties for sound recordings.

The Digital Performance Right in Sound Recordings Act of 1995 (DPRA) drew a distinction between the public performance right and other

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203. H.R. REP. NO. 94-1476 at 63 (1976).

204. Abrams, *supra* note 114, § 5:196.

205. *See* NIMMER & NIMMER, *supra* note 62, §8.14[C][2].

206. *See id.* §8.24[B] ("[D]igital technology produces a breakdown and conflation of legal categories that were meaningful in the analog era.").

207. *See id.* §8.24[A]. For more on time and space shifting, see Schnaps, *supra* note 35.

copyright protections, such as reproduction or public distribution.[208] The DPRA created two separate schemes, the digital transmission right for public performances and compulsory licensing for digital phonorecord delivery to deal with reproduction and public distribution.[209] However, in drafting the statutory definition of "digital phonorecord delivery," Congress "cross[ed] categories with reckless abandon."[210] It would appear that liability in the DPRA is not tethered to the results of particular action, but rather careful classification of that action.[211] Practical application shows that the conflation of the legal categories of performance and reproduction/distribution can have absurd results. If a transmission is categorized as a "delivery," it would be exempt from performance fees even if it is at the volition of a paying customer; whereas a "performance" would be exempt from mechanical royalties even if a customer "play[ed] all night long the particular song ordered."[212]

The Second Circuit's public performance analysis, as discussed *supra* in Section II.B.3, results in a similarly impractical resolution of the issue. Cablevision is allowed to skirt copyright liability in part because its inefficient process of making individualized copies for each requesting customer is deemed contrary to the court's understanding of transmission "to the public."[213] Cablevision's redundant copies serve no technological purpose; their existence appears geared to support Cablevision's legal theory that it is exempt from copyright liability.

B. Judicial Resolution: A Workable Definition of "Public"

The questionable result of the Second Circuit's holding in *Cartoon Network* can be attributed to the lack of a physical definition of public place in the Copyright Act. The statutory definition makes a place "public" based on amorphous conditions.[214] Although the definition suffices for simple cases, the courts would be hard-pressed to identify an understanding that applies to all situations.[215] Judicial precedent reveals that reliance on the statutory definition produces results that depend "completely

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208. Digital Performance Right in Sound Recordings Act of 1995, Pub. L. No. 104-39.

209. NIMMER & NIMMER, *supra* note 62, §8.24[B]

210. *Id.* (noting that the definition includes reference to delivery by digital *transmission* of a recording resulting in an identifiable *reproduction*).

211. *See id.*

212. *Id.*

213. *See* Cartoon Network LP v. CSC Holdings, Inc., 536 F.3d 121, 135 (2d Cir. 2008).

214. *See supra* Section I.C.3.

215. Kheit, *supra* note 88, at 19-21.

on the court's chosen degree of focus or quantum time span . . . ignor[ing] other important factors like privacy, lack of control, and the nature of the place; factors that help courts arrive at what people feel are intrinsically fair outcomes."[216] The judiciary should strive for predictability and certainty in the public performance analysis by setting forth a workable definition of "public."

One option is to determine whether the place is "public" through a balancing of key factors: privacy, control, and the nature of the place.[217] A place would be considered "public" if there was no privacy afforded to the consumers, no consumer control over the method or mode of consumption, and if the place was commonly known to be open to the public.[218] Although the popular understanding of the nature of the place is important, it should not determinative. A transmission viewed in a home filled with 100 people is more in line with the concerns of content owners than a performance of a work in a stadium with only one viewer. If the balancing test were to be applied to *Cartoon Network*, Cablevision's RS-DVR would not infringe the "public" performance right. The home is the paradigm of privacy and control. The owner of the home, and arguably the cable subscriber, would expect a high level of privacy in his home and would control who was able to view any performances in his home.

The statute further confuses the public performance analysis by failing to provide any useful guidelines or numeric values for how many people qualify as a "substantial" number. The legislative history states performances in "semipublic" places constitute public performances subject to copyright liability because they represent a gathering of a "substantial number of persons."[219] However, without any limits, such statements are meaningless. The issue is more complicated for purposes of demonstrating a *transmission* to the public because there is no need to prove that a substantial number of persons actually viewed the challenged transmission.

In *Cartoon Network*, the Second Circuit faulted the district court's understanding of the transmit clause for "render[ing] the 'to the public' lan-

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216. *Id.* at 26-27 (noting the inconsistent application of §101(1) to achieve the disparate results in *Redd Horne*, where a small rental booth was considered public, and *PREI*, where a hotel room was considered private).

217. *See generally*, Kheit, *supra* note 88, at 27-30.

218. *See id.*

219. H.R. REP. NO. 94-1476, at 64 (1976) (stating that contrary to *Metro-Goldwyn-Mayer Distributing Corp. v. Wyatt*, 21 C.O. Bull. 203 (D. Md. 1932), "semipublic" places include clubs, lodges, factories, summer camps, and schools but not a gathering of an individual's social acquaintances, routine meetings of businesses and governmental personnel).

guage surplusage" by not accommodating non-public transmissions.[220] The clause reads that in determining who constitutes the public, it is not the potential audience of the work, but those capable of receiving a "particular transmission of a performance."[221] The legislative history states, "a performance made available by transmission to the public at large is 'public' even though the recipients are not gathered in a single place, and even if there is no proof that any of the potential recipients was operating his receiving apparatus at the time of the transmission."[222] This statement appears to predicate its definition of the "public" on an assumption that all receiving apparatuses would be able to receive the transmission if so desired.[223]

However, the encryption of recordings in the RS-DVR service would render this discussion moot. With the RS-DVR, only the requesting customer's cable box has the necessary code to receive the specific transmission. Therefore, even though every customer that requests a particular program would receive an identical digital copy of the contents of the program, the transmission of the requested copy could only be received by the single requesting customer. The encoded transmission cannot be decrypted by any other cable box in the node where the signal is sent.[224] Under *Cartoon Network*, the seemingly duplicative process protects Cablevision from liability by excluding individual transmissions from the definition of "public" performance.[225] The customer experiences no difference between having an individual copy of a requested program and accessing the same copy as all other requesting customers. This gives cable providers incentive to design systems solely for purposes of avoiding liability.

C. Legislative Resolution: Use of DRM to Control the Public Performance Right

Judicial action is not the only option to further the goal of copyright to promote creative works. Concerns over technological advances have

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220. *Cartoon Network*, 536 F.3d at 135-36 (rejecting the lower court's reading of the transmit clause because it did not "contemplate[] the existence of non-public transmissions").

221. *Id.* at 135.

222. H.R. REP. NO. 94-1476, at 64-65.

223. *See id.*

224. *See supra* Section I.A.

225. Creating individualized copies involves multiplying storage space in the hard drive simply for the purpose of avoiding copyright liability. It would arguably be more cost efficient to have one recording for all of the requesting customers because this would decrease the amount of hard drive space necessary at Cablevision's facilities.

spurred legislative action in the past.[226] The 1976 Act was conceptualized in the broadcasting era in response to judicial decisions that highlighted the inadequacy of the 1909 Act.[227] The current Act reflects technical advances in methods for reproduction and dissemination, which changed the "business relations between authors and users."[228] With the advances of the digital age, "performance is replacing distribution as the means by which people experience copyrighted works."[229]

In altering the present tools of copyright protection, Congress must evaluate the technological evidence and the compelling policy issues. People today experience the same types of copyrighted works as in the past, but through different technology.[230] Technological differences increase the "reach of the performance right . . . turn[ing] ordinary experiences into acts with copyright significance."[231] This results in copyright owners' unprecedented rights to reach private enjoyment of content, as reflected in the now infamous dancing baby case where a 29 second home video of a toddler dancing to Prince's song was targeted for copyright infringement.[232] The convenience of digital technologies is coming at the expense of freedoms consumers took for granted.[233]

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226. In *Sony*, the four dissenting justices criticized the majority for acting outside judicial authority: "'[T]here can be no really satisfactory solution to the problem . . . until Congress acts'. . . . We must 'take the Copyright Act . . . as we find it,' and 'do as little damage as possible to traditional copyright principles . . . until the Congress legislates.'" Sony Corp. of Am. v. Universal City Studios, Inc., 464 U.S. 417, 500 (1984) (Blackmun, J., dissenting). The Act was comprehensively revised in 1831, 1870, 1909, and 1976. *See* H.R. REP. NO. 94-1476, at 47.

227. *See supra* Section II.C.3.

228. *See* H.R. REP. NO. 94-1476, at 47.

229. Stadler, *supra* note 112, at 718.

230. Plays are not limited to theatres but are now accessible to friends and family through YouTube; music at parties comes from recordings, not live bands; television is not limited to the home but can be watched on a personal media player on the bus. *See id. at* 727.

231. *Id.* at 727-28.

232. Lenz v. Universal Music Corp., 572 F. Supp. 2d 1150, 1152 (N.D. Cal., 2008) (Lenz claimed post was for private use of sharing son's dancing with friends and family).

233. Stadler, *supra* note 112, at 736. The use of digital rights management technology, such as the encryption protecting downloads from Apple's iTunes service, limited consumer ability to freely experience a purchased work. *See, e.g.*, Apple, I-Tunes Store Terms and Conditions, http://www.apple.com/legal/itunes/us/service.html (last visited Dec. 5, 2008) (limiting the number of times consumers can burn physical copies of purchased songs). However, Apple recently announced that they will no longer be imposing DRM controls. Eliot Van Buskirk, *iTunes Music Store Finally Ditches DRM, Adds New Prices*, WIRED, Jan. 6, 2009 (Listening Post Blog, http://blog.wired.com/business/2009/01/apple-promises.html).

Congress could act to enable use of Digital Rights Management (DRM) technologies, specifically the abandoned Broadcast Flags, for television content.[234] The popularity of consumer-controlled content mediums evinces consumer desire to use the emerging technologies to receive content when and where they desire.[235] The current state of performance rights encourage copyright owners to avoid providing the public with tangible copies, in favor of charging royalties for each experience of the work.[236] DRM can give copyright owners control over what features can be used in conjunction with DVR technology. The greater the number of consumer experiences enabled, the higher the pricing for copyrighted content.[237]

DRM could be an effective enforcement tool because the Digital Millennium Copyright Act's (DMCA) Anti-Circumvention clause gives copyright holders the right to sue anyone who circumvents copyright protection measures.[238] In *Cartoon Network*, the cable provider profited from enabling their DVR customers to record all transmitted programming without any additional licensing deals with content owners for providing the service. With the use of DRM, content owners could encrypt the digital transmissions sent to the cable providers in order to prevent unapproved copying. Content owners could subject cable companies to additional li-

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234. Consumers who do not wish to have any constraints on their content would pay more than consumers who receive content with use limitations.

235. There has been a proliferation of new technologies that are vying for customers who desire to time-shift and space-shift content: YouTube, Slingbox, Hulu.com, Justin.tv, mobiTV, video iPod, etc. The increasing popularity of these services could render the debate over DVR technology moot.

236. Stadler, *supra* note 112, at 735 (noting a gradual shift in consumer preferences from ownership to "convenience," i.e. with "on demand" services). There is concern that widespread use of DRM technology would not preserve valuable copyright protections for fair use, though this topic is not covered in this Note. For further discussion of fair use, see generally Bagley & Brown, *supra* note 48.

237. *See* Stadler, *supra* note 112, at 743-44. There are several possible categories for price discrimination within DVR service which were not available for traditional works, and could provide additional profits for content providers. DVR technology could be modified to allow for price discrimination based on ability to use "trick modes," ability to "space shift" content by copying it to a portable hard disk device (i.e. video iPod), difference in quality of the programming (i.e. high definition, or blu-ray quality content), time restraints on how long a program can remain stored in a DVR, and viewing restraints on the number of times the recorded program can be accessed.

238. *See* 17 U.S.C. §§ 1201, 1203 (2006).

censing fees to receive DRM-free programming signals, which would allow the RS-DVR system to work as designed.[239]

With congressional support, content owners could control their copyrighted works through a DRM technology known as the Broadcast Flag. In 2003, content owners successfully lobbied the Federal Communications Commission (FCC) to mandate a Broadcast Flag which required consumer electronic devices that receive television signals to obey instructions embedded in broadcast signals that limit a viewer's ability to make use of the content received.[240] Although the Court of Appeals for the D.C. Circuit invalidated the FCC's Order in 2005 for lack of jurisdiction,[241] they could be a viable solution through congressional expansion of the FCC's jurisdiction.[242] Particular restrictions of a transmitting party could be based in contract law and DRM technology could be used to implement the contractually agreed-upon restrictions.[243]

The use of DRM to protect creative content is an imperfect solution to end-user desires for unrestricted consumption of copyrighted works. However, the system would allow content owners to capture the value of their creative works, while giving consumers the option to pay for use of the features available through new technologies. If this system is implemented, content owners could price the new features exorbitantly as to effectively deny their use. In order to prevent such counterproductive behavior, an independent body such as the FCC could set limits on pricing. The problem of ambiguity does not have to be resolved solely by one branch of government, cooperation with interested private parties can faithfully promote the goals of copyright: the progress of science and the promotion of the useful arts.

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239. Arguably, controlling cable providers, instead of end users, avoids the formidable Fourth Amendment barriers to investigating individual infringement of the DMCA. U.S. CONST. amend. IV.

240. Bagley & Brown, *supra* note 48, at 608-09; *see generally* Digital Broadcast Content Protection, 18 F.C.C.R. 23, 550 (2003).

241. Am. Library Ass'n v. FCC, 406 F.3d 689, 691-92 (D.C. Cir. 2005) (noting that the FCC has "never before asserted such sweeping authority" to regulate apparatuses "not engaged in the process of receiving a broadcast transmission").

242. *See generally* Molly Shaffer Van Houweling, *Communications' Copyright Policy*, 4 J. ON TELECOMM & HIGH TECH. L. 97 (2005).

243. *See* Knobler, *supra* note 202, at 591. A price discrimination model would allow for unrestricted content at a higher price. For more on the possible use of price discrimination, see Michael J. Meurer, *Copyright Law and Price Discrimination*, 23 CARDOZO L. REV. 55 (2001) and Cohen, *supra* note 198.

IV. CONCLUSION

The issue of public performance is becoming increasingly controversial. The Supreme Court has never interpreted the public performance provisions of the 1976 Act. If certiorari is granted in this case, there could soon be a definitive answer on the issues of fixation, volition, and public performance.

However, the judiciary is not the only body capable of resolving the copyright issues arising from the proliferation of digital technologies. Congress could empower copyright holders to use DRM technologies, such as Broadcast Flags, to increase control over how consumers enjoy copyrighted content. The resolution of the case in favor of Cablevision could herald similar automated technologies from other cable companies, further jeopardizing the content owner's exclusive rights.[244] Public performance is but one issue that is implicated by digital technologies. Positive action needs to be taken in order to dispel ambiguities in the current Act and support the continued growth of digital technology.

If the government fails to act, content owners can focus their efforts on modifying their business models to capitalize on the new technology:[245] "[I]f history is a predictor of future potential, past content owners' fears of technological advances have eventually been dispelled upon their acceptance of the technology as a possible lucrative new market."[246] The positive potential for DVR technology can be compared to the effects of VCR technology on content industries. Hollywood feared collapse after the *Sony* Betamax decision. However, what damage the studios may have sustained from the consumers who time-shifted live shows was clearly offset by huge profits based on the technology they fought against.[247] "Not long after the Court's ruling, the fact that one could . . . record television programs without penalty was taken for granted by all parties involved."[248]

It appears inevitable that consumer demand will force the current content-provider business model to change. Whether the change comes from

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244. It has been reported that Comcast and Time Warner Cable are also planning to introduce a networked DVR service if Cablevision wins its legal battles. Verizon, which offers TV service through its Fios service, has also said it would consider offering a similar service. Marguerite Reardon, *Supreme Court Declines to Hear Cable DVR Case*, CNET, Jan. 13, 2009, http://news.cnet.com/8301-1023_3-10141706-93.html?tag=mncol.

245. *See generally* Timothy Wu, *Copyright's Communications Policy*, 103 MICH. L. REV. 278, 343-57 (2004) (discussing copyright holders and advances in technology).

246. Schnaps, *supra* note 35, at 85.

247. Bower, *supra* note 44, at 419.

248. *Id.*

the judiciary, the legislature, or content providers, new lines need to be drawn to give effect to copyright protections. The lack of clear liability can chill innovation, contrary to the primary goals of copyright law. A concerted effort must follow in order to impose the rule of law in the digital realm.

JACOBSEN V. KATZER: THE FEDERAL CIRCUIT WEIGHS IN ON THE ENFORCEABILITY OF FREE AND OPEN SOURCE SOFTWARE LICENSES

By Hersh R. Reddy

"Open Source" and "Free Software" are terms that elicit strong opinions from both the software industry and the legal profession. Proponents of open source attribute its openness and collaborative workflow for the creation of more robust software packages at a low overall cost to society.[1] On the other hand, some extreme opponents of open source claim that it usurps the constitutional provisions for the promotion of intellectual property by the use of "viral" licenses that forcibly open up proprietary systems.[2]

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1. *See, e.g.*, ERIC STEVEN RAYMOND, THE CATHEDRAL AND THE BAZAAR (3d ed. 2002), http://www.catb.org/~esr/writings/cathedral-bazaar/cathedral-bazaar/.

> Many people (especially those who politically distrust free markets) would expect a culture of self-directed egoists to be fragmented, territorial, wasteful, secretive, and hostile. But this expectation is clearly falsified by (to give just one example) the stunning variety, quality, and depth of Linux documentation. It is a hallowed given that programmers *hate* documenting; how is it, then, that Linux hackers generate so much documentation? Evidently Linux's free market in egoboo works better to produce virtuous, other-directed behavior than the massively-funded documentation shops of commercial software producers.

Id. at http://www.catb.org/~esr/writings/cathedral-bazaar/cathedral-bazaar/ar01s11.html.

2. *See* Letter from Dan McBride, President & CEO, The SCO Group, Inc., Open Letter on Copyrights (Dec. 4, 2003), http://www.sco.com/copyright/

> However, there is a group of software developers in the United States, and other parts of the world, that do not believe in the approach to copyright protection mandated by Congress. In the past 20 years, the Free Software Foundation and others in the Open Source software movement have set out to actively and intentionally undermine the U.S. and European systems of copyrights and patents. Leaders of the FSF have spent great efforts, written numerous articles and sometimes enforced the provisions of the GPL as part of a deeply held belief in the need to undermine or eliminate software patent and copyright laws.

Id.

The Federal Circuit acknowledged the former view in *Jacobsen v. Katzer*.[3] In *Jacobsen* an open source licensor sued an alleged infringer who had appropriated material from the open source project without adhering to the terms of the public license.[4] In holding for the defendant and alleged infringer, the District Court interpreted the specific open source license at issue (known as the Artistic License) as granting a right to use the copyrighted material, encumbered only by contractual covenants, but not preconditions.[5] The Federal Circuit reversed and held that the license had several preconditions to its grant.[6] In doing so, the Federal Circuit explicitly acknowledged the value that open source projects bring to society[7] and reaffirmed the copyright holder's freedom to license his property on his own terms.[8] The holding also confirmed the enforceability of open source licenses under copyright law. Ultimately, however, the scope of the *Jacobsen* decision may be limited by the emphasis placed by the court on contract construction. Since contract law varies from jurisdiction to jurisdiction, *Jacobsen v. Katzer* cannot stand for the universal enforceability of the Artistic License, let alone open source licenses in general.

This Note examines the Federal Circuit's *Jacobsen* decision. Part I provides a brief background on open source software and explains the important role copyright law plays in protecting the incentives that drive the creation of open source. Part II explores the legal background on the issues that the Federal Circuit relied on in its decision, including: (1) the difference between a bare license and a contract, (2) the implications of treating an open source license as a contract, (3) the remedies that are typically pursued by open source licensors, and (4) why licensors prefer copyright remedies to contract remedies. Part III concludes with a discussion of the implications of this decision and why it may be less important outside of California than many open source advocates hope.

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3. Jacobsen v. Katzer, 535 F.3d 1373, 1378-79 (Fed. Cir. 2008).

4. *Id.* at 1376.

5. Jacobsen v. Katzer, No. C 06-01905 JSW, 2007 WL 2358628, at *6-7 (N.D. Cal. Aug. 17, 2007).

6. *Jacobsen*, 535 F.3d at 1381-82.

7. *Id.* at 1378 (noting the 1,800 MIT courses available at OpenCourseWare, the 100,000,000 works licensed under Creative Commons licenses, the GNU/Linux operating system, Firefox web browser, PERL programming language, Apache web server, and the 9,000,000 articles of Wikipedia).

8. *Id.* at 1381-82.

I. BACKGROUND

The appeal in *Jacobsen v. Katzer* garnered a great deal of attention, despite being a fairly straightforward copyright license dispute, because the specific license at issue in the case was not a standard copyright agreement—it was an open source license known as the Artistic License. *Jacobsen* represents the first time a U.S. court has opined on the enforceability of an open source license.

This Part provides a brief background on open source, which gives necessary context to the case. Section I.A is a description of open source and how it provides an alternative software development model to proprietary software. Section I.B describes some of the motivations that drive open source developers and examines various incentives, which play an important part in making open source a viable software development model. This lays a background for section I.C, which explains why copyright protection is necessary to protect the incentives and motivations that drive open source development.

A. Open Source

"Open Source" and "Free Software" have precise definitions promulgated by open source advocacy groups,[9] but perhaps their most defining

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9. Though most people are quite sure what they mean when they call something "Open Source" or "Free Software," the official definitions are sometimes a surprise. The terms "Free Software" and "Open Source Software" are often used interchangeably, but they have slightly different meanings. GNU, one of the better known Free Software groups, famous for the GNU/Linux operating system, defines Free Software as software which provides users with four freedoms:

1. The freedom to run the program, for any purpose.
2. The freedom to study how the program works, and adapt it to your needs. Access to the source code is a precondition for this.
3. The freedom to redistribute copies so you can help your neighbor.
4. The freedom to improve the program, and release your improvements to the public, so that the whole community benefits. Access to the source code is a precondition for this.

GNU.org, The Free Software Definition, http://www.gnu.org/philosophy/free-sw.html (last visited Apr. 14, 2009).

The Open Source Initiative, a public interest organization, maintains the Open Source Definition, which details ten criteria that must be met before a software package can be called "Open Source." Many of the criteria overlap with the four freedoms listed by the Free Software foundation, but there are at least two nontrivial departures. First, the Open Source Definition requires that any Open Source license "must not place restrictions on other software that is distributed along with the licensed software. For example, the license must not insist that all other programs distributed on the same medium must be open-source software." And second, the definition requires that "[t]he license must allow modifications and derived works, and must allow them to be distributed under the same

characteristic is that they make source code available to the general public.[10] Source code is the human-readable version of software, which is used to construct software applications.[11] Most proprietary software packages provide only a machine-readable "executable" to their users, while the human-readable source is kept secret to prevent duplication by would-be competitors.[12] The executable is sufficient to run the application and take advantage of its features, but the lack of source code prevents users from fixing bugs or making modifications on their own—or at least it prevents the implementation of these changes in a practical or efficient way. The freedom to access the source code of one's software applications gives users the ability to fix or customize their own software.[13]

At first glance this may seem like a freedom that is not terribly important, akin perhaps to the freedom that one has to modify one's automobile engine—a freedom that even when given to the public, is rarely exercised. However, software source freedom is fundamentally different from other freedoms to tinker.

Tinkering with and modifying software is a cumulative activity across the entire community of users. Once an improvement is made, as long as everyone has access to the software source code, anyone can incorporate the change. These changes, when aggregated across a large population of developers—though they may be of varying skill levels—can lead to a significant boost in the quality and stability of open source software applications.[14]

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terms as the license of the original software." Open Source Initiative, The Open Source Definition, http://www.opensource.org/docs/osd (last visited Apr. 14, 2009). But it should be noted that GNU's own GPL license protects downstream rights by using Copyleft, in effect fulfilling one of the additional criteria of Open Source software. *See* GNU Operating System, What is Copyleft?, http://www.gnu.org/copyleft/copyleft.html (last visited Apr. 14, 2009).

10. *See, e.g.*, *supra* note 9 ("4. The freedom to improve the program, and release your improvements to the public, so that the whole community benefits. Access to the source code is a precondition for this.").

11. For a brief overview of software code, see generally The Linux Information Project, Source Code Definition, http://www.linfo.org/source_code.html (last visited Apr. 14, 2009).

12. *Id.*

13. *Id.*

14. *See* RAYMOND, *supra* note 1, at Release Early Release Often ("More users find more bugs because adding more users adds more different ways of stressing the program. This effect is amplified when the users are co-developers. Each one approaches the task of bug characterization with a slightly different perceptual set and analytical toolkit, a different angle on the problem.").

Open source has been credited by some software engineers with providing a more efficient model of software development than the closed and proprietary model preferred by commercial software companies.[15] Open source is said to do this by increasing the effectiveness of the debugging and development model by empowering users with source code information that they would not have under a proprietary model.[16] With source code in hand, users are able to communicate bug reports to the core development team with a level of detail that is impossible for users of proprietary software. Armed with this detailed information from a wide community of users, open source developers are more efficiently able to hone in on the flaws in their software. Their proprietary software counterparts are limited by the ambiguity in their users' bug reports, which results from the lack of transparency in a proprietary system.

The effectiveness of open source development methods—as an alternative to the conventional proprietary method of developing software—is illustrated by the contributions made by open source projects to our information economy. Although proprietary software will continue to play a vital role in our economy, open source software has made major inroads into many markets. For example, GNU/Linux, an open source operating system, was estimated to have 12.7% of the server market share in 2007[17]—an industry worth nearly fourteen billion dollars in the second

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15. *See* Tina Gasperson, *Award-Winning Snort Creator Roesch Shares Secrets of His Success*, LINUX.COM, Nov. 20, 2007, http://www.linux.com/feature/121377.

> We get tremendous efficiency in our development. The size of our research and development team is very small compared to our competitors'. We use a lot of open source tools, we interact with our community, and have people who are long-time open source users who work here. We use it consistently; it helps reduce costs and achieve a lot of economy. I can't imagine how expensive it would have been to build this company without the open source world. We wouldn't have had the community hungry for the solution when it finally came to market.

Id.

16. *See* RAYMOND, *supra* note 1, at The Importance of Having Users.

> Another strength of the Unix tradition, one that Linux pushes to a happy extreme, is that a lot of users are hackers too. Because source code is available, they can be *effective* hackers. This can be tremendously useful for shortening debugging time. Given a bit of encouragement, your users will diagnose problems, suggest fixes, and help improve the code far more quickly than you could unaided.

Id.

17. Linux-Watch.com, Linux Server Market Share Keeps Growing, May 29, 2007, http://www.linux-watch.com/news/NS5369154346.html (relying on market research from IDC, WORLDWIDE QUARTERLY SERVER TRACKER (2007), available at www.idctracker.com).

quarter of 2008 alone.[18] Apache, an open source web server, was estimated to run over 45% of active websites on the Internet in August 2008.[19] MySQL, an open source database application, has 25% market share among software developers.[20] Sourceforge.net, an archive for open source projects, now lists literally thousands of open source projects under every category from Networking to Games.[21] Thus, there is a substantial public interest in ensuring that the incentives and structure that enable open source to function are protected.

B. Incentives to Create Open Source Software

Open source software developers, although not always compensated by monetary rewards, are nonetheless often motivated by self-interest. The rewards and incentives that participation in an open source project provides to developers can be critical to the success of the project.

Open source developers, while not technically prevented from charging for their software, are limited by the very nature of open source from charging the same rates that proprietary software companies do. Because the source code of an open source project is freely available, modifiable, and distributable, users have little incentive to pay a lot for it. If a developer charges a price a user is unwilling to pay, the user can simply download the source code and build the project herself, or obtain it from a third party for less—sometimes even for free. In order to compensate for this, some enterprises have integrated open source software into business models that generate profit by selling ancillary services and support, rather than by software sales.[22]

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18. Press Release, IDC, Second Quarter Server Market Continues to Accelerate, Future Growth Remains Uncertain, According to IDC (Aug. 27, 2008), http://www.idc.com/getdoc.jsp?containerId=prUS21399008.

19. Netcraft.com, August 2008 Web Server Survey (Aug. 29, 2008), http://news.netcraft.com/archives/2008/08/29/august_2008_web_server_survey.html.

20. MySQL.com, Market Share, http://www.mysql.com/why-mysql/marketshare/ (last visited Feb. 8, 2009).

21. Sourceforge.net, Find Software, http://sourceforge.net/ (last visited Feb. 8, 2009).

22. *Open-Source Business: Open, But Not as Usual*, THE ECONOMIST, March 18, 2006, at 73 ("[MySQL], founded in 1995, has a hybrid business model. It gives away its software under an open-source licence. At the same time, it sells its software along with maintenance and support contracts."); *see also* Posting of Matt Asay to Open Sources, Red Hat: The Mother of All Business Models, http://weblog.infoworld.com/openresource/archives/2006/01/red_hat_the_mot.html (Jan. 15, 2006 05:49 EST) (discussing the Red Hat business model where open source software is used to drive the sales of profitable services).

The lack of direct software sales sometimes creates the misunderstanding that open source software does away with self-interest altogether.[23] It is more accurate to say that open source software satisfies developer self-interest in ways not strictly limited to compensation derived from software sales. Instead, open source developers are motivated by alternative reasons,[24] including enhanced professional status, personal beliefs that source code should be open, reputation within the open source community, and dislike of proprietary software.[25] In addition, a significant portion of open source developers are paid by private parties to contribute to specific projects.[26] Even without direct monetary rewards, self-interest can play a part in motivating many open source contributors since the prospect of enhanced reputation and professional status can translate into increased monetary compensation in the market.[27]

Because these incentives can be so important to the success of an open source project, and because so many of them are tied to the enforcement of the underlying license protecting the code, judicial protection of the requirements of an open source license can be critical. For example, provisions that require author attribution are essential in preserving the author information, which allows the developer to gain reputational benefits from her contributions to the open source project. Provisions that require disclosure of source modifications allow open source developers to benefit from the bug fixes and modifications from other developers in their community, thus giving them the benefit of the labor and ingenuity of a wider population of contributors.

C. Copyright and Open Source

Since developers are making source code widely available either for free or for a nominal charge, it may seem like open source software requires no copyright protection. However, making source code freely avail-

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23. *See* Richard A. Epstein, *Why Open Source is Unsustainable*, FINANCIAL TIMES, Oct. 21, 2004, *available at* http://www.ft.com/cms/s/2/78d9812a-2386-11d9-aee5-00000e2511c8.html (comparing open source software groups to idealistic workers' communes, and predicting their failure for the same reason those idealistic groups fail).

24. *See generally* Karim R. Lakhani & Robert G. Wolf, *Why Hackers Do What They Do: Understanding Motivation Effort in Free/Open Source Software Projects* (MIT Sloan Sch. of Mgmt., Working Paper No. 4425-03, 2003). The study conducted by the MIT Sloan School of Management surveyed 687 software developers from 287 different Open Source projects to compile a picture of what motivates Open Source contributors. *Id.*

25. *Id.* at 23, T.6.

26. *Id.* at 9.

27. *See* Josh Lerner & Jean Tirole, *The Simple Economics of Open Source* 14-15 (Harvard Business Sch. & NBER, Working Paper No. 00-059, 2000), *available at* http://www.hbs.edu/research/facpubs/workingpapers/papers2/9900/00-059.pdf.

able to the public is not the same as dedicating the source code to the public domain. Putting source code in the public domain can create situations that may be at odds with the open source development model by allowing proprietary software developers to co-opt the source code. Once integrated into a proprietary package, author information could be removed from the open source software and future improvements could be withheld from the public.

Source code that is dedicated to the public domain is available for anyone to use and modify. However, if a third party changes the code with copyrightable modifications, thus creating a copyrightable derivative work, there is no obligation to make this derivative work available to the public as open source—or even to the developer of the original material herself. Nor is there any obligation to give attribution to the authors of the original work. In this way public software can be appropriated into proprietary and closed packages.[28] The conversion of downstream work, like bug fixes, into proprietary software reduces many of the benefits of open source—such as cumulative software improvement and user transparency described supra in Section I.A.

Copyright is important in that it gives software developers an exclusive property right to their creation. Once given this right, developers are then free to give the public a copyright license to use the material, subject to conditions that enforce open source values like attribution and source availability. This use of copyright law to keep derivative works available to the public is often called copyleft.[29]

II. LEGAL BACKGROUND

This section discusses the differences between a bare copyright license and a contractual copyright license, and the implications of treating an open source license as a contract. It also discusses the remedies available to a licensor when an open source contract is breached, and the difference between contract law remedies and copyright law remedies.

A. License Versus Contract

Treating an open source agreement as a contract rather than as a license has repercussions on both its enforceability and the applicable remedies for breach.[30] A license is defined as a "permission, [usually] re-

28. *See* Dr. José J. González de Alaiza Cardona, *Open Source, Free Software, and Contractual Issues*, 15 TEX. INTELL. PROP. L.J. 157, 173 (2007).

29. *See* GNU Operating System, *supra* note 9.

30. *See* Cardona, *supra* note 28, at 186-88 (noting the differences between copyright and contract, especially the uniformity that is present in copyright law and the require-

vocable, to commit some act that would otherwise be unlawful."[31] A contract on the other hand is "[a]n agreement between two or more parties creating obligations that are enforceable or otherwise recognizable at law."[32]

The mutual obligations of a contract require formalities during the formation of the agreement that are not required for a license.[33] There must be a bargain in which an offer for exchange is made and mutually accepted,[34] and there must be some consideration or valuable exchange between the parties.[35]

Copyright licenses are not always contracts. A license is merely the unilateral permission to do something.[36] For instance, when a property owner grants someone permission to enter his private property, that permission is a license, not a contract. In the case of a copyright license, contract law does not enter the picture unless some obligations are imposed on the licensee beyond the exclusive rights granted by copyright law.[37] Once obligations are imposed on a licensee, courts tend to analyze the copyright license as a contractual instrument.[38]

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ment of privity between the parties in contract); *see also* Herkko A. Hietanen, *A License or a Contract, Analyzing the Nature of Creative Commons Licenses*, 76 NORDISKT IMMATERIELLT RÄTTSSKYDD (NORDIC INTELLECTUAL PROPERTY LAW REVIEW) at 17 (forthcoming 2007), *available at* http://papers.ssrn.com/sol3/Delivery.cfm/SSRN_ID-1029366_code896196.pdf?abstractid=1029366&mirid=1 (noting that copyright law criminalizes infringement in many countries, giving licensors the option of sharing some of their litigation costs with the state when pursuing infringers).

31. BLACK'S LAW DICTIONARY 938 (8th ed. 2004).

32. *Id.* at 341.

33. *See* Hietanen, *supra* note 30, at 8-9.

34. RESTATEMENT (SECOND) OF CONTRACTS § 17 (1981) ("[T]he formation of a contract requires a bargain in which there is a manifestation of mutual assent to the exchange and a consideration.").

35. *Id.* § 71.

36. BLACK'S LAW DICTIONARY, *supra* note 31; Diane Rowland & Andrew Campbell, *Supply of Software: Copyright and Contract Issues*, 10 INT'L J.L. & INFO. TECH. 23, 26 (2002).

37. *See* Lulirama Ltd.. v. Axcess Broad. Servs., Inc., 128 F.3d 872, 882 (5th Cir. 1997) ("a nonexclusive license supported by consideration is a contract"); I.A.E., Inc. v. Shaver, 74 F.3d 768, 772 (7th Cir. 1996); Avtec Sys., Inc. v. Peiffer, 21 F.3d 568, 574 n.12 (4th Cir. 1994); Keane Dealer Servs., Inc. v. Harts, 968 F. Supp. 944, 947 (S.D.N.Y. 1997); Johnson v. Jones, 885 F. Supp. 1008, 1012 n.6 (E.D. Mich. 1995); *see also* Rowland, *supra* note 36, at 26 ("A non-contractual copyright licence is a licence to do, or authorise the doing of, any of the acts restricted by copyright. Effectively then, the term 'licence' in the copyright context can be regarded as interchangeable with 'consent' or 'permission.'") (citations omitted).

38. *See Lulirama*, 128 F.3d at 882.

B. Enforceability of Open Source Licenses as Contracts

Open source licenses are a special type of copyright license that generally grant the licensee a nonexclusive right to use the copyrighted material, subject to specific obligations.[39] These obligations may include giving proper attribution to the original authors, refraining from distributing modified versions of the copyrighted material, making the modified version's source code available to the public, or any combination of these requirements.[40]

The manner by which users obtain open source software presents some unique circumstances not usually seen in other software transactions. Developers typically download open source software from online archives such as SourceForge.net.[41] These archives provide the developer with not only the source code for the software in question, but also details about who the author or authors are, what license applies, and what the development history of the package is.[42] The software source code itself is most often downloaded from the online archive in a compressed file format, which contains all the necessary source code and documentation needed for a developer to build the software package.[43] When the compressed file is decompressed onto the developer's hard drive it creates not only the source code and documentation files, but also typically a license file that contains the terms of the open source license which applies to that particu-

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39. *See generally* Open Source Initiative, Open Source Initiative OSI—The Artistic License: Licensing, Oct. 31, 2006, http://www.opensource.org/licenses/artistic-license-1.0.php [hereinafter The Artistic License]; GNU Operating System, GNU General Public License, http://www.gnu.org/licenses/gpl-3.0.html (last updated Jan. 18, 2009) [hereinafter GPL 3.0].

40. *See* The Artistic License, *supra* note 39, ¶¶ 1, 3-4; GPL 3.0, *supra* note 39, ¶¶ 4-6.

41. *See, e.g.*, SourceForge.net: Open Source Software, http://sourceforge.net/ (last updated Feb., 2009). SourceForge.net is an online source code repository, which provides a simple centralized interface where multiple developers can work simultaneously on one project. Similar sites include Tigris.org, RubyForge (http://www.rubyforge.org), and GNU Savannah (http://savannah.gnu.org).

42. *See, e.g.*, JMRI Model Railroad Interface—Details, http://sourceforge.net/projects/jmri/ (last updated Jan. 13, 2009).

43. For example, see the download and decompress production release files of the JMRI project v. 2.4A. *Id.* Upon decompressing the archive observe that the directory contains sub-directories such as "lib" which contain the project source files, as well as a "help" directory. The "help" directory contains documentation pertaining to the project, which guides developers who seek to build the project themselves as opposed to using the premade executables. The file called "COPYING" is also included in every directory. This file contains the terms of the license that applies to this particular open source project.

lar package. A generally suggested licensing practice for open source is to place a message at the top of the source code files drawing the developer's attention to the existence of the license file.[44] Through this mechanism of a license file and a message in each source file, the authors of open source software provide notice to their developers about the existence of a copyright license, which governs usage of their software.[45]

Despite this notice, there are still doubts as to whether the standard contractual requirements of offer, acceptance, and consideration have been met. Some scholars have argued that a developer who uses open source code has entered into a valid contract, despite the fact that the licensee's acceptance and consideration are not overtly present.[46] Consideration on the part of the licensor is obvious—the source code is clearly valuable. On the other hand, consideration on the licensee's side is less clear; some scholars have argued that adherence to the open source license itself is sufficient consideration for the contract.[47]

The closest analogy to open source licensing has been "shrinkwrap" licensing, used commonly in the commercial software industry.[48] In the seminal case *ProCD, Inc. v. Zeidenberg*, the 7th Circuit ruled that the license notice on the outside of a software package, the actual license contained within, and the right to return the software if the user decided not to accept the terms constituted an offer and acceptance for the purposes of contract, and thus created a valid and enforceable agreement.[49] This mechanism of software licensing has been called "shrinkwrap licensing."[50] Although

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44. *See* GNU Operating System, How To Use GNU Licenses For Your Own Software, http://www.gnu.org/licenses/gpl-howto.html (last updated Oct. 30, 2008) (suggesting licensing practices recommended by the Free Software Foundation).

45. *Id*.

46. *See* Cardona, *supra* note 28, at 193-94 ("[I]t seems more reasonable to understand that the licensee's consideration is his promise to abide by the copyleft clause."); Jason B. Wacha, *Taking the Case: Is the GPL Enforceable*, 21 SANTA CLARA COMPUTER & HIGH TECH. L.J. 451, 475 (2005) ("The reliance of each party on the promise of the other constitutes the consideration. The licensee's promise to abide by the GPL induces the licensor to make the offer. The licensor's grant of otherwise restricted rights induces the licensee to make her promise.").

47. *See* Wacha, *supra* note 46, at 474-75 ("The licensee, as consideration, agrees to keep all copyright notices intact, to insert certain required notices, and to redistribute code only under certain conditions."); *In re* Owen, 303 S.E.2d 351, 353 (N.C. Ct. App. 1983) ("[C]onsideration exists when the promissee, in exchange for the promise, does anything he is not legally bound to do, or refrains from doing anything he has a right to do . . . .").

48. *See* Wacha, *supra* note 46, at 488.

49. ProCD, Inc. v. Zeidenberg, 86 F.3d 1447, 1451 (7th Cir. 1996).

50. Cardona, *supra* note 28, at 195-96.

court decisions have not been completely uniform in evaluating the enforceability of shrinkwrap licenses, there have been enough decisions upholding these licenses to support a strong presumption of validity.[51] These courts generally require that the licensor provide proper notice and allow the prospective licensee to turn down the agreement if the terms are unfavorable.[52]

Similar to shrinkwrap licenses, open source licenses are typically made available as text files that accompany the source code. In addition, attention is usually called to the license text file within the source code files themselves. Although this method of including a license file and notice of that file in the source files is closely analogous to the shrinkwrap licensing scheme, it had not been directly tested in court before *Jacobsen v. Katzer*.

C. Infringement of a Copyright Licensing Contract

In a copyright infringement action that includes a contract dispute, establishing the existence and validity of a licensing agreement is only the first step. Even if a valid contract exists, infringement can be found if the licensee acted outside the bounds of her grant.[53] Courts must scrutinize the copyright agreement in question to discern not only the scope of the rights granted by the licensor, but also what elements of the agreement are preconditions to the copyright license and what elements are merely contractual promises or covenants. If there are preconditions to the copyright license that have not been met by the would-be licensee, there is no license

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51. *See* Wacha, *supra* note 46, at 489.

> The trend in U.S. courts is to uphold shrinkwrap and clickwrap agreements. Thus, the courts have given a legal stamp of approval to one of the fastest growing methods of software distribution: via the Internet. In fact, U.S. courts have not only expressly upheld both shrinkwrap and clickwrap agreements, they have gone as far as to actually affirmatively recommend the use of a clickwrap license.

Id.

52. Cardona, *supra* note 28, at 198-99. An example of proper notice would be a label on the outside of packaging which draws consumers' attention to the existence of a printed license enclosed within.

53. *See* S.O.S., Inc. v. Payday, Inc., 886 F.2d 1081, 1087 (9th Cir. 1989) ("A licensee infringes the owner's copyright if its use exceeds the scope of its license.") (citing Gilliam v. Am. Broad. Cos., 538 F.2d 14, 20 (2d Cir. 1976)); MELVILLE NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT, 3-10, § 10.15 (2008) ("[W]hen a license is limited in scope, exploitation of the copyrighted work outside the specified limits constitutes infringement.").

and infringement will be found even if the remainder of the agreement describes a broad grant of rights.[54]

On the other hand, if the licensor grants a license without preconditions, or if those preconditions are met, a violation of other terms in the copyright licensing agreement will not give the licensor the right to bring a copyright infringement action against the licensee.[55] The licensor may still have a cause for action under contract law for violation of contractual covenants, but her license grant will function as the equivalent of a promise not to sue for copyright infringement.[56]

In interpreting a copyright license, courts rely on state law to guide contractual construction.[57] However, the application of state law is limited when it leads to an outcome that is contrary to the purposes of federal copyright law.[58] For instance, courts have set aside the California rule of construction that interprets the contract against the drafter when the drafter is a copyright holder who did not explicitly retain rights.[59] Interpreting a contract to grant rights simply because those rights were not explicitly retained would be contrary to federal copyright law, which presumes that copyright licenses prohibit any use not explicitly authorized.[60]

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54. *See* Graham v. James, 144 F.3d 229, 237 (2d Cir. 1998) ("'[I]f the nature of a licensee's violation consists of a failure to satisfy a condition to the license . . . , it follows that the rights dependent upon satisfaction of such condition have not been effectively licensed, and therefore any use by the licensee is without authority from the licensor and may therefore, constitute an infringement of copyright.'") (citations omitted).

55. *See* Fantastic Fakes, Inc. v. Pickwick Int'l, Inc., 661 F.2d 479, 483-84 (5th Cir. Unit B Nov. 1981) ("A mere breach of covenant may support a claim of damages for breach of contract but will not disturb the remaining rights and obligations under the license including the authority to use copyrighted material.").

56. *See* Jacob Maxwell, Inc. v. Veeck, 110 F.3d 749, 753 (11th Cir. 1997) (stating that implicit in a nonexclusive license is the promise not to sue for copyright infringement).

57. *See* Fantastic Fakes, 661 F.2d at 483 (ruling that state law is not displaced merely because a contract relates to intellectual property).

58. *See* Sears, Roebuck & Co. v. Stiffel Co., 376 U.S. 225, 229 (1964). *Sears* states:

> [Federal patent and copyright laws,] like other laws of the United States enacted pursuant to constitutional authority, are the supreme law of the land. When state law touches upon the area of these federal statutes, it is "familiar doctrine" that the federal policy "may not be set at naught, or its benefits denied" by the state law.

Id. (citations omitted).

59. S.O.S., Inc. v. Payday, Inc., 886 F.2d 1081, 1088 (9th Cir. 1989).

60. *Id.* at 1088 ("The district court applied the California rule that the contract should be interpreted against the drafter, thereby deeming S.O.S. to have granted to Payday any right which it did not expressly retain. This result is contrary to federal copyright

D. Remedies for Breach of an Open Source License

As described in Section II.C, a failure to comply with a precondition to the license gives rise to copyright infringement, while a failure to perform a covenant of the contract may only give rise to breach of contract. Whether a particular requirement of the license is a precondition or covenant can have great bearing on the outcome of a case because of the differing remedies available under copyright law versus under contract law. Naturally, as a legal instrument, there may be some ambiguities in the interpretation of a copyright license, which leave unclear whether specific provisions are preconditions to the license or merely contractual promises.

Depending on the nature of the copyright license and the circumstances of the infringement, a copyright holder may find adequate remedy in either contract or copyright law. However, in the case of open source licenses, there are several reasons why the licensor may find contract remedies insufficient. Perhaps the most compelling reason from a developer's point of view is simply that copyright law presents a level of international and national harmonization that contract law lacks. International treaties such as the Berne Convention have brought a degree of international homogenization to copyright law that contract law has yet to match.[61] Even within the United States, contract law varies considerably from state to state. In theory, the uniformity in copyright law gives open source developers a more predictable set of rules on which to rely, which in turn gives them a more predictable set of remedies for breach.

In addition, contract law's preference for granting monetary damages in the case of breach creates difficulties for open source developers. As mentioned supra, open source developers rarely sell their software directly, but instead hope for some non-monetary advantage from distributing their software.[62] Regardless of whether the goal is to foster a developer community or to sell other commercial ancillary services, the non-monetary nature of open source transactions makes it difficult to quantify the monetary damages associated with a particular breach of an open source license. Injunctions and specific performance—such as court-ordered release of source code—are more difficult to obtain under contract law.[63] However, it is these latter remedies that are usually of greater inter-

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policy: copyright licenses are assumed to prohibit any use not authorized.") (citations omitted).

61. *See* Berne Convention Implementation Act, Pub. L. No. 100-568, 102 Stat. 2853-2861 (1988).

62. *See supra* Section I.I.B.

63. MURRAY ON CONTRACTS, 1-9, § 127 (2001) (noting that there are many cases where an injunction or specific performance was not granted because there was an ade-

est to an open source developer given the difficulty they have estimating their money damages for a particular breach.

Because of the ambiguity in calculating money damages in an open source license infringement, copyright law gives licensors at least two advantages that contract law does not. First, copyright law has provision for statutory damages that can amount to up to $30,000 per infringement, or up to $150,000 in the case of willful infringement.[64]

Second, copyright law is much more generous in its application of injunctions in favor of the copyright holder. In the 2006 case *eBay Inc. v. MercExchange* the Supreme Court reaffirmed the four-factor test used to determine when a court should issue an injunction.[65] The Court stated:

> According to well-established principles of equity, a plaintiff seeking a permanent injunction must satisfy a four-factor test before a court may grant such relief. A plaintiff must demonstrate: (1) that it has suffered an irreparable injury; (2) that remedies available at law, such as monetary damages, are inadequate to compensate for that injury; (3) that, considering the balance of hardships between the plaintiff and defendant, a remedy in equity is warranted; and (4) that the public interest would not be disserved by a permanent injunction. The decision to grant or deny permanent injunctive relief is an act of equitable discretion by the district court, reviewable on appeal for abuse of discretion.[66]

Until *eBay*, copyright holders merely had to show a likelihood of success on the merits in their infringement suit in order to obtain a preliminary injunction from the courts, on the basis of presumed irreparable harm.[67] Some commentators posit that this practice could change due to

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quate remedy at law, as well as cases where courts found the terms of a contract sufficiently certain to grant damages, but too uncertain to grant an injunction).

64. 17 U.S.C. § 504(c) (2006).

65. 547 U.S. 388 (2006).

66. *Id.* at 391.

67. *See, e.g.*, Sun Microsystems, Inc. v. Microsoft Corp., 188 F.3d 1115, 1119 (9th Cir. 1999) ("Under federal copyright law, however, a plaintiff that demonstrates a likelihood of success on the merits of a copyright infringement claim is entitled to a presumption of irreparable harm."); *id.* ("The standard for a preliminary injunction balances the plaintiff's likelihood of success against the relative hardships to the parties"); Triad Sys. Corp. v. Se. Exp. Co., 64 F.3d 1330, 1335 (9th Cir. 1995); Sega Enters. v. Accolade, Inc., 977 F.2d 1510, 1517 (9th Cir. 1992) (stating that in order to receive a preliminary injunction a copyright holder is required to show "either a likelihood of success on the merits and the possibility of irreparable injury, or that serious questions going to the merits were raised and the balance of hardships tips sharply in its favor"); Nat'l Ctr. for Immigrants Rights v. I.N.S., 743 F.2d 1365, 1369 (9th Cir. 1984) ("The greater the relative hardship of the moving party, the less probability of success must be shown."); Apple

eBay.[68] However, the change wrought by *eBay* has yet to fully materialize, as there have so far been only a few cases that have explicitly applied the *eBay*-mandated factors in a copyright injunction scenario.[69] Meanwhile, despite *eBay*, the open source licensor in *Jacobsen v. Katzer* pursued an injunction through copyright law under the time-tested theory that a likelihood of success on the merits gives rise to a presumption of irreparable harm in a copyright suit.[70]

III. THE *JACOBSEN V. KATZER* DECISION

In *Jacobsen v. Katzer*, an open source licensor attempted to enforce the terms of an open source license against a commercial developer who refused to obey the obligations in the license document.[71] Section III.A provides a detailed factual background of the case. Section III.B summarizes the District Court's decision and Section III.C describes the Federal Circuit's analysis and ruling.

A. Factual Background

Plaintiff Jacobsen ran an open source software group, the Java Model Railroad Interface project (JMRI), which created an application called DecoderPro that enabled hobbyists to control their model trains using a personal computer.[72] The DecoderPro source files were available for free download under the terms of the Artistic License.[73] The Artistic License

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Computer, Inc. v. Franklin Computer Corp., 714 F.2d 1240, 1254 (3d Cir. 1983) ("A copyright plaintiff who makes out a prima facie case of infringement is entitled to a preliminary injunction without a detailed showing of irreparable harm.").

68. *eBay*, 547 U.S. at 391; *see also* Michael A. Jacobs & David E. Melaugh, eBay Inc. v. MercExchange*: Copyright's Promise for Patent Injunctions*, SANTA CLARA UNIVERSITY TECHLAW FORUM, Nov. 5, 2006, http://www.techlawforum.net/patent-reform/articles/ebay-v-mercexchange-patent-injunctions/ ("*eBay* could signal an end to the easy ride copyright plaintiffs have gotten.").

69. Jacobs & Melaugh, *supra* note 68 ("[O]nly time will tell *eBay*'s true effect. The first decision in its wake—*z4 Techs*—suggests perhaps that instead of copyright jurisprudence acting to insure patent injunctive relief remains common, patent jurisprudence may work to make copyright injunctions less so."); *see also* Tillery v. Leonard & Sciolla, LLP, 437 F. Supp. 2d 312 (E.D. Pa. 2006); Disney Enters., Inc. v. Delane, 446 F. Supp. 2d 402 (D. Md. 2006); Busch v. Seahawk Software Dev., L.L.C., No. CV 04-0425-PHX-PGR, 2006 U.S. Dist. LEXIS 39484, at *13-14 (D. Ariz. June 12, 2006).

70. *See infra* Section III.A.

71. 535 F.3d 1373, 1376 (Fed. Cir. 2008).

72. *See* Jacobsen v. Katzer, 535 F.3d 1373, 1376 (Fed. Cir. 2008). *See also* Second Am. Compl. for Declaratory Judgment, Violations of Copyright and Federal Trademark Laws, and State Law Breach of Contract at ¶¶ 229-37, Jacobsen v. Katzer, No. C06-1905-JSW, 2007 WL 5138282 (N.D. Cal. Dec. 12, 2007).

73. *See Jacobsen*, 535 F.3d at 1376.

set forth certain preconditions to be fulfilled before a user could redistribute or modify the DecoderPro files, including that the downstream copier retain the author's name and website information and that any modifications to the program be described if not disclosed.[74]

As part of the DecoderPro project the JMRI developers created what are called "decoder definition files," which are interface specifications for the various types of available model railway hardware.[75] These specifications enabled the DecoderPro software to control equipment from different manufacturers. The decoder definitions appear to have been assembled through significant effort—Jacobsen alleged that the JMRI wrote definitions for over 350 decoders, assembled in over 100 files.[76] Each individual manufacturer's equipment required gathering information specific to that manufacturer.

Defendant Katzer sold a commercial product, Decoder Commander, which was similar to the DecoderPro.[77] Katzer allegedly incorporated material into Decoder Commander that was directly copied from DecoderPro's decoder definition files,[78] but failed to adhere to the terms of the Artistic License. In particular, Katzer failed to acknowledge the inclusion of DecoderPro definition files, failed to give credit to Jacobsen, failed to describe modifications he had made to the DecoderPro files, and failed to include Jacobsen's website information—all conditions laid out explicitly in the Artistic License.[79]

Initially, Jacobsen was allegedly not even aware of the potentially infringing content in Decoder Commander. Jacobsen claimed that the contents of Decoder Commander only came to his attention after Katzer himself first threatened Jacobsen with a patent infringement lawsuit.[80] Katzer, as the holder of several patents relating to Model Railway control software, had been seeking ways to monetize his intellectual property for some time. Some early lawsuits brought against other commercial competitors did not succeed, allegedly because there were significant questions

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74. *See* The Artistic License, *supra* note 39, ¶¶ 1, 3-4 (requiring that downstream users include original copyright holder's information in any verbatim distribution and that any public distribution of a modified version include either the modified source or clear documentation of modifications along with information about where to get the standard version).

75. *See Jacobsen*, 535 F.3d at 1376. *See also* Second Am. Compl., *supra* note 72, ¶ 223.

76. *See* Second Am. Compl., *supra* note 72, ¶ 223.

77. *See Jacobsen*, 535 F.3d at 1376.

78. *See* Second Am. Compl., *supra* note 72, ¶ 244.

79. *See Jacobsen*, 535 F.3d at 1376.

80. *See* Second Am. Compl., *supra* note 72, ¶ 313.

about the validity or enforceability of the asserted patents.[81] According to Jacobsen, after Katzer's early actions against commercial entities failed, Katzer went after noncommercial actors, one of which was the JMRI project.[82]

Jacobsen discovered the allegedly infringing material in Katzer's product while gathering information to invalidate Katzer's patents during the course of a declaratory judgment action.[83] Jacobsen then moved for a preliminary injunction arguing that the violation of the Artistic License terms constituted copyright infringement and that irreparable harm could be presumed. The District Court disagreed and found that the violated terms were covenants giving rise only to an action for breach of contract.[84] Without the presumption of irreparable harm, the District Court found no basis for allowing a preliminary injunction.[85] Jacobsen appealed the denial of the preliminary injunction to the Federal Circuit.

B. The District Court's Analysis

The District Court dismissed Jacobsen's motion for preliminary injunction after determining that he had no cause of action under copyright law. The court acknowledged that the plaintiff's copyrighted material had been incorporated in the defendant's software package, but interpreted the terms of the Artistic License such that this taking was a contract rather than copyright violation.[86]

In coming to this conclusion the District Court implicitly treated the restrictions of the Artistic License as covenants of the license, rather than as preconditions to it, and held that there was a cause of action under copyright law only if the defendant's use was beyond the scope of the grant in the copyright license.[87] The court stated:

> The condition that the user insert a prominent notice of attribution does not limit the scope of the license. Rather, Defendants' alleged violation of the conditions of the license may have constituted a breach of the nonexclusive license, but does not create

81. *See id.* ¶¶ 364-70.
82. *See id.* ¶¶ 371-77.
83. *See id.* ¶ 313.
84. Jacobsen v. Katzer, No. C 06-01905 JSW, 2007 WL 2358628, at *6-7 (N.D. Cal. Aug. 17, 2007).
85. *Id.* at 7.
86. *Id.*
87. *Id.* at 6-7.

> liability for copyright infringement where it would not otherwise exist.[88]

The District Court's decision is somewhat puzzling since the language of the Artistic License is quite clear in stating that its terms are conditions, not covenants: "The intent of this document is to state the conditions under which a Package may be copied . . . ."[89]

Despite the explicit language found in the Artistic License, the district court found that the "[p]laintiff has chosen to distribute his decoder definition files by granting the public a nonexclusive license to use, distribute and copy the files . . . . [I]mplicit in a nonexclusive license is the promise not to sue for copyright infringement."[90]

Without the possibility of success on the merits of the copyright claim, Jacobsen could not be presumed to have suffered irreparable harm, and thus the district court denied him an injunction.[91]

C. The Federal Circuit's Analysis

On appeal, the Federal Circuit considered two arguments against the injunction. First, Katzer argued that there was no cause for action under copyright law because the rights protected by the Artistic License were noneconomic, and therefore unprotected by copyright law, which seeks to vindicate economic rather than moral rights.[92] Second, mirroring the district court's reasoning, Katzer argued that the requirements in the Artistic License were merely covenants and not conditions that would limit the scope of rights granted by the copyright owner.[93]

Dismissing the first argument, the Federal Circuit found that there were certainly nonmonetary economic interests protected by the Artistic License. The court briefly acknowledged the valuable role that open source has played in developing several important public projects, including Linux, Firefox, Wikipedia, Perl, and the Creative Commons.[94] It then went on to describe how an open source license, even if not granting monetary rights, could still protect valuable economic interests by growing market share, enhancing the author's reputation, and allowing for rapid development.[95] The court decided that these objectives, although not mon-

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88. *Id.* at 7.
89. The Artistic License, *supra* note 39, Preamble.
90. *Jacobsen*, 2007 WL 258628 at *6.
91. *Id.* at 7.
92. Jacobsen v. Katzer, 535 F.3d 1373, 1381 (Fed. Cir. 2008).
93. *Id.* at 1380.
94. *Id.* at 1378.
95. *Id.* at 1379.

etary, were economic interests worthy of protection under U.S. copyright law.[96]

The defendant's second argument was that the Artistic License's requirements were merely covenants, not preconditions that constrained the scope of the copyright grant. The Federal Circuit disagreed. It examined the language of the license and concluded that the agreement created conditions that were prerequisites to the grant, and that their violation created a cause of action for copyright infringement.[97] The court pointed out that there was explicit language indicating the creation of preconditions to the grant: "'The intent of this document is to state the *conditions* under which a Package may be copied.'"[98] Citing *Diepenbrock v. Luiz*,[99] the court also noted that the phrase "provided that," which appears before every requirement in the Artistic License, typically denotes a condition under California state law, rather than a covenant.[100]

The court then explained that treating the requirements as conditions was critical to achieving copyright law's purpose of protecting the economic interests of the author, and recognized that when the author's objective is nonmonetary, the injunctive relief available under copyright is critical:

> Copyright licenses are designed to support the right to exclude; money damages alone do not support or enforce that right. The choice to exact consideration in the form of compliance with the open source requirements of disclosure and explanation of changes, rather than as a dollar-denominated fee, is entitled to no less legal recognition.[101]

IV. CONCLUSION

Although the Artistic License is not a very popular open source license in the developer community—even the JMRI has moved on to GNU GPL[102]—the *Jacobsen v. Katzer* decision has important implications for the future enforceability of open source licenses.

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96. *Id.* ("The lack of money changing hands in open source licensing should not be presumed to mean that there is no economic consideration, however.")

97. *Id.* at 1381.

98. *Id.* (citing the Artistic License) (emphasis in original).

99. 115 P. 743 (1911).

100. *Jacobsen*, 535 F.3d at 1381.

101. *Id.* at 1381-82.

102. *See* JMRI Model Railroad Interface—Details, http://sourceforge.net/projects/jmri/ (last updated Jan. 13, 2009). Note that the project is now licensed under GNU GPL 1.0. GNU GPL 1.0 is an open source license promulgated by the Free Software Founda-

In California, it would now appear that many open source licenses, like the GNU GPL, have a good chance of being valid and enforceable under copyright law. GNU GPL versions 1, 2, and 3 use language very similar to that highlighted by the Federal Circuit in *Jacobsen v. Katzer*. The phrase "provided that" found in the Artistic License is present before every requirement in the GPL licenses as well.[103] And the GPL licenses also state in their preamble that "[t]he precise terms and conditions for copying, distribution and modification follow."[104] This is similar to the language from the Artistic License preamble, which states, "The intent of this document is to state the conditions under which a Package may be copied."[105] In California, an open source license similar to the Artistic License—at least to the degree that GNU GPL is—would likely be found enforceable under copyright law under *Jacobsen v. Katzer*.[106]

In other jurisdictions the picture is not as clear. Despite copyright licensors' pursuit of jurisdictional uniformity through copyright law, the reality appears to be that the jurisdictional variation of contract law is unavoidable. Although a copyright violation is determined under copyright law, the license itself is interpreted under state contract law. Because of this, the licensor is at the mercy of local contract rules despite copyright law's supremacy. The rules, which govern what language creates a covenant versus a condition, vary from jurisdiction to jurisdiction, leaving the *Jacobsen v. Katzer* court's critical discussion of covenants and conditions somewhat toothless in other states.

However, the court's acknowledgement that the requirements of an open source license have economic value, despite being nonmonetary, is a model for future decisions concerning open source licenses.[107] The *Jacobsen* court's reasoning on this subject would be hard for a licensee to refute,

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tion. GNU Operating System, GNU General Public License, version 1, http://www.gnu.org/licenses/gpl-1.0.html (last modified Sept. 9, 2008) [hereinafter GPL 1.0]. GNU GPL is one of the most popular open source licenses—a quick search on Sourceforge.net reveals that over 115,000 projects use the license.

103. *See* GPL 3.0, *supra* note 39; GNU Operating System, GNU General Public License, version 2, http://www.gnu.org/licenses/gpl-2.0.html (last updated Jan. 30, 2009) [hereinafter GPL 2.0]; GPL 1.0, *supra* note 102.

104. GPL 3.0, *supra* note 39, at Preamble; GPL 2.0, *supra* note 103, at Preamble; GPL 1.0, *supra* note 102, at Preamble.

105. The Artistic License, *supra* note 39, Preamble.

106. *See Jacobsen*, 535 F.3d at 1381-82 (finding that the Artistic License's use of the words "provided that" coupled with the phrase "the intent of this document is to state conditions" strongly supported the conclusion that the requirements in the license were conditions and not covenants).

107. *See supra* Section III.C.

making future arguments based on the theory that there are no economic rights at issue in an open source license harder to sustain.

The *Jacobsen v. Katzer* decision is less significant on the issue of software contract formation in general. Typically, copyright infringement actions assume that, when there is a license, there is a valid copyright contract between the parties. That contract then dominates the discussion of the parties' rights, as it did in *Jacobsen*. However, the court in this case never explicitly analyzed whether a valid contract had been formed—whether the formalities of offer/acceptance and consideration had been observed. The licensee himself never raised the argument that the Artistic License was inapplicable, because his only rights to use the material derived from that license. Without the Artistic License, it would have been much more difficult for Katzer to argue that he had any permission at all to use the copied material.

Because of the lack of discussion on the subject of contract formation, the existence of a valid contract formed through the common open source method—including the license file in the distribution and giving notice in the source files—would appear to carry little weight in future disputes. The licensee did not dispute that he had notice in this case, and in a future case where the formation of the open source contract itself was at issue, the licensee could very well do that to avoid being bound by the license. However, in that case, the would-be licensee would have no permission to use the software and would have to rely on some other defense, such as fair use.

Ultimately, *Jacobsen v. Katzer* faced fundamental issues about the interpretation and enforcement of open source licenses. Although the Artistic License is only one of many open source licenses, the precedent set in this case has confirmed the enforceability of at least one open source license under copyright law. Although *Jacobsen v. Katzer* can be considered a victory for the open source movement, it is but a modest one whose eventual scope in other jurisdictions remains to be seen.

OF RIGHTS AND MEN: THE RE-ALIENABILITY OF TERMINATION OF TRANSFER RIGHTS IN *PENGUIN GROUP V. STEINBECK*

By Adam R. Blankenheimer

From its inception, United States copyright law has granted authors reversionary interests in their copyrightable works.[1] Because an author's initial bargaining position with a publisher may be relatively weak,[2] Congress has consistently given the author the right to regain his copyright after the work has already been published and exploited on the market.[3] With copyright back in hand and knowledge of its fair market worth, the author has a second opportunity to sell it for a price that better reflects the work's value.[4]

The Copyright Act of 1976 introduced the modern incarnation of the author's reversionary interest in his copyright: the right to terminate a transfer. During the statutory period, the author or his statutory heirs may terminate any prior assignment of his exclusive rights to the work.[5] Whereas an author's reversionary rights prior to the 1976 Act were assignable or waivable,[6] in 1976 Congress mandated that termination of transfer

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1. *See* Lee Ford Tritt, *Liberating Estates Law From the Constraints of Copyright*, 38 RUTGERS L.J. 109, 147 (2006) (reviewing the history of copyright recapture rights).

2. *See* Stewart v. Abend, 495 U.S. 207, 218-19 (1990) ("It not infrequently happens that the author sells his copyright outright to a publisher for a comparatively small sum." (quoting H.R. REP. NO. 2222, at 14 (1909))).

3. *See* Melville B. Nimmer, *Termination of Transfers Under the Copyright Act of 1976*, 125 U. PA. L. REV. 947, 950 (1977) ("[T]he most compelling justification for a reversionary right: an author's property, unlike other forms of property, is by its very nature incapable of accurate monetary evaluation prior to its exploitation.").

4. *See Stewart*, 495 U.S. at 218-19.

5. 17 U.S.C. §§ 203(a), 304(c)-(d) (2006). Section 203(a) gives authors the right to terminate post-1978 transfers, 304(c) gives authors the right to terminate pre-1978 transfers, and 304(d) gives authors a second chance to terminate pre-1978 transfers.

6. *See* Fred Fisher Music Co. v. M. Witmark & Sons, 318 U.S. 643, 656-59 (1943) (upholding an author's assignment of his renewal right under the 1909 Act).

rights were inalienable by providing that "[t]ermination . . . may be effected notwithstanding any agreement to the contrary. . . ."[7]

However, the Second Circuit recently ruled in *Penguin Group (USA) Inc. v. Steinbeck* that when the author's widow renegotiated a 1938 assignment of publication rights to the author's works in 1994, the author's statutory heirs lost their § 304(d) right to terminate the assignment.[8] The court found that the 1994 agreement superseded the 1938 agreement, and thus there was no pre-1978 grant for the heirs to terminate.[9] The court held that as a post-1978 re-grant of copyright, the 1994 assignment was not void as an "agreement to the contrary," even though it had the effect of extinguishing the right to terminate a pre-1978 grant of copyright.[10] Accordingly, the Second Circuit ruled that an author or his heirs could either renegotiate a pre-1978 copyright assignment or exercise the statutory right to terminate it, but not both.[11]

The *Steinbeck* decision carves out an exception to the statutory inalienability of termination of transfer rights, and it illustrates the tension between Congress's intent to prevent authors and their heirs from selling future copyright interests and courts' unwillingness to curtail freedom of contract. This Note will argue that, regardless of the wisdom of granting an inalienable reversionary interest in copyright, the *Steinbeck* court wrongly interpreted the statute and incorrectly distinguished its own precedent in *Marvel Characters, Inc. v. Simon*,[12] that the court reached a result inconsistent with the Copyright Act's statutory inheritance scheme, and that the court's decision does not offer a predictable standard for future termination of transfer cases.

I. EVOLUTION OF REVERSIONARY RIGHTS IN COPYRIGHTS

Though authors have consistently retained reversionary interests in their works, Congress has several times amended the Copyright Act to alter the statutory period in which those interests vest, in whom they vest, and the conditions under which they are alienable or extinguishable. This Part will first present the legislative history and policy considerations of copyright renewal leading up to the 1976 Act. It will then explain the sta-

7. 17 U.S.C. §§ 203(a)(5), 304(c)(5).
8. 537 F.3d 193, 204 (2d Cir. 2008).
9. *Id*. at 202-03.
10. *See id.* at 204.
11. *Id.*
12. 310 F.3d 280 (2d Cir. 2002).

tutory formalities and effects of termination of transfer rights. Finally, it will discuss how and why Congress made termination of transfer rights inalienable.

A. 1790 to 1978: The Copyright Renewal System

Prior to the 1976 Act, an author could renew copyright for a second term after the initial term of protection expired. Although renewal theoretically gave the author a second opportunity to capitalize on his copyright, courts ruled that it was alienable. As a result, publishers often required the author to assign them the right of renewal prior to initial publication of the work. Consequently, publishers, rather than authors, enjoyed the benefit of the optional renewal term of copyright protection. The right to renew copyright appears in the first United States copyright statute.

1. The Right of Renewal Under the Copyright Acts of 1790 and 1831

Congress modeled the two-term renewal system of the Copyright Act of 1790 after England's Statute of Anne.[13] Under the Statute of Anne, an author enjoyed an initial fourteen-year term of copyright protection for his work and the right to renew for another fourteen years, but if the author died before the initial term expired, his renewal right dissolved and the work entered the public domain.[14] Unlike its British counterpart, the 1790 Act explicitly allowed the author to assign his right of renewal.[15] If the author survived beyond the initial fourteen years, the statute provided that he, his executor, or his assigns could exercise the right to renew copyright protection for a second fourteen-year term.[16]

The Copyright Act of 1831 doubled the initial copyright term to twenty-eight years and preserved the right to renew for an additional fourteen years.[17] Yet unlike the 1790 Act, the 1831 Act mandated that if the author died before expiration of the original term, his right of renewal passed to

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13. *Compare* Act of May 31, 1790, ch. 15, 1 Stat. 124 (repealed 1831) *with* Statute of Anne, 1710, 8 Ann, c. 19 (Eng.). *See also* Fred Fisher Music Co. v. M. Witmark & Sons, 318 U.S. 643, 648-49 (1943) (reviewing the history of the Copyright Act).

14. *See Fred Fisher Music Co.*, 318 U.S. at 647. However, an English court interpreting the Statute of Anne held that an author who conveyed "all his interest in the copyright" at the beginning of the first term also conveyed his interest in the renewal term. Carnan v. Bowles, 2 Bro. C.C. 80 (1786), *discussed in* Diane Leenheer Zimmerman, *Authorship Without Ownership: Reconsidering Incentives in a Digital Age*, 52 DEPAUL L. REV. 1121, 1138 n.70 (2003).

15. *Compare* Act of May 31, 1790, ch. 15, 1 Stat. 124 (repealed 1831) *with* Statute of Anne, 1710, 8 Ann, c. 19 (Eng.).

16. Act of May 31, 1790, ch. 15, 1 Stat. 124 (repealed 1831).

17. Act of Feb. 3, 1831, ch. 16, 4 Stat. 436 (repealed 1909).

his surviving spouse and children.[18] Notably, the 1831 Act excised the 1790 Act's provision that the author's assigns may have the right to renew the copyright.[19] Still, the Supreme Court held in *Paige v. Banks* that if an author assigned his copyright "forever" during the first term and survived into the renewal term, then the right of renewal vested in the assignee rather than the author.[20] The *Paige* decision, by validating an author's assignment of the right to renew under the 1831 Act despite congressional intent to vest the right in the author or his heirs, foreshadowed the Court's interpretation of the renewal provision of the Copyright Act of 1909 Act in *Fred Fisher Music v. Witmark & Sons*.[21]

2. *The Right of Renewal Under the 1909 Act*

In 1905, on Theodore Roosevelt's suggestion, the House Patent Committee undertook revising the Copyright Act to reflect the sentiment that "authors no longer needed to be . . . protected from their own incompetence by the renewal device."[22] Nevertheless, perhaps persuaded by Mark Twain's testimony that he had only made money from *Innocents Abroad* because he owned the right to renew its copyright,[23] Congress preserved the dual copyright term renewal system in the Copyright Act of 1909.[24]

Under the 1909 Act, copyright subsisted for an initial twenty-eight years followed by an optional twenty-eight year renewal term.[25] Section 23 provided that the right of renewal vested in the author during the twen-

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18. *Id*.

19. *Id*. *See also Fred Fisher Music Co.*, 318 U.S. at 651; Michael Rosenbloum, *Give Me Liberty and Give Me Death: The Conflict Between Copyright Law and Estates Law*, 4 J. INTELL. PROP. L. 163, 167 (1996). One commentator theorizes that Congress intended to prevent the author from conveying the reversionary interest to anyone but his family. *See* William F. Patry, *The Copyright Term Extension Act of 1995: Or How Publishers Managed to Steal The Bread From Authors*, 14 CARDOZO ARTS & ENT. L.J. 661, 670 (1996).

20. 80 U.S. (13 Wall.) 608, 614-15 (1871) ("The fair and just interpretation of the terms of the agreement indicate unmistakably that the author of the manuscript . . . intended to vest in the publishers a full right of property thereto.").

21. 318 U.S. at 656-59 (validating an author's assignment of the renewal right); *see also* Rosenbloum, *supra* note 19, at 167-68.

22. Kathleen M. Bragg, The Termination of Transfers Provision of the 1976 Copyright Act: Is it Time to Alienate it or Amend it?, 27 PEPP. L. REV. 769, 770 (2000).

23. Patry, *supra* note 19, at 670 (citing Arguments Before the Committees on Patents on S. 6330 and H.R. 19853, 59th Cong., 1st Sess. 116-21 (1906) (statement of Mark Twain)). Patry notes the irony that Mr. Twain in fact testified in support of a single copyright term of life plus a fixed duration.

24. Copyright Act of 1909, Pub. L. No. 349, 35 Stat. 1075 (repealed 1976).

25. *Id*.

ty-eighth year of the first copyright term.[26] If the author was no longer alive, the renewal right would vest in the following order: to the author's widow and children; to the author's executor; or, in the absence of a will, to the author's next of kin.[27] Theoretically, the right of renewal gave the author or his statutory heirs a chance to renegotiate the terms of a license or transfer with the enhanced leverage of knowing the market valuation of the copyrighted work.[28] In practice, copyright renewal proved difficult and confusing due to unwieldy renewal formalities, which often led to works lapsing into the public domain.[29]

Moreover, publishers often required an author to assign the right of renewal before it vested, a practice the Supreme Court upheld in *Fred Fisher Music*.[30] Though the Court noted the House Committee's sentiment "that it should be the exclusive right of the author to take the renewal term . . . so that he could not be deprived of that right,"[31] the Court enforced an author's pre-assignment of his renewal copyright interest in his musical composition "When Irish Eyes Are Smiling."[32] Justice Frankfurter inferred that if Congress had intended to forbid the author from assigning his right of renewal, it would have made the restriction explicit in the Copyright Act itself.[33] Consequently, the Court refused to nullify an assignment of renewal rights because there was no statutory language to that effect in the 1909 Act.[34]

B. 1978 to Present: The Right to Terminate Transfer of Copyright

Publishers' practice of compelling authors to assign their renewal rights, validated in *Fisher*, prevented authors from getting a second oppor-

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26. *Id*.

27. *Id*.

28. *See* Stewart v. Abend, 495 U.S. 207, 218-19 (1990) (citing H.R. REP. NO. 2222, at 14 (1909)).

29. *See* Stephen W. Tropp, *It Had to Be Murder or Will Be Soon – 17 U.S.C. § 203 Termination of Transfers: A Call for Legislative Reform*, 51 J. COPYRIGHT SOC'Y U.S.A. 797, 802 (2004) ("the formalities associated with registration of the renewal term often led to forfeiture"); *see also* MELVILLE B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT § 9.03 *et seq*. (2008); R. Anthony Reese, *Reflections on the Intellectual Commons: Two Perspectives on Copyright Duration and Reversion*, 47 STAN. L. REV. 707, 717 (1995) ("[t]he bipartite term increased the availability to the public of creative works . . . since any author desiring continued protection could obtain it by filing for the renewal term.").

30. Fred Fisher Music Co. v. M. Witmark & Sons, 318 U.S. 643, 656-59 (1943).

31. *Id.* at 654 (quoting H.R. REP. NO. 2222, at 14-15 (1909)).

32. *Id.* at 656-59.

33. *Id.* at 655-56.

34. *Id.*

tunity to control their copyrights, and thereby eroded the justification for copyright renewal and the dual term copyright regime.[35] With the Court's admonition from *Fisher* in mind,[36] authors' rights groups petitioned Congress to explicitly restrict the alienability of copyright reversionary interests.[37] The Copyright Act of 1976 incorporated their proposal.

The 1976 Act eliminated the dual copyright term in favor of a single duration of the life of the author plus fifty years. The Sonny Bono Copyright Term Extension Act of 1998 (CTEA) lengthened the single term to life plus seventy years.[38] For pre-1978 works in their original or renewal copyright term, the 1976 Act and the CTEA granted an additional nineteen and twenty years of copyright protection, respectively.[39]

Since the single term copyright regime precluded an authors' right to a renewal period, the 1976 Act and the CTEA replaced it with the right to terminate assignments of copyrights.[40] Sections 203(a) and 304(c) granted the right to terminate post-1978 and pre-1978 assignments, respectively.[41] Because neither party to a pre-1978 assignment agreement could have contemplated new legislation extending the copyright term, the assignee might have received a windfall from the extended term of copyright protection.[42] Instead, Congress intended that authors should receive the windfall and consequently granted authors the right to terminate pre-1978 copyright transfers.[43]

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35. *See* Stewart v. Abend, 493 U.S. 207, 218 (1990); Mills Music, Inc. v. Snyder, 469 U.S. 153, 185 (1985) (White, J., dissenting); *see also* Bill Gable, *Taking it Back*, LOS ANGELES LAWYER, June 2008, at 34. Gable makes the interesting observation that after *Fisher*, a speculation market developed for third parties to buy up authors' renewal rights in the hopes that the underlying works were successful.

36. Justice Frankfurter proclaimed that if Congress had intended "statutory restraints upon the assignment by authors of their renewal rights, it is almost certain that such purpose would have been manifested." 318 U.S. at 655-56.

37. *See* Tropp, *supra* note 29, at 803-07.

38. 17 U.S.C. § 302(a) (2006).

39. 17 U.S.C. § 302(a)(2).

40. 17 U.S.C. §§ 203(a), 304(c). Note that the statute excludes from termination all copyrights in works made for hire.

41. *Id.*

42. See John Molinaro, Note, Who Owns Captain America? Contested Authorship, Work-For-Hire, and Termination Rights Under the Copyright Act of 1976, 21 GA. ST. U. L. REV. 565, 573-74 (2004) (citing H.R. REP. NO. 94-1476, at 140 (1976), reprinted in 1976 U.S.C.C.A.N. 5659, 5756).

43. 17 U.S.C. § 304(c). *See also* H.R. REP. NO. 94-1476, at 140 ("[T]he author or the dependents of the author should be given a chance to benefit from the extended term. . . . [T]here are strong reasons for giving the author, who is the fundamental beneficiary of copyright under the Constitution, an opportunity to share in it."); *id.* at 124 (not-

The following three sections will explain the mechanics of termination rights, the effects of terminating a transfer, and the inalienability of termination rights.

1. Conditions of § 203(a) and § 304(c)-(d) Termination

a) Timing and Formalities

To exercise the right to terminate any exclusive or non-exclusive post-1978 copyright grant, the author or his statutory heirs must serve notice to the grantee and the Copyright Office between the twenty-fifth and thirty-third year of the grant and exercise the termination right between the thirty-fifth and fortieth year.[44] To terminate a pre-1978 grant of copyright entered into before January 1, 1978, the author or his heirs must serve notice between ten and two years before the termination right vests[45] and exercise it during a five-year period beginning at the end of fifty-six years from the date on which copyright was secured, or January 1, 1978, whichever is earlier.[46] If the author or his heirs do not exercise the termination right within this period, they will have another opportunity to terminate the assignment beginning at the end of seventy-five years from the date on which the copyright was secured.[47]

b) Who May Exercise the Termination Right

If the author dies before he can exercise his termination rights, the statute mandates that the rights pass in one of the following ways: fifty percent to his surviving spouse and fifty percent to the surviving children and/or surviving children of dead children to be split evenly between them; solely to his surviving spouse, if the author has no living children or grandchildren; or solely to his surviving children and surviving children of any dead children, if the author has no surviving spouse.[48] Furthermore, a per stirpes majority of the statutory rights holders must join together to effect termination of a grant.[49] However, if a party other than the author

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ing that Congress granted termination of transfer rights in order to protect "authors against unremunerative transfers"); Molinaro, *supra* note 42, at 573-74.

44. 17 U.S.C. § 203(a)(3)-(4). Note that a post-1978 transfer must be made by the author himself to be eligible for statutory termination.

45. 17 U.S.C. § 304(c)(4)-(d)(1).

46. 17 U.S.C. § 304(c).

47. 17 U.S.C. § 304(d)(2).

48. 17 U.S.C. § 203(a)(2).

49. 17 U.S.C. § 203(a)(1). *See also* Allison M. Scott, *Oh Bother: Milne, Steinbeck, and an Emerging Circuit Split Over the Alienability of Copyright Termination Rights*, 14 J. INTELL. PROP. L. 357, 368 n.66 (2007) (reasoning that "[b]ecause a fractionated termi-

enters into a pre-1978 grant, only that party pursuant to § 304(a)(1)(C) has the authority to terminate it.[50]

2. *Effects of § 203(a) and § 304(c)-(d) Termination*

Upon termination of a grant, ownership of the copyright reverts to the author or his statutory heirs, even those statutory heirs that owned a minority interest in the termination right and did not join with the majority to exercise it.[51] Each statutory heir obtains an ownership interest in the reverted copyright proportional to his interest in the termination right.[52]

The practical effect of this scheme is that a further grant of the reverted copyright, or an agreement to make a further grant, is only valid if signed by a majority interest of the right holders[53] and made after the effective date of termination, unless it is a re-grant to the original assignee and is made after proper notice of termination.[54] If valid, the further grant is binding on the minority termination right holders, who can hold an accounting for their share of the benefits of the grant.[55]

C. The Inalienability of Termination of Transfer Rights

The statute permits the author or his statutory heirs to terminate a grant of copyright "notwithstanding any agreement to the contrary, including an agreement to make a will or to make any future grant."[56] Indeed, the Supreme Court in *Stewart v. Abend* characterized the termination of transfer rights as "inalienable."[57] By establishing that the termination of transfer right "cannot be waived . . . or contracted away,"[58] Congress avoided the

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nation interest must be exercised 'on a per stirpes basis,' a majority of heirs will not necessarily represent a majority of the interest.").

50. 17 U.S.C. § 304(c)(1).

51. 17 U.S.C. § 203(b).

52. 17 U.S.C. § 203(b)(2).

53. 17 U.S.C. § 203(b)(3).

54. 17 U.S.C. § 203(b)(4).

55. 17 U.S.C. § 203(b)(3).

56. 17 U.S.C. § 304(c)(5)-(d)(1). Note that this applies to both § 203(a) and § 304(c)-(d).

57. Stewart v. Abend, 495 U.S. 207, 230 (1990); *See also* David Nimmer & Peter S. Menell, *Sound Recordings, Works for Hire, and the Termination-of-Transfers Time Bomb*, 49 J. COPYRIGHT SOC'Y U.S.A. 387, 396 (2001) (noting that "Congress made the termination rights inalienable"). *But see* Milne v. Stephen Slesinger, Inc., 430 F.3d 1036, 1043 (9th Cir. 2005) ("The only discussion in *Stewart* pertaining to inalienability is the Court's relatively brief portrayal of the evolution of copyright law.").

58. H.R. REP. NO. 94-1476, at 125 (1976), *reprinted in* 1976 U.S.C.C.A.N. 5659, 5740.

"*Witmark* problem"[59] by guaranteeing that authors and their heirs would keep a reversionary copyright interest.

Despite this seemingly clear statutory language, the Ninth Circuit held in *Milne v. Stephen Slesinger, Inc.* that a post-1978 re-grant of *Winnie the Pooh* copyrights superseded the original pre-1978 grant such that A.A. Milne's statutory heirs lost their right to terminate the initial agreement.[60] The *Milne* court reasoned that the post-1978 agreement was not an "agreement to the contrary" simply because it had the collateral effect of extinguishing the right to terminate the original agreement.[61] A post-1978 renegotiated agreement thus served "as an alternative to [§ 304(c)] termination."[62] The Second Circuit found *Milne* persuasive when it addressed the same issue in *Penguin (USA) v. Steinbeck*.

II. *STEINBECK* CASE SUMMARY

A. Facts

In 1938, John Steinbeck and Viking Press entered into an agreement (1938 Agreement) for the exclusive right to publish Steinbeck's books in the United States and Canada in exchange for net royalties.[63] Viking later assigned the United States publishing right to Penguin Group (USA) Inc., which assumed the contractual duties owed to Steinbeck.[64]

Steinbeck renewed all copyrights covered by the 1938 Agreement during his lifetime.[65] He died in 1968, leaving the entire interest in his copyrights to his widow, Elaine Steinbeck.[66] Steinbeck's sons from a previous marriage, Thomas Steinbeck and John Steinbeck IV, each received a sum of money, but Steinbeck's will excluded his sons from ownership of the copyrights.[67] When Congress granted the § 304(c) statutory termination

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59. Nimmer, *supra* note 3, at 951 (referring to *Fred Fisher Music Co. v. M. Witmark & Sons*, 318 U.S. 643 (1943), in which the Supreme Court frustrated Congress' attempt to give authors a chance to regain copyright by validating assignments of renewal rights prior to vesting).

60. 430 F.3d 1036, 1046 (9th Cir. 2005), *cert. denied*, 126 S.Ct. 2969 (2006).

61. *Id.* at 1046.

62. *Id.* It is not clear whether the Ninth Circuit's ruling extends to renegotiation of a post-1978 copyright grant as a viable alternative to § 203(a) termination.

63. Penguin Group (USA) Inc. v. Steinbeck, 537 F.3d 193, 196 (2d Cir. 2008).

64. *Id.*

65. *Id.* at 196-97.

66. *Id.* at 196.

67. *Id.* at 196-97.

right in 1978, Steinbeck's sons and his widow each had a one-half interest in the right to terminate.[68]

The parties never came together to form the majority interest necessary to terminate the 1938 grant under § 304(c). Instead, Elaine Steinbeck, as owner of the copyrights to Steinbeck's books, entered into a new agreement with Penguin in 1994 (1994 Agreement) to publish the works covered by the 1938 Agreement and some additional works.[69] She received a larger guaranteed advance and an increased royalty rate, and the parties explicitly provided that the 1994 Agreement would terminate and supersede the earlier publishing agreement.[70] Thomas and John Steinbeck IV were not parties to the 1994 Agreement because, although they shared a portion of the statutory right to terminate transfer of the copyrights, they did not have an ownership interest in the copyrights themselves.[71]

When Elaine Steinbeck died in 2003, she left her ownership interest in John Steinbeck's copyrights to a variety of heirs,[72] but her will specifically excluded Thomas Steinbeck, John Steinbeck IV, and their heirs.[73] Because Elaine's share of the § 304(d) termination right was not devisable or inheritable, it expired upon her death, leaving Thomas and the surviving child of John IV (collectively the "Steinbeck Descendants") with the totality of the termination interest between the two of them.[74] In June 2004, the Steinbeck Descendants served a notice to terminate the 1938 Agreement and recapture the copyrights from Penguin.[75] Penguin immediately filed suit in the United States District Court for the Southern District of New York seeking declaratory judgment against the Steinbeck Descendants that their notice of termination was invalid because the 1938 Agreement, having been superseded by the 1994 Agreement, was no longer terminable.[76] Elaine's heirs and estate filed suit seeking the same declaration, and the district court consolidated the actions.[77]

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68. *See* 17 U.S.C. § 304(c)(2)(A)-(B) (2006).
69. *Steinbeck*, 537 F.3d at 196.
70. *Id*.
71. *Id.* at 196-97.
72. None of Elaine's devisees were related to John Steinbeck. *See* Steinbeck v. McIntosh & Otis, Inc., 433 F. Supp. 2d 395, 400 (S.D.N.Y. 2006).
73. *Id.* at 197.
74. *Id.* at 196-97.
75. *Id.* at 197.
76. *Id.* at 199.
77. *Id.* at 199.

B. The District Court Decision

The district court found that the Steinbeck Descendants' termination notice was valid, and granted summary judgment against Penguin and Elaine Steinbeck's heirs.[78] The court held that the termination was valid for three reasons: (1) the 1994 Agreement did not supersede the 1938 Agreement because it did not change any of the parties' rights and obligations from the earlier agreement;[79] (2) the 1994 Agreement intended to preserve the statutory termination right because it contemplated a future exercise of the right;[80] and (3) even if the 1994 Agreement superseded the 1938 Agreement, it was void under the Copyright Act as "an agreement to the contrary" to the extent that it barred the Steinbeck Descendants from exercising their inalienable termination right.[81] The *Steinbeck* district court found that the plain language of the phrase "notwithstanding any agreement to the contrary" nullified "any contract the effect of which is in contravention of or which negates [§ 304(c)-(d)] termination rights."[82] To interpret the 1994 Agreement as stripping Steinbeck's statutory heirs of their termination right to the benefit of Elaine and her heirs, the court reasoned, would be "contrary to the very purpose of the termination statute."[83] Penguin appealed and the Second Circuit reviewed the lower court's decision.[84]

C. The Second Circuit Decision

On appeal, the Second Circuit found that the district court was in error on all three issues. It reversed and remanded for entry of summary judgment against the Steinbeck Descendants and declared their notice of termination invalid.

1. The 1994 Agreement Superseded the 1938 Agreement

The Second Circuit overruled the district court finding that the 1938 Agreement survived because the 1994 Agreement did not alter the parties' rights and obligations under the earlier Agreement.[85] The court stated that

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78. Steinbeck v. McIntosh & Otis, Inc., 433 F. Supp. 2d 395, 401 (S.D.N.Y. 2006).
79. *Id*. at 401-02.
80. *Id.* at 401 (the court asserted that the 1994 Agreement "explicitly carries forward possible future termination under the statute, reading: 'If Elaine Steinbeck exercises her right to terminate grants made to Publisher in this agreement (in accordance with *Section 304(c) of Title 17 of the U.S. Code . . .*)'").
81. *Id.* at 399 (citing 17 U.S.C. § 304(c)(5) (2006)).
82. *Id.*
83. *Id.* at 402 n. 23.
84. Penguin Group (USA) Inc. v. Steinbeck, 537 F.3d 193, 199-200 (2d Cir. 2008).
85. *Id.* at 200-01.

its "central inquiry is . . . [the parties'] intent to terminate the 1938 Agreement."[86] Under New York state contract law, a subsequent agreement terminates and replaces the original agreement if the subsequent agreement expresses a clear intent to do so.[87] Because the 1994 Agreement stated it would "cancel and supercede the previous agreements," the court held that this was the parties' intent, and the 1994 Agreement therefore superseded the 1938 Agreement.[88]

2. *Even if the 1994 Agreement Contemplated Survival of the Termination Right, the Right Was Extinguished Because There Was No Pre-1978 Transfer to Terminate*

The court further ruled that the Steinbeck Descendants did not have a valid termination right because, since the 1994 Agreement superseded the 1938 Agreement, there was no pre-1978 grant of copyright to terminate.[89] Though the lower court observed that the 1994 Agreement intended to preserve the termination rights, the Second Circuit found this conclusion insignificant.[90] The court reasoned that whether or not the author's heirs could exercise the termination right depended on the existence of a pre-1978 grant to satisfy the statute, rather than on the contractual intent of the parties.[91] In addition, the court concluded that neither the statute nor its legislative history expressed the intent that an original grant of copyright should survive a subsequent grant solely for the purposes of exercising future termination rights.[92] Therefore, because the 1994 Agreement clearly superseded the 1938 Agreement, the court found that the Steinbeck Descendants had no right to terminate the assignment and recapture copyright.[93]

3. *The 1994 Agreement Was Not Void as an "Agreement to the Contrary"*

Finally, the court held that the 1994 Agreement was not void as an "agreement to the contrary" under the statute. It refused to read "agreement to the contrary" broadly, as the district court had, to mean any

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86. *Id.* at 201.
87. *Id.* at 200.
88. *Id.*
89. *Id.* at 202.
90. *Id.* at 201.
91. *Id.*
92. *Id.* at 203 (citing Milne v. Stephen Slesinger, Inc., 430 F.3d 1036, 1046 (9th Cir. 2005)).
93. *Id.* at 201.

agreement that has the effect of eliminating a termination right.[94] Based on this reading, the court concluded that neither the plain language nor legislative intent of the Copyright Act precluded authors and their heirs from losing the right to terminate a pre-1978 grant by renegotiating it.[95] It satisfied the statute that Elaine, Steinbeck's widow, devisee of copyright and statutory successor to half of the termination interest, used her termination right as bargaining power to renegotiate the agreement with Penguin.[96]

Nor did the court consider the 1994 Agreement an "agreement to the contrary" because it barred exercise of the § 304(d) termination right, which Congress did not grant, and therefore did not exist, until 1998.[97] The court reasoned that because § 304(d) termination is available only if the rights-holder(s) has not already exercised § 304(c), the statute affords but one opportunity to use the termination right.[98] Moreover, since Elaine used the § 304(c) termination right as a bargaining chip to renegotiate the original publishing agreement, she "exhausted the single opportunity provided by statute."[99] Thus, though the 1994 Agreement precluded the exercise of § 304(d) termination rights, the court held that it did not violate the statute as an "agreement to the contrary."[100]

4. *Policy Underpinning of the Steinbeck Decision*

Steinbeck interprets the reversionary interest provision of the Copyright Act to favor the publisher, despite Congress's desire to protect au-

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94. *Id.* at 202.

95. *Id.* at 203.

96. *Id.* at 204 (reasoning that "nothing in the statute suggests that an author or an author's statutory heirs are entitled to more than one opportunity, between them, to use termination rights to enhance their bargaining power or to exercise them."). However, note that because Elaine only had a fifty percent share of the termination interest, she could not have effected termination unless she had agreed to do so with the Steinbeck Descendants.

97. *Id.* at 202-03 ("We cannot see how the 1994 Agreement could be an 'agreement to the contrary' solely because it had the effect of eliminating termination rights that did not yet exist."). Still, the 1976 Congress intended for the § 304(c) termination right to give authors, rather than their assignees, the windfall from an unforeseen extension of copyright term. *See* Molinaro, *supra* note 42, at 573-74 (citing H.R. REP. NO. 94-1476, at 140 (1976), *reprinted in* 1976 U.S.C.C.A.N. 5659, 5756). When Congress extended the copyright term in 1998 it granted authors a second termination opportunity, suggesting a similar intent to § 304(d).

98. *Steinbeck*, 537 F.3d at 202-03 (citing 17 U.S.C. § 304(d) (2006)).

99. *Id.* at 204.

100. *Id*.

thors and their heirs.[101] There have been, and continue to be, compelling policy reasons for courts to rule that the authors' reversion interests are alienable, although the Second Circuit did not expressly discuss them in its decision.[102] Echoing Justice Frankfurter's sentiment in *Fred Fisher Music*,[103] scholars have frequently criticized sections 203 and 304 as paternalistic and overprotective of authors.[104] Under standard economic theory, the argument goes, restricting an author's ability to part with termination rights might prove detrimental to both authors and publishers because it devalues the copyright as an asset.[105] Though the common justification for an inalienable termination right is that the author cannot demand fair compensation for the work before it has been exploited because its accurate value is not then known, the author and the publisher each take the reciprocal risk that the work might be worth more or less than what they bargained for.[106] Additionally, termination rights are intended to correct the balance of bargaining powers between author and publisher, but "the present statute creates its own imbalance by assuming that all authors have no bargaining power."[107]

III. DISCUSSION

This Part will contend that the Second Circuit erred in its construction of the termination of transfers statute, that *Steinbeck* is inconsistent with the statutory inheritance scheme for termination rights, and that *Steinbeck* does not provide a reliable rule for future cases.

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101. *See* Mills Music, Inc. v. Snyder, 469 U.S. 153, 172-73 (1985) (noting that the legislative history and plain text of the statute show that "[t]he principal purpose of the amendments in § 304 was to provide added benefits to authors.").

102. Note, however, that the Second Circuit approvingly cited the *Milne* decision, in which the Ninth Circuit was far more explicit about such policy considerations. *See* Milne v. Stephen Slesinger, Inc., 430 F.3d 1036, 1046 (9th Cir. 2005).

103. Fred Fisher Music v. M. Witmark & Sons, 318 U.S. 643, 657 (1943) ("While authors may have habits making for intermittent want, they may have no less a spirit of independence which would resent treatment of them as wards under guardianship of the law.").

104. *See* Bragg, *supra* note 22, at 769-70.

105. *See id.* at 657 ("Nobody would pay an author for something he cannot sell.").

106. *See* Reese, *supra* note 29, at 736-37 (the Nozickian view would "likely regard the reversion of rights to an author as an expropriation of the assignee's justly acquired property . . . [t]he minimal state should have no role in allocating these risks" between author and publisher).

107. Bragg, *supra* note 22, at 802.

A. The Steinbeck Court Construed "Any Agreement to the Contrary" Narrowly

The *Steinbeck* court's holding that an author's termination rights can be alienable recalls the Court's holding in *Fred Fisher Music*. However, the *Fisher* Court interpreted the 1909 Act, which did not explicitly restrict alienability of renewal rights.[108] The 1976 Act, in fact, added the provision that termination of transfer rights "may be effected notwithstanding any agreement to the contrary" so as to directly override *Fisher*.[109] The *Steinbeck* court construed this statute narrowly, but neither its interpretation methods nor its distinguishing of the Second Circuit's precedent in *Marvel v. Simon* were satisfactory.

1. Plain Language

According to the canons of statutory interpretation, a court first focuses on the plain language of the statute.[110] If the language is unambiguous, "judicial inquiry is complete."[111] If there is ambiguity, the court then looks to the legislative history and purpose of the statute and "must 'construct an interpretation that comports with [the statute's] primary purpose and does not lead to anomalous or unreasonable results.'"[112]

Although the *Steinbeck* district court found that the plain language of the phrase "notwithstanding any agreement to the contrary" nullified "any contract the effect of which is in contravention of or which negates [§ 304(c)-(d)] termination rights,"[113] the Second Circuit in *Marvel*[114] and the Ninth Circuit in *Milne*[115] concluded that this language *was* ambiguous, and those courts subsequently examined the statute's history and purpose.

The Second Circuit in *Steinbeck*, by contrast, did not address whether the statute was ambiguous. Instead, the court began its analysis by stating:

> We do not read the phrase "agreement to the contrary" so broadly that it would include any agreement that has the effect of eli-

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108. *See Fisher*, 318 U.S. at 647.

109. *See* NIMMER & NIMMER, *supra* note 29, § 11.01.

110. *See* Cmty. for Creative Non-Violence v. Reid, 490 U.S. 730, 739 (1989).

111. Connecticut Nat'l Bank v. Germain, 503 U.S. 249, 253 (1992) (citing Rubin v. United States, 449 U.S. 424, 430 (1981)).

112. Marvel Characters, Inc. v. Simon, 310 F.3d 280, 290 (2d Cir. 2002) (quoting Connecticut ex rel. Blumenthal v. United States DOI, 228 F.3d 82, 89 (2d Cir. 2000)).

113. Steinbeck v. McIntosh, 433 F. Supp. 2d 395, 399 (S.D.N.Y. 2006) (citing 17 U.S.C. § 304(c)(5) (2006)).

114. *Marvel Characters*, 310 F.3d at 290.

115. Milne v. Stephen Slesinger, Inc., 430 F.3d 1036, 1046 (9th Cir. 2005), *cert. denied*, 126 S.Ct. 2969 (2006).

> minating a termination right. To do so would negate the effect of other provisions of the Copyright Act that explicitly contemplate the loss of termination rights.[116]

As an example of a provision of the Copyright Act that envisions "loss of termination rights," the court offered the hypothetical of a majority of termination rights-holders agreeing not to exercise termination, which would extinguish the right as to the minority interests.[117] While the court was correct that majority interest holders could eliminate the minority's interest by not exercising termination, the statute explicitly forbids an *agreement* not to exercise termination: "[t]ermination . . . may be effected notwithstanding any agreement to the contrary."[118] Any such agreement would be unenforceable under the plain language of § 304(c)(5). The Second Circuit's analogy fails because it equates a de facto extinction of termination rights with a legal agreement effecting such a loss. For this reason, the court's logic is an imprecise and unsatisfactory attempt at statutory interpretation.

2. *Distinguishing Marvel, Following Milne*

The *Steinbeck* court distinguished its own precedent in *Marvel Characters v. Simon*, and instead followed the Ninth Circuit's ruling in *Milne*. In *Marvel*, the court considered whether a settlement agreement between the author and a publisher characterizing the *Captain America* comic book as a work made for hire barred the author from exercising his § 304(c) termination rights.[119] Because it was uncertain that the settlement agreement was an "agreement to the contrary" by the plain language of the statute, the *Marvel* court looked to the legislative intent.[120] After considering the legislative background, the court reasoned that the statute intended "to prevent authors from waiving their termination rights by contract."[121] Accordingly, the court ruled that the settlement agreement classifying the work as a work made for hire was void as an "agreement to the contrary" to the extent that it stripped the author of his right to terminate the transfer.[122]

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116. Penguin Group (USA) Inc. v. Steinbeck, 537 F.3d 193, 202 (2d Cir. 2008).

117. *Id.* at 204 (citing 17 U.S.C. § 304(d)). Because a per stirpes majority is needed to exercise termination, the minority rights-holders lose their interest if the majority agrees not to terminate.

118. 17 U.S.C. § 304(c)(5) (2006).

119. Marvel Characters, Inc. v. Simon, 310 F.3d 280, 285 (2d Cir. 2002).

120. *Id.* at 290.

121. *Id.*

122. *Id.*

The *Steinbeck* court distinguished *Marvel* as holding "only that backward-looking attempts to recharacterize existing grants of copyright so as to eliminate the right to terminate under § 304(c) are forbidden by § 304(c)(5)."[123] However, the court omitted any discussion of *Marvel*'s statutory construction of the termination provision. Instead, the *Steinbeck* court adopted the Ninth Circuit's reasoning in *Milne* that because Congress intended authors to get a second chance to benefit from their copyright, a renegotiated grant that precludes exercise of the termination right is not void as an "agreement to the contrary."[124] Even assuming that *Steinbeck* was correct in following *Milne*, the court was careless to distinguish *Marvel* without addressing *Marvel*'s conclusion that Congress intended the statute to prohibit any contract that would strip authors of termination rights. In so doing, *Steinbeck* charts a course that greatly diverges from both the plain language and the intent of the statute.

B. Steinbeck's Outcome Contravenes the Copyright Act's Statutory Inheritance Scheme for Reversionary Rights

The most compelling justification for the Second Circuit's ruling is that Elaine Steinbeck accomplished exactly what Congress envisioned for authors and their heirs: she renegotiated an assignment of copyrights at a time when she knew what they were worth on the market, thus securing more of the works' value.[125] Yet Congress did not intend to benefit the author's widow alone if the author has living children or grandchildren.[126]

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123. Penguin Group (USA) Inc. v. Steinbeck, 537 F.3d 193, 203 (2d Cir. 2008).

124. *Id.* (citing Milne v. Stephen Slesinger, Inc., 430 F.3d 1036, 1046 (9th Cir. 2005)).

125. *Milne*, 430 F.3d at 1046 (quoting H.R. REP. NO. 94-1476, at 124 (1976), *reprinted in* 1976 U.S.C.C.A.N. 5659, 5740). The court stated:

> The rationale behind the legislation was to "safeguard[] authors against unremunerative transfers" and improve the "bargaining position of authors" by giving them a second chance to negotiate more advantageous grants in their works after the works had been sufficiently "exploited" to determine their "value." . . . Congress sought to foster this purpose by permitting an author's heirs to use the increased bargaining power conferred by the imminent threat of statutory termination to enter into new, more advantageous grants.

Id. Still, it is doubtful that Elaine did in fact wield an "imminent threat of statutory termination" during her 1994 renegotiations with Penguin, because "without a majority termination interest, it appears that Elaine Steinbeck would have been unable to terminate the 1938 Agreement on her own." *Steinbeck*, 537 F.3d at 203 n.5.

126. *See* H.R. REP. NO. 94-1476, at 125 ("There are three different situations in which the shares . . . of a dead author's widow or widower, children, and grandchildren, must be divided under the statute: (1) The right to effect a termination; (2) the ownership

Just as the termination provisions restrict an author's freedom of contract, so too do they interfere with the author's freedom of testation.[127] The author is free to devise his copyright ownership interest, but the statute mandates that his family receive the termination of transfer rights upon his death. In this way, the Copyright Act protects the author's family from disinheritance.[128]

By contrast, Elaine Steinbeck completely disinherited the Steinbeck Descendants when she re-granted the publication rights to Penguin. That the author's successor in ownership of copyright can unilaterally prevent the statutory class of heirs from realizing their reversionary interest is inconsistent with the statute.[129] The *Steinbeck* court erred in following *Milne*'s reasoning that renegotiation of a grant of copyright is a legal "alternative" to termination. Renegotiation, unlike termination, does not necessarily benefit all, or even some of the statutory heirs.[130] Perhaps a court would reach a different result if the author devised his copyrights, and with them the right to renegotiate grants, to his dry cleaner, say, instead of his widow.[131]

C. Steinbeck Fails to Provide a Predictable Rule

When the *Steinbeck* district court decided for the Steinbeck Descendants, some commentators anticipated a split between the Ninth and Second Circuits on the question of whether or not termination rights "can be relinquished or otherwise alienated through contractual arrangements prior to their formal exercise."[132] However, the Second Circuit in *Steinbeck*

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of the terminated rights; and (3) the right to make further grants of reverted rights."). *See also* 17 U.S.C. §§ 203(a)(2), 304(c)(2) (2006).

127. *See generally* Rosenbloum, *supra* note 19 (reviewing how copyright law preempts the author's conveyance of his contingent copyright interests).

128. *See* Saroyan v. William Saroyan Found., 675 F. Supp. 843, 846 (S.D.N.Y. 1987) (holding that an author's reversionary copyright interest belonged to the statutory heirs "regardless of the author's own wishes"). *See also* Rosenbloum, *supra* note 19, at 164-65.

129. For a general overview of the how copyright law conflicts with a deceased author's testament, see Tritt, *supra* note 1, at 182-86.

130. This result also undermines the court's intent to encourage parties' freedom of contract. *See* Scott, *supra* note 49, at 386-87 ("[A]llowing one heir to use his termination rights as a bargaining tool to negotiate a post-transfer contract completely deprives other heirs of their ability to similarly use their termination rights as a basis for negotiating their own bargains.").

131. Under the *Steinbeck*/*Milne* rule, if an author devised ownership of his copyrights to a party not belonging to the statutory inheritance class, and that party subsequently renegotiated the grant of copyright, none of the author's statutory heirs would be able to exercise termination rights or indeed receive any benefit from the author's works.

132. Scott, supra note 49, at 387-88; see also Roxanne E. Christ, Milne v. Slesinger: The Supreme Court Refuses to Review the Ninth Circuit's Limits on the Rights of Au-

adopted the *Milne* rule, and the circuits now agree that renegotiating a pre-1978 grant of copyright dissolves the right to terminate it.[133] Consequently, the Supreme Court, which denied the petition for certiorari in *Milne*,[134] is unlikely to address the issue.

It is unlikely that the rule in *Steinbeck* and *Milne* will yield reliable results. In the recent case *Classic Media, Inc. v. Mewborn*, for instance, the Ninth Circuit found valid an heir's termination interest in the *Lassie* copyright, because even though the heir renegotiated an assignment with the production company, her termination rights had not vested at the time.[135] Thus, she had "nothing in hand with which to bargain," and so the new assignment did not extinguish her termination interest.[136] The court distinguished *Milne* as a case where the rights-holder "had—and knew that he had—the right to vest copyright in himself at the very time he revoked the prior grants and leveraged his termination rights to secure the benefits of the copyrighted works for A.A. Milne's heirs."[137]

Similarly, to determine whether a re-grant dissolves termination rights, a court's inquiry might now become: (1) whether the subsequent agreement superseded the original, and (2) whether or not the author or his heirs in fact used their termination interest as leverage. This is neither a logical nor dependable method to determine the availability of copyright interests granted by federal statute. The first factor requires courts to apply state contract law. The *Steinbeck* court, for instance, looked to New York law to resolve whether the subsequent grant superseded the original. If the other circuits adopt the *Steinbeck* and *Milne* rule, application of differing state contract laws could generate a lack of uniformity in future termination cases. It could also encourage forum shopping. The second factor of *Steinbeck/Milne* rule is similarly unpredictable, as it "require[s] a very

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thors and Their Heirs to Reclaim Transferred Copyrights, 14 UCLA ENT. L. REV. 33, 44-45 (2007) (theorizing that "[w]ith Marvel Characters, Inc. as binding precedent, there is at least a greater likelihood in the Second Circuit than in the Ninth Circuit that the termination right would be considered inalienable.").

133. The Ninth and Second Circuits agree that termination rights may be either exercised or used as leverage in negotiations, but not both. It will be interesting to see if the Steinbeck Descendants subsequently attempt to hold Elaine's estate for an accounting of fifty percent of the profits from the 1994 Agreement on the theory that they are statutorily determined beneficiaries of the termination interest from which only Elaine derived benefits.

134. Milne v. Stephen Slesinger, Inc., 126 S. Ct. 2969 (2006).

135. 532 F.3d 978, 989 (9th Cir. 2008). At the time Mewborn's heir re-assigned the copyright, she was at the earliest six years away from serving the notice of termination that would vest her right to terminate the grant.

136. *Id.*

137. *Id.*

speculative evaluation of whether or not [the benefits from the agreement] are equivalent to what the heirs would have received through the formal exercise of their termination rights."[138] Having courts judge the adequacy of such bargains is almost certain to fuel an increase in litigation over the exercise of copyright grant termination.

IV. CONCLUSION

The Second Circuit ruled in *Steinbeck* that termination of transfer rights may either be exercised or used as leverage in renegotiating a copyright grant. It joined the Ninth Circuit in holding that statutory termination rights are alienable by contract just so long as the author or his heirs have the opportunity to exercise them. In so doing, the Second Circuit has undermined legislative intent and further complicated what was an already complex statute.[139] Authors and their heirs should be extremely wary about renegotiating the terms of a copyright assignment, as it will likely have the effect, intended or not, of extinguishing their reversionary interests.

138. Scott, *supra* note 49, at 387.

139. One practitioner has cautioned that termination of transfers are "potentially fraught with peril." Gable, *supra* note 35, at 34.

DAVIS V. BLIGE: THE SECOND CIRCUIT'S REJECTION OF RETROACTIVE COPYRIGHT LICENSES

By Michael Todd Mobley

On August 28, 2001, MCA Records released Mary J. Blige's album "No More Drama."[1] This critically acclaimed album—the "Queen of Hip-Hop Soul's" fifth studio release—moved over five million units worldwide and earned Blige a Grammy.[2] However, with the success of "No More Drama" came setbacks. Soon after the album was released, a legal dispute began regarding the copyrights in the musical compositions for two of the album's tracks.

In *Davis v. Blige*, the Second Circuit announced that both transfers of ownership interest in a copyright and the conveyance of nonexclusive licenses to exploit a copyright are prospective—neither may be applied retroactively to cure past infringement.[3] Although various district courts have addressed this issue, the Second Circuit was the first of the courts of appeals to do so.[4] The court stated that its new rule was based on traditional principles of copyright liability and that it was intended to further the policy goals of facilitating predictability and discouraging infringement of joint works.[5]

Some commentators have argued that this rule is inconsistent with the 1976 Copyright Act (1976 Act) and that the court erroneously relied upon tort law to reach its decision.[6] However, others have asserted that reliance on tort law to define the boundaries of copyright liability is deeply rooted

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1. Mary J. Blige, *Discography*, Mary J. Blige: Official Site, http://www.mjblige.com/discography/ (last visited Feb. 13, 2009).

2. Grammy Award Winners, Grammy.com, http://www.grammy.com/GRAMMY_Awards/Winners/Results.aspx (last visited Feb. 13, 2009).

3. Davis v. Blige, 505 F.3d 90, 104 (2d Cir. 2007), *cert. denied*, 129 S. Ct. 117 (2008).

4. *Id.* at 97.

5. *Id.* at 103-05.

6. *See* Posting of William Patry to The Patry Copyright Blog, The Second Circuit Goes to the Dark Side, http://williampatry.blogspot.com/2007/10/second-circuit-goes-to-dark-side.html (Oct. 8, 2007, 09:00 EST).

in copyright jurisprudence.[7] This Note will address both of these contentions. It will also analyze the two policy rationales—facilitating predictability and discouraging infringement—the court provided to justify the promulgation of a prohibition on retroactive transfers and retroactive nonexclusive licenses.

To facilitate this discussion, Part I examines the nature and scope of copyright protection for joint works by defining "joint works," addressing issues regarding their ownership, and explicating how that ownership is exploited and alienated. Part II focuses on the specific situation that gave rise to *Davis* and discusses how the district court and the Second Circuit confronted that situation. Part III analyzes the Second Circuit's decision and highlights possible complications that *Davis* may present.

This Note argues that the Second Circuit's holding is rooted in and consistent with traditional notions of copyright liability and that the court's rule furthers its stated policy goals. However, the Second Circuit's decision in *Davis* does leave two important issues unaddressed: (1) the 1976 Act's allowance for co-owners of joint works to grant, unilaterally, prospective nonexclusive licenses is itself inconsistent with the court's policy goals of facilitating predictability and discouraging infringement; and (2) the rule creates uncertainty regarding the status of previously existing retroactive conveyances granted pursuant to settlement agreements.

Davis does make advances toward striking a balance between providing co-owners full freedom to exploit and alienate their ownership interests in their joint work and ensuring that all co-owners maintain the reliable ability to protect and enjoy the exclusive rights in their work. However, the case also highlights how courts can only go so far in facilitating predictability, certainty, and fairness amongst co-owners of a joint work. Co-ownership of joint works may result in numerous complications. Co-owners should be aware of these complications and attempt to mitigate them by entering into detailed written agreements that shape the contours of the co-ownership of the copyright in their joint works.

I. BACKGROUND

Prior to the 1976 Act, common law governed joint ownership of copyright.[8] However, the 1976 Act codified the common law principles and

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7. *See, e.g.*, Peter S. Menell & David Nimmer, *Unwinding Sony*, 95 CALIF. L. REV. 941, 996 (2007) ("Courts looked to principles of tort law in delineating the contours of copyright liability.") [hereinafter Menell, *Unwinding Sony*].

8. *See* Avner D. Sofer, *Joint Authorship: An Uncomfortable Fit With Tenancy in Common*, 19 LOY. L.A. ENT. L. REV. 1, 4 (1998).

stated that a joint work is "a work prepared by two or more authors with the intention that their contributions be merged into inseparable or interdependent parts of a unitary whole."[9] If the joint work qualifies for copyright protection,[10] the joint authors become co-owners of the copyright in that joint work.[11]

This Part begins with an examination of the ways in which courts have interpreted the statutory definition of joint works and the ways in which courts have determined who are considered authors of joint works. It then addresses the rights and responsibilities that those authors have as co-owners of the copyright in the joint work. It concludes with a discussion of an issue specific to *Davis*—whether transfers of copyright ownership may operate retroactively.

A. Requirements for Joint Work Status

Most courts have interpreted the statute as emphasizing the authors' intent as the primary requirement for joint work status—the authors must, at the time of the work's creation, intend that each contribution be included in an integrated unit.[12] For example, the Second Circuit has explained that "[t]he wording of the statutory definition appears to make relevant only the state of mind regarding the unitary nature of the finished work—an intention 'that their contributions be merged into inseparable or interdependent parts of a unitary whole.'"[13] The Ninth Circuit has provided factors that should be considered when determining if the authors intended for their contribution to be merged into a unitary whole: (1) whether each contributor exercises control in the creation and production of the work; (2) whether all of the contributors demonstrated objective manifestations of an intent to be deemed co-authors of the joint work; and (3) whether the work's "audience appeal" can be attributed, at least in part, to each of the contributions.[14]

In addition to the intent requirement, most of the federal circuits have interpreted the 1976 Act to require that each contributor provide an independently copyrightable contribution to the work.[15] Although the Second

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9. 17 U.S.C. § 101 (2006).

10. The 1976 Act states, "Copyright protection subsists . . . in original works of authorship fixed in any tangible medium of expression, now known or later developed, from which they can be perceived, reproduced, or otherwise communicated, either directly or with the aid of a machine or device." 17 U.S.C. § 102(a) (2006).

11. 17 U.S.C. § 201(a) (2006).

12. *See, e.g.*, Thomson v. Larson, 147 F.3d 195, 199 (2d Cir. 1998).

13. Childress v. Taylor, 945 F.2d 500, 507 (2d Cir. 1991).

14. Aalmuhammed v. Lee, 202 F.3d 1227, 1234 (9th Cir. 1999).

15. NIMMER ON COPYRIGHT § 6.07[3][b] (2008).

Circuit has adopted this additional requirement, it found the issue to be "troublesome" because the 1976 Act lacks explicit direction that each authors' contribution be independently copyrightable.[16] Nevertheless, the Second Circuit was "persuaded to side with the position taken by the case law and endorsed by the agency administering the Copyright Act."[17] To support its decision, the court noted that the independent copyrightability requirement might be beneficial in curbing fraudulent claims "by those who might otherwise try to share the fruits of the efforts of a sole author of a copyrightable work . . . ."[18]

B. Ownership of Joint Works

Courts have long analogized the relationship between copyright co-owners to that of tenants-in-common in property law.[19] The legislature ratified this analogy in the 1976 Act.[20] Like tenants-in-common, co-owners of a joint work share equal undivided interests in the work as a whole. This remains true, at least in the copyright context, notwithstanding inequalities in each co-owner's respective contributions to the joint work.[21] Therefore, if one author's contribution could be quantified or qualified as less substantial than another author's contribution, both authors, as co-owners of the joint work, would still possess equal undivided interests in the work.[22] However, co-owners may contractually reallocate ownership interest through a written agreement.[23] Co-owners of a joint work are also similar to tenants-in-common in that they, independently, are entitled to exploit their interest in the common property.[24] However, that right also may be contractually altered.[25]

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16. *Childress*, 945 F.2d at 506-07.

17. *Id.* at 507 (noting that "[t]he Register of Copyrights strongly supports this view, arguing that it is required by the statutory standard of 'authorship' and perhaps by the Constitution.").

18. *Id.*

19. *See, e.g.*, Maurel v. Smith, 271 F. 211, 214 (2d Cir. 1921) (stating that "there is no distinction, independent of statute, between [copyrighted property] and property of any other description").

20. H.R. REP. NO. 94—1476, at 121 (1976), *as reprinted in* 1976 U.S.C.C.A.N. 5659, 5736 ("Under the bill, as under the present law, coowners of a copyright would be treated generally as tenants in common . . . .").

21. NIMMER, *supra* note 15, § 6.08.

22. *Id.*

23. *Id.*

24. 17 U.S.C. § 201(d)(2) (2006).

> Any of the exclusive rights comprised in a copyright, including any subdivision of any of the rights specified in section 106, may be transferred . . . and owned separately. The owner of any particular exclusive

1. *Transferring Ownership Interest in the Joint Work*

Without obtaining his or her co-owners' consent, a co-owner may transfer to a third party his or her proportional share of ownership interest in the joint work.[26] In such a situation, the transferor relinquishes her ownership interest to the transferee. The transferee, then, becomes co-owner of the transferred interest in the joint work. To illustrate, consider the following example. Allison and Bob are co-owners of a joint work—a musical composition. They each own an equal undivided interest in the copyrighted composition's exclusive rights.[27] Allison may, without Bob's consent, transfer her fifty percent ownership interest in the composition's exclusive rights to Charlie. Thereafter, Charlie and Bob are co-owners of the composition. Allison relinquished her ownership interest in the composition and, therefore, is no longer a co-owner of the work.

Allison, however, need not have transferred her proportional share in all of the composition's exclusive rights to Charlie. If she had so desired, Allison could have transferred to Charlie her proportional share of only one of the composition's exclusive rights—perhaps the exclusive right to prepare derivative works of the composition.[28] In this situation, Bob and Charlie are co-owners of the exclusive right to prepare derivative works,

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> right is entitled, to the extent of that right, to all of the protection and remedies accorded to the copyright owner by this title.

25. NIMMER, *supra* note 15, at § 6.08.

26. The Copyright Act defines a "transfer of copyright ownership" as "an assignment, mortgage, exclusive license, or any other conveyance, alienation, or hypothecation of a copyright or of any of the exclusive rights comprised in a copyright, whether or not it is limited in time or place of effect, but not including a nonexclusive license." 17 U.S.C. § 101 (2006).

27. The 1976 Act grants copyright owners:

> [T]he exclusive rights to do and to authorize any of the following: (1) to reproduce the copyrighted work . . . (2) to prepare derivative works . . . (3) to distribute copies or phonorecords of the copyrighted work . . . (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 copyright work publicly by means of a digital audio transmission.

17 U.S.C. § 106 (2006).

28. 17 U.S.C. § 201(d)(1) (2006). Prior to the 1976 Act, copyright owners were prohibited from parceling out exclusive rights and transferring them individually. NIMMER, *supra* note 15, § 10.01. However, the 1976 Act repealed this prohibition. Section 201(d)(1) of the 1976 Act states, "The ownership of a copyright may be transferred in whole or in part . . . ." § 201(d)(1). Furthermore, section 201(d)(2) states, "Any of the exclusive rights comprised in a copyright, including any subdivision of any of the rights specified by section 106, may be transferred as provided by clause (1) and owned separately." § 201(d)(2).

while Allison and Bob are co-owners of the composition's other exclusive rights.

Although Allison may transfer to Charlie her proportional share of the exclusive right to prepare derivative works of the composition, she is prohibited from unilaterally transferring complete ownership of the exclusive right itself. One co-owner may not transfer ownership of any exclusive right in its entirety unless *all* of the co-owners consent to the transfer.[29] Once 100 percent ownership of an exclusive right is transferred, only the transferee may exploit that right. If Allison were permitted, unilaterally, to transfer ownership of an exclusive right to Charlie, she would impair Bob's interest in that exclusive right. Allison cannot do this because co-owners of a joint work are prohibited from exploiting the work in a way that impairs the interests of fellow co-owners.[30] Therefore, co-owners may unilaterally transfer their proportional share of ownership interest in an exclusive right, but they may not transfer the entirety of the ownership interest in an exclusive right without the consent of their fellow co-owners.[31]

2. Nonexclusive Licenses to Exploit a Joint Work

Although a co-owner is prohibited from unilaterally transferring the entirety of the ownership interest in an exclusive right to a third party, one co-owner may grant a third party a nonexclusive license to exploit the joint work's exclusive rights.[32] For example, although Allison, without Bob's consent, may not convey to Charlie the exclusive right to reproduce the joint work, Allison may, without Bob's consent, grant Charlie a nonexclusive license to reproduce the joint work. This is permitted because a nonexclusive license does not convey an ownership interest to the licensee.[33] Rather, nonexclusive licenses permit licensees merely to exploit the joint work.[34] Because nonexclusive licenses do not permit the licensee to exclude others from exploiting the joint work, nonexclusive licenses may be granted to multiple licensees.[35] Therefore, "[a] co-owner may grant a *non-exclusive* license to use the work unilaterally, because his co-owners may also use the work or grant similar licenses to other users and because

29. *See* Maurel v. Smith, 271 F. 211, 216 (2d Cir. 1921).

30. *Id.*

31. *Id.* at 215 ("[W]hen the [co-owners] granted right[s] . . . they could but transmit what they had to part with, and they could not transfer what interest the [other co-owner] had.").

32. NIMMER, *supra* note 15, § 6.10[A].

33. *See id.*

34. *Id.*

35. *See* Davis v. Blige, 505 F.3d 90, 101 (2d Cir. 2007).

the nonexclusive license presumptively does not diminish the value of the copyright to the co-owners."[36]

Although co-owners can freely grant nonexclusive licenses without the consent of their fellow co-owners, there are limitations on the licensee's ability to alienate a nonexclusive license.[37] Courts maintain that a nonexclusive license is personal to the licensee; therefore, the nonexclusive licensee cannot sublicense without the consent of the licensor.[38] Courts imported this principle from patent law's nonassignability doctrine.[39] Under the 1909 Act, this nonassignability doctrine applied to both nonexclusive and exclusive licenses.[40] However, with the exception of the Ninth Circuit, courts have held that under the 1976 Act, exclusive licensees may sublicense without the consent of the licensor.[41]

3. *Duty to Account to Co-Owners*

The ability to exploit and to alienate the joint work is subject to one important limitation—co-owners are obliged to account for any profits made.[42] If a co-owner personally exploits the joint work, she must account to the other co-owners for a prorated share of the profits that she generated. Similarly, if a co-owner grants a third party a nonexclusive license to exploit the work, the licensing co-owner must account to the non-licensing co-owners for a prorated share of the profits generated from the licensing agreement. The licensee, however, is not obliged to account to the non-licensing co-owners.[43] Rather, the licensee must adhere to the contractual obligations established in the licensing agreement.[44] For example, Allison and Bob, as previously discussed, are co-owners of a musical composition. Allison grants Charlie a nonexclusive license to reproduce and distribute the composition. According to the nonexclusive licensing agreement, Charlie will sell the composition for ten dollars. For every composition

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36. *Id.*

37. Peter S. Menell, *Bankruptcy Treatment of Intellectual Property Assets: An Economic Analysis*," 22 BERKELEY TECH. L.J. 733, 800 (2007) [hereinafter Menell, *Bankruptcy*].

38. *See In re* Patient Educ. Media, Inc., 210 B.R. 237, 240 (Bankr. S.D.N.Y. 1997).

39. Menell, *Bankruptcy*, *supra* note 37.

40. *See id.* at 801-02.

41. Menell, *Bankruptcy*, *supra* note 37, at 801 ("[I]n the Ninth Circuit, the 'applicable law' prohibits the assignment of exclusive licenses without the licensor's consent.").

42. NIMMER, *supra* note 15, § 6.12[A].

43. Only co-owners are subject to the duty to account. Because nonexclusive licenses do not convey an ownership interest in the copyright, nonexclusive licensees are not co-owners of the copyright. Therefore, nonexclusive licensees are not subject to the duty to account. NIMMER, *supra* note 15, § 6.12[B].

44. *Id.*

Charlie sells, he will give Allison two dollars. Charlie is under no duty to account to Bob. Yet Allison is. For every two dollars that Allison receives from Charlie, she must give one dollar to Bob.

However, if Allison were to sell Charlie her ownership interest in the musical composition, she would not have to account to Bob for the proceeds of that sale because the right to an accounting may only be enforced against other co-owners. Once Allison sells her ownership interest, she is no longer a co-owner. In this situation, Charlie, the transferee, is replacing Allison, the transferor, as a co-owner. The transferee, as a new co-owner, now carries the duty to account to the other co-owners for any profits he may realize from exploiting or licensing the joint work.[45]

The discussion above helps to illuminate the importance of distinguishing between a transfer of ownership interest in a joint work and a grant of a nonexclusive license to use the joint work.[46] The two forms of conveyance trigger different rights and responsibilities regarding the joint work.

4. *Methods of Conveyance for Transfers of Ownership Interest and Nonexclusive Licenses*

Prior to the 1976 Act, transfers of an ownership interest in a copyright could be conveyed orally or by conduct.[47] However, the 1976 Act rejected that practice and required that transfers of copyright ownership be memorialized in writing.[48] Courts have interpreted the statute to permit oral or implied grants of nonexclusive licenses because they do not convey an ownership interest to the licensee.[49]

Although the 1976 Act does state that transfers of ownership interest must be made in writing, it does not state whether the writing must be memorialized contemporaneously to the agreement. The Second Circuit has addressed this gap in the 1976 Act, and it has held that a subsequent writing may ratify a prior oral transfer agreement. In *Dan-Dee Imports, Inc. v. Well Made Toy Manufacturing Corp.*, the Second Circuit stated that "[i]t is hornbook law, of course, that the memorandum need not be contemporaneous with the [transfer agreement]."[50] The Second Circuit provided a more detailed rationale for permitting the written ratification of a prior oral transfer agreement in *Eden Toys, Inc. v. Florelee Undergarment*

45. *Id.* § 6.12[C][1].
46. *Id.*
47. Eden Toys, Inc. v. Florelee Undergarment Co., 697 F.2d 27, 36 (2d Cir. 1982).
48. 17 U.S.C. § 204(a) (2006).
49. NIMMER, *supra* note 15, § 10.03[7].
50. 524 F. Supp. 615, 618 (2d Cir. 1981).

Co., where the court observed that the purpose of the writing requirement is to prohibit persons from fraudulently claiming that they received an oral license as a defense to an infringement suit.[51] The court explained that when "the copyright holder appears to have no dispute with its licensee on this matter, it would be anomalous to permit a third party . . . to invoke this provision against the licensee."[52] Therefore, according to the Second Circuit, the writing requirement cannot be invoked by a third party if both parties to the oral licensing agreement, at some point, have acknowledged the validity of the agreement by ratifying it in writing.

C. Retroactive Transfers and Nonexclusive Licenses of Joint Works

Several district courts have ruled that transfers of ownership interest and nonexclusive licenses can apply retroactively to cure past infringement.[53] In many of these cases, the courts held that defendants were immunized from liability to one co-owner of a joint work because they were granted retroactive transfers or licenses from another co-owner during the course of litigation.[54]

For example, in *Lone Wolf v. CBS*, Orion Pictures, as part of a settlement agreement, granted a retroactive license to CBS for the nonexclusive right to exploit a derivate work of an original movie produced by Orion and Lone Wolf.[55] Orion and Lone Wolf were co-owners of the copyright in the original movie.[56] However, Lone Wolf was not a party in the original copyright infringement lawsuit against CBS and did not participate in the settlement agreement between Orion and CBS.[57] After Orion settled with CBS, Lone Wolf sued CBS for copyright infringement.[58] The court granted summary judgment for CBS because the retroactive license from Orion insulated CBS from liability to Lone Wolf.[59] The court held that

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51. *See* 697 F.2d at 36.

52. *Id.*

53. *See* Johnson v. Tuff-n-Rumble Mgmt., Inc., No. Civ.A. 99-1374, 2000 WL 1808486, at *4 (E.D. La. Dec. 8, 2000); Lone Wolf McQuade Assocs. v. CBS Inc., 961 F. Supp. 587, 599 (S.D.N.Y. 1997); SBK Catalogue P'ship v. Orion Pictures Corp., 723 F. Supp. 1053, 1059 (D.N.J. 1989).

54. *See, e.g.*, Copyright.net Music Publ'g v. MP3.com, No. 01 Civ. 7321 (JSR), 2003 WL 740757, at *1 (S.D.N.Y. Mar. 4, 2003).

55. *Lone Wolf*, 961 F. Supp. at 590.

56. *Id.*

57. *Id.*

58. *Id.*

59. *Id.* at 598.

Lone Wolf's sole remedy was an action for an accounting of the profits received by Orion pursuant to the settlement agreement.[60]

A district court in Louisiana also addressed this issue and held that a retroactive license from one co-owner can immunize a defendant from liability to another co-owner.[61] In this case, Tuff City and the plaintiffs were co-owners of a joint work.[62] Tuff City granted the defendant, Boutit, a retroactive license pursuant to a settlement agreement.[63] Subsequently, plaintiffs sued Boutit for copyright infringement.[64] The court held that because Boutit received a retroactive license from Tuff City, plaintiffs' suit against Boutit had to be dismissed.[65]

Conversely, the Central District of California in *Leicester v. Warner Brothers*, held that retroactive licenses cannot cure past infringement.[66] The court "reject[ed] the idea that [an] earlier infringement can be retroactively validated by the later grant of [a] license."[67] Though the court failed to address precedent or statutory provisions to support its decision, it alluded to the notion that once infringement occurs each co-owner accrues the right to collect damages for that infringement.[68] After the fact licensing, according to this court, could not insulate the infringer from liability for acts already committed.[69]

A district court in the Sixth Circuit agreed with *Leicester* and provided policy rationales for doing so.[70] The court stated that allowing retroactive licenses to cure past infringement might induce infringement of joint works because if the infringer were caught, the infringer could negotiate with one co-owner for liability immunization through a retroactive license.[71] This, the court held, "would plainly contradict the purposes underlying federal copyright law."[72] The court, however, failed to explain

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60. *Id.* at 597.

61. Johnson v. Tuff-n-Rumble Mgmt., Inc., No. Civ.A. 99-1374, 2000 WL 1808486, at *4 (E.D. La. Dec. 8, 2000).

62. *Id.* at *1.

63. *Id.*

64. *Id.*

65. *Id.* at *4.

66. 47 U.S.P.Q. 2d 1501, 1506 (C.D. Cal. 1998).

67. *Id.*

68. *See id.* ("[O]ne owner of a joint authorship work may sue for infringement of the joint work . . . . [I]f an infringement [occurs, it cannot] be later validated by the grant of the license.").

69. *Id.*

70. Encore Ent., L.L.C. v. KidDesigns, Inc., No. 3:03 1129, 2005 WL 2249897, at *10 (M.D. Tenn. Sept. 14, 2005).

71. *Id.*

72. *Id.*

what it considered to be the purposes underlying federal copyright law; it also did not address the potential remedy provided through an action for an accounting—a remedy that the Southern District of New York determined to be sufficient.[73]

II. *DAVIS V. BLIGE*

The Southern District of New York held that a retroactive transfer of ownership interest could cure past infringement and granted Blige's motion for summary judgment.[74] However, the Second Circuit reversed and announced a broad rule of law in the process—neither transfers of ownership interest in a copyright's exclusive rights nor nonexclusive licenses to exploit a copyright apply retroactively.[75]

This Part will first flesh out the situation that gave rise to the copyright infringement suit against Blige and her co-defendants. It will then briefly discuss the district court's ruling before moving to a more in depth look at the Second Circuit's treatment of this case.

A. *Davis v. Blige*: Facts

In 1998, Sharice Davis and Bruce Chambliss (Blige's stepfather) composed and recorded the song "L.O.V.E." at a mutual friend's home and a second song, "Don't Trade in My Love," at Ruff Riders Studio.[76] Sometime after this recording session, Davis played "L.O.V.E." for Blige. Blige enjoyed what she heard and soon sent her brother, Bruce Miller (Chambliss' son), to purchase the copyrights in several of Davis's compositions. Davis, hoping to use the songs to jumpstart her own singing career, declined the offer.[77] However, Davis's refusal failed to deter Blige and Miller, who copied Davis's composition for "L.O.V.E." and heavily relied upon "Don't Trade in My Love" to create Blige's composition for "Keep it Moving." After recording the songs, Blige and Miller decided to include both of these records on Blige's upcoming project, "No More Drama." Davis did not receive song-writing credit on the album.[78]

Chambliss, an original co-owner of the copyrights in the challenged compositions, testified that prior to Blige and Miller using the composi-

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73. *See* Lone Wolf McQuade Assocs. v. CBS Inc., 961 F. Supp. 587, 597 (S.D.N.Y. 1997).

74. Davis v. Blige, 419 F. Supp. 2d 493, 499 (S.D.N.Y. 2005), *rev'd*, 505 F.3d 90 (2d Cir. 2007).

75. Davis v. Blige, 505 F.3d 90, 104 (2d Cir. 2007).

76. *Id.* at 94.

77. *Id.*

78. *Id*.

tions, Chambliss entered into an oral agreement with Miller. This agreement transferred to Miller all of Chambliss' ownership interest in the challenged compositions.[79] Although this oral transfer allegedly occurred in 1998, Chambliss and Miller failed to ratify the agreement in writing until June of 2004, one day before Chambliss' deposition.[80] The written agreement, like the oral agreement, transferred to Miller all of Chambliss' ownership interest in the challenged compositions' copyrights. Additionally, the written agreement was backdated to take effect on the date that those compositions were first created.[81]

In August 2001, Blige and Miller registered "Love" and "Keep It Moving" with the United States Copyright Office.[82] In February 2002, Blige and Miller conveyed an exclusive license to Universal Tunes to reproduce and distribute the compositions included on the album.[83] In August 2002, Davis registered her compositions for "L.O.V.E." and "Don't Trade in My Love" with the Copyright Office and promptly sued Blige and Miller for copyright infringement.[84]

B. The District Court Holds that Transfers and Nonexclusive Licenses Can Apply Retroactively and Grants Blige's Motion for Summary Judgment

Davis brought actions against Blige and Miller for infringement of her copyrights in the disputed compositions by: "(1) recording and registering copyrights on 'Love' and 'Keep It Moving,' which were substantially similar to her compositions, and (2) falsely attributing authorship to [the defendants]."[85] The defendants answered that (1) Chambliss and Miller entered into an oral agreement whereby Chambliss transferred his ownership interest in the compositions' copyrights to Miller before Blige and Miller used the compositions, and (2) that a written agreement ratified this prior oral agreement.[86] Arguing in the alternative, the defendants claimed that this written agreement explicitly stated that it was intended to apply retroactively.[87] According to the defendants, Chambliss' retroactive transfer to Miller effectively made Miller a co-owner of the disputed compositions' copyrights on the day that Chambliss composed and recorded those

79. *Id.* at 95.
80. *Id.*
81. *Id.*
82. *Id.* at 94.
83. *Id.*
84. *Id.*
85. *Id.* at 96.
86. *Id.* at 95, 96.
87. *Id.* at 96.

two tracks. Therefore, because a co-owner cannot sue another co-owner, Davis can neither bring suit against Miller, nor can she bring suit against Blige, because Miller assigned the use of the compositions to Blige.[88]

Although the district court stated that the Second Circuit previously had determined that the 1976 Act's writing requirement could be satisfied by the written ratification of a prior oral agreement, the court did not base its decision on this point of law.[89] The court refrained from doing so because the complicated and highly suspect nature of the situation surrounding this oral agreement left many questions of genuine fact that could not be resolved during a hearing on a motion for summary judgment.[90] Therefore, the court based its decision on defendants' ability to "cure past infringement" by receiving a retroactive assignment of the copyright.[91] To support this, the court cited previous decisions addressing this issue and coming to substantially similar conclusions.[92] The district court, after holding that Chambliss' retroactive transfer to Miller immunized defendants from copyright infringement liability, granted the defendants' motion for summary judgment.[93]

C. The Second Circuit's Reversal

The Second Circuit reversed and remanded.[94] Whether a co-owner of a joint work can transfer retroactive ownership interests to a third party, thereby eliminating the accrued rights of the other co-owners to sue for infringement, was a matter of first impression for the Second Circuit. The court, acknowledging that the 1976 Act is silent on the issue, held that this type of retroactive conveyance is invalid.[95] The court ruled that transfers of ownership interests and grants of nonexclusive licenses only apply prospectively.[96]

The court looked to New York property law, specifically the laws governing tenancy in common, to determine the extent to which one co-owner can or cannot bind other co-owners to an agreement concerning the alienation of jointly owned copyrights.[97] The court explained that copyright ownership is similar to property ownership in that it contains numer-

88. *Id*. at 96-97.
89. Davis v. Blige, 419 F. Supp. 2d 493, 498 (S.D.N.Y. 2005).
90. *Id.*
91. *Id.* at 500.
92. *Id.* at 499-501.
93. *Id.*
94. Davis v. Blige, 505 F.3d 90, 109 (2d Cir. 2007).
95. *Id.* at 97-98.
96. *Id.* at 103.
97. *Id.* at 102.

ous discreet rights, which taken together, comprise the entirety of the ownership interest in the copyright.[98] The court stated that one of these discreet rights is the right to sue for infringement.[99] If a copyright is infringed, all co-owners receive an equal undivided right to sue for infringement.[100] Therefore, if one co-owner transfers retroactive rights to exploit the copyright, this would extinguish the other co-owners already accrued right to sue for infringement.[101] This, the court decided, a co-owner cannot do unilaterally.[102] The court stated that, "a retroactive license or assignment would—if given legal effect—erase the unauthorized use from history with the result that the nonparty co-owner's right to sue for infringement, which accrues when the infringement first occurs, is extinguished."[103]

The court also noted two policy reasons to support its decision: (1) the need to facilitate predictability and create certainty regarding ownership of joint works, and (2) the need to discourage infringement.[104] The court explained that prohibiting retroactive transfers and nonexclusive licenses allows co-owners of joint works to identify infringers with greater ease.[105] Additionally, the prohibition will provide co-owners with the confidence that they may bring suit against infringers without the fear that their co-owners could interfere by immunizing infringers with retroactive conveyances.[106] Similarly, the inability of one co-owner to undercut another co-owner's lawsuit by granting a retroactive conveyance to an infringer will, according to the Second Circuit, deter infringement. The Second Circuit explained that if a potential infringer knows that he cannot buy his way out of an infringement suit, he will be less likely to transition from potential to actual infringement.[107]

Ultimately, the Second Circuit, like the district court, did not address whether Chambliss and Miller's written agreement could ratify their prior oral agreement. This, apparently, leaves the holding in *Eden Toys*—that written agreements do not have to be contemporaneous with the oral transfer—intact. Rather, the court focused solely on whether transfers and nonexclusive licenses can apply retroactively. The Second Circuit disagreed

98. *Id*. at 98.
99. *Id*. at 99.
100. *See id.*
101. *Id*. at 103.
102. *Id*.
103. *Id.*
104. *Id.* at 105.
105. *Id.*
106. *Id.*
107. *Id.* at 106.

with the district court's ruling because the "decisions relied upon . . . involved retroactive licenses granted pursuant to negotiated settlements of accrued infringement claims."[108] The court explained that the case before it did not involve a retroactive license granted pursuant to a negotiated settlement; therefore, it was distinguishable.[109] Notwithstanding the Second Circuit's attempt to distinguish *Davis* from prior cases upholding retroactive transfers pursuant to settlement agreements, the court took the opportunity to address that line of cases. In dicta, the court announced that "[a] settlement agreement can only waive or extinguish claims held by a settling owner; it can have no effect on co-owners who are not parties to the settlement agreement."[110] Because the cases cited by the district court did rely on settlement agreements to extinguish claims held by co-owners who were not parties to those settlement agreements, it seems that *Davis* has called into question the continued validity of those decisions.

III. DISCUSSION

Following the Second Circuit's decision in *Davis*, neither transfers of ownership interest in a copyright nor nonexclusive licenses can apply retroactively to cure past infringement. This Part demonstrates that this holding is rooted in, and consistent with, traditional notions of copyright liability. This Part also highlights the ways in which *Davis*'s rule furthers the court's policy goals—facilitating predictability and discouraging infringement. However, the Second Circuit's decision in *Davis* does leave two important issues unaddressed: (1) the 1976 Act's allowance for co-owners of joint works to grant, unilaterally, prospective nonexclusive licenses is itself inconsistent with the court's policy goals of facilitating predictability and creating certainty; and (2) the rule creates uncertainty regarding the status of previously existing retroactive conveyances granted pursuant to settlement agreements.

A. The Second Circuit's Rule that Neither Transfers Nor Nonexclusive Licenses Can Apply Retroactively to Cure Past Infringement is Consistent with Traditional Principles of Copyright Liability

In *Davis*, the Second Circuit stated that because tort principles shaped copyright liability, the court had to "examine carefully whether retroactive licenses and assignments that extinguish a co-owner's accrued right to sue

108. *Id.* at 101.
109. *Id.*
110. *Id.* at 102.

are consistent with the general principles of tort . . . law that underlie the accrual and settlement of infringement claims."[111] The court explained that when a tort is committed and damages are incurred, the injured party immediately accrues the right to bring suit.[112] For example, when one party trespasses upon the property of another, the owner of that property accrues the right to sue the trespasser for any damages the trespasser caused. According to the Second Circuit, there is nothing in the history of tort law to insinuate that a tortfeasor may be immunized from liability by a third party.[113] Therefore, the court reasoned, because the same principles apply to copyright infringement, an infringer may not be immunized from liability by a co-owner who is not a party to the infringement suit.[114]

Scholars also have advocated the notion of looking to tort law to "delineat[e] the contours of copyright liability."[115] Professors Peter Menell and David Nimmer have argued that throughout the nineteenth and early twentieth centuries, "courts looked to the law of torts as the wellspring for determining the boundaries of copyright liability."[116] For example, in 1924 Judge Cardozo stated that "[t]he author who suffers infringement of his copyright . . . may count upon the infringement as a tort, and seek redress under the statute by action in the federal courts."[117] Additionally, in *Ted Browne Music Co. v. Fowler*, the Second Circuit held that "[c]ourts have long recognized that infringement of a copyright is a tort."[118]

However, some have criticized the Second Circuit's reliance on tort law.[119] For example, William Patry argued that the Second Circuit should not have turned to principles of tort law because the 1976 Act provides sufficient guidance.[120] Patry explains that, according to the 1976 Act, once an ownership interest in a copyright has been transferred, or once a license to exploit any of the copyright's exclusive rights has been granted, the transferee or the licensee is immunized from infringement liability regardless of whether the transfer or license was conveyed after the infringement

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111. *Id.* at 103.
112. *Id.*
113. *Id.* at 104.
114. *Id.*
115. Menell, *Unwinding Sony*, *supra* note 7, at 996.
116. *Id.*
117. *Id.*
118. Ted Browne Music Co. v. Fowler, 290 F. 751, 754 (2d Cir. 1923); *see also* Screen Gems-Columbia Music, Inc. v. Metlis & Lebow Corp., 453 F.2d 552, 554 (2d Cir. 1972) ("Copyright infringement is in the nature of a tort . . . .").
119. Patry, *supra* note 6.
120. *Id.*

occurred.[121] Patry contends that for co-owners and licensees, infringement immunity is absolute.[122] The 1976 Act provides a remedy—the duty to account.[123]

Patry does not, however, support his argument by highlighting any provision of the 1976 Act that states that co-owners or licensees are immunized from liability for infringement that occurred prior to becoming a co-owner or licensee. Indeed, Patry fails to mention that the legislative history for the 1976 Act states that Congress saw "no need for a specific statutory provision concerning the rights and duties of the coowners of a work" and that "court-made law on this point is left undisturbed."[124] As Menell and Nimmer have demonstrated, court-made law regarding liability for copyright infringement is rooted in principles of tort law.[125] Because the Second Circuit's rule—transfers and nonexclusive licenses cannot apply retroactively to cure past infringement—is consistent with principles of tort law, and because copyright liability historically has been shaped by principles of tort law, the Second Circuit's decision seems firmly rooted in both traditional copyright jurisprudence and legislative intent behind the 1976 Act.

B. The Second Circuit's Rule that Transfers and Nonexclusive Licenses Cannot Apply Retroactively to Cure Past Infringement Furthers the Court's Stated Policy Goals

The Second Circuit's decision in *Davis* also appears to be a reasonable manner of furthering the court's stated policy goals—facilitating predictability and discouraging infringement—by eliminating incentives willfully to infringe joint works.[126] Regarding predictability, the Second Circuit stated that retroactive transfers and retroactive nonexclusive licenses would prohibit co-owners of a joint work from definitively knowing if their work has been infringed, because any infringement could potentially be "undone" by one co-owner granting a retroactive conveyance to the infringer.[127] Therefore, by proscribing retroactive conveyances, the Second Circuit has provided co-owners with the ability to know more reliably who is entitled to exploit the work. Furthermore, because co-owners know that infringement cannot be undone by a retroactive conveyance,

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121. *Id.*
122. *Id.*
123. *Id.*
124. H.R. REP. NO. 94-1476, at 121 (1976), *as reprinted in* 1976 U.S.C.C.A.N. 5659, 5736.
125. *See* Menell, *Unwinding Sony*, *supra* note 7, at 996.
126. *See* Davis v. Blige, 505 F.3d 90, 105 (2d Cir. 2007).
127. *Id.*

they can be more certain in their ability to protect their interest in the joint work's copyright by successfully bringing suit.[128]

Regarding the discouragement of infringement, the Second Circuit presents valuable observations as to why a prohibition on retroactive transfers and retroactive nonexclusive licenses is beneficial. The court explained that "retroactive activity lowers the cost of infringement to infringers, thus making infringement more attractive."[129] This might be the case because "[a]n infringer could 'buy' his way out of an infringement suit . . . by paying a single co-owner" for a nonexclusive license or a transfer of ownership interest.[130] It is quite possible that this could be a viable option because one co-owner might be willing to accept an offer from the infringer, which "is likely to cost much less than the value of the copyright interest including the cost of litigation."[131]

However, the settling co-owner's duty to account to the plaintiff co-owner for any profits received pursuant to a settlement agreement may mitigate the risk of one co-owner undercutting the plaintiff co-owner's infringement suit by granting a retroactive nonexclusive license. If the settling co-owner's motives were purely pecuniary, it would be in his or her best interest to pursue the most lucrative option because a co-owner must account to the other co-owners for any profit received. In such a situation, the duty to account creates an incentive for non-suing co-owners to balance the financial benefits of granting a retroactive nonexclusive license against the potential damages that may be received as a result of another co-owner's successful infringement suit. Yet it seems reasonable that not all co-owners will grant retroactive licensing agreements to immunize a third party from another co-owner's infringement suit for pecuniary purposes. As *Davis* demonstrates, some co-owners may desire purely to grant retroactive immunity from copyright liability to a third party for personal reasons—or for consideration not subject to the duty to account.[132] Perhaps the fear of such situations guided the court's decision in *Davis*.

C. The Ability to Grant Prospective Nonexclusive Licenses is Inconsistent with *Davis*'s Policy Goals

Although the Second Circuit's rule in *Davis* does provide a means of limiting uncertainty and facilitating predictability amongst co-owners of a joint work, it fails to fully address this issue. The court demonstrates how

128. *Id.*
129. *Id.* at 106.
130. *Id.*
131. *Id.*
132. *See id.* at 90.

retroactive transfers and retroactive nonexclusive licenses potentially obfuscate the boundaries of ownership interests in joint works. Retroactive transfers would inhibit co-owners' knowledge of who maintains a right to exploit the joint work—an infringer today could potentially be a valid co-owner or licensee tomorrow. However, the court fails to confront that the ability of all co-owners, unilaterally, to grant nonexclusive licenses can cause similar obfuscation with regard to contemporaneous or prospective activity. Although only retroactive transfers or nonexclusive licenses undermine a co-owner's *already accrued* right to sue for infringement, the ability to grant nonexclusive licenses prospectively does limit a co-owner's knowledge about or control over who maintains a right to exploit the joint work. Regardless of a prohibition on retroactive activity, one co-owner might never know who is included in the pool of authorized users or licensees of a copyright at any given time.

Furthermore, because nonexclusive licenses may be conveyed orally or through conduct, infringers may still be capable of avoiding liability for infringing a joint work. To do so, the infringer would have to negotiate a fraudulent oral agreement with a co-owner who is not a party in the litigation. Yet the potential exists nonetheless. Given the right price, some co-owners might be willing to sell fraudulent corroboration that a prior oral agreement indeed existed.

The nature of nonexclusive licenses—they may be conveyed unilaterally by one co-owner without the consent or knowledge of the other co-owners—undermines the potential for creating predictability and reliability with regard to co-ownership of joint works. Although the Second Circuit has taken a step toward facilitating heightened certainty amongst co-owners by placing restrictions on their ability to alienate or exploit a joint work retroactively, co-owners should be well aware that the 1976 Act permits unilateral nonexclusive licensing, which places limits on the co-owners' collective ability predictably to control the exploitation of their joint work.

D. *Davis* Creates Uncertainty Regarding the Status of Retroactive Conveyances Granted Pursuant to Settlement Agreements

Additionally, the statement in *Davis* that "[a] settlement agreement can only waive or extinguish claims held by a settling owner" and that "it can have no effect on co-owners who are not parties to the settlement agreement" could potentially cause problems for the media industries.[133] Prior to *Davis*, within the Second Circuit, district courts held that defendants

133. *Id.* at 102.

were immunized from liability to one co-owner because they were granted retroactive licenses from another co-owner pursuant to a settlement agreement.[134] Parties have relied on such rulings, and it is not uncommon for settlement agreements to contain retroactive licenses to protect the defendant against future lawsuits from co-owners not party to the original litigation.[135]

The future of such agreements is now unclear. Because settlement agreements often contained retroactive licenses intended to immunize a third party from future infringement actions brought by co-owners who were not party to the settlement agreement, it seems likely that many of those non-settling co-owners will begin to bring suits against the third parties. Under these circumstances, infringers may be liable for damages in addition to expenses already paid under the settlement agreement. Additionally, the co-owners may receive recompense twice—the settling co-owner must account to the non-settling co-owner, and the non-settling co-owner who later prevails in an infringement suit and receives damages must account to the co-owner that had settled previously. Therefore, the Second Circuit's rule, coupled with the 1976 Act's duty to account, could result in windfalls for co-owners in situations where one co-owner granted a third party a retroactive license pursuant to a settlement agreement and the other co-owner later prevails in an infringement action against that third party.

IV. CONCLUSION

Davis's prohibition on both retroactive transfers of ownership interest in a copyright and retroactive nonexclusive licenses is consistent with traditional principles of copyright liability. Additionally, the rule does help to further the Second Circuit's policy goals of facilitating predictability and discouraging infringement. However, the Second Circuit's rule in *Davis* also highlights that the potential remains for other complications to arise with regard to co-ownership of joint works. A closer look into these complications might provide valuable insight for both co-owners of joint works and the practitioners who counsel them. It does appear that it would be in all co-owners' best interest to be mindful when creating their joint works. Entering into written agreements at the outset might be helpful in facilitating later disputes between co-owners of a joint work. Such agree-

134. *See* Copyright.net Music Publ'g v. MP3.com, No. 01 Civ. 7321 (JSR), 2003 WL 740757, at *1 (S.D.N.Y. Mar. 4, 2003).

135. *See* Patry, *supra* note 6; *see also* Henry L. Self III, *Settlement of Infringement Claims by Copyright Co-Owners*, 13 TEX. INTELL. PROP. L.J. 65, 73 (2004).

ments might outline the roles, responsibilities, and limitations on transferring and licensing the joint work. Addressing the ability to grant nonexclusive licenses in a written agreement may help to further the policy goal of predictability because the co-owners would have reliable knowledge regarding each co-owners' rights and limitations on nonexclusive licensing. This might help to alleviate the number of disputes coming before the courts, and it also might help the courts to adjudicate more easily the disputes that do arise.

FILTERS, FAIR USE & FEEDBACK: USER-GENERATED CONTENT PRINCIPLES AND THE DMCA

By Michael S. Sawyer

In the Web 2.0[1] era, internet business models increasingly shifted to user-generated content (UGC).[2] UGC sites rely on their users to contribute

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1. For a full discussion of the meaning of this term, see Tim O'Reilly, *What is Web 2.0: Design Patterns and Business Models for the Next Generation of Software*, O'REILLY, Sept. 30, 2005, http://www.oreillynet.com/pub/a/oreilly/tim/news/2005/09/30/what-is-web-20.html. *But see* Posting of Tim Bray to ongoing, Web 2.0 or Not?, http://www.tbray.org/ongoing/When/200x/2005/08/09/Web-2.0 (Aug. 11, 2005) (arguing that the term "Web 2.0" is used too broadly to have real meaning); *see also* Posting of Robin Wauters to TechCrunch, The Death of "Web 2.0", http://www.techcrunch.com/2009/02/14/the-death-of-web-20/ (Feb. 14, 2009) (reporting that usage of the term "Web 2.0" is declining).

2. The accuracy of this now-ubiquitous term is questionable. Some question whether creators of content can fairly be classified as users. *See, e.g.*, Posting of Scott Karp to Blog Herald, Death of the User, http://www.blogherald.com/2006/12/27/death-of-the-user/ (Dec. 27, 2006 20:53). Yet much of the content is really studio-generated and only user-appropriated. Posting of Scott Karp to Publishing 2.0, A Lot of User-Generated Content Is Really User-Appropriated Content, http://publishing2.com/2006/11/18/a-lot-of-user-generated-content-is-really-user-appropriated-content/ (Nov. 18, 2006). Other names have gained traction. UGC is called "user-created content" overseas, but the UCC acronym has been converted to "user-copied content" by critics. *See* SACHA WUNSCH-VINCENT & GRAHAM VICKERY, ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, PARTICIPATIVE WEB: USER-CREATED CONTENT 1 (2007), http://www.oecd.org/dataoecd/57/14/38393115.pdf (indicating that UGC is called "user-created content" overseas); Posting of Danny Kim to http://publishing2.com /2006/11/18/a-lot-of-user-generated-content-is-really-user-appropriated-content/ (Nov. 20, 2006 00:34 PST).

For analysis of other legal issues related to user-generated content, see Niva Elkin-Koren, *Governing Access to Users-Generated-Content: The Changing Nature of Private Ordering in Digital Networks*, *in* GOVERNANCE, REGULATIONS, AND POWERS ON THE INTERNET (E. Brousseau et. al. eds., forthcoming 2009), *available at* http://papers.ssrn.com/sol3/ papers.cfm?abstract_id=1321164; Tom W. Bell, *The Specter of Copyism v. Blockheaded Authors: How User-Generated Content Affects Copyright Policy*, 10 VAND. J. ENT. & TECH. L. 841 (2008) (providing an economic view of UGC and predicting that UGC will drive down the costs and increase accessibility for all content); Greg Lastowka, *User-Generated Content and Virtual Worlds*, 10 VAN. J. ENT. & TECH. L. 893 (2008); Edward Lee, *Warming Up to User-Generated Content*, 2008 U. ILL.

content. Blogs, wikis, social-networking sites, and video-sharing sites (e.g., YouTube) are among the most popular UGC technologies. These technologies have revolutionized media by enabling individuals to reach a global audience and facilitate communication on an unprecedented scale.

Copyright owners, however, are troubled by the onslaught of UGC. Not only does UGC represent another competitor in an already crowded media marketplace,[3] but a significant portion of technologies designed for UGC in fact end up unlawfully offering copyrighted material.[4] A user may upload a music video to YouTube or a news article may be wholly copied into a personal blog. Copyright owners are unable to protect their works effectively by suing uploaders because the quantity of UGC is so large.[5] For example, thirteen hours of video is uploaded to YouTube every minute.[6]

Copyright owners are thus forced to target UGC sites to protect their works. They may sue sites hosting infringing UGC under theories of sec-

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L. REV. 1459 (arguing that UGC informal copyright practices act as important gap-fillers in copyright law); Tal Z. Zarsky, *Law and Online Social Networks: Mapping the Challenges and Promises of User-Generated Information Flows*, 18 FORDHAM INTELL. PROP. MEDIA & ENT. L.J. 741 (2008).

3. Jonathan Handel, *Is Content Worthless*, HUFFINGTON POST, April 11, 2008, http://www.huffingtonpost.com/jonathan-handel/is-content-worthless_b_96195.html. UGC's ability to displace traditional media has earned its own name—crowdsourcing. *See, e.g.*, Jeff Howe, *The Rise of Crowdsourcing*, WIRED, June 2006, http://www.wired.com/wired/archive/14.06/crowds.html.

4. No one knows for sure what percentage of UGC is copyrighted material, and the percentage likely varies widely between different sites. One study claims that less than six percent of all views on YouTube, the most popular UGC video site, were of copyrighted material. BRI HOLT, HEIDI R. LYNN & MICHAEL SOWERS, VIDMETER.COM, ANALYSIS OF COPYRIGHTED VIDEOS ON YOUTUBE.COM 2 (2007), http://www.vidmeter.com/i/vidmeter_copyright_report.pdf. The methodology of that study, however, is questionable because it treats UGC as not covered by copyright unless a successful DMCA takedown notice has issued. *Id.* at 1-2. Another study, which actually viewed a random sample of video material, concluded that twelve percent of the videos posted on YouTube are infringing. Digital Ethnography, YouTube Statistics (2008), http://ksudigg.wetpaint.com/page/YouTube+Statistics. But that study took place in March 2008, after YouTube had already begun testing filtering technology to block infringing content before it is uploaded. *See* Mark Hefflinger, *Google to Test In-House YouTube Content Filter with Disney, Time Warner*, DIGITAL MEDIA WIRE, June 12, 2007, http://www.dmwmedia.com/news/2007/06/12/google-to-test-in-house-youtube-content-filter-with-disney-time-warner.

5. "Chasing individual consumers is time consuming and is a teaspoon solution to an ocean problem . . .." Randal C. Picker, *Copyright as Entry Policy: The Case of Digital Distribution*, 47 ANTITRUST BULL. 423, 442 (2002).

6. Brian Stelter, *Some Media Companies Choose to Profit from Pirated YouTube Clips*, N.Y. TIMES, Aug. 16, 2008 at C1.

ondary liability, but these sites are often able to seek shelter under the Digital Millennium Copyright Act (DMCA) safe harbors[7] or other copyright doctrines.[8] The DMCA generally places the burden on copyright owners to locate the infringing material and issue takedown notices.[9] This burden to police infringing activity may be one that copyright owners cannot, or at least should not, bear. The sheer volume of infringing material on the Internet makes human policing very costly. Because UGC sites such as YouTube profit from the infringing activity, either directly or indirectly, some have argued that UGC sites ought to bear some costs of policing infringing material.[10] Moreover, UGC sites may be in the best position to develop technological solutions that decrease or eliminate the need for costly human review.

A recent initiative seeks to partially shift this burden to the UGC sites on a voluntary basis. In October 2007, several UGC sites, including MySpace, Veoh, DailyMotion, and Soapbox (via Microsoft),[11] collaborated with large content companies, including Disney, CBS, NBC Universal, and Viacom, in proposing "Principles for User Generated Content Services" (UGC Principles).[12] The major change proposed in the UGC Principles is the recommendation that UGC sites should use copyright filtering technology. This technology compares uploaded material against samples of copyrighted material (Reference Material) provided by copyright owners.[13] If uploaded material matches any Reference Material, then the uploaded material must either be blocked before it is ever uploaded, or licensed from the copyright owner.[14] The initiative seeks to have copyright owners and UGC sites cooperate to implement filtering technology "in a manner that effectively balances legitimate interests in (1) blocking in-

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7. 17 U.S.C. § 512 (2006).

8. *E.g.*, Sony Corp. of Am. v. Universal City Studios, Inc., 464 U.S. 417, 442 (1984) (borrowing the "staple article of commerce doctrine" from patent law to excuse technologies enabling copyright infringement as long as they have "commercially significant noninfringing uses").

9. Sites have to takedown infringement if it is "apparent." 17 U.S.C. § 512(c)(1)(A)(ii) (2006). However, courts interpreting this requirement take a narrow view of when infringement is apparent. *See infra* Section I.B.1.

10. *See* Brandon Brown, Note, *Fortifying the Safe Harbors: Reevaluating the DMCA in a Web 2.0 World*, 23 BERKELEY TECH. L.J. 437, 463-66 (2008).

11. Posting of Michael Arrington to TechCrunch, Microsoft SoapBox Just Launched, http://www.techcrunch.com/2006/09/18/microsoft-soapbox-to-launch-on-tuesday/ (Sept. 18, 2006).

12. Principles for User Generated Content Services, http://ugcprinciples.com (last visited Feb. 4, 2009) [hereinafter UGC Principles].

13. *Id.*

14. *Id.*

fringing user-uploaded content, (2) allowing wholly original and authorized uploads, and (3) accommodating fair use."[15]

The UGC Principles propose a difficult task—creating technology that can distinguish between copyright infringement and fair use. Given how challenging fair use determinations are for courts to evaluate, it is difficult to believe that any technological solution could reach accurate determinations. In recognition of the difficulties of implementing technology capable of applying fair use doctrine, the Electronic Frontier Foundation (EFF) has proposed "Fair Use Principles for User Generated Video Content" (Fair Use Principles).[16] The Fair Use Principles recommend quantitative standards to evaluate fair use and erring on the side of fair use when removing or blocking potentially infringing content.[17] Despite the EFF's proposal, UGC sites appear to be implementing filters and erring on the side of removal.[18]

This Note argues that when the policing burden shifts from copyright owners to UGC sites, fair-use considerations are in danger of being largely dropped because technological filters are unable to accommodate them. Part I discusses the relevant technical and legal background and demonstrates several ways in which technology has outpaced the law. Part II examines the UGC Principles and EFF Fair Use Principles and contrasts them with the status quo. Part III explains why copyright filters[19] cannot accommodate fair use, and describes why the risk-averse nature of large companies in the industry may lead to expansion of copyright protection and contraction of the safe harbors through feedback loops, including the "standard technical measures" requirement of section 512(i). Part IV recognizes that there are actually two policing burdens, the technological burden to identify potentially infringing content and the human burden to evaluate fair use of potentially infringing content, and surveys obstacles to establishing a two-stage policing system.

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15. *Id.*

16. Electronic Frontier Foundation, Fair Use Principles for User Generated Video Content, http://www.eff.org/issues/ip-and-free-speech/fair-use-principles-usergen (last visited Feb. 4, 2009) [hereinafter Fair Use Principles].

17. *Id.*

18. *See* Julian Sanchez, *EFF Seeks Mashup Makers to Fight YouTube Filtering*, ARS TECHNICA, Feb. 3, 2009, http://arstechnica.com/telecom/news/2009/02/eff-seeks-mashup-makers-to-fight-youtube-filtering.ars.

19. Proponents of filtering technology refer to it as identification technology, but then usually use it to automatically filter "identified content." For this reason, the author opts to use the term "copyright filter." Other pieces use the term "content filter," but that term is most frequently used to describe technology that filters out objectionable content, such as pornography.

I. BACKGROUND

A. UGC on the Internet

UGC is creative material published by users outside of their professional routines.[20] UGC has been present on the Internet at least since GeoCities enabled users to create personal web "communities" in the early 1990s.[21] UGC shows up on traditional websites in the form of consumer reviews and discussion sections, but UGC did not become a real headache for copyright owners until Web 2.0. With Web 2.0, technology entrepreneurs began to create web applications, treating the Internet as a platform rather than a mere data conduit.[22] Many of these web applications rely on users to upload content, some of which is unlicensed copyrighted material.

Several web applications demonstrate the potential of UGC as well as the problems it creates. Applications such as Blogger enable users to create a blog—a simple website analogous to an online journal. Blogs take on many different forms ranging from personal journals to corporate blogs, but all enable users to easily post content on the Internet. Blogs create problems at both ends of the copyright spectrum. For example, the Associate Press sent DMCA takedown notices to blogs that quoted small portions of AP articles.[23] However, bloggers themselves have copyright complaints; they are concerned that other blogs are stealing their content and depriving them of advertising revenue.[24]

Other web applications, such as YouTube, allow users to post video content online. Some of these sites have become incredibly popular. For example, YouTube is the third most visited web domain in the world and fourth most visited in the United States.[25] YouTube has enabled unprecedented participation in multimedia culture, most notably in the 2008 presi-

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20. WUNSCH-VINCENT & VICKERY, *supra* note 2, at 8.

21. *See Beverly Hills Internet, Builder of Interactive Cyber Cities, Launches 4 More Virtual Communities Linked to Real Places*, BUSINESS WIRE, July 5, 1995, *available at* http://findarticles.com/p/articles/mi_m0EIN/is_1995_July_5/ai_17190114.

22. O'Reilly, *supra* note 1.

23. Posting of Michael Kwun to Electronic Frontier Foundation Deeplinks Blog, Biting the Hand that Feeds (Traffic to) Them, http://www.eff.org/deeplinks/ 2008/06/ biting-hand-feeds-traffic-them (June 17, 2008).

24. Posting of Tibi Puiu to Lost Art of Blogging, Protect Your Blog and Counter Copyright Thefts, http://www.lostartofblogging.com/protect-your-blog-and-counter-copyright-thefts (Jan. 23, 2008).

25. Alexa, Global Top Sites, http://www.alexa.com/site/ds/top_sites? ts_mode= global&lang=none (last visited Feb. 4, 2009); Alexa, Top Sites in United States, http://www.alexa.com/site/ds/top_sites?cc=US&ts_mode=country&lang=none (last visited Feb. 4, 2009).

dential election when thirty-five percent of Americans watched online video pertaining to the election.[26] Not only did users upload their own political videos, but presidential candidates used YouTube to communicate with the public as well.[27]

Nonetheless, many criticize YouTube for its handling of copyright. Content owners claim that YouTube purposefully built its user base through massive copyright infringement.[28] Viacom is currently suing YouTube over copyright infringement for one billion dollars.[29] Others, including presidential candidate John McCain, criticize YouTube's handling of DMCA takedown notices and claim that they give too much credit to copyright claims.[30] The ten-year-old DMCA lies at the heart of most criticisms.

B. DMCA

In 1998, the DMCA created safe harbors that limit online service providers' (OSPs) liability for copyright infringement.[31] These safe harbors protect OSPs from monetary liability for material that is transmitted over networks,[32] cached on a server,[33] linked to,[34] or stored at the direction of a user.[35] These limitations were intended to "ensure that the efficiency of

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26. LEE RAINIE & AARON SMITH, PEW INTERNET & AMERICAN LIFE PROJECT, THE INTERNET AND THE 2008 ELECTION II (2008), http://www.pewinternet.org/Reports/2008/The-Internet-and-the-2008-Election.

27. Jose Antonio Vargas, *The YouTube Presidency*, WASH. POST, Nov. 14, 2008 (44 Blog), http://voices.washingtonpost.com/44/2008/11/14/the_youtube_presidency.html.

28. *See, e.g.*, First Amended Complaint ¶ 37, Viacom Int'l Inc. v. YouTube, Inc., No. 1:07-cv-02103, 2008 WL 2062868 (S.D.N.Y. Apr. 24, 2008). For an appraisal of issues in the Viacom lawsuit against YouTube, see Branwen Buckley, *SueTube: Web 2.0 and Copyright Infringement*, 31 Colum. J.L. & Arts 235 (2008).

29. First Amended Complaint, *supra* note 28, ¶ 10.

30. Letter from Trevor Potter, General Counsel, McCain for America, to Chad Hurley, CEO, YouTube, LLC (Oct. 13, 2008), *available at* http://image.guardian.co.uk/sysfiles/Media/documents/2008/10/15/mccainletter.pdf. For YouTube's response, see Letter from Zahavah Levine, Chief Counsel, YouTube, to Trevor Potter, General Counsel, McCain-Palin 2008 (Oct. 14, 2008), *available at* http://www.eff.org/files/08-10-14YouTube Response to Sen. McCain.pdf.

31. 17 U.S.C. § 512 (2006). "These safe harbors limit liability but 'do not affect the question of ultimate liability under the various doctrines of direct, vicarious, and contributory liability.' " Perfect 10, Inc. v. CCBill LLC, 488 F.3d 1102, 1109 (9th Cir. 2007) (quoting Perfect 10, Inc. v. Cybernet Ventures, Inc., 213 F. Supp. 2d 1146, 1174 (C.D. Cal. 2002)).

32. 17 U.S.C. § 512(a).

33. *Id.* § 512(b).

34. *Id.* § 512(d).

35. *Id.* § 512(c).

the Internet will continue to improve and that the variety and quality of services on the Internet will continue to expand."[36]

These limitations, however, do not come for free: OSPs must adopt and implement certain policies in order to qualify. In order to be eligible for any of the four safe harbors, OSPs must satisfy two generic policies.[37] First, they must adopt and reasonably implement a plan to terminate the accounts of repeat infringers and must notify users of this plan.[38] Second, they must also accommodate "standard technical measures" used by copyright owners to identify infringing material.[39] The DMCA does not, however, extend the safe harbors in all circumstances to eligible OSPs; each safe harbor has separate statutory requirements limiting its applicability.

To qualify for the section 512(c) safe harbor, which precludes OSP liability for storing user content, OSPs must satisfy three additional requirements. First, the OSP cannot have actual knowledge that infringing content is on its system or be "aware of facts or circumstances from which infringing activity is apparent," and if it later becomes aware of such content, the OSP must expeditiously remove the content from its system.[40] Second, the OSP cannot receive a direct financial benefit from any infringing activity which it has the right and ability to control.[41] Finally, an OSP must expeditiously remove infringing content if it receives a takedown notice from the copyright owner.[42]

These five requirements (two generic and three specific to section 512(c)) appear to allocate the copyright policing burden to content owners. If a hosting site is designed so that its owners lack knowledge of infringement, do not receive a direct financial benefit from infringement that they have the right and ability to control, and reasonably implement a policy to terminate repeat infringers, the DMCA places the burden on copyright owners to issue takedown notices and use standard technical measures to protect copyright.[43] Yet this burden worsens as technological innovations

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36. S. REP. NO. 105-190, at 8 (1998).
37. 17 U.S.C. § 512(i)(1).
38. *Id.* § 512(i)(1)(A).
39. *Id.* §§ 512(i)(1)(B), 512(i)(2).
40. *Id.* § 512(c)(1)(A).
41. *Id.* § 512(c)(1)(B).
42. *Id.* § 512(c)(1)(C).
43. *See* 17 U.S.C. § 512(m) ("Nothing in this section shall be construed to condition the applicability of subsections (a) through (d) on . . . a service provider monitoring its service or affirmatively seeking facts indicating infringing activity, except to the extent consistent with a standard technical measure . . ..").

enable cheap copying on a large scale.[44] Courts have recognized this shift and used theories of secondary liability to punish technological innovators attempting to profit by enabling copyright infringement.[45] Thus, technological innovators may face liability for failing to police infringement on their networks despite the section 512(c) safe harbor.[46]

Most UGC sites are designed to gain the section 512(c) safe harbor—keeping the policing burden on content owners—but several ambiguities create uncertainty as to exactly what policies the safe harbor requires. There are at least four possible indeterminacies in the law.[47] First, there is no consensus on what constitutes "circumstances from which infringing activity is apparent."[48] Second, it remains unclear how to prove that a site received a "direct" financial benefit from infringement.[49] Third, many questions remain about when service providers are deemed to have the

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44. *See, e.g.*, TOM STEINERT-THRELKELD, ZDNET UNDERCOVER: THE YOUTUBE FILE 4 (2008), http://whitepapers.zdnet.com/abstract.aspx?docid=393305.

45. *See* Peter S. Menell & David Nimmer, *Legal Realism in Action: Indirect Copyright Liability's Continuing Tort Framework and* Sony*'s De Facto Demise*, 55 UCLA L. REV. 143, 150-55, 177-87 (2007) (discussing how courts have effectively applied tort law principles in indirect copyright infringement cases, specifically *Napster*, *Aimster*, and *Grokster*, to assign liability to technological innovators "whose product, albeit capable of substantial noninfringing use, was in fact used more for the purpose of committing copyright infringement").

46. *See, e.g.*, A&M Records, Inc. v. Napster, Inc., 239 F.3d 1004, 1023 (9th Cir. 2001) (holding that Napster had to fully exercise its ability to police infringing content on its network to avoid vicarious liability). There is a possibility that secondary liability could trump any safe harbor, *see* Posting of Eric Goldman to Technology & Marketing Law Blog, Io v. Veoh Comments—a Terrific 512(c) Defense-Side Win, http://blog.ericgoldman.org/archives/ 2008/ 09/io_v_veoh_comme.htm (Sept. 1, 2008 21:54 PST), but most commentators and courts appear to assume that the DMCA safe harbors preclude monetary liability for all infringement, not just direct infringement. Legislative history supports the majority viewpoint. H.R. REP. NO. 105-796, at 73 (1998) (Conf. Rep.) ("The limitations in subsections (a) through (d) protect qualifying service providers from liability for all monetary relief for direct, vicarious and contributory infringement.") Of course, legislative history for a 1998 Act cannot speak to the inducement liability established in *Grokster*. *See* MGM Studios Inc. v. Grokster, Ltd., 545 U.S. 913, 936-37 (2005).

47. For a discussion of other statutory ambiguities, see Jane C. Ginsburg, *Separating the* Sony *Sheep from the* Grokster *Goats: Reckoning the Future Business Plans of Copyright-Dependent Technology Entrepreneurs*, 50 ARIZ. L. REV. 577, 592-602 (2007) (analyzing the terms "service provider" and "storage at the direction of a user" in relation to new business models, such as YouTube, which alter the format of user-uploaded content before making it available online).

48. *Cf.* 17 U.S.C. § 512(c)(1)(A)(ii).

49. *Cf. id.* § 512(c)(1)(B).

"right and ability" to control infringement.[50] Finally, there is virtually no case law elucidating the "standard technical measures" requirement.[51]

1. *Apparent Infringing Activity*

To qualify for the section 512(c) safe harbor, OSPs are required to expeditiously remove infringing material once they have actual knowledge of infringing activity or are "aware of facts or circumstances from which infringing activity is apparent."[52] The circumstances which make infringing activity apparent are called "red flags."[53] The few cases analyzing possible red flags do not establish clear standards separating red flags from excusable ignorance.

Two cases imply that the red flags must be rather obvious and that the defendant must see them. In *Perfect 10, Inc. v. CCBill LLC*, the Ninth Circuit held that references to pornographic material as "illegal" and "stolen" were not sufficient to make infringement apparent because such descriptions may just "be an attempt to increase the salacious appeal" of titillating photographs.[54] In *Io Group, Inc. v. Veoh Networks, Inc.*, the Northern District of California held that the presence of the plaintiff's trademarks in a user-uploaded pornographic video did not make infringement apparent to the UGC site because there was no evidence that the site was aware of the trademarks.[55] Both courts enforced the statutory requirement that the service provider have subjective awareness of factors making infringement apparent.[56]

Neither case provides much guidance on how to prove subjective awareness of such factors, but it appears that plaintiffs may face a difficult task even if the public is generally aware of infringing material on the website. Some plaintiffs attempt to prove subjective awareness by demonstrating wide public knowledge of infringing material,[57] but no court has yet addressed whether such evidence will restrict the safe harbor for all works or just the works with demonstrated awareness. Copyright infringement is ordinarily evaluated on a work-by-work basis; knowledge of

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50. *Cf. id.*

51. *Cf. id.* § 512(i)(2).

52. *Id.* § 512(c)(1)(A)(ii).

53. Perfect 10, Inc. v. CCBill LLC, 481 F.3d 751, 763 (9th Cir. 2007), *amended by* Perfect 10, Inc. v. CCBill LLC, 488 F.3d 1102 (9th Cir. 2007).

54. 488 F.3d at 1114.

55. 586 F. Supp. 2d 1132, 1148-49 (N.D. Cal. 2008).

56. *See CCBill*, 488 F.3d at 1114; *Io Group*, 586 F. Supp. 2d at 1148-49.

57. *See, e.g.*, First Amended Complaint, *supra* note 28, ¶ 37 ("The rampant infringement of Plaintiffs' copyrights on YouTube is open and notorious and has been the subject of numerous news reports.").

some infringement does not mean knowledge of all infringements.[58] It is unclear if the safe harbor eligibility will also be evaluated on a work-by-work basis.[59]

Restrictions on the amount of policing that service providers must perform seem to indicate that the safe harbor will be evaluated by work, not by site. Section 512(m) clarifies that safe harbor eligibility is not to be conditioned on a service provider "monitoring its service or affirmatively seeking facts indicating infringing activity." In *CCBill*, the Ninth Circuit held that service providers do not bear the burden to investigate suspicious websites, such as lists of passwords or pictures labeled "stolen," to determine whether they contain infringing material.[60] Thus, it seems unlikely the presence of some infringing material on a site would trigger a duty to scan the entire site for infringements.

These restrictions, however, seem to encourage willful ignorance. If the knowledge requirement only limits the safe harbor when service providers have specific subjective awareness of red flags, then service providers may be encouraged to design their sites as to minimize their awareness of red flags. Such incentives seem contrary to a developing tort framework in digital copyright cases that punishes sites primarily designed to profit from infringement.[61] Indeed, Professor Ginsburg has argued for greater liability to counter this moral hazard.[62]

2. *Direct Financial Benefit*

The DMCA adopts the language of the common law vicarious liability standard as an eligibility condition for the 512(c) safe harbor; sites are not eligible if they receive a direct financial benefit from infringing activity which they have a right and ability to control.[63] The direct-financial-benefit prong adopts settled meaning from general common-law princi-

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58. *Cf.* Hendrickson v. Amazon.com, Inc., 298 F. Supp. 2d 914, 916-17 (C.D. Cal. 2003) (holding that DMCA notices were insufficient to force takedowns of all future instances of the work).

59. In *CCBill*, the Ninth Circuit seemed to indicate that safe harbor eligibility could be evaluated on a site-by-site basis rather than a work-by-work basis due to the section 512(i)(1)(A) requirement that service providers reasonably implement a repeat infringer policy. 488 F.3d at 1113. It held that a defendant's "response to adequate non-party notifications is relevant in determining whether they reasonably implemented their policy against repeat infringers." *Id.* Unfortunately, this site-by-site evaluation relies on DMCA takedown notifications, so it fails to elucidate the knowledge standard as applied to service providers. *Id.*

60. *Id.* at 1114.

61. *See* Menell & Nimmer, *supra* note 45, at 150-55, 177-87.

62. *See* Ginsburg, *supra* note 47, at 597-98.

63. *See* 17 U.S.C. § 512(c)(1)(B) (2006); *CCBill*, 488 F.3d at 1117-18.

ples.[64] The case law implies that using infringing content to build or expand a user base constitutes a direct financial benefit (though proving it is another matter). It is less clear how to evaluate the context in which ads are displayed on a site—an important UGC issue.

Case law demonstrates that infringing activity that increases a user base is considered a direct financial benefit. In *Ellison v. Robertson*, the Ninth Circuit held that directness of a financial benefit hinges on "whether the infringing activity constitutes a draw for subscribers, not just an added benefit."[65] Thus, when a business attracts subscribers and their fees by using infringing activity, there is a sufficient nexus for the benefit to be considered direct. Similarly, if infringing activity attracts users who do not pay fees but do aid the business through increased ad revenue, then the business still reaps a direct financial benefit from the infringing activity.[66]

While the law may be clear that attracting users through infringing activity will constitute a direct financial benefit, it is silent on how to prove it. Professor Ginsburg observes that the problem of proof may lock UGC sites and copyright owners in a "vicious circle."[67] One way to show proof is to compare user traffic after the UGC sites are ordered to remove all infringing material. But if this is the only method, then copyright owners cannot prove their case without first procuring the remedy they seek.[68]

It is also unclear when the nexus between advertising and infringing activity is sufficiently close to constitute a direct financial benefit. For example, YouTube does not display ads next to potentially infringing content.[69] But YouTube may attract users with infringing content, and these new users may then venture to view other, ad-supported, noninfringing content. Is that relationship sufficiently direct? No case is clearly on point. In *Fonovisa, Inc. v. Cherry Auction, Inc.*, the court held that a flea market owner received a direct financial benefit from infringing sales by a flea market vendor because the owner's revenue from admissions fees, parking fees, and concessions sales increased as more people came to the flea market.[70] YouTube's situation is somewhat like the flea market.[71] Though

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64. *CCBill*, 488 F.3d at 1117-18.

65. 357 F.3d 1072, 1079 (9th Cir. 2004).

66. Arista Records, Inc. v. MP3Board, Inc., No. 00 Civ. 4660 (SHS), 2002 WL 1997918, at *11 (S.D.N.Y. Aug. 29, 2002).

67. Ginsburg, *supra* note 47, at 599-600.

68. *Id.*

69. Andy Greenberg, *YouTube's Filter Fails to Please*, FORBES, Oct. 18, 2007, http://www.forbes.com/2007/10/18/google-viacom-video-tech-cx_ag_1018youtube.html.

70. 76 F.3d 259, 263 (9th Cir. 1996).

71. Copyright owners may dispute this claim by arguing that an internet company's valuation is directly tied to the size of its user base. *See, e.g.*, First Amended Complaint,

it does not receive ad revenue for each unique user to its site, it does receive revenue for views of noninfringing, ad-supported content. Therefore, YouTube would be like a flea market receiving revenue from noninfringing concessions sales but not receiving revenue from admissions or parking. *Fonovisa* may have reached a different result if the flea market did not charge for admission or parking.

3. *Right and Ability to Control*

Even if UGC sites derive a direct financial benefit from infringing activity, they will not lose safe harbor protection unless they have the right and ability to control such infringing activity.[72] Just as with the direct-financial-benefit prong, the right-and-ability-to-control prong adopts the common law standard for vicarious liability.[73] Courts do not, however, always follow the common law standard, which typically turns on the ability to block infringing use.[74] Instead, courts may require "something more," such as an ability to locate the infringing use.[75] The departure from the common law standard is justified in order to preserve the integrity of the DMCA. If the mere ability to block access constituted the right and ability to control infringing activity, then the right-and-ability-to-control prong would conflict with the section 512(c)(1)(C) requirement that sites be able to remove infringing content upon receipt of a takedown notice. Moreover, section 512(m) states that the safe harbors are not conditioned on service providers actively policing content.[76] Thus, "something more" is required than the mere technical ability to block access.

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supra note 28, ¶ 37 ("Indeed, the presence of infringing copyrighted material on YouTube is fully intended by Defendants as a critical part of their business plan to drive traffic and increase YouTube's network, market share and enterprise value, as reflected in the purchase price of $1.65 billion Google paid for YouTube . . ..").

72. 17 U.S.C. § 512(c)(1)(B) (2006).

73. *See* Perfect 10, Inc. v. CCBill LLC, 488 F.3d 1102, 1117-18 (9th Cir. 2007) (citing Ellison v. Robertson, 357 F.3d 1072, 1078 (9th Cir. 2004)).

74. *Compare* A&M Records, Inc. v. Napster, Inc., 239 F.3d 1004, 1023-24 (9th Cir. 2001) (holding that Napster had the "right and ability to control" infringing content because it could search its system for names of copyrighted songs and then delete the songs from the listing), *with* Hendrickson v. eBay, Inc., 165 F. Supp. 2d 1082, 1093-94 (C.D. Cal. 2001) (holding that eBay lacked the "right and ability to control" infringing content even though it was able to voluntarily search its system for infringing content).

75. *See, e.g.*, Io Group, Inc. v. Veoh Networks, Inc., 586 F. Supp. 2d 1132, 1151 (N.D. Cal. 2008) ("the pertinent inquiry is not whether Veoh has the right and ability to control it [sic] *system*, but rather, whether it has the right and ability to control the *infringing activity*").

76. 17 U.S.C. § 512(m) (2006).

For service providers that have the ability to remove infringing material, the "something more" requirement appears to be a technological ability to locate infringing material amidst a sea of noninfringing material. In *Perfect 10, Inc. v. Amazon.com, Inc.*, the Ninth Circuit has interpreted the ability-to-control standard to mean practical, not just theoretical ability.[77] When considering vicarious liability for Google Image Search, the Ninth Circuit affirmed a district court's holding that Google lacked the practical ability to control infringing activity because its technology was incapable of comparing every image on the web to every copyrighted image in existence.[78] In *Io v. Veoh*, the district court held that a video-sharing website lacked the practical ability to control infringing activity where it could not locate infringing content with simple text searches because content could be mislabeled.[79] If the site had technology that could search the video content itself, and not just the text labeling the video, the *Io* court may have reached a different conclusion.

Despite this apparently clear standard, it appears that courts may still return to tort principles to evaluate whether a service provider has the right and ability to control infringing activity. Professor Ginsburg predicts that the true "something more" requirement will depend on whether the business is focused on illegitimate uses (the "*Grokster* goats") or legitimate uses (the "*Sony* sheep").[80] Her prediction is bolstered by the manner in which the *Io* court distinguished *Napster*. When discussing the ability to control infringing activity, the *Io* court distinguished *Napster* on the grounds that the Napster service was devoted to copyright infringement, whereas the Veoh service did not encourage infringement.[81] The good faith of a service, however, has little to do with its practical ability to locate infringing material.

4. Standard Technical Measures

The DMCA requires service providers to accommodate and not interfere with "standard technical measures" used by copyright owners to identify infringing material.[82] Standard technical measures must meet three requirements. First, they must be "developed pursuant to a broad consen-

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77. 508 F.3d 1146, 1173 (9th Cir. 2007) (discussing the right and ability to control standard under a vicarious infringement test but still involving a service provider's eligibility for safe harbors under the DMCA).

78. *Id.* at 1174 ("Without image-recognition technology, Google lacks the practical ability to police the infringing activities of third-party websites.").

79. *Io Group*, 586 F. Supp. 2d at 1153.

80. Ginsburg, *supra* note 47, at 601-02.

81. *Io Group*, 586 F. Supp. 2d at 1153.

82. 17 U.S.C. § 512(i)(1)(B) (2006).

sus of copyright owners and service providers in an open, fair, voluntary, multi-industry standards process."[83] Second, standard technical measures must be available on reasonable and nondiscriminatory terms.[84] Finally, they must not impose substantial costs on service providers.[85] Very few cases have interpreted these requirements.[86]

Indeed, there is only one reported case considering whether certain technology qualifies as a standard technical measure. In *Perfect 10, Inc. v. CCBill LLC*, a website host and credit card processor disabled a copyright owner's access to a members-only area of a website alleged to host infringing material.[87] The site claimed it disabled access only because the copyright owner ceased paying for access.[88] The Ninth Circuit remanded to the district court to determine whether granting copyright owners free access to a pay area of the website imposed a substantial cost on service providers.[89] The Supreme Court denied the copyright owner's petition for certiorari and the parties stipulated to dismissal, so the district court never considered whether free access would have been a substantial cost to the service provider.

It should not be surprising that there is so little litigation involving standard technical measures because there are historically few incentives for service providers to agree to such measures. Despite the strong urging of both the House and the Senate to start serious discussions on standard technical measures,[90] service providers had very little statutory incentive to engage copyright owners in discussions.[91] Indeed, if there are no standard technical measures, then service providers are better able to profit from infringing activity and avoid any costs associated with compliance. However, as discussed below, the UGC Principles may signal a change in such financial incentives.

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83. *Id.* § 512(i)(2)(A).

84. *Id.* § 512(i)(2)(B).

85. *Id.* § 512(i)(2)(C).

86. A Westlaw search of all federal cases for the phrase "standard technical measures" returns only 13 results as of March 15, 2009. Most cases simply note that safe harbor eligibility is conditioned on accommodating standard technical measures.

87. 488 F.3d 1102, 1115 (9th Cir. 2007).

88. *Id.*

89. *Id.*

90. H.R. REP. NO. 105-551, pt. 2, at 61 (1998); S. REP. NO. 105-190, at 52 (1998).

91. 3 MELVILLE B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT, § 12B.02[B][3][b] (2008). ("Given the incentives of the various parties whose consensus is required before any such technical measures can win adoption, it seems unlikely …that the need for any such monitoring will eventuate.").

C. Fair Use

1. Basic Background

Fair use allows the use of copyrighted material without the owner's permission in the context of criticism, comment, news reporting, or educational settings.[92] Fair use is a traditional First Amendment safeguard that prevents copyright law from hindering free speech.[93] The doctrine can be traced back to Justice Story's opinion in *Folsom v. Marsh*[94] and has since been codified at 17 U.S.C. § 107.

Section 107 states a four-factor test for evaluating fair use. The factors are the purpose and character of the use, the nature of the use, the amount and substantiality of the taking, and the effect on the market for the copyrighted work.[95] The first and fourth factors are usually considered most important.[96]

Fair use is a highly context-dependent test, and there are few clear rules. Judge Learned Hand called the issue of fair use "the most troublesome in the whole law of copyright."[97] For example, sometimes it is acceptable to copy an entire work,[98] but other times it is unacceptable to even copy a small portion.[99]

2. Lenz v. Universal: Fair Use and the DMCA

DMCA takedowns will inevitably ensnare fair uses of content. If such takedowns are issued in bad-faith, then copyright owners can face liability.[100] In *Lenz v. Universal Music Corp.*, the plaintiff uploaded to YouTube a short home video of a baby dancing with copyrighted music by the musician Prince playing in the background.[101] Even though the sound quality was terrible and the music could only be heard for about twenty

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92. 17 U.S.C. § 107 (2006).
93. *See* Eldred v. Ashcroft, 537 U.S. 186, 220-21 (2003).
94. 9 F. Cas. 342 (C.C.D. Mass.) (No. 4,901).
95. 17 U.S.C. § 107 (2006).
96. Barton Beebe, *An Empirical Study of U.S. Copyright Fair Use Opinions*, 156 U. PA. L. REV. 549, 616 (2008).
97. Dellar v. Samuel Goldwyn, Inc., 104 F.2d 661, 662 (2d Cir. 1939) (per curiam).
98. *See, e.g.*, Sony Corp. of Am. v. Universal City Studios, Inc., 464 U.S. 417 (1984); Sega Enters., Ltd. v. Accolade, Inc., 977 F.2d 1510 (9th Cir. 1992); Higgins v. Detroit Educ. Television Found., 4 F. Supp. 2d 701, 707 (E.D. Mich. 1998).
99. *See, e.g.*, Harper & Row, Publishers, Inc. v. Nation Enters., 471 U.S. 539, 564 (1985); Nihon Keizai Shimbun, Inc. v. Comline Bus. Data, Inc., 166 F.3d 65, 73 (2d Cir. 1999).
100. *See* Lenz v. Universal Music Corp., 572 F. Supp. 2d 1150, 1155-56 (N.D. Cal. 2008).
101. *Id.* at 1151-52.

seconds, Universal issued a DMCA takedown notice alleging copyright infringement.[102] The plaintiff sued Universal alleging misrepresentation under section 512(f) of the DMCA,[103] which assigns liability to anyone "who knowingly materially misrepresents . . . that material or activity is infringing."[104] Universal moved to dismiss, advancing two arguments why it should not have been held liable under section 512(f). First, it argued that though fair use excused *liability*, the material was still *infringing*.[105] Second, it argued that the plaintiff could not prove that it issued the takedown notice in bad faith.[106] Judge Fogel rejected both arguments and denied the motion to dismiss.[107]

Judge Fogel avoided the thorny issue of whether fair use is a right or a defense,[108] but he rejected Universal's claim that failure to consider fair use cannot be a basis for section 512(f) liability.[109] While noting that he could have relied on Supreme Court opinions stating that fair use is not an

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102. *Id.* at 1152.

103. *Id.*

104. 17 U.S.C. § 512(f) (2006).

105. "Fair use is an *affirmative defense* to conduct that otherwise infringes one or more of the exclusive rights of copyright under Section 106." Motion to Dismiss at 9, *Lenz*, 572 F. Supp. 2d 1150 (No. CV 07-03783), 2008 WL 2242356 at *11.

106. "Although Plaintiff does assert '[o]n information and belief' that Universal had 'actual subjective knowledge' that Plaintiff's posting was non-infringing, Plaintiff fails to back up this conclusory averment with any allegations that justify an inference of actual knowledge." *Id.* (citation omitted).

107. *Lenz*, 572 F. Supp. 2d at 1154, 1156-57.

108. This issue has been discussed in the case law, *see, e.g.*, Bateman v. Mnemonics, Inc., 79 F.3d 1532, 1542 n.22 (11th Cir. 1996) (expressing Judge Birch's personal viewpoint that fair use is a right after it was codified at section 107 by the 1976 act); White v. Samsung Elecs. Am., Inc., 989 F.2d 1512, 1517 (9th Cir. 1993) (Kozinski, J., dissenting) ("Copyright law specifically gives the world at large the right to make 'fair use' parodies, parodies that don't borrow too much of the original."), in legal academia, *see, e.g.*, Wendy J. Gordon & Daniel Bahls, *The Public's Right to Fair Use: Amending Section 107 to Avoid the "Fared Use" Fallacy*, 2007 UTAH L. REV. 619, 655 (arguing that section 107 should explicitly state that fair use is a right); David R. Johnstone, *Debunking Fair Use Rights and Copyduty under U.S. Copyright Law*, 52 J. COPYRIGHT SOC'Y U.S.A. 345, 387 (2005) (critiquing the reasoning of Judge Birch, Judge Kozinski, Prof. Patterson, Prof. Lessig and several others in concluding that fair use is a right), and in the blogosphere, *see, e.g.*, Groklaw, Fair Use: Affirmative Defense or Right? Do I Have to Choose?, http://www.groklaw.net/article.php?story=20070907195435565 (Sept. 9, 2007 1:40 PM EDT) (arguing that fair use is both a right and a defense); Posting of Patrick Ross to The Copyright Alliance Blog, The Remix Culture, http://blog.copyrightalliance.org/2008/07/the-remix-culture/ (July 7, 2008) (arguing that fair use is a defense, and therefore not a right).

109. *Lenz*, 572 F. Supp. 2d at 1154-56.

infringement of copyright,[110] Judge Fogel based his reasoning on the purpose and scheme of the DMCA. He examined the takedown notice guidelines, which require the issuer of the takedown notice to have "a good faith belief that use of the material in the manner complained of is not authorized by the copyright owner, its agent, or the law."[111] Because fair use is a lawful use of copyright, he concluded that the purpose of section 512(f)—preventing the abuse of takedown notices—would be circumvented if copyright owners were able to issue takedown notices without first considering fair use.[112]

Judge Fogel resolved the second issue in a more favorable way for Universal. He held that copyright owners would only be liable under section 512(f) for subjectively bad-faith takedown notices.[113] He also doubted that the plaintiff would be able to prove that Universal acted with subjective bad faith and indicated that the case could easily result in summary judgment for the defendant.[114]

One element of the case has a perplexing quality. Why would Universal issue a takedown notice for a heavily-distorted, twenty-second long song clip accompanied by video of a cute dancing baby? Surely no rational person could argue that the short clip would have a negative effect on the potential market for the underlying sound recording. A longer, high-fidelity clip of the song can be found for free on iTunes. Commentator Sherwin Siy suggests that Universal was using an automated system to issue takedown notices without any human review.[115] He argues that the title of the video, "Let's Go Crazy #1," was close enough to the title of the song, "Let's Go Crazy," that a text-searching program coupled with an audio analyzer could have matched them.[116]

There is no clear evidence to establish whether Universal used an automated system without human review. But if it did use such a system, would that use coupled with the knowledge that automated systems cannot accommodate fair use[117] be sufficient to establish subjective bad faith?

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110. *Id.* at 1154 n.4.
111. *Id.* at 1154 (quoting 17 U.S.C. § 512(c)(3)(A)(v)).
112. *Id.* at 1156.
113. *Id.*
114. *See id.*
115. Posting of Sherwin Siy to Public Knowledge Policy Blog, Of Dancing Babies and Overzealous Takedowns: When "Fair Use Is Hard!" Doesn't Cut It, http://www.publicknowledge.org/node/1718 (Aug. 21, 2008 18:16 PST).
116. *Id.*
117. *See infra* Section III.A.

This question points to perhaps the most troubling aspect of *Lenz* for copyright owners. Judge Fogel observed:

> The DMCA already requires copyright owners to make an initial review of the potentially infringing material prior to sending a takedown notice; indeed, it would be impossible to meet any of the requirements of Section 512(c) without doing so. A consideration of the applicability of the fair use doctrine simply is part of that initial review.[118]

While noting that a "full *investigation*" is not required, Judge Fogel nonetheless required a good-faith fair-use evaluation to avoid section 512(f) liability.[119] If purely automated systems cannot accommodate fair-use doctrine, then it seems unlikely that a copyright owner could meet Judge Fogel's requirement of a good-faith fair-use evaluation with a purely automated system.[120]

3. *Fair Use and Digital Rights Management Technology*

UGC copyright filters are not the first attempt to fuse technology and fair use. Digital Rights Management technology (DRM)[121] protects content from being unlawfully copied, but it usually fails to provide access to content for fair use. DRM generally protects copyrighted work by distributing the work in encrypted form and only providing the decryption key to certain authorized machines or player software. Unfortunately, DRM's attempts to prevent unauthorized copying usually prevent fair-use copying, thus appropriating broader protection through technical means than allowed by copyright law.[122]

Despite being largely unable to accommodate fair use, DRM technology has been extensively implemented across all media. The film and TV

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118. *Lenz*, 572 F. Supp. 2d at 1155.

119. *Id.* at 1156.

120. *See* Rossi v. Motion Picture Ass'n of Am. Inc., 391 F.3d 1000, 1003-05 n.7 (9th Cir. 2004) (implying that automated takedown systems lacking a human review component may be evidence of bad-faith takedown).

121. Just as with user-generated content, *see supra* text accompanying note 2, the term "digital rights management" is controversial. Fair use proponents argue that "digital restrictions management" is more appropriate because the technology restricts rights, such as fair use, previously available. *See* Free Software Foundation, Digital Restrictions Management and Treacherous Computing, http://www.fsf.org/campaigns/drm.html (last visited Feb. 4, 2009).

122. *See* Jerome H. Reichman, Graeme B. Dinwoodie & Pamela Samuelson, *A Reverse Notice and Takedown Regime to Enable Public Interest Uses of Technically Protected Copyrighted Works*, 22 BERKELEY TECH. L.J. 981, 1019, 1022-24 (2007).

industry has incorporated DRM into DVDs,[123] Blu-ray discs,[124] and personal computers.[125] The music industry has explored DRM in CDs,[126] digital downloads,[127] and internet radio.[128] Even the publishing industry has implemented DRM in electronic books[129] and audiobooks.[130]

Nonetheless, the chilling forecasts made by opponents of DRM technology have not been fully realized because an unlocked version of the content can usually be located with relatively little hardship for tech-savvy users. DRM is easily circumvented primarily for two reasons. First, any lock can eventually be picked. The latest example of this is BD+, the second generation DRM technology used in high-definition Blu-ray discs. Industry analysts expected BD+ to withstand cracking attempts for at least 10 years.[131] Yet, less than a year and a half later an internet group called Doom9 cracked the BD+ standard and distributed source code enabling copying.[132] Second, every digital technology has an "analog hole," which means that protected digital content must eventually be converted to an unprotected, human-readable analog form.[133] There are many different proposals to plug the analog hole, including High-bandwidth Digital Copy Protection (HDCP), which would encrypt video content all the way to the

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123. Universal City Studios, Inc. v. Reimerdes, 111 F. Supp. 2d 294, 309 (S.D.N.Y. 2000), *aff'd sub nom.*, Universal City Studios, Inc. v. Corley, 273 F.3d 429 (2d Cir. 2001).

124. Erik Gruenwedel, *Blu-ray's Copy-Protection Advantage*, HOME MEDIA MAGAZINE, July 8-14, 2007, at 10.

125. *E.g.*, David Chartier, *Apple Brings HDCP to a New Aluminum MacBook Near You*, ARS TECHNICA, Nov. 17, 2008, http://arstechnica.com/apple/news/2008/11/apple-brings-hdcp-to-a-new-aluminum-macbook-near-you.ars.

126. Bruce Schneier, *Real Story of the Rogue Rootkit*, WIRED, Nov. 17, 2005, http://www.wired.com/politics/security/commentary/securitymatters/2005/11/69601.

127. Jim Wagner, *Apple Hit by Lawsuit*, INTERNETNEWS, Jan. 6, 2005, http://www.internetnews.com/bus-news/article.php/3455431.

128. Posting of William Patry to The Patry Copyright Blog, DRMs and Internet Use, http://williampatry.blogspot.com/2007/07/drms-and-internet-radio.html (July 17, 2007).

129. Rob Beschizza, *Killed By DRM: e-Books*, WIRED, Apr. 26, 2007 (Gadget Labs Blog), http://blog.wired.com/gadgets/2007/04/killed_by_drm_e.html.

130. Derrick Story, *Why I Won't Be Adding Audible.com to My Xmas Card List*, O'REILLY, Jan. 3, 2003 (Mac DevCenter Blog), http://www.oreillynet.com/mac/ blog/2003/01/why_i_wont_be_adding_audibleco.html.

131. Gruenwedel, *supra* note 124, at 10.

132. Posting of "Oopho2ei" to Doom9's Forum, http://forum.doom9.org/showthread.php?t=140571&page=15 (Oct. 28, 2008 19:28 PST).

133. 151 CONG. REC. E2,569-70 (2006) (statement of Rep. Sensenbrenner).

screen (the final analog hole).[134] It remains unclear whether any of these proposals will be successful.

Though unable to prevent determined piracy, DRM has had a significant impact on the casual user.[135] Because of DMCA penalties for circumventing technological protection measures,[136] technologies enabling DRM circumvention for fair uses remain largely unavailable through legitimate markets. Thus, DRM can prevent users from copying lawfully-obtained content to new devices.[137] Such restrictions have frustrated users to the point that many content owners are now beginning to offer DRM-free versions of their content as a marketing tool.[138]

Because user dissatisfaction led to DRM-free content (at least in some media), fair-use concerns may seem less critical than some commentators make them out to be. But fair-use concerns for UGC copyright filters are qualitatively different because copyright filters do not just attempt to directly restrict access to content, like DRM, but instead restrict access to distribution. Whereas DRM prevents access to a single piece of content that may possibly be found unencrypted elsewhere, copyright filters threaten to quash an entire medium without accommodations for fair use.

D. Video Identification Technology

Automatically matching uploaded content to a copyrighted work is a difficult—but important—task requiring the cooperation of content owners and UGC sites. For this technology to work, content owners must upload copyrighted works (or at least identifying data about those works) to a central database, and UGC sites must provide similar data about uploaded works to enable comparison. The primary comparison method is

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134. George Leopold, Rick Merritt & Junko Yoshida, *Plugging the Analog Hole*, EE TIMES, Sept. 20, 2002, http://www.eetimes.com/issue/fp/OEG20020920S0062; *see also* Thomas S. Fletcher, *American Library Ass'n v. FCC: Charting the Future of Content Protection for Digital Television*, 21 BERKELEY TECH. L. J. 613, 617-20 (2006) (surveying the possible solutions and analyzing the legal implications).

135. *See The Analog Hole: Can Congress Protect Copyright and Promote Innovation: Hearing Before the S. Comm. on the Judiciary*, 109th Cong. 8-9 (2006) (statement of Gary J. Shapiro, President and CEO, Consumer Electronics Association).

136. 17 U.S.C. § 1203 (2006).

137. *See, e.g.*, Barry Collins, *Q&A: Microsoft Defends Return to DRM*, PC PRO, Jan. 22, 2009, http://www.pcpro.co.uk/news/245859/qa-microsoft-defends-return-to-drm.html.

138. *See, e.g.*, Brad Stone, *Want to Copy iTunes Music? Go Ahead, Apple Says*, N.Y. TIMES, Jan. 7, 2009, at B1; Eliot Van Buskirk, *Random House Ditches Audiobook DRM after Watermark Experiment*, WIRED, Feb. 25, 2008 (Listening Post Blog), http://blog.wired.com/music/2008/02/random-house-di.html.

based on a video "fingerprint."[139] Companies like Audible Magic and YouTube use this method to analyze "perceptual characteristics" of a media file in order to create a unique fingerprint.[140] This matching does not rely on digital watermarks, text, or metadata, but instead relies on the actual sounds and images in the video.[141] Creators claim their technologies match videos even if they are differently encoded, compressed, or distorted.[142] Preliminary tests indicate that existing identification technologies do not come close to identifying all matches.[143] However, later anecdotal experiences with YouTube's Content ID system indicate that it matches many uses of copyrighted material, including arguable fair uses.[144]

To analyze the potential impact of this technology, it may be tempting to draw a parallel between video identification technology and other protection technologies, such as DRM. But such an analogy is inapt. Certainly, there will be some back and forth between the technology developers and copyright infringers just as hackers would race to break each new DRM technology. For example, copyright infringers might determine that they are able to circumvent the identification technology by deleting every fifteenth frame or adding a border to a video clip.[145] But there are two im-

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139. Aaron Weiss, *Content Filters*, 12 NETWORKER 24, 29-30 (Mar. 2008). Vobile markets its technology with a similar forensic analogy—VideoDNA™. Vobile, Technology Overview, http://vobileinc.com/videodna.htm (last visited Feb. 6, 2009).

140. Audible Magic, Content Identification Services, http://www.audiblemagic.com/products-services/contentsvcs/ (last visited Feb. 6, 2009).

141. *Id.*

142. *Id.*

143. *See, e.g.*, STEINERT-THRELKELD, *supra* note 44, at 3, 7 (reporting that YouTube's VideoID system works anywhere from three to eighty percent of the time); Liz Gannes, Does Digital Fingerprinting Work?: An Investigative Report, NewTeeVee, June 8, 2007, http://newteevee.com/2007/06/08/does-digital-fingerprinting-work-an-investigative-report/ (describing how supposedly "blocked" videos could be uploaded to multiple video sharing websites); *see also* Chris Palmer & Seth Schoen, Staff Technologists, Electronic Frontier Foundation, Debunking Audible Magic—Again (July 20, 2004), http://w2.eff.org/share/audible_magic.php?f=audible_magic2.html (explaining how encryption can defeat Audible Magic's filtering technology on college campuses); Posting of "enigmax" to TorrentFreak, ISP: It's Impossible For Us to Stop Illegal, http://torrentfreak.com/isp-its-impossible-for-us-to-stop-illegal-p2p-080923/ (Sept. 23, 2008) (describing how a Belgian ISP could not implement Audible Magic's filter to block infringing peer-to-peer traffic despite a court order requiring that it do so).

144. Posting of Fred von Lohmann to Electronic Frontier Foundation Deeplinks Blog, YouTube's January Fair Use Massacre, http://www.eff.org/deeplinks/2009/01/youtubes-january-fair-use-massacre (Feb. 3, 2009).

145. The examples of possible workarounds are seemingly limitless. Potential solutions include removing every nth frame, slightly desynchronizing the audio and video,

portant distinctions. First, this technology is much more adaptable because its central location enables quick changes, whereas the distributed model of DRM (the distributor, content, and player all need to incorporate the protection) makes it difficult to fix without rolling out a second generation of technology.[146] Second, the engineering problem is much more difficult than DRM. Rather than designing a lock as with DRM, technologists now have the much more difficult task of designing a visual recognition system akin to the human eye. The problem is difficult enough before even contemplating questions of fair use.

II. UGC PRINCIPLES

This Part will compare the UGC Principles to the DMCA status quo. It will then examine the fair-use accommodations in the UGC Principles and contrast them to the EFF Fair Use Principles. Finally, this Part will discuss the licensing provisions in the UGC Principles in the context of the larger battle for distribution.

The UGC Principles propose a new framework for policing infringing material that is very different from the DMCA notice-and-takedown framework. The UGC Principles recommend two principal changes. First, they would require UGC sites to adopt "Identification Technology,"[147] while the DMCA only requires UGC sites to accommodate "standard technical measures" used by copyright owners.[148] The Identification Technology is not a particular product, but rather any copyright filter that will compare uploaded content to a database of Reference Material supplied by copyright owners.[149] If the uploaded material matches the database, then the UGC site must block it unless the copyright owner has provided alternate directions (such as an agreement to license the content in exchange for ad revenue).[150] This requirement may represent an explicit shift in the policing burden from copyright owners to UGC sites because UGC sites are required to implement the Identification Technology (pre-

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intermittently distorting video or audio, shifting half the picture one pixel to the left, etc. Perhaps none of these ideas would work, but technologically savvy users would most likely be able to find several workarounds.

146. *See* Hal R. Varian, *Kaizen, That Continuous Improvement Strategy, Finds Its Ideal Environment*, N.Y. TIMES, Feb. 8, 2007, at C3.

147. UGC Principles, *supra* note 12, ¶ 3.

148. *See* 17 U.S.C. § 512(i)(1)(B) (2006).

149. UGC Principles, *supra* note 12, ¶ 3a.

150. *Id.* ¶ 3a, c.

sumably by designing it, at significant cost, or purchasing it from third-party vendors).[151]

The second major difference between the UGC Principles and the current notice-and-takedown framework is that the UGC Principles remove the user protections provided by the counter notification process in the DMCA. When UGC sites block uploads and periodically remove matching content from the site,[152] users will likely be unable to force uploads and repost content because they lack a right to post content to a particular site.[153] Under the current system, UGC sites get to play a neutral role where users can effectively "force" a repost of removed material, within ten to fourteen days, by issuing a counter notification under section 512(g)(3). If content is removed without a takedown notice,[154] users cannot threaten suit against copyright owners, for they played no part in the removal other than contributing reference material. Users cannot sue the UGC site because the sites can prevent suit with their terms-of-use agreements. Thus, users are left without legal recourse to upload fair use of content.

Indeed, the UGC Principles say very little about fair use. They only require that copyright owners consider fair use when making infringement claims,[155] and that "Identification Technology is implemented in a manner that effectively balances legitimate interests in (1) blocking infringing user-uploaded content, (2) allowing wholly original and authorized uploads, and (3) accommodating fair use."[156] The UGC Principles provide no indication of how fair use would be weighted in this balancing test.

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151. It is unclear whether the DMCA would require UGC sites to adopt some kind of filtering technology. *See infra* Section III.C.

152. UGC Principles, *supra* note 12, ¶ 3h.

153. There is no statutory right to upload content and most terms of service state that content can be removed at any time for any reason. *See, e.g.*, YouTube, Terms of Service, http://www.youtube.com/t/terms (last visited Feb. 6, 2009) ("YouTube may remove such User Submissions and/or terminate a User's access for uploading such material in violation of these Terms of Service at any time, without prior notice and at its sole discretion.")

154. Note that the UGC Principles preserve the option for content owners to issue DMCA takedown notices, UGC Principles, *supra* note 12, ¶¶ 6-9, but it is not clear how frequently copyright owners will issue takedown notices if Identification Technology is effective. Indeed, if a copyright owner wants to avoid issuing DMCA takedown notices (due to possible liability for an automated takedown system), *see supra* Section I.C.2, upon identifying infringing material, the copyright owner could simply upload that infringing material as Reference Material for the Identification Technology.

155. UGC Principles, *supra* note 12, ¶ 6. The DMCA requires the same considerations. Lenz v. Universal Music Corp., 572 F. Supp. 2d 1150, 1155 (N.D. Cal. 2008).

156. UGC Principles, *supra* note 12, ¶ 3d.

Concerned that the UGC Principles do not give adequate consideration to fair use, the Electronic Frontier Foundation proposed the Fair Use Principles.[157] These principles generally advocate giving a wide berth to creative uses and erring on the side of fair use. In particular, the EFF recommends that content only be blocked if both the audio and video tracks match the same work and ninety percent or more of the uploaded content comes from a single work.[158] The Fair Use Principles also recommend the preservation of the notice and takedown procedures of the DMCA when removing content in direct opposition to the UGC Principles' requirement that the Identification Technology automatically remove material.[159] Finally, the Fair Use Principles encourage dialogue between content owners and users with an informal "dolphin" hotline to resolve fair-use takedowns.[160] These recommendations address two of the three primary shortfalls in the UGC Principles for accommodating fair use: erroneous blocking and a lack of remedies to erroneous blocking.

The EFF Fair Use Principles, however, do not address the third fair-use shortfall: the possibility that the licensing option in the UGC Principles may cause "digital sharecropping." When an uploaded work is matched to copyrighted material, the copyright owner can choose to block or license the material.[161] But a technological match might actually be a fair use, causing the copyright owner to obtain licensing revenues on works which should not warrant it. This blurs the line between fair use and derivative works. Worse, authors who uploaded the fair use will be denied opportunities to tap into the advertising revenue generated by their original work.[162] Unlike previous accusations of digital sharecropping,[163] which lacked a coercive analog to actual sharecropping, the licensing option could coerce users by restricting access to the entire online video me-

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157. Fair Use Principles, *supra* note 16.

158. *Id.* Note that this standard has obvious flaws. A ten second clip of a two-hour movie would be blockable, but a video consisting of three two-hour movies appended together would not be blockable.

159. *Id.*

160. *Id.* It is called a dolphin hotline because fair uses are caught in an infringement sweep just like dolphins caught in a tuna net. *See id.*

161. UGC Principles, *supra* note 12, ¶ 3a, c.

162. *See, e.g.*, Brian Stelter, *YouTube Videos Pull in Real Money*, N.Y. TIMES, Dec. 11, 2008, at A1.

163. *See, e.g.*, Lawrence Lessig, *Lucasfilm's Phantom Menace*, WASH. POST, July 12, 2007, at A23; Posting of Nicholas Carr to Rough Type, Sharecropping the Long Tail, http://www.roughtype.com/archives/2006/12/sharecropping_t.php (Dec. 19, 2006 08:55 PST).

dium.[164] Thus, independent creators may be left with two options: sign over monetization rights for their fair use or lose access to the most popular online distribution channels.

Perhaps it should not be surprising that the UGC Principles threaten to shut users out of revenue streams because the UGC Principles are just a single front in the larger battle for control of the online video medium. Content identification not only enables copyright owners to monetize their content, but it also helps them establish a foothold for their own online video sites (or the video sites of their choice).[165] Control of the site gives the copyright owner more control over the type and quantity of advertising.[166] Moreover, as a site's popularity grows, the copyright owner will gain a built-in audience for new content, enabling successful launches of new content franchises.[167] As media titans and internet upstarts race for control of this new medium, it is too easy for them to forget that users are creators too. After all, when multi-industry agreements such as the UGC Principles are forged, users do not even have a seat at the negotiating table.

III. FILTERS CANNOT FULLY ACCOMMODATE FAIR USE, BUT THEY MAY ALTER FAIR-USE DOCTRINE

This Part will explain why any purely automated filter cannot fully accommodate fair use. It will then consider two consequences of the framework and Identification Technology proposed in the UGC Principles. First, the automatic blocking scheme eliminates important fair-use safeguards and will restrict casual, spontaneous fair use. Second, the licensing option and inter-industry nature of the proposals could have profound feedback effects on copyright law.

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164. Previous accusations involve particular sites, not entire mediums. These situations lacked coercion because users seeking to monetize their contributions could go to (or create) a different site within the same medium. If the UGC Principles become a legal requirement, *see infra* Section III.C, the entire medium will be restricted.

165. *See, e.g.*, Kate Kaye, *Viacom Flexes Digital Muscle in Uphill Video Control Battle*, CLICKZ, Feb. 13, 2007, http://www.clickz.com/3624975.

166. *See, e.g.*, Press Release, Brightcove, Brightcove Announces Distribution Partnerships with Bebo, Meebo, RockYou, Slide, and Veoh (Apr. 7, 2008), http://www.brightcove.com/about-us/newsroom/press-releases/?ID=267.

167. This is similar to the way that broadcast television stations would try to launch new shows by placing them immediately after successful hits. NBC did this in the 1990s with its hit shows, Seinfeld and Friends. Stephen Battaglio, *NBC Gets Nothing from Seinfeld for Christmas*, HOLLYWOOD REP., Dec. 29, 1997, at 1.

A. Fair Use Computer?

The general question of whether technology can evaluate fair use is not new. Professors Burk and Cohen have already considered this issue in relation to DRM technology:

> Building the range of possible uses and outcomes into computer code would require both a bewildering degree of complexity and an impossible level of prescience. There is currently no good algorithm that is capable of producing such an analysis. Relatedly, fair use is a dynamic, equitable doctrine designed to respond to changing conditions of use. Programmed fair use functionality, in contrast, is relatively static. At least for now, there is no feasible way to build rights management code that approximates both the individual results of judicial determinations and the overall dynamism of fair use jurisprudence.[168]

Incorporating fair use into Identification Technology presents three similar problems, albeit with a few new wrinkles. Technology is generally unable to handle the qualitative nature of fair-use doctrine, to incorporate information external to the work into a fair-use determination, or to consider the separable nature of digital works.

The first and largest problem involves the qualitative nature of fair-use doctrine. Computers excel at computation and quantitative analysis. Fair-use doctrine, however, strongly resists quantitative characterization. The first two fair-use factors, "purpose and character of the use" and "nature of the copyrighted work,"[169] are primarily qualitative. Even though the third fair-use factor, "the amount and substantiality of the portion used in relation to the copyrighted work as a whole,"[170] requires quantitative analysis, that factor is by no means determinative. Professor Beebe's empirical fair-use study shows that when an entire work was copied, courts found fair use twenty-seven percent of the time.[171] Yet, when courts determined that the "heart" or "essence" of a work had been taken, they found fair use only five percent of the time.[172] There is no conceivable way that a computer

168. Dan L. Burk & Julie E. Cohen, *Fair Use Infrastructure for Rights Management Systems*, 15 HARV. J.L. & TECH. 41, 56 (2001).
169. 17 U.S.C. § 107 (2006).
170. *Id.*
171. Beebe, *supra* note 96, at 616.
172. *Id.*

could reliably determine whether someone had copied the "heart" or "essence" of a work.[173] Such determinations can only be made by a human.

Second, fair-use determinations involve information external to the work itself. For example, in order to assess the fourth factor, "the effect of the use upon the potential market for or value of the copyrighted work,"[174] the technology must consider information about the market that is not contained in the uploaded work.[175] To program a computer to acquire and consider such information would require solving the hardest type of problem in artificial intelligence.[176] Current computer systems are not able to analyze these markets the way a human being could.[177]

Third, digital works are easily separable, and an analysis of only portions of a work may prevent proper fair-use analysis. Consider *Campbell v. Acuff-Rose*,[178] where 2 Live Crew took a very identifiable bass riff and some lyrics from "Oh, Pretty Woman," a song by Roy Orbison.[179] The Supreme Court held the use was fair because 2 Live Crew parodied the song, but indicated that a less transformative use would likely not be fair.[180] If the Court had mechanically analyzed just the copied lyrics and music, it may well have reached a different determination. Similarly, erroneous determinations can easily occur with online video. For instance, commentary accompanying embedded videos can easily transform the videos into a portion of a "critical video essay," such as movie review ac-

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173. *See* Burk & Cohen, *supra* note 168, at 56; Edward W. Felten, *A Skeptical View of DRM and Fair Use*, COMMC'NS. OF THE ASS'N FOR COMPUTING MACH., Apr. 2003, at 56, 58.

174. 17 U.S.C. 107. A majority of courts used to consider this to be the most important factor, but since *Campbell v. Acuff-Rose Music, Inc.*, 510 U.S. 569 (1994), only about one quarter of cases continue to express this view. Beebe, *supra* note 96, at 616-17.

175. *See* Felten, *supra* note 173, at 58.

176. *See id.*

177. *Id.*

178. 510 U.S. 569 (1994).

179. *Id.* at 588.

180. The Supreme Court stated:

> For the purposes of copyright law, the nub of the definitions, and the heart of any parodist's claim to quote from existing material, is the use of some elements of a prior author's composition to create a new one that, at least in part, comments on that author's works. If, on the contrary, the commentary has no critical bearing on the substance or style of the original composition, which the alleged infringer merely uses to get attention or to avoid the drudgery in working up something fresh, the claim to fairness in borrowing from another's work diminishes accordingly (if it does not vanish), and other factors, like the extent of its commerciality, loom larger.

Id. at 580 (citation omitted).

companying a film clip, which should be protected under fair use.[181] Text overlays or annotations commenting on an uploaded video may also make the underlying work fair use.[182]

Some may be tempted to blame fair-use doctrine, rather than technology, for erroneous determinations. After all, fair-use doctrine contains large gray areas, including cases where even experienced judges would reach conflicting decisions.[183] Yet, the inexactness of judicial fair-use determinations does not excuse the limitations of identification technology. Judges reach conflicting decisions due to differences in balancing the four fair-use factors, but technology reaches erroneous decisions due to its innate inability to consider certain factors, such as the nature of a use or the market effect.[184] When judges reach differing fair-use conclusions, the underlying fair-use question is usually a marginal one.[185] But when poor technology prevents a fair use of content, it is far more likely to be profoundly wrong.[186]

Nonetheless, if the technology cannot fully accommodate fair use, perhaps it can get pretty close. Indeed, Richard Cotton, General Counsel of NBC Universal (a supporter of the UGC Principles), claims that filters are getting very good at distinguishing fair uses.[187] None of these claims have been proven, and until they do, any claims that technology can properly evaluate fair use remain dubious.[188]

B. Implications of an Automatic Blocking Process

Even though technological filters are currently incapable of accommodating fair-use doctrine, they could be immensely helpful in pointing out potentially infringing content. Yet, the UGC Principles harm fair use by

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181. *See* Posting of Karina Longworth to SpoutBlog, YouTube Cracking Down on Critical Video Essays, http://blog.spout.com/2009/01/12/youtube-cracking-down-on-critical-video-essays/ (Jan. 12, 2009).

182. *See* YouTube, YouTube Video Annotations, http://www.youtube.com/t/annotations_about (last visited Feb. 6, 2009). Some may think such a problem is easily solved by allowing all uploads with overlays, but infringers could easily recognize and abuse such a tactic.

183. *See* Felten, *supra* note 173, at 58.

184. *See id.*

185. *See, e.g.*, Williams & Wilkins Co. v. United States, 487 F.2d 1345 (Ct. Cl. 1973) (holding in a 4-3 decision that government employee copying of single articles from medical journals for research purposes was fair use), *aff'd by an equally divided court*, 420 U.S. 376 (1975).

186. *See* Siy, *supra* note 115.

187. *YouTube's 75 Percent Solution: Closing Down Illegal Videos* (ZDNet Webcast Nov. 2008), http://whitepapers.zdnet.com/abstract.aspx?docid=393306&promo=100510.

188. *See* Felten, *supra* note 115, at 58-59.

requiring an essentially automatic filtering process,[189] in which UGC sites block matching uploads before they are ever available on the site.[190] This Section will explain why an automated blocking scheme deprives users of two important fair-use safeguards—the DMCA counter-notification system and public concern over erroneous takedowns. It will also compare YouTube's Content ID system to the process proposed by the UGC Principles. This Section will then discuss how the automated blocking scheme may not prevent determined infringers, but will deter casual, spontaneous fair uses (just like DRM) because navigating the scheme will likely require significant technical and legal knowledge.

The automated blocking scheme proposed in the UGC Principles could destroy the counter-notification process, an important statutory safeguard for free speech. The scheme bypasses the DMCA takedown and counter-notification balance by requiring the UGC site to block matching content, thus rendering takedown notices from copyright owners unnecessary. Under the DMCA, UGC sites do not need to arbitrate disputes and can avoid liability by removing content upon receipt of a takedown notice and replacing content upon receipt of a counter notification.[191] Counter notifications enable users to contest erroneous takedowns, and UGC sites have tended to restore content as a matter of course upon receipt of a counter notification.[192] UGC sites replace content upon receipt of counter notifications because there is very little economic incentive for them to ignore the counter notification. However, if the UGC Principles shift the costly bur-

189. The Filtering Process allows UGC sites to utilize human review, at their own expense, in addition to Identification Technology when blocking content. UGC Principles, *supra* note 12, ¶ 3f. However, UGC sites have very little incentive to utilize expensive human review because they likely face no liability for blocking fair uses. UGC sites could, and probably do, preserve the right to block content for any reason in their terms of use. *See, e.g.*, YouTube, Terms of Service, http://www.youtube.com/t/terms (last visited Feb. 6, 2009); *see also* Letter from Zahavah Levine, *supra* note 30 (stating that YouTube will not engage in substantive review before taking down videos).

190. "UGC Service should use the Identification Technology to block such matching content before that content would otherwise be made available on its service ('Filtering Process')." UGC Principles, *supra* note 12, ¶ 3c. The only way the content will be uploaded is if the content owner has indicated a preference other than blocking such as licensing or leaving up the content. *Id.*

191. *See* 17 U.S.C. § 512(c)(1)(C), (g) (2006).

192. Unfortunately, restored content may then be subjected to future takedown notices. *See, e.g.*, Jacqui Cheng, *NFL Fumbles DMCA Takedown Battle, Could Face Sanctions*, ARS TECHNICA, Mar. 20, 2007, http://arstechnica.com/business/news/2007/03/nfl-fumbles-dmca-takedown-battle-could-face-sanctions.ars.

den of human review[193] to UGC sites,[194] then UGC sites will face financial pressure to ignore counter notifications. Such financial pressure would not be problematic if there was counterbalancing liability for ignoring counter notifications. Yet, the only possible liability would be a contractual one.[195] Thus, if UGC sites properly structure their terms of use, then they will face no liability for failing to restore content upon receipt of a counter notification. By turning UGC sites into fair-use arbitrators, the UGC Principles could effectively deprive users of their only legal mechanism to contest erroneous blocking.

By blocking content before it is publicly available, the UGC Principles also deprive users of an important nonlegal mechanism to contest erroneous takedowns—the wisdom of crowds. The public can recognize when content has been wrongly removed. Erroneously removed content can generate headlines, but erroneously blocked content is unlikely to generate sufficient public concern. Social bookmarking sites such as Digg and del.icio.us provide constant updates of the "hottest" links on the Internet. When such links are taken down after significant interest has been generated, users may backlash until the links are replaced.[196] If the links are never up there to begin with, the public would not know what it was missing.

One such example involves the Church of Scientology, which aggressively uses the DMCA to scour the Internet of disparaging information.[197] On January 14, 2008, a Scientology promotional video featuring Tom

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193. *See* STEINERT-THRELKELD, *supra* note 44, at 4 ("Viacom employs between one and two dozen people at any given time just to watch videos uploaded to YouTube for infringement.").

194. *See* UGC Principles, *supra* note 12, ¶ 3f (proposing that UGC sites do human review in addition to filtering technology).

195. The DMCA exempts service providers from liability for good-faith takedowns except when it receives a counter notification. 17 U.S.C. § 512(g)(1) (2006). Upon receipt of a counter notification, service providers must repost the material within 10-14 days to preserve the liability exemption. 17 U.S.C. § 512(g)(2) (2006). Yet, service providers have no need for an exemption absent an underlying cause for liability.

196. *See, e.g.*, Mike Nizza, *The Day Digg Users Revolted*, N.Y. TIMES, May 2, 2007 (The Lede Blog), http://thelede.blogs.nytimes.com/2007/05/02/the-day-the-digg-users-revolted/?scp=1&sq=digg&st=cse.

197. *See, e.g.*, Cyndy Aleo-Carreira, *Bogus Anti-Scientology DMCA Notices Sent to YouTube Linked to Wikipedia User*, INDUSTRY STANDARD, Sept. 8, 2008, http://www.thestandard.com/news/2008/09/08/youtube-slammed-dmcas-over-anti-scientology-content; Posting of "CmdrTaco" to Slashdot, Scientologists Force Comment Off Slashdot, http://slashdot.org/yro/01/03/16/1256226.shtml (Mar. 16, 2001 08:05 PST); Truth About Scientology, DMCA Complaint from Scientology, http://www.truthaboutscientology.com/dmca.html (last visited Feb. 6, 2009).

Cruise, which the Church of Scientology presumably owned, was uploaded to YouTube.[198] The Church of Scientology promptly filed a takedown notice.[199] After a few hours, YouTube removed the video, but a different website, Gawker, retained a copy.[200] Gawker promptly received a DMCA takedown notice but kept the video up under a claim of fair use.[201] Due to the public outcry, the video was back up on YouTube within three days.[202] The video is quite arguably fair use, but even under the lenient EFF ninety percent standard[203] the video would never have been uploaded under an automatic blocking regime. In an automatic blocking regime, the public and other news organizations may never have known about the video. The very anonymity provided by UGC sites may have been critical to the initial leaking of the video because the Church of Scientology has a history of harassing its critics and the press.[204]

YouTube's new Content ID system fails to preserve the public concern fair-use safeguard that was critical to distributing the Scientology video, but it does preserve the counter-notification fair-use safeguard. Copyright owners can set rules for handling videos matched to their content through YouTube's Content ID system. When copyright owners choose to block videos, YouTube allows users to contest such blocking through a dispute process that parallels the DMCA counter-notification process.[205] In this way, YouTube preserves the neutral status it has under the DMCA. Yet

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198. Posting of Seth to Defamer, Secret Tom Cruise Scientology Indoctrination Video Finally Hits Web; Proves He Is Even Crazier Than We Ever Imagined, http://defamer.com/344781/secret-tom-cruise-scientology-indoctrination-video-finally-hits-web-proves-he-is-even-crazier-than-we-ever-imagined (Jan. 14, 2008 15:57 PST).

199. *Id.*

200. Nick Denton, *The Cruise Indoctrination Video Scientology Tried to Suppress*, GAWKER, Jan. 15, 2008, http://gawker.com/5002269/the-cruise-indoctrination-video-scientology-tried-to-suppress.

201. Nick Denton, *Church of Scientology Claims Copyright Infringement*, GAWKER, Jan. 16, 2008, http://gawker.com/5002319/church-of-scientology-claims-copyright-infringement.

202. The video was uploaded again on January 17, 2008. *See* Posting of "Aleteuk" to YouTube, Tom Cruise Scientology Video—(Original UNCUT), http://www. youtube. com/watch?v=UFBZ_uAbxS0 (Jan. 17, 2008). Note that the repost could not have been the result of a counter notification, which would take ten days to replace content.

203. *See supra* Part II.

204. Posting of Eva Galperin to Electronic Frontier Foundation Deeplinks Blog, YouTube Anti-Scientology Takedowns: Good News, Bad News, http://www.eff.org /deeplinks/2008/09/youtube-anti-scientology-takedowns-good-news-bad-n-0 (Sept. 25, 2008); *see also* Douglas Frantz, *An Ultra-Aggressive Use of Investigators and the Courts*, N.Y. TIMES, Mar. 9, 1997, at 131.

205. *See* YouTube, Copyright Claim Disputes: Video ID Disputes, http://www. google.com/support/youtube/bin/answer.py?answer=83768 (last visited Mar. 16, 2009).

because the Content ID system enables automatic blocking of videos, the public does not have an opportunity to render its own fair use judgment. Instead, users must resort to uploading videos protesting automatic blocking.[206] Unfortunately, such protest videos lack the underlying work so the public cannot render an informed fair-use judgment.

Finally, the automatic blocking of content enabled by filters such as YouTube's Content ID system will deter casual or spontaneous fair uses just like DRM deterred casual circumvention of its protection measures. Motivated infringers, however, will still be able to circumvent the automated blocking scheme, just as motivated infringers could crack DRM. Those committed to fair use or infringement will still be able to upload significant portions of copyrighted content simply by understanding how the technological filter works.[207] Users who lack technological savvy will be denied distribution for their lawful content. Indeed, Rick Cotton, General Counsel of NBC Universal, admits that the filter is only intended to be a hurdle and that it will not be able to deter motivated infringers.[208]

There is, however, an important distinction between DRM and filtering when it comes to harming casual fair use. With DRM, each copyrighted work could be released in DRM or non-DRM format. Despite a concerted recording industry push for DRM, consumer backlash against the restrictions eventually led to a market for DRM-free music tracks. However, the feedback effects of the DMCA may mean that once the industry reaches a filtering tipping point, every UGC site must adopt copyright filters that automatically block content. Once that happens, there may be no way to turn back, absent legislative intervention.

C. Feedback Effects

A feedback loop occurs when the output of a control system is fed back ("looped") as an input to the system. In audio systems, feedback loops produce a rather unpleasant sound. In law, feedback loops may lead to a consistent expansion or contraction of legal rights.[209] The UGC Principles could profoundly alter copyright law through two different feedback loops: (1) the fourth factor of the fair-use test, "the effect of a use upon the potential market for the value of the copyrighted work";[210] and (2) the multi-industry "standard technical measures" requirement of the

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206. *See, e.g.*, Posting of Fred von Lohmann, *supra* note 144.

207. *See supra* text accompanying note 145.

208. *YouTube's 75 Percent Solution*, *supra* note 187.

209. *E.g.*, James Gibson, *Risk Aversion and Rights Accretion in Intellectual Property Law*, 116 YALE L.J. 882, 887-906 (2007).

210. 17 U.S.C. § 107 (2006).

DMCA.[211] The UGC Principles, if widely adopted, could expand copyrights through licensing fair uses and contract safe harbors by establishing, at last, a set of "standard technical measures."

Professor James Gibson explained how the decisions of risk-averse companies can have feedback effects on fair-use doctrine under the fourth prong of the fair-use test, market effect.[212] He used an example of a filmmaker editing a documentary about manufacturing job losses.[213] The filmmaker wanted to include a clip of a blue collar worker singing a verse from a Bruce Springsteen song about a mill closing.[214] Even if the use was likely fair, the ambiguity of copyright law coupled with the threat of injunctive relief would probably compel the filmmaker to license the song rather than risk litigation which could holdup the release of the movie.[215] As this culture of licensing pervaded the movie industry, a market popped up for licensing likely fair uses of content.[216] Once established, these markets now weigh against fair use on the fourth (and most important) prong of the fair-use test, market effect.[217] Thus, legal ambiguity created a market, which in turn generated more legal ambiguity, which in turn expanded the market, and so on. Or as Professor Gibson states, "Lather, rinse, repeat."[218]

The UGC Principles might cause a similar accretion of copyrights. Under the UGC Principles, copyright owners can choose to block their content or license it (presumably in exchange for ad revenue).[219] Because it is an automated system, it will capture fair use as well as infringement.[220] Once a licensing market develops for fair uses of content, a feedback loop will again pop up based on the fourth fair-use factor. Imagine two different UGC sites, where site A considers twenty-second clips to be fair use and site B considers only ten-second clips to be fair use.[221] If a

211. 17 U.S.C. § 512(i) (2006).
212. Gibson, *supra* note 209, at 887-906.
213. *Id.* at 887.
214. *Id.* at 887-88.
215. *See id.* at 887-95.
216. *Id.*
217. *Id.*
218. *Id.* at 884.
219. UGC Principles, *supra* note 12, ¶ 3f.
220. *See supra* Section III.A.
221. This example may be unfair because UGC sites could enable copyright owners to set their own fair use limits. For example, YouTube's ContentID system allows copyright owners to independently set time limits before content is removed. Nonetheless, if copyright owners are able to license, according to their own rules, very small clips on one site, then UGC sites that do not allow them to license such small clips would still have a negative market effect on the copyright owner's works.

fifteen second clip of a copyrighted work is used in a mashup on site A, the copyright owner could claim that the fifteen second clip is not fair use because the clip has an effect on the licensing market available on site B. Professor Gibson notes that custom, the usual barrier to such runaway feedback loops, is inapplicable in situations involving new markets recently created by new technology.[222]

Feedback loops created by the UGC Principles would bear another similarity to the movie-licensing feedback loop Professor Gibson discusses—the role of mutual backscratching amongst moneyed players in expanding licensing opportunities. Professor Gibson referenced big, risk-averse movie studios licensing each others' content as a means of expanding markets.[223] A similar type of backscratching could occur under the UGC Principles. UGC sites have a ready-to-go distribution network but they are hesitant to display ads on even likely fair uses because they may lose safe harbor under the direct financial benefit prong of 512(c). Similarly, content owners, nervous about the shifting models of media consumption, seem willing to tap any revenue streams possible.

A second feedback loop could arise (or already has arisen) around the DMCA "standard technical measures" requirement. To be eligible for any of the four DMCA safe harbors, a service provider must accommodate standard technical measures, which the DMCA defines as having four requirements. First, they must be "used by copyright owners to identify or protect copyrighted works."[224] Second, the measures must be "developed pursuant to a broad consensus of copyright owners and service providers in an open, fair, voluntary, multi-industry standards process."[225] Third, the measures must be "available to any person on reasonable and nondiscriminatory terms."[226] Finally, the measures must not "impose substantial costs on service providers or substantial burdens on their systems or networks."[227]

The automatic filtering scheme proposed in the UGC Principles arguably meets these four requirements to qualify as a standard technical measure. First, automatic filters are used by copyright owners to identify mate-

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222. *See* Gibson, *supra* note 209, at 896-97 ("When the defendant's use has only recently become possible (e.g., because it uses a new technology), these standards may do little to clear the muddy waters of circularity; who can say whether an unforeseen use is 'reasonable' or is 'likely to be developed' by the copyright owner?").

223. *See* Gibson, *supra* note 209, at 901.

224. 17 U.S.C. § 512(i)(2) (2006).

225. *Id.* § 512(i)(2)(A).

226. *Id.* § 512(i)(2)(B).

227. *Id.* § 512(i)(2)(C).

rial when the copyright owner submits reference material. The fact that the blocking is done by UGC sites instead of copyright owners may or may not matter to a court. Second, a broad consensus of copyright owners and service providers proposed the UGC Principles. All of the commercial broadcast networks and five of the six major movie studios support the UGC Principles.[228] Four major UGC sites also support the principles.[229] YouTube did not support the UGC Principles, but is largely abiding by their recommendations.[230] Thus, there is a fairly large consensus. Third, the technology is arguably being licensed on reasonable and nondiscriminatory terms. Audible Magic, one vendor of copyright filters, has licensed its technology to many UGC companies.[231] It also makes its filtering technology available for free to smaller sites.[232] Moreover, patent case law demonstrates that the "reasonable and nondiscriminatory" requirement can be elusive.[233] Finally, there are open factual and legal questions as to whether identification technology imposes a substantial cost on service providers or a substantial burden on their networks. The costs for the technology are likely to decrease as more vendors produce software, but eventual licensing costs remain uncertain. Moreover, no court has yet interpreted what qualifies as a "substantial cost" or a "substantial burden." Thus, the automatic filtering scheme proposed in the UGC Principles could qualify as a standard technical measure.

Yet even if the automatic filtering scheme qualifies as a standard technical measure, some may argue that service providers are not required to *implement* every standard technical measure but instead are only required to *accommodate* and not interfere with standard technical measures used

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228. UGC Principles, *supra* note 12. NBC, FOX, CBS, and ABC (through Disney) represent the major broadcast television networks. Paramount (through Viacom), Sony, Universal, Disney, and Fox represent five of the big six film studios. Only Warner Bros. (owned by Time Warner Inc.) did not support the UGC principles.

229. Dailymotion, Soapbox (through Microsoft), Myspace, and Veoh all support the principles. UGC Principles, *supra* note 12.

230. *See* Google, YouTube Copyright Policy: Video Identification Tool, http://www.google.com/support/youtube/bin/answer.py?answer=83766 (last visited Feb. 6, 2009); *see also* Heather Havenstein, *Viacom CEO Dismisses Google Antipiracy Plan*, PC WORLD, Oct. 20, 2007, http://www.pcworld.com/article/138717/ viacom_ceo_dismisses_google_antipiracy_plan.html.

231. Audible Magic, Content Identification Services Customers, http://www.audiblemagic.com/clients-partners/contentsvcs.asp (last visited Feb. 6, 2009).

232. Press Release, Audible Magic, Audible Magic Broadens Reach with Free Service for UGC Websites (Apr. 8, 2008), http://www.audiblemagic.com/news/press-releases/pr-2008-04-08.asp.

233. Mark A. Lemley, *Intellectual Property Rights and Standard-Setting Organizations*, 90 CALIF. L. REV. 1889, 1964-65 (2002).

by copyright owners.[234] But what exactly does it mean to "accommodate"? One interpretation of this requirement would be that service providers simply need to make their sites compatible with standard technical measures.[235] Another plausible interpretation would be that service providers must supply standard technical measures on their sites.[236] Section 512(m) lends support to the latter interpretation by limiting a service provider's duty to "monitor[] its service or affirmatively seek[] facts indicating infringing activity, *except to the extent consistent with a standard technical measure*."[237] If a court adopts the latter interpretation, a UGC site that did not provide for an automatic filtering system on its site could lose the safe harbor.

Thus, while the fit between the automatic filtering scheme in the UGC Principles and the standard technical measures requirement in the DMCA is not exact, it is close enough that the risk-averse nature of large players in the industry will create a feedback loop. The uncertainty surrounding the standard technical measures requirement will cause risk-averse players to do more than the DMCA requires. Unfortunately, the DMCA's requirements are based on industry standards. In this way, relatively few industry players can make decisions that snowball into legal mandates for the whole industry.

The industry-wide adoption of Audible Magic's filtering technology follows this model. MySpace, which is owned by News Corporation,[238] announced a pilot video-filtering program using Audible Magic's technology in February 2007.[239] Less than two weeks later, news broke that YouTube licensed filtering technology from Audible Magic[240] (although the companies actually formed the agreement in January).[241] Over the next

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234. 17 U.S.C. § 512(i)(1) (2006).

235. THE AMERICAN HERITAGE DICTIONARY OF THE ENGLISH LANGUAGE 8 (4th ed. 2006) (defining accommodate as "[t]o make suitable; adapt").

236. *Id.* (defining accommodate as "[t]o provide for; supply with").

237. 17 U.S.C. § 512(m)(1) (emphasis added).

238. Press Release, News Corp., News Corporation to Acquire Intermix Media, Inc. (July 18, 2005), http://www.newscorp.com/news/news_251.html. News Corporation is a major media conglomerate. News Corporation, Investor Relations, http://www.newscorp.com/investor/index.html (last visited Feb. 6, 2009).

239. Press Release, Audible Magic, MySpace Implements Video Filtering System to Block Unauthorized Use of Copyrighted Content (Feb. 12, 2007), http://www.audiblemagic.com/news/press-releases/pr-2007-02-12.asp.

240. Elise Ackerman, *YouTube Expected to Filter Content: Sources Say Google Selected Audible's Technology for Site*, SAN JOSE MERCURY NEWS, Feb. 23, 2007, at BU1.

241. Greenberg, *supra* note 69.

three months, other leading internet video sites, including GoFish,[242] Break.com,[243] Soapbox,[244] and Dailymotion,[245] licensed filtering technology from Audible Magic. By April 2008, Audible Magic announced that it would give a free version of its identification technology away to smaller websites.[246] In light of this industry shift, new UGC sites may be unable to gain safe harbor unless they adopt filtering technology on the same terms as their competitors.

While this example provides anecdotal support for the claim that UGC sites play "follow the leader" in their filtering decisions, it does not illustrate the legal mechanism motivating this behavior. Whereas the fair-use feedback effect occurred through a single statutory loop, the market-effect prong of the fair-use test, the filtering feedback effect could occur through multiple statutory loops. The standard technical measures requirement provides two such loops: broad consensus and substantial costs. While it is clear that the broad consensus prong depends on industry behavior, it is unclear whether a court will look to how much other industry players are paying to determine when costs are substantial. Yet, if every industry peer is licensing some technology, it seems unlikely a UGC site will be able to convince a court that the costs are substantial.

As Web 2.0 matures, these feedback loops threaten to shut out the interests of individual users. The DMCA is essentially a bargain between copyright owners and service providers and only secondarily considers the interests of individual users.[247] Not that long ago, the economic interests of service providers (gaining a large user base) led them to pursue the interests of individuals. Yet, as the interests of copyright owners and service providers begin to merge (creating a shared revenue stream through the

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242. Press Release, Audible Magic, GoFish Partners with Audible Magic (Mar. 7, 2007), http://www.audiblemagic.com/news/press-releases/pr-2007-03-07.asp.

243. Press Release, Audible Magic, Audible Magic Licenses Digital Filtering Technology to Break.com (Mar. 15, 2007), http://www.audiblemagic.com/news/press-releases/pr-2007-03-15.asp.

244. Press Release, Audible Magic, Microsoft Selects Audible Magic's Digital Fingerprinting Technology as Filtering Solution for Soapbox Video Site (Mar. 26, 2007), http://www.audiblemagic.com/news/press-releases/pr-2007-03-26.asp.

245. Press Release, Audible Magic, Dailymotion Selects Audible Magic's Fingerprinting Solution for Detecting Copyrighted Video (May 10, 2007), http://www.audiblemagic.com/news/press-releases/pr-2007-05-10.asp.

246. Press Release, *supra* note 232.

247. The only statutory right granted to individual users is the weak counter notification remedy which enables users to contest removals of material and "requires" service providers to repost material within ten to fourteen days. *See* 17 U.S.C. § 512(g) (2006). Even this remedy lacks teeth because service providers are not really "required" to repost the material due to the lack of an underlying cause of action. *See supra* Section III.B.

combination of the copyright owner's content and the service provider's user base and distribution system),[248] no player is left to pursue the interests of individual users. New players wishing to provide services that promote the interests of individual users may find the safe harbors closed due to the feedback effects of the actions of current players in the industry.

IV. A BETTER WAY

There is a better way. Copyright filters ought to be used to identify—but not automatically block—potentially infringing content. After potentially infringing content is identified, takedowns or blocking should only occur after human review of the content. Section IV.A explains how technological filters separate the copyright policing burden into two separate burdens: the burden to identify infringing content and the burden to evaluate fair use. Section IV.B then considers several obstacles to properly balancing fair use in a policing system.

A. Splitting the Burdens

Copyright filters are not the first technology claimed to be capable of emulating a uniquely human ability. In 1770, an inventor claimed to have created a chess automaton, which became known as "the Turk."[249] The automaton comprised a wooden man seated at a cabinet, which could be opened and appeared to be filled with gears.[250] The inventor would not reveal how the automaton was able to play chess, but he showed audiences the machinery and performed strange motions near the cabinet that misled audiences.[251] In actuality, there was a player seated inside the cabinet, but more than eighty years passed before this secret of the Turk was formally revealed in an article in *The Chess Monthly*.[252] Before the article was published, many believed that the machine was capable of playing chess.[253]

We risk being duped in a similar manner if we believe claims that filtering technology is currently capable of handling fair use without demanding an explanation as to *how* it accommodates fair use. Given the limits of current technology, incorporating fair use seems to be an impossible task.[254] This does not mean it will never happen. Just as technology evolved several hundred years after the Turk to enable a machine's victory

248. Ben Fritz, *MySpace Cozies up to the Biz*, DAILY VARIETY, Feb. 12, 2007, at 2.
249. TOM STANDAGE, THE TURK 22 (2002).
250. *Id.* at 22-24.
251. *See id.* at 64-65.
252. *Id.* at 194-95.
253. *See id.* at 219.
254. *See supra* Section III.A.

over the best chess player in the world,[255] technology may eventually be able to accommodate fair use. But until such accommodations are explained, we must assume that fair use and technological filters are incompatible.

Thus, the first—and most important—step to preserving fair use in a maturing Web 2.0 world is realizing that that the burden to police infringing content is not one burden but two: the burden to identify potentially infringing content (which can be done by technology) and the burden to evaluate fair use of that content (which currently must be done through human review). If we do not separate these burdens then copyright filters may gain widespread appreciation as technological marvels capable of solving the copyright policing problem. Their use may expand to cover all internet traffic, not just content uploaded to UGC sites.[256] If technological filters gain such widespread acceptance under a belief that they are capable of accommodating fair use, then society risks much more than being duped into believing that technology is capable of a task it is not. Instead, society risks the existence of the remix culture[257] made possible by the widespread availability of consumer electronics. It would be sadly ironic if technology ended the culture it helped create.

B. Obstacles to Splitting the Burden

The important goals of accommodating fair use and preventing copyright infringement are best balanced by using technology to identify potentially infringing material and human review to screen the material before it is taken down. However, there are several obstacles to implementing such a policing system. Some obstacles are economic: human review is expensive and perhaps too slow to identify infringing content before significant damage is done. Other obstacles are legal: several DMCA requirements may prevent UGC sites from implementing a two-stage review system. This section surveys those obstacles and identifies possible solutions.

One economic obstacle is the cost of human review. Content companies currently employ significant numbers of people solely to search the

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255. William Saletan, *Chess Bump*, SLATE, May 11, 2007, http://www.slate.com/id/2166000/.

256. *Cf.* Free Press, 23 F.C.C.R. 13028, 13058 ¶ 50 (2008) (stating that network providers may filter content violating copyright law, provided the filtering is application neutral).

257. For a discussion of the relationship between remix culture and technology, see Lawrence Lessig, *In Defense of Piracy*, WALL ST. J., Oct. 11, 2008, at W3.

Internet for infringing content.[258] Without filtering technology, this cost cannot be eliminated because users can re-upload infringing content after review ceases. Moreover, the cost is likely to increase as more UGC sites arise and copyright owners produce more content. Thus, structures that decrease the frequency of human review are necessary.

Filtering technology can decrease the cost of human review in several ways. First, the reviewers will no longer need to search for infringing content because the technology does it for them. Second, when filters are combined with the wisdom of crowds, they may be able to prevent human review of the vast majority of uploaded material because so much uploaded content is hardly ever viewed. So even if it is infringing, copyright owners suffer negligible harm. Thus, costs can be decreased by uploading content and only performing human review on potentially infringing content after the number of views passes a certain threshold. For YouTube, a threshold of approximately 2000 views could eliminate ninety percent of uploaded content.[259]

Even if filtering technology could be used to decrease the cost of human review, there are legal obstacles to implementing such a two-stage review process. Once filtering technology is available, the DMCA may require UGC sites to utilize it to block potentially infringing content before considering fair use with human review. This requirement could manifest itself in restricting the safe harbor under several prongs. First, under the apparent infringing activity prong, UGC sites could be deemed to have constructive knowledge whenever a copyright filter identifies material as potentially infringing.[260] Second, under the right-and-ability-to-control prong, the existence of filtering technology may make UGC sites practically capable of controlling infringing activity by providing them with a location mechanism.[261] Risk-averse UGC sites are likely to recognize these possibilities and automatically block potentially infringing content rather than litigate because eligibility for the entire safe harbor hangs in the balance. Unfortunately, the only way to prevent these statutory uncer-

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258. *See, e.g.*, STEINERT-THRELKELD, *supra* note 44, at 4 (Viacom employs between one and two dozen people at any given time solely to search YouTube for infringing material).

259. Martin Halvey & Mark T. Keane, *Analysis of Online Video Search and Sharing*, *in* PROCEEDINGS OF THE EIGHTEENTH CONFERENCE ON HYPERTEXT AND HYPERMEDIA 217, 222 (2007), http://portal.acm.org/citation.cfm?id=1286240. However, it is not clear that it would eliminate ninety percent of infringing content. Infringing content is likely viewed more frequently than noninfringing content.

260. *See supra* Section I.B.1.

261. *See supra* Section I.B.3.

tainties from turning into legal obstacles is to clarify the legal requirements through litigation or legislation.

A final obstacle, the lack of incentives for the UGC site to invest in human review before blocking content, is economic with legal roots. UGC sites have stronger economic incentives to avoid uploading infringing content than they do to avoid blocking fair use. Not only do they risk losing the safe harbor by uploading infringing content, but they also risk losing licensing agreements and the battle for distribution rights by angering content partners.[262] However, they face little cost from blocking fair use other than some potential lost revenue, but even this cost is minimal because UGC sites are hesitant to monetize content without knowledge that it is not infringing.[263] Blocking fair use may anger users, but users tend to direct most of their anger at the copyright owner requesting blocking rather than the UGC site.[264] Thus, blocking infringing content is a higher priority for UGC sites, so they are unlikely to design policing systems that involve human review.

Copyright owners, on the other hand, have economic incentives to avoid both copyright infringement and blocking fair use. Copyright owners can lose revenue from infringement on UGC sites, but they may gain exposure and expand a fan base.[265] They also risk liability from blocking fair use if they design a system without human review or issue bad-faith takedown notices.[266] Thus, copyright owners have better incentives than UGC sites to design policing systems that contain proper fair-use safeguards.

The differing incentives faced by copyright owners and UGC sites point to several possible changes that could ensure proper fair-use safeguards (e.g., human review before blocking) in a copyright policing system. First, the content and UGC industries could agree to split the burdens: UGC sites could supply the identification technology while copyright owners supply the human review. Unfortunately, it seems that neither industry would agree to such a compromise because it forces both to inter-

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262. *See, e.g.*, Fritz, *supra* note 248 (indicating that copyright filtering is key for UGC sites hoping to partner with Hollywood).

263. Greenberg, *supra* note 69 ("YouTube spokesman Ricardo Reyes counters that YouTube doesn't place in-video advertising on any clips that could potentially violate copyright laws . . . .").

264. *See, e.g.*, Greg Sandoval, *YouTube Users Caught in Warner Music Spat*, CNET NEWS, Jan. 27, 2009, http://news.cnet.com/8301-1023_3-10150588-93.html.

265. *See, e.g.*, Posting of "Q" to Rethinking Basketball, WNBA 2.0: Can Web 2.0 Tools Help the WNBA Build Its Fanbase?, http://rethinkbball.blogspot.com/2008/06/wnba-20-can-wnba-build-fan-base-with.html (June 24, 2008).

266. *See supra* Section I.C.2.

nalize the large cost of considering fair use, whereas both industries are currently headed towards externalizing the costs of considering fair use.[267]

Alternatively, Congress could amend the DMCA to allow section 512(f) actions against UGC sites for bad-faith removals under the guise of protecting copyright. Such liability would make the UGC site's economic incentives similar to those of copyright owners who can face liability for issuing takedown notices without considering fair use. With balanced economic incentives, UGC sites would be more likely to implement a balanced copyright policing system by utilizing human review or working really hard on making its copyright filter fair-use friendly. While such a change may offer more fair-use protections, it seems unfair to allocate the entire policing responsibility to UGC sites.

V. CONCLUSION

As industry powers shift the policing burden from copyright owners to UGC sites, the adoption of wholly automated filtering technology threatens to restrict fair use in the UGC medium. Such restrictions are regretful because they will decrease public opinion of filtering technology, which can be a powerful tool that decreases the costs of policing infringing activity. And if implemented in the proper way, copyright filters could help improve fair-use doctrine by providing constructive feedback.[268] Yet when identification technology is adopted without fair-use safeguards, public opinion will sour just as it did with DRM. Unfortunately, this will reinforce the discourse pitting individual users against copyright owners instead of encouraging constructive dialogue on balancing the important tasks of accommodating fair use and preventing copyright infringement.

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267. By shifting fair use considerations to technological filters, both industries are able to claim that the filters accommodate fair use even if the filters actually ensnare significant amounts of fair use.

268. *See* Beebe, *supra* note 96, at 596-97 (discussing the difference between syntactic feedback and cybernetic feedback).

EBAY'S EFFECT ON COPYRIGHT INJUNCTIONS: WHEN PROPERTY RULES GIVE WAY TO LIABILITY RULES

By Jake Phillips

Until recently, intellectual property rights plaintiffs were virtually guaranteed injunctions if they could show either a likelihood of success for preliminary injunctions or a likelihood of continued infringement for permanent injunctions. In 2006, *eBay Inc. v. MercExchange, L.L.C.*[1] changed the landscape of intellectual property remedies by mandating the application of traditional equity principles to determinations of injunctive relief. Although *eBay* specifically addressed permanent injunctions in the patent context, there has been much speculation about how it will affect other areas of intellectual property law. Justice Thomas, writing for a unanimous Court, devoted half a page in his five-page *eBay* opinion to the Copyright Act, analogizing the Copyright Act's language about injunctive relief to the Patent Act.[2] Specifically, Justice Thomas announced that the Supreme Court "has consistently rejected invitations to replace traditional equitable considerations with a rule that an injunction automatically follows a determination that a copyright has been infringed."[3]

This Note forecasts the likely impact of *eBay* on copyright law by applying a framework of entitlements based on a property rule/liability rule dichotomy. Part I provides background information on injunctive relief, addressing the historical and policy bases for injunctions. It also lays out a utilitarian framework for evaluating when injunctions should be denied. Part II summarizes the Supreme Court's decision in *eBay*. Part III examines *eBay*'s actual impact on copyright law to date, and then offers a paradigm for predicting which kinds of disputes are most likely to be affected by *eBay* in the future. To create this predictive model, the law and economics framework described in Part I is applied to the equitable principles mandated by the *eBay* Court, summarized in Part II. Part IV concludes that *eBay*'s mandate will not affect the outcome in the vast majority of copy-

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1. 547 U.S. 388 (2006).
2. *Id.* at 392-93.
3. *Id.*

right cases. However, in those cases where injunctions would be suboptimal from a social utility perspective, the *eBay* decision could encourage courts to deny injunctive relief in favor of monetary remedies.

I. BACKGROUND

A. Historical Basis for Injunctive Relief in Copyright Law

The origins of injunctive relief trace back to the former courts of equity in England, where disputes were settled according to principles of fairness and conscience rather than strict legal doctrine.[4] As a result, determinations about whether to grant injunctions are rooted in a balancing of equities whereby courts weigh all the relevant facts and circumstances to decide whether monetary compensation would be sufficient to return a plaintiff to the status quo ante.[5]

The first English codification of copyright law, the Statute of Anne, provided injunctive relief as a remedy for infringement in 1710. In addition to creating an exclusive right for authors in copies of their creative works, the statute provided that infringers "shall Forfeit" any misappropriated works "to the Proprietor or Proprietors of the Copy thereof, who shall forthwith Damask and make Waste-Paper of them . . . ."[6] Although there were also certain penalties associated with infringement, actual monetary damage awards did not become available for most British copyright holders until 1801.[7] Moreover, the adequacy of remedies at law did not bear on whether the chancery would grant equitable relief.[8] Rather, history suggests that monetary awards were considered "categorically inadequate" and injunctions were issued as a matter of course upon a finding of infringement.[9]

For the vast majority of modern copyright cases in the United States, courts have continued to presume the inadequacy of legal remedies and

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4. 4 JAY DRATLER, JR. & STEPHEN M. MCJOHN, INTELLECTUAL PROPERTY LAW: COMMERCIAL CREATIVE AND INDUSTRIAL PROPERTY § 13.01 (2008).

5. *Id.* ("Equity abjures snap decisions in favor of balanced judgments based on complete knowledge of the case.").

6. Statute of Anne, 1710, 8 Ann., c. 19 (Eng.).

7. H. Tomás Gómez-Arostegui, *What History Teaches Us About Copyright Injunctions and the Inadequate-Remedy-at-Law Requirement*, 81 S. CALIF. L. REV. 1197, 1201 (2008).

8. *Id.* at 1201.

9. *Id.*

automatically award injunctive relief upon a showing of infringement.[10] The 1976 Copyright Act leaves the question of injunctive relief to judicial discretion. It provides that a court "*may*. . . grant temporary and final injunctions on such terms as it may deem reasonable to prevent or restrain infringement. . . ."[11] With such little legislative guidance, most judges look primarily to the case law when deciding whether to grant injunctions,[12] and the case law has predominantly favored injunctive relief.[13]

The Supreme Court, meanwhile, has repeatedly issued opinions stressing that injunctive relief should not be granted automatically.[14] As early as 1908, the Court held that in cases for which "an injunction would be unconscionable . . . the copyright owner should be remitted to his remedy at law."[15] In 1994, twelve years before *eBay*, Justice Souter admonished in an oft-cited footnote from *Campbell v. Acuff-Rose Music, Inc.* that the goals of copyright law are "not always best served by automatically granting injunctive relief."[16] The Supreme Court reiterated the point in 2001 when Justice Ginsberg, expressing the majority's finding of infringement in *New York Times Co., Inc. v. Tasini*, cautioned that "it hardly follows from today's decision that an injunction . . . must issue."[17] The circuit courts have recognized these admonitions in some cases,[18] but for the most part they have gone unheeded.[19]

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10. *See, e.g.*, Nat'l Football League v. McBee & Bruno's, Inc., 792 F.2d 726, 729 (8th Cir. 1986); Pac. & S. Co., Inc. v. Duncan, 744 F.2d 1490, 1499 (11th Cir. 1984); Superhype Publ'g, Inc. v. Vasiliou, 838 F. Supp. 1220, 1226 (S.D. Ohio 1993).

11. 17 U.S.C. § 502(a) (2006) (emphasis added).

12. Gómez-Arostegui, *supra* note 7, at 1204.

13. DRATLER & MCJOHN, *supra* note 4, § 13.01.

14. *See, e.g.*, N.Y. Times Co. v. Tasini, 533 U.S. 483, 505 (2001); Campbell v. Acuff-Rose Music, Inc., 510 U.S. 569, 578 n.10 (1994).

15. Dun v. Lumbermen's Credit Ass'n, 209 U.S. 20, 23-24 (1908).

16. *Campbell*, 510 U.S. at 578 n.10.

17. *Tasini*, 533 U.S. at 505.

18. *See, e.g.*, Silverstein v. Penguin Putnam, Inc., 368 F.3d 77, 80 (2d Cir. 2004) ("Even if Silverstein's creative contribution to the selection of Mrs. Parker's previously uncollected poems is non-trivial, and even if Penguin's appropriation of it was deliberate, enforcement of his rights by a preliminary or permanent injunction that stops publication of Complete Poems is an abuse of discretion."); Boisson v. Banian Ltd., 280 F. Supp. 2d 10 (E.D.N.Y. 2003) (holding that low likelihood of future infringement renders injunction unnecessary); Love v. Kwitny, 772 F. Supp. 1367, 1375 (S.D.N.Y. 1991) ("When the injurious consequences to [the owner's] copyright from continued circulation of [the infringing] book are, if anything, 'trifling,' no injunction is warranted.").

19. *See infra* note 122 and accompanying discussion.

B. Policy Basis for Injunctive Relief in Copyright Law

Thomas Jefferson wrote that copyright is not "a natural and exclusive right," but rather "an encouragement to men to pursue ideas."[20] In keeping with Jefferson's view, U.S. copyright law is based on the utilitarian theory that granting exclusive rights in creative works will "promote the Progress of Science and useful Arts."[21] Accordingly, rewarding authors with property rights enriches the public by encouraging the creation of valuable intellectual works.[22]

Injunctive relief for copyright infringement is based on an exclusive rights approach to intellectual property.[23] Because monetary compensation alone would not sustain this approach, the only way to give the exclusive right practical effect is to award injunctions against the violation of exclusivity.[24]

This section provides an economic framework for injunctive relief in the copyright context. Section I.B.1 examines the incentive theory, efficiency arguments, and the utilitarian justification for exclusive rights. Section I.B.2 provides background on property rules and liability rules, concluding that although property rules are generally favored as the optimal means to protect the exclusive rights of authors, there are occasions when a liability rule is more socially and economically efficient.

1. The Utilitarian Justification for Injunctive Relief

Copyright protection, as it exists in the United States, is essentially an economic model designed to maximize societal welfare by promoting artistic progress and enriching the public. According to this incentive theory, lack of compensation would deter many potential authors from creating at all.[25] Thus, the number of creative works produced and published would be less than socially optimal if authors were not adequately compensated for their investments of time and money in the creation and publication processes.[26] As a result, the public would be deprived of the fruits of the minds of those forced to earn a living some other way. This societal depri-

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20. Alex Kozinski & Christopher Newman, *What's So Fair About Fair Use?*, 46 J. COPYRIGHT SOC'Y U.S.A. 513, 519 (1999) (citing DAVID N. MAYER, THE CONSTITUTIONAL THOUGHT OF THOMAS JEFFERSON 78 (1994)).

21. U.S. CONST. art. I, § 8, cl. 8.

22. Kozinski & Newman, *supra* note 20, at 519.

23. DRATLER & MCJOHN, *supra* note 4.

24. *Id.*

25. ROGER D. BLAIR & THOMAS E. COTTER, INTELLECTUAL PROPERTY: ECONOMIC AND LEGAL DIMENSIONS OF RIGHTS AND REMEDIES 30-31 (2005).

26. *Id.*

vation represents a theoretical market failure that copyright law seeks to remedy. It does this by granting exclusive rights in creative works as a means of achieving "allocational efficiency," which is realized when rights and resources are distributed so as to maximize societal utility.[27]

The goal of efficiency dictates that the utilitarian aims of copyright are reached when entitlements, or legal rights to intellectual property, are allocated so as to encourage the maximum amount of creation at the lowest possible cost to the public. Accordingly, the law should protect copyright holders enough to encourage their creative efforts and to ensure that those efforts are shared with the public, but not provide so much protection that the public must pay a higher price for the works than is absolutely necessary to induce their creation.

Utilitarian arguments can only justify equitable relief when the public would be deprived of certain creative contributions without the strong legal protection of an injunction. If copyright holders were denied injunctions following infringement, the resulting damages-only awards would be equivalent to forced judicial licensing, a weaker legal protection than injunctive relief. Such weak protection would likely undermine the reliability and cost effectiveness that provides security for licensing and other copyright transactions.[28] The resulting uncertainty, combined with the lack of control over supposedly exclusive rights, would likely weaken the economic incentives for which copyright protection was created. Thus, authors may be less inclined to create if the expected financial yield of their efforts falls below the value they perceive as adequate.[29] The corollary is that strong protection for intellectual property in the form of injunctive relief promotes innovation. Excessively broad protection, however, would also lead to suboptimal levels of creation because it deprives the public of new works that build upon earlier ones.[30] According to United States District Court Judge Pierre Leval, exclusive rights in creative works that are so broad as to prevent analytical reference to prior works or the building of new ideas out of older ones would "strangle the creative proc-

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27. Robert P. Merges, *Of Property Rules, Coase, and Intellectual Property*, 94 COLUM. L. REV. 2655, 2661 (1994).

28. Richard A. Epstein, *The Property Rights Movement and Intellectual Property: A Response to Peter Menell*, REGULATION MAG., Winter 2008, at 58, 63 (discussing utilitarianism in the context of patents).

29. BLAIR & COTTER, *supra* note 25, at 30-31.

30. *Id.* Note that copyright law provides many exceptions such as the merger doctrine and scène à faire, as well as fair use, which attempt to mitigate the inefficiency that results from overprotection.

ess."[31] The fair use defense provides some protection against this kind of market failure. For instance, derivative works that are sufficiently transformative, such as parodies, are defensible against infringement claims.[32] From a societal welfare maximizing perspective, copyright law should incentivize the creation of any and all derivative works that add original creative value to the public that exceeds the amount taken from the copyright holder.[33]

Despite their potential to hinder the creation of derivative works, injunctions can sometimes be useful in forcing the parties to negotiate for a license. However, the threat of an injunction can also be used as undue leverage in licensing negotiations.[34] Additionally, injunctions can lead to inefficient holdouts,[35] which cause the very market failure copyright law is meant to prevent. In extreme cases, equitable discretion can even give "courts the power to order books burned."[36]

Thus, injunctions are not always the optimal remedy from a societal utility-maximizing perspective. However, Congress has provided little guidance about how courts should decide when to deny equitable relief for copyright violations.[37] Because each case has a unique set of facts that may or may not justify the kind of strong protection achieved by an injunction, the incentive theory suggests that courts should not adopt a blanket rule. Instead, to achieve optimal utility, courts should engage in a careful case-by-case examination of the factors of each case with an eye towards the most socially desirable outcomes, which the framers of the Constitution intended to encourage when they provided for copyright protection.[38]

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31. Pierre N. Leval, *Toward A Fair Use Standard*, 103 HARV. L. REV. 1105, 1109 (1990).

32. *See, e.g.*, Campbell v. Acuff-Rose Music, Inc., 510 U.S. 569 (1994).

33. Kozinski & Newman, *supra* note 20, at 528.

34. Richard Dannay, *Copyright Injunctions and Fair Use: Enter* eBay*—Four-Factor Fatigue or Four-Factor Freedom?*, 55 J. COPYRIGHT SOC'Y U.S.A. 449, 459 (2008) (referring to Bill Graham Archives v. Dorling Kindersley, Ltd., 448 F.3d 605 (2d Cir. 2006), *aff'g* 386 F. Supp. 2d 324 (S.D.N.Y.)) In *Bill Graham Archives*, the plaintiff insisted on a fee of $2,500 per image although its typical fee was about $150 per image, and threatened "the most aggressive action possible" if the "exorbitant" fee was not paid. *Bill Graham Archives*, 386 F. Supp. 2d at 326.

35. *See infra* Section I.B.2.b).

36. Kozinski & Newman, supra note 20, at 516 (referring to the injunction, impoundment and destruction ordered in Dr. Seuss Enters., L.P. v. Penguin Books USA, Inc., 924 F. Supp. 1559 (S.D. Cal. 1996)).

37. *See supra* text accompanying note 11.

38. *See* U.S. CONST. art. I, § 8, cl. 8.

2. *Property Rules vs. Liability Rules in the Copyright Context*

Applying equitable principles to decisions about equitable relief seems axiomatic. Thorough consideration of each case should lead to the most socially desirable outcomes regarding entitlements in creative works. In their seminal 1972 article, Guido Calabresi and A. Douglas Melamed offered a useful framework for analyzing how best to protect and regulate these kinds of legal entitlements.[39] According to their theory, entitlements are subject to either a property rule or a liability rule.[40]

A property rule is based on the notion that in order to take an entitlement away from its owner, a buyer must convince the seller to release his rights through a voluntary transaction at a mutually agreed upon price.[41] According to Professor Robert Merges, under a property rule a legal entitlement can only be transferred "after bargaining with the entitlement holder."[42] Thus, the price for the use is set ex ante since the parties must come to a financial agreement before the would-be infringer can use the entitlement holder's property.[43] A liability rule, on the other hand, depends not on the subjective valuation of the buyer and seller, but on an objective valuation by the state.[44] Under this rule, one may infringe first and pay later at a price determined by a third party, usually a court.[45]

According to Calabresi and Melamed's framework of property and liability rules, transaction costs determine whether it is more efficient to set the price by private negotiation or collective valuation.[46] Low transaction costs make bargaining relatively simple, whereas high transaction costs can be prohibitive to reaching an exchange. Transaction costs generally fall into one of two categories: (1) expenses and barriers to negotiation, such as too many parties at the bargaining table; and (2) the risk that some of the sellers might engage in strategic behavior in order to artificially in-

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39. Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089 (1972).

40. *Id.* at 1105. Note that the authors also include a third rule, inalienability, which does "not allow the sale of the property at all" under such circumstance as when "a transaction would create significant externalities." *Id.* at 1106, 1111. This rule, however, is beyond the scope of the discussion of copyright entitlements in this Note.

41. *Id.* at 1092. According to this rule, the subjective valuation by the copyright owner and the license seeker are the only valuations that matter because "once the original entitlement is decided upon, the state does not try to decide its value."

42. Merges, *supra* note 27, at 2655.

43. *Id.*

44. Calabresi & Melamed, supra note 39, at 1092.

45. Merges, *supra* note 27, at 2655.

46. Calabresi & Melamed, supra note 39, at 1106.

flate the price.[47] The extent and nature of these transaction costs in each particular case should weigh heavily in the determination of whether, upon a finding of infringement, a copyright owner is entitled to injunctive relief via a strong property rule or merely a damages award via a liability rule.[48]

a) Copyright Generally Favors Property Rules

Property rules generally lead to more optimal outcomes than liability rules when transaction costs are low.[49] That is, when there are minimal barriers and expenses to negotiation and the risk of strategic behavior is low, private negotiations promote efficiency.[50] This occurs because each of the interested parties has a seat at the bargaining table.[51]

Copyright transactions frequently involve a relatively small number of parties, often just the buyer and the seller of the entitlement, so many scholars argue that intellectual property rights favor a property rule approach.[52] Moreover, if the other costs of transacting are generally low, then the parties are better equipped to determine the price for the exchange than are courts.[53] Thus, property rules have tended to dominate copyright law despite certain statutory exceptions, such as those that provide for compulsory licensing,[54] limitations on exclusive rights,[55] and affirmative defenses such as fair use.[56]

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47. Mark A. Lemley & Philip J. Weiser, *Should Property or Liability Rules Govern Information?*, 85 TEX. L. REV. 783, 786 (2007).

48. Merges, *supra* note 27, at 2664.

49. *See* BLAIR & COTTER, *supra* note 25, at 41.

50. Merges, *supra* note 27, at 2664

51. *Id.*

52. *See, e.g.*, *id.*

53. *See, e.g.*, *id.*; *see also* BLAIR & COTTER, *supra* note 25, at 39.

54. *See* 17 U.S.C. §§ 104A(d)(3), 104A(h)(6), 111(c), 114(d)(2), 114(f) (2006); *but see* BLAIR & COTTER, *supra* note 25, at 40 n.105 (arguing that compulsory licensing schemes are suboptimal because they are subject to "legislative lock-in," making them highly inflexible to change since interested parties can lobby Congress to veto any changes in the existing licensing scheme) (citing Robert P. Merges, *Contracting into Liability Rules: Intellectual Property Rights and Collective Rights Organizations*, 84 CALIF. L. REV. 1293, 1296 (1996)).

55. For example, the first sale doctrine, codified by 17 U.S.C. § 109(a) (2006), limits the copyright holder's distribution right by entitling "the owner of a particular copy or phonorecord lawfully made under this title, or any person authorized by such owner . . . to sell or otherwise dispose of the possession of that copy or phonorecord." Similarly, 17 U.S.C. § 108 (2006) provides a limitation on the copyright holder's exclusive rights by permitting reproduction by libraries and archives. The copyright holder's public display right is limited by 17 U.S.C. § 109(c) (2006), which provides that "the owner of a particular copy lawfully made under this title, or any person authorized by such owner is entitled, without the authority of the copyright owner, to display that copy publicly,

The preference for property rules has led courts to grant injunctive relief almost as a matter of course upon proof of copyright infringement.[57] The benefit of an injunction is to leave licensing negotiations up to the individual parties, with the power in the hands of the copyright owner. By contrast, a damages-only remedy is the equivalent of third-party price determination, which is the hallmark of a liability rule. According to Professor Merges, this form of judicial licensing effectively "place[s] a ceiling on the amount the right holder can collect."[58] If courts set the ceiling too low, it could undermine the economic incentives that exclusive rights were meant to promote. Thus, according to Merges, "[t]he only way to prevent this is to set [the price] equal to the holders' valuation in each case—which is of course most efficiently accomplished by a property rule."[59]

b) Liability Rules Are More Efficient When Transaction Costs Are High

Instead of granting injunctive relief, liability rules only entitle property owners to monetary damages. In doing so, they overcome barriers to efficiency that are present in transactions involving numerous parties, otherwise high transaction costs, and other conditions that may lead to market failure. As discussed infra,[60] holdout behavior, such as strategic bargaining,[61] can be an insurmountable barrier to negotiations. Similarly, transactions with significant public benefits that are not considered by the private parties at the bargaining table can also lead to market failure.[62] In these situations, without objective third-party valuation, a transfer might not occur even though it would be socially desirable.[63] Therefore, according to Calabresi and Melamed, liability rules become preferable to property rules when "market valuation of the entitlement is deemed inefficient."[64]

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either directly or by the projection of no more than one image at a time, to viewers present at the place where the copy is located."

56. *See* 17 U.S.C. § 107 (2006).

57. *See* BLAIR & COTTER, *supra* note 25.

58. Merges, *supra* note 54, at 1306.

59. *Id.*

60. *See infra* text accompanying note 71.

61. Merges, *supra* note 27, at 2664.

62. Lydia Pallas Loren, *Redefining the Market Failure Approach to Fair Use in an Era of Copyright Permission Systems*, 5 J. INTELL. PROP. L. 1, 26 (1997).

63. *Id.*

64. Calabresi & Melamed, *supra* note 39, at 1110.

In the copyright realm, collective rights organizations (CROs)[65] and statutory licensing[66] have helped overcome the high transaction costs associated with too many parties and too many transactions. In CROs like ASCAP and BMI, for example, knowledgeable music industry participants establish a set of rules for the licensing of songs, thus solving the market failure problem by eliminating the high transaction costs associated with having too many parties at the bargaining table.[67] CROs are usually more efficient than compulsory licensing schemes because they reflect industry expertise and are more flexible over time.[68] Compulsory licenses set by Congress[69] are subject to the inflexibility of the statutory revision process as well as to the susceptibility of legislators to influence by powerful lobbyists. Despite these limitations, such licenses have been effective at overcoming certain high transaction costs.[70]

Even with CROs and compulsory licenses, several pockets remain where strong property rules lead to market failure in copyright law. Holdout behavior creates one of these pockets. For example, authors often refuse to negotiate with those who would create derivatives of their works, such as satires,[71] that fall outside the scope of fair use protection.[72] Judge Alex Kozinski of the Ninth Circuit emphasized that this is particularly true when a derivative work "has undertones of ridicule that are likely to make

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65. Examples of CROs include the Copyright Clearance Center (CCC) for textual works such as books or journal articles, a smattering of entities that each represent various size groups of visual artists and photographers, the American Society of Composers, Authors, and Publishers (ASCAP) and Broadcasting Music, Inc. (BMI) for musical performance rights, the Recording Industry Association of America (RIAA) for sound recordings, and the Motion Picture Licensing Corporation (MPLC) for public display rights in films.

66. S*ee infra* note 69.

67. Merges, *supra* note 54, at 1295.

68. *Id.* at 1296-97.

69. 17 U.S.C. § 111(d) (2006) (creating a compulsory license for secondary transmission by cable systems); 17 U.S.C. § 115 (2006) (creating a compulsory license for making and distributing phonorecords); 17 U.S.C. § 116 (2006) (creating a compulsory license for public performances by coin-operated phonorecord players).

70. Merges, *supra* note 54, at 1296, 1299.

71. The Supreme Court distinguished satire from parody in *Campbell v. Acuff-Rose Music, Inc.,* 510 U.S. 569 (1994). While parodies comment on the underlying work, satires use the underlying work to target a third party. *Id.* at 580. Parodies more often fall under fair use protection since the owner of the underlying work would be unlikely to license a new use that criticizes his/her own work. Supposedly copyright owners would not have the same reservations for derivative works that target third parties. *See* Kozinski & Newman, *supra* note 20, at 516-18.

72. Blair & Cotter, *supra* note 25, at 40.

owners of the original work uncomfortable."[73] The market failure that occurs when a copyright holder refuses to negotiate suggests that a liability rule would be the more efficient paradigm in these kinds of cases.

Holdups can also be problematic in copyright law because of what Professors Mark Lemley and Philip Weiser term the "extortion-based principle."[74] Holdups occur when the scope of an injunction would be broader than the scope of the rights infringed.[75] Such overbroad protection occurs, for example, when enjoining an entire work that incorporates copyrighted material only as a small part of the creative whole.[76] In these situations, rights holders leverage the knowledge that an injunction would harm the user more than it would benefit the copyright owner to drive settlement rates far above what would be socially optimal.[77]

Risk aversion on the part of would-be infringers has led to yet another pocket of inefficiency in copyright law. This type of market failure often occurs at the boundaries of fair use because of the uncertainty associated with fair use determinations.[78] While the questionable fair use of a copyrighted work might be permitted without requiring the user to pay a licensing fee, the denial of this statutory defense has almost always guaranteed an injunction.[79] The fuzzy borders of fair use, coupled with the harsh specter of an injunction when fair use is denied, has arguably led to the underproduction of useful derivative works.

Finally, when the use of a work would provide significant external or social benefits that will not be efficiently internalized or cannot be easily monetized in licensing negotiations, a liability rule would lead to the more socially desirable outcome.[80] For example, Professor Lydia Pallas Loren argued that in *Princeton University Press v. Michigan Document Services,*

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73. Kozinski & Newman, *supra* note 20, at 518.

74. Lemley & Weiser, *supra* note 47, at 796.

75. *Id.* at 795-96.

76. *See, e.g.*, Woods v. Universal City Studios, Inc., 920 F. Supp. 62, 65 (S.D.N.Y. 1996) (enjoining distribution of a motion picture that contained five scenes where the set design was based on a copyrighted drawing).

77. Lemley & Weiser, *supra* note 74, at 795.

78. For example, a biographer elected not to include reproductions of her subject's paintings in a biography for fear of an injunction even though it would probably have been considered fair use. Similarly, Merchant Ivory decided not to use actual Picassos in the film *Surviving Picasso*. *See* Dannay, *supra* note 34, at 454; *see also* Pierre N. Leval, *Fair Use or Foul?*, 36 J. COPYRIGHT SOC'Y U.S.A. 167, 179 (1989) (discussing how "the widely varying perceptions of different judges" makes fair use determinations difficult to predict).

79. Leval, *supra* note 78, at 179.

80. Loren, *supra* note 57, at 48-53.

Inc.[81] the external benefit of a better-educated citizenry would probably not be internalized by the individual students in a classroom who were unwilling to pay the high royalty fees charged by the publisher to reproduce excerpts from certain copyrighted works.[82] Loren, citing the dissenting opinion in that case, predicted that such market failure would "result in classroom handouts not being used as frequently or as effectively, and promise[d] to hinder scholastic progress nationwide."[83] In an en banc rehearing of the case on appeal, the Sixth Circuit found that the unauthorized reproduction was not protected by the classroom exception under fair use because of the commercial nature of the transaction.[84] The court issued a permanent injunction.[85] Since the social interest in a well-educated citizenry is non-monetizable, the result of the injunction was market failure. Thus, the presumption favoring a property rule should yield to a liability rule when an injunction would subvert the utilitarian policy aims of copyright protection.

II. CASE SUMMARY OF *EBAY INC. V. MERCEXCHANGE*

Over the years, the Supreme Court has gently reminded the lower courts through footnotes and dicta to use their discretion when deciding whether to issue injunctive relief upon a finding of infringement.[86] Finally, in 2006, *eBay Inc. v. MercExchange*[87] brought the issue to the forefront of intellectual property law. In its brief, but unanimous opinion, the Court announced that lower courts were required to consider traditional equitable principles when deciding whether to issue injunctions.[88]

This section recounts the majority's analysis in *eBay*. It also analyzes the two concurrences, which offer glimpses into the types of cases in which injunctive relief should be denied in favor of a liability rule.

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81. 99 F.3d 1381 (6th Cir. 1996). In this case, publishers brought a copyright infringement action against a copy shop that reproduced and distributed copyrighted works to students in the form of coursepacks, without paying royalties or permission fees. The appellate court held that it was not fair use.

82. Loren, *supra* note 62, at 52.

83. *Id.* (citing Princeton Univ. Press v. Michigan Document Servs., Inc., 99 F.3d 1381, 1393 (6th Cir. 1996) (Martin, J., dissenting)) (internal quotations omitted).

84. *Princeton Univ. Press*, 99 F.3d at 1383.

85. *Id.* at 1392-93.

86. *See supra* Section I.A and notes 14-18.

87. 547 U.S. 388 (2006).

88. *Id.*

A. The Decision

MercExhange, L.L.C. v. eBay, Inc. arose when MercExchange sued eBay for infringing certain online auction patents it held, including the popular "Buy It Now" feature,[89] after attempted licensing negotiations failed.[90] A jury found eBay guilty of infringement and awarded damages.[91] MercExchange moved for permanent injunctive relief as well.[92] The district court denied the request, concluding that "the plaintiff's willingness to license its patents [and] its lack of commercial activity in practicing the patents" indicated that the patent holder would not suffer irreparable harm.[93] The Federal Circuit Court of Appeals reversed the district court, applying a "general rule" that "a permanent injunction will issue once infringement and validity have been adjudged."[94] The Supreme Court granted certiorari "to determine the appropriateness of this general rule."[95]

In its unanimous ruling, the Court held that it was error to apply a "general rule" to a patent injunction determination.[96] Instead, traditional equitable principles required the plaintiffs to demonstrate that balancing the following factors supported their request for injunctive relief: (1) irreparable harm, (2) the inadequacy of monetary damages, (3) the balance of hardships, and (4) the public interest.[97] Additionally, the Supreme Court held that although the district court made reference to this test, it also abused its discretion by failing to apply it properly.[98] Specifically, the district court's adoption of "expansive principles" was an abuse of discretion that improperly led the district court to conclude "that injunctive relief could not issue in a broad swath of cases."[99]

Although the facts of the case relate specifically to injunctive relief for infringement of a business method patent, the Supreme Court emphasized in its decision that the four-factor traditional equitable relief analysis from *eBay* "is consistent with [the Court's] treatment of injunctions under the

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89. MercExchange, L.L.C. v. eBay, Inc., 275 F. Supp. 2d 695, 719 (E.D. Va. 2003).
90. *eBay*, 547 U.S. at 390.
91. *eBay*, 275 F. Supp. 2d at 698.
92. *Id.* at 710-11.
93. *Id.* at 712.
94. MercExchange, L.L.C. v. eBay, Inc., 401 F.3d 1323, 1338 (Fed. Cir. 2005) (acknowledging that there are special circumstances that would preclude issuing an injunction, but holding that none of those circumstances was present in this case).
95. *eBay*, 547 U.S. at 391.
96. *Id.* at 394.
97. *Id.* at 391.
98. *Id.* at 393.
99. *Id.*

Copyright Act."[100] The Court admonished that it "has consistently rejected invitations to replace traditional equitable considerations with a rule that an injunction automatically follows a determination that a copyright has been infringed."[101] Thus, the *eBay* Court instructed that categorical rules are no longer permissible when determining whether to grant injunctive relief to patent and copyright holders alike. Rather, courts must carefully balance the four *eBay* factors in each case, according to traditional principles of equity.

B. The Concurrences

In his concurring opinion, Chief Justice Roberts cited "the basic principle of justice that like cases should be decided alike" as a primary reason for requiring courts to apply the traditional four-factor test.[102] He also reasoned that within that framework, the first two factors, irreparable harm and inadequate remedies at law, will normally be satisfied if the plaintiff establishes infringement.[103] This is because of the "difficulty of protecting a right to *exclude* through monetary remedies that allow an infringer to *use* an invention against the patentee's wishes."[104] Chief Justice Roberts also conceded that this is why courts have historically granted injunctive relief upon a finding of infringement.[105] Thus, the Chief Justice tacitly acknowledged that a property rule represents the historic norm for intellectual property rights, even if it does not actually *entitle* rights holders to injunctive relief.

Justice Kennedy's concurrence challenged the Chief Justice's reasoning. He countered that "a right to exclude does not dictate the remedy for a violation of that right."[106] Moreover, according to Justice Kennedy, the historical preference for injunctions does not create a presumption that an injunction should be granted today, or that other remedies at law are inadequate. Rather, history merely "illustrates the result of the four-factor

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100. *Id.* at 392.

101. *Id.* at 392-93 (citing N.Y. Times Co. v. Tasini, 533 U.S. 483, 505 (2001); Campbell v. Acuff-Rose Music, Inc., 510 U.S. 569, 578 n.10 (1994); Dun v. Lumbermen's Credit Ass'n, 209 U.S. 20, 23-24 (1908)).

102. *Id.* at 395 (Roberts, C.J., concurring) ("Discretion is not whim, and limiting discretion according to legal standards helps promote the basic principle of justice that like cases should be decided alike.") (citing Martin v. Franklin Capital Corp., 546 U.S. 132 (2005)).

103. *Id.*

104. *Id.*

105. *Id.*

106. *Id.* at 396 (Kennedy, J., concurring).

test in the contexts then prevalent."[107] Justice Kennedy went on to discuss patent law's modern context.[108] Today, non-practicing patent holders[109] often use the threat of injunction as a bargaining tool to extract "exorbitant" licensing fees.[110] When the patented invention is only a small component of the product being produced, the threat of injunction creates "undue leverage in negotiations [for which] legal damages may well be sufficient to compensate for the infringement and an injunction may not serve the public interest."[111] Thus, Justice Kennedy favored a liability rule in holdup situations where patent owners—and presumably copyright owners, as well—would have an unfair advantage at the bargaining table. So long as monetary damages would adequately compensate the rights holder, a strong property rule would be unjustified since a liability rule would better serve the public interest.

III. ANALYSIS OF *EBAY*'S LIKELY IMPACT ON COPYRIGHT LAW

Part III analyzes the role *eBay* has played in shaping copyright infringement determinations so far, and then forecasts its potential impact on future decisions regarding requests for equitable relief in copyright infringement actions. Section III.A summarizes how courts have ruled in the aftermath of *eBay* in copyright infringement cases where plaintiffs have sought injunctive relief. The case law provides some insights, but also some confusion, about the effect *eBay* has actually had on copyright injunction cases. Section III.B identifies four types of market failure that result from adherence to strict property rules in copyright law. Applying the four factors to specific fact patterns, this section explains how *eBay* gives courts the opportunity to correct these failures.

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107. *Id.*

108. *Id.* at 396-97.

109. Non-practicing patent holders are frequently called patent trolls, although Justice Kennedy makes no mention of this epithet. *See, e.g.*, Blair Silver, *Controlling Patent Trolling with Civil RICO*, 11 YALE J.L. & TECH. 70, 72 (2008).

110. *eBay*, 547 U.S. at 396 (Kennedy, J., concurring) ("For these firms [that obtain patents primarily to obtain licensing fees], an injunction, and the potentially serious sanctions arising from its violation, can be employed as a bargaining tool to charge exorbitant fees to companies that seek to buy licenses to practice the patent.").

111. *Id.* at 396-97.

A. *eBay*'s Impact on Copyright Law To Date Has Been Minimal

Of twenty-eight copyright injunction cases that have been decided since *eBay*,[112] only two have denied a plaintiff's request for equitable relief.[113] Both of these injunction denials involved copyrights for architectural designs. In *Christopher Phelps & Assocs. v. Galloway*, the Fourth Circuit refused to enjoin the sale of an infringing house even though the

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112. These cases were found using Westlaw's KeyCite Alert feature for cases citing the Supreme Court's decision in *eBay* and JurisNotes.com, Inc.'s "Intellectual Property Notes" e-mail updates, as well as other secondary sources such as LexisNexis Expert Commentaries, through Dec. 18, 2008.

113. Injunction denied: Christopher Phelps & Assocs. v. Galloway, 492 F.3d 532 (4th Cir. 2007); Allora, L.L.C. v. Brownstone, Inc., No. 1:07CV87, 2007 WL 1246448 (W.D.N.C. April 27, 2007) (preliminary injunction motion denied in part and granted in part). Preliminary injunction granted after applying *eBay* factors: Agdata v. Gupta, No. 3:08cv419, 2008 WL 4811674 (W.D.N.C. Oct. 31, 2008); Ticketmaster, LLC v. RMG Techs., Inc., 507 F. Supp. 2d 1096 (C.D. Cal. 2007); Nat'l League of Junior Cotillions v. Porter, No. 3:06-cv-508-RJC, 2007 WL 2316823 (W.D.N.C. Aug. 9, 2007); Advance Magazine Publishers Inc. v. Leach, 466 F. Supp. 2d 628 (D. Md. 2006). Permanent injunction granted after applying *eBay* factors: CoxCom, Inc. v. Chaffee, 536 F.3d 101 (1st Cir. 2008); Warner Bros. Entm't Inc. v. RDR Books, 575 F. Supp. 2d 513 (S.D.N.Y. 2008); Idearc Media Corp. v. Nw Directories., Inc., No. 07-796-HA, 2008 WL 2185334 (D. Or. May 23, 2008); Bryant v. Mattel, Inc., No. CV 04-09049 SGL(RNBx), 2008 WL 3367605 (C.D. Cal. Aug. 8, 2008); MGM v. Grokster, 518 F. Supp. 2d 1197 (C.D. Cal. 2007); Warner Bros. Entm't Inc. v. Carsagno, No. 06 CV 2676(NG)(RLM), 2007 WL 1655666 (E.D.N.Y. Jun. 4, 2007); Microsoft Corp. v. McGee, 490 F. Supp. 2d 874 (S.D. Ohio 2007); Propet USA, Inc. v. Shugart, No. C06-0186-MAT, 2007 WL 4376204 (W.D. Wash. Dec. 13, 2007); Priority Records LLC v. Rodriguez, No. CV F 06-0484 AWI LJO, 2007 WL 120033 (E.D. Cal. Jan. 11, 2007); Capitol Records, Inc. v. Zahn, No. 3:06-0212, 2007 WL 542816 (M.D. Tenn. Feb. 16, 2007); UMG Recordings, Inc. v. Blake, No. 5:06-CV-00120-BR, 2007 WL 1853956 (E.D.N.C. Jun. 26, 2007); Litecubes L.L.C. v. Northern Lights Prods., No. 4:04CV00485 ERW, 2006 WL 5700252 (E.D. Mo. Aug. 25, 2006); Lava Records L.L.C. v. Ates, No. Civ.A. 05-1314, 2006 WL 1914166 (W.D. La. Jul. 11, 2006); Disney Enters., Inc. v. Delane, 446 F. Supp. 2d 402 (D. Md. 2006). Permanent injunction granted without considering *eBay* factors: Arista Records LLC v. Furia Sonidera, Inc., No. 05 CV 5906(ILG)(RER), 2007 WL 922406 (E.D.N.Y. Mar. 26, 2007); Mitchell Int'l, Inc. v. Fraticelli, Civil No. 03-1031 (GAG/BJM), 2007 WL 4197583 (D.P.R. Nov. 26, 2007); Disney Enters., Inc. v. Merchant, No. 6:05-CV-1489, 2007 WL 1101110 (N.D.N.Y. Apr. 10, 2007); Sony Pictures Home Entm't, Inc. v. Chetney, No. 5:06-CV-227 (FJS/GJD), 2007 WL 655772 (N.D.N.Y. Feb. 26, 2007); Columbia Pictures Indus., Inc. v. Molina, Civil No. 06-00288 JMS-LEK, 2007 WL 1080086 (D. Haw. Apr. 6, 2007); Columbia Pictures Film Prod. Asia Ltd. v. Uth, No. CIV S-06-1054 FCD DAD, 2007 WL 36283 (E.D. Cal. Jan. 4, 2007); Sony Pictures Home Entm't, Inc. v. Lott, 471 F. Supp. 2d 716 (N.D. Tex. 2007); Paramount Pictures Corp. v. Davis, Civil Action No. 05-0316, 2006 WL 2092581 (E.D. Pa. July 26, 2006).

first two *eBay* factors favored the plaintiff.[114] In evaluating the third factor, the balance of hardships, the court determined that a permanent injunction would "impose a draconian burden" on the defendant and "take on a fundamentally punitive character, which has not been countenanced in the Copyright Act's remedies."[115] The fourth factor also strongly disfavored an injunction because the court considered the restraint on alienability of real property to be categorically against the public interest.[116] Thus, the court denied the permanent injunction based on the last two *eBay* factors despite the plaintiff's demonstration of irreparable injury and the inadequacy of monetary damages.

Similarly, in *Allora, L.L.C. v. Brownstone, Inc.*, the other architectural design case, the court denied the plaintiff's request for a preliminary injunction to stop the construction of three infringing homes that were already near completion.[117] First, the plaintiff failed to show "that the existence of these three homes substantially and irreparably harm[ed] Plaintiff beyond a point that monetary damages cannot address."[118] Second, the balance of the harms strongly favored the defendants because "preventing the completion and sale of these homes could cause massive damage to Defendants' reputations and financial stability."[119] Finally, the public interest strongly disfavored an injunction, which would be a waste of resources, put subcontractors and laborers out of work, and leave an unpleasant site with potentially hazardous conditions for the neighborhood.[120]

These two decisions suggest that lower courts are taking *eBay* seriously. Moreover, their careful analysis of equitable considerations and subsequent denials of injunctive relief demonstrate that there are occasions when lower court judges think property rules should give way to liability

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114. 492 F.3d 532, 544 (4th Cir. 2007) ("Irreparable injury often derives from the nature of copyright violations, which deprive the copyright holder of intangible exclusive rights . . . . [C]alculation of future damages and profits [would be] . . . difficult or impossible in this case.").

115. *Id.* at 545.

116. *Id.* at 545-46.

117. Allora, L.L.C. v. Brownstone, Inc., No. 1:07CV87, 2007 WL 1246448, at *8 (W.D.N.C. April 27, 2007) ("Plaintiff's motion for a preliminary injunction halting construction of Defendants' three homes based upon Plaintiff's design plans will be denied, and Defendants will be allowed to complete construction on the three houses currently being built.")

118. *Id.* at *6.

119. *Id.* at *7.

120. *Id.* at *8.

rules in copyright law. The question remains, however, whether this holds true outside the architectural design milieu.

Among the other twenty-six post-*eBay* copyright injunction decisions, eight neglected to apply traditional equitable principles at all or to make any mention of *eBay*.[121] The lack of consideration for *eBay*'s holding might suggest that the analysis by lower courts may not change much as a result of that decision. After all, according to Richard Dannay, former president of the Copyright Society of the U.S.A., "[t]he Supreme Court dicta in *Campbell* and *Tasini* has not gone unnoticed but has been largely unheeded."[122] However, all eight cases involved willful infringement,[123] and five were default judgments,[124] which may have mitigated the need for traditional equitable considerations.

Among the cases that did apply *eBay*, willful infringement often led courts to find irreparable harm for which monetary damages would not

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121. Arista Records LLC v. Furia Sonidera, Inc., No. 05 CV 5906(ILG)(RER), 2007 WL 922406 (E.D.N.Y. Mar. 26, 2007); Mitchell Int'l, Inc. v. Fraticelli, Civil No. 03-1031 (GAG/BJM), 2007 WL 4197583 (D.P.R. Nov. 26, 2007); Disney Enters., Inc. v. Merchant, No. 6:05-CV-1489, 2007 WL 1101110 (N.D.N.Y. Apr. 10, 2007); Sony Pictures Home Entm't, Inc. v. Chetney, No. 5:06-CV-227 (FJS/GJD), 2007 WL 655772 (N.D.N.Y. Feb. 26, 2007); Columbia Pictures Indus., Inc. v. Molina, Civil No. 06-00288 JMS-LEK, 2007 WL 1080086 (D. Haw. Apr. 6, 2007); Columbia Pictures Film Prod. Asia Ltd. v. Uth, No. CIV S-06-1054 FCD DAD, 2007 WL 36283 (E.D. Cal. Jan. 4, 2007); Sony Pictures Home Entm't, Inc. v. Lott, 471 F. Supp. 2d 716 (N.D. Tex. 2007); Paramount Pictures Corp. v. Davis, Civil Action No. 05-0316, 2006 WL 2092581 (E.D. Pa. July 26, 2006).

122. Dannay, *supra* note 34, at 456 (referring to Campbell v. Acuff-Rose Music, Inc, 510 U.S. 569, 578 n.10 (1994) and N.Y. Times, Inc. v. Tasini, 533 U.S. 483, 505 (2001)).

123. Arista Records LLC v. Furia Sonidera, Inc., No. 05 CV 5906(ILG)(RER), 2007 WL 922406 (E.D.N.Y. Mar. 26, 2007); Mitchell Int'l, Inc. v. Fraticelli, Civil No. 03-1031 (GAG/BJM), 2007 WL 4197583 (D.P.R. Nov. 26, 2007); Disney Enters., Inc. v. Merchant, No. 6:05-CV-1489, 2007 WL 1101110 (N.D.N.Y. Apr. 10, 2007); Sony Pictures Home Entm't, Inc. v. Chetney, No. 5:06-CV-227 (FJS/GJD), 2007 WL 655772 (N.D.N.Y. Feb. 26, 2007); Columbia Pictures Indus., Inc. v. Molina, Civil No. 06-00288 JMS-LEK, 2007 WL 1080086 (D. Haw. Apr. 6, 2007); Columbia Pictures Film Prod. Asia Ltd. v. Uth, No. CIV S-06-1054 FCD DAD, 2007 WL 36283 (E.D. Cal. Jan. 4, 2007); Sony Pictures Home Entm't, Inc. v. Lott, 471 F. Supp. 2d 716 (N.D. Tex. 2007); Paramount Pictures Corp. v. Davis, Civil Action No. 05-0316, 2006 WL 2092581 (E.D. Pa. July 26, 2006).

124. Arista Records LLC v. Furia Sonidera, Inc., No. 05 CV 5906(ILG)(RER), 2007 WL 922406 (E.D.N.Y. Mar. 26, 2007); Disney Enters., Inc. v. Merchant, No. 6:05-CV-1489, 2007 WL 1101110 (N.D.N.Y. Apr. 10, 2007); Sony Pictures Home Entm't, Inc. v. Chetney, No. 5:06-CV-227 (FJS/GJD), 2007 WL 655772 (N.D.N.Y. Feb. 26, 2007); Columbia Pictures Indus., Inc. v. Molina, Civil No. 06-00288 JMS-LEK, 2007 WL 1080086 (D. Haw. Apr. 6, 2007); Columbia Pictures Film Prod. Asia Ltd. v. Uth, No. CIV S-06-1054 FCD DAD, 2007 WL 36283 (E.D. Cal. Jan. 4, 2007).

adequately compensate.[125] The finding of irreparable harm was usually due to the threat of ongoing or continued infringement.[126] Similarly, courts also found that inducement strongly suggested a likelihood of future third party infringement and thus irreparable injury and the inadequacy of monetary damages.[127] In all of these cases, courts granted injunctive relief.

In most of the cases surveyed, courts found that the balance of hardships factor also favored plaintiffs.[128] Ordinarily, the only harm that would befall the enjoined defendants was their forced acquiescence to the law. Meanwhile, courts relied on the threat of continued infringement as a source of hardship for plaintiffs. Thus, the threat of infringement can implicate all of the first three *eBay* factors: irreparable harm, the inadequacy of monetary damages, and the balance of hardships.

Finally, most courts determined that there is a "public interest in preserving a copyright holder's exclusive rights and no public interest w[ould] be disserved" by an injunction.[129] Courts usually considered the countervailing public interests as well, such as the "interest in receiving copyrighted content for free."[130] But they still concluded that the public interest in the "enforcement of federal statutes"[131] and "the incentive for original authors to create new works"[132] weighed more heavily.

Overall, the lower courts have applied traditional equitable principles almost seventy-five percent of the time since *eBay*.[133] Most of the time, the four factors were given more than a cursory review. And all but twice, the required framework still led courts to uphold strong property rules for copyright owners.[134] Those two cases show that severe hardship to the in-

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125. *See, e.g.*, Disney Enters., Inc. v. Delane, 446 F. Supp. 2d 402 (D. Md. 2006); Warner Bros. Entm't Inc. v. Carsagno, No, 06 CV 2676(NG)(RLM), 2007 WL 1655666, at *6 (E.D.N.Y. Jun. 4, 2007); *see also supra* note 113.

126. *See, e.g.*, MGM v. Grokster, 518 F. Supp. 2d 1197 (C.D. Cal. 2007); Warner Bros. Entm't Inc. v. Carsagno, No. 06 CV 2676(NG)(RLM), 2007 WL 1655666 (E.D.N.Y. Jun. 4, 2007); Propet USA, Inc. v. Shugart, No. C06-0186-MAT, 2007 WL 4376204 (W.D. Wash. Dec. 13, 2007).

127. *See, e.g.*, *Grokster*, 518 F. Supp. 2d 1197.

128. *See, e.g.*, CoxCom, Inc. v. Chaffee, 536 F.3d 101, 112 (1st Cir. 2008); Warner Bros. Entm't Inc. v. RDR Books, 575 F. Supp. 2d 513, 553 (S.D.N.Y. 2008); *see also supra* note 113.

129. UMG Recordings, Inc. v. Blake, No. 5:06-CV-00120-BR, 2007 WL 1853956, *3 (E.D.N.C. Jun. 26, 2007).

130. *Grokster*, 518 F. Supp. 2d at 1222.

131. *CoxCom*, 536 F.3d at 112.

132. *RDR Books*, 575 F. Supp. 2d at 553.

133. Twenty of the twenty-eight (or 71.4% of) post-*eBay* cases applied the four factors in at least a cursory fashion. *See supra* note 113.

134. *See supra* note 113.

fringer and a strong public interest in denying an injunction can lead courts to adopt liability rules.

B. *eBay* has Potential to Solve Market Failures Associated with Property Rules in Copyright Law

Based on the law and economics framework developed in Section I.B.2, copyright law should favor property rules, and therefore injunctions, except where they would lead to market failures. High transaction costs due to numerous stakeholders, holdout behavior, and the existence of positive externalities not considered during licensing negotiations are all common barriers to socially optimal distributions of copyright entitlements.[135] As discussed supra, collective rights organizations such as ASCAP and BMI have become efficient, market-based solutions to the high transaction costs associated with numerous parties and multiple copyrights.[136] Statutory-based compulsory licenses have helped solve those problems as well.[137] However, even with these solutions to the problem of numerous parties as a barrier to negotiation, other kinds of market failures remain.[138] Various forms of holdout behavior, disregard for public benefits, and risk aversion still provide pockets of inefficiency in copyright transactions guided by property rules.[139]

Moreover, property rules do not comport with the utilitarian aims of copyright protection when applied to derivative works that would contribute something original and valuable to the public. As previously mentioned,[140] even though some derivative works are protected by fair use, the uncertainty of a fair use determination, combined with the surety of being enjoined if the use is not considered fair, has often led to risk aversion and suboptimal levels of derivative expression. Unfortunately, until more courts rely on the *eBay* standard to deny injunctions, this problem is likely to persist. Nevertheless, in the wake of *eBay* there now exists an analytical framework for courts to apply so that close-call fair use cases no longer inevitably lead to automatic injunctions upon a finding of infringement. According to Judge Leval, this is especially true when the secondary use "serve[s] a valuable productive function" and "[t]he copyright owner's interest may be fully protected by damages."[141] Over time, therefore, *eBay*

135. *See supra* text accompanying notes 71-85.
136. *See supra* text accompanying notes 65-70.
137. *See supra* text accompanying notes 65-70.
138. Loren, *supra* note 62, at 33.
139. *See supra* text accompanying notes 71-85.
140. *See supra* text accompanying notes 78-79.
141. Leval, *supra* note 78, at 179.

has the potential to mitigate likely market failure due to risk aversion related to the uncertainties associated with fair use.

Section III.B looks at each of the various forms of market failure that *eBay*'s demand for equitable principles has the potential to help overcome. It applies the four-factor framework to pre-*eBay* cases to illustrate how they might have come out differently had they been decided today. By urging courts to consider the balance of harms and the public interest, *eBay* should, in theory, lead to the denial of injunctive relief when property rules would lead to market failure. In light of copyright's utilitarian aims, many of these scenarios involve the close-call fair use cases mentioned above because there is often a strong public interest disfavoring injunctions in those cases. Section III.B.1 suggests that *eBay* could lead to the denial of injunctions for holdout behavior, when owners refuse to negotiate for a license that would be socially optimal. Section III.B.2 discusses how the inability of owners to negotiate, particularly in the case of orphan works for which the owner cannot be found, could lead to the equivalent of a judicial license. Section III.B.3 focuses on holdup behavior, suggesting that *eBay* should lead to the denial of injunctions when copyright owners hold up negotiations strategically to extort higher licensing fees. Finally, Section III.B.4 addresses *eBay*'s impact in the context of positive externalities, concluding that injunctions should be denied when private parties fail to take these externalities into consideration during failed negotiations.

1. When Owners Refuse To Negotiate

When an owner refuses to negotiate despite a strong public interest in licensing the use of a copyrighted work, *eBay*'s fourth factor, the public interest, should lead to a liability rule. There are a number of scenarios under which a copyright holder might refuse to license his copyrighted work under any terms. This Note explores two. First, authors may refuse to license criticism of their work that falls outside the scope of fair use. Second, they may refuse to license satires that use their copyrighted work to target third parties.

a) Public Interest in Criticism

The public interest in criticism is hard to deny. The Copyright Act itself states that "the fair use of a copyrighted work . . . for purposes such as criticism, comment, news, reporting, teaching (including multiple copies for classroom use), scholarship, or research" provides a limitation on an author's exclusive rights.[142] But the Act fails to define precisely what con-

142. 17 U.S.C. § 107 (2006).

stitutes "fair use" for these purposes. There are examples of courts issuing injunctions after finding that precisely these kinds of uses were not fair. As discussed supra,[143] in *Princeton University Press* the Sixth Circuit enjoined the reproduction of excerpts of copyrighted works prepared for classroom teaching purposes.[144] Similarly, the Second Circuit issued an injunction against the photocopying of scientific journal articles for research purposes in *American Geophysical Union v. Texaco, Inc.*[145] For both of these cases, the statute expressly included the purposes of the use as defenses for infringement. Yet in both cases, appellate courts found infringement and issued injunctions.

Thus, it is understandable that the author of a critical biography about a well-known artist might be loath to include reproductions of his paintings in her book without his permission. Such was the case with Jill Johnston's "unfavorable" biography of Jasper Johns.[146] Despite the public interest in matching the images of his works with text that says "[t]he art of Jasper Johns . . . conceals the truth of his life,"[147] the pictures were left out of the biography. Although a court might have found fair use in this case due to its purpose as criticism, the commerciality of the book might just as easily have led to an injunction[148]—before *eBay*, that is. But after *eBay*, a court will have to analyze the four equitable factors before enjoining the work. Considering the utilitarian aims of copyright protection and the public interest in meaningful critique, the fourth factor regarding the public interest would likely defeat the request for injunctive relief, as it did in *Christopher Phelps & Assocs.*[149] Arguably, censorship of this kind that limits free speech could cause even more public harm than restricting the alienability of real property.[150] On the other hand, it could also be argued that Jasper Johns might lose his incentive to share his creations with the public if he is forced to allow critics to show his art alongside their criticisms. But on the whole, burning Johnston's book to protect the exclusive rights of an artist whose pride makes him unwilling to negotiate a licensing fee would probably be even more detrimental. Thus, *eBay* has the potential to overcome the market failure caused by the uncertainty associated

143. *See* discussion *supra* notes 81-85 and accompanying text.

144. Princeton Univ. Press v. Mich. Document Servs., 99 F.3d 1381 (6th Cir. 1996).

145. 60 F.3d 913, 916 (2d Cir. 1994).

146. *See* Dannay, *supra* note 34, at 454.

147. *See id.* (quoting Grace Glueck, *Hiding Behind the Flag*, N.Y. TIMES BOOK REV., Feb. 9, 1997, at 28 (reviewing JILL JOHNSON, JASPER JOHNS (1996))).

148. *See* 17 U.S.C. § 107 (2006).

149. Christopher Phelps & Assocs., L.L.C. v. Galloway, 492 F.3d 532 (4th Cir. 2007). *See* discussion *supra* Section III.A.

150. *See Christopher Phelps*, 492 F.3d at 545.

with fair use and the insurmountable transaction costs of a copyright owner who is unwilling to bargain.

Similarly, when Merchant Ivory made the film *Surviving Picasso*, the artist's son strongly objected to the making of the film and refused to license the use of any of his father's art.[151] Again, the exploitation would appear to be fair use since its purpose is to comment on the life of a famous artist. But a film is also commercial. Before *eBay*, if the court did not find fair use, the plaintiff was almost certain to get his injunction. The uncertainty of the risk led the filmmakers to use fakes "that looked like Picassos, but not too much."[152] As with *Jasper Johns*, after *eBay*, courts should be less likely to grant an injunction here. In addition to the public interest in seeing reproductions of Picasso's actual artwork when learning about his life, the balance of hardships would tip heavily in favor of the defendants since the costs of enjoining a film's distribution could be astronomical.[153] Balancing these two factors against any possible irreparable harm to Picasso's heir and the adequacy of monetary damages to compensate him, a court would likely deny the injunction. After a trio of similarly vexing fair use cases, Judge Leval dubbed the heir who refuses to negotiate for a license to critical works "the widow censor."[154] In the majority of these cases, a liability rule would solve the market failure when a copyright owner refused to negotiate.

In one particularly high profile case, the Second Circuit reversed Judge Leval's finding of fair use when a biographer quoted the unpublished works of J.D. Salinger to paint an unflattering picture of the reclusive author.[155] Judge Leval later admitted error in his overall finding of fair use because "some of the quotations took Salinger's artistic expression for the artistic expression" rather than for productive or transformative purposes.[156] Judge Leval had earlier acknowledged some of these infringing uses in his court opinion.[157] But he found fair use because of the public interest in the "overall usefulness of the book."[158]

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151. *See* Dannay, *supra* note 34, at 454.

152. *Id.* (quoting Edward Lewine, *Painting Sort of, Kind of, But Not Exactly Like Picasso*, N.Y. TIMES, Sept. 29, 1996, § 2 (Arts), at 15).

153. *But see* Woods v. Universal City Studios, Inc., 920 F. Supp. 62, 65 (1996) (holding that the cost to the filmmakers was irrelevant since they should not have infringed).

154. Leval, *supra* note 78, at 172.

155. *See* Salinger v. Random House, Inc., 811 F.2d 90 (2d Cir. 1987).

156. Leval, *supra* note 78, at 170.

157. *Id*. at 171.

158. *Id.*

In the wake of *Salinger* being overturned and the biography enjoined, Judge Leval used the case to illustrate why a finding of infringement should not necessarily lead to equitable relief.[159] In fact, seventeen years before *eBay*, he argued that "[w]e should think twice before burning informative books, even if we conclude they contain quotations that exceed fair use."[160] He illustrated the public interest in licensing the use of Salinger's quotations by relating what happened in the aftermath of the injunction. When the author replaced the enjoined quotations with adjectives describing the contents of Salinger's letters, a reviewer who also had access to the letters publicly disagreed with the biographer's characterization.[161] Without access to the quotations, the public had no way of knowing whether the biographer or the reviewer was right.[162] A post-*eBay* court might find that the public interest in "allowing the readers to judge for themselves by reading revelatory extracts" far outweighs any harm to the copyright holder.[163] Even in 1989, Judge Leval opined that if the same facts presented themselves again he would find infringement but deny an injunction. "In this fashion [he] would protect the copyright owner's entitlements, while preventing the misuse of the copyright law for the protection of secrecy and the suppression of valuable information."[164]

b) Public Interest in Satires

Satirical works are similar to the Jasper Johns biography, the Picasso film and the Salinger biography because they are often highly critical. However, unlike the critical works previously discussed, satires use copyrighted works to criticize something besides the underlying work.[165] Since their target is a third party, one might expect that copyright owners would not have the same motivation for holding out. However, "while imitation may be the highest form of flattery, it is also the commonest form of ridicule."[166] As such, copyright holders may refuse to negotiate and subsequently win injunctions against satirists.

Such was the case with *Dr. Seuss Enterprises, L.P. v. Penguin Books USA, Inc.*, a case involving a satire of the O.J. Simpson trial presented in the style of Dr. Seuss.[167] There, the satire fell short of fair use and was en-

159. *Id.* at 179.
160. *Id.*
161. *Id.* at 172.
162. *Id.*
163. *Id.* at 172.
164. *Id.* at 180.
165. *See supra* note 71.
166. Kozinski & Newman, *supra* note 20, at 518.
167. 924 F. Supp. 1559 (S.D. Cal. 1996).

joined because it targeted the trial rather than the underlying Dr. Seuss work.[168] Afterwards, the rights holder refused to negotiate a license.[169] The satire was never to be seen again, even though the court conceded that it was a creative and original expression of the author's opinion about an event of considerable interest to the public.[170] As the Supreme Court warned in *Campbell,* the goals of copyright, "to stimulate the creation and publication of edifying matter," were not best served by enjoining a satire that went "beyond the bounds of fair use."[171] The public was deprived of an original and highly creative critical commentary on one of the most notorious criminal trials of the century.

More recently, a book entitled *Goodnight Bush*, which borrowed copyrighted expression from the children's classic *Goodnight Moon* to target the George W. Bush presidency, has been the object of infringement speculation.[172] The publishers of *Goodnight Bush* are relying on the fair use doctrine to shield them from copyright infringement claims.[173] Nevertheless, because the derivative work targets the Bush administration rather than the underlying creative work, a court might conclude that *Goodnight Bush* is a satire and thus unprotected by fair use.[174] The *eBay* analytical framework provides courts with the ability to deny injunctive relief for this kind of potential copyright dispute that suffers from the uncertainty of a fair use determination[175] and for which injunctive relief would compromise the goals of copyright law. For an author or publisher relying on the fair use doctrine in a close-call case, it would be unfair and overly harsh to ban publication of the book entirely. Thus, the third *eBay* factor, the balance of hardships, would strongly favor satirists whose works would be destroyed by injunctions. Moreover, although the copyright owners of *Goodnight Moon* might establish hardship, and perhaps even irreparable

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168. *Id.* at 1567-68.

169. Kozinksi & Newman, *supra* note 20, at 518.

170. *Id.* at 517.

171. Campbell v. Acuff-Rose Music, Inc., 510 U.S. 569, 578 n.10 (1994).

172. *See* Joanne Kaufman, *The Secret to Success in Publishing: Bash Bush, With Nods to a Classic*, NY. TIMES, Jun. 16, 2008, at C6.

173. *See id.*

174. *See supra* note 71.

175. *See Campbell*, 510 U.S. at 581 ("[P]arody often shades into satire when society is lampooned through its creative artifacts . . . ."); Andrew S. Long, *Mashed Up Videos and Broken Down Copyright: Changing Copyright to Promote the First Amendment Values of Transformative Video*, 60 OKLA. L. REV. 317, 335-339 (2007); Jason M. Vogel, *The Cat in the Hat's Latest Bad Trick: The Ninth Circuit's Narrowing of the Parody Defense to Copyright Infringement in* Dr. Seuss Enterprises v. Penguin Books USA, Inc., 20 CARDOZO L. REV. 287, 312-13 (1998).

harm, from the undesirable associations and "undertones of ridicule"[176] inherent in a satirical work, the fourth *eBay* factor, the public interest, outweighs this harm in light of copyright's utilitarian aims. As in *Dr. Seuss*,[177] the public has a strong interest in the political commentary and social criticism contained in *Goodnight Bush*, which are useful contributions to the public dialogue about current events. Thus, the equitable principles mandated by *eBay* should save from enjoinder satirical works that provide public value.

2. *When Owners Are Unable To Negotiate*

There are at least two additional scenarios that make negotiation nearly impossible. The first occurs when the number of stakeholders is so numerous as to be prohibitive to negotiations. Those situations are usually remedied through collective rights organizations and legislative compulsory licensing.[178]

The second scenario involves orphan works. Although there is legislation pending in Congress that would "allow good-faith users of copyrighted content to move forward in cases where they wish to license a use but cannot locate the copyright owner after a diligent search,"[179] significant opposition still threatens the proposal.[180] In the meantime, fear that a latent copyright holder will materialize and sue for an injunction can lead to market failures like those found in the Jasper Johns biography and the *Surviving Picasso* film, where risk aversion led to inefficiency.

In the wake of *eBay*, an orphan works user should emerge victorious from an injunction hearing. First, the balance of hardships tips heavily in the defendant's favor, particularly when the defendant has made a good faith effort to locate the copyright holder. One can imagine a filmmaker who has included images and artifacts of historical and social significance in a documentary film after fruitlessly searching for the copyright holders to get their permission. To enjoin the film, even in part, after an absent owner emerges would be a financial disaster to the filmmaker. Moreover, the public would be deprived of the socially valuable documentary work. It would therefore lead to a more socially optimal result if an injunction

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176. Kozinski & Newman, *supra* note 20, at 518.

177. Dr. Seuss Enters., L.P. v. Penguin Books USA, Inc., 924 F. Supp. 1559 (S.D. Cal. 1996).

178. *See* discussion *supra* Section I.B.2.

179. Marybeth Peters, Orphan Works: The Importance of Orphan Works Legislation, Sept. 25, 2008, http://www.copyright.gov/orphan/.

180. *See* The SAA Orphan Works Blog, http://orphanworks.blogspot.com/ (last visited Feb. 5, 2009) (SAA is the abbreviation for the Stock Artists Alliance, the trade association of stock photographers).

were denied in favor of a judicially-determined fee that compensated the author of the original work.[181] This is precisely what the Registrar of Copyrights has recommended to Congress for the orphan works legislation.[182] But even without a legislative mandate, courts applying *eBay* should come to the same conclusion.

3. *When Owners Strategically Hold Up Negotiations*

Justice Kennedy's concurrence in *eBay* referenced patent owners who do not practice their patents, but instead use the threat of injunctive relief to extract "exorbitant" licensing fees out of companies that actually produce something useful.[183] Similarly, noted intellectual property scholar Mark Lemley has argued that "when the copyright owner's only legitimate interest is in compensation rather than control," an injunction should be denied.[184] This is particularly true when the threat of an injunction is "used as leverage in fee negotiations."[185]

The Second Circuit found undue leverage used by the copyright holder in *Bill Graham Archives v. Dorling Kindersley* when it ruled that a publisher's unauthorized reproduction of seven Grateful Dead posters in a 480-page biographical work was a fair use.[186] The defendant-publisher had attempted to get a license for use of the posters, but the copyright holder insisted on a figure that was almost seventeen times the going rate and threatened aggressive legal action if its terms were not met.[187] The publisher took the risk, used the images without obtaining a license, and prevailed on the fair use defense.[188]

Even if the publisher had lost the fair use defense, under *eBay*, an injunction should not have been issued. The first two *eBay* factors require a plaintiff to show irreparable harm and the inadequacy of monetary relief. The plaintiff, Bill Graham Archives, would have had a difficult time showing that seven concert posters reproduced in miniature for a bio-

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181. *The "Orphan Works" Problem and Proposed Legislation: Hearing before the Subcomm. on Courts, the Internet, and Intellectual Property of the H. Comm. on the Judiciary*, 110th Cong. 19-20, 22 (March 13, 2008) (statement of Marybeth Peters, Register of Copyrights, U.S. Copyright Office).

182. *See* Peters, *supra* note 179 ("Reasonable compensation will be mutually agreed [upon] by the owner and the user or, failing that, be decided by a court.").

183. *See supra* Section II.B and note 110.

184. Mark A. Lemley, *Should A Licensing Market Require Licensing?*, 70 LAW & CONTEMP. PROBS. 185, 187 (2007).

185. Dannay, *supra* note 34, at 459.

186. Bill Graham Archives v. Dorling Kindersley, Ltd., 448 F.3d 605 (2d Cir. 2006).

187. Dannay, *supra* note 34, at 459.

188. *Bill Graham Archives*, 448 F.3d at 608.

graphical work would create any kind of significant harm that could not be adequately compensated by a monetary award. Moreover, the balance of hardships would have strongly favored the defendant, whose books would have had to be recalled, edited, and republished in the event of an injunction. Finally, the public interest would also have disfavored injunctive relief since, like the Jasper Johns biography, the public has an interest in seeing the images associated with historical events as it reads about them. Hence *eBay* solves the market failure that results from strategic hold-ups by once again favoring a liability rule for damages.

Bill Graham Archives is but one of many cases in which the threat of injunction from the owner of an original work that is only a small part of a new creative whole is used strategically to drive up licensing fees. Justice Kennedy addressed this issue in the patent context in his *eBay* concurrence:

> When the patented invention is but a small component of the product the companies seek to produce and the threat of an injunction is employed simply for undue leverage in negotiations, legal damages may well be sufficient to compensate for the infringement and an injunction may not serve the public interest.[189]

Nevertheless, with the majority's pronouncement that *eBay*'s equitable approach "is consistent with [the] treatment of injunctions under the Copyright Act,"[190] there is reason to believe that *eBay* applies with equal force when the copyrighted work is "but a small component"[191] of a new creative work. Music sampling is an example of this kind of work. Fortunately, sampling clearinghouses have made great strides in solving this particular market failure.[192] Like ASCAP or BMI, these clearinghouses receive authorization from their member copyright holders to license music samples according to a pre-negotiated fee structure.[193]

However, there is no current market solution for clearing rights to visual works. Sure, if viewers are barely able to perceive the incorporation of a visual work into films or television programs, courts may view the use as de minimis and therefore beyond the scope of protection.[194] But as with

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189. eBay, Inc. v. MercExchange, LLC, 547 U.S. 388, 396-97 (Kennedy, J., concurring).

190. *Id.* at 392 (majority opinion).

191. *Id.* at 396 (Kennedy, J., concurring).

192. A. Dean Johnson, *Music Copyrights: The Need for an Appropriate Fair Use Analysis in Digital Sampling Infringement Suits*, 21 FLA. ST. U.L. REV. 135, 163 (1993).

193. *Id.*

194. Andy Bechtel & Arati Korwar, The Limits of Copyright Protection for the Use of Visual Works in Motion Pictures, Print Media and Pop Art in the 1990s, (Oct. 24,

fair use, the boundary is unclear. Moreover, even if the visual work is easily perceptible an injunction could still lead to inefficient outcomes from a utilitarian copyright perspective.

In *Woods v. Universal City Studios, Inc.*, the court issued a preliminary injunction enjoining the distribution of the film *12 Monkeys*, which incorporated a set design based on the plaintiff's graphite pencil drawing.[195] The design appeared four times for a total of less than five minutes in the 130-minute film.[196] In spite of this, the court ruled that the use was not de minimis, declaring that "whether an infringement is de minimis is determined by the amount taken without authorization from the infringed work, and not by the characteristics of the infringing work."[197] The parties settled after the injunction was issued, and Universal reportedly paid in the high six-figures for the use.[198] Perhaps the large fee was warranted because Universal should have obtained permission before it appropriated the work. But what if Woods had refused to settle? The harm to the studio, in the process of rolling out an international release, would have been financially devastating.[199] Furthermore, the public would have been deprived of an Academy Award nominated film.[200] Woods' willingness to settle after obtaining an injunction is strong evidence that his only interest in seeking an injunction was leverage for negotiations. Rather than suffering irreparable harm, Woods may have benefited from greater public rec-

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1998), http://list.msu.edu/cgi-bin/wa?A2=ind9810d&L=aejmc&P=54 (submitted to the Visual Communication Division of the Association for Education in Journalism and Mass Communication).

195. 920 F. Supp. 62, 63-64 (1996).

196. *Id.* at 65.

197. *Id.*

198. *See* Copyright Website, 12 Monkeys, http://www.benedict.com/visual/monkeys/monkeys.aspx (last visited Feb. 13, 2009).

199. *See* James Thompson, *Permanent Injunctions in Copyright Infringement: Moral and Economic Justification for Balancing Individual Rights Instead of Following Harsh Rules*, 7 S. CAL. INTERDISC. L.J. 477, 503 (1998). Thompson argued that:

> The district court's rash decision [in *Woods*] to resort to a potentially crippling permanent injunction could have caused grossly unfair results if Universal was a true innocent or good faith infringer. Instead of reserving the right to balance the interests or equities between parties in future innocent infringement cases, the district court forever turned its back on the idea that certain circumstances in an infringement case might not warrant a permanent injunction.

Id.

200. *12 Monkeys* was nominated for best supporting actor (Brad Pitt) and best costume design. Twelve Monkeys (1998)—Awards, http://www.imdb.com/title/tt0114746/awards (last visited Mar. 9. 2009).

ognition of his artwork. As for the adequacy of monetary damages, Woods' willingness to settle suggests that money could make him whole. After *eBay*, courts have the opportunity to apply a more socially optimal liability rule to a case like this, granting only monetary damages instead of rigidly adhering to the old property rule-injunction regime.

4. When Negotiating Parties Fail To Consider Positive Externalities

The final market failure resulting from property rules occurs when the copyright holder and the would-be licensee fail to take into account public benefits that would occur if the license were granted. As such, the license seeker may not be willing to pay a price that reflects the total social value of the license. When this happens, the fourth *eBay* factor is likely to lead courts to deny injunctions if the courts follow Lemley's reasoning that "the perceived public benefit in disseminating a work is sufficient to overwhelm market factors."[201]

For example, assuming arguendo that Salinger would have been willing to license quotations from his private letters, the amount his biographer was willing to pay may have fallen short of the socially optimal price for obtaining the license.[202] In other words, according to Judge Leval, the biographer might not have considered the public value in viewers deciding for themselves whether the tone of the letters was "self promoting [and]. . . boastful" or "self-deprecating and charged with hope."[203] Thus, when there is no one to represent the public interest at the bargaining table, negotiations between the buyer and seller may not maximize social utility. When this happens, a third party such as a court must sometimes step in to set a price that will lead to more socially efficient outcomes.[204]

In one 1997 case, the Ninth Circuit held that rebroadcasting the video of a police beating in Los Angeles was not a fair use and therefore required a license from the owner of the video.[205] Although the court did not reach the issue of an injunction in denying the defendant's motion for summary judgment, after *eBay*, an injunction is far less likely due to the extraordinary public interest in viewing such a timely news segment as the Los Angeles riots were unfolding. This is especially likely given the adequacy of monetary damages to compensate the owner and the unlikelihood that the plaintiff would suffer irreparable harm.

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201. Lemley, *supra* note 184, at 193.
202. Loren, *supra* note 62, at 23.
203. Leval, *supra* note 31, at 1114-15.
204. Loren, *supra* note 62, at 26.
205. L.A. News Serv. v. KCAL-TV Channel 9, 108 F.3d 1119 (1997).

IV. CONCLUSION

More than two years after *eBay*, the long-term ramifications of that decision on copyright law are still indeterminate. Of the twenty-eight copyright infringement cases since *eBay* reviewed in this Note, only two denied injunctive relief upon findings of infringement, and both involved architectural designs. From this evidence, one might conclude that *eBay*'s impact on copyright law could be almost as insignificant as prior Supreme Court admonitions.[206]

Nevertheless, the *eBay* Court's mandate that lower courts apply equitable principles to copyright injunction determinations presents an opportunity for courts to solve the market failures that are sometimes caused by strong property rules in copyright law. There are four key scenarios that lead to this kind of market failure. First, when copyright holders refuse to negotiate, which often occurs in close-call fair use cases, *eBay* reminds judges that they have the discretion to deny injunctive relief if it is in the public interest. Second, when owners are unable to negotiate because of high transaction costs, or simply because the author of a derivative work is unable to locate the copyright holder, courts have the opportunity to adopt a liability rule since a property rule would most likely tip the balance of hardships in favor of the creator of the derivative work. Third, when copyright owners strategically hold up negotiations in order to extort higher licensing fees, judges can rely on *eBay* to deny injunctive relief in favor of a forced judicial license. Finally, when negotiations fail because parties at the bargaining table neglect to account for positive externalities, *eBay* allows judges the discretion to account for these societal benefits by adopting a liability rule.

Thus, *eBay* has the potential to have a dramatic impact on four particular areas of copyright law. Judge Leval suggests that, in light of the four equitable factors and copyright's utilitarian aims, "[i]f an injunction would impoverish society, and the copyright owner can be appropriately protected by money damages, an injunction should not be granted."[207] Whether *eBay* will fulfill this promise remains to be seen.

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206. *See supra* Section III.A.
207. Leval, *supra* note 78, at 179.

PROCEED WITH CAUTION: HOW DIGITAL ARCHIVES HAVE BEEN LEFT IN THE DARK

By Alyssa N. Knutson

Digital preservation practice exists in a legal gray area. Following the proposed settlement of Google's Library Project litigation—a pair of class action copyright infringement lawsuits brought against Google in 2005 by the Authors Guild, the Association of American Publishers, and several publishing houses[1]—the legality of digital archives and libraries remains unclear. Furthermore, cases such as the short-lived *Internet Archive v. Shell*[2] provide little guidance but highlight many of the dangers digital archives may encounter.

This Note lays out the principal liabilities to which digital archives are exposed, including their potential but imperfect defenses, using the recently settled but non-precedential *Internet Archive v. Shell* case as an example of the uncertainty surrounding digital archiving. Digital archives face many legal barriers, including practically perpetual copyright terms in the material they include, an uncertain fair use doctrine, a chaotic licensing scheme, and a proliferation of online contracting that threaten archivists' efforts to construct comprehensive digital libraries. While scholarly literature has already explored the application of the fair use defense to archives such as Google's Library Project[3] and to some extent the Internet Archive,[4] this Note further explores the fair use defense in light of the Google

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1. *See generally* Lawrence Jordan, *The Google Book Search Project Litigation—"Massive Copyright Infringement" or "Fair Use"?*, 86-SEP. MICH. B.J. 32 (2007) (providing a quick overview of Google Book Project and the New York litigation).

2. 505 F. Supp. 2d 755 (D. Colo. 2007).

3. *See, e.g.*, ROBIN JEWELER, CONG. RESEARCH SERV., THE GOOGLE BOOK SEARCH PROJECT: IS ONLINE INDEXING A FAIR USE UNDER COPYRIGHT LAW? (2005), *available at* http://www.opencrs.com/rpts/RS22356_20051228.pdf; Jonathan Band, *Google and Fair Use*, 3 J. BUS. & TECH. L. 1 (2008); Douglas L. Rogers, *Increasing Access to Knowledge Through Fair Use—Analyzing the Google Litigation to Unleash Developing Countries*, 10 TUL. J. TECH. & INTELL. PROP. 1 (2007); Elizabeth Hanratty, *Google Library: Beyond Fair Use?*, 2005 DUKE L. & TECH. REV. 10.

4. *See, e.g.*, Kinari Patel, *"Authors v. Internet Archives": The Copyright Infringement Battle Over Web Pages*, 89 J. PAT. & TRADEMARK OFF. SOC'Y 410 (2007); Rebecca Bolin, *Locking Down the Library: How Copyright, Contract and Cybertrespass Block*

Library Project settlement and new threats to such projects including breach of contract actions and an unsympathetic preemption doctrine.

The legal uncertainty shrouding archives threatens current efforts to preserve the world's digital information, a socially and historically beneficial undertaking. Because of this unresolved legal area, archivists operate over cautiously. To avoid litigation of their status, or for a better chance to win at future litigation, archives have implemented and respected 'opt-out' policies, thus allowing copyright and webpage owners to refuse the inclusion of their materials in the archive. By doing so, the Internet Archive and similar archive projects have significantly compromised their overall goal of creating a comprehensive record of past knowledge. This compromise hurts the greater social interest in preservation and access to knowledge.

Furthermore, after Google's settlement[5] it takes a rare company to enter this chilling environment. Without clear guidance on how the fair use doctrine may play out, individuals and institutions may be discouraged from creating or maintaining noncommercial preservation entities. Because the settlement did not go to the merits of the dispute, any entity that seeks to enter the digital archive field will continue to be subject to liability for copyright infringement, although it may not have Google's extensive resources to fight for fair use in court.

This Note concludes with a discussion of broad solutions to this legal limbo. These solutions highlight digital archives' socially beneficial nature but respect both copyright law's safeguards to incentivize creation and the personal right to enter into private contracts. Congress and the courts should encourage public digital preservation by implementing a safe harbor for digital archives under particular conditions and by rethinking traditional preemption analysis. We must create a new framework that enables us to endorse the prospects of nonprofit digital archiving while overcoming the present and emerging obstacles resulting from uncertain legal doctrines and Google's market-based approach to digital archiving.

Internet Archiving, 29 HASTINGS COMM. & ENT L.J. 1 (2006); Kelly Jines-Storey, Comment, *Does Rocky and Bullwinkle Hold the Key to Unlocking the Mystery of Fair Use in the Age of Internet Archiving?*, 35 CAP. U. L. REV. 1021 (2007).

5. *See* discussion *infra* Section II.A.4 (discussing how the proposed Google Library Project settlement effects digital archives' fair use defense); *see also* Jonathan Band, *The Google Library Project: Both Sides of the Story*, 1 PLAGIARY: CROSS-DISCIPLINARY STUDIES IN PLAGIARISM, FABRICATION, AND FALSIFICATION 6 (2006), http://quod.lib.umich.edu/p/plag/images/5240451.0001.002.pdf (providing background on the Google Library Project, the surrounding litigation, Google's fair use defense, and some copyright holders' responses to Google's arguments).

I. CURRENT STATUS OF ARCHIVES

A. Preservation Practice

Scholars widely acknowledge that preservation of and access to cultural artifacts is necessary for a robust cultural life. Historical preservation impacts a society's "collective memory"—the way in which a society sees itself, its values, and its traditions.[6] Furthermore, since new ideas can build on past knowledge, access to collective knowledge leads to the creation of new creative expression.[7] Access to information also allows citizens to exercise their First Amendment right to information and ideas, fundamental democratic values on which the United States was founded.[8]

As many scholars have documented, preservation of cultural property and knowledge is not new.[9] From the ancient library of Alexandria to the Smithsonian Institution, a great deal of time and effort has been expended gathering, storing, preserving, and exhibiting cultural property.[10] Early examples of preservation practice reflect societal interest in collecting and preserving knowledge. King Ptolemy III required that all books brought to Alexandria be copied for the library's archives.[11] The Renaissance saw the

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6. See ARCHIVES, DOCUMENTS AND INSTITUTIONS OF SOCIAL MEMORY: ESSAYS FROM THE SAWYER SEMINAR 165 (Francis X. Blouin, Jr. & William G. Rosenberg eds., 2006), for a collection of essays discussing the role of memory institutions in "conditioning social memory and creating certain kinds of cultural understandings." *See also* JOSEPH L. SAX, PLAYING DARTS WITH A REMBRANDT: PUBLIC AND PRIVATE RIGHTS IN CULTURAL TREASURES 197 (1999) (arguing that cultural property forms the basis of our collective memory); Guy Pessach, *[Networked] Memory Institutions: Social Remembering, Privatization and its Discontents*, 26 CARDOZO ARTS & ENT. L.J. 71, 75 (2008) ("Landscapes of history and social remembering are major forces in the construction of ideologies and people's preferences.").

7. This is expressly the IP Clause's quid pro quo. *See* U.S. CONST. art. 1, § 8, cl. 8 ("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.").

8. Richard J. Peltz, *Use "The Filter You Were Born With": The Unconstitutionality of Mandatory Internet Filtering for the Adult Patrons of Public Libraries*, 77 Wash. L. Rev. 397, 397 (2002) (arguing that libraries are "the quintessential venue for citizens to exercise their First Amendment right to receive information and ideas").

9. *See* Peter S. Menell, *Knowledge Accessibility and Preservation Policy for the Digital Age*, 44 HOUS. L. REV. 1013, 1014 (2007) ("[S]ocieties have long sought to preserve and catalog human knowledge and make it publicly accessible."); *see generally id.* (providing a detailed account of the history of archives and libraries).

10. J.H. Merryman, *The Public Interest in Cultural Property*, 77 CALIF. L. REV. 339, 344 (1989).

11. Andrew Erskine, *Culture and Power in Ptolemaic Egypt: The Museum and Library of Alexandria*, 42 GREECE & ROME 38, 39 (1995).

first law, the French "Ordonnance de Montpellier," that required the deposit of books and other cultural property in a library for preservation purposes.[12]

Likewise, legal and social institutions in the United States have recognized the importance of the preservation of knowledge and cultural property. Congress recognized the public interest in preservation and access to knowledge when it established the Smithsonian Institution in 1846, requiring one copy of each copyrighted work be delivered to the Librarian at the Smithsonian Institution and to the Library of Congress within three months of publication.[13] This requirement lives on today.[14] In the Copyright Act of 1976, Congress further reinforced the preservation and access goals of the copyright system by insulating public libraries from vicarious liability for the acts of patrons and authorizing limited photocopying to maintain the integrity and comprehensiveness of their collections.[15]

B. Into the Digital Realm

Digital technology offers extraordinary opportunities for preservation of and access to knowledge. The problems of the past, such as lack of storage or geographical limitations, are disappearing as a variety of preservation institutions digitize their materials and make them more accessible to the public. Digital search tools allow instantaneous and global access to millions of users and effectively unlimited retrieval possibilities. Traditional institutions that have preserved knowledge and made it accessible to

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12. JULES LARIVIÈRE, INT'L FED'N OF LIBRARY ASS'NS AND INSTS., GUIDELINES FOR LEGAL DEPOSIT LEGISLATION ch. 2 (2000) (a revised, enlarged, and updated edition of the 1981 publication by Dr. Jean Lunn IFLA Committee on Cataloguing).

13. Act of Aug. 10, 1846, ch. 178, §10, 9 Stat. 102, 106 (1851). Charles Jewett, the first librarian of the Smithsonian Institution, extolled the virtues of preservation without omission:

> [I]n coming years, the collection would form a documentary history of American letters, science and art. It is greatly to be desired . . . that the collection should be complete, without a single omission. We wish for every book, every pamphlet, every printed or engraved production, however apparently insignificant. Who can tell what may not be important in future centuries?

SMITHSONIAN INSTITUTION, FOURTH ANNUAL REPORT OF THE BOARD OF REGENTS 35 (1850).

14. The modern Copyright Act requires the owner or exclusive rights holder in a work published in the U.S. to deposit two complete copies of the work within three months after publication. 17 U.S.C. § 407(a) (2006).

15. Copyright Act of 1976, Pub. L. No. 94-553, §108, 90 Stat. 2541, 2546-47 (codified at 17 U.S.C. § 108 (2006)). *See also* Digital Millennium Copyright Act of 1998, Pub. L. 105-304, 112 Stat. 2860 (codified as amended at 17 U.S.C. §§ 512, 1201-1205, 1301-1332, 4001 (2006)) (updating digital preservation and access in the Copyright Act).

the public including the Smithsonian Institution, the Library of Congress, and university research libraries have now launched digital counterparts and projects.[16] Similarly, traditional newspaper, periodical, and print publishers now make content available on the Internet, as do research institutions, courts, and government entities.

Digital archives, today's version of the traditional library, organize, maintain, and support collections of informational items in digital format, accessible to users through networks. Because traditional libraries are limited by storage space and the cost of maintaining that space, digital libraries have the potential to store and make available much more information at a fraction of the cost and space.[17] The effects are clear; internet archiving has already preserved a great deal of culture. For example, the Internet Archive, a digital archive that collects, stores, and makes available old webpages, surpassed ten billion webpages by 2002, or 100 terabytes of information, an amount of material four times greater than all the books in the Library of Congress.[18]

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16. For example, the Library of Congress's American Memory Project offers free access through the Internet to literature, speeches, sound recordings, movies, pictures, prints, maps, and sheet music that document the "American experience." Hannibal Travis, *Building Universal Digital Libraries: An Agenda for Copyright Reform*, 33 PEPP. L. REV. 761, 770 (2006); *see generally* Library of Congress, American Memory Home, http://memory.loc.gov/ammem/index.html (last visited Dec. 23, 2008). Similarly, JSTOR, Ithaka, the Library of Congress and the Andrew W. Mellon Foundation launched a project called Portico, an e-journal archive that preserves scholarly electronic journals to ensure their continued availability to scholars and researchers. June M. Besek & Philippa S. Loengard, *Maintaining the Integrity of Digital Archives*, 31 COLUM. J.L. & ARTS 267, 341 (2008); *see generally* About Portico, http://www.portico.org/about/ (last modified Nov. 30, 2007).

17. While servers are not free strictly speaking, all-digital libraries require fewer labor resources such as hands-on maintenance of the materials, fewer space resources, and fewer material resources. *See* Lynn Silipigni Connaway & Stephen R. Lawrence, *Comparing Library Resource Allocations for the Paper and the Digital Library: An Exploratory Study*, 9 D-LIB Magazine, Dec. 2003, http://www.dlib.org/dlib/december03/connaway/12connaway.html (conducting a study on costs associated with paper libraries versus costs associated with all-digital libraries). The move to an all-digital library, however, requires a strong commitment to maintaining and backing up the digital copies.

18. Travis, *supra* note 16, at 769. How much information is currently contained on the Web and how fast it will grow is an interesting question which has generated a lot of debate. *E.g.*, *compare* SCHOOL OF INFO. MGMT. SYS., UNIV. OF CALIFORNIA-BERKELEY, HOW MUCH INFORMATION? 8 (2003), *available at* http://www2.sims.berkeley.edu/research/projects/how-much-info-2003/printable_report.pdf, *with* Edward T. O'Neill et al., *Trends in the Evolution of the Public Web* (1998-2002), 9 D-LIB MAGAZINE, Apr. 2003, http://www.dlib.org/dlib/april03/lavoie/04lavoie.html. As of June 2008, Cisco Systems, the leading supplier of networking equipment and network management for the Internet, estimated internet traffic at seven exabytes a month, which is about 160 tera-

A remarkable variety of institutions are developing or planning to develop digital archives. Some, such as Google's Library Project, are organized privately and are commercial entities open to the public. Other digital archives, like Burning Well, a public image depository, rely on submissions from a community of contributors and users.[19] Project Gutenberg uses the services of numerous volunteers to proofread and prepare texts for online publication.[20] LexisNexis and Westlaw, which provide legal materials for a fee, are examples of private, commercial, and exclusionary archives.[21]

C. Internet Archive: The Digital Web Archive

The Internet Archive is a not-for-profit privately funded digital preservation institution with similar goals and spirit as the original public preservation institutions like the Library of Congress or Library of Alexandria. It has confronted the legal barriers and challenges typical of those digital archives face. Its methods of collecting, preserving, and displaying the information collected remain legally vulnerable under multiple areas of law, including copyright and state contract law. One of the Internet Archive's recent cases, *Internet Archive v. Shell*, sheds light on the uncertainty surrounding the legality of digital archives.

1. Brewster Kahle's Vision

> Do you know what's carved above the Carnegie Library in Pittsburgh?—'FREE TO THE PEOPLE'—what a goal! . . . I can believe in this! At the Internet Archive, we think of our mission as 'universal access to all knowledge.'[22]

The Internet Archive is a widely known and esteemed example of a grand vision of modern preservation practice. Based in San Francisco, California, the nonprofit Internet Archive seeks to preserve and maintain a

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bytes per second. Bobby White, *Cisco Projects Growth to Swell for Online Video*, THE WALL ST. J., June 16, 2008, at B5.

19. BurningWell.org, BurningWell.org Frequently Asked Questions, http://www.burningwell.org/donors_faq.html (last visited Dec. 23, 2008).

20. Project Gutenberg, Gutenberg: Volunteers' FAQ, http://www.gutenberg.org/wiki/Gutenberg:Volunteers%27_FAQ (last modified Mar. 24, 2008).

21. The distinction between nonprofit and for-profit digital archives makes a difference under copyright law's fair use analysis. *See* discussion *infra* Section II.A.2.

22. Heidi Benson, *A MAN'S VISION: WORLD LIBRARY ONLINE, Brewster Kahle Hopes to Realize His 25-Year Dream of an International Book Archive*, S.F. CHRON., Nov. 22, 2005, at A1.

comprehensive record of the Internet.[23] The Archive collaborates with institutions such as the Library of Congress and the Smithsonian to preserve a record of modern society's history and culture as a resource for future generations and present-day researchers, historians, and scholars.[24] In addition to copies of webpages taken at various points in time, the Archive also includes software, movies, books, and audio recordings.[25]

Brewster Kahle, the founder and digital librarian of the Internet Archive, understood the importance of preserving what is stored and created on the Web. The Web has increasingly evolved into a storehouse of valuable scientific, cultural, and historical information. A wide variety of individuals use the Internet as a storehouse of knowledge that they can access when needed, often multiple times a day. However, webpages are ephemeral, sometimes only lasting weeks or days or even less.[26] For example, the ten most popular stories on CNN.com are updated every twenty minutes.[27] Therefore, the very content and layout of CNN.com's homepage changes seventy-two times a day. The Archive's goal is to preserve and store this intangible and impermanent content before it disappears.

Furthermore, Kahle envisioned an educational future for the Internet Archive as part of the eventual Universal Library of the Internet and digital culture.[28] By capturing different versions of webpages over time, the Archive documents the electronic past. The Archive can provide a snapshot of the "cultural state of society at any given point in time."[29] Further,

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23. Internet Archive v. Shell, 505 F. Supp. 2d 755, 760 (D. Colo. 2007). A web archive is a "web server that caches snapshots of different websites at regular intervals and subsequently makes them available to the public." Boštjan Berčič, *Protection of Personal Data and Copyrighted Material on the Web: The Cases of Google and Internet Archive*, 14 INFO. & COMM. TECH. L. 17, 22 (2005).

24. Internet Archive's Motion to Dismiss Counterclaims at 3, Internet Archive v. Shell, No. 06-cv-01726-LTB-CBS (D. Colo. Nov. 16, 2006).

25. Internet Archive, About the Internet Archive, http://www.archive.org/about/about.php (last visited Dec. 23, 2008).

26. Of the roughly 50,000 software titles published over the years released, the vast majority are currently unavailable commercially. Moreover, in 2000, the average webpage was taken down after a mere seventy-five days, which meant that half of the websites were disappearing within a year's time or less. Travis, *supra* note 16, at 803.

27. *See* CNN Homepage, CNN.com (last visited Dec. 23, 2008).

28. Discussing his vision for the Internet Archive, Kahle stated:

> I see this in a broader context than just making a time capsule. I'm not proposing that I know how we can build the ultimate digital library, but at least we can start the collection for those libraries that in a few years will become an integral part of our information ecology.

JOHN BROCKMAN, DIGERATI: ENCOUNTERS WITH THE CYBER ELITE—WEB ADDITION ch. 15 (1996), *available at* http://www.edge.org/documents/digerati/Kahle.html.

29. Patel, *supra* note 4, at 411.

Kahle believes that by documenting the past and archiving the whole Internet we can understand the phenomenon of the Internet and digital explosion in the future.[30] The Archive also serves as a record of our cultural past, documenting politics, entertainment, and more as content moves into the digital environment.[31]

The Internet Archive has also been used to preserve electronic information. For example, old webpages are often used as evidence in court.[32] They can be useful in making novelty, statutory bar, or nonobviousness arguments in patent cases, and trademark attorneys can prove infringement or first use on particular trademarks.[33] The Archive can also be used as a backup for dead sites when websites disappear or webmasters move on.[34]

2. *How the Internet Archive Works*

To collect data from the Web, the Archive employs the "Wayback Machine" to systematically browse the entire World Wide Web, copy the content from the browsed websites, and place it in a publicly searchable archive. The Wayback Machine uses a software program known as a "web crawler," "spider," or "robot" that moves across the Internet in search of

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30. BROCKMAN, *supra* note 28.

31. For example, the Internet Archive had a project with the Smithsonian Institution to archive the 1996 presidential election to see how the Internet affected the political landscape. *Id.* In an early interview Kahle explained how one could use the Archive as a sociological research tool:

> If you have a full copy of the Internet in one place, you can do clustering studies to understand the evolution of communities and their overlaps, as we move from being a global village where everybody is chanting the same theme song from a popular sitcom to having lots and lots of different communities out there. We can track demographic shifts and even experiment with new indexing technologies. A centralized resource may not be the correct long-term solution, but it's a way to get started quickly.

Id.

32. *See, e.g.*, Telewizja Polska USA v. Echostar Satellite Corp., No. 02-C-3293, 2004 WL 2367740 (N.D. Ill. Oct. 15, 2004); *see also* Matthew Fagan, *"Can You Do a Wayback On That?" The Legal Community's Use of Cached Web Pages In and Out of Trial*, 13 B.U. J. SCI. & TECH. L. 46, 67-70 (2007) (discussing use of cached webpages under the Federal Rules of Evidence).

33. The use of pages culled from Internet Archive's Wayback Machine as evidence has been the subject of debate. *See, e.g.*, Novak v. Tuscows, Inc., No. 06-CV-1909, 2007 WL 922306, at *5 (E.D.N.Y. Mar. 26, 2007) (holding contested webpages from Internet Archive not authenticated under Rules of Evidence because neither testimony nor sworn affidavits were proffered); *Telewizja*, 2004 WL 2367740, at *6 (allowing entry of data from Internet Archive service, however it was accompanied by an affidavit of a representative of Internet Archive attesting to its authenticity).

34. BROCKMAN, *supra* note 28.

new webpages. After the software downloads a page, it looks for cross references, or links, to other pages. To avoid downloading duplicates, the crawler evaluates uniform resource locators (URLs) against what is already archived in its database.[35] This technology generally operates with no human involvement or intervention. Google, Yahoo, and many other companies employ similar crawler technology for indexing websites for use in search engines.[36] After collection it generally takes six months or more for pages to appear in the Wayback Machine searchable archive because of delays of transferring materials to long-term storage.[37]

The Wayback Machine does not seek the website owners' prior permission to reproduce the website content, but the Internet Archive website provides information advising website owners of how to prevent their material from being copied and how to remove the material from the archive.[38] First, authors who do not want their webpages archived can opt-out though the use of the robot exclusion standard. The robot exclusion standard, also known as the Robots Exclusion Protocol or robots.txt, is a method to prevent cooperating web crawlers from accessing all or part of a website that is otherwise publicly viewable.[39] Website owners who do not want their old site versions to be copied and ultimately accessible to the public include a denial text string into their robots.txt file on the computer that hosts the website.[40] Web crawlers will ignore particular websites that contain the denial string in their search. The Internet Archive's crawler program, which recognizes the robot exclusion standard, will refrain from making copies of any sites that include the robots.txt protocol. Therefore, sites that employ the robots.txt will not be accessible to the public through the Wayback Machine.[41] While this is an efficient way for people to pre-

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35. Brewster Kahle, *Preserving the Internet*, 276 SCI. AM. 82, 82 (1997).

36. For an analysis of the differences between search engines' caching of webpages and general archiving of webpages, see Berčič, *supra* note 23, at 20.

37. Internet Archive, Frequently Asked Questions, http://www.archive.org/about/faqs.php (last visited Dec. 23, 2008).

38. *Id.* Along with giving tips for how to exclude material from the Wayback Machine, the Archive asserts that it "is not interested in preserving or offering access to websites or other Internet documents of persons who do not want their materials in the collection." *Id.*

39. Parker v. Yahoo!, Inc., 88 U.S.P.Q.2d 1779 (BNA), fn.9 (E.D. Pa. Sept. 25, 2008) (explaining how robots.txt works).

40. *See* About /robots.txt, http://www.robotstxt.org/robotstxt.html (last updated Apr. 1, 2008).

41. Internet Archive, Internet Archive Contacts: Removing Content from the Wayback Machine, http://www.archive.org/about/exclude.php (last visited Dec. 23, 2008) (stating that the robots.txt file will do two things: (1) remove all documents from a par-

liminarily opt-out of their pages being archived or cached, it is not legally required and up to the website publisher to implement.[42]

The Internet Archive also removes material from the Wayback Machine archive on request from a website owner.[43] In its Terms of Use, the Internet Archive recognizes that authors and publishers of the "publicly available Internet documents" may not desire to have their documents included in the Archive.[44] Besides relying on website publishers to tag their web files for robot exclusion, the Archive allows the website owner to contact the Archive to remove that portion of the collection.[45] The Internet Archive also employs a Copyright Agent to handle standard DMCA § 512 notice and takedown requests from copyright owners who believe their material is being infringed.[46]

3. *Litigation Against the Internet Archive*

It was only a matter of time before the Internet Archive would be brought into court. Brewster Kahle himself acknowledged the large legal implications of a project of this magnitude:

> There are a bunch of legal and social issues as well. Most institutions cannot touch this because it hits every privacy, copyright, and export controversy. I feel like we've touched a raw nerve in attempting this project, since it can change the Net forever from an ephemeral medium to an enduring one.[47]

The major impediment to Kahle's project moving forward smoothly appears to be the looming lawsuits, the outcome of which appears far from clear. Given the fact that the very activity of preservation requires wholesale copying, it was inevitable that the Archive would face legal challenges.

However, past cases have not focused on the legality of the Internet Archive's project, but instead have challenged the Archive's obligation to not archive webpages with exclusion mechanisms installed. The Internet Archive was sued in *Healthcare Advocates, Inc. v. Harding, Earley, Foll-*

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ticular domain from the Wayback Machine, and (2) tell Internet Archive not to crawl a particular site in the future).

42. *See* Bolin, *supra* note 4, at 30.

43. Internet Archive v. Shell, 505 F. Supp. 2d 755, 760 (D. Colo. 2007).

44. Internet Archive, Internet Archives' Terms of Use, Privacy Policy, and Copyright Policy (Mar. 10, 2001), http://www.archive.org/about/terms.php.

45. *Id.*

46. *Id. See* 17 U.S.C. § 512 (2006).

47. BROCKMAN, *supra* note 28.

mer & Frailey[48] as a co-defendant for breach of contract, breach of fiduciary duty, and negligent misrepresentation based on a failure to perform its duty of blocking access to the plaintiff's website via the Wayback Machine. The plaintiff had installed a robots.txt file on its website after the Internet Archive's web crawlers copied their website.[49] When it requests a website, the Archive's server automatically checks to see if the site has a robots.txt file; if it does, the Archive's servers are not to display the page.[50] However, in this case, the Archive's servers malfunctioned allowing the website to be viewed by the co-defendant law firm.[51]

Healthcare Advocates joined the Internet Archive in the suit for its failure to adequately secure and to remedy at least twelve separate acts of unauthorized access to Healthcare Advocate's website. Plaintiff alleged this failure constituted violations of the Digital Millennium Copyright Act, breach of contract, promissory estoppel, breach of fiduciary duty, negligent dispossession, and negligent misrepresentation.[52] Plaintiff's breach of contract claim rested on the theory that the Internet Archive had an agreement with Healthcare Advocates to block archived historical content of the plaintiff's website through plaintiff's inclusion of a denial text string in the robots.txt file on the computer hosting the www.healthcareadvocates.com website.[53] The court dismissed Internet Archive early, after the parties' stipulation, leaving the issue of whether the Archive had breached a contract undecided.[54]

More recently, in *Internet Archive v. Shell*, a pro se litigant sued the Internet Archive. She alleged that its copying of her website breached a contract contained therein.[55] The dispute arose when Suzanne Shell discovered the Wayback Machine had reproduced and archived the contents of her website approximately eighty-seven times between May 1999 and October 2004 and displayed the contents publicly.[56] Shell's website was devoted to providing information and services to individuals accused of child neglect and abuse and was registered with the U.S. Copyright Of-

48. 497 F. Supp. 2d 627 (E.D. Pa. 2007).
49. *Id.* at 632.
50. *Id.*
51. *Id.*
52. Second Amended Complaint for Violations of the Digital Millennium Copyright Act, Copyright Infringement, Violations of the Computer Fraud and Abuse Act, and Related Violations of Common Law at ¶¶ 118-53, Healthcare Advocates, Inc. v. Harding, Earley, Follmer & Frailey, No. 05-3524, 2006 WL 1784161 (E.D. Pa. May 26, 2006).
53. *Id.* at ¶¶ 117-25.
54. *Healthcare Advocates*, 497 F. Supp. 2d at 633.
55. Internet Archive v. Shell, 505 F. Supp. 2d 755, 764-66 (D. Colo. 2007).
56. *Id.* at 761.

fice.[57] The site's terms of use deemed any copying of its contents as entering into a contract.[58] On December 12, 2005, Shell requested that her website contents be removed from the Wayback Machine, and the Archive complied.[59] Shell also demanded payment of $100,000 and threatened to sue if the Archive failed to pay.[60]

On January 20, 2006, the Internet Archive filed a declaratory judgment action in the U.S. District Court of the Northern District of California seeking a judicial determination that it did not violate Shell's copyrights.[61] In Shell's answer she counterclaimed copyright infringement, conversion, civil theft, breach of contract, and violations of the Racketeer Influenced and Corrupt Organizations Act (RICO) and the Colorado Organized Crime Control Act (COCCA), and added members of the Archive's board of directors as third party defendants for the racketeering claims.[62] The parties stipulated to transfer the case to the District of Colorado where the Archive moved to dismiss Shell's claims for conversion, civil theft, breach of contract, and RICO for failure to state a claim under Federal Rule of Civil Procedure 12(b)(6).[63] On February 13, 2007, Chief Judge Babcock dismissed all the counterclaims other than Shell's breach of contract and copyright claims.[64]

On the motion to dismiss the court discussed Shell's counterclaim for breach of contract. Shell argued that copying her site constituted an acceptance of the site's terms of use and that the Internet Archive breached that contract when it failed to pay her the prescribed fees. The Archive responded that it never entered into a contract with Shell and that Shell failed to state a claim for breach of contract because the Archive only learned of Shell's terms of use after it copied the information.[65] The Archive further argued that while its automated web browser accessed Shell's website multiple times, it was not in fact aware of the terms of use, and Shell had not alleged that it or a human being at the Internet Archive was

57. *Id.* at 760.

58. The website contained the following notice: "If you copy or distribute anything on this site-you are entering into a contract. Read the contract before you copy or distribute. your act of copying and/or distributing objectively and expressly indicates your agreement to and acceptance of the following terms." *Id.* at 760 (capitalization omitted).

59. *Id.* at 762.

60. *Id.* at 761.

61. *Id.*

62. *Id.*

63. *Id.* at 761.

64. *Id.* at 770. The court's analysis of any of claims other than breach of contract or copyright is not the subject of this Note.

65. *Id.* at 764.

aware of the terms of use.[66] Absent such actual knowledge, the Archive argued, there cannot be a contract.[67]

The court denied the Internet Archive's motion to dismiss on breach of contract grounds, holding that the counterclaim stated a viable cause of action for breach of contract and that Internet Archive's argument required a factual determination premature for this stage of the litigation. The court could not determine if the Archive knew at the time it copied defendant's site that doing so constituted acceptance of the site's terms of use.[68] The court noted that the record before it was unclear both as to the manner in which the terms of use were displayed and whether the Archive had received any notice of them given that it only accessed the site via an automated web crawler. Because Shell's complaint stated that notice of the contract terms "is published on every page of the website," the court noted that a factual investigation needed to be made on the location of the terms, "how a user reaches [them], and when a user becomes aware of [their] existence."[69] Moreover, the court stated that "while Internet Archive [might] be correct that the absence of human consent to this contract dooms Shell's claims, Shell ha[d] not had the opportunity to develop a factual record on this point."[70]

The Internet Archive further argued that the U.S. Copyright Act preempted Shell's claim of breach of contract.[71] The court, agreeing with the majority opinion among circuit courts, found that contracts requiring payment for use of copyrighted material protect rights beyond those protected by the Copyright Act; therefore, the Copyright Act does not preempt Shell's claim for breach of contract.[72]

4. Unanswered Questions and Potential Implications

While this case did little to resolve the legally ambiguous environment in which digital archives operate, it does highlight several of their biggest legal risks. First, the Internet Archive did not challenge the sufficiency of Shell's copyright infringement claim, postponing instead for an uncertain fair use battle at a later stage of litigation. In addition, without a clear ruling on the breach of contract claim this case may have opened a Pandora's

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66. *Id.* at 765.
67. *Id.*
68. *Id.*
69. *Id.*
70. *Id.* at 765-66.
71. *Id.* at 766-67; *see* 17 U.S.C. § 301 (2006).
72. *Id.* at 767. The Internet Archive also pled unconscionability, but the court noted that: "[A]bsent further factual findings, I cannot conclude that [the alleged] contract is unconscionable." *Id.*

box. After *Shell*, website owners can creatively draft contracts to stop any and all copying of their websites and then extract large fees by credibly threatening to take archivists through discovery, thereby increasing archivists' incentive to settle instead of fight. This possibility creates a new kind of copyright troll.[73] Without any clear ruling on the contract and copyright issues presented in *Shell*, more litigation will follow and will affect how these nonprofit digital archives operate in the future.

II. LEGAL RISKS OF ARCHIVES

"Kitchen sink" approaches to litigation, like Shell's, where a complainant brings any claim or counterclaim against the respondent that arguably fits the facts, have a significant impact on the presence and permanence of archives. Although courts will throw out many of the claims at an early stage, archives still must expend considerable time and resources to defend themselves, exposing their vulnerabilities in the process. Even when the complainant's principal grievance is for breach of contract or copyright infringement, archives face and defend a multitude of claims such as RICO, wire fraud, trespass, conversion, and computer fraud and abuse. Until the uncertainty surrounding these major risks is dealt with more conclusively either by the courts or the legislature, archives face uncertain and burdensome litigation.

A. Copyright Liability

Copyright concerns are the most serious problem facing digital libraries.[74] Digital preservation resides in a murky legal gray area because of the need to copy digital information (one of the exclusive rights of the copyright owner) to preserve it. In addition, for an archive to be complete to the point of being socially beneficial there is a great interest in preserving in-copyright works without having to get the approval of each individual copyright holder, an expensive and time-consuming endeavor. Therefore, copyright law dominates the digital archive discussion.

Moreover, the proposed Google Library Project settlement and the lack of circuit level or Supreme Court rulings on similar digital archive

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73. *See* Field v. Google, 412 F.Supp.2d 1106, 1123 (D. Nev. 2006) (finding bad faith on part of Plaintiff Field for taking affirmative steps to get his works included in Google's search results, where he knew they would be displayed with "cached" links to Google's archival copy, and deliberately ignoring protocols that would have prevented the caching).

74. *See* Travis, *supra* note 16, at 785 ("[A] government panel found that copyright was the 'single most significant barrier to preserving our cultural heritage' in digital libraries.").

matters has possibly made the question of whether a digital archive's copying constitutes fair use more uncertain. Whether digital archiving constitutes a fair use is an unsettled question, and Google's plan to make a Books Rights Registry and to make money from its endeavor may have shifted the analysis. The Google litigation could have settled the fair use issue, for better or worse. Instead, the settlement has left archives in the dark.

1. Copyright Infringement

The Copyright Act affords protection to "original works of authorship fixed in any tangible medium of expression."[75] Works published on the Internet are fully protected and subject to the same qualifications and limitations as non-digital works.[76] Digital works are "fixed" if they can be perceived, reproduced, or otherwise communicated for more than a transitory duration.[77] The copyright owner of a website or web content has the same exclusive rights under the Copyright Act as copyright holders of non-digital works.[78]

Under a strict interpretation of copyright law, archiving meets the threshold of copyright infringement and therefore makes archivists liable without a defense. Archiving violates three exclusive rights of copyright owners: the right to reproduction,[79] the right to distribution,[80] and the right to display.[81] First, archives necessarily make copies of each new webpage as their software crawls the Internet. This step is essential to the project of

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75. 17 U.S.C. § 102 (2006).

76. They are still required to meet the subject matter requirements of § 102, must be fixed in a tangible medium, and be original works of authorship.

77. Whether fixation on a computer hard disk or random access memory (RAM) is enough is now controversial. *Compare* Triad Sys. v. SoutheasterExpress Co., 64 F.3d 1330, 1333 (9th Cir. 1995) (granting preliminary injunction when defendant copied software into RAM of computer) *and* MAI Sys. v. Peak Computers, 991 F.2d 511, 518 (9th Cir. 1993) (finding that the "representation created in the RAM is 'sufficiently permanent or stable to permit it to be perceived, reproduced, or otherwise communicated for a period of more than transitory duration'"), *with* The Cartoon Network L.P. v. CSC Holdings, Inc., 536 F.3d 121, 129-30 (2d Cir. 2008) (finding that the cable television company's embodiments of copyrighted television programs and movies in data buffers under 1.2 seconds did not last for a period of more than a transitory duration and therefore were not "fixed") *and* CoStar Group, Inc. v. LoopNet, Inc., 373 F.3d 544, 551 (4th Cir. 2004) (holding information and data downloaded onto a user's RAM are not "fixed" because they are for no more than a transitory duration).

78. Those rights include: the right of reproduction (i.e. copying), the right to display, the right to prepare derivative works, and the right to distribute. 17 U.S.C. § 106 (2006).

79. § 106(1).

80. § 106(3).

81. § 106(5).

preservation. Second, archives distribute the copied web content when they make the material available via their website. Lastly, archives violate the exclusive right to display copyrighted material when they make the pages available on a website that is open to the public.[82] As a result, digital archives like the Internet Archive will be found liable for copyright infringement without an exception or defense.

There are statutory exceptions to the exclusive rights of copyright holders like the library exception[83] or the DMCA safe harbor for ISPs.[84] Unfortunately, there are currently no similar exceptions for digital preservation by archives and their strongest defense, fair use,[85] is unpredictable, fact intensive, and uncertain.

2. *Library Exception*

The "library exception" of section 108 of the Copyright Act[86] is a narrow limitation on the exclusive rights of copyright holders. The primary purpose of the library provisions is to promote access to copyrighted works and reinforce preservation, while safeguarding against the commercial sale of works being supplanted by copying.[87]

While the library exception allows for preservation, flexibility, and access to knowledge by the public, it also reflects concerns about the unauthorized commercial exploitation of copyrighted works and disruption of markets. Under section 108, a library may make a maximum of only three copies of a published work to replace a damaged, deteriorating, lost, or stolen copy, or if the existing format of the work becomes obsolete. Any copies must be only for the library's own use.[88] Libraries are only allowed isolated and unrelated reproduction or distribution of a single copy of copyrighted materials for patrons requesting library materials.[89] Public libraries and archives are exempted from liability for the reproduction or distribution of a single copy of work, as long as the reproduction or distribution is not for commercial advantage, the collections are publicly

82. *See* H.R. REP. 94-1476 at 64 (1976) ("'[D]isplay' would include . . . the showing of an image on a cathode ray tube, or similar viewing apparatus connected with any sort of information storage and retrieval system.").

83. 17 U.S.C. § 108 (2006).

84. 17 U.S.C. § 512 (2006).

85. 17 U.S.C. § 107 (2006).

86. § 108.

87. *See* Menell, *supra* note 9, at 1034-35 (explaining that the provisions "augment the general fair use privilege and afford libraries greater leeway in copying and distributing copyrighted works").

88. § 108(c).

89. § 108(g).

available, and a notice of copyright is included in the reproduction or distribution of the work.[90] Furthermore, nonprofit libraries, archives, and educational institutions are exempted from liability for circumventing technological protection measures to the extent necessary to determine whether to add copyrighted works to their collections.[91]

Digital archives do not fall under the section 108 library exception. First, the exception does not apply to material the library or archive does not own. Second, under section 108 a library cannot distribute digital copies or make them available to patrons outside the library premises.[92] Furthermore, although the DMCA allows for the digital preservation of copyrighted works, it states that pure digital libraries and archives that exist only on the Internet are not part of the library exception. The legislative history clearly shows congressional intent not to extend the library exception to libraries and archives existing wholly on the Internet. The Senate Judiciary Committee stated:

> Although online interactive digital networks have since given birth to online digital 'libraries' and 'archives' that exist only in the visual (rather than physical) sense on websites, bulletin board and homepages across the Internet, it is not the Committee's intent that [17 U.S.C. § 108] as revised apply to such collections of information. The ease with which such sites are established online literally allows anyone to create his or her own digital 'library' or 'archives.' The extension of the application of section 108 to all such sites would be tantamount to creating an exception to the exclusive rights of copyright holders that would permit any person who has an online website, bulletin board or a homepage to freely reproduce and distribute copyrighted works. Such an exemption would swallow the general rule and severely impair the copyright owners' right and ability to commercially exploit their copyrighted works.[93]

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90. § 108(a).

91. Digital Millennium Copyright Act, § 103, 112 Stat. 2866 (codified at 17 U.S.C. § 1201(d) (2006)).

92. *See* § 108(b)-(c) (2006). However, the exception allows libraries and archives to reproduce, distribute, display, or perform in digital form a copy of a copyrighted work during the last twenty years of any term of copyright for purposes of preservation, scholarship, or research as long the work is not still being commercially exploited, the work can not be obtained at a reasonable price, or the copyright holder does not provide notice that one of the above conditions applies. § 108 (h)(1).

93. S. REP. NO. 105-190 at 62 (1998).

However, although the rigid library exception does not apply to digital archives' activities, an archive's actions in creating the archive could arguably fall under the fair use defense of the Copyright Act.[94]

3. *Fair Use*

Digital archives' best chance to refute copyright infringement is the unpredictable fair use doctrine, which provides the best defense for digital archives, but is also the principal impediment to archiving projects.[95] Some scholars and commentators applying the fair use defense to digital archives believe that courts are likely to find fair use.[96] However, they fail to take into consideration the difficulty, fact intensity, and unpredictability of the doctrine that must be proven for each specific act of infringement in each lawsuit brought against a digital archive.[97]

Section 107 of the Copyright Act "permits courts to avoid rigid application of the copyright statute when, on occasion, it would stifle the very creativity which that law is designed to foster."[98] The fair use defense creates a balance between exclusionary rights and free access, between social benefits and costs, and between the rights of authors to promote creative production and a democratic society's need for access to information and a free flow of ideas, information, and commerce.[99] The Copyright

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94. § 108(f)(4) ("Nothing in this section . . . in any way affects the right of fair use as provided by section 107 . . ."). For a discussion of the fair use doctrine and its application to the activities of digital archives, see *infra*, Section II.A.3.

95. *See* Menell, *supra* note 9, at 1015-16 (discussing the instability of the fair use defense as an impediment to Google's Book Search Project).

96. *See, e.g.*, Jines-Storey, *supra* note 4, at 1048-56 (finding fair use for the Internet Archive because there has been no demonstrable effect on the market by its copying of publicly accessible webpages).

97. *See* Bolin, *supra* note 4, at 25 (2006) ("Fair use is a doctrine too unstable to rely on when verbatim copying millions of webpages a day without consent."); *see also* Patel, *supra* note 4, at 424-26 (discussing the fact specific nature of the fair use defense); Travis, *supra* note 16, at 814, 816 (finding that the fair use doctrine has little to offer digital libraries because "courts have eviscerated it" post-*Sony*); Posting of Siva Vaidhyanathan to The Googlization of Everything Blog, My Initial Take on the Google-Publishers Settlement, http://www.googlizationofeverything.com/2008/10/my_initial_take_on_the_googlep.php (Oct. 28, 2008 7:21 EST) ("Fair use in the digital world is just as murky and unpredictable (not to mention unfair and useless) as it was yesterday.").

98. Dr. Seuss Enters., L.P. v. Penguin Books USA, Inc., 109 F.3d 1394, 1399 (9th Cir. 1997) (citing Iowa State Univ. Research Found., Inc. v. Am. Broadcasting Cos., 621 F.2d 57, 60 (2d Cir.1980)).

99. *See* Harper & Row, Publishers, Inc. v. Nation Enters., 471 U.S. 539, 545-46 (1985) (balancing copyright's rewards to the individual against the interests of the public and arguing that "copyright is intended to increase and not to impede the harvest of

Act provides that the fair use of a copyrighted work for the purposes of criticism, comment, news reporting, teaching, scholarship, or research, is not an infringement[100] because copying of the works for those particular purposes is favored over protection of intellectual property.

Congress has identified four nonexclusive factors as especially relevant in determining fair use.[101] In determining whether the use made of a work in any particular case is a fair use the factors to be considered include: the purpose and character of the use, including whether such use is for commercial purposes or is for nonprofit educational purpose and whether the use is transformative; the nature of the copyrighted work; the amount and substantiality of the portion used in relation to the copyrighted work as a whole; and the effect of the use on the potential market or value of the original copyrighted work.[102] There is no "rigid bright-line approach to fair use" and all four factors must be analyzed individually, in light of the purposes of copyright.[103]

There remains a legal uncertainty as to whether courts would consider the copying and display of digital archives fair use.[104] This Note does not provide a detailed and thorough analysis of the fair use defense, but rather shows the unpredictable and fact-intensive nature of the imperfect fair use defense as applied to digital archives. The second and third factors do not seem to argue for or against a finding of fair use; however, the first and

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knowledge"); Sony Corp. of Am. v. Universal City Studios, Inc, 464 U.S. 417, 429 (1984) ("Because this task involves a difficult balance between the interests of authors and inventors in the control and exploitation of their writings and discoveries on the one hand, and society's competing interest in the free flow of ideas, information, and commerce on the other hand, our patent and copyright statutes have been amended repeatedly."); Orrin G. Hatch, *Toward a Principled Approach to Copyright Legislation at the Turn of the Millennium*, 59 U. PITT. L. REV. 719, 723 (1998) ("[C]opyright rights should be protected, unless it can be shown that the extent of protection is hampering creativity or the wide dissemination of works."); Marybeth Peters, *Copyright Enters the Public Domain: The 33rd Donald C. Brace Memorial Lecture Delivered at New York University School of Law on Apr. 29, 2004*, 51 J. COPYRIGHT SOC'Y USA 701, 722 (2004) ("Striking the balance between meeting consumer expectations and limiting harmful copying and distribution is the key to preserving copyright's standing in the eyes of the public.").

100. 17 U.S.C. § 107 (2006).

101. *Id.*

102. *Id.*; *see also Harper*, 471 U.S. at 539-40.

103. Campbell v. Acuff-Rose Music, 510 U.S. 569, 584-85 (1994).

104. There does not seem to be a serious unauthorized distribution question for digital archives unless they are copying the digital content and then freely giving it to someone else. Whether they can be liable for contributory copyright infringement liability for their patrons' use of the copyrighted works on the Wayback Machine is not within the scope of this Note.

fourth factors tend to be the most uncertain and raise the most interesting questions.

a) The Purpose and Character of the Infringing Work

The first factor of the fair use analysis is likely the most persuasive and most uncertain of the four factors when analyzing liability for digital archives. It considers a variety of elements including: whether the work is for commercial or nonprofit purposes; whether it fits in one of the categories laid out in statute (e.g., criticism, comment, news reporting, teaching, scholarship, or research or some other socially beneficial purpose); and whether the use is transformative.

The Internet Archive and other similar digital archives and libraries provide services available to the public and increase the availability of content published on the Internet, serving the policies of access and social benefit that the fair use doctrine was designed to promote. The Internet Archive in particular is a nonprofit organization with the goals of supporting research and scholarship. The funding for the archive comes from donations from foundations and the general public, and the website contains no commercial advertisements for personal profit.[105] Furthermore, the Internet Archive does not receive revenue from its users or by exploiting the information.

However, it is questionable whether a project such as a digital archive that employs web crawlers to systematically copy and display copyrighted content could be considered transformative. As the Supreme Court wrote in *Cambell v. Acuff-Rose*:

> Although . . . transformative use is not absolutely necessary for a finding of fair use, the goal of copyright, to promote science and the arts, is generally furthered by the creation of transformative works. Such works lie at the heart of the fair use doctrine's guarantee of breathing space within the confines of copyright.[106]

A transformative use "adds something new, with a further purpose or different character, altering the first with new expression, meaning or message."[107] The transformative nature of archives is closely analogous to cases in which search engines that indexed websites and included thumb-

105. *See* Internet Archive, Homepage, http://www.archive.org/index.php (last visited Dec. 23, 2008); Internet Archive, Donate, http://www.archive.org/donate/index.php (last visited Dec. 23, 2008).

106. *Campbell*, 510 U.S. at 579.

107. *Id.*

nails were found to be transformative fair use.[108] Indices with thumbnails were found to be fair use in part because use of the copyrighted works improved access to information on the Internet and provided a new electronic reference tool. Archives might also enjoy protection because they too put the web content to a new use by archiving and displaying the websites for the purpose of historic preservation. Technology such as that employed by the Wayback Machine allows visitors to see how the Web looked in the past and how it has evolved. Moreover, by serving as a record of a website on any particular day it also enables older websites to be used as evidence.

On the other hand, courts may be packing too much into the word "transformative."[109] Digital archives, such as the Internet Archive, are simply copying the entire World Wide Web and the copyrighted works it contains and putting it somewhere else to be searchable in a different way at a different time. This arguably is not changing the nature of the work

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108. In *Kelly v. Arriba Soft Corp.*, 336 F.3d 811 (9th Cir. 2003), the Ninth Circuit ruled on whether Arriba Soft had violated copyright law without a fair use defense in the use of thumbnail pictures and inline linking from Kelly's website in Arriba's image search engine. The court found fair use because the thumbnail images as previews were sufficiently transformative and the creation of the thumbnails did not substantially harm the market for the original photographs and may even have increased the public's exposure to the original works. The court held that by improving access to information on the Internet, Arriba Soft created a new use for the works. *Arriba Soft*, 336 F.3d at 818-19, 821-22. *See also* Worldwide Church of God v. Phila. Church of God, Inc., 227 F.3d 1110 (9th Cir. 2000) (holding that "where the use is for the same intrinsic purpose as [the copyright holder's] . . . such use seriously weakens a claimed fair use"); Núñez v. Caribbean Int'l News Corp., 235 F.3d 18 (1st Cir. 2000) (holding that copying a photograph intended to be used in a modeling portfolio and instead using it in a news article was transformative because it created a new meaning or purpose for the work).

Perfect 10 v. Google is the most recent case to apply the fair use defense to search engines. Perfect 10 v. Google, 416 F. Supp. 2d 828 (C.D.Cal. Feb 17, 2006), *aff'd in part, rev'd in part and remanded by* Perfect 10, Inc. v. Amazon.com, Inc., 487 F.3d 701 (9th Cir. 2007), *opinion amended on rehearing by* 508 F.3d 1146 (9th Cir. 2007). Relying on *Arriba Soft* the court found fair use of photographs based on the significantly transformative nature of Google's search engine and in light of its public benefit and only hypothetical harm to the market for the original work. The court found that the search engine transforms the copyrighted image into a "pointer" directing a user to a source of information. *Id.* at 721. Moreover, a search engine provides a social benefit by incorporating an original work into a new work, an electronic reference tool, to serve a completely different purpose. *Id. Perfect 10* was a huge win for Google and proponents of a wide application of the fair use doctrine because it held that even making an exact copy of a work may be transformative so long as the copy serves as different function than the original work.

109. For a discussion of the meaning of the term "transformative," see Matt Williams, *Recent Second Circuit Opinions Indicate That Google's Library Project Is Not Transformative*, 25 CARDOZO ARTS & ENT. L.J. 303, 305-07 (2007) (arguing that a transformative use involves "the creation of original expression that contains commentary").

because the content remains the same. The copying of a website to be viewed in a different database at a different time is analogous to copying a song to include in a music collection to be heard at a later time such as in *UMG Recordings, Inc. v. MP3.Com, Inc.*[110] Defendant MP3.com argued that its use was a transformative "space shift" because subscribers can enjoy their music on the computer without having to lug around the physical disks themselves.[111] The court rejected this argument finding that the unauthorized copies being retransmitted in another medium was an insufficient basis for any legitimate claim of transformation.[112] The song was not being transformed, but simply being moved and placed in a different collection. Furthermore, the archive may be archiving already archived webpages, which would clearly not be transformative because the Internet Archive would not be adding anything new. The Archive allows for public availability of websites long gone; however, the unavailability of a copyrighted work does not make it legally acceptable to copy. Further, providing all the webpages available in a unified source is not an acceptable transformative use or all not-for-profit public libraries could copy any book they wanted for their shelves without paying based on a beneficial unified source theory.[113]

Only a few courts have considered whether archiving should be considered transformative. In *Texaco*, the Second Circuit, found the copying of

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110. 92 F. Supp. 2d 349 (S.D.N.Y. 2000).

111. *Id.* at 351.

112. *Id.*; *see also* Am. Geophysical Union v. Texaco Inc., 60 F.3d 913, 923 (2d Cir. 1994), *cert. dismissed*, 516 U.S. 1005 (1995) ("[A]n untransformed copy is likely to be used simply for the same intrinsic purpose as the original, thereby providing limited justification for a finding of fair use."); Basic Books, Inc. v. Kinko's Graphics Corp., 758 F. Supp. 1522, 1530 (S.D.N.Y. 1991) (quoting District Court Judge Leval that to be transformative "[t]he use . . . must employ the quoted matter in a different manner or for a different purpose from the original").

113. *But see* Lloyd L. Weinreb, *Fair's Fair: A Comment on the Fair Use Doctrine*, 103 HARV. L. REV. 1137, 1143 (1990) (arguing that the usefulness of "transformative" value as a criterion is overstated and posits that "[a] use may serve an important, socially useful purpose without being transformative, simply by making the copied material available"). In an example closely analogous to digital archives' purposes of preservation and access to knowledge, he further states:

> One may wonder whether the publication of material in a new "package" may not itself constitute a transformative use. For example, the publication of a volume of Salinger's letters would have a purpose entirely different from that which prompted Salinger to write and send the letters contained in the volume. Preparing the collection involves effort and, perhaps, judgment of a kind that often is enough to sustain a copyright.

Id. at 1143, n.29.

scientific articles for archival purposes was not a fair use, despite the benefit of a more usable format.[114] The court linked its analysis of the first factor to that of the fourth factor. Based on the fact that Texaco's scientists made copies of the articles and archived them, essentially creating personal libraries without paying for additional subscriptions or license fees, the court held that the first factor weighed against fair use. A court applying *Texaco* would be hard pressed to view archives more favorably because archiving essentially takes copyrighted content and places it in a more publicly accessible library without asking for permission or licensing the content. In the Ninth Circuit, the caching of thumbnail pictures in *Arriba* and *Perfect 10* was arguably like archiving because they were copying and storing large amounts of copyrighted material so that it could be publicly searchable. However, the use of the works went beyond merely storing the pictures and instead included new highly beneficial electronic reference tools. Therefore, it remains uncertain whether courts applying Ninth Circuit precedent will find that storing and displaying copyrighted content in a new database is transformative and whether the beneficial nature of a digital archive is enough to tip the balance in favor of fair use without a transformative finding.

b) Nature of Work and Amount and Substantiality Used

The second and third factors of the fair use determination, the nature of the work and the amount and substantiality of the copyrighted work used, are not dispositive in the fair use determination for digital archives.

In considering the nature of the work, courts look at whether the original work is published or unpublished, whether the right of first publication has been exercised, and whether the work is creative or factual in nature.[115] In the case of the Internet Archive and similar digital archives, the material being copied has already been published and made publicly accessible at the time the information was made available on the Internet.[116]

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114. 60 F.3d at 931.

115. Harper & Row, Publishers, Inc. v. Nation Enters., 471 U.S. 539, 563-64 (1985).

116. There is also an argument that the copying and viewing of the webpages that were publicly accessible and free to view (and impliedly licensed to the user to copy and view) at a later date is analogous to broadcast television that was at issue in *Sony Corp. of America v. Universal City Studios, Inc*, 464 U.S. 417 (1984), and different than other cases where the material content is closed. The public and the Internet Archive were impliedly invited to view the webpages as they existed on the date they were copied. Viewing the webpages at a later date, like recording and viewing movies at a later date (i.e., timeshifting), does not change the fact that the webpages were originally available for public viewing. *See also* Field v. Google, 412 F. Supp. 2d 1106, 1121 (D. Nev. 2006)

Furthermore, because the Internet Archive seeks to archive the entire Internet, the nature of the work is mixed between creative works and collection of facts and data. The various elements at play in this analysis, that the works are published but that some of the works may be creative and expressive in nature, make it difficult to determine whether courts would find for or against digital archives on this point. Notwithstanding a class action type-lawsuit, the outcome of this element would essentially depend on who is suing the archive and the nature of their work.

Next, courts consider the amount and substantiality of the portion used in relation to the copyrighted work as a whole.[117] Digital archives like the Internet Archive create copies of the entire website, allowing users to browse the entire website as it would have appeared on that date. Qualitatively the heart of the work is copied, and quantitatively the whole of the work is copied. Moreover, all elements of expression are copied, such as the graphics, creative speech, word placement, etc. However, to serve its transformative purpose as a website archive, Internet Archive needs to copy as much of the original as possible. This analysis is analogous to the court's consideration of the copying for the use of parody; most if not all of the work is necessary for the transformative use to be successful and therefore this factor remains neutral.[118]

c) Effect on Potential Market for Original

The effect on the market for the original copyrighted work, generally considered the most important factor in the fair use analysis,[119] is also uncertain. In determining the outcome of this factor, courts consider what effect the allegedly infringing use has on the current or potential markets for the original work.[120] The market is harmed if users will substitute the new work for the original[121] or if there is "unrestricted and widespread conduct of the sort engaged in" that would result in a "substantially ad-

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(finding this factor neutral because Field made his content available for free on his website and Google only used no more than necessary (even though it was all of it)).

117. *Harper*, 471 U.S. at 564.

118. *See* Campbell v. Acuff-Rose, 510 U.S. 569, 588-89 (1994). See also *Sony Corp.*, 464 U.S. at 449-50, for a case in which substantial copying—copying of entire programs for private viewing—was upheld as fair use. Likewise, see *Kelly v. Arriba Soft Corporation*, 336 F.3d 811, 820-21 (2003), where the Ninth Circuit held that copying an entire photo to use as a thumbnail in online search results did not weigh against fair use, "if the secondary user only copies as much as is necessary for his or her intended use."

119. *Sony*, 464 U.S. at 450-51.

120. *Harper*, 471 U.S. at 567.

121. *Arriba Soft*, 336 F.3d at 821.

verse impact" on the potential market for the original or its derivatives.[122] A copyright holder need only establish with reasonable probability that the infringement resulted or will result in a loss of revenue.[123] The burden then shifts to the infringer to show that the damages would have occurred without the alleged infringement.[124]

Whether the court finds that the copying has an effect on the market of the original work is closely linked to the purpose for which the copyrighted work has been copied. If the purpose is for research or scholarship, market effect may be difficult to prove.[125] As the Supreme Court stated in *Sony*, "[a] use that has no demonstrable effect upon the potential market for, or the value of, the copyrighted work need not be prohibited in order to protect the author's incentive to create . . . The prohibition of such noncommercial uses would merely inhibit access to ideas without any countervailing benefit."[126] Therefore, to rebut fair use, plaintiffs need to show proof either that the particular use is harmful or that if it should become widespread that it would adversely affect the potential market for the copyrighted work.[127]

When applying the fourth factor to noncommercial digital archives like the Internet Archive courts could find there is no effect on the market. The Archive only copies publicly accessible webpages and displays them without charge to the public and without relying on advertisements or subscription fees to make revenue. Because the copyright holder made the work freely accessible in the first place, such as broadcast television in *Sony*,[128] and the Archive is not selling the works or making profit from the display, there seems to be no effect on the market.

On the other hand, courts could easily find a market effect when taking into account the archival nature of the service. Libraries also provide a public benefit but they cannot simply copy wholesale a book and place it on their shelves. Also, users might bypass paying for content from commercial sites by seeking older content through use of the Internet Archive's services, which could result in the loss of advertising revenue and subscription fees for those commercial websites. For example, old arc-

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122. *Campbell*, 510 U.S. at 590.
123. *Harper*, 471 U.S. at 567.
124. *Id.*
125. *But see* Sony Corp. of Am. v. Universal City Studios, Inc, 464 U.S. 417, 450 (1984) ("[E]ven copying for noncommercial purposes may impair the copyright holder's ability to obtain the rewards that Congress intended him to have.")
126. *Sony*, 464 U.S. at 450-51.
127. *Id.* at 451.
128. *Id.*

hives of many online newspapers cost money to view and databases such as LexisNexis charge fees to view their archives of court documents and laws. Users could circumvent paying these fees by finding the material in the Wayback Machine. Moreover, a complainant might demonstrate a loss of traffic and revenue from its site or that people are using the archives services as a replacement for original sites.

However, the Internet Archive could argue that it is only intended to be used when a past version, not a current version, of a site is sought, and can only be accessed through the Wayback Machine, where content less than six months old is not included. Furthermore, opt-out mechanisms fall in favor of the Internet Archive on the fourth fair use factor. Similar to the content owners in *Sony*,[129] many if not most copyright and website owners do not object to having their websites archived and therefore the best rule may be to require owners to opt-out of the archive project rather than requiring them to opt-in. Arguably a website owner cannot complain about the impact on the market when she could just opt-out of the project with minimal effort.[130] For example, the court in *Field v. Google*[131] stated that because the complainant knew about the opt-out options of Google's web caching and failed to avail himself of those options, that knowledge formed the basis of an implied license.[132] This could be a digital archive's best case against market effect in the fair use analysis but how it would fare in court when a web operator does not have actual knowledge remains to be seen.

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129. *Id.* at 456 (finding that substantial numbers of copyright holders who licensed their works for broadcast on free television would not object to having their broadcasts time-shifted by private viewers).

130. There are a number of cases where immediate takedown precludes later relief. *See, e.g.*, Biosafe-One, Inc. v. Hawks, No. 07 Civ. 6764(DC), 2007 WL 4212411 (S.D.N.Y. Nov. 29, 2007).

131. 412 F. Supp. 2d 1106, 1116-17 (D. Nev. 2006).

132. However, arguing that because people have the right to opt-out and therefore the archive project does not have an effect on the market of their original work begs the question of whether opt-out mechanisms are even legal, let alone good for archives. For a discussion on the legality of opt-out mechanisms, see Oren Bracha, *Standing Copyright Law on Its Head? The Googlization of Everything and the Many Faces of Property*, 85 TEX. L. REV. 1799 (2007). For an analysis on why digital archives should not have to rely on opt-out mechanisms to insulate themselves from liability, see Bolin, *supra* note 4 (discussing how right to withdraw under copyright "creat[es] a legal regime [that gives] authors the right to opt-out of history").

4. *Fair Use in Light of the Proposed Google Library Project Settlement*

The uncertainty over whether courts will find internet archiving a fair use is even more prominent after the proposed settlement of the Google Library Project litigation. The case, heralded as the one to resolve the fair use issue, has resulted in more uncertainty because the settlement was not on the merits.[133] Other individuals or entities who seek to do similar archival projects will face the same legal battles, without Google's power and wealth. Furthermore, Google's development of a market for book archiving might alter the market analysis because courts might be more likely to find potential markets where none exist or will likely exist, such as in the licensing of webpages to digital archives.

Authors and publishers brought suit against Google in 2005, claiming that Google violated their copyrights and those of other rightsholders of books and inserts, by scanning books from libraries, creating an electronic database of those books, and displaying short excerpts without the permission of the copyright holders.[134] Google denied all the claims and countered that digitizing these books and displaying only snippets of material was noninfringing or fair use of the material.[135]

Under the settlement, which must be approved by a federal judge before it takes effect,[136] Google will pay authors and publishers $125 million. Part of the settlement amount will be used to create a Book Rights Registry, which will allow copyright owners to register their works and receive a share of revenues of institutional subscriptions of books made available through the Google Book Search, as well as from sales of the books to online consumers. Another portion will go to resolving existing claims of rightsholders for books and inserts Google scanned without permission. Google will also allow users to purchase full books, which are saved to an "electronic bookshelf," offer institutional subscriptions, including free online portals for public and higher education libraries, and

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133. *See generally* Settlement Agreement, The Authors Guild, Inc., et al. v. Google, Inc., Case No. 05-cv-8136 (S.D.N.Y. Oct. 20, 2008).

134. Class Action Complaint, The Authors Guild, Inc., et al. v. Google, Inc., Case No. 05-cv-8136 (S.D.N.Y. Sept. 20, 2005).

135. Answer, Jury Demand, and Affirmative Defenses of Defendant Google Inc., The Authors Guild, Inc., et al. v. Google, Inc., Case No. 05-cv-8136 (S.D.N.Y. Nov. 30, 2005).

136. The fairness hearing will be held June 11, 2009 before Judge John E. Sprizzo. Justia News & Commentary, The Author's Guild et al v. Google Inc., Docket #64, http://news.justia.com/cases/featured/new-york/nysdce/1:2005cv08136/273913/ (last updated Apr. 16, 2009).

continue to point users to buy or borrow the books found through their Book Search.[137]

Some see promise in the Google Library Project settlement.[138] The proposed settlement will expand access to both in-print and out-of-print books through Google's Book Search project, preserving millions of books.[139] The settlement allows easy access for individuals anywhere in the United States to the collections of books included in the database.[140] Authors of out-of-print books win because they obtain otherwise unobtainable revenue from online purchase of older books which would not normally provide any royalties.[141]

Others do not share the same enthusiasm. For example, some fear the Google Library settlement raises a hornet's nest of concerns including privacy and antitrust issues and providing too many limits on access to culturally valuable copyrighted works.[142] The settlement also leaves undecided

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137. Settlement Agreement, *supra* note 133. For more information on the Google Library Project settlement, see Jonathan Band, *A Guide for the Perplexed: Libraries and the Google Library Project Settlement*, LLRX, Dec. 14, 2008, *available at* http://www.llrx.com/features/googleprojectsettlement.htm.

138. Posting by David Drummond, Senior Vice President, Corporate Development, and Chief Legal Officer of Google, to Google Blog, New Chapter for Google Book Search, http://googleblog.blogspot.com/2008/10/new-chapter-for-google-book-search.html (Oct. 28, 2008 7:14 EST).

139. *Id.*

140. *Universities See Promise in Google Book Search Settlement*, STANFORD REPORT, October 28, 2008, http://news-service.stanford.edu/news/2008/october29/google-102908.html.

141. *Google Revolution the End of the Publishing World?*, TODAY'S ZAMAN, Dec. 9, 2008, http://www.todayszaman.com/tz-web/detaylar.do?load=detay&link=160437.

142. *See* Fred von Lohmann, EFF Deeplinks Archive, Google Book Search Settlement: A Reader's Guide (Oct. 31, 2008), http://www.eff.org/deeplinks/2008/10/google-books/settlement-readers-guide (discussing user privacy questions opened by the settlement); Laura G. Mirviss, *Harvard-Google Online Book Deal at Risk*, THE HARVARD CRIMSON, Oct. 30, 2008, *available at* http://www.thecrimson.com/article.aspx?ref=524989 (quoting University Library Director Robert C. Darnton that "the settlement contains too many potential limitations on access to and use of the books" and "[t]he settlement provides no assurance that the prices charged for access will be reasonable . . . especially since the subscription services have no real competitors [and] the scope of access to the digitized books is in various ways both limited and uncertain"); Posting by Neil Netanel to Balkinization Blog, Google Book Search Settlement, http://balkin.blogspot.com/2008/10/google-book-search-settlement.html (Oct. 28, 2008 9:02 EST) ("[T]he bottom line is that Google is left with a de facto monopoly over this 'universal library' service and . . . potential competitors face a higher barrier to entry than if Google had fought and prevailed on fair use (or if Congress enacts a statutory license for such uses)".).

the issue of whether Google's scanning of entire books into a digital archive and its display of snippets is a fair use.

Many scholars believed that the courts would have ultimately held that it is a fair use, thus setting important precedent.[143] Now other library initiatives that do not have Google's wealth have to step up to fight or quit since most other preservation initiatives may not be able to bear the enormous legal costs of fighting so many copyright holders. Google has essentially carved out a special status for itself, with rights that others do not have and that libraries cannot afford to buy.

Moreover, because of Google's commercial plans, it may have made it more difficult to claim that such archival uses of copyrighted material do not harm a potential licensing market, an important aspect to a successful fair use argument. The most interesting part of the proposed settlement is the prospect of future revenues for both Google and the rightsholders. Rightsholders will receive a share of revenues of institutional subscriptions of books made available through the Google Book Search under the settlement, as well as from sales of the books by online consumers. They will also be paid for printouts at public libraries, as well as for other uses. Payments will flow through a Book Rights Registry, an ASCAP-like entity for writer's rights. The settlement therefore creates a new commercial opportunity for copyright holders to balance against fair use—if Google can create a licensing scheme, the archives have the potential too. Therefore, it is unclear whether the market effect factor will be bigger now after the settlement.

The uncertainty of the fair use doctrine surely had a hand in the bargaining of the settlement deal. Although the deal has yet to pass muster at the fairness hearing, in some ways its very existence suggests a change in fair use law for the worse. Google, as a private entity and not a library, has cast a large shadow over emerging not-for-profit institutions like the Internet Archive.

Surely, liability for copyright infringement without a defense or exception poses the biggest threat to digital archives and the Google settlement has left this legal area on shaky ground. But even if digital archives can get around the copyright hurdle, archives run straight into a conflict with website owners' increasing tendency to contract around the Copyright Act.

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143. *See generally* Nari Na, *Testing the Boundaries of Copyright Protection: The Google Books Library Project and the Fair Use Doctrine*, 16 CORNELL J.L. & PUB. POL'Y 417 (2007); Rogers, *supra* note 3.

B. Liability Sounding in Contract

The uncertainty left after the *Shell* settlement[144] opened the doors to potential breach of contract liability for digital archives. The fact that even a beneficial nonprofit institution like the Internet Archive could not dispose of the *Shell* litigation at an early stage shows the uncertainty on the Web as to whether web crawlers, like the one employed by the Internet Archive, can be subject to breach of contract actions. Scholars and courts disagree on the legality of browsewrap agreements and whether an automated agent or an unsuspecting individual can fully and knowingly enter into a contract.[145] The cases to date seem to apply traditional contract rules of offer and acceptance to automated software programs, but even these cases are based on a very fact-specific inquiry.[146] Professor Mark Lemley offers some insight as to the way courts are ruling, but his article only highlights the unresolved issue of whether a court would hold a digital archive liable for a contract entered into by its universal web crawler.[147]

1. Electronic Contracting Cases

In an era of digital content, copyright owners have increasingly turned away from the express statutory limits on their rights contained in the Copyright Act and instead have invoked the institution of contract law. These contracts proliferate on the web and govern most consumer transactions. More and more these non-negotiated contracts include restrictions on fair use, and most courts and commentators have rejected preemption as the appropriate tool for challenging these provisions.

Owners of websites often post website disclaimers and agreements called "user agreements," "terms of use," or "terms of service," that establish rules for access to their websites and/or use of the content included on the website. Some agreements simply notify the users that the website publisher holds the copyright in the content on the site and inform the users that they may only use the material for personal, noncommercial purposes and cannot reproduce or distribute without the website owner's permission. Essentially, these agreements simply restate their rights under the Copyright Act. More prevalent are contracts that have terms prohibiting certain uses or actions that include hefty fines for breach and often contain forum selection and dispute resolution clauses. These electronic

144. *See supra* Sections I.C.3-4 (discussing *Internet Archive v. Shell* and undecided breach of contract issues).

145. *See infra* Section II.B.1.

146. *See infra* Section II.B.2.

147. Mark Lemley, *Terms of Use*, 91 MINN. L. REV. 459 (2006).

contracts have often been held to be legally binding by the courts even when website users did not know about the contract terms.[148]

Browsewrap contracts, such as the disputed contract in *Shell*, are formed by a user's action of simply visiting or viewing a website. Users enter into the contract without taking any affirmative action before the website performs its end of the contract and are generally entered into implicitly through continued use of the site or use of the site's contents. While this is still a developing area of law and the subject of much legal debate, courts have held browsewrap agreements to be valid as long as there is notice (i.e., the online agreement is conspicuous to website users).[149]

2. Can Electronic Agents Enter into Legally Binding Contracts?

Today, possibly due to the acceptance of new technology, courts are more likely to find browsewrap agreements binding on automated users of websites, especially in the commercial context. In *Ticketmaster Corp. v. Tickets.com*, the U.S. District Court for the Central District of California upheld the validity of a browsewrap license entered into by a spider based solely on the evidence that the defendant knew of the license but neverthe-

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148. *See, e.g.*, Feldman v. Google, Inc., 513 F. Supp. 2d 229 (E.D. Pa. 2007) (upholding forum selection clause in clickwrap agreement); Hotmail Corp. v. Van$ Money Pie, Inc., 47 U.S.P.Q.2d 1020 (N.D. Cal. 1998) (granting preliminary injunction for breach of contract for violating terms of service by using a Hotmail account for an improper use; contract upheld because clicking button after notice gave consent); Caspi v. Microsoft Network, 732 A.2d 528 (N.J. Super. Ct. App. Div. 1999) (finding forum selection clause contained in clickwrap membership agreement was enforceable because user had to click on an "I Agree" button). The history and legality of electronic contracting has been widely documented and analyzed. For background on electronic contracts, including shrinkwrap, clickwrap, and browsewrap licenses, see Ryan J. Casamiquela, *Contractual Assent and Enforceability in Cyberspace*, 17 BERKELEY TECH. L.J. 475 (2002); Rachel S. Conklin, *Be Careful What You Click For: An Analysis of Online Contracting*, 20 LOYOLA CONSUMER L. REV. 326 (2008); Christina L. Kunz et al., *Browse-Wrap Agreements: Validity of Implied Assent in Electronic Form Agreements*, 59 BUS. LAW. 279 (2003); Juliet M. Moringiello & William L. Reynolds, *Survey of the Law of Cyberspace: Electronic Contracting Cases 2006-2007*, 63 BUS. LAW. 219 (2007); Ian Rambarran & Robert Hunt, *Are Browse-Wrap Agreements All They Wrapped Up To Be*, 9 TUL J. TECH. & INTELL. PROP. 173 (2007); Renée Zimurchyk, *Contractual Validity of End User License Agreements*, 11 APPEAL REV. CURRENT L. & L. REFORM 55 (2006).

149. *See* Pollstar v. Gigmania Ltd., 170 F. Supp. 2d 974 (E.D. Cal. 2000) (refusing to enforce terms of online license agreement because the link to it was not sufficiently obvious; website provider placed a notice on its homepage that users would be bound by a license agreement reachable through a hyperlink if they continued on the site); Specht v. Netscape Comm. Corp., 150 F. Supp. 2d 585 (S.D.N.Y. 2001) (finding arbitration provision contained in browsewrap license invalid because end users were able to download the free software without reviewing the license agreement).

less continued to send its spider to the plaintiff's interior webpages.[150] Likewise, in *Register.com, Inc. v. Verio, Inc*. the Second Circuit found that Verio's repeated access to and use of information from Register.com's WHOIS database evidenced consent to Register.com's terms of use, even though Verio used an automated robot to go to the website and did not see the terms of use until after it had completed using the database.[151] In *Cairo, Inc. v. CrossMedia Servs., Inc.*, the Northern District of California similarly found that the terms of use found on CrossMedia's internet site were binding, given the continued use of the site.[152] Even though defendant Cairo had no actual knowledge of the terms of use, its repeated access to plaintiff's site via a "robot" resulted in imputed knowledge to defendant even though the robot was not capable of, and did not, collect information on the contents of such terms.[153]

While the majority of courts have yet to rule on whether an automated or electronic agent can enter into a legally binding contract and whether imputed knowledge under *Cairo* should be the best standard, the Uniform Electronic Transactions Act (UETA) and Electronic Signatures in Global and National Commerce Act (ESIGN) have attempted to deal with this issue. Under section 14 of the UETA, a contract may be formed by the interaction of electronic agents of the parties, even if no individual was aware of or reviewed the electronic agents' actions or the resulting terms and agreements.[154] Under section 101(h) of ESIGN, a contract may not be denied legal effect, validity, or enforceability solely because its formation, creation, or delivery involved the action of one or more electronic agents. However, this section allows the creation of contracts by electronic agents only so long as the action of the electronic agent is legally attributable to the person to be bound.[155] While courts following these statutes would likely find that an electronic agent entered into a legally binding contract, the statutes do not state that all contracts formed by bots are enforceable.

The *Shell* court did not discuss the issue of whether electronic agents have the authority to bind their principals to contracts and the electronic

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150. Ticketmaster Corp. v. Tickets.com, Inc., No. CV997654HLHVBKX, 2003 WL 21406289, at *2 (C.D. Cal. Mar. 7, 2003).

151. Register.com v. Verio, Inc., 356 F.3d 393 (2d Cir. 2004).

152. Cairo, Inc. v. Crossmedia Servs. Inc., No. C 04-04825 JW, 2005 WL 756610, at *5 (N.D. Cal. Apr. 1, 2005).

153. *Id.*

154. Uniform Electronic Transactions Act [UETA] § 14 (1999) (codified at 15 U.S.C. § 7002 *et seq.*).

155. Electronic Signatures in Global and National Commerce Act [ESIGN] § 7001(h), Pub.L. 106-229, 114 Stat. 464 (codified at 15 U.S.C. § 7001-31, Ch. 96 (2006)) (emphasis added).

agent issue has not received much judicial scrutiny. However, under the reasoning of *Verio* and *Cairo*, the Internet Archive most likely assented to the contract by visiting and copying Shell's website over eighty times over the course of four years. It appears in this case that there may have been adequate notice to put a reader on notice that an act of copying and distributing indicates agreement and acceptance of the terms.

However, unlike *Verio* and *Cairo*, where the defendants knew or might have known about the terms of use at some time while they were visiting the webpage, there is no evidence that the Internet Archive knew about the terms of use until after Shell contacted them. In fact, the Archive attempted to distinguish the facts from those in *Verio* by arguing that while its agents accessed Shell's website numerous times, no human being at the Internet Archive was aware of the terms.[156] The court recognized that the absence of human consent to this contract could doom Shell's claims but denied the argument on a motion to dismiss because Shell did not have the opportunity to conduct discovery on this point.[157]

Professor Mark Lemley attempts to shed some light on this issue in his article "Terms of Use."[158] He distinguishes cases where courts found browsewrap agreements, including those entered into by automated agents, enforceable versus ones that were held not, finding that courts generally enforce agreements against sophisticated commercial entities who are repeat players and not against consumers.[159] It is an interesting question to determine where digital archives may fall in this continuum: as sophisticated companies that can enter into electronic contracts via an electronic agent, as consumers where browsewraps are generally not enforced, or as something else. If enforcement is limited to the context in which it has so far occurred, where do and should these preservation entities lie?

Accordingly, should there be a different standard for crawlers, such as the Internet Archive's or Google's that indiscriminately crawl the Web versus crawlers that target one or more particular sites? So far in the case law all browsing programs in question have been built to access one of a few particular websites, which were picked to some extent by their user.[160] For example, in *Ticketmaster*, defendant Tickets sent a spider to plaintiff

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156. Internet Archive v. Shell, 505 F. Supp. 2d 755, 765-66 (2007).

157. *Id.*

158. Lemley, *supra* note 147.

159. *Id.* at 463, 472-77.

160. *See, e.g.*, Cairo, Inc. v. Crossmedia Servs. Inc., No. C 04-04825 JW, 2005 WL 756610, at *5 (N.D. Cal. Apr. 1, 2005); Ticketmaster Corp. v. Tickets.com, Inc., No. CV997654HLHVBKX, 2003 WL 21406289, at *2 (C.D. Cal. Mar. 7, 2003).

Ticketmaster's site to sweep it for particular information. Similarly, in *Cairo*, Cairo's robots crawled plaintiff's servers exclusively. Arguably, if the company set up the crawlers to crawl particular sites, it knew or should know the terms of use on the websites. But along that same line of reasoning, digital archives that have software that crawls the entire Internet should know that there will be terms of use on some of the websites and that they may be entering into them simply by visiting and viewing the sites.

3. Intersection of Copyright and Contract: Copyright Preemption

The liability of digital archives unknowingly entering into contracts while crawling the Web is exacerbated by the fact that the majority of courts find that federal copyright law does not preempt state contractual rights, even when the right is essentially the same right covered by the Copyright Act, as was the case in *Shell*.[161] The fact specific and generally unwelcoming application of the federal preemption doctrine to state contract law places digital archives in a position where what they are essentially doing is copyright infringement with a potential fair use defense but are stuck litigating a contract that they cannot get around.

When it comes to the collision of exclusive rights under the Copyright Act and contractual rights, the majority of districts that have ruled on the issue have held that because contract rights depend on extra elements that distinguish them from exclusive rights under the Copyright Act[162]—essentially the presence of a bargained-for exchange—contract claims are not preempted.[163] A minority of courts, however, reject this literal application of the extra-element test and will preempt a contract claim that alleges the extra element of a promise as long as the promise amounts only to a promise to refrain from doing one of the rights exclusively reserved for copyright owners in the Copyright Act (i.e., reproducing, performing, dis-

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161. *See* discussion *infra* Section II.B.3.

162. State law claims are preempted by the Copyright Act when:

> (1) the particular work to which the claim is being applied falls within the type of works protected by the Copyright Act under 17 U.S.C. §§ 102 and 103, and (2) the claim seeks to vindicate legal or equitable rights that are equivalent to one of the bundle of exclusive rights already protected by copyright law under 17 U.S.C. § 106.

Briarpatch Ltd., L.P. v. Phoenix Pictures, Inc., 373 F.3d 296, 305 (2d Cir. 2004).

163. GOLDSTEIN ON COPYRIGHT 17.2.1.2 (3rd ed. 2007) (citations omitted); *see also* ProCD, Inc. v. Zeidenberg, 86 F.3d 1447, 1454 (7th Cir. 1996); Nat'l Car Rental Sys., Inc. v. Computer Assocs. Int'l, Inc., 991 F.3d 426, 433 (8th Cir. 1993), *cert. denied*, 510 U.S. 861 (1993); Taquino v. Teledyne Monarch Rubber, 893 F.2d 1488, 1501 (5th Cir. 1990); Acorn Structures, Inc. v. Swantz, 846 F.2d 923, 926 (4th Cir. 1988).

tributing, or displaying the work).[164] Whether a browsewrap agreement that alleges no more than rights contained under the Copyright Act passes the extra-elements test depends on whether courts determine whether the browsewrap contains a bargained-for exchange.[165]

Copyright scholars have argued that contractual licenses that contract away statutory rights should not be enforced.[166] Browsewrap agreements hurt innovation, fair use, and copyright policy by restricting use even in cases, such as here, where the challenged behavior is potentially legal under fair use. Moreover, they exceed and misuse the rights given to them under the Copyright Act by charging excessive fees and creating a monopoly unintended by our founding fathers.

Although courts and scholars disagree over whether copyright law should preempt contract law, they generally recognize that copyright law needs a remedy for contractual overreaching such as in the *Shell* litigation.[167] Currently, no test for preemption accommodates the interest in private contracting and the interests promoted by the Copyright Act. Scholars have proposed new models and methods for addressing the copyright preemption problem including using copyright misuse as a defense where the copyright owner uses a contract to expand their copyright "monopoly" by its scope under the Copyright Act[168] and refining the preemption analysis such as by drawing on law more related to contractual waivers of statutory rights.[169] However, most of the alternatives are after-the-fact solutions. Digital archives and search engines will still be subject to litigation

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164. *See* Wrench LLC v. Taco Bell Corp., 256 F.3d 446, 457 (6th Cir. 2001).

165. The extra-element test has been criticized heavily for its lack of guidance to the courts. Commentators believe that courts first decide independently whether they are going to apply preemption and then use the extra elements test to reach that conclusion. Schuyler Moore, *Straightening Out Copyright Preemption*, 9 UCLA ENT. L. REV. 201, 204 (2002).

166. *See, e.g.*, Kathleen K. Olson, *Preserving the Copyright Balance: Statutory and Constitutional Preemption of Contract-Based Claims*, 11 COMM. L. & POL'Y 83, 84 (2006).

167. *See, e.g.*, Christina Bohannan, *Copyright Preemption of Contracts*, 67 MD. L. REV. 616, 669 (2008) ("Copyright law has failed to develop a coherent account of contract preemption that harmonizes the individual interest in freedom of contract and the societal interest in federal copyright policy.").

168. Mark A. Lemley, *Beyond Preemption: The Law and Policy of Intellectual Property Licensing*, 87 CALIF. L. REV. 111, 144-47 (1999) (arguing that we should use other doctrinal tools instead of preemption because using the preemption doctrine against contracts "is something like swinging a sledgehammer at a gnat").

169. Bohannan, *supra* note 167, at 648-54 (proposing that courts consider, on a case-by-case basis, whether the copyright licensee is waiving rights that benefit him or rights that benefit others).

costs before they get to the preemption doctrine in court and it, like the fair use defense, is subject to unreliability.

III. CONCLUSION

As the Internet Archive case has illustrated, the opportunities for digital technology to freely preserve vast amounts of digital information and ensure easy access to all the world's knowledge are being impeded by exceptionally narrow statutory exceptions and fact-intensive and uncertain legal doctrines. The current law is not written for Kahle and the country's social entrepreneurs, and they cannot and should not make the economically beneficial concessions that Google, as a private commercial entity, has made.

In addition, time is working against the archivists. Internet content is ephemeral and even material in libraries is fragile and disappearing. Kahle's project is a noble effort to preserve digital culture from fading into the past. Similarly, Google's Library Project is making access to a broad range of out-of-print books that would have disappeared from our cultural memory as fast as yesterday's website. However, the restrictive laws and the unguided legal doctrines are creating a legally ambiguous environment for the individuals and institutions who are attempting the socially beneficial task of preserving knowledge. Unless they are very wealthy, like Google and Kahle, they will not be able to compete or have a chance at survival between the litigation costs and the uncertain outcomes.

Instead of allowing this legal uncertainty over whether digital preservation techniques constitute fair use continue unaddressed over the years as digital archives wait in the dark for the next lawsuit, Congress should preemptively confront the liabilities and create an adequate exemption for digital archiving.[170] There have been a variety of proposals to create such an exception. For example, Professor Peter Menell offers a framework for Congress to confront and deal with the uncertainty by crafting a safe harbor with safeguards that would recognize the appropriate balance between promoting progress and preserving human knowledge.[171] Other scholars

170. By simply relying on the market to sort it out, as we are with the Google litigation, nonprofit digital preservation entities will be left in fear of costly and uncertain litigation and without the resources to compete against commercial entities that may be making compromises hurtful to their ultimate preservation goals.

171. *See* Menell, *supra* note 9, at 1064-66. Professor Menell would require companies to make commitments to the public nature of digital archive information to fall within the scope of the safe harbor and allow for a right of action for copyright owners against the archives for using insufficient technological protection measures to ensure the security of the copyrighted material. *Id.* Oren Bracha argues for a similar statutory safe haven

suggest a compulsory licensing scheme that would authorize reproduction of copyrighted works for the purposes of digital archiving and cultural preservation.[172] Additionally, the Section 108 Study Group, a group selected by the U.S. Copyright office and the National Digital Information Infrastructure and Preservation program of the Library of Congress to update the Copyright Act for the needs of libraries and archives, has proposed a new exception to section 108 to permit libraries and archives to capture and reproduce publicly available online content for preservation purposes and to make those copies accessible to users for purposes of private study, scholarship, or research.[173] The Group also recommends that sites that use browsewrap agreements should be considered publicly available for purposes of the exception and subject to capture.[174]

Furthermore, the future of copyright and digital preservation could be severely damaged by the advent of traditional contract principles being applied in the most unfamiliar terrain without exception. Until we develop intelligent spiders that can scan for the terms of use on websites, digital archives must be conscious that they may be liable for their scan first, opt-out later policy. We are in need of alternatives to the traditional legal doctrines of copyright and contract that allow for the promotion of preservation and access to knowledge while safeguarding copyright law's incentives to create and the personal right to create and enter into contracts. If the legislative safe harbors, new exceptions, or compulsory licensing schemes cannot be enacted, then the courts will have to face the question of fair use and breach of contract, and digital preservation practice will have to take the hit.

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like § 512(c) of the DMCA's safe haven for ISPs. The statutory plan for digital archives would be to define the conditions under which digital libraries are exempt from copyright liability and employ opt-out options. Bracha, *supra* note 132, at 1861-65.

172. Guy Pessach, *Museums, Digitization and Copyright Law: Taking Stock and Looking Ahead*, 1 J. INT'L MEDIA & ENT. L. 253, 267-68 (2007) (discussing a "general, statutory compulsory license that authorizes reproduction for purposes of digital, cultural preservation," "together with a scheme that provides a just and fair compensation to copyright owners").

173. U.S. COPYRIGHT OFFICE & THE NATIONAL DIGITAL INFORMATION INFRASTRUCTURE AND PRESERVATION PROGRAM OF THE LIBRARY OF CONGRESS, SECTION 108 STUDY GROUP REPORT 80 (2008), *available at* www.section108.gov/docs/Sec108StudyGroupReport.pdf.

174. *Id.* at 84.

ADDITIONAL DEVELOPMENTS—COPYRIGHT

SYBERSOUND RECORDS, INC. V. UAV CORP.

517 F.3d 1137 (9th Cir. 2008)

The Ninth Circuit held that a transfer of a co-owner's divisible copyright interest, if unaccompanied by a like transfer from the other co-owners of the interest, confers upon the transferee only a non-exclusive right, and that the transferee therefore lacks standing under 17 U.S.C. § 501(b) to sue on it. The court also ruled that, absent such standing, any claims depending on the underlying copyright claim necessarily fail.

Plaintiff Sybersound Records, Inc. (Sybersound), a company that produces and sells karaoke records, contracted with the third-party co-owner of at least nine copyrighted songs to become the "exclusive assignee and licensee of [the co-owner's] copyrighted interests for purposes of karaoke use, and also the exclusive assignee of the right to sue to enforce the assigned copyright interest" in the songs. Based on this agreement, Sybersound sued several of its karaoke record-maker competitors for selling records which included songs Sybersound believed it had the exclusive right to use for karaoke-related purposes under its agreement with the co-owner of the various songs. The court, however, held that the third party co-owner of the nine referenced copyrights lacked the exclusive karaoke right to grant to Sybersound in the first place. The court reasoned that, as a mere co-owner along with various other music publishers and record companies, the third-party co-owner did not have an exclusive right, as required for a valid transfer of copyright ownership under section 201(d).

The Ninth Circuit also affirmed the district court's dismissal of Sybersound's non-copyright claims. Sybersound alleged that the defendants violated the Lanham Act and various California laws by misrepresenting to customers their right to sell karaoke records of the songs by labeling the records "fully licensed," and as claiming its licenses to be "current, valid and paid in full." Citing *Dastar v. Twentieth Century Fox*, the court rejected the Lanham Act claims to avoid "overlap between the Lanham and Copyright Acts," noting that it would be inappropriate to use the Lanham Act to litigate underlying copyright infringement when the non-exclusive copyright holders have no legal standing to do so under the Copyright Act. In addition, the court held that the Copyright Act, and Sybersound's lack of standing under it, preempted Sybersound's state law claims based on the defendant's alleged misrepresentations of the records' copyright licensing status.

GREENBERG V. NATIONAL GEOGRAPHIC SOCIETY

533 F.3d 1244 (11th Cir. 2008), cert. denied, 129 S. Ct. 727 (2008)

The United States Court of Appeals for the Eleventh Circuit held that National Geographic's CD-ROM collection, which contains every magazine issue in digital form, is a privileged "revision" of the original printed magazine under 17 U.S.C. § 201(c).

Jerry Greenberg contributed photographs to four issues of National Geographic Magazine. Greenberg retained the copyright to his individual contributions, but National Geographic owned the copyright for the magazines as collective works. When National Geographic produced the CD-ROM collection, which included Greenberg's photographs, Greenberg brought an infringement claim. The district court granted summary judgment for National Geographic, but Greenberg appealed successfully and on remand was awarded $400,000 in damages. National Geographic then appealed in light of *New York Times Co. v. Tasini*, 533 U.S. 483 (2001). Section 201(c) provides:

> In the absence of an express transfer of the copyright or of any rights under it, the owner of copyright in the collective work is presumed to have acquired only the privilege of reproducing and distributing the contribution as part of that particular collective work, any revision of that collective work, and any later collective work in the same series.

The court of appeals relied on *Tasini* for the proposition that aggregation of multiple magazine issues "is permissible if the original context of the individual contribution is preserved." Because the CD-ROM collection "uses the identical selection, coordination, and arrangement of the underlying individual contributions," similar to a microfilm or microfiche, users perceive the photographs in their original context and National Geographic does not infringe. The court distinguished an infringing searchable database in *Tasini* that displayed articles individually, preventing users from "flipping" digital pages to other articles in the periodical as originally issued. In response to a dissenting argument that such "contextual fidelity" is merely a threshold inquiry, the court explained that the test requires a determination of whether newly added material "so alters the collective work as to destroy its original context." The court then determined that the new elements of the CD-ROM collection, including a brief open-

ing montage and a computer program with search and zoom functions, do not destroy the original context.

MDY INDUSTRIES, LLC V. BLIZZARD ENTERTAINMENT, INC.

2008 WL 2757357 (D.Ariz. 2008)

The United States District Court for the District of Arizona granted summary judgment in favor of Blizzard Entertainment, Inc. and Vivendi Games, Inc. (collectively, Blizzard) in their suit against MDY Industries (MDY) for contributory and vicarious infringement of Blizzard's copyright in World of Warcraft (WoW) software.

Blizzard is the creator and operator of the multiplayer online role-playing game WoW and Blizzard owns the copyright in the WoW software. MDY developed WowGlider, a bot that plays WoW for users while they are away from their computers, enabling the users to advance in the game more quickly than they would otherwise. Blizzard contended that WoW users were licensees permitted to copy the client software to RAM only in conformance with the End User License Agreement (EULA) and Terms of Use Agreement (TOU), both of which prohibited the licensee from using bots such as WowGlider. Thus, Blizzard asserted that when users launched WoW using WowGlider, they exceeded the scope of the rights granted in the license and created infringing copies of the client software. Blizzard alleged that MDY was therefore liable for contributory copyright infringement because it materially contributed to WowGlider users' direct infringement, and vicarious copyright infringement because MDY had the ability to stop the users' direct infringement and derived a financial benefit from it. MDY did not dispute that it promoted the use of WowGlider in connection with WoW or that it controlled and profited from WowGlider. Rather, MDY contended that prohibiting use of bots was a term of the contract, not a limitation on the scope of the license. Therefore, according to MDY, there may have been a breach of contract, but there was no copyright infringement. Additionally, MDY asserted a copyright misuse defense and an ownership defense under 17 U.S.C. § 117.

The Ninth Circuit has held that "[g]enerally, a copyright owner who grants a nonexclusive license to use his copyrighted material waives his right to sue the licensee for copyright infringement and can sue only for breach of contract. If, however, a license is limited in scope and the licensee acts outside the scope, the licensor can bring an action for copyright infringement." Therefore, to prevail on its copyright infringement claim, Blizzard needed to establish that: (1) its EULA and TOU were limited in scope, (2) the provisions WowGlider violated were limitations on the

scope of the license and not separate contractual covenants, and (3) WowGlider users acted outside the scope of the license.

The court addressed each of these issues in turn. First, the court found that the language of the EULA and TOU, specifically the references to a "Grant of Limited Use License" and a "limited, non-exclusive license," explicitly indicated that the license was limited. Moreover, the court found that the provisions of section 4 of the TOU, which established that users may not exercise Blizzard's exclusive rights under § 106 of the Copyright Act to copy, distribute, or modify the WoW software, were limits on the scope of Blizzard's user license. Finally, the court concluded that WowGlider users acted outside the scope of the license provisions in section 4 of the TOU, which prohibited the use of bots. Consequently, the court held that when users copied the client software to RAM while using the WowGlider bot, they infringed Blizzard's copyright.

The court held that MDY was not entitled to a copyright misuse defense because the WowGlider infringed Blizzard's copyright, and Blizzard was therefore not controlling areas outside of its limited monopoly. The court also held that MDY was not entitled to a defense under 17 U.S.C. § 117, which permits the owner of a copy of a computer program to copy it to RAM if the copy "is created as an essential step in the utilization of the computer program. . . ." The Ninth Circuit has held that licensees of a computer program do not own their copy of the program and therefore do not fall under the provisions of § 117. In *Wall Data Inc. v. Los Angeles County Sheriff's Dept.*, 447 F.3d 769 (Fed. Cir. 2006), the Ninth Circuit provided a two-part test for determining whether a purchaser of a computer program is a licensee or an owner: "if the copyright holder (1) makes clear that it is granting a license to the copy of the software, and (2) imposes significant restrictions on the use or transfer of the copy, then the transaction is a license, not a sale, and the purchaser of the copy is a licensee, not an 'owner' within the meaning of section 117." In granting Blizzard summary judgment on its copyright infringement claim, the court found that Blizzard made it clear that it was granting a license and imposed restrictions on the transfer and use of its client software that were "at least as severe as the restrictions in *Wall Data*." Therefore, the court found that users of WoW "are licensees of the copies of the game client software and are not entitled to a section 117 defense."

TICKETMASTER L.L.C. V. RMG TECHNOLOGIES, INC.

507 F. Supp. 2d 1096 (C.D. Cal 2007)

A California district court granted Ticketmaster's motion for a preliminary injunction against RMG Technologies for copyright infringement, violation of the Digital Millennium Copyright Act (DMCA), and breach of contract. Plaintiff Ticketmaster sells tickets to the public for entertainment and sporting events through its copyrighted website, ticketmaster.com. Defendant RMG developed and marketed a software application that enabled its customers to purchase highly sought after tickets on ticketmaster.com before other buyers, allowing them to resell these tickets at a premium.

The court held that Ticketmaster was likely to prove that RMG infringed by using the ticketmaster.com website "in excess of the authorization . . . grant[ed] through the website's Terms of Use." Specifically, the court found that RMG violated the Terms of Use provisions that "prohibit commercial use, prohibit the use of bots and automated devices, limit the frequency with which users can make requests of the website, and require the user to agree not to interfere with the proper working of the website."

In finding RMG directly liable for infringement, the court concluded that each time RMG accessed ticketmaster.com it necessarily made a copy within the definition of 17 U.S.C. §101 in the form of a cached download in a computer's temporary random-access memory. The court further determined that RMG had received notice of Ticketmaster's nonexclusive license under the Terms of Use each time RMG accessed ticketmaster.com. The website's browser-wrap Terms of Use agreement appears on the homepage and with every ticket purchase.

The court also found that Ticketmaster was likely to succeed on its indirect copyright infringement claim. The court concluded that RMG, which marketed itself as "stealth technology [that] lets you hide your IP address, so you never got blocked by Ticketmaster," intended to allow third parties to infringe on ticketmaster.com.

The court determined that Ticketmaster was likely to prove that RMG violated the DMCA by "trafficking in devices designed to circumvent 'technological measure[s] that effectively control[] access'" to a copyrighted work. In doing so, the court concluded that Ticketmaster's CAPTCHA image, which "presents a box with stylized random characters partially obscured behind hash marks," qualified as a technological measure that controlled access and protected the rights of the copyrighted works under the DMCA.

This decision raises several issues. Is website browsing always defined as copying under the Copyright Act? If so, how is RMG's application distinguished from search engine robots that make webpage copies and display search results? How visible does a browser-wrap Terms of Use agreement have to be to put users on notice? In what other situations will helping to block IP identification be enough to find contributory infringement? Will CAPTCHA and password-protection barriers qualify as sufficient technological measures to protect copyrighted websites under the DMCA? One commentator notes that these issues are left unanswered by the court.

IO GROUP, INC. V. VEOH NETWORKS, INC.

586 F. Supp. 2d 1132 (N.D. Cal. 2008)

A Northern California federal district court issued a significant ruling, finding that Veoh Networks Inc. (Veoh), a video-hosting website, qualified for the 17 U.S.C. § 512(c) safe harbor of the Digital Millennium Copyright Act (DMCA). Although copyright holders have sued user-generated content sites before, this is the first case to reach a final ruling.

Io Group, Inc. (Io), an adult entertainment distributor, brought a copyright infringement suit against Veoh, a hosting service that allows users to upload streaming video, after finding ten clips of its adult films hosted on veoh.com. The suit was the first notice Io provided to Veoh of the claimed copyright infringement. Io argued that Veoh should not qualify for the DMCA safe harbor because it does not meet the threshold requirement of having a reasonable repeat-infringer policy.

Veoh has a repeat-infringer policy, under which a user's account is terminated if there are repeat DMCA-compliant notices of infringement based on content uploaded by the user. Io argued that this procedure is ineffective—a user could easily create another Veoh account using a different email address—and as such Veoh should not qualify for the DMCA safe harbor because it had not complied with the section 512(i) condition for safe-harbor eligibility that requires the service provider to have a policy for account termination of repeat infringers. The court disagreed, noting that section 512(i) does not require a particular type of policy, only that the service provider respond to complaints. The DMCA does not require service providers to track users in a particular way or to affirmatively police users for evidence of repeat infringement. Veoh satisfied the threshold requirement to qualify for safe harbor by implementing its repeat infringer policy in a reasonable manner.

17 U.S.C. § 512(c)(1) limits a service provider's liability "for infringement of copyright by reason of the storage at the direction of a user of material that resides on a system or network controlled or operated by or for the service provider." A service provider is eligible for the safe harbor as long as it (A) has no knowledge of infringing material or reason to suspect infringement, (B) does not benefit financially from infringing material where the provider could have controlled the material, and (C) "responds expeditiously to remove" the material when it is made aware of infringement by take-down notice or otherwise.

Veoh fell within the section 512(c) safe harbor because it established a system whereby software automatically processes user-submitted content. Veoh was not required to prescreen every submission before it was pub-

lished, even if it received direct financial benefit from the alleged infringing activity, in order to be eligible for safe harbor. The court held that Veoh's right and ability to control its system and its central index did not equate to the right and ability to control infringing activity. Veoh had neither encouraged copyright infringement on its system nor could control what content its users chose to upload before it was uploaded.

The court found that Veoh had policed its system to the fullest extent permitted by its architecture by removing blatantly infringing content, responding promptly to infringement notices, terminating infringing content on its system and users' hard drives, preventing the same infringing content from being uploaded again, and by terminating the accounts of repeat offenders. According to the court, the DMCA was never intended to require service providers like Veoh to shoulder the entire burden of policing third party copyright infringements at the cost of losing their business upon failure to do so. The essential question was whether Veoh took appropriate steps to deal with copyright infringements that occurred. The court found that Veoh did, and granted Veoh summary judgment.

Bloggers and commentators mostly postulate that *Veoh* bodes well for YouTube in its ongoing billion-dollar dispute with Viacom. On *Veoh*, the Chief Counsel for YouTube wrote, "It is great to see the Court confirm that the DMCA protects services like YouTube that follow the law and respect copyrights."

VERNOR V. AUTODESK, INC.

555 F. Supp. 2d 1164 (W.D. Wash. 2008)

The United States District Court for the Western District of Washington held that a transfer of copies of software was a "sale with restrictions on use" rather than a license. This sale triggered the first sale doctrine, codified at 17 U.S.C. § 109(a), allowing the copies to be resold without the author's permission.

Timothy S. Vernor listed for sale on eBay several authentic, used copies of Autodesk's AutoCAD software that he acquired from a third party architecture firm (CTA). Autodesk issued DMCA takedown notices for each auction. eBay initially suspended all the auctions but later reinstated them upon receipt of Vernor's counter notices, resulting in delay of the auctions and suspension of Vernor's eBay account for one month. Vernor sued for declaratory relief and claimed that Autodesk had engaged in unfair competition. Autodesk moved for dismissal for failure to state a claim or, alternatively, for summary judgment. Vernor had standing under the Declaratory Judgment Act because delay of his auctions, suspension of his account, his intention to sell more copies of AutoCAD, and threats of further legal action by Autodesk created a controversy of sufficient immediacy to warrant declaratory relief.

The court held that because Autodesk's transfer of copies of AutoCAD to CTA was a sale, subsequent resale of those copies did not constitute copyright infringement. Under section 109(a), the owner of a lawfully-made copy "is entitled, without the authority of the copyright owner, to sell . . . that copy . . . ." Under this first sale rule, Autodesk exhausted its exclusive right to distribute the copies of its software that it sold to CTA. Citing *United States v. Wise*, the court stated that merely labeling an agreement a "license" does not necessarily make it so. Licenses transfer "only limited rights . . . for a limited purpose and for a limited period of time." The "critical factor" in distinguishing a sale from a license is whether the transferor required the transferee to return the copy. Because Autodesk's contract did not require CTA to return its copies, the transaction was a sale. Therefore neither CTA nor Vernor was guilty of copyright infringement, and Autodesk could only claim that CTA breached its contract.

Autodesk further argued that by reselling copies of AutoCAD, Vernor would commit contributory copyright infringement by knowingly inducing his customers to make further copies when they ran the program on their computers. Stating that the phrase "owner of a copy" in 17 U.S.C. § 117 has the same meaning as "owner of a particular copy" in section

109(a), the court held that section 117 permits Vernor's customers to copy AutoCAD where the copying is essential to use the software. The court dismissed Autodesk's theory of contributory infringement because Autodesk did not allege that Vernor's customers would copy the software outside the scope of section 117.

COPYRIGHT ENFORCEMENT

Record companies continue to bring suits against users of peer-to-peer (P2P) networks alleging infringement of their exclusive right to distribute copyrighted works under 17 U.S.C. § 106(3).

In *Capitol Records, Inc. v. Thomas*, 2008 U.S. Dist. LEXIS 106255 (D. Minn. Dec. 23, 2008), a Minnesota District Court granted a motion for a new trial partly on the grounds of erroneous jury instructions, reversing the jury's $222,000 award of damages against Jammie Thomas for sharing twenty-four unauthorized music files on KaZaa, a P2P service.

The court followed the decisions in *London-Sire Records, Inc. v. Doe 1* and *Atlantic Recording Corp. v. Howell*, to rule that merely making an unauthorized copy of a copyrighted work available to the public via P2P does not violate section 106(3). In *London-Sire Records*, the court held that, although the defendant "completed all the steps necessary for distribution," he had not necessarily made a distribution under the statute. Similarly, the owner of a shared folder on a P2P network in *Atlantic Recording* did not make or distribute an unauthorized copy of the work simply because he gave the public access to and the means to make unauthorized copies. Because the copy in the shared folder never left the defendant's hard drive, the *Atlantic* defendant did not make a distribution. However, third-party P2P users did make unauthorized copies when they downloaded it to their computers from the defendant's shared folder. As such, the owner of a shared folder is not liable as a primary infringer of the distribution right, but may be liable as a secondary infringer of the reproduction right.

The court in *Elektra Entm't Group, Inc. v. Barker*, 551 F. Supp. 2d. 234 (S.D.N.Y. 2008) reached the opposite conclusion, holding that an offer to distribute a file through a P2P file-sharing service infringes the copyright owner's distribution right under section 106(3). However, the court may have reached its conclusion by treating "distribution" as synonymous with "publication." Thus, the *Elektra* decision presents a different interpretation of the Copyright Act's distribution right.

Although the Copyright Act does not explicitly define the distribution right, it does define "publication" as either a distribution or an offer to distribute for purposes of further distribution. A distribution of a copyrighted work does not violate section 106(3) unless it involves a "'sale or other transfer of ownership' or a 'rental, lease, or lending'" of an unauthorized copy of the work.

Also, the Department of Justice is criminally prosecuting P2P users for piracy of copyrighted works. June 2008 marks the first time in U.S. his-

tory that a jury convicted a P2P user, a former administrator of EliteTorrents.org, for criminal distribution of copyrighted works.

INTERNATIONAL COPYRIGHT ENFORCEMENT

Across the Atlantic, France is on the verge of passing *Loi Olivennes*, a "graduated response" (or "three strikes" rule) bill that would require Internet service providers (ISPs) to monitor and police subscriber traffic for copyright infringement. Under *Loi Olivennes*, ISPs would send suspected copyright infringers warnings for their first offense, suspend their service for the second offense, and finally ban them from service for a year if they persist in infringing.

In response to the three-strikes proposals, the European Parliament (EP) passed a non-binding resolution in April 2008 condemning member states' plans to authorize banning suspected unauthorized file-sharers from Internet activity. EP suggested that depriving citizens' Internet access conflicts with "civil liberties and human rights and with the principles of proportionality, effectiveness and dissuasiveness." In September 2008, the EP again voted in favor of an amendment that will prevent member states from implementing the "three strikes" rule.

Despite EP's efforts to protect Internet users, *Promusicae v. Telefónica de España SAU*, a January 2008 decision of the European Court of Justice (ECJ), strengthened states' abilities to enforce digital copyrights. The ECJ ruled that, although member states are not required to order ISPs to give up users' identities, they are free to order ISPs to disclose such data in civil copyright infringement proceedings. Member states thus retain discretion to require ISPs to disclose subscriber data in copyright infringement suits.

In an analogous effort to combat illegal file-sharing, the New Zealand government passed its own three strikes law. However, the implementation of the law has been delayed while the internet community negotiates a voluntary code of practice. If an agreement is reached, the law would be put into effect for six months, during which its effectiveness will be monitored by the government. The New Zealand enactment of the law has evoked outcry among internet users who organized a protest to blackout their web pages.

Inspired by their New Zealand counterparts, Irish internet users mounted a similar protest in response to an initiative by the Irish Recorded Music Association (IRMA) demanding ISPs to block certain websites. The protest followed a settlement between the IRMA and Eircom, an Irish ISP, in which Eircom agreed to block certain websites.

Although the British government previously had a "serious legislative intent" to compel ISPs to implement similar policing activities to discon-

nect repeat copyright infringers, it has since ruled out any proposals to enforce a three strikes policy.

On April 1 2009, Sweden passed its own anti-piracy law based on the European Union's Intellectual Property Rights Enforcement Directive (IPRED) allowing copyright owners to obtain a court order to obtain the IP addresses of computers illegally sharing copyrighted material. The day after the law took effect, Swedish Internet traffic dropped by more than 30 percent.

Closer to home, the Recording Industry Association of America has embraced the three strikes approach instead of engaging in mass lawsuits. Despite the controversy it has engendered, the "three strikes" approach to unauthorized file-sharing has continued to receive worldwide appeal, with countries such as Japan, South Korea, and Australia considering its adoption.

A SAFE HARBOR FOR TRADEMARK: REEVALUATING SECONDARY TRADEMARK LIABILITY AFTER *TIFFANY V. EBAY*

By Elizabeth K. Levin

The risk of trademark infringement poses a tremendous threat to a company's business and reputation. As merchandise sales on the Internet have skyrocketed, so have online sales of counterfeit goods.[1] United States "businesses and industries lose about $200 billion a year in revenue and 750,000 jobs due to the counterfeiting of merchandise,"[2] and worldwide, counterfeiting accounts for more than half a trillion dollars in global trade each year.[3] Counterfeiters can easily distribute forgeries globally through online auction websites such as eBay.com,[4] where warranties of authenticity and quality are basically nonexistent. Meanwhile, the cost for an individual trademark holder to police the Internet for infringement is enormous. As a result, trademark owners across the globe have brought lawsuits against eBay for trademark infringement on the eBay website.[5] First, European companies including Montres Rolex SA, L'Oreal, Christian Dior

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1. According to the National Consumer League, goods never delivered or misrepresented through auction sites made up thirteen percent of all internet scams in 2007. National Consumer League Internet Fraud Watch, 2007 Top 10 Internet Scams, http://www.fraud.org/ifw.htm (last visited Mar. 2, 2009).

2. Press Release, U.S. Customs and Border Protection, U.S. Customs Announces International Counterfeit Case Involving Caterpillar Heavy Equipment (May 29, 2002), *available at* http://www.cbp.gov/xp/cgov/newsroom/news_releases/archives/legacy/2002/52002/05292002.xml.

3. Press Release, U.S. Customs and Border Protection, Passage of Anti-Counterfeiting Law Strengthens CBP's Efforts to Seize Counterfeit Goods (Apr. 03, 2006), *available at* http://www.cbp.gov/xp/cgov/newsroom/news_releases/archives/2006_news_releases/042006/04032006_5.xml.

4. "During 2007, Internet auction fraud was by far the most reported offense, comprising 35.7% of referred crime complaints." NATIONAL WHITE COLLAR CRIME CENTER, 2007 INTERNET CRIME REPORT 5 (2007), http://www.ic3.gov/media/annualreport/2007_IC3Report.pdf.

5. This threat is also reflected in the recently enhanced criminal penalties for trademark counterfeiting in the Prioritizing Resources and Organization for Intellectual Property Act (PRO-IP Act). Public Law No. 110-403 § 204 (amending 18 U.S.C. § 2320) (2008).

Couture and its subsidiary LVMH Moet Hennessy Louis Vuitton SA complained of counterfeit fashion goods on eBay.[6] Then, New York-based Tiffany & Co. claimed eBay should improve its system for identifying and removing counterfeit goods.[7] Currently, experts warn that the rapid spread of counterfeit sales on eBay hurts legitimate vendors and turns away both buyers and sellers from online marketplaces such as eBay.[8]

This Note addresses the problem of counterfeit good sales online by examining both the district court's decision in *Tiffany v. eBay* and relevant law in order to propose a statutory solution that clarifies the legal rights of both online marketplaces and trademark owners. The Note focuses on eBay because it is the world's largest online marketplace and is thus the website that luxury-goods companies like Tiffany are most likely to sue. Although this Note does not discuss other large online marketplaces such as Amazon.com, Google, and Yahoo, the legal remedy proposed also applies to those sites.

This Note begins by reviewing European case law addressing eBay's trademark liability and the relevant legal framework in the U.S. Part II describes the growth of e-commerce sites and eBay's current system for protecting against the sale of counterfeit goods. Part III discusses *Tiffany v. eBay* and the district court's refusal to find eBay responsible for monitoring trademark infringement on its site. Parts IV and V review the doctrines of secondary liability for trademark and copyright law. Specifically, Part IV illustrates how courts have used common law secondary liability principles in cases involving trademark infringement, while Part V examines how courts have applied secondary liability in the copyright context and how the safe harbor provisions of the Digital Millennium Copyright Act (DMCA) protect ISPs from copyright infringement claims. Lastly, Part VI demonstrates that, despite the fundamental differences between copyright and trademark law, a statutory solution similar to the DMCA safe harbor provisions would provide greater certainty in the area of trademark infringement on the Internet.

This Note will propose that Congress adopt a DMCA-like safe harbor to protect online auction websites from liability for contributory trademark

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6. *See, e.g.*, Ricardo v. Rolex, S.A., 1 ZR 73/05 (German Fed. S. Ct., Apr. 30, 2008); Rolex, S.A. v. eBay GmbH, 1 ZR 35/04 (German Fed. S. Ct., Apr. 19, 2007); S.A. Louis Vuitton Malletier v. eBay, Inc., Tribunal de Commerce de Paris, Premiere Cass. B. (Paris Commercial Court), Case No. 200677799 (June 30, 2008); Stokke A/S v. eBay Int'l AG, Hanseatisches Oberlandesgericht (Hanseatic Provincial High Court and Court of Appeal), Case No. 3U 216 06 (July 24, 2008).

7. *Fed Up With Fakes*, BUSINESS WEEK, Oct. 9, 2006, at 56.

8. *Id.*

infringement. If courts were to hold that eBay must seek out infringement on its site, this would increase the strength of trademark holders' rights without a policy justification for doing so. Yet, if eBay had no responsibility for infringement on its site, trademark infringement on the Internet would likely increase, causing more consumer confusion and a decrease in the goodwill of trademarks. A safe harbor will provide balanced protection for online marketplaces, while also guarding trademark owners' rights. Recognizing that society wants to support companies like eBay that contribute valuable services, a statute would require online auction sites to work with intellectual property rights holders in regulating infringement.

I. EBAY AND THE SALE OF COUNTERFEIT PRODUCTS: DIFFERING LEGAL TREATMENT AROUND THE WORLD

A. Europe

While *Tiffany v. eBay* is among the first of its kind of cases in the United States,[9] European law has tended to protect makers of status and luxury goods. For example, several European courts have held that eBay is not doing enough to combat counterfeit sales. In July 2008, a French court ordered eBay to pay $60.8 million in damages to the French luxury goods company LVMH.[10] LVMH claimed that 90 percent of the Louis Vuitton bags and Dior perfumes sold on eBay were fakes.[11] In June 2008, a French court ordered eBay to pay 20,000 euros to Hermes for eBay's role in the sale of three counterfeit handbags.[12] In 2007, the Federal Supreme Court of Germany ordered eBay to take preventative measures against the sale of counterfeit goods when Rolex sought damages and an injunction preventing the sale of fake Rolex watches on the online auctioneer.[13] According to the Federal Supreme Court, a price of less than 800 euros provided sufficient evidence that an auctioned watch was a fake.[14]

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9. *See* Cathleen Flahardy, *Tiffany & Co. Cracks Down on Ebay Counterfeiters: Kate Spade and Prada Join the Fight to Protect Their Brands*, CORP. LEGAL TIMES, Sept. 2004, at 20.

10. Doreen Carvajal, *French Court Tells eBay To Pay for Counterfeits*, N.Y. TIMES, July 1, 2008, at C1.

11. *Id.*

12. Dan Goodin, *French court fines eBay for sale of counterfeit handbags*, THE REGISTER, June 5, 2008, http://www.theregister.co.uk/2008/06/05/ebay_counterfeit_ruling/.

13. Eric Auchard, *EBay dealt blow on fake Rolexes by German court*, REUTERS, July 27, 2007.

14. *Id.*

B. United States

Stateside, in contrast, the law is less likely to protect luxury-goods companies. In July 2008, the Southern District of New York's decision in *Tiffany v. eBay* was the first U.S. case to address the trademark liability of online auction websites.[15] The court held that trademark law cannot force online auctioneers to filter for trademarked material.[16] Rather, provided that the website removes the material when an intellectual property owner files a complaint, trademark owners must monitor for infringement.[17] Though this decision provided some clarity in the area of secondary trademark liability, it raised the question of when auction websites such as eBay should be required to investigate and take action against trademark infringement on their sites.

While Congress addressed e-commerce providers' secondary liability for copyright infringement with the Digital Millennium Copyright Act (DMCA),[18] the law on trademark infringement over the Internet is undeveloped in comparison. Courts have not yet answered the question of whether internet service providers (ISPs) are liable for a user's infringement of a trademark. Because of "fundamental differences" between copyright and trademark law, the U.S. Supreme Court has said secondary liability for trademark infringement should be more narrowly drawn than secondary liability for copyright infringement.[19] A statutory solution, based on the balance developed by the Southern District of New York in *Tiffany v. eBay*, will clarify for both trademark owners and ISPs what constitutes contributory trademark infringement.

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15. Tiffany Inc. v. eBay, Inc., 576 F. Supp. 2d 463, 527 (S.D.N.Y. 2008). On August 11, 2008, Tiffany appealed the district court's decision. *Tiffany files eBay ruling appeal*, BBC NEWS, Aug. 11, 2008, *available at* http://news.bbc.co.uk/1/hi/business/7555147.stm.

16. *Tiffany Inc.*, 576 F. Supp. 2d at 527.

17. *Id.*

18. *See* 17 U.S.C. § 512 (2000).

19. Sony Corp. of Am. v. Universal City Studios, Inc., 464 U.S. 417, 439 n.19 (1984) (noting the fundamental differences between copyright law and trademark law, the Court refused to look to the standard for contributory infringement set forth in Inwood Labs. v. Ives Labs., 456 U.S. 844, 854-55 (1982), which was created for use in trademark cases).

II. EXPLORING EBAY

eBay.com, which describes itself as "the world's largest personal online trading community,"[20] has also become one of the largest online venues for the sale of counterfeit goods. Founded in 1995, it pioneered the online auction model. Since going public in 1998, eBay has grown into a community of 81 million unique visitors per month.[21] Though eBay is best known for auction-style listings, sellers can also sell through fixed price or "Buy It Now" listings.[22] Separately, eBay offers a classified ad service through which sellers publish advertisements for available goods.[23]

To buy or sell on eBay, a user must provide personal information, choose a unique username and password,[24] and accept eBay's User Agreement.[25] eBay collects listing fees and commissions from auction sellers. A seller pays a listing fee to put an item up for auction by listing a picture, description, and opening bid in the appropriate eBay category.[26] Each auction runs for a fixed time, and at its conclusion, the highest bidder "wins" and is then expected to purchase the item.[27] This bidder and the seller complete the transaction on their own without further involvement from eBay; the buyer pays the seller and the seller sends the product to the buyer and pays a commission to eBay.[28]

eBay seeks to avoid legal liability for fraud by staying out of the transaction and characterizing itself as only "a venue" for people to buy and sell goods.[29] eBay does not sell items and never takes physical possession

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20. Press Release, eBay, eBay Inc. Outlines Global Business Strategy (Sept. 20, 2000), *available at* http://investor.ebay.com/releasedetail.cfm?ReleaseID=26939.

21. Press Release, eBay, eBay Inc. Reports Second Quarter 2008 Results (July 16, 2008), *available at* http://files.shareholder.com/downloads/EBAY/449703089x0x213648/375348ca-3cd2-4c58-98a5-e24a06092b30/213648.pdf.

22. eBay, Selling using a fixed price, http://pages.ebay.com/help/sell/fixed-price.html (last visited Dec. 20, 2008).

23. eBay, Advertising with Classified Ads, http://pages.ebay.com/help/sell/classified.html (last visited Dec. 20, 2008).

24. eBay, Privacy Policy, http://pages.ebay.com/help/policies/privacy-policy.html (last visited Dec. 20, 2008).

25. eBay, Your User Agreement, http://pages.ebay.com/help/policies/user-agreement.html (last visited Dec. 20, 2008).

26. eBay, Creating a Listing, http://pages.ebay.com/help/sell/listing_ov.html (last visited Feb. 7, 2009).

27. *See* eBay, Sell an Item—Getting Started, http://pages.ebay.com/help/sell/sell-getstarted.html (last visited Dec. 20, 2008).

28. *See id.*

29. eBay, Your User Agreement, *supra* note 25. The eBay user agreement states:

> You will not hold eBay responsible for other users' content, actions or inactions, or items they list. You acknowledge that we are not a tradi-

of the goods sold, though it does exercise some control by requiring users to register with eBay and sign a user agreement.[30] eBay expressly forbids its sellers from directly infringing third parties' copyright and trademark rights,[31] and it restricts the types of items sellers can list.[32]

A. eBay's Response to Counterfeits

In response to growing concern over counterfeit products on the site, eBay has increased its regulation and responsiveness to complaints of fraud.[33] Specifically, eBay "now performs a number of fraud protection activities, including cooperating with law enforcement to remove illegal items and assist investigations, working with intellectual property rights owners to remove allegedly infringing items, investigating some user complaints, and providing users some limited forms of financial coverage against fraud loss."[34] eBay also developed the Verified Rights Owner program (VeRO), which allows intellectual property rights owners to request the removal of eBay listings that contain infringing material.[35] According to eBay, it spends $5 million a year maintaining VeRO, "which has 13,000 rules that are designed to identify counterfeit listings based on words such as 'replica' or 'knock-off.'"[36]

> tional auctioneer. Instead, the sites are a venue to allow anyone to offer, sell, and buy just about anything, at anytime, from anywhere, in a variety of pricing formats and venues, such as stores, fixed price formats and auction-style formats. We are not involved in the actual transaction between buyers and sellers. We have no control over and do not guarantee the quality, safety or legality of items advertised, the truth or accuracy of users' content or listings, the ability of sellers to sell items, the ability of buyers to pay for items, or that a buyer or seller will actually complete a transaction.

Id.

30. *See id.*

31. *See id.*

32. *See generally*, eBay, Prohibited and Restricted Items, http://pages.ebay.com/help/policies/items-ov.html (last visited Dec. 20, 2008) (listing prohibited items such as drugs, firearms and alcohol).

33. Brad Stone, *EBay Says Its Crackdown on Fraud Is Showing Results,* N.Y. TIMES, June 14, 2007, at C9.

34. Mary M. Calkins, Alexei Nikitov & Vernon Richardson, *Mineshafts on Treasure Island: A Relief Map of the eBay Fraud Landscape*, 8 U. Pitt. J. Tech. L. & Pol'y 1, 4 (Fall 2008).

35. eBay, What is VeRO and why was my listing removed because of it?, http://pages.ebay.com/help/policies/questions/vero-ended-item.html (last visited Mar. 3, 2009).

36. Holly Jackson, *Software makers threaten to sue eBay over counterfeits*, CNET NEWS, July 25, 2008, http://news.cnet.com/8301-1023_3-9999429-93.html.

VeRO is a "notice-and-takedown" system, whereby rights owners must first file a Notice of Claimed Infringement (NOCI) form to report to eBay any listing offering potentially infringing items.[37] The NOCI form requires rights owners or their authorized agents to assert, under penalty of perjury: (1) ownership of an intellectual property right and (2) a "good faith belief" that the listings identified constitute infringement.[38] An allegedly infringing listing can be removed based on the submission of a NOCI.[39] eBay provides the seller with the email address of the rights holder who submitted the NOCI,[40] and it is then up to the accused seller to prove that the sale is legitimate for it to be relisted.[41]

Judging by the wording of its NOCI policy, eBay appears to have based its counterfeit crackdown system on the DMCA. The NOCI system and the DMCA have striking parallels. For instance, VeRO provides that only an intellectual property rights owner or authorized agent can report potentially infringing items or listings to eBay.[42] If such an owner has a good faith belief that a listing on eBay infringes its copyright, trademark, or other intellectual property right, the owner can submit a NOCI form to eBay.[43] eBay then has discretion to remove the listing or leave it up.[44] Similarly, the DMCA prescribes a notice-and-takedown system under which a person authorized to act on behalf of the intellectual property owner may submit a notice of claimed infringement to the internet service provider.[45] Under the DMCA, an ISP that properly implements such a takedown process is not liable for any subsequent claim of infringement, provided the ISP disabled access to or removed the material claimed to be infringing.[46]

According to eBay, its practice is to remove listings flagged in a NOCI within twenty-four hours, and, according to eBay's internal calculations,

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37. eBay, Reporting Intellectual Property Infringements (VeRO), http://pages.ebay.com/help/tp/vero-rights-owner.html (last visited Mar. 3, 2009).

38. eBay, Notice of Claimed Infringement, http://pages.ebay.com/help/community/NOCI1.pdf (last visited Dec. 20, 2008).

39. eBay, What is VeRO and why was my listing removed because of it?, *supra* note 35.

40. *Id.*

41. Alorie Gilbert, *Software takes aim at auction fakes*, CNET NEWS, May 5, 2003, http://news.cnet.com/Software-takes-aim-at-auction-fakes/2100-1017_3-999876.html.

42. eBay, Reporting Intellectual Property Infringements (VeRO), *supra* note 37.

43. *Id.*

44. Tiffany (NJ) Inc. v. eBay, Inc., 576 F. Supp. 2d 463, 478 (S.D.N.Y. 2008). According to the court, "eBay's practice was to remove reported listings within 24 hours of receiving a NOCI." *Id.*

45. 17 U.S.C. § 512(c)(3)(A)(1) (2000).

46. *Id.* § 512(g)(1).

about nintey-five to ninety-nine percent are removed during that time-frame.[47] In fact, during the course of the *Tiffany v. eBay* litigation, eBay claimed that seventy to eighty percent of reported listings were removed within twelve hours and nearly three quarters were removed within four hours.[48] Additionally, if bidding on a listed item has not ended, eBay notifies the seller and any bidders that the listing has been removed and that all bids have been cancelled.[49] If bidding has ended, eBay cancels the transaction retroactively, removes the listing, and informs both the winning bidder and the seller that the listing has been terminated and that the parties should not complete the transaction.[50]

Although eBay has not always been forthcoming about problems with fraud, in recent years it has increased efforts to protect eBay members.[51] In 2007, it attempted to reduce sales of counterfeit goods and revised its feedback system to provide buyers and sellers with more information about each other.[52] eBay directed these efforts towards the 100 categories favored by counterfeiters, including clothing and luxury goods.[53] Under these rules, eBay limits the number of items sellers can sell and prohibits sales using short one- or three-day auctions.[54] eBay claims that it has "over 2,000 trust and safety personnel" who work around the clock to minimize fraud.[55]

eBay maintains that, because it never takes possession of items for sale, it is not a traditional auctioneer and is instead a venue to allow others to offer, sell, and buy products and services.[56] It states that it is not involved in the actual transaction between buyers and sellers and does not guarantee the quality, safety, or legality of items advertised, or truth of

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47. Defendant eBay's Post-Trial Memorandum at 12, Tiffany (NJ) Inc. v. eBay Inc., No. 04 Civ. 4607, (RJS) (S.D.N.Y. Dec. 7, 2007).

48. *Id.*

49. *Tiffany (NJ) Inc.*, 576 F. Supp. 2d at 478.

50. *Id.*

51. *See* Stone, *supra* note 33.

52. *Id.*

53. *Id.*

54. *Id.* eBay users have found that shorter auction listings can be a sign of fraud. *See, e.g.*, eBay, eBay Guides—Fraud Scam Warning, http://reviews.ebay.com/FRAUD-SCAM-WARNING-Ebay-Auction-URGENT_W0QQugidZ10000000002186085 (last visited Mar. 3, 2009).

55. *Cyber crime on the rise* (Australian Broadcasting Corp. television broadcast Feb. 10, 2008), *transcript available at* http://www.abc.net.au/7.30/content/2008/s2380759.htm.

56. *See* eBay, Your User Agreement, *supra* note 25.

listings. It also does not guarantee the ability of sellers to sell, the ability of buyers to pay, or that parties will complete a transaction.[57]

B. eBay's Response to Competition

In recent years eBay has tried to remain seller friendly in order to compete with other online marketplaces, while still responding to complaints of fraud from buyers and intellectual property owners. Although eBay's single auction-oriented marketplace helped to propel eBay to high profits in the early 2000s, sites including Amazon and Google have been catching up. Three years ago eBay had 30 percent more traffic than Amazon.[58] Today eBay has 84.5 million active users, while Amazon reported 81 million active customer accounts in June 2007.[59] Amazon has focused on attracting small online vendors, becoming more like eBay, while eBay has emphasized fixed-price sales of new and old merchandise, becoming more like Amazon.[60]

On January 29, 2008, eBay announced policy changes to make its business more competitive with Amazon, which does not charge independent sellers to list items for sale.[61] To reward sellers who have high satisfaction and to lower shipping fees, eBay decreased the fees it charges to list an item and increased the percentage it takes from the final sale price.[62] Further, eBay decided that sellers can only leave positive feedback for buyers, and can no longer leave negative or neutral feedback.[63] eBay also announced that it will give higher volume "Powersellers"[64] up to a

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57. *Id.*

58. Brad Stone, *Amid the Gloom, an E-Commerce War*, N.Y. TIMES, Oct. 12, 2008, at B1.

59. *Id.*

60. *Id.*

61. Saul Hansell, *Sellers Give Negative Feedback on eBay Changes*, N.Y. TIMES, Jan. 29, 2008, (Bits Blog), http://bits.blogs.nytimes.com/2008/01/29/sellers-give-negative-feedback-on-ebay-changes/.

62. *See id.*

63. *Id.* eBay's feedback system allows sellers and buyers to leave feedback after each transaction is complete. Feedback can only be left for eBay members, and is public and permanent. Buyers can leave an overall feedback rating for a seller, as well as detailed seller ratings in four areas: item as described, communication, shipping time and shipping and handling charges. eBay, How do I leave Feedback?, http://pages.ebay.com/help/feedback/questions/leave.html (last visited Mar. 3, 2009).

64. According to eBay.com, the requirements for being a Powerseller are: "consistent sales volume, 98% total positive Feedback, eBay marketplace policy compliance, an account in good financial standing, and beginning in July 2008, detailed seller rating (DSRs) of 4.5 or higher in all four DSRs—item as described, communication, shipping time, and shipping and handling charges." eBay, Becoming a PowerSeller, http://pages.ebay.com/help/sell/sell-powersellers.html (last visited Mar. 3, 2009).

fifteen percent discount on the final value fees.[65] Powersellers can also receive better terms on shipping costs and preferential positioning in search results.[66] Though eBay advertised the changes as leading to a decrease in prices, AuctionBytes, a newsletter for online merchants, claims that because of the new policies, in some situations sellers would actually pay more than they did before.[67]

A more recent change may make eBay more vulnerable to claims of secondary infringement. In August 2008, eBay announced that beginning in late October it would stop accepting checks and money orders for payment.[68] Now buyers must use eBay's PayPal, pay with a credit or debit card through a seller's merchant credit card account, use ProPay, or pay upon physical pick up.[69] In early 2009, eBay integrated all of its electronic payment options into its checkout process.[70] In an explanation to customers, eBay said the change would make payments faster and more reliable.[71] eBay noted that buyers who pay with a check or money order were eighty percent more likely to file an "item not received" dispute, and fifty percent more likely to leave a negative feedback than buyers who pay with PayPal or a credit card.[72] Because most buyers now use eBay's PayPal to complete their purchases, eBay has become more involved in each transaction, thereby making its claim that all transactions take place independently less tenable.

III. *TIFFANY V. EBAY*

Tiffany & Co. is a world-renowned seller of luxury goods, including jewelry, watches, crystal, and china. Tiffany's dispute with eBay is not about whether counterfeit Tiffany products should be sold on eBay, but rather about who should bear the burden of policing Tiffany's valuable

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65. *See* Ina Steiner, *eBay Lowers Insertion Fees, Raises Commission Fees*, AUCTIONBYTES, Jan. 29, 2008, http://www.auctionbytes.com/cab/abn/y08/m01/i29/s05. A final value fee is charged by email if a seller's item sells or ends with a winning bid. The fee applies whether or not the sale is completed. eBay, Final Value Fees, http://pages.ebay.com/help/sell/fvf.html (last visited Mar. 3, 2009).

66. Hansell, *supra* note 61.

67. *Id.* (citing AuctionBytes.com). "In one comparison, the fees increased by 33 percent." *Id.*

68. eBay, Fees August 2008 Accepted Payments Policy Changes, http://pages.ebay.com/sell/August2008Update/Payments (last visited Feb. 7, 2009).

69. *Id.*

70. *Id.*

71. *Id.*

72. *Id.*

trademarks in internet commerce.[73] In 2004, Tiffany sued eBay and alleged that hundreds of thousands of counterfeit jewelry items were offered for sale on eBay's website from 2003 to 2006.[74] Tiffany attempted to hold eBay liable for "direct and contributory trademark infringement, unfair competition, false advertising, and direct and contributory trademark dilution," arguing that eBay facilitated and allowed the sale of imitation goods through its website.[75] Tiffany claimed that eBay was on notice that its sellers offered counterfeit Tiffany products on eBay and that eBay thus had the obligation to investigate and control these illegal activities.[76] eBay, however, responded that it was Tiffany's burden, as the intellectual property holder, to monitor eBay's website for counterfeits and to bring such counterfeits to eBay's attention.[77]

Judge Richard J. Sullivan found that eBay was not liable for contributory trademark infringement.[78] The court applied a knowledge standard that considered not whether eBay could reasonably anticipate possible infringement but rather whether eBay continued to supply its services to sellers when it knew or had reason to know of infringement by them.[79] The court found that the test developed by the U.S. Supreme Court in *Inwood*

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73. Tiffany (NJ) Inc. v. eBay, Inc., 576 F. Supp. 2d 463, 469 (S.D.N.Y. 2008). Tiffany quality control personnel inspect Tiffany merchandise before it is released for distribution. Tiffany does not sell or authorize the sale of Tiffany merchandise on eBay or other online marketplaces, nor does it use liquidators, sell overstock merchandise, or put its good on sale at discounted prices. Despite the evidence of Tiffany's controls, the court noted that the trial record contained virtually no testimony about the size of the legitimate secondary market in Tiffany goods. *Id.* at 472-73.

74. *Id.* at 469. Tiffany filed an Amended Complaint in the Southern District of New York on July 15, 2004:

> Specifically, Tiffany's Amended Complaint asserts the following six causes of action: (1) direct and contributory trademark infringement of Tiffany's trademarks in violation of Section 32(1), 15 U.S.C. § 1114(1), and 34(d), 15 U.S.C. § 1116(d), of the Lanham Act; (2) trademark infringement and the use of false descriptions and representations in violation of Sections 43(a)(1)(A) and (B) of the Lanham Act, 15 U.S.C. § 1125(a)(1)(A) and (B); (3) direct and contributory trademark infringement under common law; (4) direct and contributory unfair competition under common law; (5) trademark dilution in violation of Section 43(c) of the Lanham Act, 15 U.S.C. § 1125(c); and (6) trademark dilution in violation of New York General Business Law § 360-1.

Id. at 470-71.

75. *Id.* at 469.

76. *Id.*

77. *Id.*

78. *Id.* at 468.

79. *Id.*

Laboratories, Inc. v. Ives Laboratories, Inc.[80] applied to eBay because, as the *Inwood* test requires, eBay provided a marketplace for infringement and maintained direct control over that venue.[81] The *Inwood* test states that liability can be imposed not only if a distributor induces a retailer to infringe a trademark, but also if a company "continues to supply its product to one whom it knows or has reason to know is engaging in trademark infringement."[82] The court found, under *Inwood*, that although eBay possessed generalized knowledge of counterfeiting on its website, this general knowledge was neither sufficient to impute knowledge to eBay of specific acts of actual infringement nor to impose on eBay an affirmative duty to remedy the situation.[83] "Quite simply, the law demands more specific knowledge as to which items are infringing and which seller is listing those items before requiring eBay to take action."[84] Further, the court found that eBay was not willfully blind to the evidence of counterfeiting on its website, and when eBay had the requisite knowledge of infringement—"knows or has reason to know"[85]—it took appropriate steps to cut off the supply of its service to the infringer.[86]

Tiffany argued that because eBay was able to screen out potentially counterfeit Tiffany listings more cheaply, quickly, and effectively than Tiffany, the burden to police the Tiffany trademark should have shifted to eBay.[87] The court, however, held that even if it were true that eBay were best situated to prevent trademark infringement, the burden of policing the Tiffany mark rests with Tiffany.[88] "The owner of a trade name must do its own police work."[89] Judge Sullivan rejected eBay's argument that it was just an online classified advertising venue.[90] Because of the value-added

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80. 456 U.S. 844 (1982).

81. *Tiffany (NJ) Inc.*, 576 F. Supp. 2d at 502. The Court found that the relevant inquiry for contributory trademark infringement is the "extent of control exercised by the defendant over the third party's means of infringement." *Id.* (citing the Ninth Circuit's reasoning in Lockheed Martin Corp. v. Network Solutions, Inc., 194 F.3d 980, 984 (9th Cir. 1999)). The Court noted that while the Second Circuit had not explicitly endorsed this reasoning, the Southern District of New York had cited the case with approval. *Id.* at 506.

82. Inwood Labs., Inc. v. Ives Labs., Inc., 456 U.S. 844, 854 (1982).

83. *Tiffany (NJ) Inc.,* 576 F. Supp. 2d at 508, 510.

84. *Id.* at 470.

85. *Id.* at 513.

86. *Id.* at 470.

87. *Id.* at 518.

88. *Id.*

89. *Id.* (citing MDT Corp. v. New York Stock Exch., 858 F.Supp. 1028, 1034 (C.D. Cal. 1994)).

90. *Id.* at 507.

services eBay provides to its sellers and the significant control that eBay retains over transactions on its website, the court found eBay more like an online swap meet than a classified ad service.[91]

On August 11, 2008, Tiffany appealed the district court's decision to the U.S. Court of Appeals for the Second Circuit, which has not yet scheduled oral arguments.[92] Several amici have already filed briefs. The Electronic Frontier Foundation, Public Citizen and Public Knowledge, Yahoo, Amazon, Google, and others have filed in support of eBay, while beauty-products manufacturer Coty, Inc., the Council of Fashion Designers of America, and the International Anticounterfeiting Coalition have filed in support of Tiffany's.[93]

IV. COMMON LAW SECONDARY LIABILITY FOR TRADEMARK LAW

To understand the current law on trademark infringement over the Internet, it is helpful to look at the development of indirect trademark liability. Section IV.A discusses the policy differences behind trademark and copyright law. Section IV.B traces the development of indirect trademark liability and examines the current standard for contributory trademark liability as set forth in *Inwood*. Finally, Section IV.C examines principles of secondary trademark infringement in the online context.

A. Comparison: Trademark and Copyright Law

The differences between trademark and copyright law result, in part, from their differing rationales. Copyright law originates in the Constitution and encompasses a broad range of subject matters.[94] It gives exclusive rights to creators of original work in order to provide authors an incentive to create new works and to share existing works. Copyright protection attaches from the moment a work is fixed in a tangible medium of expression[95] and, generally, is limited to the life of the author plus seventy years.[96]

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91. *See id.*

92. As of April 2009, the Second Circuit had not yet scheduled oral arguments.

93. *See* Electronic Frontier Foundation, Tiffany v. eBay, http://www.eff.org/cases/tiffany-v-ebay (last visited Apr. 1, 2009).

94. *See* U.S. CONST., art. I § 8, cl. 8 ("The Congress shall have 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.")

95. *See* 17 U.S.C. § 102 (1994).

96. *Id.* § 302(a) (1998).

Trademark law, on the other hand, "focuses on ensuring the integrity of the marketplace by protecting consumers against confusion as to the source of products."[97] It facilitates and enhances consumer decisions and encourages businesses to supply quality products and services.[98] A trademark does not "depend upon novelty, invention, discovery, or any work of the brain. It requires no fancy or imagination, no genius, no laborious thought."[99] Trademark rights are acquired when a trademark is used in commerce, and continue only so long as that use continues.[100] Traditionally, there has been no federal policy to encourage the creation of more trademarks, unlike the desire to encourage invention and creation that underlies patent and copyright law.[101] Instead, trademark law has developed from tort-based causes of action: the tort of misappropriation of the goodwill of the trademark owner and the tort of deception of the consumer.[102]

The Lanham Act,[103] enacted in 1946, codified federal trademark protection and was introduced as a bill "to place all matters relating to trademarks in one statute and to eliminate judicial obscurity . . . and [to make] relief against infringement prompt and effective."[104] The Lanham Act promotes three policies: it prevents consumer confusion, protects the goodwill of businesses, and encourages competition within the market.[105]

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97. *See* Peter S. Menell & David Nimmer, *Unwinding Sony*, 95 CALIF. L. REV. 941, 971 (2007). The core mission of trademark law is to protect consumers by improving the quality of information in the marketplace. Stacey L. Dogan & Mark A. Lemley, *Grounding Trademark Law Through Trademark Use*, 92 IOWA L. REV. 1669, 1690 (2007).

98. *See* Peter S. Menell & Suzanne Scotchmer, 2 HANDBOOK OF LAW AND ECONOMICS 1537 (A. Mitchell Polinsky & Steven Shavell eds., Elselvier 2007).

99. Trade-Mark Cases, 100 U.S. 82, 94 (1879).

100. Robert P. Merges, Peter S. Menell & Mark A. Lemley, INTELLECTUAL PROPERTY IN THE NEW TECHNOLOGICAL AGE 635 (4th ed. 2007). Under the Trademark Law Revision Act of 1998, "it is now possible to register and protect a trademark based on an *intention* to use that mark in commerce at some time within the next three years." *Id.* at 635 n.6 (citing 15 U.S.C. § 1051(b) (1988)).

101. Menell & Scotchmer, *supra* note 98, at 1538.

102. *Id.*

103. Lanham Act, Pub. L. No. 79-489, 60 Stat. 427 (codified as amended at 15 U.S.C. § 1127 (2000)).

104. U.S. Patent and Trademark Office, Transforming Work: The E-Government Work Place, http://www.uspto.gov/web/offices/com/strat21/action/p1t01.htm. (last visited Dec. 20, 2008).

105. Fara S. Sunderji, *Protecting Online Auction Sites from the Contributory Trademark Liability Storm: A Legislative Solution to the Tiffany Inc. v. eBay Inc. Problem*, 74 FORDHAM L. REV. 909, 917-18 (2005).

Neither the Lanham Act nor the Copyright Act contains express contributory liability provisions.[106] Rather, the imposition of contributory infringement liability derives from common law tort theories.[107] Similarly, common law guides the appropriate boundaries of contributory liability in the trademark context.[108]

B. Indirect Trademark Liability

The concept of indirect trademark infringement has had a long history, and yet is still underdeveloped.[109] The Lanham Act contains no express provisions for contributory infringement or vicarious liability;[110] instead, courts borrow principles of indirect trademark infringement from tort law to reflect the impulse that "[o]ne who induces another to commit a fraud and furnishes the means of consummating it is equally guilty and liable for the injury."[111] Courts have compared indirect liability principles in copyright and trademark law; for example, both indirect trademark infringement[112] and indirect copyright infringement[113] share a similar knowledge requirement. Courts have also recognized, however, that the doctrine of contributory trademark infringement is narrower than its copyright counterpart.[114]

1. Contributory Trademark Infringement

The doctrine of contributory infringement originated in tort law and developed from the notion that one who directly contributes to another's infringement should be held accountable.[115] A contributory infringer is

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106. By contrast, the Patent Act defines direct and contributory infringement. 35 U.S.C. § 271 (2000) (defining liability for those who directly infringe, "actively induce[]" infringement, and who sell components "knowing" them to be adapted for use to infringe). *Id.* at §§ 271(a)-(c).

107. John T. Cross, *Contributory Infringement and Related Theories of Secondary Liability for Trademark Infringement*, 80 IOWA L. REV. 101, 109-29 (1994).

108. Hard Rock Cafe Licensing Corp. v. Concession Servs, Inc., 955 F.2d 1143, 1148 (7th Cir. 1992).

109. Dogan & Lemley, *supra* note 97, at 1678.

110. 15 U.S.C. § 1127 (2000); *see also* Polo Ralph Lauren Corp. v. Chinatown Gift Shop, 855 F. Supp. 648, 650 (S.D.N.Y. 1994).

111. William R. Warner & Co. v. Eli Lilly & Co., 265 U.S. 526, 530-31 (1924).

112. *See* Inwood Labs., Inc. v. Ives Labs., Inc., 456 U.S. 844, 854 (1982) (footnote and citations omitted).

113. *See* Sony Corp. of Am. v. Universal City Studios, Inc., 464 U.S. 417, 435 (1984).

114. *See, e.g.*, Perfect 10, Inc. v. Visa Int'l Serv. Ass'n, 494 F.3d 788, 806 (9th Cir. 2007) ("The tests for secondary trademark infringement are even more difficult to satisfy than those required to find secondary copyright infringement.").

115. Menell & Nimmer, *supra* note 97, at 977.

"one who, with knowledge of the infringing activity, induces, causes or materially contributes to the infringing conduct of another."[116] Contributory liability is properly imposed on one who is in a position, but fails, to take reasonable precautions against a third person's infringing conduct under circumstances in which his knowledge of the infringing conduct is so apparent that the infringement could be reasonably anticipated.[117]

The Supreme Court first recognized the doctrine of contributory liability in *William R. Warner & Co. v. Eli Lilly & Co.*,[118] a case involving manufacturers of chocolate quinine beverages. Two manufacturers each sold the beverage to druggists in bottles with clearly distinguishing labels; the druggists then sold the liquid in different containers.[119] The plaintiff sold a high-quality version; defendant, a cheaper one.[120] According to evidence presented at trial, the defendant's salesmen suggested to druggists "that, without danger of detection, prescriptions and orders for [the original] could be filled by substituting" the defendant's product.[121] Although the manufacturer had not directly caused any confusion or deception, the Court imposed liability.[122] "The wrong was in designedly enabling the dealers to palm off the preparation as that of the respondent."[123]

Coca-Cola Co. v. Snow Crest Beverages, which also addressed whether a manufacturer could be held liable for downstream undisclosed substitution of its product for another, further developed the doctrine.[124] In *Snow Crest*, Coca-Cola alleged that when bars received orders for rum and Coca-Cola, they frequently substituted the defendant's product for Coca-Cola.[125] The issue was whether the defendant had a duty to investigate

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116. Gershwin Publ'g Corp. v. Columbia Artists Mgmt., Inc., 443 F.2d 1159, 1162 (2d Cir. 1971).

117. *See* RESTATEMENT (THIRD) OF UNFAIR COMPETITION § 27 (1995); *see also* RESTATEMENT (FIRST) OF TORTS § 302(b) (1934) (supporting the notion that the standard for contributory liability is based on the core common law principle that a party can be liable for creating "unreasonable risk" of injury based on the "expectable action" of third parties); RESTATEMENT (SECOND) OF TORTS § 877(c) (1965) (stating that contributory liability attaches if one permits use of "premises" or "instrumentalities, knowing or having reason to know" that another "is acting or will act tortiously").

118. 265 U.S. 526 (1924).

119. *Id.* at 529-30.

120. *Id.*

121. *Id.* at 530.

122. *Id.*

123. *Id.* (citations omitted); *see also* Coca-Cola Co. v. Gay-Ola Co., 200 F. 720 (6th Cir. 1912); N. K. Fairbank Co. v. R. W. Bell Manuf'g Co., 77 Fed. 869, 875, 877-78 (2d Cir. 1896).

124. 64 F. Supp. 980 (D. Mass. 1946).

125. *Id.* at 988.

such substitution or to curtail sales of its product after it had notice that some unnamed bars had used its product instead of Coca-Cola.[126]

The court held that the defendant could be contributorily liable if the plaintiff had given the defendant (1) reliable information that would have caused a normal bottler in defendant's position to believe that bars were substituting defendant's product for Coca-Cola or (2) notice that specific bars which defendant was continuing to supply were serving defendant's product when plaintiff's product was requested.[127] The court found that the plaintiff met neither standard.[128] To be held as a contributory infringer, one who supplies another with the instruments that the other uses to commit a tort must be shown to have knowledge that the other will or can reasonably be expected to commit a tort with the instruments.[129] The test is whether the defendant might have anticipated wrongdoing by the purchaser.[130] The court noted that the issue was whether a reasonable person in the defendant's position would realize that he had created the temptation to wrong or that he was dealing with a customer whom he should know would be particularly likely to use the defendant's product wrongfully.[131]

In 1982, the Supreme Court, relying on *Snow Crest*, set forth the current test for contributory trademark infringement in *Inwood Laboratories, Inc. v. Ives Laboratories, Inc.*[132] There, the Court considered an action against a manufacturer of generic pharmaceuticals.[133] Non-party pharmacists packaged the defendant's less-expensive generic pills, but labeled them with the plaintiff's protected trademark rather than a generic label.[134] The plaintiff stated a cause of action for contributory infringement by alleging that the defendant "continued to supply [the product] to pharmacists who the petitioners knew were mislabeling generic drugs."[135] The Court wrote that:

> if a manufacturer or distributor intentionally induces another to infringe a trademark, or if it continues to supply its product to one whom it knows or has reason to know is engaging in trade-

126. *Id.*
127. *Id.* at 990 (citation omitted).
128. *Id.*
129. *Id.* at 989 (citations omitted).
130. *Id.* (citations omitted). This test is an example of the judicial indeterminacy that the Lanham Act was intended to eliminate.
131. *Id.*
132. 456 U.S. 844 (1982).
133. *Id.* at 846.
134. *Id.*
135. *Id.* at 854.

> mark infringement, the manufacturer or distributor is contributorily responsible for any harm done as a result of the deceit.[136]

However, the Court upheld the district court's holding that manufacturer of the generic drug had not intentionally induced the pharmacists to mislabel generic drugs, nor had it continued to supply its product to pharmacists whom the manufacturer knew were mislabeling generic drugs,[137] and thus was not contributorily liable.[138]

Justice White, concurring, noted that the majority's rule expanded the knowledge requirement for contributory liability.[139] Before *Inwood*, contributory infringement required *actual* knowledge that others would use the product for infringing purposes.[140] The *Inwood* formulation of the knowledge requirement, however, specified that the contributory infringer must only know or have reason to know, suggesting that something less than actual knowledge could be adequate.[141]

a) Applying *Inwood*

Courts applying *Inwood* have found contributorily liable operators of swap meets or flea markets in which counterfeit products are sold if the operators exercise "[d]irect control and monitoring of the instrumentality used by a third party to infringe the plaintiff's mark."[142]

In *Hard Rock Cafe Licensing Corp. v. Concession Services, Inc.*, the Seventh Circuit applied the *Inwood* test for contributory trademark liability to the operator of a flea market.[143] The flea market rented stalls to vendors, charged vendors fees for reservations and storage, charged admission fees to customers, and operated concession stands.[144] Although there was no proof that the flea market had actual knowledge that vendors were selling counterfeit Hard Rock Cafe trademark merchandise, the court held that

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136. *Id.* (footnote omitted) (citing William R. Warner & Co. v. Eli Lilly & Co., 265 U.S. 526, 530-31 (1924), and Coca-Cola Co. v. Snow Crest Beverages, Inc., 64 F. Supp. 980, 989 (D. Mass. 1946), *aff'd*, 162 F.2d 280 (1st Cir. 1947)).

137. *Id.* at 855.

138. *Id*. at 856-58.

139. *Id.* at 861.

140. *See* Brian D. Kaiser, *Contributory Trademark Infringement by Internet Service Providers: An Argument for Limitation*, 7 J. TECH. L. & POL'Y 4, 86-87 (2002).

141. *Inwood Labs*., 456 U.S. at 854.

142. Lockheed Martin Corp. v. Network Solutions, Inc., 194 F.3d 980, 984 (9th Cir. 1999).

143. Hard Rock Cafe Licensing Corp. v. Concession Servs., Inc., 955 F.2d 1143, 1148-89 (7th Cir. 1992). A flea market or swap meet is arguably the brick-and-mortar equivalent of eBay.

144. *Id.* at 1146.

contributory liability could be imposed if the swap meet was "willfully blind" to ongoing violations.[145] It held that a company is responsible for the torts of vendors it permits on its premises if it knows or has reason to know that the vendor "is acting or will act tortiously,'"[146] though it still "has no affirmative duty to take precautions against the sale of counterfeits."[147] To be held contributorily liable, a party must suspect wrongdoing and deliberately fail to investigate.[148] The Seventh Circuit ruled that because the district court had made little mention of the flea market operator's state of mind, there was no evidence that the operator knew or had reason to know of the vendor's trademark violations. Hard Rock did not publicize the information that legitimate Hard Rock clothing could only be found in its cafes and there was no "particular reason to believe that inexpensive t-shirts with cut labels [were] obviously counterfeit."[149] The operator was therefore not willfully blind and not contributorily liable for the violations.[150]

b) eBay Under the *Inwood* Standard

Under the *Inwood* standard, as developed in *Hard Rock Cafe*, a court could find eBay contributorily liable for trademark infringement on its site. For example, using the considerations set forth in *Hard Rock Cafe* as to whether the flea market operator was willfully blind, eBay provides its sellers with the digital space to sell goods and charges sellers fees both to post items for sale and for completed sales. Arguably, once trademark owners notify eBay of infringement, if eBay does not take action, it is "willfully blind" to ongoing violations. In particular, once eBay is aware that a particular vendor has attempted to violate another's trademark rights, it, unlike the swap meet operator in *Hard Rock*, has reason to know the seller "is acting or will act tortiously."[151] Furthermore, as the *Snow Crest* court framed the issue, in such a scenario, eBay could certainly anticipate the wrongdoing.

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145. *Id.* at 1149. A person who suspects wrongdoing and deliberately fails to investigate is willfully blind and is considered knowledgeable under the Lanham Act. *Id.*

146. *Id.* (quoting RESTATEMENT (SECOND) OF TORTS § 877(c) & cmt.d (1979)).

147. *Id.*

148. *Id.*

149. *Id.*

150. *Id.* at 1149-50. "We decline to extend the protection that Hard Rock finds in the common law to require CSI, and other landlords, to be more dutiful guardians of Hard Rock's commercial interests. Thus the district court's findings do not support the conclusion that CSI bears contributory liability for Parvez's transgressions." *Id.* at 1149.

151. *Id.*at 1149 (quoting RESTATEMENT (SECOND) OF TORTS § 877(c) & cmt.d (1979)).

2. Vicarious Trademark Infringement

Vicarious trademark liability requires the defendant and the infringer to have an apparent or actual partnership, to have authority to bind one another in transactions with third parties, or to exercise joint control over the infringing product.[152] A defendant "exercises control over a direct infringer when he has both a legal right to stop or limit the directly infringing conduct, as well as the practical ability to do so."[153] Agency principles underlie vicarious trademark liability, and even an independent contractor relationship may be sufficient.[154] The more control exercised by a defendant over a third-party's means of infringement, the more likely a court is to find vicarious liability.[155] If a defendant has direct control and the ability to monitor the instrumentality used by a third party to infringe a plaintiff's mark, courts are likely to find vicarious liability.[156]

In *Hard Rock*, the court held that a flea market owner could not be vicariously liable under trademark law for infringing acts by vendors who rented space there.[157] The court noted that the owner's supervision of the flea markets was minimal: no one looked over the vendors' wares before they entered the market and the owner did not keep records of the names and addresses of the vendors.[158] Thus, the owner did not exercise control over the vendors beyond that exercised by a landlord over his tenants.[159]

This case directly contrasts with *Fonovisa, Inc. v. Cherry Auction, Inc.*, where the plaintiff, who owned copyrights and trademarks to certain music recordings, claimed that the defendant, a swap meet proprietor, was liable for third-party vendors' sales of counterfeit recordings. The Ninth Circuit found that the proprietor could be held vicariously liable for the infringement of its vendors, and thus Fonovisa had stated a claim for contributory trademark infringement.[160] Because the swap meet proprietor had the right to terminate vendors for any reason, the court held, it had the ability to control the activities of vendors on the premises.[161] Unlike in

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152. *Id.* at 1150 (citing David Berg & Co. v. Gatto Int'l Trading Co., 884 F.2d 306, 311 (7th Cir. 1989)).

153. Perfect 10, Inc. v. Amazon.com, Inc., 508 F.3d 1146, 1173 (9th Cir. 2007).

154. AT&T Co. v. Winback and Conserve Program, Inc., 42 F.3d 1421, 1435-36 (3d Cir. 1994).

155. Fonovisa, Inc. v. Cherry Auction, Inc., 76 F.3d 259, 262 (9th Cir. 1996).

156. Lockheed Martin Corp. v. Network Solutions, Inc., 194 F.3d 980, 984 (9th Cir. 1999).

157. *Hard Rock Cafe Licensing Corp.*, 955 F.2d at 1149-50.

158. *Id.* at 1146.

159. *Id.* at 1149-50.

160. *Fonovisa, Inc.*, 76 F.3d at 262, 265.

161. *Id.*

Hard Rock, the proprietor in *Fonovisa* also promoted the swap meet and controlled customers' access to the swap meet area.[162]

C. Principles of Secondary Trademark Infringement in the Online Context

It can be difficult to apply principles of secondary trademark infringement in the online context because many ISPs do not have actual knowledge of infringements on their servers. For example, in *Lockheed Martin Corp. v. Network Solutions, Inc.*, the plaintiff asked the district court to extend contributory liability to the relationship between a domain name registrar and domain name registrants alleged to have infringed the plaintiff's mark.[163] The court held the registrars not subject to secondary liability for infringing domain names because the service they provide is "remote from domain name uses that are capable of infringement."[164] The Ninth Circuit affirmed, agreeing with the district court that the defendant could not "reasonably be expected to monitor the Internet" for evidence of infringement by its registrants.[165]

In *Gucci v. Hall & Assoc.*, the Southern District of New York, however, declined to apply *Lockheed* where the alleged contributory trademark infringer was an ISP.[166] In this case, the direct infringer used the ISP's services to advertise counterfeit Gucci jewelry.[167] The ISP had ignored two notices from Gucci alleging that the direct infringer was using the ISP's services for trademark infringement.[168] The court distinguished domain name registries from ISPs, whose computers provide the actual storage and communications for infringing material, and were therefore more accurately compared to flea market operators.[169] Therefore, the accused ISP could have prevented the infringing conduct by exercising direct control and monitoring sites using its services.[170] Thus, the plaintiff had stated a triable claim for relief from contributory trademark infringement against

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162. *Id.*

163. Lockheed Martin Corp. v. Network Solutions, Inc., 985 F. Supp. 949, 960 (C.D. Cal. 1997), *aff'd*, 194 F.3d 980 (9th Cir. 1999).

164. *Id.* at 962.

165. *Lockheed*, 194 F.3d at 985 (quotations omitted). The court identified a two-prong test: (1) did the domain name registrar supply a product and (2) did the domain name registrar have actual or constructive knowledge of any direct infringement. *Id.*

166. Gucci Am., Inc. v. Hall & Assocs., 135 F. Supp. 2d 409, 416 (S.D.N.Y. 2001).

167. *Id.* at 411.

168. *Id.*

169. *Id.* at 416.

170. *Id.* at 416 n.14.

the ISP.[171] The court noted that *Lockheed* did not foreclose "the application of contributory [trademark] infringement in the Internet context."[172]

V. SECONDARY COPYRIGHT LIABILITY AND THE DMCA

To highlight the differences between trademark and copyright law, this section will examine how courts have applied secondary liability in the copyright context and how the DMCA's safe harbor provisions protect ISPs from claims of copyright infringement.

A. Contributory Copyright Infringement

The common law doctrine that one who knowingly participates in or furthers a tortious act is jointly and severally liable with the prime tortfeasor underpins contributory copyright infringement law.[173] Although the Copyright Act does not address secondary liability, the Supreme Court has explained this does not exclude the imposition of liability on third parties.[174] Proving contributory infringement requires: (1) an act of direct infringement by someone other than the secondary party, (2) that the secondary party have knowledge of the infringing activity, and (3) that the secondary party induced, caused, or materially contributed to the infringement.[175] This standard does not differ substantially from contributory trademark infringement, which holds that one who induces another to infringe a trademark, or continues to supply a product to one whom it knows or has reason to know is engaging in trademark infringement, is contributorily responsible for any harm done as a result of the deceit.[176]

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171. *Id.* at 422.

172. *Id.* at 416 (quotations omitted).

173. 1 NIEL BOORSTYN, BOORSTYN ON COPYRIGHT § 10.06[2], at 10-21 (1994) ("In other words, the common law doctrine that one who knowingly participates in or furthers a tortious act is jointly and severally liable with the prime tortfeasor, is applicable under copyright law").

174. Sony Corp. of Am. v. Universal City Studios, Inc., 464 U.S. 417, 435 (1984).

175. Gershwin Publ'g Corp. v. Columbia Artists Mgmt., Inc., 443 F.2d 1159, 1162 (2d Cir. 1971) (footnote omitted). "Recognizing the impracticability or futility of a copyright owner's suing a multitude of individual infringers . . . the law allows a copyright holder to sue a contributor to the infringement instead, in effect as an aider and abettor." In re Aimster Copyright Litig., 334 F.3d 643, 644 (7th Cir. 2003) (citations omitted).

176. Inwood Labs., Inc. v. Ives Labs., Inc., 456 U.S. 844, 854 (1982) (footnote omitted) (citing William R. Warner & Co. v. Eli Lilly & Co., 265 U.S. 526, 530-31 (1924), and Coca-Cola Co. v. Snow Crest Beverages, Inc., 64 F. Supp. 980, 989 (D. Mass. 1946), *aff'd*, 162 F.2d 280 (1st Cir.)).

B. Vicarious Copyright Infringement

The Second Circuit developed the doctrine of vicarious copyright liability as an "outgrowth of the agency principles of respondeat superior."[177] A party may be vicariously liable if it (1) has the right and ability to supervise the infringing activity and (2) obtains a direct financial benefit from the infringing activities.[178] Vicarious liability creates liability for an indirect infringer whose economic interests are intertwined with the direct infringer's, even without a traditional employer/employee relationship.[179] Unlike contributory liability, vicarious liability does not require knowledge.[180] "[A] defendant exercises control over a direct infringer when he has both a legal right to stop or limit the directly infringing conduct, as well as the practical ability to do so."[181]

In *Fonovisa, Inc. v. Cherry Auction, Inc.*, the Ninth Circuit found sufficient elements of control where the swap meet proprietor had the right to terminate vendors for any reason, promoted the swap meeting, controlled customers' access to the swap meet area, and was aware that vendors were selling counterfeit recordings in violation of plaintiff's copyrights and trademarks.[182] The court rejected defendant's argument that the financial benefit prong of the test for finding vicarious liability could only be satisfied where the defendant earned a commission directly tied to the sale of a particular infringing item.[183]

In *A&M Records, Inc. v. Napster, Inc.*, the Ninth Circuit then extended *Fonovisa* to the online context.[184] In that case, where Napster facilitated the transmission of copyrighted music between its users free of charge, the court stated that "[t]he ability to block infringers' access to a particular environment for any reason" constituted evidence of Napster's right and ability to supervise.[185] The court then explained that because Napster had the right and ability to supervise its users' conduct, to escape the imposition of vicarious liability it was required to exercise the right to police to its fullest extent. "Turning a blind eye to detectable acts of infringement

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177. Fonovisa, Inc. v. Cherry Auction, Inc., 76 F.3d 259, 261-62 (9th Cir. 1996).

178. *Gershwin Publ'g Corp.*, 443 F.2d at 1162 (citing Shapiro, Bernstein & Co., Inc. v. H. L. Green Co., 316 F.2d 304 (2d Cir. 1963); *see also* A&M Records, Inc. v. Napster, Inc., 239 F.3d 1004, 1023 (9th Cir. 2001).

179. *Gershwin Publ'g Corp.*, 443 F.2d at 1162.

180. 3 NIMMER ON COPYRIGHT 12.04[A][1], at 12-70.

181. Perfect 10, Inc. v. Amazon.com, Inc., 508 F.3d 1146, 1173 (9th Cir. 2007).

182. *Fonovisa*, 76 F.3d at 261-62.

183. *Id.* at 263.

184. *Napster, Inc.*, 239 F.3d 1004 (9th Cir. 2001).

185. *Id.* at 1023 (citing *Fonovisa*, 76 F.3d at 262).

for the sake of profit gives rise to liability."[186] The plaintiffs were successful in establishing a likelihood of success on the merits because Napster controlled access to its system, reserved the right to terminate user accounts for any reason, and could locate infringing material listed on its search indices.[187] The court remanded the case, finding that Napster could be vicariously liable when it failed to "affirmatively use its ability to patrol its system and preclude access to potentially infringing" users.[188]

C. Statutory Scheme for Contributory Infringement on the Internet

The Digital Millennium Copyright Act was enacted in 1988 as a response to the difficulty of applying offline legal standards to online actors. This subsection will examine the DMCA, which serves as a model for the proposed statute in this Note. The DMCA represents an effort by Congress to provide greater certainty to ISPs concerning their legal exposure for copyright infringement.[189] It was "designed to facilitate the robust development and world-wide expansion of electronic commerce, communications, research, development, and education in the digital age."[190] Title II of the DMCA, the Online Copyright Infringement Liability Limitation Act (known as the "safe harbor provisions"), seeks to "preserve[] strong incentives for service providers and copyright owners to cooperate to detect and deal with copyright infringements that take place in the digital networked environment."[191] These safe harbors shield service providers from liability for secondary copyright infringement provided that the service providers remove infringing materials upon proper notification from copyright owners.[192] The safe harbors protect ISPs from liability for all monetary relief for direct and secondary infringement,[193] but "'do not affect the question of ultimate liability under the various doctrines of direct, vicarious, and contributory liability.'"[194]

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186. *Id.*

187. *Id.* at 1023-24.

188. *Id*. at 1027.

189. *See* Ellison v. Robertson, 357 F.3d 1072, 1076 (9th Cir. 2004) (quoting S. REP. NO. 105-190, at 20 (1998); H.R. REP. NO. 105-551(II), at 49 (1998)).

190. S. REP. NO. 105-190, at 1-2 (1998).

191. *Id.* at 20; H.R. REP. 105-551(II), at 49 (1998).

192. 17 U.S.C. §§ 512(a)-(d) (2000).

193. *See* Corbis Corp. v. Amazon, Inc., 351 F.Supp.2d 1090, 1098-99 (W.D. Wash. 2004).

194. Perfect 10, Inc. v. CCBill LLC, 488 F.3d 1102, 1109 (9th Cir. 2007) (quoting Perfect 10, Inc. v. Cybernet Ventures, Inc., 213 F.Supp.2d 1146, 1174 (C.D. Cal. 2002)).

To take advantage of the DMCA safe harbors, a defendant must satisfy certain threshold requirements.[195] The defendant must be a "service provider"[196] and it must adopt, reasonably implement, and inform subscribers of a policy that it may, in appropriate circumstances, terminate the accounts of repeat infringers.[197] Section 512(c) states that "[a] service provider shall not be liable for monetary relief" if it does not know of infringement or if it acts "expeditiously to remove, or disable access to, the material" when it (1) has actual knowledge, (2) is aware of facts or circumstances from which infringing activity is apparent, or (3) has received notification of claimed infringement meeting the requirements of section 512(c)(3).[198] Section 512(i) does not require service providers to track users in a particular way or to police users for evidence of repeat infringement.[199] Instead, "[a] policy is unreasonable only if the service provider failed to respond when it had knowledge of the infringement."[200]

The DMCA prescribes a notice-and-takedown system similar to eBay's VeRO policy.[201] A copyright owner submits a notification under penalty of perjury, including a list of specified elements, to the ISP's designated agent.[202] Failure to comply substantially with the statutory requirements means that the notification will not be considered in determining the requisite knowledge by the service provider.[203] The notice must be in written form and contain a physical or electronic signature of a person authorized to represent the copyright owner.[204] It must contain a statement that the complaining party has a good faith belief that infringement is occurring. The statement also must identify the infringed copyrighted work, the allegedly infringing material, and the location of the material.[205] Finally, the complaining party must certify that the notice is truthful and that the party is authorized to represent the copyright owner.[206]

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195. *See* 17 U.S.C. §§ 512(a)-(d).
196. *Id.* § 512(k).
197. *See id.* § 512(i)(1)(A).
198. *Id.* §§ 512(c)(1)(A)-(C). "[T]he plain language of section 512(c) indicates that the pertinent inquiry is not whether Veoh has the right and ability to control its *system*, but rather, whether it has the right and ability to control the *infringing activity.*" Io Group, Inc. v. Veoh Networks, Inc., 586 F.Supp.2d 1132, 1151 (N.D.Cal.2008).
199. *Perfect 10, Inc.*, 488 F.3d at 1111.
200. *Id.* at 1113.
201. *See supra* Section II.A.
202. *See* 17 U.S.C. §512(c)(3).
203. *Id.*
204. *Id.*
205. *Id.*
206. *Id.*

An ISP, upon such notice, must expeditiously remove any material identified as infringing.[207] The ISP is required to take reasonable steps to notify the creator of the offending content that its page was removed as a result of a DMCA takedown request.[208] The accused infringer then has the opportunity to "counter notify" the ISP if it believes the takedown was the result of a mistake or misidentification.[209] The ISP is then required to notify the original claimant that unless it receives notice of pending legal action within fourteen days, the material will be reinstated.[210]

The DMCA was not intended to protect ISPs that facilitate or turn a blind eye to infringement. The liability limitations are "not presumptive, but granted only to 'innocent' service providers who can show that they do not have a defined level of knowledge . . . ."[211] For innocent service providers that choose to comply with the DMCA and are deemed eligible, "the DMCA represents a legislative determination that copyright owners must themselves bear the burden of policing for infringing activity—service providers are under no such duty."[212] If an ISP fails to comply with the DMCA, the threshold for liability is the common law standard for contributory or vicarious liability.

D. *Hendrickson v. eBay:* Secondary Liability under the DMCA

Hendrickson v. eBay established that eBay qualifies as an ISP entitled to DMCA protection.[213] Hendrickson, the copyright owner, sued eBay for the third-party sale of counterfeit copies of his documentary.[214] The issue was whether the DMCA's safe harbor provisions afforded protection to eBay when Hendrickson sought to hold eBay secondarily liable for copyright infringement by its sellers.[215] The court held Hendrickson's failure to comply with the DMCA's procedural formalities was fatal to his claim.[216]

The court analyzed each of the three prongs necessary for an ISP to qualify for DMCA protection, and held under the second prong—which

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207. *Id.* § 512(c)(1)(C).
208. *Id.* § 512(g)(2)(A).
209. *Id.* § 512(g)(3).
210. *Id.* § 512(g)(2)(C).
211. *In re* Aimster Copyright Litigation, 252 F. Supp. 2d 634, 657 (N.D. Ill. 2002) (citation omitted), *aff'd*, 334 F.3d 643 (7th Cir. 2003).
212. *Id.*
213. Hendrickson v. Ebay, Inc., 165 F. Supp. 2d 1082, 1088 (C.D. Cal. 2001). "There is no dispute over whether eBay is an Internet 'service provider' within the meaning of Section 512. eBay clearly meets the DMCA's broad definition of online 'service provider.'" *Id.* (citation omitted).
214. *Id.* at 1086.
215. *Id*. at 1083-84.
216. *Id*. at 1092.

mimics the test for vicarious liability—that because eBay did not have the "right and ability to control" infringing activity, there was no need to address whether it received a "direct financial benefit" as a result of the infringement.[217]

> [T]he "right and ability to control" the infringing activity, as the concept is used in the DMCA, cannot simply mean the ability of a service provider to remove or block access to materials posted on its website or stored in its system. To hold otherwise would defeat the purpose of the DMCA and render the statute internally inconsistent.[218]

The court rejected the plaintiff's request for an injunction covering all future possible infringing advertisements because this would require eBay to "monitor the millions of new advertisements posted on its website each day and determine, on its own, which of those advertisements infringe . . . ."[219] The court explained that the law does not impose an affirmative duty on companies like eBay to engage in such monitoring.[220]

VI. HOW SHOULD INDIRECT TRADEMARK INFRINGEMENT BE REGULATED IN THE DIGITAL AGE?

A. Relying on Common Law for a Safe Harbor is Ineffective

Courts have applied secondary liability to determine whether an internet service provider should be found liable for trademark infringement. Current law does not provide effective and reliable measures for insulating ISPs from liability, so ISPs are overly cautious in removing material from their sites, which can jeopardize free speech rights.[221] The developments of the digital revolution have hindered the Lanham Act's goals of placing all trademark matters in one statute and eliminating judicial obscurity. The *Tiffany v. eBay* decision provided some clarity on what steps an ISP can take to detect and control misconduct in order to escape liability. However, the development of this law has been haphazard. Courts should not create the doctrine of secondary trademark liability piecemeal; instead,

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217. *Id.* at 1089-90. eBay had argued that it is too large to "control" and "monitor."
218. *Id*. at 1093.
219. *Id.* at 1095.
220. *Id.*
221. Telephone Interview with Michael Kwun, Sr. Intellectual Property Attorney, Electronic Frontier Foundation (Dec. 19, 2008) (on file with author) [hereinafter Kwun Interview]; *see also* Lisa M. Bowman, *Free speech feels Net copyright chill*, CNET NEWS, Oct. 24, 2002, http://news.cnet.com/2100-1023-963122.html.

Congress should look to Judge Sullivan's decision in *Tiffany v. eBay* for guidance in determining what the law requires from ISPs. Under the current law, a court could still reject the Southern District of New York's analysis, hold eBay accountable for counterfeiting on its site, and thereby force eBay to find a way to decrease the number of infringements.[222] Although such a result would arguably serve the goals of trademark law—to reduce consumer confusion and to protect the goodwill trademark owners have built in their marks—it would place too great a burden on eBay.

One of the primary features of trademark law is that it is the trademark owner's duty to police its own mark.[223] Trademark holders bear the burden of protecting their marks from infringement.[224] If courts were to hold that ISPs must seek out infringement on their sites, the trademark holder's right would be dramatically strengthened without a policy justification for doing so. The benefit of trademarks in reducing consumer search costs requires that the trademark owner maintain consistent quality in order to preserve its reputation.[225] Trademark's self-policing feature means that the market will generally discipline the trademark owner who fails to maintain quality by "whittling away the distinctiveness" of its mark.[226] For a website such as eBay, where thousands of listings are available at any given time, such a responsibility would be debilitating and nearly impossible to achieve successfully.[227]

Commentators have suggested multiple ways to improve regulation of counterfeit goods sold through online auction sites such as eBay. These proposals include a registration and feedback system whereby a user builds a public online reputation by engaging in transactions and receiving public feedback;[228] consumer laws similar to state consumer protection laws;[229] internal industry action;[230] and a licensing scheme that would re-

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222. *See, e.g.*, S.A. Louis Vuitton Malletier v. eBay, Inc., Tribunal de Commerce de Paris, Premiere Cass. B (Paris Commercial Court), Case No. 200677799 (June 30, 2008).

223. Merges, Menell & Lemley, *supra* note 100, at 635-36.

224. *Id.*

225. Steven M. Auvil, *Gray Market Goods Produced by Foreign Affiliates of the U.S. Trademark Owner: Should the Lanham Act Provide a Remedy?,* 28 AKRON L. REV. 437, 448 (1995).

226. *Id.*

227. For example, the Communications Decency Act does not apply to intellectual property claims. 47 U.S.C. § 230(e)(2) (2000).

228. Mary M. Calkins, *My Reputation Always Had More Fun than Me: The Failure of eBay's Feedback Model To Effectively Prevent Online Auction Fraud*, 7 RICH. J.L. & TECH. 33 (2001).

229. Matthew Fornaro, *A Parallel Problem: Grey Market Goods and the Internet*, 8 J.TECH.L. & POL'Y 69, 89 (2003).

230. *Id.*

quire websites and merchants who sell new merchandise featuring U.S. trademarks on the Internet to pay a licensing fee to the affected valid U.S. trademark holder.[231]

None of these proposals are as practical as a statutory solution. According to James B. Swire, who represents Tiffany in the *Tiffany v. eBay* litigation, strengthening consumer laws would not effectively improve regulation of counterfeit goods sold through online auction sites.[232] It is also unlikely that websites such as eBay would accept a licensing scheme, as there is little basis for such a system under current law.[233] Under the first sale doctrine, once a trademark owner has sold its goods, it has exhausted its trademark rights in those goods.[234] Thus, the owner cannot rely on its trademark rights to dictate how or where the buyer uses or redistributes those goods.[235] Sites like eBay, which often sell redistributed items the trademark owner has already "sold" for purposes of the first sale doctrine, are likely to balk at having to pay licensing fees.

B. Why a Statutory Solution Makes Sense

Both Congress and the courts have attempted to strike a balance so that ISPs are not liable for damages for content posted on their systems. If internet intermediaries were liable every time someone posted infringing content on their site, the resulting liability would likely force all sites, including eBay, to shut down. Such balancing efforts are evident in, for example, section 512 of the DMCA, which protects ISPs from allegations of copyright infringement, providing they follow statutorily prescribed steps in removing infringements upon notice.[236] Similarly, section 230 of the Communications Decency Act, by establishing a safe harbor for internet intermediaries from liability arising from third-party generated content, effectively grants ISPs immunity from torts such as defamation committed

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231. *Id.* at 90.

232. Telephone Interview with James B. Swire, Partner, Arnold & Porter LLP (Dec. 18, 2008) (on file with author).

233. *Id.*

234. 17 U.S.C. § 109 (2000).

235. *Id.* In Europe, however, trademark rights give owners greater control over how their goods are distributed. According to Stanford University intellectual property professor Mark Lemley, the different outcomes in the eBay cases in Europe result "[b]ecause the U.S. has a legal system that respects and encourages the development of the Internet, and France, so far, does not." Posting of Zusha Elinson to Legal Pad, France hates the Internet. And your shoes., http://legalpad.typepad.com/my_weblog/2008/07/france-hates-th.html (July 14, 2008, 16:29 PST).

236. 17 U.S.C. § 512(c) (2000).

by their users.[237] And finally, section 1114(2) of the Lanham Act[238] creates a safe harbor from trademark infringement for printers and publishers; the definition of publishers includes online providers of content written by a third party.[239] "It exempts at least some Internet intermediaries—those who are 'innocent infringers,' a term that is not defined in the Lanham Act—from damages liability, and also from liability for injunctive relief in circumstances where an injunction would interfere with the normal operation of the online publisher."[240]

In the past, Congress has responded to other trademark infringement concerns on the Internet by enacting legislation. For example, the Anticybersquatting Consumer Protection Act[241] prohibits the unauthorized registration of trademarks as internet domain names by creating civil liability for anyone who "registers, traffics in, or uses a domain name" that is identical to, confusingly similar, or dilutes a trademark. The registrant must have a "bad faith intent to profit."[242] The Act created an easier procedure whereby trademark owners can obtain a court order for the forfeiture or cancellation of the domain name or the transfer of the domain name to the owner.[243]

In light of the above comparison of secondary copyright and trademark liability and the similarities between the two doctrines, Congress should enact a safe harbor to regulate trademark infringement on online auction sites. Although the rationales behind copyright and trademark law differ, for both doctrines courts have held that one who contributes to the fraud or tort of another should also be held liable. Secondary liability for both trademark and copyright has been created by courts and is not found in the Lanham Act or the Copyright Act.

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237. 47 U.S.C. § 230(c)(1) (2000). "No provider or user of an interactive computer service shall be treated as the publisher or speaker of any information provided by another information content provider." *Id.*

238. 15 U.S.C. § 1114(2) (2000).

239. *Id.* § 1114(2)(B)-(C).

240. Mark Lemley, *Rationalizing Internet Safe Harbors* 7 (Stanford Public Law Working Paper No. 979836, 2007), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=979836. According to Lemley, it is unclear how broadly the exemption applies to internet intermediaries, like eBay, who are not themselves publishing the content. *Id.*

241. 15 U.S.C. § 1125(d) (2006).

242. *Id.* § 1125(d)(1)(A).

243. *Id.* § 1125(d)(2)(D)(i).

C. A Safe Harbor for Trademark Infringement

Trademark law does not currently have any provisions similar to the DMCA's safe harbor rules for copyright infringement on the Internet. In most cases, a trademark owner's only option is to contact an ISP and request that a listing be removed. A trademark owner can file an action against the service provider for contributory trademark infringement, but unless the ISP has made no effort to regulate infringement on its site, and has in fact taken steps to "intentionally induce another to infringe a trademark," the suit is unlikely to be successful. Further, it is often too costly and time consuming for trademark owners to file suit in every case of alleged infringement on the Internet.

Although copyright and trademark law are both based on the common law of torts, they serve different policy goals. It is therefore not obvious that trademark infringement on the Internet should be regulated in the same manner as copyright infringement. However, courts regularly apply principles from one area of intellectual property law to another[244] and many courts have analogized between different areas of law to impose liability in intellectual property cases.[245] Early copyright cases looked to tort principles in recognizing third party liability.[246] Then, "on the basis of what it asserted as a[n] 'historic kinship between the patent and copyright law,' the [Supreme] Court engrafted an express provision from the Patent Act of 1952 onto the Copyright Act of 1976."[247]

A parallel safe harbor for trademark law would support the same goals as the DMCA: to preserve strong incentives for service providers and trademark owners to detect and deal with trademark infringements that take place on the Internet; to allow ISPs to take clear steps that will limit their liability; and to encourage the development of the Internet. "The common element of . . . safe harbors is that the service provider must do what it can reasonably be asked to do to prevent the use of its service by 'repeat infringers.'"[248] eBay has already developed the VeRO system,

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244. *See, e.g.*, MGM Studios Inc. v. Grokster, Ltd., 545 U.S. 913, 932 (2005); *see also* Sony Corp. of Am. v. Universal City Studios, Inc., 464 U.S. 417, 435 (1984) (explaining that "vicarious liability is imposed in virtually all areas of the law, and the concept of contributory infringement is merely a species of the broader problem of identifying circumstances in which it is just to hold one individual accountable for the actions of another.").

245. Menell & Nimmer, *supra* note 97, at 996-97.

246. *Id.* (citing *Sony Corp. of Am.*, 464 U.S. at 439).

247. *Id.* at 943.

248. In re Aimster Copyright Litig., 334 F.3d 643, 655 (7th Cir. 2003) (citing 17 U.S.C. § 512(i)(1)(A) (2000)).

which regulates both copyright and trademark infringement and functions according to the DMCA takedown-and-notice provisions. By codifying the safe harbor for trademark, Congress will eliminate uncertainty and unnecessary lawsuits for both ISPs and trademark holders. In the digital age, responsibilities of companies like eBay need to be clearly defined so as to promote their growth.

D. Proposed Statute

Congress should enact a trademark statute modeled after the DMCA, though with a few critical changes. This statute, which could stand on its own or be added to the DMCA, should conditionally limit the liability of online auction websites for infringing products listed on their systems. Like the DMCA, the statute should require online auction sites to meet the following conditions: (1) the online auction site must not have actual knowledge of the infringing activity and must not be aware of facts or circumstances from which infringing activity is apparent; (2) if the site has the right and ability to control the infringing activity, it must not receive a financial benefit directly attributable to the infringing activity; and (3) upon receiving proper notification of claimed infringement, the site must expeditiously take down or block access to the material. Like section 512(i) of the DMCA, the proposed statute will not require online auction sites to track users in a particular way or affirmatively police users for evidence of repeat infringement.

However, the trademark statute should not model section 512(c)(1)(B) of the DMCA, which explains that the DMCA does not protect any intermediary that receives a financial benefit directly attributable to the infringing activity if the ISP has the right and ability to control such activity.[249] This section leaves ISPs open to liability for vicarious infringement, and courts have gradually expanded the scope of vicarious infringement, finding that the direct financial benefit prong could be satisfied without proof of any revenue and the ability to control infringement prong is satisfied if a site owner could stop infringement by shutting down the system.[250] In *Tiffany v. eBay*, though Judge Sullivan did not find eBay liable for vicarious infringement, another court could easily find that eBay does in fact receive a financial benefit directly attributable to the infringing activity of the third party and therefore is vicariously liable for trademark infringement. To give eBay and others certainty that legitimate, responsive, com-

249. 17 U.S.C. § 512(c)(1)(B) (2006).

250. Lemley, *supra note* 240, at 17 (citing A&M Records, Inc. v. Napster, Inc., 239 F.3d 1004 (9th Cir. 2001) and Fonovisa, Inc. v. Cherry Auction, Inc., 76 F.3d 259 (9th Cir. 1996)).

pliant procedures will shield it from potentially crushing liability, this gap in the safe harbor must be closed concerning trademarks.

The statute should also establish procedures for proper notification, such as those under the DMCA's section 512(c)(3),[251] and for counter notification, such as those under 512(g) of the DMCA.[252] If the online auc-

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251. 17 U.S.C. § 512(c)(3) (2006). The relevant portion is:

(3) Elements of notification.

(A) To be effective under this subsection, a notification of claimed infringement must be a written communication provided to the designated agent of a service provider [including]:

(i) A physical or electronic signature of a person authorized to act on behalf of the owner of an exclusive right that is allegedly infringed.

(ii) Identification of the copyrighted work claimed to have been infringed . . . .

(iii) Identification of the material that is claimed to be infringing . . . and information reasonably sufficient to permit the service provider to locate the material.

(iv) Information reasonably sufficient to permit the service provider to contact the complaining party . . . .

(v) A statement that the complaining party has a good faith belief that use of the material . . . is not authorized by the copyright owner, its agent, or the law.

(vi) A statement that the information in the notification is accurate, and under penalty of perjury, that the complaining party is authorized to act on behalf of the owner of an exclusive right that is allegedly infringed.

(B)(i) Subject to clause (ii), a notification from a copyright owner [or an authorized agent] . . . that fails to comply substantially with the provisions of subparagraph (A) shall not be considered . . . in determining whether a service provider has actual knowledge or is aware of facts or circumstances from which infringing activity is apparent.

(ii) In a case in which the notification . . . fails to comply substantially with . . . subparagraph (A) but substantially complies with clauses (ii), (iii), and (iv) of subparagraph (A), clause (i) of this subparagraph applies only if the service provider promptly attempts to contact the person making the notification or takes other reasonable steps to assist in the receipt of notification that substantially complies with all the provisions of subparagraph (A).

252. 17 U.S.C. § 512(g) (2006). The relevant portion is:

(g) Replacement of removed or disabled material and limitation on other liability.

(1) No liability for taking down generally. Subject to paragraph (2), a service provider shall not be liable . . . for any claim based on the service provider's good faith disabling of access to, or removal of, material or activity claimed to be infringing . . . .

tion site receives a counter notification complying with statutory requirements, including a statement under penalty of perjury that the material was removed through mistake or misidentification, then unless the trademark owner files an action seeking a court order against the subscriber, the site must put the listing back up. Unlike the DMCA, which requires an ISP to repost the material within ten to fourteen business days after receiving the counter notification,[253] the trademark statute should require the auction site to repost the listing within a slightly shorter period of time in order to encourage ISPs to repost legitimate content quickly, especially where the complaint is frivolous.

The DMCA requires that contested material remain off the Internet until any litigation between the copyright owner and alleged infringer is re-

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> (2) Exception. Paragraph (1) shall not apply with respect to material residing at the direction of a subscriber of the service provider on a system or network controlled or operated by or for the service provider that is removed . . . pursuant to a notice provided under subsection (c)(1)(C), unless the service provider—
>
> (A) takes reasonable steps promptly to notify the subscriber that it has removed . . . the material;
>
> (B) upon receipt of a counter notification . . . promptly provides the person who provided the notification . . . with a copy of the counter notification, and informs that person that it will replace the removed material . . . in 10 business days; and
>
> (C) replaces the removed material . . . not less than 10, nor more than 14, business days following receipt of the counter notice, unless its designated agent first receives notice from the person who submitted the notification . . . that such person has filed an action seeking a court order to restrain the subscriber from engaging in infringing activity relating to the material . . . .
>
> (3) Contents of counter notification. To be effective under this subsection, a counter notification must be a written communication provided to the service provider's designated agent that includes substantially the following:
>
> (A) A physical or electronic signature of the subscriber.
>
> (B) Identification of the material that has been removed . . . and the location at which the material appeared . . . .
>
> (C) A statement under penalty of perjury that the subscriber has a good faith belief that the material was removed or disabled as a result of mistake or misidentification of the material . . . .
>
> (D) The subscriber's name, address, and telephone number, and a statement that the subscriber consents to the [U.S.] jurisdiction of [either the subscriber or the ISP].
>
> (4) Limitation on other liability. A service provider's compliance with paragraph (2) shall not subject the service provider to liability for copyright infringement with respect to the material identified . . . .

253. *Id.* § 512(g)(2)(C).

solved.[254] This means that a copyright owner may receive the benefit of an injunction without meeting the traditional standard required for an injunction.[255] Further, after the ISP receives a counter notification, the copyright owner has up to fourteen days to decide whether to file an action seeking a court order against the subscriber.[256] A two-week waiting period may seem short, but as the EFF has pointed out, "if you're doing something targeted towards what's happening at the moment, if your material is down for two weeks, it may no longer have any useful voice."[257] In order to counteract these potential problems, the trademark statute should shorten the window before the listing must be reposted.[258] While it is likely inevitable that some legitimate listings will be temporarily removed, limiting the time before they are reposted will minimize damage to the content creator—or in the case of eBay, to the seller.

Finally, the statute should broadly define online auction website.[259] For example, a definition could read: "a website where third parties can offer goods for sale." This would include websites that provide both fixed price and auction-format listings, and would encompass eBay, Amazon, and Google, among others.

The proposed statute provides online auction websites with clear steps to protect them from liability. Currently, eBay's VeRO system is modeled after the DMCA. As Judge Sullivan recognized in *Tiffany v. eBay*, eBay's efforts to regulate trademark infringement on its site are likely sufficient. This statute would codify Judge Sullivan's analysis, thereby clarifying

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254. *Id.* Upon receipt of a valid counter notification, the ISP must replace the removed material unless it "receives notice from the person who submitted the notification . . . that such person has filed an action seeking a court order to restrain the subscriber from engaging in infringing activity relating to the material on the service provider's system or network."

255. *Id.* A plaintiff seeking a permanent injunction must satisfy a four-factor test:

> (1) that it has suffered an irreparable injury; (2) that remedies available at law, such as monetary damages, are inadequate to compensate for that injury; (3) that, considering the balance of hardships between the plaintiff and defendant, a remedy in equity is warranted; and (4) that the public interest would not be disserved by a permanent injunction.

eBay Inc. v. MercExchange, L.L.C., 547 U.S. 388, 391 (2006).

256. 17 U.S.C. § 512(g)(2)(C).

257. Kwun Interview, *supra* note 221.

258. I would argue that the DMCA should soon follow suit, in particular because copyright law implicates First Amendment concerns more often than trademark.

259. The DMCA defines "internet service provider" broadly, as "a provider of online services or network access, or the operator of facilities therefore." 17 U.S.C. § 512(k)(1)(B).

eBay's legal liability so that it would no longer need to rely on common law for the safe harbor.

VII. CONCLUSION

This article seeks to establish that the current method of regulating trademark infringement for counterfeit goods on the Internet leaves unclear the rights of trademark holders and the responsibilities of ISPs. Fraud perpetrated over the Internet continues to grow and ISPs continue to be unsure of their liability.[260] If Tiffany prevails at the Second Circuit, online auction sites, in their current form, would face potentially crippling litigation costs, jeopardizing their business models.[261] And if eBay succeeds, trademark infringement on the Internet will likely increase, causing more consumer confusion and a decrease in the goodwill of well-known trademarks.[262] By providing a safe harbor for trademark infringement we can prevent further litigation similar to the *Tiffany v. eBay* dispute and avoid an incentive for online auction websites to limit speech. This statutory solution will afford protection to online auction sites, trademark owners, and honest sellers.

Once this statute is enacted, if eBay then chooses not to implement the monitoring procedures or not to follow the appropriate take-down requirements, Tiffany would have a valid claim of contributory trademark infringement against eBay. In such a case a court could apply contributory liability to determine whether eBay should be held liable, and there would

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260. A more recent dispute over trademark infringement on the Internet arose earlier this year over Scrabulous, an online version of Scrabble that, until it was forced to shut down, had more than two million users worldwide. Hasbro, the maker of the board game Scrabble, sued the two brothers who designed Scrabulous. Brad Stone, *Hasbro Notches Triple-Word Score Against Scrabulous With 'Lawsuit'*, N.Y. TIMES, July 24, 2008, (Bits Blog), http://bits.blogs.nytimes.com/2008/07/24/hasbros-notches-triple-word-score-against-scrabulous-with-lawsuit/. Here again, it was unclear whether Facebook.com, the ISP that supported Scrabulous, could be liable for contributory infringement. Hasbro has dropped its lawsuit against the makers of Scrabulous. *Hasbro Drops Scrabulous Lawsuit*, N.Y. TIMES, Dec. 17, 2008, (Dealbook Blog), http://dealbook.blogs.nytimes.com/2008/12/17/hasbro-drops-scrabulous-lawsuit/.

A related case is also currently pending in the copyright context. Viacom, in its $1 billion U.S. copyright lawsuit against Google, is making the same argument as Tiffany did in the eBay litigation. In response to Viacom's accusation that Google is an "unlawful business model," Google says it respects rights holders and complies with their take-down notices. David Kravets, *Judge Doesn't Give Tiffany a Trademark Silver Spoon in eBay Flap*, Wired Blog Network, July 14, 2008, http://blog.wired.com/27bstroke6/2008/07/judge-doesnt-gi.html.

261. Sunderji, *supra* note 105, at 940.

262. *Id.*

be direct evidence that eBay had failed to comply with the provisions of the trademark version of the DMCA. Congress should act to ensure that the rights of trademark holders and responsibilities of ISPs are concretely set forth in a statute.

ADDITIONAL DEVELOPMENTS—TRADEMARK

PRO-IP ACT OF 2008

Pub. L. No. 110-403, 124 Stat. 4256 (to be codified as amended in scattered sections of 15 U.S.C., 17 U.S.C., 18 U.S.C., and 42 U.S.C.)

In October 2008 President George W. Bush signed into law the Prioritizing Resources and Organization for Intellectual Property Act of 2008 (PRO-IP Act). The PRO-IP Act makes amendments and additions to existing intellectual property laws that provide for enhanced remedies for piracy and counterfeiting, greater investigative and forensic resources for enforcing intellectual property laws, and better coordination of intellectual property policy in the executive branch. According to the members of the House of Representatives who supported the PRO-IP Act, the law will help strengthen the protection of the nation's intellectual property, and ultimately combat the growth in intellectual property crimes that account for billions of dollars in lost revenue for U.S. companies each year, and even greater losses to the U.S. economy in terms of jobs, tax receipts, trade deficits, and threats to public health and safety.

The PRO-IP Act provides enhanced remedies by doubling the statutory damages available for use of counterfeit trademarks from a range of $500-$100,000 to a range of $1000-$200,000, and doubling the amount of statutory damages available for the willful use of a counterfeit mark from $1 million to $2 million. Additionally, the law broadly expands forfeiture penalties for pirating, by allowing not only seizure of infringing copies and phonorecords, but also seizure of "[a]ny property used, or intended to be used, in any manner or part to commit or facilitate the commission of" a criminal copyright infringement.

The PRO-IP Act also creates the position of Intellectual Property Enforcement Coordinator—or "IP Czar"—within the executive branch to serve as the chair of the Interagency Intellectual Property Enforcement Advisory Committee. Furthermore, the PRO-IP Act authorizes the Justice Department to provide $25 million annually for the years 2009 through 2013 to fund local and state law enforcement entities for education, enforcement, and prosecution of intellectual property crimes. It also authorizes $10 million annually for the years 2009 through 2013 for the Director of the FBI and the Attorney General to hire and train more staff, and to procure advanced forensic tools to help investigate, study and prosecute intellectual property crimes.

There has been criticism of the PRO-IP Act from members of congress and public advocacy groups, such as the Electronic Frontier Foundation (EFF) and Public Knowledge, that the Act creates tools to protect corporate interests rather than the public interest of "promot[ing] the progress of science and useful arts." The legislative history also reveals concerns about the broadened forfeiture penalties, especially relating to the possible seizure of property of innocent intermediaries such as internet service providers, businesses, libraries, or schools. Furthermore, some investment analysts have criticized the PRO-IP Act for allowing the content industry to rely on outdated business models that restrict competitive growth and adaptation to new distribution methods. Still, The EFF approvingly noted that key elements of the entertainment industry's wish list were stripped from the bill, including higher damages for file sharing, a vast intellectual property enforcement bureaucracy, and a grant of authority to the Attorney General to file civil copyright-infringement suits on behalf of copyright holders.

VENTURE TAPE CORP. V. MCGILLS GLASS WAREHOUSE

540 F.3d 56 (1st Cir. 2008)

The United States Court of Appeals for the First Circuit unanimously affirmed summary judgment for plaintiff-appellee Venture Tape Corporation (Venture) that defendant-appellant McGills Glass Warehouse (McGills) was liable under the Lanham Act for willful infringement of Venture's registered trademarks. The First Circuit also affirmed the district court's finding of damages, ordering McGills to pay Venture an equitable share of profits and an award of attorneys' fees.

McGills and Venture were internet retailers of stained glass products. McGills, without authorization, embedded Venture's trademarks in the metatags and background display of McGills' website. Venture brought suit, alleging McGills willfully infringed its trademarks. In a deposition, McGills' owner admitted that he used Venture's marks in this manner with the intent of luring potential Venture customers to its own website via internet search traffic. The district court granted summary judgment as a matter of law in favor of Venture, holding that McGills was liable for willful infringement of Venture's trademarks. The court awarded Venture attorneys' fees and an equitable share of McGills' profits. McGills appealed the judgment, arguing that: (1) summary judgment was improper because Venture produced no evidence of actual consumer confusion from McGills' use of the trademarks and therefore there was a genuine issue of material fact as to infringement, (2) the award of an equitable share of profits was improper because the district court was in error in its finding of willfulness, and (3) the award of attorneys' fees was improper because the district court abused its discretion in finding the case "exceptional."

The First Circuit affirmed the summary judgment. It held that the district court properly applied the *Pignon* eight-factor "likelihood of confusion" test for internet consumers to find that there was no genuine issue of material fact as to McGills' infringing use of Venture's trademarks, even though Venture produced no evidence of actual consumer confusion. The First Circuit noted that though actual consumer confusion is a strong indicator of likelihood of confusion, the absence of actual consumer confusion was not in itself sufficient to defeat summary judgment in favor of the plaintiff.

The court also affirmed the award of an equitable share of profits under the Lanham Act section 35(a), because it found no clear error by the district court in its determination of "willful infringement." Although it declined to decide whether "willfulness" was a necessary prerequisite to

an award of profits under the Lanham Act, the First Circuit suggested that even if it was, McGills' concealment of Venture's trademarks on its website's metatags and background, coupled with its admitted intent to poach Venture's internet search customers, provided strong circumstantial evidence of willfulness. Thus, the district court's award of profits was not clearly in error.

The attorneys' fee award under 15 U.S.C. § 1117(a) was likewise affirmed on the basis that due to McGills' willful infringement as a matter of law, the district court did not abuse its discretion in finding this an "exceptional case" where an award of attorney's fees was appropriate.

TRADEMARK INFRINGEMENT IN WEB CONTENT

In a series of cases, the United States District Courts evaluated the permissibility of using trademarks in web content. The District Court of Massachusetts and the Northern District of California followed the emerging trend regarding keyword advertising, holding that use of a competitor's mark in sponsored linking constitutes trademark use in advertising under the Lanham Act. However, the courts differed in their interpretation of whether such use necessarily leads to trademark infringement through customer confusion. In a pair of other cases, the Eastern District of Wisconsin and the District Court of South Carolina clarified the application of the Lanham Act to commercial websites and private blogs.

BOSTON DUCK TOURS, LP V. SUPER DUCK TOURS, LLC

527 F. Supp. 2d 205 (D. Mass. 2007)

In *Boston Duck Tours*, the United States District Court of Massachusetts clarified the scope of a preliminary injunction that prohibited Super Duck Tours from using Boston Duck Tours' trademark. The court held that use of a trademark in sponsored link advertising qualifies as use in advertising under the Lanham Act, yet Super Duck had not violated the injunction by using such advertising.

In July 2007, the court issued the preliminary injunction barring Super Duck from using "duck tours" in connection with its tourist services. Super Duck subsequently changed its name to Super Duck Excursions, but continued to purchase sponsored links for the phrase "boston duck tours" through the Google search engine. This purchase resulted in the display of Super Duck's online advertisements for user searches on Boston Duck's trademark. To distinguish itself from Boston Duck, Super Duck included a disclaimer at the bottom of its website, "Not to be confused with Boston Duck Tours." Super Duck then moved for clarification of the injunction to determine if these purchases were compliant with the injunction.

The court addressed two questions in its opinion: first, did Super Duck's use of the trademark in sponsored linking constitute trademark use under the Lanham Act? Second, did the preliminary injunction prohibit the purchase of sponsored linking? In answering the first question, the court acknowledged the opinions of the Second Circuit that hold that sponsored linking is internal use of a trademark, and is largely invisible to the customer. However, the court did not follow the Second Circuit, and instead approved of the "emerging view" in the Ninth and Tenth Circuits,

as well as several district courts within the Third Circuit, that use of a trademark in sponsored linking comprises use for purposes of the Lanham Act. Because sponsored linking provides a user with a direct link to an infringer's website, the use of a trademark in sponsored linking qualifies as use in advertising under the plain language of the Lanham Act.

In answering the second question, and evaluating Super Duck's compliance with the preliminary injunction, the court examined the purpose behind the original injunction. The court concluded that the injunction was intended to bar all future infringement, not all lawful or unlawful use of the trademark. The court reasoned that the injunction was designed to compel Super Duck to select a new, non-infringing mark, but was not intended to prohibit Super Duck from employing the mark in lawful secondary uses. The court further held that because of the diminished likelihood of consumer confusion, Super Duck had acted lawfully in using "duck tours" in Google's sponsored links. The court did not employ the eight-factor *Sleekcraft* test to determine the likelihood of consumer confusion, observing that the *Sleekcraft* factors are designed for cases involving competing trademarks, while the Super Duck case involved a particular use of a trademark by a competitor. The court instead reasoned that, because Super Duck had adopted a new trademark—Super Duck Excursions—and had included the disclaimer at the bottom of its website, the likelihood of consumer confusion had decreased rather than increased. Thus, while Super Duck's use of Boston Duck's trademark in sponsored linking was an aggressive move, it did not constitute a violation of either the Lanham Act or the preliminary injunction.

STORUS CORP. V. AROA MARKETING, INC.

2008 WL 449835 (N.D. Cal. 2008)

In *Storus*, the Northern District of California granted partial summary judgment against Aroa for infringement of Storus' "smart money clip" trademark, but denied Storus summary judgment against Skymall, Inc. The court focused its analysis on initial interest confusion caused by: (1) Aroa's use of Storus' mark in sponsored links on Google, and (2) the search results produced by Skymall's online catalog. The court held that Aroa's use of sponsored links on Google satisfied the *Sleekcraft* analysis of initial interest confusion, and, finding no material issue of fact, granted Storus partial summary judgment of trademark infringement by Aroa. However, the court did not find such a clear case of initial interest confusion in the behavior of Skymall's search engine, and thus denied Storus' motion against Skymall.

Storus developed, marketed, and sold the "Smart Money Clip," a money clip designed to hold money bills and credit cards. Storus patented technology for this money clip, and registered the mark "Smart Money Clip" in 2001. Aroa, an online retailer, sold money clips and associated products, including, for a two-year period, the Storus Smart Money Clip. Aroa employed the Google AdWords program to purchase and register sponsored links for specific keywords, including the keyword string "smart money clip." Thus, when a user typed "smart money clip" in a Google search, the search results displayed the search string—Smart Money Clip—in large, underlined font, accompanied by an advertisement for Aroa's online retail website. Over an eleven-month period, Google searches for "smart money clips" produced results including the Aroa website over 36,000 times, and users selected the Aroa website from these results over 1,300 times.

Skymall sold a variety of products, including money clips, through its online retail website www.skymall.com. The website provided a search engine to allow consumers to search for specific products. In addition, the website included an entry for an Aroa money clip, and the description of the Aroa product included the phrase "smart money clip."

Storus argued that it was entitled to summary judgment against both Aroa and Skymall because: (1) Storus owned a valid trademark in the phrase "smart money clip," and (2) the use of this trademark by the Google or Skymall search engines had created a strong likelihood of initial interest confusion. Storus asserted that, by registering the phrase 'smart money clip", Storus owned a valid, protectable mark. Storus further claimed that, by directing users who entered this mark into either the Google or Skymall search engines to Aroa products, and not to Storus products, both Aroa and Skymall satisfied as a matter of law the *Sleekcraft* factors for initial interest confusion.

The court recognized the validity of Storus' mark despite assertions from Aroa and Skymall that the mark was merely descriptive. Noting that registration of a mark presents a strong presumption of validity, the court also observed that Aroa and Skymall had offered no evidence that the mark was descriptive, and not distinctive. Additionally, Aroa and Skymall had not met the burden of showing that the mark had no secondary meaning.

In assessing the likelihood of consumer confusion from Aroa's use, the court agreed with Storus, and held that the use of "smart money clip" in sponsored linking created initial interest confusion as a matter of law. Citing *Interstellar Starship Services, Ltd. V. Epix Inc.*, the court employed a modified version of the *Sleekcraft* factors customized for cases involving

the internet. The court attributed added weight to three factors—the similarity of the trademarks, the relatedness of the goods, and the marketing channels used—and required that the remaining factors must weigh predominantly against the likelihood of confusion to prevent a finding of infringement in the context of website disputes. The court found that Aroa's use of "smart money clip" in sponsored links satisfied the three primary factors, and disagreed with Aroa's assertion that because the Google search results displayed the Aroa website and associated trademark, the marks were not sufficiently similar to satisfy the first primary factor. The court countered that the web page displaying the search results included the trademark "smart money clip" in a large, underlined font, thus constituting not just use of a similar mark, but use of an identical mark. The court found that the remaining factors did not substantially outweigh the three primary factors, as Aroa had either offered no evidence to support these factors or had conceded that they weighed in favor of Storus.

The court reached a different conclusion with regard to Skymall. The court did not reach the *Sleekcraft* factors in its analysis of Skymall's infringement, and instead focused on the uncertain link between the use of "smart money clip" in the Skymall search engine and a page displaying Aroa products. Skymall had not conceded that a search for "smart money clip" would certainly direct the user to Aroa's products, and the court noted that such a search might direct users to Aroa's products not through any use of Storus' trademark, but rather because the search string included the terms "money clip." Thus, because Storus' allegations of infringement rested on contestable issues of fact, Storus was not entitled to summary judgment against Skymall.

STANDARD PROCESS, INC. V. TOTAL HEALTH DISCOUNT, INC.

559 F. Supp. 2d 932 (E.D. Wisc. 2008)

In *Standard Process*, the Eastern District of Wisconsin ruled on a variety of motions related to Total Health Discount's reselling of Standard Process' dietary supplements. As a part of its ruling, the court held that Total Health's defenses under the first sale doctrine and nominative fair use were insufficient to warrant dismissal of trademark infringement claims through summary judgment.

Standard Process, a dietary supplement manufacturer, sold its products only to contractually authorized resellers. Total Health, an online retailer of vitamins and supplements, purchased Standard Process products from

authorized sellers and resold these products without authorization while displaying the Standard Process logo and pictures of Standard Process products on its website. In addition, Total Health purchased sponsored links from a variety of search engines for the search string "standard process," and posted text that suggested an affiliation between Standard Process and Total Health. In March 2006, Standard Process mailed written notice to Total Health stating that Total Health's use of the Standard Process logo and product pictures violated Standard Process' trademark. Total Health responded by removing the Standard Process logo and pictures and replacing them with the Standard Process name and product names in plain text. Total Health also posted a disclaimer on its web pages offering Standard Products, indicating that Total Health was not an authorized seller of Standard Process products and was not affiliated with Standard Process. Standard Process subsequently sued Total Health for trademark infringement, as well as false advertising, unfair competition, intentional interference with contractual relations, and other related claims. Total Health responded with a motion for summary judgment on these claims, and Standard Process countered with a motion for partial summary judgment on false advertising and a motion to remove the confidential designation on Total Health's customer lists.

The court denied Total Health's summary judgment motion on trademark infringement, holding that Total Health had not sufficiently established its first sale and nominative fair use defenses. While Total Health had removed the Standard Process logo and product pictures, and had posted the disclaimer, the sponsored links and text suggesting an affiliation between Standard Process and Total Health could have given consumers the false impression that Standard Process had endorsed Total Health's resale of Standard Process products. As a result, the court held that Total Health had not sufficiently shown that its unauthorized sales were covered by either the first sale doctrine or nominative fair use, and that judgment as a matter of law was inappropriate.

BIDZIRK, LLC V. SMITH

2007 WL 3119445 (D.S.C. 2007)

The United States District Court of South Carolina assessed trademark infringement in blogs in *Bidzirk*, holding that, because the blogger reproduced the trademark in the context of news reporting, the blogger's use was authorized by the Lanham Act.

Phillip Smith, the defendant blogger, published a blog post detailing his experiences working with BidZirk, a company that facilitates the sale

of customers' items on auction sites for a consignment fee. Smith included BidZirk's trademark in his blog, and described both the positive and negative elements of working with BidZirk. BidZirk subsequently sued Smith for defamation, invasion of privacy, and trademark infringement, seeking damages and an injunction. Smith failed to answer, but, rather than find Smith in default, the court allowed Smith additional time to answer. BidZirk subsequently moved for a preliminary injunction, which was denied by the court, and affirmed by the Fourth Circuit. Smith filed several counterclaims, but the claims were dismissed for lack of jurisdiction. BidZirk then moved for judgment on the pleadings and summary judgment, but the court denied these motions. Finally, Smith moved for summary judgment.

The court granted Smith's motion for summary judgment and imposed a $1000 sanction on BidZirk's attorney. The court disposed of the allegations of defamation and invasion of privacy, holding that Smith's blog was merely a statement of opinion, and could not be construed as highly offensive by a reasonable person. For BidZirk's trademark infringement claim, the court held that Smith had used the BidZirk trademark in a publication intended to inform the public. Thus, Smith's use was in the context of news commentary, and was protected by section 1125(c)(4)(C) of the Lanham Act. Because Smith was engaged in news reporting, and there was no evidence that the sole purpose of the blog post was to disparage BidZirk, Smith was entitled to summary judgment.

EDWARDS AND COVENANTS NOT TO COMPETE IN CALIFORNIA: LEAVE WELL ENOUGH ALONE

By David R. Trossen

The California Supreme Court recently reannounced California's stance against covenants not to compete in *Edwards v. Arthur Andersen LLP*.[1] In ruling a noncompetition agreement invalid pursuant to section 16600 of the California Business and Professions Code, the Court rejected the Ninth Circuit's "narrow-restraint" exception as an improper interpretation of California law.[2] Under the "narrow-restraint" exception, section 16600 would not invalidate a noncompetition agreement unless it restrains the employee from practicing any part of his profession, trade, or business.[3] After determining that the language of section 16600 was unambiguous, and that the legislature could have written the statute to apply only to unreasonable or overbroad restraints if it had desired to do so, the court left it to the legislature to relax section 16600's general prohibition against noncompetition clauses or to adopt additional exceptions.[4]

This decision epitomizes the California state courts' strong preference for employee mobility over employers' interest in protecting themselves from unfair competition. Part I details the statutes and case law relevant to the *Edwards* decision. Part II summarizes the facts and procedural history of *Edwards* and considers its practical impact on noncompete agreements in California. Part III considers the existing literature on the role of California's noncompetition law in the development of its economy. In particular, Part III analyzes whether the California State Legislature should modify section 16600's noncompete prohibition and concludes that, given the success of Silicon Valley and the lack of evidence showing that California's noncompetition law is a hindrance to innovation, leaving section 16600 intact is a wise decision.

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1. 189 P.3d 285 (Cal. 2008).
2. *Id.* at 290-91.
3. Campbell v. Bd. of Trs. of Leland Stanford Junior Univ., 817 F.2d 499, 502-03 (9th Cir. 1987).
4. *Edwards*, 189 P.3d at 292.

I. BACKGROUND

This section summarizes the history and law leading up to *Edwards*. Section I.A describes section 16600 of the California Business and Professions Code and its history. Section I.B reviews the Ninth Circuit's narrow-restraints exception to section 16600. Finally, Section I.C analyzes the trade-secrets exception to section 16600.

A. Historical Development of Section 16600

1. Enactment

Covenants not to compete are employer-employee contracts that provide that the employee will not, after termination of his or her employment, compete with the employer in the employer's existing or contemplated businesses for a designated period of time and within a designated geographic area.[5] The law governing covenants not to compete has traditionally been the province of the states.[6]

At common law, and under many state statutory regimes today, a restraint on the practice of a trade or occupation of a former employee is valid if reasonable.[7] By adopting California Civil Code section 1673 in 1872 (now section 16600 of the California Business and Professions Code), the California State Legislature enacted a rule generally prohibiting noncompetition agreements rather than a reasonableness approach.[8] California's noncompete law has remained virtually unchanged since.

The history of section 16600 began in 1847, when Senator David Field of New York was charged with codifying the law of the courts of record of his state.[9] Although New York never adopted Field's civil code, states newly admitted to the Union, like California, sought to impose a consistent body of law throughout their territories.[10]

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5. Chiara F. Orsini, Comment, *Protecting an Employer's Human Capital: Covenants Not To Compete and the Changing Business Environment*, 62 U. PITT. L. REV. 175, 176 (2000).

6. *See* Norman D. Bishara, *Covenants Not To Compete in a Knowledge Economy: Balancing Innovation from Employee Mobility Against Legal Protection for Human Capital Investment*, 27 BERKELEY J. EMP. & LAB. L. 287, 297 (2006).

7. Bosley Med. Group v. Abramson, 207 Cal. Rptr. 477, 480 (Ct. App. 1984).

8. *Id.*

9. Ronald J. Gilson, *The Legal Infrastructure of High Technology Industrial Districts: Silicon Valley, Route 128, and Covenants Not to Compete*, 74 N.Y.U. L. REV. 575, 613-14 (1999).

10. *Id.* at 614.

Consequently, a series of California governors urged codification of the state's laws, and eventually the legislature appointed a commission to revise and compile the laws of California.[11] The commission moved promptly to adopt Field's proposed New York Civil Code in total, and ultimately the legislature adopted a version of it.[12] Section 833 of Field's proposed New York Civil Code, adopted verbatim by the California State Legislature, was the precursor of Business and Professions Code section 16600.[13]

Today section 16600 reads: "Except as provided in this chapter, every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void."[14] Section 16600 ensures that all citizens retain the right to pursue any lawful employment and enterprise of their choice.[15]

Subsequent sections exempt three kinds of noncompetition agreements: restraints on persons who sell the goodwill of a business from carrying on a similar business (section 16601); restraints on a partner from carrying on a similar business after the dissolution of the partnership or his disassociation from it (section 16602); and restraints on a member of a limited liability company from forming a similar business after the dissolution of, or the termination of his interest in, that limited liability corporation (section 16602.5).[16] The statutory exceptions to section 16600 reflect legislative policy decisions. Section 16601, for example, reflects the policy judgment that when the goodwill of a business is sold, it is fair for the parties to contract to prohibit the seller from engaging in competition that would diminish the value of the asset he or she sells.[17]

2. *Early Judicial Interpretation*

In interpreting section 16600, the California Supreme Court has read the statutory prohibition broadly. For example, the California Supreme Court has used section 16600 to invalidate noncompetition agreements

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11. *Id.* at 615-16.
12. *Id.* at 616.
13. *Id.* Section 833 of the proposed New York code became section 1673 of the California Civil Code in 1872, which in turn became section 16600 of Business and Professions Code in 1941. *Id.* at 619.
14. CAL. BUS. & PROF. CODE § 16600 (2008).
15. Metro Traffic Control, Inc. v. Shadow Traffic Network, 27 Cal. Rptr. 2d 573, 577 (Ct. App. 1994).
16. CAL. BUS. & PROF. CODE §§ 16601-16602.5 (2008).
17. Hill Med. Corp. v. Wycoff, 103 Cal. Rptr. 2d 779, 785 (Ct. App. 2001).

that only partially restrain trade. In *Chamberlain v. Augustine* the defendant became financially interested in, and assumed control of, a competing foundry, despite the defendant's agreement not to do so as part of a contract for the sale of foundry stock.[18] In finding the agreement void pursuant to the precursor of section 16600, the court rejected the argument that the agreement was valid because it applied to only three states and allowed the defendant to act as a laborer at specifically named foundries.[19] The court noted that the statute prohibited "*every* contract by which anyone is restrained from exercising a lawful business," and made no exception for partial restraints.[20]

Some California courts have extended the reach of section 16600 by refusing to enforce choice-of-law provisions in an employment contract containing a covenant not to compete. For example, in *Application Group, Inc. v. Hunter Group, Inc.*, the court applied California law to a noncompete agreement between a Maryland employer and a Maryland resident despite a Maryland choice-of-law clause.[21] The California court opined that California has a strong interest in protecting the freedom of movement of persons whom California-based employers wish to employ, regardless of the person's state of residence or precise degree of involvement in California projects.[22]

B. The Ninth Circuit's "Narrow-Restraint" Exception to Section 16600

The Ninth Circuit created a judicial exception to section 16600 in *Campbell v. Board of Trustees of Leland Stanford Junior University.*[23]

The California Supreme Court has called the Ninth Circuit's *Campbell* interpretation of section 16600 the "narrow-restraint" exception because the interpretation upholds so-called narrow restraints, or restraints that do not entirely preclude employees from engaging in a lawful profession, trade, or business.[24] In *Campbell*, plaintiff Campbell and Stanford Univer-

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18. 156 P. 479, 479-80 (Cal. 1916).
19. *Id.* at 480.
20. *Id.* (emphasis added); *see also* Morey v. Paladini, 203 P. 760, 763-64 (Cal. 1922) (invalidating an exclusive contract for the sale of lobsters under California Civil Code section 1673, now section 16600 of the California Business and Professions Code, as being at least a partial restraint of trade).
21. 72 Cal. Rptr. 2d 73 (Ct. App. 1998).
22. *Id.* at 84-85.
23. 817 F.2d 499 (9th Cir. 1987).
24. Edwards v. Arthur Andersen LLP, 189 P.3d 285, 290 (Cal. 2008).

sity entered into a contract in which Campbell agreed to make certain revisions to the Strong-Campbell Interest Inventory (SCII) test for vocational guidance counseling.[25] Additionally, Campbell promised to refrain from preparing or causing to be published any similar work that might injure the sale of the SCII test.[26] In a breach of contract suit based on diversity jurisdiction, Campbell argued that the noncompete clause was void under section 16600.[27]

The federal district court granted summary judgment in favor of Stanford University on the validity of the noncompete, and held that California courts imply a reasonableness standard into section 16600 and that the covenant not to compete was "inherently reasonable."[28] The Ninth Circuit disagreed with the lower court's interpretation of the statute.[29] Acknowledging that the California State Legislature had rejected the common-law rule that reasonable restraints of trade are generally enforceable, the panel reasoned that section 16600 "only makes illegal those restraints which preclude one from engaging in a lawful profession, trade, or business," thus creating the "narrow-restraint" exception.[30] The court remanded the case for determination of Campbell's profession and whether the noncompete clause precluded him from pursuing it.[31]

The Ninth Circuit in *Campbell* acknowledged that California law governs the substantive issues of state law in a diversity action.[32] Accordingly, the Ninth Circuit supported its "narrow-restraint" exception to section 16600 with the California Court of Appeal case *Boughton v. Socony Mobil Oil Co.*,[33] while distinguishing the California Court of Appeal case *King v.*

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25. *Campbell*, 817 F.2d at 501. Plaintiff-appellant Campbell revised and further developed the test for career guidance counseling called the Strong Vocational Interest Blank test. The current edition of the test is identified as the Strong-Campbell Interest Inventory test. *Id.*

26. *Id.*

27. *Id.*

28. *Id.* at 502.

29. *Id.*

30. *Id.*; *see also* Edwards v. Arthur Andersen LLP, 189 P.3d 285, 290 (Cal. 2008) (labeling the *Campbell* rule a "narrow-restraint" exception).

31. *Campbell*, 817 F.2d at 503.

32. *Id.* at 501.

33. 41 Cal. Rptr. 714 (Ct. App. 1964). *Boughton* held that section 16600 did not prohibit a restriction on the use of a parcel of land as a gas station for a limited time. *Id.* at 715. The Ninth Circuit supported its interpretation of section 16600 with *Boughton*'s statement that "while the cases are uniform in refusing to enforce a contract wherein one is restrained from pursuing an *entire* business, trade, or profession, as falling within the

Gerold.[34] However, the Ninth Circuit in *Campbell* failed to mention, much less distinguish, *Chamberlain*, a California Supreme Court case that seems to reject such an exception in favor of a general rejection of *any* restraint, regardless of its purported narrowness.[35]

The Ninth Circuit applied its "narrow-restraint" exception twice more, in *General Commercial Packaging, Inc. v. TPS Packaging Engineering* and in *International Business Machines Corp. v. Bajorek*.[36] In *General Commercial Packaging*, TPS Packaging Engineering (TPS) agreed not to work directly for, or solicit business from, any company that General Commercial Packaging introduced it to and contracted it to do business for.[37] The Ninth Circuit determined that section 16600 did not invalidate General Commercial's contract with TPS unless the agreement entirely precluded TPS from pursuing its trade or business.[38] After determining that the contract did not bar TPS from soliciting work from any firm with which it had a prior relationship, the Ninth Circuit concluded that the contract only limited TPS's access to a narrow segment of the packing and shipping market, and was therefore valid.[39]

The Ninth Circuit's application of the "narrow-restraint" exception in *International Business Machines Corp. v. Bajorek* held valid an agreement that required an employee to forfeit his stock options if he worked for a competitor within six months after termination.[40] The court noted that the

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ambit of section 16600 . . . where one is barred from pursuing only a small or limited part of the business, trade or profession, the contract has been upheld as valid." *Campbell*, 817 F.2d at 502 (quoting *Boughton*, 41 Cal. Rptr. at 716).

34. 240 P.2d 710 (Cal. Ct. App. 1952). *King* upheld an agreement restricting a manufacturer from making a particular model of housing trailers. *Id* at 712. The Ninth Circuit in *Campbell* read *King* as upholding a noncompete agreement to stop making housing trailers as long as the manufacture of housing trailers in general was not prohibited by the agreement. *Campbell*, 817 F.2d at 503. The Ninth Circuit distinguished *King* as only barring the production of one particular model, rather than from prohibiting competing tests in general. *Id*.

35. *Campbell*, 817 F.2d 499. *See infra* Section II.B. for the Supreme Court of California's determination in *Edwards* that *Campbell*'s reliance on *Boughton* and *King* was misguided.

36. Gen. Commercial Packaging, Inc. v. TPS Package Eng'g, Inc., 126 F.3d 1131, 1133 (9th Cir. 1997); IBM v. Bajorek, 191 F.3d 1033, 1041 (9th Cir. 1999).

37. *Gen. Commercial Packaging, Inc.*, 126 F.3d at 1132.

38. *Id.* at 1133.

39. *Id.* at 1134.

40. *Bajorek*, 191 F.3d at 1041.

employee could have kept the value of the stock options and gone to work for a competitor immediately upon quitting, had he exercised his stock options six months before he quit.[41] Because the restraint was thereby limited, the court found the restriction to be distinguishable from a California Supreme Court case holding that section 16600 invalidated an agreement that required a worker to forfeit his pension if he ever worked for a competitor.[42]

C. The Trade-Secrets Exception to Section 16600

In addition to the statutory exemptions to section 16600, and the Ninth Circuit's "narrow-restraint" exception which was rebuked by the California Supreme Court in *Edwards*, a trade-secrets exception to section 16600 might exist. Of particular importance to the practical effects of *Edwards* on noncompete practice in California, discussed infra in Section II.C, is whether there is a trade-secrets exception to section 16600.

The Court in *Edwards* specifically declined to decide the issue, and stated in a footnote, "[w]e do not here address the applicability of the so-called trade-secrets exception to section 16600."[43]

Gordon v. Landau is the critical case on the issue of whether there is a trade-secrets exception.[44] In *Gordon*, a collector-salesman was given a set of cards on each working day containing confidential customer information such as the customer's name, address and a list of previously purchased merchandise.[45] Despite having signed an agreement to the contrary, shortly after his termination, the salesman began selling the same kind of merchandise along his old route to the customers he knew through his former employer.[46] In holding that section 16600 did not void the contract, the Supreme Court of California determined that the terms of the contract did not prevent the defendant from carrying on a business, but rather prevented him from using his employer's confidential lists for a period of one year following his termination.[47] The court determined that the contract was valid and enforceable because the list of customers was a

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41. *Id.*
42. *Id.*; *see also* Muggill v. Reuben H. Donnelley Corp., 42 Cal. Rptr. 107, 109 (Cal. 1965).
43. Edwards v. Arthur Andersen LLP, 189 P.3d 285, 291 n.4 (Cal. 2008).
44. 321 P.2d 456 (Cal. 1958).
45. *Id.* at 457-58.
46. *Id.* at 458.
47. *Id.* at 459.

valuable trade secret and that the employer was damaged by the defendant's unlawful use of that trade secret.[48]

The later Supreme Court of California case *Muggill v. Reuben H. Donnelley Corp.* created the language typically cited for the trade-secrets exception.[49] In *Muggill*, the court cited *Gordon* in dictum for the proposition that section 16600 invalidates noncompetition agreements "unless they are necessary to protect the employer's trade secrets."[50] Although many recent appellate court cases recognize the exception,[51] it may be unwise for employers to count on it as a mechanism for enforcement of noncompete clauses for two key reasons. First, the appellate courts have repeated the dictum from *Muggill* without much analysis, and the dictum may stand for nothing more than the proposition that section 16600 doesn't void or preempt California trade secrets law.[52] Secondly, even if the trade-secrets exception exists, the California courts hesitated in viewing such provisions as necessary to protect an employer's trade secrets, and have never upheld a noncompetition agreement because of the trade-secrets exception.[53] *D'sa v. Playhut* illustrates the courts' preference in interpreting a provision as restricting competition, rather than as necessary to protect trade secrets.[54]

In *D'sa*, an employee alleged that his employer hired him pursuant to an oral contract for an indefinite term.[55] Thereafter, the employer presented the employee with a confidentiality agreement, which the employee refused to sign.[56] After the employee was fired, he brought a wrongful termination claim alleging that the employment agreement contained a covenant not to compete in violation of section 16600, and that the fact that the agreement contained a severability provision making the remainder of the contract lawful did not make his termination lawful.[57]

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48. *Id.*
49. Muggill v. Reuben H. Donnelley Corp., 42 Cal. Rptr. 107 (Cal. 1965).
50. *Id.* at 109.
51. *See, e.g.*, Thompson v. Impaxx. Inc., 7 Cal. Rptr. 3d 427, 429-30 (Ct. App. 2003); Whyte v. Schlage Lock Co., 125 Cal. Rptr. 2d 277, 292-93 (Ct. App. 2002) (in dicta); ReadyLink Healthcare v. Cotton, 24 Cal. Rptr. 3d 720, 731 (Ct. App. 2005); D'sa v. Playhut, Inc., 102 Cal. Rptr. 2d 495, 500 (Ct. App. 2000).
52. *See infra* Section II.C.
53. *See infra* Section II.C.
54. *See D'sa*, 102 Cal. Rptr. 2d at 500.
55. *Id.* at 497.
56. *Id.*
57. *Id.*

The California Court of Appeals first determined that the intended purpose of the provision at hand was to create a covenant not to compete, not one to protect trade secrets.[58] As a result, the agreement was void under section 16600.[59] The court noted that other provisions of the agreement were meant to provide trade secret protection, and the covenant not to compete placed a one year restriction on the plaintiff's activities while the other provisions were not so limited.[60] After the court determined the clause invalid, it ruled in favor of the defendant, and held that it did constitute wrongful termination to fire an employee for refusing to sign an employment agreement containing an invalid covenant not to compete, even if the contract contained a severability provision that would make the lawful provisions survive.[61] The court rejected the concept that a worker, compelled by the economic necessity to secure employment, could be coerced into signing such a sweeping agreement in the uninformed hope that the agreement would not be enforced by the courts.[62]

II. CASE SUMMARY

The California Supreme Court finally rebuked the Ninth Circuit's "narrow-restraint" exception to section 16600 in *Edwards*.[63] Section II.A discusses the facts and procedural history of *Edwards*. Section II.B details the California Supreme Court's analysis. Finally, Section II.C discusses the practical impacts of *Edwards* on noncompete practice in California.

A. Facts and Procedural History

Raymond Edwards II (Edwards), a certified public accountant, was offered a position as a tax manager at the accounting firm Arthur Andersen LLP (Andersen) contingent upon his signing a noncompetition agreement.[64] The agreement prohibited Edwards: (1) for eighteen months after his termination, from performing professional services of the type he provided for any client for whom he had worked during the eighteen months prior to his termination; (2) for twelve months after his termination, from soliciting any client for whom he had worked during the eighteen months

58. *Id.* at 501.
59. *Id.*
60. *Id.*
61. *Id.* at 497.
62. *Id.* at 501.
63. Edwards v. Arthur Andersen LLP, 189 P.3d 285 (Cal. 2008).
64. *Id.* at 285.

prior to his termination; and (3) for eighteen months after his termination, from soliciting away from Andersen any of its personnel.[65]

After signing the agreement, Edwards worked for Andersen for several years, during which he moved into the firm's private client services practice group, where he handled income, gift, and estate tax planning for wealthy individuals and entities.[66] In April 2002, in response to Andersen's indictment in connection with the federal investigation of Enron, Andersen announced it would cease its United States accounting practices and began selling off its practice groups.[67] HSBC USA, Inc. (HSBC) contracted to purchase a portion of Andersen's tax practice, including Edwards's group.[68] As part of the deal, HSBC required that Andersen provide it with a completed "Termination of Non-compete Agreement" (TONC) signed by every employee on the "Restricted Employees" list, of which Edwards's name was listed on at least one draft.[69] In July 2002, HSBC offered Edwards employment, contingent on Edwards executing the TONC, which required Edwards to: (1) voluntarily resign from Andersen, (2) release Andersen from any and all claims, (3) continue indefinitely to preserve Andersen's confidential information and trade secrets except as otherwise provided by a court or government agency, (4) refrain from disparaging Andersen or its related entities or partners, and (5) cooperate with Andersen in connection with any investigation or litigation against Andersen.[70] In exchange, Andersen would agree to accept Edwards's resignation, agree to Edwards's employment by HSBC, and release Edwards from the 1997 noncompetition agreement.[71] After Edwards refused to sign the TONC Andersen terminated him and HSBC withdrew Edwards's employment offer.[72]

In April 2003, Edwards filed a complaint in California state court against Andersen for intentional interference with prospective economic advantage.[73] Edwards alleged that Andersen's noncompetition agreement

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65. *Id.*
66. *Id.* at 285-86.
67. *Id.* at 286.
68. *Id.*
69. *Id.*
70. *Id.*
71. *Id.*
72. *Id.* Edwards refused to sign the TONC, in part, because he was afraid of losing his right to indemnification from his employer. *See id.* at 286-87.
73. *Id.* at 286. In order to prove a claim for intentional interference with prospective economic advantage, a plaintiff has the burden of proving five elements: (1) an economic

violated section 16600, and therefore Andersen's demand that he give consideration to be released from it was a wrongful interference.[74] The Superior Court of Los Angeles County determined that the noncompetition agreement did not violate section 16600 because it was narrowly tailored and did not deprive Edwards of his right to pursue his profession.[75] The Court of Appeal reversed, holding that the noncompetition agreement was invalid under section 16600.[76] The Court of Appeal further held that requiring Edwards to sign the TONC as consideration to be released from it was in violation of public policy and an independently wrongful act for purposes of a claim of intentional interference with prospective economic advantage.[77]

B. The Supreme Court of California's Analysis

The Supreme Court of California affirmed the Court of Appeal's ruling that the noncompetition agreement was invalid pursuant to section 16600 because it restrained Edwards's ability to practice his profession.[78]

In reaching this conclusion, the court rejected Andersen's request that the court adopt the "narrow-restraint" exception to section 16600 that the Ninth Circuit discussed in *Campbell*.[79] The court was similarly not persuaded by the analysis of either *Boughton* or *King*.[80] Distinguishing *Boughton* because it involved a covenant not to use a parcel of land as a gasoline station, the court held that section 16600 was not implicated in that case because it involved the use of land.[81] With regards to *King*, the court emphasized that the plaintiff was allegedly selling a trailer design substantially similar to that of his former employer, the inventor of the de-

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relationship between plaintiff and a third party, with the probability of future economic benefit to the plaintiff; (2) defendant's knowledge of the relationship; (3) an intentional act by the defendant, designed to disrupt the relationship; (4) actual disruption of the relationship; and (5) economic harm to the plaintiff proximately caused by the defendant's wrongful act, including an intentional act by the defendant that is designed to disrupt the relationship between the plaintiff and a third party. *Id.* at 287.

74. *Id*.

75. *Id*.

76. Edwards v. Arthur Andersen LLP, 47 Cal. Rptr. 3d 788, 803 (Ct. App. 2006).

77. *Id*. at 804.

78. *Edwards*, 189 P.3d at 290.

79. *Id*. at 290-92.

80. *Id*. at 291-92; *see also supra* Section I.B.

81. *Edwards*, 189 P.3d at 291 (distinguishing Boughton v. Socony Mobil Oil Co., 41 Cal. Rptr. 714 (Ct. App. 1965)).

sign.[82] The court emphasized that the case involved more than the plaintiff simply manufacturing and selling competing goods.[83] Furthermore, after stating that neither *Boughton* nor *King* provides any guidance on the issue of noncompetition agreements, the court went on to say that "to the extent they are inconsistent with our analysis, we disapprove."[84]

Although the court agreed with Andersen that *Campbell* has been followed in some Ninth Circuit cases, the court stated that no reported California state court decision has endorsed the Ninth Circuit's reasoning.[85] The court emphasized that section 16600 was unambiguous, and stated that if the legislature intended the statute to apply only to restraints that were unreasonable or overbroad, it could have included language to that effect.[86]

C. The Practical Effect of *Edwards* on Noncompete Practice in California

The *Edwards* decision rebuked the Ninth Circuit's "narrow-restraint" exception to section 16600 and reaffirmed California's robust right to employee mobility. The decision recognized the statutory exceptions to section 16600's prohibition on noncompetes in connection with the sale or dissolution of a business, partnership, or limited liability corporation.[87] However, *Edwards* did not decide whether there is a trade-secrets exception to section 16600.[88]

In light of *Edwards*, employers should review their existing noncompetition agreements to make sure that they do not contain unenforceable clauses that rely on the Ninth Circuit's "narrow-restraint" exception. Employers should also redraft their employment agreements for incoming employees to remove any unlawful noncompetition clauses.

Additionally, employers should not count on the trade-secrets exception to section 16600. *Gordon*, which held a contract prohibiting a salesman from selling to customers on his former employer's secret list enforceable because the list of customers was a valuable trade secret, might be construed to only apply to activities, such as misuse of trade secrets or

82. *Id.*
83. *Id.* at 291 (distinguishing King v. Gerold, 240 P.2d 710 (Cal. Ct. App. 1952)).
84. *Id.* at 293 n.5.
85. *Id.* at 291.
86. *Id.* at 292.
87. *Id.* at 288; CAL. BUS. & PROF. CODE §§ 16601-16602.5 (2008).
88. *See supra* Section I.C.

breach of fiduciary duty, that are illegal in the absence of contract.[89] Accordingly, contracts that restrict these activities are not a restraint of a "*lawful* profession, trade or business."[90] Under this interpretation, the trade-secrets exception stands for nothing more than the proposition that section 16600 doesn't void or preempt the operation of California trade secrets law.[91]

Assuming arguendo that the proof of an interest in trade secrets might make a noncompetition agreement valid under the trade-secrets exception, an employer should not rely on the exception for enforcement of their noncompetion agreements. In particular, no California case has ever upheld a noncompetition agreement under the trade-secrets exception.[92] Hence, even if the trade-secrets exception exists, cases like *D'sa* illustrate that California courts may view skeptically noncompetition agreements alleged to be provisions legitimately protecting trade secrets.[93] Accordingly, it is unwise for employers to count on this exception in drafting noncompetition agreements.

Furthermore, an employer should be careful about firing an employee who refuses to sign an agreement containing an invalid noncompetition clause, as this may be grounds for a wrongful termination action.[94]

Additionally, employers should not count on choice-of-law provisions to ensure the enforcement of noncompetition clauses.[95] However, even though a California court might refuse to enforce a choice-of-law provision as in *Application Group*, companies with employees in other jurisdictions may still wish to include choice-of-law and choice-of-forum provisions.[96]

III. DISCUSSION

The California Supreme Court in *Edwards* declined to legitimize the Ninth Circuit's "narrow-restraint" exception to section 16600.[97] This deci-

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89. Brief for Law Professors & Writers of Learned Treatises as Amici Curiae at 12-13, *Edwards*, 189 P.3d 285.
90. *Id.*
91. *Id.*
92. *Id.* at 14.
93. *See supra* Section I.C.
94. *See supra* Section I.C.
95. *See* Orsini, *supra* note 5, at 192-93.
96. *See supra* Section I.A.
97. Edwards v. Arthur Andersen LLP, 189 P.3d 285, 291-92 (Cal. 2008).

sion raises the question of whether or not the California State Legislature should revise existing noncompetition law. This Note analyzes empirical and theoretical sources, with an emphasis on Silicon Valley, and concludes that the legislature should leave California's noncompetition law alone.

A. Regional Studies about the Effect of Noncompetition Law on the Success of Technology-Focused Economies

Many commentators have suggested that California noncompete law has played a key role in the development of California's technology sector.[98]

In particular, AnnaLee Saxenian traced the importance of high employee mobility in the development of the Silicon Valley. After noting, inter alia, that the Silicon Valley was distinguished by unusually high levels of job hopping, and that the job tenures of the region's computer professionals averaged two years during the 1970s, Saxenian concluded that this fluid environment accelerated the diffusion of technological capabilities and know-how in the region.[99] Saxenian posited that when engineers moved between companies, they took with them knowledge, skills, and experience from their previous jobs that created a localized accumulation of knowledge that enhanced the viability of Silicon Valley startups.[100]

Likewise, Professor Ronald Gilson posits that California's lack of enforcement of covenants not to compete played a pivotal role in the Silicon Valley's triumph over the similarly technology-focused region in Massachusetts called Route 128.[101] Gilson suggested that California's general prohibition against noncompetes, as contrasted to Massachusetts' general enforcement of them under a reasonableness approach, explains how Silicon Valley has continued its economic success, while Route 128's economic prosperity waned.[102] According to Gilson, much of a company's intellectual property is embedded within the tacit knowledge[103] of its employees.[104] Section 16600 creates an easy path for employees to move be-

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98. *See, e.g.*, ANNALEE SAXENIAN, REGIONAL ADVANTAGE: CULTURE AND COMPETITION IN SILICON VALLEY AND ROUTE 128 (1994); Gilson, *supra* note 9, at 627.

99. SAXENIAN, *supra* note 98, at 34-37.

100. *Id.* at 37.

101. *See* Gilson, *supra* note 9, at 608-09.

102. *Id.* at 594, 608-09.

103. "'Tacit knowledge' is the skill or expertise, as opposed to easily codifiable information, that employees acquire through experience." *Id.* at 577 n.10.

104. *Id.* at 594.

tween employers, and take with them and apply in their new position their former employer's tacit knowledge.[105] California's legal infrastructure of noncompetition has caused employers to adopt a strategy of simultaneous cooperation and competition, which in turn generated a dynamic process leading to Silicon Valley's characteristic career pattern, lack of vertical integration, knowledge spillovers, and business culture.[106] Thus, the legal infrastructure generated the initial conditions which ultimately caused Silicon Valley to thrive.[107] In contrast, the widespread use and enforcement of covenants not to compete in Massachusetts slowed employee mobility below the threshold necessary to support continued regional economic success.[108]

Gilson and Saxenian agree that knowledge spillover is of primary importance in sustaining a technology-based economy. Gilson also claims that noncompetition law is a casual underpinning to the creation of the culture of the region and ultimately led to the Valley's success. Based on these studies, it would appear at first glance that the California State Legislature should not modify section 16600.

However, despite the success of the Silicon Valley under California's existing noncompetition law, a later analysis including Austin, Texas, and the Research Triangle in North Carolina, indicates that Gilson's emphasis on noncompete law as a driving force of sustainable economic success in a technology-based economy is either overemphasized or obscured by other factors in the complex industrial development equation.[109] Despite a wide diversity in noncompetition law, with California and Texas being reluctant to enforce such covenants and North Carolina and Massachusetts favoring enforcement,[110] Jason Wood found that in the years following Gilson's

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105. *Id.* at 593, 608.

106. *Id.* at 608-09.

107. *See id.* at 609.

108. *See id.* at 602-03.

109. *See generally* Jason S. Wood, *A Comparison of the Enforceability of Covenants Not To Compete and Recent Economic Histories of Four High Technology Regions*, 5 VA. J.L. & TECH. 14 (2000).

110. As discussed *supra* in Section I.A., postemployment covenants not to compete are generally unenforceable in California. In Massachusetts, which is generally representative of the approach taken by the great majority of states, postemployment covenants are enforced, under a rule of reason, if the covenant's duration and geographic coverage are no greater than necessary to protect an employer's legitimate business interest and not otherwise contrary to the public interest. Gilson, *supra* note 9, at 603-04. In Texas, noncompetes are evaluated under a four factor rule of reason, although in practice the Texas Supreme Court has generally refused to enforce covenants not to compete by virtually

study, all four of these regions have enjoyed high levels of economic success.[111] In particular, since Gilson's article, the technology section in the Route 128 area rebounded economically, and the Research Triangle in North Carolina exhibited the largest rate of entrepreneurial growth.[112] Despite California's continued lead in venture capital investment in absolute dollars, Wood questioned how important a region's noncompetition law is in the development and growth of a complex technology-based economy.

From these studies, it is difficult to determine if California's choice of noncompetition law hindered or helped Silicon Valley's economy. For example, proximity to elite universities, the awarding of government contracts, the interaction of universities with local businesses, attractive weather and geography, cultural perceptions of risk, industry associations, nonhierarchical management, and lack of vertical integration—rather than noncompetion law—might be the real factors leading to the success of Silicon Valley.[113] Accordingly, comparing the noncompetition law in various regions to the economic success of those regions does not convincingly demonstrate the optimum form of noncompetition law. Therefore, in considering whether the legislature should modify California's noncompetition law, a more tractable approach is to determine if major negative effects have materialized from California's choice of noncompetition law.

B. Institutional Developments Have Mitigated the Drawbacks of California's Noncompete Law

Silicon Valley has developed unique solutions to overcome each major drawback accompanying California's noncompetition law.[114] Accordingly, even assuming arguendo that laws more permissive to noncompete contracting were optimal ex ante, reliance and the Valley's success in mitigating or overcoming these drawbacks make retention of the law optimal.

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always invalidating the agreements under the rule of reason factors. Wood, *supra* note 109, at 29. North Carolina also follows a rule of reason approach, although unlike Massachusetts, North Carolina requires a few additional factors, such as valuable consideration, which makes it somewhat tougher for employers to enforce such agreements. *Id.* at 25-26.

111. Wood, *supra* note 109, at 44.

112. *Id.* at 39, 48-49.

113. SAXENIAN, *supra* note 98, at 29-57.

114. *See supra* Section II.B.

This Note will now address the two most important critiques of California's noncompetition law: (1) disincentive to employers to provide employee training, and (2) employer reduction in investment in research and development due to deteriorated trade secret and misappropriation protection.

1. Disincentive to Provide Employee Training

Commentators have suggested that high employee mobility and concern over employee poaching may undermine an employer's incentive to invest in training.[115] Under this theory, firms operating in a regime with limited recourse to noncompete agreements perceive they cannot count on returns on investment in human capital and therefore inefficiently underinvest in their employees.[116]

Assuming arguendo that these commentators are correct in their hypothesis, Silicon Valley appears to have addressed this limitation of weak noncompete law with a unique solution: a labor market that facilitates the rapid hiring and shedding of labor. By making it easy for employers to obtain employees with specific skills and experience, the importance of encouraging employer investment in training homegrown employees lacking the requisite skills may decrease. Hence, a mobile work force of specialized employees that can be matched to specific jobs at a low transaction cost might shift the optimal point of employer investment in employee training downward.

In Silicon Valley, employers hire for specific skill sets and experience, and accordingly, they are able to eliminate some job training, job ladders, and mentoring because of specific labor market institutions that match specific skills with specific needs.[117] Accordingly, Silicon Valley uses temporary employees—employees of temporary help agencies—at twice the national rate.[118] In high tech, temporary employees do not just work in such traditional temporary positions as secretaries and receptionists, they also work in technical jobs such as programming and manufacturing.[119]

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115. *See* Gillian Lester, *Restrictive Covenants, Employee Training, and the Limits of Transaction-Cost Analysis*, 76 IND. L.J. 49, 75 (2001); Bishara, *supra* note 6, at 303.

116. *See* Lester, *supra* note 115, at 75-76.

117. ALAN HYDE, WORKING IN SILICON VALLEY 96 (2003).

118. *Id.* at 98.

119. *Id.*

The nature of the job market led one executive of AT&T to say, "'[j]obs' are being replaced by 'projects' and 'fields of work.'"[120]

Saxenian also determined that the while Silicon Valley's social and professional networks disseminate technical and market information, they also function as efficient job search networks.[121] Accordingly, the Valley's social and professional networks may have evolved to help address the need for easy acquisition of highly specialized labor as an alternative to employer training of existing labor.

Silicon Valley also extensively uses electronic job sites to match workers to jobs.[122] Electronic recruiting, on websites such as hotjobs.com and careerbuilder.com, supports the short-term hiring of individuals with particular skills, as opposed to long-term commitment to individuals who would be trained and retrained for changing roles.[123] These electronic recruiting sites facilitate information flow in the labor market and reduce employee search costs, thereby making it possible for an employer to rely on a mobile labor market rather than a homegrown work force.[124]

Silicon Valley's infrastructure supporting the matching of qualified employees to specialized jobs has decreased the importance and need to encourage employer investment in training. In order to secure investment in employee training where employer training is necessary, such as for skilled employees whose demand exceeds the supply, alternative methods to noncompetes can be used to prevent employee loss. For example, Professor Bishara has suggested that employers may be able to secure costly investment in valuable employees by potentially lucrative yet-to-vest stock options, other forms of delayed compensation, or simply by encouraging employee ownership.[125]

As an alternative to employer-provided training, employers may also emphasize skill development by using competency-based organization, whereby employees are paid for the skills they have, rather than under traditional job evaluation formulas.[126] According to this management style, skill-based pay gives employees an incentive to acquire new skills on their

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120. Katherine V.W. Stone, *Knowledge at Work: Disputes over the Ownership of Human Capital in the Changing Workplace*, 34 CONN. L. REV. 721, 728-29 (2002).

121. SAXENIAN, *supra* note 98, at 32-34.

122. HYDE, *supra* note 117, at 143-45.

123. *Id.* at 145-46.

124. *Id.* at 143-44.

125. Bishara, *supra* note 6, at 296.

126. *See* Stone, *supra* note 120, at 733-34.

own, and they will pressure employers to provide training development opportunities.[127]

The alternative methods to employer-provided training coupled with Silicon Valley's hiring practices and unique labor market make up for any employer disincentive to provide training that might exist under *Edwards* or section 16600 in general.

2. *Effect of Research and Development Investment*

Commentators have suggested that protecting trade secrets in high technology is important in order to encourage investment in research and development (R&D).[128] Most of the results of R&D are not patentable.[129] Without protection for trade secrets, firms would have reduced incentives to invest in R&D and instead may invest financial resources in raising salaries so as to draw creative employees from firms that have made investments in R&D.[130] Thus, in theory, rival firms could free ride on firms rather than invest in R&D.

To assess the validity of this contention, it is first necessary to evaluate whether or not weak noncompete law leads to the underenforcement of trade secret law. Although this statement has not been definitively or otherwise proved, many commentators have suggested that high employee mobility weakens trade secret protection.[131] But assuming California's noncompetition law has weakened its trade secret protection, has this caused underinvestment in R&D?

There are several explanations why firms might continue to produce technological information even if it cannot be excluded from competitors in a highly mobile labor market. For example, firms might make so much money from technological change that R&D is still their best investment, despite the cyclical turnover of their labor force.[132] Under this theory, a

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127. *Id.* at 734.

128. Yuval Feldman, *Experimental Approach to the Study of Normative Failures: Divulging of Trade Secrets by Silicon Valley Employees*, 2003 U. ILL. J.L. TECH. & POL'Y 105, 120 (2003).

129. *Id.*

130. *Id.*

131. *See* Gilson, *supra* note 9, at 594-96 (Silicon Valley firms have been unable to prevent knowledge spillover because of the legal infrastructures failure to provide complete protection for an important category of intellectual property); Feldman, *supra* note 128, at 117 (trade secret disclosure correlates with non-compete contracts).

132. *See* HYDE, *supra* note 117, at 50-54.

firm may still invest in R&D *and* accept its loss resulting from high turnover as a cost of doing business.[133]

Increased information spillover also reduces the level of R&D necessary to achieve a given cost reduction.[134] For example, in Silicon Valley, informal information exchange about technical matters facilitates rapid technological advancement at reduced costs.[135] Analogously, the reduction in the cost of R&D resulting from receiving competitors' trade secrets might *exceed* the investment loss resulting from spillover, making it profitable for the firm to nevertheless invest in research and development.

Additionally, some of a firm's trade secrets might be embedded in firm-specific form, and therefore would not be as valuable to competitors.[136] Professor Kenneth Arrow posits that each firm has a way of *coding* information which need not be uniquely optimal, like the multiplicity of human languages.[137] This firm-specific aspect of information makes it less valuable to rivals.[138]

One study showed that research and development experience from previous employers has a positive and significant impact on an employee's wages.[139] Accordingly, because employees may be on the market soon, they have maximum financial incentives to produce valuable information for their current employer.

Retention of employees by means other than noncompete agreements can also make investment in R&D profitable. Stock options may be useful in retaining employees with valuable information. Technology firms grant options three times as aggressively as non-technology firms, and stock options are used particularly generously in Silicon Valley firms.[140] Although studies question the relation between stock option grants and employee retention, stock options might be effective in binding employees for a few additional years who would otherwise leave sooner.[141] In high technology

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133. *See* SAXENIAN, *supra* note 98, at 35.

134. HYDE, *supra* note 117, at 50-54.

135. SAXENIAN, *supra* note 98, at 33.

136. Kenneth J. Arrow, *The Economics of Information: An Exposition*, 23 EMPIRICA 119, 126-27 (1996).

137. *Id.* at 127.

138. *Id.* at 126-27.

139. Jarle Møen, *Is Mobility of Technical Personnel a Source of R&D Spillovers?* 17 (Nat'l Bureau of Econ. Research, Working Paper No. 7834, 2000), *available at* http://www.nber.org/papers/w7834.

140. HYDE, *supra* note 117, at 187-88.

141. *Id.* at 190.

industries where trade secrets are of a time-sensitive nature due to obsolescence from technological progress, stock option compensation may prove to be an effective tool in retaining critical employees and preventing the spillover of critical information.

In conclusion, employer alternatives to noncompete agreements, the positive effects of information spillover, and the firm-specific nature of some trade secrets counterbalances any employer disincentive to invest in R&D that might exist under *Edwards* or section 16600 in general.

IV. CONCLUSION

The Supreme Court in *Edwards* rejected the Ninth Circuit's "narrow-restraint" exception as an improper interpretation of California law. In many ways this case can be seen simply as the California Supreme Court rebuking the Ninth Circuit for interfering with the province of the state by trailblazing a judicial exception to section 16600. However, *Edwards* also stands for the court's prudent approach to California noncompete law: leave well enough alone.

In particular, despite the theoretical debate on optimal noncompetition law, employer backlash from a jurisdiction without covenants not to compete as labor investment protection has not materialized within Silicon Valley.[142] Rather, the Valley continues to thrive as evidenced by California's continued lead in venture capital investment in absolute dollars.[143] Whether firms continue to invest in the Valley *despite* California's noncompete law or whether a highly mobile labor market aids in the Valley's success is uncertain. The problem of promoting technological growth is very complex, but until the evidence clearly shows that California's noncompetition law is a hindrance to innovation, leaving section 16600 intact is a wise decision.

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142. Bishara, *supra* note 6, at 309.

143. Wood, *supra* note 107, at 39, 48-49. However, the landscape of venture capital investment might be in for a radical change due to the 2008 banking meltdown. It would be prudent to compare the venture capital investment in technological innovation across the United States as the economic crisis progresses.

ADDITIONAL DEVELOPMENTS—TRADE SECRETS

CYPRESS SEMICONDUCTOR CORP. V. SUPERIOR COURT

77 Cal. Rptr. 3d 685 (6th Dist. 2008)

In *Cypress*, the Court of Appeal for the Sixth District of California unanimously held that the trial court erred in its reading and application of the California Uniform Trade Secrets Act (CUTSA). The court held that the statute of limitations for a trade secret misappropriation claim does not hinge on a third party having actual notice from the trade secret owner that the information is a trade secret. Rather, the statute of limitations begins to run when the trade secret owner has any reason to suspect that a third party knows, or reasonably should know, that the information is a trade secret.

In 1998, a former employee of Silvaco Data Systems joined Circuit Systems, Inc. (CSI), and incorporated trade secrets from Silvaco's SmartSpice electronic design automation software into CSI's DynaSpice software. In 2000, Silvaco sued both the employee and CSI for trade secret misappropriation. Silvaco did not notify or file claims against licensed DynaSpice users, but Silvaco's suit was publicized in relevant trade publications and on various web sites. Silvaco and CSI settled the suit in 2003, with a stipulated judgment that CSI incorporated Silvaco's trade secrets into the DynaSpice product. Cypress Semiconductor Corporation, a customer of CSI and licensee of DynaSpice software, learned of the settlement in August 2003. Silvaco directly contacted Cypress one month later, insisting that Cypress stop using the DynaSpice product. Allegedly, Cypress continued to use DynaSpice despite this notice. In May 2004, Silvaco sued Cypress for trade secret misappropriation.

At trial, Cypress attempted to employ a statute of limitations defense. Cypress argued that its use of the DynaSpice software was a continuation of CSI's unauthorized use of the trade secret. According to Cypress, section 3426.6 of the CUTSA required Silvaco to file a trade secret misappropriation claim within three years of when Silvaco first suspected unauthorized use by CSI, not Cypress. Therefore, because Silvaco did not file claims against Cypress in 2000, when it first suspected misappropriation by CSI, the three-year statute of limitations had expired by the time of the May 2004 complaint. Silvaco countered that the statute of limitations under the CUTSA did not begin to run until Cypress had

knowledge of the trade secret misappropriation, which occurred in 2003. The trial court concluded that, because Cypress could not have been charged with misappropriation until it knew of the wrongfulness of its conduct, the statute of limitations for the offense did not begin to run until Cypress acquired knowledge of CSI's misappropriation in August 2003. Therefore, Silvaco's 2004 complaint against Cypress fell within the CUTSA's three-year statute of limitations. Cypress filed a petition for writ of mandate, and the Sixth District Court of Appeal granted the petition.

The Sixth District rejected Cypress's argument that its trade secret misappropriation was merely a continuation of CSI's unauthorized use. In holding that Cypress's use constituted an independent misappropriation, the court observed that Cypress was not the original unauthorized user of the trade secret, did not have a direct relationship with Silvaco, and had allegedly committed a different form of misappropriation. To hold that Cypress's misappropriation fell within CSI's unauthorized use, the court reasoned, would allow third parties to simply wait out the three-year statute of limitations for the original misappropriation, and then use the trade secret without liability. To avoid such unjust results, the court held that "a plaintiff may have more than one *claim* for misappropriation, each with its own statute of limitations, when more than one defendant is involved."

The court also rejected the lower court's interpretation of the trigger for the statute of limitations under the CUTSA. The court observed that the statute of limitations for a cause of action does not wait for a plaintiff to have all the evidence required for a winning claim. Rather, suspicion of one or more elements of a claim, in conjunction with knowledge of any remaining elements, is sufficient to start the clock. Therefore, the trial court erred in focusing on whether Cypress knew of the misappropriation, rather than determining whether Silvaco had reason to suspect that unidentified users of CSI's product knew or should have known that the product contained misappropriated trade secrets.

FAIR HOUSING COUNCIL V. ROOMMATES.COM: A NEW PATH FOR SECTION 230 IMMUNITY

By Varty Defterderian

Over the years, there have been various terms for the notion that the Internet was something fundamentally different than any communications system or environment that came before it, and thus deserving of a different set of rules.[1] Whether called *digital* or *cyberlibertarianism*,[2] *cyberspace*[3] or *internet exceptionalism*,[4] the underlying concept was the same: "the online environment should . . . be permitted to develop its own discrete system of legal rules and regulatory processes" without "the imposition of existing offline legal systems grounded in territorially-based sovereignty."[5] Internet exceptionalism posits that cyberspace should be free from legal oversight because the fluid and constantly-evolving nature of the Internet and its technologies would independently develop more effective rules of conduct.[6]

Many have deemed section 230 of the Communications Decency Act (CDA), which grants immunity to online service providers for content provided by third parties, as "a flagship example of such exceptionalism."[7] Section 230's safe harbor grants online service providers (OSPs)[8] a

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1. *See* Lawrence Lessig, Commentaries, *The Law of the Horse: What Cyberlaw Might Teach*, 113 HARV. L. REV. 501, 505, 513 (1999).

2. H. Brian Holland, *In Defense of Online Intermediary Immunity: Facilitating Communities of Modified Exceptionalism*, 56 U. KAN. L. REV. 369, 377 (2008) (describing a vision of "freedom, liberty, and self-regulation" for online environments).

3. Posting of Eric Goldman to Technology & Marketing Law Blog, Roommates.com Denied 230 Immunity by Ninth Circuit En Banc (With My Comments), http://blog.ericgoldman.org/archives/2008/04/roommatescom_de_1.htm (April 3, 2008, 20:05:00 PST) (a belief that "the Internet was unique/special/different and therefore should be regulated differently").

4. Holland, *supra* note 2, at 376 (Internet exceptionalism "presumes that cyberspace cannot be confined by physical borders or controlled by traditional sovereign governments.").

5. *Id.* at 378.

6. *Id.* at 377.

7. 47 U.S.C. § 230 (2006); *Posting of Eric Goldman*, *supra* note 3. *See* Holland, *supra* note 2, at 388 ("Section 230 as a Form of CyberLibertarian Exceptionalism"); Post-

unique status; they receive immunity for behavior that would otherwise create liability in their brick-and-mortar counterparts. As one commentator noted,

> [t]his expansion has created an environment in which many of the norms and regulatory mechanisms present in the offline world are effectively inapplicable. This is so not because the very nature of cyberspace makes such application impossible, or because sovereign law is necessarily ineffective or invalid, but rather because sovereign law has affirmatively created that condition.[9]

In enacting section 230, the legislature effectively created a shield from liability to OSPs unavailable to their offline counterparts.[10]

Yet, a recent 2008 Ninth Circuit opinion, *Fair Housing Councils v. Roommates.com* (*Roommates.com*), seems to call for the end for such cyber exceptionalism.[11] This Note explores this attempt at curtailing the scope of section 230 immunity. Part I provides an overview of the safe harbor, including prior judicial interpretations of contributory liability under the statute. Part II discusses the *Roommates.com* decision and its new and somewhat controversial rubric for liability. Part III attempts to make sense of the opinion's new direction. This Note then addresses the shortcomings of such a liability scheme and the ironically minimal practical effect such an unprecedented interpretation creates. The Note concludes by advocating that such massive doctrinal and policy changes are best left to the Legislature.[12]

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ing of Adam Thierer to The Technology Liberation Front, Web 2.0, Section 230, and Nozick's "Utopia of Utopias", http://techliberation.com/2009/01/13/web-20-section-230-and-nozicks-utopia-of-utopias, (Jan. 13, 2009) ("In many ways, section 230 is the cornerstone of 'Internet freedom' in its truest and best sense of the term.").

8. In this Note, the term "online service provider" or "OSP" is used interchangeably with "interactive computer service" to denote "any entity providing access by users to information contained in a networked computer server." *See* Keith Silver, *Good Samaritans in Cyberspace*, 23 RUTGERS COMPUTER & TECH. L.J. 1, 1 n.1 (1997). OSPs include not only Internet service providers (typically known as ISPs), but also the operators of bulletin board services, websites, web portals, and other information services.

9. Holland, *supra* note 2, at 388.

10. 141 Congressional Record H8470 (daily ed., Aug. 4, 1995) (statement of Rep. Cox) ("it will establish as the policy of the United States that we do not wish to have content regulation by the Federal government of what is on the Internet . . . .").

11. Fair Hous. Council v. Roommates.com, LLC, 521 F.3d 1157 (9th Cir. 2008).

12. Though *Roommates.com* dramatically departs from section 230 jurisprudence, the practical effect will be minimal.

I. SECTION 230: THE STATUTORY LANDSCAPE

In 1996, Congress enacted section 230, which mandates that "no provider or user of an interactive computer service shall be treated as the publisher or speaker of any information provided by another information content provider."[13] This Part first examines the liability landscape for online service providers prior to section 230, specifically looking to the case that inspired the passage of the statute. Section I.B provides an overview of Section 230, including congressional intent behind enacting the statute. Finally, Section I.C discusses subsequent judicial interpretation exempting OSPs from contributory liability for third party content.

A. The Catalyst That Brought About the Communications Decency Act Safe Harbor: *Stratton Oakmont, Inc. v. Prodigy Services, Co.*

Prior to section 230, common law governed liability for publication of materials among online service providers by analogy to their brick and mortar equivalents. Specifically, liability hinged on whether the service providers exercised any editorial control. If so, they were relegated to the status of publishers of the content and exposed to liability. *Stratton Oakmont, Inc. v. Prodigy Services Co.* illustrates this distinction and exemplifies the resulting problematic conclusions.[14]

In 1995, Stratton Oakmont, a securities investment banking firm, brought a defamation suit against Prodigy, owner and operator of a computer network whose members communicated with each other via Prodigy's bulletin boards.[15] Stratton Oakmont was concerned about several libelous posts on Prodigy's boards characterizing them as unethical and criminal.[16] Under common law defamation principles, publishers are subject to contributory liability for third-party content, whereas mere distributors are not.[17] Because it considered Prodigy a publisher, the court granted Stratton's motion for partial summary judgment.[18] The court based its decision on several factors, all of which stemmed from Prodigy's "exer-

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13. 47 U.S.C. § 230(c)(1).

14. Stratton Oakmont, Inc. v. Prodigy Servs. Co., No. 31063/94, 1995 WL 323710 (N.Y. Sup. Ct. May 24, 1995).

15. *Id.* at *1.

16. *Id.*

17. *See, e.g.*, Cubby, Inc. v. Compuserve Inc., 776 F. Supp. 135, 139 (S.D.N.Y. 1991) ("With respect to entities such as news vendors, book stores, and libraries, however, 'New York courts have long held that vendors and distributors of defamatory publications are not liable if they neither know nor have reason to know of the defamation.'").

18. *Stratton Oakmont, Inc.*, 1995 WL 323710, at *1.

cis[ing] editorial control" over the content of posts on their message boards.[19] This editorial control included the circulation of guidelines for acceptable content, the use of screening software, and Prodigy's implied self-analogy to a "'responsible newspaper.'"[20]

Though the court maintained that online message boards should generally be treated like bookstores, libraries, or other distributors, rather than like publishers of content, it found Prodigy to be an exception.[21] The court emphasized the differences between passive and active service providers. Because distributors were "*passive* receptacle[s] or conduit[s]," they would escape liability.[22] In contrast, "exercise of editorial control and judgment" placed service providers, like newspapers, squarely within the bounds of publisher liability.[23] Therefore, any attempt to filter, edit or even sort the content would be an act of editorial control, burdening proactive service providers with greater liability than those that left all data posted to their servers untouched. The *Stratton Oakmont* ruling thus severely limited incentives to self-police one's website for illegal third-party content.[24]

B. The Communications Decency Act and Section 230

Congress moved swiftly to counteract the *Stratton Oakmont* outcome.[25] The Communications Decency Act of 1996 (CDA) established a safe harbor for interactive computer services from liability arising from

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19. *Id.* at *2.
20. *Id.* at *1-2.
21. *Id.* at *4.
22. *Id.* at *3 (emphasis added).
23. *Id.* at *3.
24. The court considered the implications of this decision, though it summarily disregarded any serious disincentives, reasoning that the market would produce sites willing to police content. "[T]he fear that this Court's finding of publisher status for PRODIGY will compel all computer networks to abdicate control of their bulletin boards, incorrectly presumes that the market will refuse to compensate network for its increased control and the resulting increased exposure." *Id.* at *5.
25. The legislative history specifically criticized the *Stratton Oakmont* and similar decisions that had relegated OSPs to publisher status because they took steps to restrict access to objectionable third-party content that they played no role in creating. S. REP. NO. 104-230, 194 (1996); *see also* 141 CONG. REC. H8469-H8470 (daily ed., Aug. 4, 1995) (statement of Rep. Cox, referring to disincentives created by *Stratton Oakmont* decision, "We want to encourage people like Prodigy. . . to do everything possible for us, the customer, to help us control, at the portals of our computer, at the front door of our house, what comes in and what our children see."); *see* H.R. REP. NO. 104-458, 194 (1996) ("The conferees believe that [decisions like *Stratton Oakmont*] create serious obstacles to the important federal policy of empowering parents to determine the content of communications their children receive through interactive computer services.").

content generated by third-parties.[26] This section discusses the requirements for section 230 immunity and then explores the legislative intent and general judicial interpretation surrounding the statute.

Section 230 immunizes defendants who meet the following three requirements, explicated by the Fourth Circuit in *Zeran v. America Online, Inc.*: (1) the defendant must be a provider or user of the interactive computer service, (2) holding the defendant liable would treat it as a publisher or speaker of third-party content, and (3) the defendant must not have developed or created, in whole or in part, the content at issue.[27] Entitled "Protection for 'Good Samaritan' blocking and screening of offensive material," this section prohibits OSPs from being regarded as either the speaker or publisher of content provided by a third party.[28]

The third prong of the *Zeran* test bars immunity for online entities that are also "information content provider[s]," defined as those who create or develop, either completely or in part, information available on the Internet that is at issue in the suit.[29] Thus, OSPs that are actually generating the disputed content are excluded from immunity.

In enacting section 230, Congress explicitly relied on five premises, two of which are pertinent: first, that there is an inherent benefit in the increased user control offered by such online services;[30] second, that both the Internet and OSPs have thrived under minimal government oversight, to the advantage of the general public.[31] Accordingly, the Legislature intended section 230 to play a role in a larger policy scheme of "preserv[ing] the vibrant and competitive free market that presently exists," and encour-

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26. The Communications Decency Act was passed as an amendment to the Telecommunications Act of 1996. Pub. L. No. 104-104, 110 Stat. 56 (codified as amended in scattered sections of 47 U.S.C.).

27. Zeran v. Am. Online, Inc., 129 F.3d 327, 330 (4th Cir. 1997), see discussion *infra* Section I.C; Cecilia Ziniti, Note, *The Optimal Liability System for Online Service Providers: How* Zeran v. America Online *Got it Right and Web 2.0 Proves It*, 23 BERKELEY TECH. L.J. 583, 586 (2008) (discussing *Zeran*, "[t]hough it did not characterize it exactly as such, the *Zeran* court laid out what in effect functions as a three-part test for § 230(c)(1) immunity"). Section 230 further removes civil liability for restricting access or enabling such restriction of obscene or otherwise objectionable content, regardless of whether it is afforded constitutional protection. 47 U.S.C. § 230(c)(2) (2006). The goal is to remove liability for OSPs that vigorously police their networks, and in the process inadvertently end up removing constitutionally protected speech.

28. 47 U.S.C. § 230(c)(1) (2006).

29. 47 U.S.C. § 230(f)(3) (2006). Interactive computer services are "entit[ies] providing access by users to information contained in a networked computer server." Silver, *supra* note 8, at 1 n.1.

30. 47 U.S.C. § 230(a)(2) (2006).

31. 47 U.S.C. § 230(a)(4) (2006).

aging development of both the Internet and technologies aimed at enhancing user control.[32]

Guided by such legislative intent, the majority of federal courts have construed section 230 broadly, granting immunity for all causes of actions seeking to hold OSPs liable for content created or developed by their third-party users.[33] In accord with the express congressional finding that OSPs "offer a forum for a true diversity of political discourse, unique opportunities for cultural development, and myriad avenues for intellectual activity,"[34] courts have read into the statute a Congressional intent to protect and encourage the development of the freedom of internet speech.[35] In granting OSPs a special carve-out in the law and thereby keeping online government interference to a minimum, Congress attempted to ensure a robust marketplace of ideas and information in the realm of internet communication.[36] Thus, the statute immunizes an OSP defendant from suits that deem it as either the publisher or speaker of content that originates from someone else.[37] Under the safe harbor provision of section 230, an injured party "cannot sue the messenger."[38]

Though there is room for flexibility in the statute to limit this broad reading, most courts continue to interpret the immunity broadly to include both distributor and publisher liability.[39] And in the eleven years since the first broad judicial interpretation of section 230 in *Zeran*[40] Congress could

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32. 47 U.S.C. § 230(b)(1)-(3) (2006).

33. *See, e.g.*, Perfect 10, Inc. v. CCBill LLC, 488 F.3d 1102, 1118 (9th Cir. 2007); Blumenthal v. Drudge, 992 F. Supp. 44, 50 (D.D.C. 1998). The court held that:

> there simply is no evidence here that AOL had any role in creating or developing any of the information in the Drudge Report. . . . AOL was nothing more than a provider of an interactive computer service on which the Drudge Report was carried, and . . . shall not be treated as a "publisher or speaker" and therefore may not be held liable in tort.

Id.

34. 47 U.S.C. § 230(a)(3) (2006).

35. *See, e.g.*, Zeran v. Am. Online, Inc., 129 F.3d 327, 330 (4th Cir. 1997) ("Congress recognized the threat that tort-based lawsuits pose to freedom of speech in the new and burgeoning Internet medium."); Batzel v. Smith, 333 F.3d 1018, 1027 (9th Cir. 2003) ("[C]ongress wanted to encourage the unfettered and unregulated development of free speech on the Internet, and to promote the development of e-commerce.").

36. *See Zeran*, 129 F.3d at 330; *Batzel*, 333 F.3d at 1033.

37. 47 U.S.C. § 230(c) (2006).

38. Chicago Lawyers' Comm. for Civil Rights Under Law, Inc. v. Craigslist, Inc., 519 F.3d 666, 672 (7th Cir. 2008).

39. *See infra* Section II.C.

40. *Zeran*, 129 F.3d at 330.

have amended the statute but has not yet seen fit to.[41] This legislative acquiescence suggests that the courts got it right.[42]

C. Liability for Third-Party Content Under Section 230

Courts have broadly interpreted the OSP immunity provision of Section 230.

In 1997, in *Zeran v. American Online, Inc.*, the Fourth Circuit became the first appellate court to interpret the scope of the safe harbor.[43] The plaintiff, Zeran, sought to hold AOL liable for defamatory messages posted on AOL bulletin boards by an unidentified third party.[44] In the complaint, Zeran highlighted AOL's delay in removing the posted messages, refusal to post a retraction, and failure to screen for essentially identical postings.[45] Zeran argued that, although section 230 eliminated publisher liability, it left distributor liability intact.[46] The court was unconvinced; relying on the plain language of the statute, it held that distributors were a subset of the more expansive category of publishers. Therefore, immunity must necessarily extend to distributors as well as to publishers.[47] The court barred suits against service providers for their exercise of what the court deemed "a publisher's traditional editorial functions" such as discretion over publication, removal, and modification of content.[48]

The court focused on the legislative intent regarding internet exceptionalism and maintained that the Legislature explicitly chose not to use

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41. See Lisa Guernsey, EBay Not Liable for Goods That Are Illegal, Judge Says, N.Y. TIMES, Nov. 13, 2000, at C2; Susan Estrich, Should Internet protect against defamation?, USA TODAY, Aug. 29, 2001, at 13; Marc S. Reisler, Internet Issues: Differing Statutes, 231 N.Y. L.J. 5 (2004); Adam Liptak, Ideas & Trends: The Ads Discriminate, but Does the Web?, N.Y. TIMES, March 5, 2006, § 4, at 16; Protection for Web Publishers, N.Y. TIMES, Nov. 21, 2006, at C6. Even courts have noted that

> [t]he fact that . . . [Congress] has not amended section 230 to add a similar provision in the 10 years since it was enacted, or in the eight years since the example of the DMCA has been in existence, strongly supports the conclusion that Congress did not intend to permit notice liability under the CDA.

Barrett v. Rosenthal, 146 P.3d 510, 520 (Cal. 2006).

42. *See* 73 AM. JUR. 2D STATUTES § 84 (2008); United States v. Elgin, J. & E. Ry., 298 U.S. 492, 500 (1936) ("Notwithstanding the intent imputed to Congress . . . no amendment has been made to the commodities clause. We must therefore conclude that the interpretation of the act then accepted has legislative approval.").

43. 129 F.3d 327 (4th Cir. 1997).

44. *Id.* at 328-29.

45. *Id.* at 328.

46. *Id.* at 332 ("[D]istributors must at a minimum have knowledge of the existence of a defamatory statement as a prerequisite to liability.").

47. *Id.*

48. *Id.* at 330.

tort liability against OSPs to deter objectionable internet speech when those OSPs are simply a means of access and dissemination for the potentially harmful speech of others.[49] In the eyes of the court, Congress regarded any court decision to the contrary as "simply another form of intrusive government regulation of speech."[50]

In 2006, the California Supreme Court revisited the issue of distributor liability in *Barrett v. Rosenthal*.[51] The plaintiff alleged that a user of an interactive service provider posted a copy of a libelous letter to an online newsgroup.[52] The trial court ruled that such republication was immune under the statute.[53] The Court of Appeal, however, reversed, stating that section 230 did not extend to distributor liability.[54] The California Supreme Court then reversed and chastised the Court of Appeal for breaking from the majority of federal and state courts in refusing to extend immunity to distributors.[55] Reiterating *Zeran*'s reasoning and policy considerations, the *Barrett* court held that section 230 barred distributor liability for online publications.[56] It noted that plaintiffs were still free under section 230 to bring suit against the creators of the defamatory online content, but that the court was not free to further expand liability.[57] Any such change must await congressional action.[58]

Zeran remains the preeminent case on section 230 immunity.[59] As reaffirmed in *Barrett*, *Zeran* firmly cemented a blanket policy exempting online service providers for publishing content created by third parties—a protection not afforded to their brick and mortar counterparts.

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49. *Id.* at 330-31.
50. *Id.* at 330.
51. Barrett v. Rosenthal, 146 P.3d 510, 513 (Cal. 2006).
52. *Id.* at 514.
53. *Id.*
54. *Id.*
55. *Id.* at 518 (citing Blumenthal v. Drudge, 992 F. Supp. 44, 51 (D.D.C. 1998); Ben Ezra, Weinstein & Co. v. Am. Online, Inc., 206 F.3d 980, 986 (10th Cir. 2000); Morrison v. Am. Online, Inc., 153 F. Supp.2d 930, 933-34 (N.D. Ind. 2001); PatentWizard, Inc. v. Kinko's Inc., 164 F. Supp. 3d 1069, 1071 (D.S.D. 2001); Green v. Am. Online, 318 F.3d 465, 470-71 (3d Cir. 2003); Carafano v. Metrosplash.com, Inc., 339 F.3d 1119, 1123-24 (9th Cir. 2003); Doe One v. Oliver, 755 A.2d 1000, 1003-04 (Conn. Super. Ct. 2000); Doe v. Am. Online, Inc., 783 So. 2d 1010, 1013-17 (Fla. 2001)).
56. *Barrett*, 146 P.3d. at 529.
57. *Id.*
58. *Id.*
59. *Id.* at 514.

II. *FAIR HOUSING COUNCIL V. ROOMMATES.COM, LLC*

In an April 2008 opinion, the Ninth Circuit addressed OSP immunity under section 230. In *Fair Housing Council v. Roommates.com, LLC*, the en banc court faced two conflicting federal statutes: the Fair Housing Act (FHA) and the CDA safe harbor.[60] The 8-3 majority relied not on whether the FHA or section 230 controlled, but rather on the meaning of information content providers.[61] In doing so, it attempted to more clearly demarcate liability for interactive service providers.[62]

A. The Fair Housing Act

To understand the *Roommates.com* decision, a quick word regarding the Fair Housing Act is necessary. Enacted in 1968, the FHA set up a legislative scheme of anti-discrimination provisions to protect individuals from discrimination by housing sellers or landlords. The FHA prohibits discrimination on the basis of "race, color, religion, sex, familial status, or national origin" in the sale or rental of a dwelling.[63] The law, however, contains an express "Mrs. Murphy" exception[64] excluding from liability persons renting out a room or unit in owner-occupied buildings of four or fewer families, including persons seeking roommates.[65]

Though the FHA permits discrimination in some situations, it also contains a universal anti-discrimination provision regarding the advertising of available housing, including advertising of housing within the Mrs. Murphy exemption. It makes unlawful:

> mak[ing], print[ing], or publish[ing], or caus[ing] to be made, printed, or published any notice, statement, or advertisement, with respect to the sale or rental of a dwelling that indicates any preference, limitation, or discrimination based on race, color, religion, sex, handicap, familial status, or national origin, or an in-

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60. Fair Hous. Council v. Roommates.com, LLC, 521 F.3d 1157, 1162 (9th Cir. 2008).

61. *Id.* at 1162-63.

62. *Id.* at 1175.

63. 42 U.S.C. § 3604(a) (2006).

64. 42 U.S.C. § 3603(b)(2) (2006).

65. The exemption is an affirmative defense. United States v. Space Hunters, Inc., 429 F.3d 416, 426 (2d Cir. 2005). The moniker arose from a hypothetical regarding a fictitious Mrs. Murphy who refused to rent rooms to African Americans in the infamous "Mrs. Murphy's boardinghouse." Diane J. Klein & Charles Doskow, *Housingdiscrimination.com?: The Ninth Circuit (Mostly) Puts Out The Welcome Mat For Fair Housing Act Suits Against Roommate-Matching Websites*, 38 GOLDEN GATE U. L. REV. 329, 334 n.17 (2008).

> tention to make any such preference, limitation, or discrimination.[66]

This provision not only attributes liability to the advertiser who actively discriminates but also holds the publisher equally accountable. Thus, the owner of an exempt building and the offline publisher through which the owner advertises, such as a newspaper or magazine, would be liable regardless of an owner's ability to lawfully hold such preferences.

B. *Roommates.com*: Factual and Procedural Background

Defendant, Roommates.com (Roommates), runs a website intended to match people looking for roommates or housemates.[67] Before a user can search or post listings, he must create a profile that consists of answers to a series of questions.[68] Some of the questions require a response (information about location, residence, rental details and household description), while others are optional (preferences and additional comments).[69] If a user declines to respond to a question, all the options are automatically selected. Among the mandatory questions, Roommates requires users to disclose sex, sexual orientation, and whether children will be in the household.[70] The profiles then allow users to search within the Roommates network under one or more of the criterion. In addition, Roommates uses these preferences to send periodic emails indicating availability of housing that match the selected criteria.

The Fair Housing Councils of San Fernando Valley and San Diego (Councils) sued Roommates in federal court, alleging that the site's business practices violated the FHA and California housing discrimination laws.[71] The district court refused to exercise supplemental jurisdiction over the state issues, and without considering the merits of the FHA claims, dismissed the action as barred by section 230.[72] The Councils ap-

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66. 42 U.S.C. § 3604(c) (2006).
67. *Roommates.com*, 521 F.3d at 1161.
68. *Id.*
69. *Id.* at 1181 (McKeown, J., dissenting).
70. *Id.* at 1161. The mandatory disclosure of sex and information with regards to children could potentially implicate discriminatory housing policies under the FHA which bars all distinctions on the basis of both sex and familial status. The disclosure regarding sexual orientation could potentially implicate similar discrimination under the California fair housing law, though the court refused to exercise supplemental jurisdiction. *Id.* at 1162.
71. *Id.*
72. *Id.*

pealed.[73] Both the Ninth Circuit panel and the en banc panel refused to extend section 230 immunity to Roommates.[74]

C. *Roommate.com's* Framework for Immunity

The Ninth Circuit en banc panel found Roommates only partially immune. The court did not afford safe harbor protection to the drop down menus, search engine, or email notifications.[75] It did, however, find the "Additional Comments" section of profile pages to be eligible for section 230 immunity.[76] The court held that a website (or user) would be an information content provider, and thus denied section 230 immunity, "if it contribut[ed] materially to the alleged illegality of the conduct."[77] Specifically, section 230 "does not grant immunity for inducing third parties to express illegal preferences."[78] Liability is premised not necessarily on the level of control a defendant had over the content at issue, but whether the defendant's actions somehow created or lent itself to the illegality. The Ninth Circuit thus clarified, or at most altered, the third prong of the *Zeran* test for immunity.[79]

D. Passive vs. Active: Muddling Through Liability

Prior to *Roommates.com*, courts did not differentiate between whether an OSP was active or passive; so long as it did not create or develop the content in question, the OSP was immune.[80] The majority broke with section 230 case law in attempting to define creation or development of content by differentiating passive and active providers or users. The court uses the terms "neutral," "generic" and "passive" almost interchangeably to demarcate the line of immunity under section 230.[81] The majority takes

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73. *Id.*

74. Fair Hous. Council v. Roommates.com, LLC, 489 F.3d 921 (9th Cir. 2007), *rev'd en banc*, 521 F.3d 1157 (9th Cir. 2008).

75. *Roommates.com*, 521 F.3d at 1170, 1172. The drop down menus were filled with options specifically delineated by Roommates, such as sex and sexual preference. *Id.* at 1165.

76. The "Additional Comments" field was a blank text field that allowed Roommate's users to type in their own specific preferences. *Id.* at 1173-74.

77. *Id.* at 1168.

78. *Id.* at 1165.

79. *See supra* Section II.B.

80. *E.g.*, Zeran v. Am. Online, Inc., 129 F.3d 327, 330 (4th Cir. 1997); *see* 141 CONG. REC. H8469-H8470 (daily ed., Aug. 4, 1995) (statement of Rep. Cox, referring to disincentives created by *Stratton Oakmont* decision, "We want to encourage people like Prodigy. . . to do everything possible for us, the customer, to help us control, at the portals of our computer, at the front door of our house, what comes in and what our children see.").

81. *Roommates.com*, 521 F.3d at 1161-76.

great pains to distinguish between providers of interactive computer services who "passively display[] content that is created entirely by third parties" and those that create content themselves or are "'responsible, in whole or in part' for creating or developing the website."[82] The former are exempt from liability, the latter are not. However the court noted that a single website may be immune for some content but be liable for other content.[83]

This distinction rested on the differences between willfully malicious or illegal services and more "generic" or "neutral" ones, such as Google or Yahoo!.[84] Roommates's flaw was actively "inducing" third parties to break the law in certain sections of its website.[85] By creating categories and allowing users to seek and filter the information based on protective statuses,[86] Roommates was liable whereas a site that simply solicits free-form comments would not be.[87] Yet the court overlooks the fact that Roommates is essentially a more user-friendly and technologically advanced version of websites that are used to find roommates, such as Craigslist.[88] These sorting tools were the tipping point of liability, signifying a more active editorial role that Roommates chose to take.

Although the court notes section 230's express purpose of overruling the *Stratton Oakmont* decision, the Ninth Circuit still reverts to the same terminology used by the *Stratton Oakmont* court. It also adopts the *Stratton Oakmont* rationales in construing liability. The repeated use of the

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82. *Id.* at 1162.

83. *Id.* at 1162-63.

84. *Id.* at 1167.

85. *Id.* at 1165 ("[Section 230] does not grant immunity for inducing third parties to express illegal preferences. Roommate's own acts—posting the questionnaire and requiring answers to it—are entirely its doing and thus section 230 of the CDA does not apply to them. Roommate is entitled to no immunity.").

86. *Id.* at 1164 ("Roommate is undoubtedly the 'information content provider' as to the questions and can claim no immunity for posting them on its website, or for forcing subscribers to answer them as a condition of using its services."). "The FHA makes it unlawful to ask certain discriminatory questions for a very good reason: Unlawful questions solicit (a.k.a. 'develop') unlawful answers. Not only does Roommate ask these questions, Roommate makes answering the discriminatory questions a condition of doing business." *Id.* at 1166.

87. Craigslist is one example of a site that simply solicits free-form comments. *See* Chicago Lawyers' Comm. for Civil Rights Under Law, Inc. v. Craigslist, Inc., 519 F.3d 666, 671-72 (7th Cir. 2008) ("Nothing in the service craigslist offers induces anyone to post any particular listing or express a preference for discrimination . . . ."). *See also Roommates.com*, 521 F.3d at 1172 n.33 ("Craigslist's service works very much like the 'Additional Comments' section of Roommate's website . . . .").

88. Note that Craigslist has a drop down menu for pets, but not for other categories.

word passive in phrases such as "passive transmitter,"[89] "passively relayed,"[90] and "passively displayed"[91] echo the "passive conduit"[92] of *Stratton Oakmont*. The *Stratton Oakmont* court held that even trivial editorial control pushed a defendant out of the passive circle.[93] In *Roommates.com*, however, the court introduces the concept of "materially contributing" to the illegality at issue as a way of differentiating between passive and active conduct.[94] Thus, Roommates has no immunity for its drop down menus, search engine, or email notification systems because it is deemed to be more than a passive conduit of third-party information.[95]

In an attempt to clarify its standard, the court offers several examples of passivity and one additional example of active illegal conduct. At the passive end of the spectrum are the activities that *Zeran* permitted in 1997: traditional editorial duties including editing typographical errors, censoring obscenity or paring down lengthy posts.[96] On the active end: "[a] dating website that requires users to enter their sex, race, religion and marital status through drop-down menus, and that provides means for users to search along the same lines. . . ."[97] The latter category is somewhat puzzling, since it is essentially a description akin to Roommates's operations. Yet the Ninth Circuit's characterization of section 230 would grant it immunity. Thus the *Roommates.com* notion of "passive" is far more nebulous than that of *Stratton Oakmont*.[98] The phrase "passive transmitter" is stripped of all but form in such a rendering of what falls outside the scope of "information content provider." Such a dating website would have designed its system to use similar criteria as Roommates in both forcing us-

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89. *Roommates.com*, 521 F.3d at 1166.

90. *Id.* at 1172 n.33.

91. *Id.* at 1174.

92. Stratton Oakmont, Inc. v. Prodigy Servs. Co., No. 31063/94, 1995 WL 323710, *3 (N.Y. Sup. Ct. May 24, 1995); *see also* discussion *supra* Section I.A.

93. *Stratton Oakmont, Inc.*, 1995 WL 323710, at *3, *5.

94. *Roommates.com*, 521 F.3d at 1167-68 ("[T]he immunity for passive conduits and the exception for co-developers must be given their proper scope and, to that end, we interpret the term 'development' as referring not merely to augmenting the content generally, but to materially contributing to its alleged unlawfulness."). The court does not use the term active conduct; it instead characterizes any such conduct as "development" as per the statute. *Id.* For purposes of this Note and consistency within the nomenclature, I will refer to such development as active conduct.

95. *Id.* at 1166.

96. *Id.* at 1169.

97. *Id.* Here the court appears to be alluding to *Carafano v. Metrosplash.com, Inc.*, 339 F.3d 1119 (9th Cir. 2003). For more on this, see discussion *infra* Section V.A.

98. *See Stratton Oakmont, Inc.*, 1995 WL 323710, at *3, *5.

ers to participate and narrowly tailoring search results.[99] Similarly, any such system must equally be said to induce the actions of its third party users and content providers.[100]

Instead of clarifying the meaning of "creation or development,"[101] the court muddied the waters. This third prong of the *Zeran* test no longer holds ground on its own; something more than a passive conduit but something less than a content creator is required to trigger immunity.[102] This something more appears to be a tie to the illegal or unlawful nature of the allegation beyond acting as a mere channel for the illegal conduct to occur; it requires that a defendant "materially contribut[e] to [the content's] alleged unlawfulness."[103]

In an effort to illustrate the precise scope of "materially contribute," the court employs the analogy of search engines. Key to drawing a distinction between Roommates and search engines like Google and Yahoo! is *neutrality*.[104] Unlike Roommates, the court noted that "ordinary search engines" allow users to search for almost anything, without biasing their activities towards unlawful or discriminatory behaviors by employing illegal criteria in executing searches.[105] The difference between the ordinary search engine and the Roommates search system is the use of "*neutral* tools":

> If an individual uses an ordinary search engine to query for a "white roommate," the search engine has not contributed to any alleged unlawfulness in the individual's conduct; providing *neutral* tools to carry out what may be unlawful or illicit searches does not amount to 'development' for purposes of the immunity exception.[106]

However, for all its reliance on the neutrality of ordinary search engines, the court failed to articulate a clear rule as to what constitutes neutrality. In this age of near absolute control of information dissemination, it

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99. *See Roommates.com*, 521 F.3d at 1167.
100. *See id.* at 1165.
101. 47 U.S.C. § 230(f)(3) (2006).
102. Zeran v. Am. Online, Inc., 129 F.3d 327, 330 (4th Cir. 1997), *supra* Section I.B.
103. *Roommates.com*, 521 F.3d at 1168. Note that the court, despite cautioning that it was not ruling as to the illegality of the Roommate's actions, appeared to be basing much of its ruling on what it evidently presumed to be the illegal nature of the action. In comparing "ordinary search engines" to Roommates, Judge Kozinski notes that "nor are they designed to achieve illegal ends." *Id.* at 1167.
104. *Id.* at 1167, 1169.
105. *Id.* at 1167.
106. *Id.* at 1169.

is difficult to argue that Google fits the mold of a neutral search engine.[107] The closest the majority gets is to contrast the search mechanisms of the major search engines of the world to actions inducing illegal behavior.[108] Thus, the test of neutrality is not a matter of the degree of involvement or manipulation of content, but rather an association with, and inducement of, something presumed to be unlawful.

III. MAKING SENSE OUT OF *ROOMMATES.COM*

In order to understand the reasoning behind the somewhat odd and precedent-breaking opinion, one must first look at *Carafano v. Metrosplash.com, Inc.*[109] The five-year-old Ninth Circuit opinion stood as the premier obstacle between precedent and the liability the court sought to impose on Roommates. In maneuvering around the *Carafano* analysis, *Roommates.com* appears to emulate, though without recognizing it, the contributory liability scheme for copyright infringement.

A. Paving Over *Carafano*

Operating under an essentially indistinguishable factual background regarding OSP input and control, Matchmaker, an online dating service, was granted full immunity under section 230 by the Ninth Circuit in 2003.[110] Like Roommates, users of Matchmaker created profiles that were then matched according to their answers to a detailed questionnaire that included both drop-down menus and text boxes for open-ended questions.[111] Like Roommates, one of Matchmaker's users used the website in an illegal manner and against the express service terms of the OSP.[112] In *Carafano*, the user created a fake, sexually-charged profile for a famous actress and divulged her home address and phone number without her consent, encouraging other users to contact her for sexual purposes.[113]

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107. *See* Mike Gudgell, *Google Takes Aim at Online Term Paper Peddlers*, ABC NEWS, May 24, 2007, http://abcnews.go.com/Technology/story?id=3207084 (discussing how Google will start blocking ads of companies selling term papers); David LaGeese, *The World According to Google*, U.S. NEWS, May 2, 2004.

108. *Roommates.com*, 521 F.3d at 1167.

109. 339 F.3d 1119 (9th Cir. 2003).

110. *Id.* at 1121.

111. *Id.*

112. *See id.* at 1121; Roommates.com Terms of Service, http://www.roommates.com/terms.rs (last visited on Dec. 19, 2008) ("You agree to NOT use the Service for any illegal or inappropriate purpose . . . .").

113. *Carafano*, 339 F.3d at 1121.

The Ninth Circuit went to great lengths to maintain that Matchmaker's actions in creating questionnaires in no way made them an information content provider:

> Under § 230(c), therefore, so long as a third party willingly provides the essential published content, the interactive service provider receives full immunity regardless of the specific editing or selection process. The fact that some of the content was formulated in response to Matchmaker's questionnaire does not alter this conclusion.[114]

Even though Matchmaker created the questions, propagated the list of answers, and put them in a drop-down menu format, the site was still immune from liability under the section 230 safe harbor; this active behavior was insufficient to remove CDA protection. The court further remarked that the matching services and email notifications offered by Matchmaker did not push it into the realm of information content providers.[115] Instead, these services were, arguably, precisely the type of continued Internet development that Congress had in mind when drafting section 230.[116]

The en banc court in *Roommates.com* sought to distinguish *Carafano*. Though the *Roommates.com* court maintained that *Carafano* was correctly decided, the court noted that it had "incorrectly suggested that it could never be liable because 'no [dating] profile has any content until a user actively creates it.'"[117] In its stead, the court offered what it deemed a more "plausible rationale" for the holding in *Carafano*: neutrality.[118] Under the *Roommates.com* definition of neutrality, it was not the degree of control that Matchmaker exerted in creating the website or soliciting information in general, but rather it was its degree of control of the purportedly illegal activity.[119] This was a necessary step in the analysis to remove

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114. *Id.* at 1124.
115. *Id.* at 1125.
116. *Id.*
117. Fair Hous. Council v. Roommates.com, 521 F.3d 1157, 1171 (9th Cir. 2008).
118. *Id.*
119. Though Matchmaker provided the technology to create and publish the fake profile, it neither prompted nor solicited the illegal content. In comparison, Roommates used drop down lists to prompt its users to engage in illegal conduct—to use sex as a criterion for choosing a roommate. The court noted that:

The allegedly libelous content there—the false implication that Carafano was unchaste—was created and developed entirely by the malevolent user, without prompting or help from the website operator. To be sure, the website provided neutral tools, which the anonymous dastard used to publish the libel, but the website did absolutely nothing to encourage the posting of defamatory content—indeed, the defamatory posting was contrary to the website's express policies.

immunity for Roommates because the layout and operations of Matchmaker and Roommates are virtually indistinguishable. Had liability been premised merely on the degree of general control and content manipulation, as was the case in *Carafano*, Roommates could not be held liable.

Interestingly enough, not only does the opinion recast *Carafano*, but in doing so it minimizes the realities of the case. In 2003, the Ninth Circuit referred to *Carafano* as a case of "cruel and sadistic identity theft."[120] However, in 2008, the *Roommates.com* opinion refers to it as the work of an "unknown prankster" and "dastard."[121] In comparison, Roommates's activity was characterized as illegal and unlawful numerous times throughout the opinion.[122] This distinction in the seriousness of the behavior highlights both the policy goals and supposed moral culpability levels between the two scenarios. By characterizing such awful harassment and identity theft as a mere prank, the court minimizes the social stigma around the action involving Matchmaker while simultaneously exaggerating the social harm caused by Roommate's website. It is unclear why a site that enables a woman to express a desire to live only with other women is deemed reprehensible and undeserving of statutory immunity, while a site that enables a random stranger to usurp the identity of an individual and subject her to incessant harassment is merely facilitating pranks.[123] Yet such characterization is essential to erode the protections of section 230. The *Roommates.com* court justified its deviation from the clearly stated goals of a statute and the accompanying consistent judicial interpretation by proclaiming strong policy grounds. While eliminating sex and racial discrimination are worthy policy goals, it is not clear that *Roommates.com* actually serves to further those goals.

In distinguishing the two cases, the opinion goes to great lengths to minimize and clarify the holding of *Carafano* in order to pave the way for *Roommates.com*'s new theory of contributory liability.

B. The *Roommates.com* Court Moves Towards Copyright Theories of Contributory Liability

While the Ninth Circuit deviated from prior section 230 jurisprudence, it steered toward other theories of contributory liability, specifically those embodied by *Sony* and *Grokster* in copyright infringement jurispru-

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Id. *See* discussion *supra* Section II.D.

120. *Carafano*, 339 F.3d at 1120.

121. *Roommates.com*, 521 F.3d at 1171.

122. *E.g.*, *id.* at 1164, 1165, 1174.

123. *See id.* at 1171.

dence.[124] These two cases are the preeminent opinions establishing contributory copyright liability under the doctrine of inducement. Without so much as even referencing either of the two cases that interestingly wound their way up from the same Ninth Circuit to the Supreme Court, the en banc panel in *Roommates.com* arrived at an analogous conclusion, merely swapping *legal* for *noninfringing* and *materially contributes* for *affirmative steps*.

The well known Sony Betamax case of 1984 marked a new era for contributory liability in copyright law and has continued to play a significant role in the internet age. The Supreme Court ruled that the making of individual copies of television shows for personal use did not constitute copyright infringement; instead it was fair use.[125] The Court also ruled that the manufacturers of home video recording devices, such as the Betamax, cannot be liable for infringement.[126] Importing the "staple article of commerce" notion from patent law, the Supreme Court held that the test for contributory liability was whether a product "is capable of commercially significant noninfringing uses."[127] In other words, regardless of the product's actual capacity for copyright infringement, so long as "the product is widely used for legitimate, unobjectionable purposes," it is safe from liability for contributory infringement.[128]

Though the doctrines of liability are essentially identical, the rationale behind each is different. Where the *Sony* Court, twenty-four years prior, was concerned in not "block[ing] the wheels of commerce,"[129] the *Roommates.com* court was instead concerned about a far-reaching and powerful Internet going unchecked.[130]

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124. *See* Sony Corp. v. Universal Studios, Inc., 464 U.S. 417, 421 (1984); Metro-Goldwyn-Mayer Studios Inc. v. Grokster, Ltd., 545 U.S. 913, 919 (2005).

125. *Sony Corp.*, 464 U.S. at 421.

126. *Id.* at 456.

127. *Id.* at 442.

128. *Id.*

129. *Id.* at 441 (citing Henry v. A.B. Dick Co., 224 U.S. 1, 48 (1912)).

130. Fair Hous. Council v. Roommates.com, 521 F.3d 1157, 1164 n.15 (9th Cir. 2008). The Ninth Circuit observed that:

> The Internet is no longer a fragile new means of communication that could easily be smothered in the cradle by overzealous enforcement of laws and regulations applicable to brick-and-mortar businesses. Rather, it has become a dominant-perhaps the preeminent-means through which commerce is conducted. And its vast reach into the lives of millions is exactly why we must be careful not to exceed the scope of the immunity provided by Congress and thus give online businesses an unfair advantage over their real-world counterparts, which must comply with laws of general applicability.

Id.

Twenty-one years after *Sony*, the Supreme Court again addressed contributory liability in copyright infringement—though this time within the realm of the Internet. In *Grokster*, the Court held that peer-to-peer file sharing companies, such as Grokster, could face contributory liability for inducing copyright infringement through acts taken in the course of marketing the software.[131]

The *Grokster* ruling narrowed *Sony*'s rule, allowing contributory liability to run in the presence of "clear expression or other affirmative steps taken to foster infringement," regardless of the substantial noninfringing uses.[132] In doing so, the Court drew a distinction between passive conduits and active inducement.[133] Not only was it Grokster's explicit objective was for the software to be used to download copyrighted works, but Grokster also actively targeted former Napster users, a program explicitly shut down because of its role in making copyright infringement readily accessible.[134] Grokster's demise was its affirmative actions in creating and fostering a product that would mainly and knowingly be used for infringement, regardless of its potential for lawful activity. Culpable inducement, as opposed to legitimate enterprise, was key to establishing liability.[135]

Roommates.com similarly focused on the purposes and uses of a website. In drawing a distinction between Roommates, arguably a specialized search engine, and more general-use search engines like Google, the court notes that "ordinary search engines" neither use illegal criteria to execute searches, nor are devised to effectuate unlawful outcomes.[136] The difference between a neutral search tool like Google and Roommates is a matter of legitimate purpose.

Roommates's drop-down menus allow the user to easily sort and choose between potential roommates on the basis of specific characteristics, such as the sex of the potential roommate. Such discrimination on the basis of sex is illegal under the FHA, online or offline. Basically, "[i]f such questions are unlawful when posed face-to-face or by telephone, they don't magically become lawful when asked electronically online."[137] Roommates's drop down menus, according to the majority, have abso-

131. Metro-Goldwyn-Mayer Studios Inc. v. Grokster, Ltd., 545 U.S. 913, 919 (2005).
132. *Id.*
133. *Id.* at 923.
134. *Id.* at 924.
135. *Id.* at 937 (stating that "[t]he inducement rule . . . premises liability on purposeful, culpable expression and conduct, and thus does nothing to compromise legitimate commerce or discourage innovation having a lawful promise").
136. Fair Hous. Council v. Roommates.com, 521 F.3d 1157, 1167 (9th Cir. 2008).
137. *Id.* at 1164.

lutely no "legitimate, unobjectionable purposes."[138] In contrast, "neutral" search engines such as Google and Yahoo! can be used for both lawful and unlawful searches. Thus, "neutral" search engines, or those "capable of commercially significant [legal] uses," are afforded the section 230 safe harbor, whereas the drop down menus of a site like Roommates.com fails the analogous test as a "staple article of commerce."[139]

Under *Roommates.com*, such a direct role in the illegal nature of the conduct places an OSP outside the scope of the CDA harbor, much like "affirmative steps" expose a company to contributory liability.[140]

IV. SHORTCOMINGS OF THE LIABILITY SCHEME

Roommates.com leaves much to be desired. It chipped away at both the judicial efficiency of a safe harbor and the underlying need and reasoning for immunity.

Post-*Roommates.com*, a court's analysis of OSP conduct to determine if they qualify for the safe harbor is a more nuanced and claim specific investigation. Conduct is no longer the determinant for establishing whether an OSP is an "information content provider" and thereby exempt from immunity.[141] Though the physical and technical methods of control, formatting, filtering, etc., may be indistinguishable, two different OSPs may face diverging liabilities. In effect, the status of *content provider* is based on the underlying claim rather than on the particular degree of content development. A dating website and a roommate matching website with indistinguishable functionality and preferences—employing identical questionnaires, profile sorting, matching and email notification technologies, that enforce the same level of minimal content management, that both include service terms that explicitly prohibit the use of their site to violate federal or state regulation—fall on opposites sides of section 230 immunity. In a statute that creates and exempts from immunity depending

138. *Grokster*, 545 U.S. at 943.

139. *See* Sony Corp. v. Universal Studios, Inc., 464 U.S. 417, 442 (1984). Despite the fact that a Google search for "white female roommate" results in a hit for an available room advertisement, complete with a short preview that republishes the potentially illegal content, Google would not be liable under the *Roommates.com* test. *See Roommates.com*, 521 F.3d at 1167. Google neither prompts such searches nor makes it easier for them, as opposed to lawful searches, to occur.

140. Section 230 specifically exempts intellectual property claims from immunity. 47 U.S.C. 230(e)(2) (2006). Although section 230 can neither limit nor expand copyright law, the similarity between *Roommates.com* and copyright inducement liability are too similar to ignore.

141. *See* 47 U.S.C. § 230(c) (2006).

on general conduct, a nuanced definition that instead looks to the underlying claim, irrespective of such conduct, supplants the Congressional definitions of *content provider*.

Such a manner of determining liability has the potential to erode both predictability and reliability of the law. Though the Ninth Circuit firmly believes that *Roommates.com* "extensively clarifies where the edge lies, and gives far more guidance than . . . previous cases," it in fact muddies the lines of liability.[142] Underlying determinations of legality, rather than OSP control and development, shape the scope of liability. Courts are able to exercise broader discretion. Preliminary determinations of guilt, with no clear standard of proof, become part of the immunity analysis, and the resulting test for immunity is blurrier rather than clearer.

Furthermore, increased judicial discretion resulting from *Roommates.com*, and the necessity for the court to determine legality of the underlying conduct, are taxing to judicial economy. The additional layers of analysis and OSP uncertainty of liability may lead to increased litigation.

Assessing guilt within a safe harbor is further troublesome because it undermines the entire purpose of immunity. In this "upside-down approach," the court must first determine guilt before determining immunity.[143] As the dissent noted, "[i]mmunity has meaning only when there is something to be immune *from*, whether a disease or the violation of a law. It would be nonsense to claim to be immune only from the innocuous."[144] Yet *Roommates.com* does precisely that. If an OSP's actions aid legal conduct, immunity is available, if not, they fall outside the safe harbor.

These changes to section 230 case law are a direct consequence of the Ninth Circuit's view on the Internet and the Internet age. The *Rooommates.com* majority no longer sees fit to extend the notion of *cyber exceptionalism*.[145] Instead it considers the Internet as just another medium of communication, no more special than any other, despite the fact section 230 uses the term "unique"[146] in describing the opportunities that the Internet creates. Specifically, it notes that special catering and "coddl[ing]"[147] of internet entities is no longer necessary because, far from "fragile," they have become the "dominant—perhaps the preeminent—means through which commerce is conducted."[148] The majority therefore

142. *Roommates.com*, 521 F.3d at 1175.
143. *Id.* at 1183 (McKeown, J., dissenting).
144. *Id.* at 1182 (McKeown, J., dissenting).
145. *See* 141 Congressional Record H8470, *supra* note 10; discussion *supra* Part I.
146. 47 U.S.C. § 230(a)(3) (2006).
147. *Roommates.com*, 521 F.3d at 1175 n.39.
148. *Id.* at 1164 n.15.

believes that section 230 has the potential of giving online organizations "an unfair advantage" over their offline counterparts.[149]

Though there may be truth to this sentiment, the majority ignores clear and specific congressional intent. Unlike most statutes, section 230 includes a list of congressional findings and official United States policy goals.[150] In fact, the statute spends more time articulating congressional findings and policy than in laying out the immunity provision.[151] This ex-

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149. *Id.*

150. 47 U.S.C. § 230(a), (b) (2006). Congressional findings are found in subsection (a) and include the following:

(1) The rapidly developing array of Internet and other interactive computer services available to individual Americans represent an extraordinary advance in the availability of educational and informational resources to our citizens.

(2) These services offer users a great degree of control over the information that they receive, as well as the potential for even greater control in the future as technology develops.

(3) The Internet and other interactive computer services offer a forum for a true diversity of political discourse, unique opportunities for cultural development, and myriad avenues for intellectual activity.

(4) The Internet and other interactive computer services have flourished, to the benefit of all Americans, with a minimum of government regulation.

(5) Increasingly Americans are relying on interactive media for a variety of political, educational, cultural, and entertainment services.

Id. United States policy according to section 230 is found in subsection (b) and includes:

(1) to promote the continued development of the Internet and other interactive computer services and other interactive media;

(2) to preserve the vibrant and competitive free market that presently exists for the Internet and other interactive computer services, unfettered by Federal or State regulation;

(3) to encourage the development of technologies which maximize user control over what information is received by individuals, families, and schools who use the Internet and other interactive computer services;

(4) to remove disincentives for the development and utilization of blocking and filtering technologies that empower parents to restrict their children's access to objectionable or inappropriate online material; and

(5) to ensure vigorous enforcement of Federal criminal laws to deter and punish trafficking in obscenity, stalking, and harassment by means of computer.

Id.

151. *See* 47 U.S.C. § 230 (2006). In fact, The Communications Decency Act may never have passed were it not for the policy iterated in section 230. *See* Vikas Arora, Note, *The Communications Decency Act: Congressional Repudiation of the "Right Stuff"*, 34 HARV. J. ON LEGIS. 473, 478 (1997) ("Ultimately, Congress passed the CDA as a legislative compromise designed to remedy the alleged abundance of pornography on the Internet without stifling the growth and use of interactive computer technology."); Jeff Magenau, *Setting Rules in Cyberspace: Congress's Lost Opportunities to Avoid the Vaguenes and Overbreadth of the Communications Decency Act*, 34 SAN DIEGO L. REV. 1111, 1114 (1997) ("The problems with the language of the CDA are the result of care-

plicitly stated congressional intent should not be taken lightly, nor should it be ignored or ruled obsolete by the judicial branch, as in *Roommates.com*. Three of the five stated policy goals are aimed at encouraging the continued growth and development of the Internet and internet technologies "unfettered by Federal or State regulation. . . ."[152] In passing section 230, the Legislature was specific in its intent and goals. It is not the role of the judiciary to overwrite such express purpose; rather, any revision to the express goals of the statute should be left up to the Legislature.

Furthermore, section 230 purposefully creates a dissonance between online enterprises and their offline counterparts; they are immunized from conduct that the offline enterprises are liable for. Thus, it is entirely incorrect when the majority notes that "[i]f [an act] is prohibited when practiced in person or by telephone, [there is] no reason why Congress would have wanted to make it lawful to profit from it online."[153] On the contrary, that is precisely what Congress legislated; OSPs were lawfully allowed to profit from such third-party action, whether via advertisements or subscriber fees.[154] In fact, co-author of section 230 Senator Ron Wyden, was weary of governmental regulation of the Internet. In discussing section 230, he noted that "the Internet is the shining star of the information age, and Government censors must not be allowed to spoil its promise."[155]

Yet the majority feels that the policy scheme articulated by Congress has reached its expiration date and must therefore be altered. The *Roommates.com* decision contradicts Congress's clearly stated intent to immunize OSPs, which was affirmed not only during the enactment of the statute but also after courts had an opportunity to interpret section 230. In 2002, the House Committee on Energy and Commerce explicitly endorsed *Zeran* and the decisions that followed it:

> The courts have correctly interpreted section 230(c), which was aimed at protecting against liability for such claims as negligence (See, e.g., Doe v. America Online, 783 So. 2d 1010 (Fla. 2001)) and defamation ([citations omitted]; Zeran v. America

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less drafting and reflect an awkward and hurried attempt at compromise among congresspersons").

152. 47 U.S.C. § 230(b)(2) (2006).

153. *Roommates.com*, 521 F.3d at 1167.

154. *See* Universal Commc'ns Sys., Inc. v. Lycos, Inc., 478 F.3d 413 (1st Cir. 2007); Carafano v. Metrosplash.com, Inc., 339 F.3d 1119 (9th Cir. 2003); Green v. Am. Online, 318 F.3d 465 (3d Cir. 2003); Ben Ezra v. Am. Online, Inc., 206 F.3d 980 (10th Cir. 2000).

155. 141 CONG. REC. H8470 (daily ed., Aug. 4, 1995) (statement of Rep. Cox).

> Online, 129 F.3d 327 (4th Cir., 1997)). The Committee intends these interpretations of section 230(c) to be equally applicable to those entities covered by H.R. 3833.[156]

However, six years later, *Roommates.com* attempts to change the course of OSP immunity.

Such drastic policy and direction change of a statute, even if there is valid reasoning behind the majority's notions, should be left to the Legislature, particularly when congressional intent is so clear.

V. LIFE AFTER *ROOMMATES.COM*

A. *Roommates.com* as Precedent

In the short time since *Roommates.com* was decided, five cases have cited the en banc opinion, none of them published.[157] Of these, most do not provide any in-depth discussion as to the basis of granting or withholding immunity from defendants. However, one of these cases uses similar terminology ("merely a search engine")[158] and the other delves into, if only superficially, the differences between active and passive behavior.[159]

Though in dicta, the district court in *Perfect 10, Inc. v. Google, Inc.*, on a remand motion for leave to amend, touches on the necessary characteristics of search engines to qualify for section 230 immunity.[160] Google created and displayed thumbnails of copyrighted images owned by Perfect 10 to its users via its search engine. Along with numerous intellectual property claims, Perfect 10 sued, claiming unfair competition.[161] Though terse, the opinion uses parallel terminology to *Roommates.com*, delineating liability depending on whether one is "merely a search engine or an information content provider."[162] The court considers this determination to be

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156. H.R. REP. NO. 107-449, 13 (2002).

157. Doe v. Friendfinder Network, Inc., No. 07-cv-286-JL, 2008 WL 2001745 (D.N.H. May 8, 2008); Nat'l Numismatic Certification, LLC. v. eBay, Inc., No. 6:08-cv-42-Orl-19GJK, 2008 WL 2704404 (M.D. Fla. July 08, 2008); Perfect 10, Inc. v. Google, Inc., No. CV 04-9484 AHM (SHx), 2008 WL 4217837 (C.D. Cal. July 16, 2008); Capital Corp. Merch. Banking, Inc. v. Corp. Colocation, Inc., No. 6:07-cv-1626-Orl-19KRS, 2008 WL 4058014 (M.D. Fla. Aug. 27, 2008); Best W. Int'l, Inc. v. Furber, No. CV-06-1537-PHX-DGC, 2008 WL 4182827 (D. Ariz. Sep. 5, 2008).

158. *Perfect 10*, 2008 WL 4217837, at *8.

159. *Best W. Int'l*, 2008 WL 4182827, at *10.

160. *Perfect 10*, 2008 WL 4217837. The court dismisses Google's 12(b)(6) motion, citing section 230 immunity as an affirmative defense and not appropriate for summary judgment. Thus, there is no actual ruling as to Google's immunity. *Id.* at *8.

161. *Id.* at *1.

162. *Id.* at *8.

highly fact intensive, though it notes that Google's enterprise reaches beyond the search engine business (citing the fact that Google owns Blogger).[163]

Like in *Roommates.com*, the court in *Perfect 10* is concerned with whether Google creates or develops any of the unlawful content. Though the court's use of the phrase "merely a search engine" suggests an adoption of the passive or active distinction of *Roommates.com*, it cites to *Roommates.com* only for the proposition that information content providers are exempt from immunity.[164] However, it bears no mention of the concept of illegality or legitimate purposes. The wording, though brief, suggests that it is instead relying on the distinction between creating content and simply providing a general means to access both the infringing and other noninfringing content. Though citing to *Roommates.com*, *Perfect 10* could equally have cited to any number of prior section 230 opinions for the same notion.

A couple of months later, an Arizona district court, in *Best Western International, Inc. v. Furber*, addressed what OSP actions qualify as passive under *Roommates.com*.[165] The court specifically rejected implied suggestions and general solicitations as actions *active* enough to bar section 230 immunity.[166] Best Western International (BWI) brought suit against Furber and Unruh for inducing users of their website, Freewriters.net, to make defamatory statements against BWI.[167] BWI claimed that Furber, via the homepage, implicitly advocated users to make defamatory statements against BWI.[168] The court not only disagreed with BWI, but also noted that the act of implicitly advocating users to make defamatory statements would be insufficient in eliminating section 230 immunity under *Roommates.com*.[169] As to Unruh, the court held that he was entitled to immunity even though he solicited content from others, as long as the solicitation was not for specifically defamatory material.[170]

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163. *Id.*

164. *Id.*

165. Best W. Int'l, Inc. v. Furber, No. CV-06-1537-PHX-DGC, 2008 WL 4182827 (D. Ariz. Sep. 5, 2008).

166. *Id.* at *10.

167. *Id.* at *4. There were other named defendants, one that sought CDA immunity for typing and posting on the website on behalf of her husband. The court considered whether the content was a product of a collaborative effort to be a matter for the jury and not appropriately dismissed under summary judgment. *Id.* at *10.

168. *Id.*

169. *Id.*

170. *Id.*

Best Western International, like *Roommates.com*, asserted a relatively wide notion of what is considered passive conduct, though *Roommates.com*'s formulation is potentially much broader.[171] So long as its actions are not calculated to induce or create the unlawful act, OSP immunity is left intact under *Best Western International*. Arguably, in a pre-*Roommates.com* world, Unruh would have been allowed immunity for soliciting defamatory material so long as they merely republished the solicited data.[172]

B. The Fate of Section 230 Post-*Roommates.com*

The dissent may be hailing the end as we know it,[173] yet in reality the narrowing of the safe harbor will not affect most internet operations. Although immunity has been sought for protection from a variety of claims, including cyber-stalking, employment torts, breach of contract, and now housing discrimination, a vast majority of suits employing the safe harbor involve libel and defamation claims. While illegal behavior occurs online, one is hard-pressed to find internet entities that operate explicitly illegal instrumentalities that would come under the *Roommates.com* decision. Sites replete with questionable content, such as *Juicy Campus*, *AutoAdmit*, and *Don't Date Him Girl*, would still fall squarely under the safe harbor specifically allowed by *Roommates.com* because they "passively display[] content that is created entirely by third parties."[174]

The majority in *Roommates.com* even struggles to point to similar situations that might warrant OSP liability, barring FHA noncompliance.

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171. *See* Fair Hous. Council v. Roommates.com, 521 F.3d 1157, 1169 (9th Cir. 2008) (allowing, in dicta, immunity for a hypothetical internet dating site that required disclosure of sex and sexual orientation, and sorted and emailed users according to those categories and preferences).

172. Immunity determinations pre-*Roommates.com* would not consider inducement liability; instead immunity would hinge on whether the information was created or produced by the OSP instead of being merely republished. *See* discussion *supra* Section II.D.

173. *Id.* at 1176 (McKeown, J., dissenting) ("The majority's unprecedented expansion of liability for Internet service providers threatens to chill the robust development of the Internet that Congress envisioned.").

174. Juicy Campus, http://www.juicycampus.com/ (last visited Feb. 3, 2009) (A website focusing on gossip, rumors, and rants related to colleges and universities in the United States. It is no longer in existence, having gone offline due to financial trouble during the publication of this Note); AutoAdmit, http://www.autoadmit.com/ (last visited Feb. 3, 2009) (A network of websites for prospective and current college, graduate, law students, best known for its message board that has gained notoriety and drawn criticism for its lack of moderation of offensive and defamatory content); Don't Date Him Girl, http://dontdatehimgirl.com/home/ (last visited Feb. 3, 2009) (a website where women can anonymously discuss their dating experiences). *See Roommates.com*, 521 F.3d at 1162.

Though the majority details several scenarios where OSPs remain in the safe harbor, it lists only one instance where immunity would be stripped:

> a website operator who edits in a manner that contributes to the alleged illegality—such as by removing the word "not" from a user's message reading "[Name] did *not* steal the artwork" in order to transform an innocent message into a libelous one—is directly involved in the alleged illegality and thus not immune.[175]

Even the staunchest critics of *Roommates.com* would be hard pressed to find fault with this reasoning. However, even this example would not have qualified for immunity pre-*Roommates.com*. If a message were altered in this way, it would be difficult to argue that this message was still purely third party content for which a website should receive immunity.

The majority's list of operations that still retain immunity include: a dating web-site set up substantially similarly to Roommates, complete with drop-down menus that sort based on sex and a housing website that sorts that on user-defined criteria, even if such criteria includes sex, so long as the user is not required to make a choice. Thus, an OSP can still retain substantial control over its content and structure, implement highly specialized search functions, and still retain immunity. It is not so much the amount of control exerted by an OSP, but rather how that control is exerted. If that control is employed to require or cause the user to engage in illegal behavior, the OSP will lose immunity. Otherwise, the OSP falls within the safe harbor as they did before the *Roommates.com* decision.

Even the implicit solicitors are safe. Juicy Campus, the self-proclaimed "place to spill the juice about all the crazy stuff going on at your campus," whose slogan reads "C'mon. Give us the juice," can operate with virtually unchecked safeguards under section 230.[176] Juicy Campus is not liable for inflammatory and potentially defamatory posts that list students by name and describe them as "super slutty girls,"[177] or even the most discussed post, "where da hoes?"[178] Juicy Campus remains a mes-

175. *Roommates.com*, 521 F.3d at 1169.

176. Juicy Campus Gossip, http://www.juicycampus.com/posts/gossips/all-campuses/ (last visited Feb. 3, 2009).

177. Posting of anonymous to Juicy Campus, *Super Slutty Girls*, http://www.juicycampus.com/posts/permalink/UT%20Austin/204087 (Nov. 22, 2008).

178. Posting of anonymous to Juicy Campus, *Where da hoes?*, http://www.juicycampus.com/posts/permalink/Hampton%20University/86616 (Oct. 1, 2008). This would be true even assuming that these statements were false and defamatory.

sage board that is as capable of legitimate use and content as it is capable of the illegitimate.[179]

It is quite difficult to imagine a scenario where an OSP would be found liable for defamatory or libelous content provided by third parties. The website operator would have to actively solicit and induce such defamatory content; mere implications in solicitation and knowledge of the content would be insufficient. A far-fetched scenario, where the website employed a drop-down menu that required users to categorize or tag their posts before posting might fall outside the confines of the safe harbor. Such a structural tool would only lead to liability if these tags: (1) were created by the website operator and not user defined, and (2) included options such as "defamation," "libel," or "false content."

Websites aimed at soliciting information for illegal purposes, such as allowing users to stalk or harass other people, might find themselves outside of section 230 protection. A hypothetical loosely based on *Best Western International* is one example of such a website.[180] Soliciting third party content that is specifically defamatory, like soliciting copyright infringement, bears a strong element of fault. Such actions bear more resemblance to actions to which we would attribute direct liability, rather than contributory liability. Defamation, even in light of an almost unchecked freedom of speech under the First Amendment, is illegal. It seems contrary, both to common sense and societal good, that the ringleader escapes liability while those under his control are clearly liable.

Judge Kozinski articulated a second example of a website soliciting information for an illegal purpose in the *Roommates.com* panel decision:

> Imagine, for example, www. harrassthem.com with the slogan "Don't Get Mad, Get Even." A visitor to this website would be encouraged to provide private, sensitive and/or defamatory information about others—all to be posted online for a fee. To post the information, the individual would be invited to answer questions about the target's name, addresses, phone numbers, social security number, credit cards, bank accounts, mother's maiden name, sexual orientation, drinking habits and the like. In addition, the website would encourage the poster to provide dirt on the victim, with instructions that the information need not be

179. Juicy Campus About Us, http://www.juicycampus.com/posts/about-us (last visited Nov. 21, 2008) (Juicy Campus is a "forum where college students discuss the topics that interest them most, and in the manner that they deem most appropriate.").

180. BWI claimed that Furber implicitly advocated users to make defamatory statements against BWI. Best W. Int'l, Inc. v. Furber, No. CV-06-1537-PHX-DGC, 2008 WL 4182827, *10 (D. Ariz. Sep. 5, 2008). *Infra* Section V.A.

> confirmed, but could be based on rumor, conjecture or fabrication.[181]

Such an OSP could not claim section 230 immunity post-*Roommates.com*.[182] It is not only difficult to imagine a legitimate and unobjectionable use of such a website, but the OSP would also be eliciting this illegal conduct and making "aggressive use of it in conducting its business."[183]

However, this is neither surprising, nor an unforeseen or unprecedented effect of *Roommates.com*. First, the safe harbor protections could have been waived simply because federal criminal laws were at issue.[184] And second, at least one court has refused to extend immunity to websites that provide such private and sensitive information. In *F.T.C. v. Accusearch, Inc.*, a district court in Wyoming declined to allow shelter under the safe harbor provision for a website that "offered for sale to its customers a variety of information products, including records of telephone call details, GPS traces (which disclose the exact location of a cell phone at any given time), Social Security Number verification, utility records, DMV records, and reverse email look-ups."[185] However, though it arrived at the same conclusion, the court did not use the same rationale as *Roommates.com*. It instead held that the claims did not "treat" defendants as "publishers" as required by section 230.[186]

As long as future courts read *Roommates.com* narrowly, few websites will lose the protections otherwise afforded by the section 230 safe harbor. Along with the immunity available for the text in comment boxes like that of Roommates, there is still room for a wide-reaching net of immunity.

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181. Fair Hous. Council v. Roommates.com, LLC, 489 F.3d 921, 928 (9th Cir. 2007), *rev'd en banc*, 521 F.3d 1157 (9th Cir. 2008).

182. Although it is somewhat unclear whether such a site would not receive section 230 immunity. Though in the panel opinion and quite important, it strikingly does not reappear in Kozinski's opinion for the en banc majority. One wonders if Judge Kozinski had to give this up in order to gain a majority. And if so, then even such sites may be immune post-*Roommates.com*.

183. Fair Hous. Council v. Roommates.com, LLC, 521 F.3d 1157, 1172 (9th Cir. 2008).

184. 47 U.S.C. § 230(e)(1) (2005) ("Nothing in this section shall be construed to impair the enforcement of section 223 or 231 of this title, chapter 71 (relating to obscenity) or 110 (relating to sexual exploitation of children) of title 18, or any other Federal criminal statute.").

185. F.T.C. v. Accusearch, Inc., No. 06-CV-105-D, 2007 WL 4356786, *1 (D. Wyo. Sept. 28, 2007).

186. *Id.* at *4-5 (the statutory meaning of publisher is ambiguous, at least as applied to this case; thus, the court turns to section 230's legislative history to conclude that Congress did not mean to protect such claims).

The only real change would be in cases dealing with FHA violations. However, if the notion of solicitation takes on a broader meaning in the future, the *Roommates.com* decision might have more serious consequences that erode the protections and liability scheme afforded by section 230.

VI. CONCLUSION

Despite over a decade of precedent and clear congressional intent, *Roommates.com* paved a new path to OSP liability. The bright line test demarcating information content providers from online service providers is gone. Though perhaps well intentioned, the majority not only created a hazier test for immunity under section 230, but also overstepped its bounds. Congress had affirmed the judicial approach of the *Zeran* court and its progeny, but still the Ninth Circuit, in *Roommates.com*, sought to alter the course of these rulings. Though a potential narrow reading of the opinion could confine its consequences to suits involving the FHA, the opinion ultimately sets the stage for greater judicial discretion. This, in turn, creates uncertainty for future defendants. For better or worse, the Ninth Circuit's reinterpretation of section 230 was an attempt to limit the reaches of internet exceptionalism, a task best left to the Legislature.

THE FCC TACKLES NET NEUTRALITY: AGENCY JURISDICTION AND THE COMCAST ORDER

By Aaron K. Brauer-Rieke

The Internet[1] has rapidly become an important source of communication, productivity, and entertainment for many Americans. Nearly seventy-five percent of Americans have access to the Internet in their homes,[2] most utilizing a high-speed broadband connection.[3] A connection to the Internet typically requires a subscription with an Internet Service Provider (ISP), which becomes the customer's sole gateway to the online world.[4] A lively debate has arisen regarding the extent to which consumers' access to the Internet should be manipulated by ISPs.[5] These arguments have raged for several years now, housed under the "net neutrality" debate. The Federal Communication Commission (FCC) recently entered the fray, exercising its authority in direct furtherance of net neutrality-related goals

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1. The Internet is statutorily conceived as the "combination of computer facilities and electromagnetic transmission media, and related equipment and software, comprising the interconnected worldwide network of computer networks that employ the Transmission Control Protocol/Internet Protocol or any successor protocol to transmit information." 47 U.S.C. § 231(e)(3) (2006). More simply, the Supreme Court has described the Internet as a "network of interconnected computers . . . ." Nat'l Cable & Telecomm. Ass'n v. Brand X Internet Servs., 545 U.S. 967, 974 (2005).

2. Press Release, Nielsen//NetRatings, Three out of Four Americans have Access to the Internet, According to Nielsen//NetRatings (Mar. 18, 2004), http://www.nielsen-netratings.com/pr/pr_040318.pdf.

3. JOHN B. HORRIGAN, PEW INTERNET & AM. LIFE PROJECT, HOME BROADBAND ADOPTION 2008: ADOPTION STALLS FOR LOW-INCOME AMERICANS EVEN AS MANY BROADBAND USERS OPT FOR PREMIUM SERVICES THAT GIVE THEM MORE SPEED (2008), http://www.pewinternet.org/~/media/Files/Reports/2008/PIP_Broadband_2008.pdf.

4. An Internet Service Provider is simply a "company which provides end-users with a data connection allowing access to the internet and the associated services . . . ." Organisation for Economic Co-Operation and Development, Glossary of Statistical Terms—Internet Service Provider (ISP), http://stats.oecd.org/glossary/detail.asp?ID=6740 (last visited Feb. 3, 2009).

5. *See infra* Part II.

for the first time. The move has been characterized as a landmark decision for both the FCC and internet policy.[6]

In August of 2008, the FCC considered whether Comcast, a popular broadband ISP, could lawfully manipulate consumer internet access by selectively interfering with peer-to-peer (P2P) protocols[7] commonly used to share files online.[8] The Commission found that Comcast's practice of selectively interfering with internet traffic was "discriminatory and arbitrary" and did not constitute reasonable network management.[9] As a result, the FCC ordered Comcast to disclose the details of its network management practices within thirty days, submit a compliance plan for ending the offending practices by the end of the year, and disclose to the public the details of intended future practices.[10] The FCC's Order (Comcast Order), accompanied by a Memorandum Opinion (Comcast Opinion), was the first Internet network management decision of its kind.[11]

This Note addresses the FCC's authority to issue the Comcast Order.[12] Part I of this Note summarizes some relevant background information, briefly reviewing the net neutrality debate, necessary technical concepts, and important aspects of FCC's regulatory power. Part II outlines the factual and procedural details of the Comcast Order and Comcast's subsequent appeal. Part III emphasizes the unclear nature of impending judicial review and enumerates important questions pertaining to the FCC's juris-

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6. *In re* Formal Complaint of Free Press & Pub. Knowledge Against Comcast Corp. for Secretly Degrading Peer-to-Peer Applications, 23 F.C.C.R. 13028, 13078 (2008) ("This is a landmark decision for the FCC—a meaningful stride forward on the road to guaranteed openness of the Internet. It's taken a while for us to get here, but that doesn't detract from the historic importance of what the Commission does today.").

7. Peer to peer networks are "an approach to computer networking where all computers share equivalent responsibility for processing data. Peer-to-peer networking (also known simply as *peer networking*) differs from client-server networking, where certain devices have responsibility for providing or 'serving' data and other devices consume or otherwise act as 'clients' of those servers." Bradley Mitchell, *Introduction to Peer to Peer Networks*, About.com, http://compnetworking.about.com/od/basicnetworkingfaqs/a/peer-to-peer.htm (last visited Feb. 3, 2009); *see also* What Is BitTorrent?, http://www.bittorrent.com/btusers/what-is-bittorrent (last visited. Feb 3, 2009).

8. *See* In re *Formal Complaint of Free Press*, 23 F.C.C.R. at 13028.

9. *Id.* at para. 1.

10. *Id.*

11. The decision has already garnered significant attention and commentary. *See* Nate Anderson, *Hammer drops at last: FCC opposes Comcast P2P throttling*, ARS TECHNICA, July 25, 2008, http://arstechnica.com/old/content/2008/07/hammer-drops-at-last-fcc-opposes-comcast-p2p-throttling.ars; Declan McCullagh, *FCC formally rules Comcast's throttling of BitTorrent was illegal*, CNET NEWS.COM, Aug. 1, 2008, http://news.cnet.com/8301-13578_3-10004508-38.html.

12. *See infra* Parts II and III.

diction in this instance. Part IV concludes that, no matter the outcome, we likely have not seen the last of the FCC on issues of internet policy.

I. BACKGROUND

A. The Net Neutrality Debate: A Brief Summary

"Net neutrality" generally refers to a paradigm where internet traffic is not prioritized based on its type, source, destination, or volume.[13] Academics have lamented the difficulty in precisely defining the term and generally agree that the concept has become distorted by political and ideological polarization.[14] At the most basic level, however, is the ideal that internet traffic should flow freely from source to source without delay or interruption from individual networks along the way.[15] Net neutrality advocates routinely make reference to a core value: the Internet should be a democratic medium that fosters innovation and free speech.[16]

1. History and Perspectives

The debate surrounding net neutrality has grown in both recognition and intensity over the past several years. In April 2006, a grassroots organization called SavetheInternet.com collected over a million signatures lobbying Congress in support of net neutrality principles.[17] Only a few months later, five separate bills addressing net neutrality were introduced in Congress.[18] None of the bills were made into law, and the likelihood of imminent congressional action has since dimmed.[19] Most recently, the

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13. Kai Zhu, Note, *Bringing Neutrality to Network Neutrality*, 22 BERKELEY TECH. L.J. 615, 615 (2007).

14. *Id.*; *see also* Philip J. Weiser, *The Next Frontier for Network Neutrality*, 60 ADMIN L. REV. 273, 276 (2008) ("One casualty of the network neutrality debate on Capitol Hill is that the issue became more politicized and polarized than traditional technology policy debates, which often stay below the radar and are initially discussed and considered by a more select group of policymakers.").

15. Save the Internet, Frequently Asked Questions, http://www.savetheinternet.com/=faq#what (last visited Feb. 3, 2009) ("Put simply, Net Neutrality means no discrimination. Net Neutrality prevents Internet providers from blocking, speeding up or slowing down Web content based on its source, ownership or destination.").

16. *Id.* ("Net Neutrality is the reason why the Internet has driven economic innovation, democratic participation, and free speech online.").

17. *See* Declan McCullagh, *House plans vote on Net neutrality*, CNET NEWS.COM, June 7, 2006, http://news.com.com/2100-1028_3-6080983.html.

18. *Id.*

19. Weiser, *supra* note 14, at 274.

FCC has asserted its authority to regulate the players in the net neutrality debate, thus gaining some of the spotlight.[20]

Concerns on both sides of the net neutrality debate have remained fairly consistent throughout the years. On the one hand, support for net neutrality stems from a deep commitment to openness harbored by many in the internet community. There is fear that ISPs will impinge upon the democratic nature of the Internet by redirecting or blocking certain kinds of content.[21] If wealthy content providers are permitted to pay for prioritized delivery of their content to the end-user, so the argument goes, then consumers' ability to access and share information of their choosing may be diminished.[22] On the other hand, those in opposition to net neutrality laws are concerned that regulating or legislating net neutrality will stifle innovation.[23] For example, cutting-edge applications, such as videoconferencing, would benefit from prioritized delivery of data, while other applications like email might be reasonably delayed for several seconds.[24] In this fashion, net neutrality skeptics usually emphasize the unforeseen consequences of strict neutrality rules. Both arguments clearly have merit, and thus the debate is unlikely to be resolved in the near future.

2. *Technical Underpinnings*

Understanding the net neutrality debate requires a basic understanding of the technology behind the Internet. The first network utilizing the basic protocols undergirding today's Internet launched January 1, 1983 on ARPANET—a government-sponsored research network.[25] The basics of internet architecture remain largely the same today, relying almost exclu-

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20. *See infra* Parts II and III.

21. Posting of Susan Crawford to Susan Crawford Blog, FAQ on Net Neutrality, http://scrawford.blogware.com/blog/_archives/2006/5/31/1998151.html (May 31, 2006) ("The whole point of price discrimination (the goal of the cablecos and telcos) is that you get to choose who pays more to travel your network. Network providers will have every incentive to favor their own services and make exclusive deals . . . .").

22. *Id.*

23. *See* Public Broadcasting Station, Two Views on Net Rules, http://www.pbs.org/now/shows/222/net-rules.html (June 2, 2006) ("The move away from net neutrality may thus represent nothing more than Internet's attempt to meet the increasingly varied and intense demands that consumers are placing on the Internet. Maintaining an attachment to the architecture of the past may stifle these new innovations.").

24. *Id.* ("[T]he proposed net neutrality legislation poses risks to innovation that are often overlooked. It could foreclose the emergence of new services that depend on a different type of network. It also risks subjecting changes in the network to the delay and political pressure inherent in the regulatory process.").

25. *See* JAMES F. KUROSE & KEITH W. ROSS, COMPUTER NETWORKING 61 (2001).

sively on the Transport Control Protocol (TCP).[26] Before data is sent over the Internet, it is separated into a number of smaller pieces called "packets."[27] Each packet contains layers of identifying information and a payload of data.[28] When data is transferred, a parade of packets leaves the source computer and is propelled through various networks toward a final destination.[29] If all goes well, the packets are reunited at the destination computer, where it is often accessed by an application like an email client or web browser. This entire process typically takes place in a matter of milliseconds, and is invisible to the typical Internet user.

The net neutrality debate is concerned with the vast number of routers that facilitate the packets' journey over the Internet—particularly those controlled by ISPs. A router is a device that determines the next point in a packet's journey as it moves towards its final destination.[30] Each router has one or more "routing tables" that function as a map for the purposes of delivering packets.[31] If, as is most often the case, a router cannot deliver a packet directly to its destination, the routing table provides the intermediary hops necessary to get it there.[32] However, if a router is particularly busy, it may need to queue a packet before sending it along, as each router-to-router connection can only carry a limited amount of data.[33] The net neutrality debate asks this technical question: should routers be permitted to *selectively* delay some packets for the benefit of others?

Since the beginning of its commercial use in the 1990s, the Internet has become increasingly complex and heterogeneous. Today's Internet is vast in scale—joining potentially infinitely deep sub-networks—and connects together a greater number of applications than ever before. Accordingly, the Internet today is defined heavily by its interconnections and routing policies, as opposed to a central structure or storage location. These routing policies, which individual ISPs in part control in the trust of their customers, are the principle focus of the net neutrality debate.

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26. *See generally* RFC793 - Transmission Control Protocol, http://www.faqs.org/rfcs/rfc793.html (last visited. Feb 3, 2009).

27. *Id.*

28. *See* KUROSE & ROSS, *supra* note 25, at 18.

29. *Id.*

30. *Id.* at 301-04.

31. *Id.*

32. *Id.*

33. *Id.*

3. *Is the Internet Really "Neutral"?*

When evaluating the net neutrality debate, it is critical to separate aspirations for what the Internet can be and what the Internet already is.[34] Many imagine or idealize the Internet as a "dumb pipe" that simply sends packets along, "fairly," in the order that they are received.[35] However, this conception is technically inaccurate and misleading.[36] Packet prioritization is commonplace today, and mostly uncontroversial, in several instances. First, the TCP architecture underlying the Internet is *itself* designed to regulate data flow based on the degree of congestion in a network.[37] Second, content providers are able to buy priority through service level agreements (SLAs) with Internet backbone providers (powerful commercial or government networks that form the "trunk" of the Internet).[38] SLAs typically provide assurances against network congestion, thus guaranteeing timely delivery of relevant data.[39] Content providers also strategically employ use of "content delivery networks" which provide data locally by caching their data.[40] Moreover, popular internet content providers, like Google, sometimes "colocate" caching servers within broadband ISPs' own facilities, reducing bandwidth costs.[41] In sum, the Internet is designed to prioritize traffic when necessary, and Internet backbone providers and caching services already afford some kinds prioritization to those who are able to pay for it. Thus, realistically conceived, the

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34. Weiser, *supra* note 14, at 279.

35. *See* Adam Thierer, *Are "Dumb Pipe" Mandates Smart Public Policy? Vertical Integration, Network Neutrality, and the Network Layer Model*, 3 J. TELECOMM. & HIGH TECH. L. 275, 276, 287-91 (2005).

36. Weiser, supra note 14, at 279 ("Stated simply, the Internet is not, and will never again be, a purely best-efforts-based network.").

37. *See* KUROSE & ROSS, *supra* note 25, at 241-48.

38. Weiser, *supra* note 14, at 281 ("Firms with major content hosted on websites (like ESPN.com) limit the opportunities for congestion by contracting with both Internet backbone providers and 'content delivery networks' . . . that have built servers across the country to store (or 'cache') content locally, which limits the likelihood of congestion along the way.").

39. *Id.*

40. *See* Editorial, *The Eden Illusion*, WASH. POST, Mar. 13, 2006, at A14 ("[B]ig e-tailers have accelerated their service by paying to 'cache' their Web pages on computers close to customers.").

41. Posting of Richard Whitt to Google Public Policy Blog, Net neutrality and the benefits of caching, http://googlepublicpolicy.blogspot.com/2008/12/net-neutrality-and-benefits-of-caching.html (December 15, 2008) ("Google has offered to 'colocate' caching servers within broadband providers' own facilities; this reduces the provider's bandwidth costs since the same video wouldn't have to be transmitted multiple times. We've always said that broadband providers can engage in activities like colocation and caching, so long as they do so on a non-discriminatory basis.").

net neutrality debate is one of degree, not absolutes. However, further "prioritization" of packets at the behest of ISPs—usually the last point of contact data traverses before reaching the end-user—is a relatively new kind of interference with internet traffic.

B. The FCC's Jurisdiction to Regulate the Internet

A significant portion of the Comcast Opinion addresses the Commission's authority to issue the Comcast Order. The FCC's jurisdiction over the Internet generally is not well settled. This Section outlines the principle jurisdictional issues contested in the Comcast Order. First, the Communications Act[42] provides an ample, but largely untested and uncertain source of authority. Second, the FCC's decision to proceed with informal adjudication, as opposed to more formalized rulemaking procedures, is a matter of some contention. Third, questions exist pertaining to the authoritative weight of the Commission's previously issued Internet Policy Statement. Finally, and most importantly, the FCC asserts its Title I ancillary jurisdiction—an arguably tentative theory of jurisdiction—as a basis for its authority to issue the Comcast Order.[43] Each of these issues will be summarized and their merits discussed in turn.

1. The Communications Act of 1934

The Communications Act of 1934[44] established the FCC for the purpose of "regulating interstate and foreign commerce in communication by wire and radio so as to make available . . .rapid, efficient, Nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges by securing a more effective execution of this policy by centralizing authority."[45]

The authority flowing from the Communications Act appears expansive. The broad scope of the FCC's organic statute is best illustrated by three provisions of the Communications Act.[46] First, statutory definitions state that the FCC's jurisdiction covers "all interstate and foreign communication by wire or radio."[47] Second, the FCC's authority includes all "instrumentalities, facilities, apparatus, and services" used for receipt, delivery, and forwarding the aforementioned transmissions.[48] Third, a sort of

42. 47 U.S.C. § 151 (2006).
43. *See infra* Part III.
44. Pub. L. No. 416, 48 Stat. 1064 (codified as amended 47 U.S.C. § 151 et seq.).
45. Communications Act of 1934, § 1, 47 U.S.C. § 151.
46. *See* Kevin Werbach, *The Federal Computer Commission*, 84 N.C. L. REV. 1, 70 (2005). In this paragraph, I closely follow Professor Werbach's presentation.
47. 47 U.S.C. § 152(a) (2006).
48. 47 U.S.C. § 153(33) (2006).

catch-all provision permits the FCC to "perform any and all acts, make such rules and regulations, and issue such orders, not inconsistent with this chapter, as may be necessary in the execution of its functions."[49] Taken together, these provisions have striking implications for the FCC's involvement in the computer and networks industry.[50]

The FCC has applied its sweeping statutory authority in numerous and diverse circumstances. For example, in the now infamous *Carterphone* decision, the FCC exercised its authority to regulate a rubber cup sold as an attachment for telephones to improve sound quality.[51] The FCC has also effected social policy, mandating that that all television sets over thirteen inches include technology to allow parental control of content (so-called "V-Chips").[52] In yet another area of communications policymaking, the FCC has directly regulated instant messaging (IM) protocols, requiring AOL to interoperate with other IM providers before approving a merger between AOL and Time Warner.[53] Thus, the Communications Act provides substantial flexibility in jurisdiction.

2. *Choice of Administrative Activity: Adjudication and Rulemaking*

The Administrative Procedure Act[54] grants administrative agencies broad discretion in choosing how to make law, subject to authority granted in the relevant organic statute.[55] Agencies might promulgate future-looking rules[56] through specified rulemaking procedures.[57] Alternatively,

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49. 47 U.S.C. § 154(i) (2006).

50. *See* Werbach, *supra* note 46, at 70.

51. *See* Use of the Carterphone Device in Message Toll Tel. Serv., 13 F.C.C.2d 420 (1968).

52. *See* Technical Requirements to Enable Blocking of Video Programming based on Program Ratings, ET Docket No. 97-206 (Fed. Commc'ns Comm'n, Mar. 13, 1998).

53. *See generally* Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations by Time Warner Inc. & Am. Online, Inc., Transferors, to AOL Time Warner, Transferee, 16 F.C.C.R. 6547 (2001).

54. The Administrative Procedures Act (APA) is a federal law that broadly governs administrative agencies. Administrative Procedure Act of 1946, Pub. L. No. 79-404, 60 Stat. 237 (codified as amended in scattered sections of 5 U.S.C.).

55. *See generally* SEC v. Chenery Corp. (*Chenery II*), 332 U.S. 194 (1947). An organic statute, or organic law, is a "law or system of laws or principles which defines and establishes the organization of its government." BLACK'S LAW DICTIONARY 991 (5th Ed. 1981). Organic statutes can define administrative agencies' organization, powers, and legal methodologies.

56. A rule is "an agency statement of general or particular applicability and future effect . . . ." 5 U.S.C. § 551(4) (2006).

agencies might issue retrospective orders through adjudication pertaining to a specific set of facts.[58] Rulemaking is often considered to be a favored method of establishing new policy because of its prospective nature and more rigorous procedural requirements.[59] However, the Supreme Court has expressly recognized agency discretion in choosing between rulemaking and adjudication, indicating that "[n]ot every principle essential to the effective administration of a statute can or should be cast immediately into the mold of a general rule. Some principles must await their own development, while others must be adjusted to meet particular, unforeseeable situations."[60] Thus, agencies are typically allowed broad discretion to act either by legislative rules via rulemaking or by individual orders via adjudication.[61] The FCC is expressly permitted to engage in both rulemaking and adjudicatory procedures in the Communications Act.[62]

3. The Internet Policy Statement

Agency-issued policy statements typically serve to inform regulated entities and the public how an agency will carry out its administrative mandate or proceed under certain factual circumstances. Policy statements generally do not carry procedural requirements for their promulgation and are not legally binding.[63] Agencies may not decide adjudicatory procedures based on a policy statement, but a policy statement can influence an agency decision within the scope of that agency's discretion. Accordingly, policy statements are among the most informal of an agency's official regulatory tools.

The FCC released its Internet Policy Statement in September of 2005.[64] The Internet Policy Statement recognized the FCC's authority to oversee and enforce the national internet policy Congress established un-

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57. Rulemaking procedures may be "formal" or "informal" in nature, each carrying varying levels of procedural rigor, depending on the requirements of statute pertaining to the subject matter of the rulemaking. 5 U.S.C. § 553 (2006).

58. An order is a "final disposition . . . of an agency in a matter other than rule making, but including licensing[.]" 5 U.S.C. § 551(6) (2006).

59. *See, e.g.*, *Chenery II*, 332 U.S. at 202 ("[U]nlike a court, [an agency] does have the ability to make new law prospectively through the exercise of its rule-making powers, [and thus] it has less reason to rely upon ad hoc adjudication to formulate new standards of conduct . . . .").

60. *Id.*

61. *Id.*

62. *See* 47 U.S.C. § 154(i) (2006).

63. *See* Gen. Elec. Co. v. EPA, 53 F.3d 1324 (D.C. Cir. 1995).

64. *In re* Appropriate Framework for Broadband Access to the Internet Over Wireline Facilities, 20 F.C.C.R. 14986 (2005) [hereinafter Internet Policy Statement].

der section 230 of the Communications Act.[65] The FCC announced its intention to incorporate Congress' policy guidelines into its policymaking and rulemaking activities.[66] Specifically, the FCC recognized its "duty to preserve and promote the vibrant and open character of the Internet as the telecommunications marketplace enters the broadband age."[67] The document also offered "guidance and insight" into the Commission's approach to internet policy and broadband access.[68] This preliminary document ends up framing the concerns addressed in the Comcast Opinion, but is not itself a source of direct authority.

4. Title I Ancillary Jurisdiction

Title I of the Communications Act created the FCC, described its mission, and detailed its general operations.[69] Title I includes a broad grant of rulemaking authority: "The Commission may perform any and all acts, make such rules and regulations, and issue such orders, not inconsistent with this chapter, as may be necessary in the execution of its functions."[70] This authority is often called the FCC's "ancillary jurisdiction" because it is used with reference to a statutory provision within the Communications Act.[71] Some scholars have argued this grant of authority is not a "full" grant of legislative authority, but rather something less—for example, the power to make and maintain internal procedures.[72] Nonetheless, the FCC has successfully invoked this authority in the past.[73]

Title I ancillary jurisdiction has become the most viable route to regulate the Internet since ISPs were reclassified under the governance of Title I. Prior to 2005, the Communications Act regulated Digital Subscriber Lines (DSL), Internet service carried over telephone wire ("dial-up" Inter-

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65. Section 230(b) states general Internet policies of the United States including "promot[ing] the continued development of the Internet" and "maximiz[ing] user control over what information is received by individuals, families, and schools." 47 U.S.C. § 230(b) (2006).

66. *Internet Policy Statement*, 20 F.C.C.R. 14988.

67. *Id.*

68. *Id.* at 14988. The FCC's list of principles includes the statement, "consumers are entitled to run applications and use services of their choice, subject to the needs of law enforcement." *Id.*

69. *See* 47 U.S.C. § 151 (2006) ("For the purpose of regulating interstate and foreign commerce in communication by wire and radio so as to make available, so far as possible, to all the people of the United States . . . .").

70. 47 U.S.C. § 154(i) (2006).

71. *See* United States v. Sw. Cable Co., 392 U.S. 157, 181 (1968).

72. *See, e.g.*, James B. Speta, *FCC Authority to Regulate the Internet: Creating It and Limiting It*, 35 LOY. U. CHI. L.J. 15, 23 (2003).

73. *See, e.g.*, *Sw. Cable Co.*, 392 U.S. 157.

net access), and cable Internet services differently, even though all provided functionally similar offerings.[74] Telephone networks were governed by Title II of the Communications Act, and thus ISPs relying on telephone networks were subject to more direct regulation and other obligations[75] from which cable services were largely exempt due to their classification as "information-service providers."[76] Recognizing this discrepancy, the FCC created a new regulatory framework for broadband connections, casting both DSL and cable modem services as unregulated "information services."[77] After a legal battle challenging the new classifications, the Supreme Court affirmed the FCC's new classifications in *National Cable & Telecommunications Association v. Brand X Internet Services.*[78] Internet services were thus consolidated in a comparatively "less regulated" statutory category under Title I. As a result, the FCC cannot rely on its Title II authority to promulgate legislative rules[79] or to adjudicate disputes[80] when dealing with ISPs. With ISPs classified as information service providers, the FCC has had to turn away from Title II as a basis for its authority and rely upon a new source—namely the grant of authority under Title I discussed in the previous paragraph.

The Supreme Court has approved the FCC's use of Title I ancillary jurisdiction under certain factual circumstances. In *United States v. Southwestern Cable Co.*,[81] a high watermark for ancillary jurisdiction, the Supreme Court relied upon Title I ancillary jurisdiction to affirm FCC regulation of cable television, even though cable television was neither a common carrier nor a broadcast service (the two relevant enumerated areas of FCC jurisdiction).[82] The Court exhibited a willingness to give the FCC broad authority, reasoning that "nothing . . . in the Act's history or purposes limits the Commission's authority to those activities and forms

74. *See* Nat'l Cable & Telecomm. Ass'n v. Brand X Internet Servs., 545 U.S. 967, 974 (2005).

75. For example, telecommunications carriers must charge just and reasonable, nondiscriminatory rates to their customers, 47 U.S.C. §§ 201-209 (2006), design systems so that other carriers can interconnect, 47 U.S.C. § 251(a)(1) (2006), and contribute to various federal funds, 47 U.S.C. § 254(d) (2006).

76. *See Brand X*, 545 U.S. at 967-68.

77. *See* Appropriate Framework for Broadband Access to the Internet over Wireline Facilities, Notice of Proposed Rulemaking, 17 F.C.C.R. 3019 (2002).

78. *Brand X*, 545 U.S. 967.

79. The Supreme Court found 47 U.S.C. § 201 gave the FCC authority to make legislative rules as to any matter in Title II. *See* AT&T Corp. v. Iowa Utils. Bd., 525 U.S. 366, 377-78 (1999).

80. *See* 47 U.S.C. §§ 207-208 (2006).

81. United States v. Sw. Cable Co., 392 U.S. 157 (1968).

82. *Id.* at 172.

of communication that are specifically described by the Act's other provisions."[83] The Court was wary of binding the FCC's hands with regard to its "ultimate purpose" without compelling evidence that Congress intended such a restriction.[84] Thus, in the wake of *Southwestern Cable*, the FCC seemed to wield a potent tool in its ancillary authority.

However, the trend since *Southwestern Cable* has been a narrowing one with regard to the FCC's ancillary authority.[85] In *FCC v. Midwest Video*, the Court struck down a variety of regulations the FCC sought to apply to cable companies, on the grounds that those companies were not within the Communication Act's substantive jurisdiction.[86] The court reasoned that while "lack of congressional guidance has in the past led us to defer—albeit cautiously—to the Commission's judgment regarding the scope of its authority," Congress' "hesitancy" on issues pertinent to the case cut strongly against approving the FCC's actions.[87] The Court clarified that ancillary authority must be invoked only when "necessary to ensure the achievement of the Commission's *statutory* responsibilities."[88] Some have perceived the Court's language as a significant narrowing of ancillary authority.[89]

Even so, Title I ancillary jurisdiction may still authorize FCC regulation of ISPs. In *Brand X*, the Court recognized in dicta the FCC's authority to regulate ISPs.[90] Specifically, the Court noted that "[ISPs] are not subject to mandatory common-carrier regulation under Title II, *though the Commission has jurisdiction to impose additional regulatory obligations under its Title I ancillary* jurisdiction to regulate interstate and foreign communications,"[91] and "the Commission remains free to impose *special*

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83. *Id.*

84. *Id.* at 177.

85. *See* Speta, *supra* note 72, at 24-25.

86. FCC v. Midwest Video Corp., 440 U.S. 689, 696—707 (1979). At issue were "rules requiring certain cable television systems to develop, at a minimum, 20-channel capacity by 1986, to make available certain channels for access by third parties, and to furnish equipment and facilities for access purposes." *Id.* at 689.

87. *Id.* at 708 ("[W]e are unable to ignore Congress' stern disapproval . . . . Though the lack of congressional guidance has in the past led us to defer—albeit cautiously—to the Commission's judgment regarding the scope of its authority, here there are strong indications that agency flexibility was to be sharply delimited.").

88. *Id.* at 706 (emphasis added).

89. *See, e.g.*, Speta, *supra* note 72, at 24-25 ("Nevertheless, more recent Supreme Court authority construes the FCC's Title I authority much more narrowly, certainly overruling the broadest language of Southwestern Cable.").

90. *See supra* Section I.B.4.

91. Nat'l Cable & Telecomm. Ass'n v. Brand X Internet Servs., 545 U.S. 967, 974 (2005) (emphasis added).

regulatory duties on facilities-based ISPs under its Title I ancillary jurisdiction."[92] This recent language seems to breathe some new life into the authoritative doctrine.

II. THE COMCAST OPINION AND ORDER

This Part summarizes the history, procedure, and reasoning of the Comcast Opinion and Order. Section II.A outlines relevant facts and procedural history. Section II.B details the FCC's reasoning. Section II.C briefly touches upon Comcast's pending appeal.

A. Facts and Procedural History

In 2007, Comcast customers began to notice problems when using BitTorrent and other peer-to-peer applications.[93] When complaints reached the media, Comcast denied responsibility, claiming, "We're not blocking any access to any application, and we don't throttle any traffic."[94] However, after conducting nationwide tests, the Associated Press (AP) concluded that Comcast was aggressively interfering with peer-to-peer applications.[95] The AP's report concluded that Comcast's method of throttling peer-to-peer traffic involved falsifying network traffic—that is, adding information to customers' data transfers.[96] By forging "reset packets" Comcast disrupted customers' data transfers until overall bandwidth usage fell below a predetermined level.[97] Although Comcast claimed that this practice was only employed during times of peak network congestion, evidence again contradicted Comcast's claim, showing slowdowns at all times of day.[98] The interference was severe, perpetrated on only one segment of internet traffic and, in some instances, blocked the traffic instead of merely slowing it down.[99]

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92. *Id.* at 996 (emphasis added). Justice Scalia bemoaned the extension of ancillary authority in his dissent, writing that "[t]his is a wonderful illustration of how an experienced agency can (with some assistance from credulous courts) turn statutory constraints into bureaucratic discretions." *Id.* at 996 (Scalia, J., dissenting).

93. *See In re* Formal Complaint of Free Press & Pub. Knowledge Against Comcast Corp. for Secretly Degrading Peer-to-Peer Applications, 23 F.C.C.R. 13028 (2008).

94. *Id.*

95. *Id.* at para. 7; Peter Svensson, *Comcast Blocks Some Internet Traffic, AP Testing Shows*, ASSOCIATED PRESS, Oct. 19, 2007.

96. In re *Formal Complaint of Free Press*, 23 F.C.C.R. at 13028, para. 8.

97. *Id.* at para. 9.

98. *Id.*

99. *Id.*

Free Press[100] filed a complaint with the FCC against Comcast on November 1, 2007, asking the Commission to declare that Comcast had violated the FCC's Internet Policy Statement by degrading peer-to-peer traffic.[101] More than twenty thousand Americans submitted complaints to the FCC shortly after.[102] Free Press also requested a declaratory ruling to "clarify that an Internet service provider violates the FCC's Internet Policy Statement when it intentionally degrades a targeted Internet application."[103]

B. The FCC's Decision

The FCC responded to the Free Press complaint through adjudication, justified its jurisdiction upon Title I ancillary authority, and deemed Comcast's network management practices unreasonable.

1. Choice of Adjudication

The Commission chose to respond to the complaints against Comcast through adjudication, rather than by promulgating regulation through rulemaking.[104] The Commission offered three reasons for its choice of procedure. First, the Commission characterized the matter of Comcast's conduct as a novel issue and deserving of extra caution.[105] Second, the Commission maintained that broadband internet access services are "specialized and varying in nature [so] as to be impossible to capture within the boundaries of a general rule."[106] Third, the Commission reasoned that a narrow adjudicatory approach was in accord with its stated policy of proceeding with restraint.[107]

Comcast challenged the use of adjudication as inappropriate, contending that "[m]aking 'policy through adjudication' would be particularly problematic here, because the Commission currently has at least four open proceedings asking whether it should, or even has the authority to, adopt

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100. The Free Press is "the largest media reform organization in the United States, with nearly half-a-million activists and members. . . ." Free Press, About Us, http://www. freepress.net/about_us (last visited Feb. 3, 2009).

101. In re *Formal Complaint of Free Press*, 23 F.C.C.R. at para. 10.

102. *Id.*

103. *Id.* at para. 11.

104. *Id.* at para. 29.

105. *Id.* at para. 30 ("[T]he Internet is a new medium, and traffic management questions like the one presented here are relatively novel.").

106. *Id.* at para. 31.

107. *Id.* at para. 32.

[such] regulations."[108] Comcast also argued its due process rights were implicated by lack of fair notice and the retroactive effects of the rule.[109] The Commission, however, maintained that Comcast had proper notice of a potential adjudication from past proceedings,[110] and stated that its decision to adjudicate did not comprise a radical departure from previous FCC interpretations of the law.

2. *Jurisdictional Grounds*

The Commission invoked Title I ancillary authority as its primary source of jurisdiction to decide the Comcast dispute.[111] The Commission reasoned that since the issue of network management implicated "communications by wire,"[112] the Commission's Title I jurisdiction applied.[113] The Commission was then required to identify specific "statutory responsibilities" to support its invocation of Title I ancillary authority.[114] The Commission cited the broad congressional internet policy mandates of section 230, arguing that since the policy goals were inscribed into "the very same Act that established this Commission as [a] federal agency,"[115] they were the FCC's to carry out and enforce.[116] Moreover, the Commission cited six separate additional statutory provisions to support its Title I ancillary authority: section 1 of the Communications Act,[117] section 201 of the Communications Act,[118] section 706 of the Telecommunications

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108. Comments of Comcast Corp., *In re* Broadband Industry Practices, WC Docket No. 07-52, at 44 (Fed. Commc'ns Comm'n 2008) [hereinafter Comcast Comments].

109. *Id.* at 54 ("[S]uch action would violate Comcast's due process rights.").

110. Specifically, in a prior proceeding involving acquisition of Adelphia's cable systems, the Commission warned that "[i]f in the future evidence arises that any company is willfully blocking or degrading Internet content, affected parties may file a complaint with the Commission." In re *Formal Complaint of Free Press*, 23 F.C.C.R. at para. 35.

111. *Id.* at para. 15 ("[W]e think our ancillary authority to enforce federal policy is quite clear.").

112. 47 U.S.C. § 152(a) (2006).

113. In re *Formal Complaint of Free Press*, 23 F.C.C.R. at para. 15.

114. FCC v. Midwest Video Corp., 440 U.S. 689, 706 (1979).

115. In re *Formal Complaint of Free Press*, 23 F.C.C.R. at para. 15.

116. *Id.*

117. 47 U.S.C. § 151 (2006) (directing the Commission to "make available, so far as possible, to all people . . . a rapid, efficient, Nation-wide, and world-wide wire and radio communication service with adequate facilities and reasonable charges").

118. 47 U.S.C. § 201(b) (2006) (providing that "[a]ll charges, practices, classifications, and regulations for and in connection with [common carrier] service, shall be just and reasonable, and any such charge, practice, classification, or regulation that is unjust or unreasonable is declared to be unlawful").

Act of 1996,[119] section 256 of the Telecommunications Act,[120] section 257 of the Telecommunications Act,[121] and section 601(4) of the Telecommunications Act.[122]

In his dissent, Commissioner Robert M. McDowell critiqued the FCC's invocation of ancillary authority.[123] Commissioner McDowell agreed that the FCC had jurisdiction over the "general areas" involved in the adjudication.[124] However, he maintained that the majority's theory of adjudicating solely based on ancillary authority was legally deficient, arguing that "in the absence of rules, neither the general policy goals set forth in sections 230 [or the other cited provisions] provide enough of a legal basis for us to act."[125] Commissioner McDowell also expressed concern that Congressional attempts at legislation suggested the FCC did not have immediate authority.[126]

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119. 47 U.S.C. § 157 (2006) (providing that the "Commission . . . shall encourage the deployment on a reasonable and timely basis of advanced telecommunications capability to all Americans").

120. 47 U.S.C. § 256 (2006) (providing that the Commission should "promote nondiscriminatory accessibility by the broadest numbers of users . . . [and] ensure the ability of users and information providers to seamlessly and transparently transmit and receive information").

121. 47 U.S.C. § 257 (2006) (mandating that the Commission eliminate "market entry barriers for entrepreneurs and other small businesses in the provision and ownership of telecommunications services").

122. 47 U.S.C. § 601 (2006) (advancing the policy of "assur[ing] that cable communications provide and are encouraged to provide the widest possible diversity of information sources and services to the public"). For summaries of the individual arguments, *see In re* Formal Complaint of Free Press and Public Knowledge Against Comcast Corp. for Secretly Degrading Peer-to-Peer Applications, 23 F.C.C.R. 13028 (2008), 23 F.C.C.R. 13028 (2008).

123. *See* In re *Formal Complaint of Free Press*, 23 F.C.C.R. at 13090 (McDowell, Comm'r, dissenting).

124. *Id.*

125. *Id.*

126. *Id.* Commissioner McDowell argued that:

> If Congress had wanted us to regulate Internet network management, it would have said so explicitly in the statute, thus obviating any perceived need to introduce legislation as has occurred during this Congress. In other words, if the FCC already possessed the authority to do this, why have bills been introduced giving us the authority we ostensibly already had?

Id.

3. *The Merits*

The Commission determined that Comcast's practices were "invasive and outright discriminatory."[127] Noting numerous customer complaints, the Commission concluded that the "conduct significantly impeded consumers' ability to access the content and use the applications of their choice."[128] The Commission expressed concern that such practices violated the expectations of internet developers and would prompt confusion as to why certain programs were underperforming.[129] The Commission also cited numerous experts and academics that had condemned the practice.[130] Finally, the Commission expressed concern that Comcast's practices could lead to anticompetitive behavior.[131]

The Commission concluded that Comcast's practices were unreasonable and not carefully tailored to the legitimate interest of easing network congestion.[132] First, customers could be affected based solely on their use of a particular application, regardless of bandwidth usage.[133] Second, the interference appeared to apply at all times of the day and not just at times of increased traffic.[134] Third, all Internet access, not just that present in particularly congested neighborhoods, was affected by the traffic shap-

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127. In re *Formal Complaint of Free Press*, 23 F.C.C.R. at para. 42.

128. *Id.* at para. 44.

129. *Id.* at para. 45.

130. *Id.* at para. 46. The Commission summarized some academic testimony as follows:

> For example, Professor Jon Peha of Carnegie Mellon termed Comcast's practices a "possible case of consumer fraud" and stated that he was "unaware of any technical literature that has proposed that ISPs adopt this particular practice as a way of dealing with congestion, or to use this practice to address any other issue that might be important in the context of network management." Indeed, he questioned whether Comcast's practices fell "within the realm of network management at all, much less reasonable network management." Professor David Reed of the Massachusetts Institute of Technology said that "[n]either Deep Packet Inspection nor RST Injection"—Comcast uses both to manage its network—"are acceptable behavior." Professor David Clark of the Massachusetts Institute of Technology testified that Comcast was in essence "imposing a value judgment on the consumer, and that is, in the end, looking at your customer and saying 'enemy.'"

Id. (internal citations omitted).

131. *Id.* at para. 47 ("Comcast's practice selectively blocks and impedes the use of particular applications, and we believe that such disparate treatment poses significant risks of anticompetitive abuse.").

132. *Id.* at para. 48.

133. *Id.*

134. *Id.*

ing.[135] Reinforcing its finding, the Commission pointed out a variety of other options at Comcast's disposal for managing traffic, including bandwidth caps.[136] The Commission also admonished Comcast for its failure to disclose its practices to its customers.[137]

Accordingly, the Commission ordered that Comcast must, within thirty days, (1) disclose the precise contours of its network management practices, (2) submit a compliance plan to the Commission, and (3) disclose to the Commission and the public details of the network management practices that it intended to deploy in the future.[138]

C. Comcast's Appeal

Comcast appealed the Commission's order on September 4, 2008 to the Court of Appeals for the D.C. Circuit.[139] Comcast's basis for appeal was the question of the FCC's jurisdiction to adjudicate the dispute.[140] David Cohen, a Comcast vice president, stated that Comcast would comply with the order, but maintained that the Commission went too far.[141] Cohen stated: "We filed this appeal in order to protect our legal rights and to challenge *the basis* on which the commission found that Comcast violated federal policy in the absence of pre-existing legally enforceable standards or rules."[142]

III. ANALYSIS

This section provides an analysis of the FCC's jurisdiction to issue the Comcast Order. Section III.A discusses the unclear standard of review,

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135. *Id.*

136. *Id.* at para. 49. Comcast has since imposed such a bandwidth cap. *See* Jacqui Cheng, *It's official: Comcast starts 250GB bandwidth caps October 1*, ARS TECHNICA, August 28, 2008, http://arstechnica.com/old/content/2008/08/its-official-comcast-starts-250gb-bandwidth-caps-october-1.ars.

137. In re *Formal Complaint of Free Press*, 23 F.C.C.R. at para. 52 ("[D]isclosure of network management practices to consumers in a manner that customers of ordinary intelligence would reasonably understand would enhance the 'vibrant and competitive free market . . . for the Internet and interactive computer services' by allowing consumers to compare and contrast competing providers' practices.") (internal citations omitted).

138. *Id.* at paras. 57-60.

139. *See* Saul Hansell, *Comcast Appeals F.C.C. Sanction*, BITS BLOG, Sept. 4, 2008, http://bits.blogs.nytimes.com/2008/09/04/comcast-appeals-fcc-sanction/.

140. David Kravets, *Comcast Appeals FCC Throttling Order*, WIRED, Sept. 04, 2008, (Threat Level blog), http://blog.wired.com/27bstroke6/2008/09/comcast-appeali.html.

141. *Id.*

142. *Id.* (emphasis added).

highlighting a circuit split where agency interpretations raise jurisdictional questions. Section III.B briefly weighs potential challenges to the FCC's use of adjudicatory proceedings. Section III.C reflects upon the fact that Title I ancillary authority is currently the FCC's only viable route to address Internet regulation and predicts the question will extend beyond the instant case.

A. The Standard of Judicial Review is Unclear

The standard of judicial review relevant to the Comcast Order is not clear. Ordinarily, courts have a duty to defer to reasonable agency interpretations of statutes that the agency is charged with administering.[143] However, there is a vexing and unresolved question as to whether strong deference should be given to agency interpretations that implicate the scope of the agency's jurisdiction.[144] Fearing aggrandizement of agency power, courts have applied various standards of review but "generally failed to enunciate clear and consistent rationales for such a result."[145] The consequence is a deep circuit split on deferential standards[146] that remains unresolved by the Supreme Court.[147] The D.C. Circuit, which will decide Comcast's appeal, has gone both ways on the issue. Ultimately, the amount of deference given will likely turn on the court's interpretation of

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143. *See* Chevron U.S.A. Inc. v. Natural Res. Defense Counsel, Inc., 467 U.S. 837 (1984); *see also* Thomas W. Merrill & Kristin E. Hickman, *Chevron's Domain*, 89 GEO. L.J. 833, 833. Merrill and Hickman explain that:

> Chevron expanded the sphere of mandatory deference through one simple shift in doctrine: It posited that courts have a duty to defer to reasonable agency interpretations not only when Congress expressly delegates interpretative authority to an agency, but also when Congress is silent or leaves ambiguity in a statute that an agency is charged with administering.

Id.

144. *See* Merrill, *supra* note 143, at 909.

145. Timothy K. Armstrong, *Chevron Deference and Agency Self-Interest*, 13 CORNELL J.L. & PUB POL'Y 203, 205 (2004).

146. The Second, Third, Fourth, and Ninth Circuits have given full *Chevron* deference to jurisdictional interpretations. *See* Connecticut v. United States Dep't. of the Interior, 228 F.3d 82, 93 (2d Cir. 2000); Air Courier Conference of Am. v. U.S. Postal Serv., 959 F.2d 1213, 1223-25 (3d Cir. 1992); Bd. of Governors of the Univ. of N.C. v. U.S. Dep't. of Labor, 917 F.2d 812, 816 (4th Cir. 1990); Transpacific Westbound Rate Agreement v. Fed. Mar. Comm'n, 951 F.2d 950, 952 (9th Cir. 1991). The Seventh Circuit has declined to do so. *See* N. Ill. Steel Supply Co. v. Sec'y of Labor, 294 F.3d 844, 846-47 (7th Cir. 2002); United Transp. Union v. Surface Transp. Bd., 169 F.3d 474, 477 (7th Cir. 1999).

147. *See* Merrill, *supra* note 143, at 909.

congressional intent.[148] Further muddying the waters is the difficult threshold question of *when* jurisdictional questions are actually implicated. Justice Scalia persuasively argued that "there is no discernable line between an agency's exceeding its authority and an agency's exceeding authorized application of its authority."[149] The D.C. Circuit may be swayed by an argument from Comcast that the Comcast Order constitutes a "jurisdictional question" of substantial scope and character in hopes of shaking traditionally strong deference.

Midwest Video[150] might provide analytic guidance regarding important issues likely to be raised on review. The *Midwest Video* court asked two central questions when analyzing the validity of an invocation of Title I ancillary authority: First, is there any indication that Congress reserved such power for itself?[151] Second, was the Commission's exercise of authority "necessary to ensure the achievement of the Commission's statutory responsibilities"?[152] Thus, when the Comcast Order undergoes judicial review, the court is likely to ask if current and past attempts at congressional net neutrality legislation are an indication that Congress "reserved authority" to regulate network management;[153] if the broad policy goals of section 230 of the Communications Act are bona fide "statutory responsibilities";[154] and if the Supreme Court's recent willingness to allow the Commission to regulate information service providers[155] carries sufficient weight to support the invocation of authority in the Comcast Order.

B. The FCC's Choice of Adjudication is Likely Valid in and of Itself, but Might Affect Judicial Review

The Commission's decision to proceed by adjudication is likely valid in and of itself. The Supreme Court has clearly affirmed agencies' broad discretion in choosing a decision-making forum.[156] It is very rare that this choice would amount to an abuse of discretion.[157] Thus, absent a compel-

148. *See Id.* at 913 (The amount of deference given to jurisdictional questions will likely "turn on an effort to uncover Congress's intent regarding the most appropriate interpreter.").

149. Miss. Power & Light Co. v. Mississippi, 487 U.S. 354, 381 (1988) (Scalia, J., concurring in the judgment).

150. *See supra* notes 86-89 and accompanying text.

151. *See* FCC v. Midwest Video Corp., 440 U.S. 689, 907 (1979).

152. *Id.* at 706.

153. *See supra* note 87 and accompanying text.

154. *See supra* note 88 and accompanying text.

155. *See supra* note 91 and accompanying text.

156. *See generally* SEC v. Chenery Corp. (*Chenery II*), 332 U.S. 194 (1947).

157. Pfaff v. HUD, 88 F.3d 739, 748 (9th Cir. 1996).

ling argument that adjudication is inappropriate in this instance,[158] proceeding by adjudication was likely a valid decision on the part of the Commission.

Nevertheless, Comcast has argued and Commissioner McDowell has agreed that rulemaking procedures would have been a more acceptable route in this instance.[159] Comcast argued that ancillary authority is only properly invoked in rulemaking processes.[160] Commissioner McDowell suggested that rulemaking would have been a stronger vehicle for policy, writing in his dissent that "[t]his matter would have had a better chance on appeal if we had put the horse before the cart and conducted a rulemaking, issued rules and *then* enforced them."[161] The idea that the FCC should act through a more deliberative rulemaking procedure when at the fringe of its jurisdiction possesses some common sense appeal, but lacks apparent doctrinal support.[162] Commissioners in support of the Comcast Order were careful to reinforce the lengthy and deliberative nature of the adjudication in their written opinions.[163] Accordingly, it is possible that the decision to adjudicate in this instance might be viewed as cutting against the FCC.

C. Jurisdiction by Ancillary Authority is the FCC's Best and Only Option

Ancillary authority is a relatively untested theory of jurisdiction that has received mixed treatment and limited attention from the courts.[164]

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158. For example, the Ninth Circuit explained that:

> Such a situation may present itself where the new standard, adopted by adjudication, departs radically from the agency's previous interpretation of the law, where the public has relied substantially and in good faith on the previous interpretation, where fines or damages are involved, and where the new standard is very broad and general in scope and prospective in application.

Id.

159. *See* Comcast Comments, *supra* note 108, at 49-50.

160. *See id.* ("The Commission's ancillary authority relates solely to its statutory authority to adopt rules and regulations . . . it is not a general grant of enforcement authority to punish entities for engaging in conduct that would violate a rule . . . that the Commission has consciously *not* adopted.").

161. *In re* Formal Complaint of Free Press & Pub. Knowledge Against Comcast Corp. for Secretly Degrading Peer-to-Peer Applications, 23 F.C.C.R. 13028, 13090 (2008).

162. Neither Comcast nor Commissioner McDowell cite authority to this point.

163. *See, e.g.*, *id.* at 13079 ("Let me emphasize again the cautious and well-considered approach the majority takes in this proceeding about the future of the Internet.").

164. *See supra* Section I.B.4.

Scholars have characterized it as "at best, uncertain"[165] and "contain[ing] few, if any, limits."[166] Further compounding uncertainty is the fact that the statutory provisions offered in support of the FCC's invocation are vague themselves. However, as the Communications Act is written today, ancillary authority is probably the only theory upon which the FCC can meaningfully impact internet policy. Professor Werbach poetically described the FCC as "a grand old hotel built many yards inland from a beach. Over time, as the beach erodes, the water creeps closer to the hotel until it reaches the edge of the property. The hotel has not grown or moved at all; the water has come to it."[167] There are no clear standards to guide the FCC in regulating the rapidly-changing world of the Internet. Accordingly, to justify many of its recent farther-reaching decisions, the Commission has been required to call upon its most capacious statutory authority.[168] Simply by virtue of a quickly-evolving technological society, the Commission's authority is bound to appear somewhat reaching in nature.

IV. CONCLUSION

The validity of the Commission's exercise of authority in the Comcast Order is difficult to predict. The authoritative doctrine applied by the FCC is relatively untested and potentially expansive.[169] The proper standard of judicial review remains shrouded in mystery.[170] The issue of net neutrality remains ideologically charged.[171] "Regulation" of the Internet is a brave new frontier.[172] Thus, there are no easy answers to be found at this stage in the game.

The D.C. Circuit, in deciding Comcast's appeal of the FCC's order, has sufficient grounds to find for Comcast. Congress' recent debates about net neutrality issues could be interpreted by the D.C. Circuit as indicating that Congress intends for itself to have authority over regulating (or not regulating) ISP network management.[173] The "statutory responsibilities" cited by the FCC might be deemed too vague, or the congressional policy

165. *Id.* at 22.
166. *Id.* at 58.
167. Werbach, *supra* note 46, at 51.
168. *See id.* at 60.
169. *See supra* Section I.B.4.
170. *See supra* Section III.A.
171. *See supra* note 14 and accompanying text.
172. *In re* Formal Complaint of Free Press & Pub. Knowledge Against Comcast Corp. for Secretly Degrading Peer-to-Peer Applications, 23 F.C.C.R. 13028, para. 30 (2008).
173. *See supra* note 87 and accompanying text.

goals of section 230 too flimsy, to support an invocation of ancillary authority practices.[174] Finally, the court might take issue with the procedural method chosen by the FCC—adjudication—and somehow cabinet the exercise of ancillary authority to the generally slower realm of rulemaking.[175]

Nevertheless, the D.C. Circuit also has sufficient grounds to affirm the FCC. Agencies traditionally enjoy strong deference when interpreting their own statutes.[176] The Supreme Court's dicta in *Brand X* indicates that the FCC has substantive authority over Title I information service providers—a category that includes ISPs—and serves as evidence that the agency has a role to play.[177] Furthermore, a plain reading of the Communication Act suggests that the FCC has substantive authority to *some* extent.[178] To what extent remains an open question.

The uncertain character of the FCC's first venture into ISP regulation does not itself suggest that the FCC is an inadequate agent for shaping internet policy. Notably, even Comcast concedes that the FCC has the power to regulate ISPs through rulemaking processes.[179] Thus, even if the Comcast Order is overturned, the FCC will likely be left to explore other authoritative and procedural methodologies to effect internet policy. The fact-finding abilities and expertise of administrative agencies will surely be needed to effectively address issues as new and complicated as net neutrality. What is almost certain is that we have not seen the last of the FCC in matters of internet policy. In the words of Commissioner McDowell, at this point two things are clear: "this debate will continue, and the FCC has generated more questions than it has answered."[180]

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174. *See supra* note 88 and accompanying text.

175. *See supra* Section III.B.

176. *See supra* Section I.B.2.

177. *See supra* note 91 and accompanying text.

178. *See supra* Section I.B.1.

179. *See, e.g.*, *In re* Formal Complaint of Free Press & Pub. Knowledge Against Comcast Corp. for Secretly Degrading Peer-to-Peer Applications, 23 F.C.C.R. 13028, para. 30 ("Indeed, Comcast *itself* admitted Commission jurisdiction over its network management practices in litigation before the U.S. District Court for the Northern District of California.").

180. *Id.* at 13095 (McDowell, Comm'r, dissenting).

"MAKE MONEY WITHOUT DOING EVIL?" CAUGHT BETWEEN AUTHORITARIAN REGULATIONS IN EMERGING MARKETS AND A GLOBAL LAW OF HUMAN RIGHTS, U.S. ICTS FACE A TWOFOLD QUANDARY

By Brian R. Israel

In 2004, Yahoo!'s Hong Kong subsidiary received a request from the Beijing State Security Bureau for information about a Yahoo! email account registration, login times, and associated IP addresses.[1] The request cited the account-holder's "illegal provision of state secrets to foreign entities."[2] Yahoo! Hong Kong complied with the request and furnished information leading to the identification of a Chinese journalist named Shi Tao. On the U.S.-based Internet site "Democracy Forum," Shi Tao had described a Chinese government warning to journalists to avoid making anti-government statements and to report any contact with human rights activists.[3]

Enabled by the information from Yahoo!, the Chinese government kidnapped Shi Tao and detained him for weeks without charge before sentencing him to ten years in prison, where he allegedly endures torture.[4] With the help of human rights organizations, the families of Shi Tao and Wang Xiaoning (another dissident persecuted after Yahoo! provided Chinese authorities with identifying information) sued Yahoo! in U.S. federal court under the Alien Tort Claims Act,[5] claiming that Yahoo! aided and

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1. Beijing State Security Bureau, Notice of Evidence Collection, 2004 BJ State Sec. Ev. Coll. No. 02, *original and English available at* http://www.duihau.org/press/news070725_ShiTao.pdf.

2. Id.

3. Human Rights Watch, "Race to the Bottom:" Corporate Complicity in Chinese Internet Censorship, Volume 18, No. 8(C) (2006) p. 107.

4. *Yahoo! Inc.'s Provision of False Information to Congress, Hearing Before H. Comm. On Foreign Affairs*, 110th Cong. 7 (2007) (Representative Christopher Smith expressed his belief that "based on our best information, [Shi Tao] is being tortured").

5. As explained below, this statute confers federal jurisdiction for gross violations of international law. *See* discussion *infra* Section I.B.2.

abetted torture and arbitrary detention.[6] Following two contentious appearances before congressional committees, Yahoo! settled with the families of Shi Tao and Wang Xiaoning in February 2007.[7]

Shi Tao's fate is unfortunately not unique. Contrary to predictions that the Internet would energize progressive reform in authoritarian states,[8] such states have proven capable of controlling the Internet within their territories, restricting unfavorable information and persecuting so-called "cyber dissidents"—activists using the Internet as a platform for political dissent.[9] A telling symptom of this repressive control is that internet journalists now comprise the single largest group of imprisoned journalists worldwide.[10] Nowhere are more internet journalists imprisoned than in China, which maintains the world's most extensive and sophisticated system for internet censorship and surveillance.[11]

Nor is the entanglement of U.S. information and communication technology companies (ICTs) in such human rights abuses likely to subside. Leading U.S. ICTs such as Yahoo!, Microsoft, and Google have come to China, drawn by unparalleled opportunities in the world's largest Internet market.[12] These companies embrace identities that combine altruism with innovation;[13] indeed, Google's well-known corporate philosophy is to

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6. Second Am. Compl., Xaioning et al v. Yahoo! Inc. et al, No. C07-02151 (N.D. Cal. Jul. 30, 2007) [hereinafter *Shi Tao complaint*] *available at* http://www.humanrightsusa.org/index.php?option=com_docman&task=doc_download&gid=68&Itemid=99999999.

7. Joint Stipulation of Dismissal, Xaioning et al v. Yahoo! Inc. et al, No. C07-02151 (N.D. Cal. Nov. 13, 2007).

8. *See, e.g.*, Nicholas D. Kristof, *Death by a Thousand Blogs*, N.Y. TIMES, May 24, 2005, at A21.

9. S*ee generally* Robert Faris and Nart Villeneuve, *Measuring Global Internet Filtering*, *in* ACCESS DENIED: THE PRACTICE AND POLICY OF GLOBAL INTERNET FILTERING 5 (Ronald Deibert, John Palfrey, Rafal Rohozinski, Jonathan Zittrain, eds., 2008).

10. COMMITTEE TO PROTECT JOURNALISTS, CPJ 2008 PRISON CENSUS: ONLINE AND IN JAIL, 1 (2008), http://cpj.org/imprisoned/cpjs-2008-census-online-journalists-now-jailed-mor.php.

11. As of December 4, 2008, 24 of 28 journalists imprisoned in China were internet journalists. *Id.* at 2; *see also* Human Rights Watch, *supra* note 3, at 9.

12. The number of Internet users in China recently eclipsed the United States, making China the world's largest Internet market. David Barboza, *China Surpasses U.S. in Number of Internet Users*, N.Y. TIMES, Jul. 26, 2008, at C3.

13. *See, e.g.*, Letter from Jerry Yang, CEO of Yahoo! Inc., to Condoleezza Rice, U.S. Secretary of State (Feb. 21, 2008) *available at* http://www.bayareanewsgroup.com/multimedia/mn/news/yang_letter_022208.pdf; Microsoft Corporate Citizenship site, http://www.microsoft.com/about/corporatecitizenship/us/default.mspx (last visited Sept. 20, 2008).

"make money without doing evil."[14] The Chinese government and its policies have tested that ethos. Unable to consummate its control over the Internet in China without the cooperation of private ICTs, the Chinese government requires ICTs to actively filter Internet content deemed unfavorable and to hand over user-information.[15]

It seems uncontroversial that U.S. ICTs face a *moral* dilemma when asked to assist with censorship and persecution of political dissidents. This often unspoken assumption pervades news reports,[16] statements by nongovernmental organizations (NGOs),[17] and congressional hearings[18] on the issue. Less appreciated, or at least insufficiently articulated, is that operating in internet-restricting countries presents a profound *business* quandary for U.S. ICTs, threatening crucial assets. This business quandary is the result of conflicting standards to which ICTs are simultaneously subject: the local regulations of authoritarian states, and a global standard informed by international human rights norms and societal expectations in the companies' home markets.

This Note seeks to articulate the business quandary facing U.S. ICTs operating in countries that condition market access on cooperation with state-imposed censorship and political persecution. Part I delineates the components of what shall be termed the *global law* with which ICT conduct must conform separate and apart from the local laws of authoritarian states. It then identifies a spectrum of business consequences for noncompliance with the global law that transcend mere moral objection. For ex-

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14. Google, *Corporate Information – Our Philosophy*, http://www.google.com/corporate/tenthings.html (last visited February 2, 2009).

15. In 2002, the Chinese Information Ministry reportedly required foreign ICTs to sign a "self-discipline pact" obligating them "not to produce or disseminate harmful texts or news likely to jeopardise national security and social stability, violate laws and regulations, or spread false news, superstitions and obscenities." The "self-discipline pact" further requires of ICTs "co-operation by sites in the fight against cybercrime and against the violation of intellectual property rights." Reporters Without Borders for Press Freedom, "Living Dangerously on the Net:" Censorship and surveillance of Internet Forums, May 12, 2003, http://www.rsf.org/print.php3?id_article=6793 (last visited Sept. 21, 2008).

16. *See, e.g.*, Nicholas D. Kristof, *China's Cyberdissidents and the Yahoos at Yahoo*, N.Y. TIMES, Feb. 19, 2006, § 4, at 13.

17. *See, e.g.*, Press Release, Human Rights Watch, China: Internet Companies Aid Censorship (Aug. 8, 2006), *available at* http://www.hrw.org/en/news/2006/08/08/china-internet-companies-aid-censorship.

18. See, e.g., The Internet In China: A Tool For Freedom or Suppression? Hearing Before H. Subcomm. On Africa, Global Human Rights, and International Operations, and H. Subcomm. Asia and the Pacific, H. Comm. On International Relations, 109th Cong. (2006).

ample, ICT conduct that leads to grave violations of international law—such as torture, extrajudicial killing, and prolonged arbitrary detention[19]—can lead to U.S. federal court actions under the Alien Tort Claims Act.[20] Part II examines recent responses to this quandary by the federal government, NGOs and ICTs. Most promising is the Global Network Initiative launched in October 2008, a comprehensive code of conduct and accountability mechanism that is the result of ongoing collaboration among ICTs, NGOs, academics, and investors. Although the problem cannot be completely overcome by nongovernment actors, the Global Network Initiative represents the best available opportunity for ICTs that wish to seize opportunities in emerging markets while adhering to their core values, avoiding litigation exposure, and safeguarding their brands and human capital.

I. THE BUSINESS QUANDARY

The business quandary can be summarized as follows. Competitive necessity drives ICT expansion into new markets, including repressive states that brutally suppress political dissent. Some such states require—by law or "voluntary" agreement—that ICTs assist the government by restricting Internet content and providing user-identifying information upon request. Companies are thus simultaneously subject to two conflicting laws: the local law and a *global law* comprising international human rights standards, company and industry codes of conduct, and the expectations of key stakeholders. Where, as in the Shi Tao case, a government requests identifying information that may lead to the persecution of a user, ICTs presently face a choice between strained ties with the host government or an Alien Torts Claim Act suit and public condemnation at home. Where the immediate human consequences of government demands are less dramatic—as is often the case with content filtering—the consequences are subtler, but the corrosive effects on brand and human capital may nonetheless impair competiveness in the long term.

A. Defining the Contours of the "Global Law"

Global law, as used here, means a standard of conduct independent of any national legal system backed by consequences for noncompliance.[21] Apart from local laws, the standard governing ICT involvement in states'

19. *See infra* Section I.B.2 (identifying the state action for which ICTs may be accessorily liable).

20. 28 U.S.C. § 1350 (2006).

21. The concept of a "global law" is inspired by Joe W. (Chip) Pitts III, *Business, Human Rights, & the Environment: The Role of the Lawyer in CSR & Ethical Globalization*, 26 BERKELEY J. INT'L L. 479, 488 (2008).

assertion of repressive control over the Internet is international human rights law. This body of treaties, customary international law and judicial decisions binds states in the first instance. As relevant here, it proscribes state-interference with expression, privacy, and physical persecution.[22] International human rights law becomes relevant to private ICTs when they *assist* state actions that violate human rights norms; for example, by filtering Internet content, intercepting electronic communications, and providing user-identifying information to state authorities.

Some measure of the state interference with privacy and expression is broadly accepted in even the most liberal democracies as necessary to secure vital public goods.[23] International human rights law demarcates the admittedly blurry line between governmental control of the Internet that is accepted, and that which carries adverse consequences for ICTs. ICT assistance with some state conduct on the wrong side of that line is actionable in U.S. courts.[24] In many instances the global law is enforced through non-legal means.[25]

Google, Yahoo! and Microsoft recently became more directly accountable for human rights norms through membership in the Global Network Initiative.[26] Through the Initiative they have voluntarily agreed to abide by a code of conduct that codifies international human rights law and to subject their operations to independent assessments of their compliance with these standards.[27] And for those ICTs not yet participating in the

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22. *See, e.g.*, Articles 17 (privacy) and 19 (expression) of the International Covenant on Civil and Political Rights, Mar. 23, 1976, General Assembly Resolution 2200A(XXI) [hereinafter ICCPR]; RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 702 (1987) (stating that torture and prolonged arbitrary detention constitute violations of international law).

23. JACK GOLDSMITH & TIM WU, WHO CONTROLS THE INTERNET? ILLUSIONS OF A BORDERLESS WORLD 65-86, 129-146 (Oxford Univ. Press 2006). In the United States, Internet restrictions necessary to protect intellectual property are widely accepted, such as those effected by the Digital Millennium Copyright Act, 35 U.S.C. § 512. Several western European states impose bans on hate speech and content deemed harmful to public morals. Laws in Britain, Germany and France require ICTs, upon notice, to take down child pornography, Nazi hate speech and illegal adoption sites, for example. Goldsmith & Wu at 73. *See also* Jonathan Zittrain and Benjamin Edelman, "Localized Google search result exclusions," http://cyber.law.harvard.edu/filtering/google/ (last visited October 12, 2008) (comparing search results on google.com to google.de and google.fr and finding fewer results available on the latter two).

24. *See* discussion of the Alien Tort Claims Act *infra* Section I.B.2.

25. *See infra* Section I.C.

26. *See infra* Section II.A.

27. Press Release, Global Network Initiative, Diverse Coalition Launches New Effort to Respond to Government Censorship and Threats to Privacy (Oct. 28, 2008), *available at* http://www.globalnetworkinitiative.org/newsandevents/Diverse_Coalition_

Global Network Initiative, international human rights law remains the standard against which NGOs measure ICT conduct.

B. Applicable International Human Rights Norms

Two categories of international human rights norms apply to ICT operations. Addressed first are those norms implicated when ICTs assist governments in Internet filtering and surveillance. Because the objective of this analysis is to delineate a global standard, it draws upon both international and regional human rights conventions and the jurisprudence of regional, national, and international tribunals. It matters little whether these instruments are "non-binding" because this law is more likely to be enforced in the so-called "court of public opinion" than in a judicial forum. What is most relevant is the convergence of norms and jurisprudence across continents. It is from this consensus that a global standard can be discerned.

Where ICT conduct leads to physical persecution by a state (limited here to torture, extrajudicial killing and prolonged arbitrary detention) a second set of human rights norms and consequences are implicated. Because victims of state persecution can directly assert this second category of norms in a judicial forum, Section I.B.2 will focus on sources cognizable in U.S. federal courts.

1. Human Rights Standards Relevant to Internet Filtering, Surveillance, and Provision of Personal Information.

Internet filtering, providing personal information, and intercepting or accessing electronic communications interfere with the freedom of expression and the right to privacy protected by international human rights law. Both rights are found, in substantially the same form, in the principal international human rights instruments, regional human rights conventions, and national constitutions.[28] The most globally ratified expression of these

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Launches_New_Effort_To_Respond_to_Government_Censorship_and_Threats_to_Privacy.php (last visited Dec. 19, 2008).

28. Examples of international human rights instruments include Articles 17 (privacy) and 19 (expression) of the ICCPR, G.A. Res. 2200A (XXI), U.N. GAOR Supp. (No. 16), at 52, U.N. Doc A/6316 (Dec. 16, 1966) and Articles 12 (privacy) and 19 (expression) of the Universal Declaration of Human Rights, G.A. Res. 217A, at 71, U.N. GAOR, 3d Sess., 1st plen. mtg., U.N. Doc A/810 (Dec. 10, 1948). Examples of regional human rights instruments include Articles 8 (privacy) and 10 (expression) of the European Convention for the Protection of Human Rights and Fundamental Freedoms, Nov. 4, 1950, 213 U.N.T.S. 222; Articles 7-8 (privacy) and 11 (expression) of the Charter of Fundamental Rights of the European Union, Dec. 18, 2000, 2000/C 364/01; Article 9 (expression) of the African Charter on Human and Peoples' Rights, Oct. 21, 1986, OAU Doc. CAB/LEG/67/3, 22 I.L.M. 58; Articles IV (expression) and V (privacy) of the

rights is the International Covenant on Civil and Political Rights (ICCPR).[29] The freedom of expression is guaranteed by Article 19 of the ICCPR, which provides that everyone "shall have the right to hold opinions without interference,"[30] and that the right to freedom of expression "shall include freedom to seek, receive and impart information and ideas of all kinds, regardless of frontiers, either orally, in writing or in print, in the form of art, or through any other media of his choice."[31] The right to privacy is anchored in Article 17 of the Covenant, which protects against "arbitrary or unlawful interference with . . . privacy . . . or correspondence."[32]

The positive statements of rights in Articles 17 and 19 of the ICCPR only partially reveal the content of the rights to freedom of expression and privacy. Even more instructive are the circumstances under which derogation from these rights is permitted. Unlike the prohibition on torture,[33] for example, the rights to freedom of expression and privacy are not absolute. Article 19(3) of the ICCPR permits restrictions on the freedom of expression, where "provided by law and [] necessary . . . for the protection of national security or of public order . . . or of public health or morals."[34] These broad principles are given greater precision by the reports of international bodies such as the *Siracusa Principles*[35]—formulated by a high level conference of international law experts—and the General Comments

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American Declaration of the Rights and Duties of Man, 1948, O.A.S. Res. XXX; Articles 11 (privacy) and 13 (expression) of the American Convention on Human Rights, Jul. 18, 1978, EA/ Ser.L.V/II.82 doc. 6 rev. 1. The First Amendment to the Constitution of the United States guarantees the freedom of expression. U.S. CONST. amend. I; *Even the Constitution of China* provides, "[c]itizens of the People's Republic of China enjoy freedom of speech, of the press, of assembly, of association, of procession and of demonstration," CHINA. CONST. art. 35, *available at* http://english.peopledaily.com.cn/constitution/constitution.html (last visited Oct. 19, 2008).

29. ICCPR, *supra* note 28.

30. *Id.* art. 19(1).

31. *Id.* art. 19(2).

32. *Id.* art. 17(1).

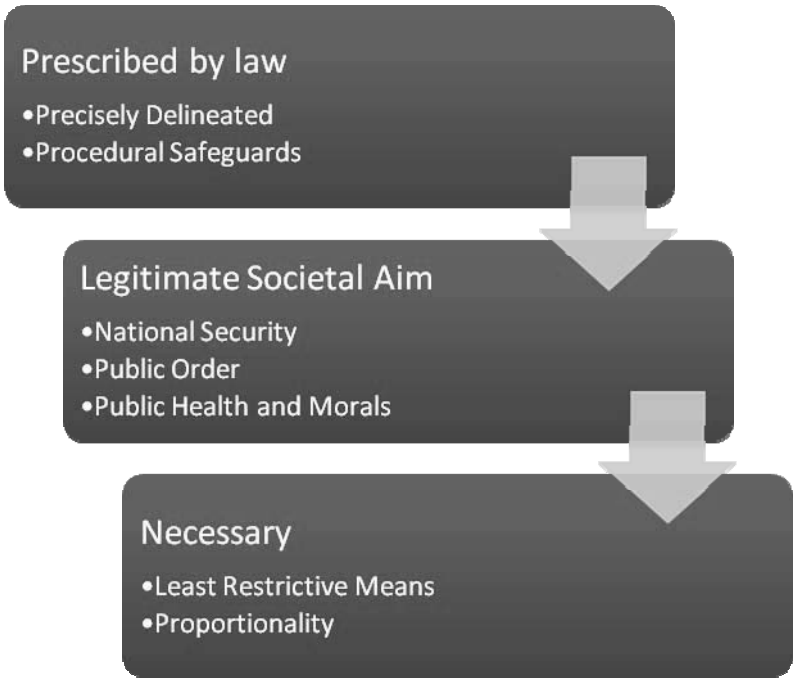
33. Convention against Torture and Other Cruel, Inhuman or Degrading Treatment or Punishment, art. 2(2), Dec. 12, 1984, 23 I.L.M. 1027, as modified, 24 I.L.M. 535 (1985), June 26, 1987 - Oct. 21, 1994, 34 I.L.M. 590, 591 (1995), *available at* http://www.unhchr.ch/html/menu3/b/h_cat39.htm (last visited Nov. 11, 2008) ("No exceptional circumstances whatsoever . . . may be invoked as a justification of torture.").

34. ICCPR, *supra* note 28, at art. 19(3)(b).

35. United Nations Economic and Social Council, United Nations Sub-Comm. on the Prevention of Discrimination and Prot. of Minorities, *Siracusa Principles on the Limitation and Derogation of Provisions in the International Covenant on Civil and Political Rights*, UN Doc. E/CN.4/1984/4 (Sep. 28, 1984).

of the United Nations Human Rights Committee.[36] Still greater precision is provided by the decisions of international, regional, and national tribunals applying to concrete situations rights mirroring the guarantees of expression and privacy in the ICCPR.

From the above-identified sources of international human rights law, the following standard emerges: international human rights law prohibits ICTs from assisting governments in interfering with the rights to freedom of expression and privacy, except when *necessary* to further a *legitimate societal aim*, and the interference is *prescribed by law*.[37] The international legal requirements for interfering with freedom of expression and privacy are depicted graphically and explained in detail below.



a) Interferences Must Be Prescribed By Law

A threshold requirement for the lawfulness of any restriction on the freedom of expression or privacy is that it be "prescribed by law."[38] Satisfaction of this condition requires not only that national law provide for the

36. Human Rights Committee, General Comment 16, (Twenty-third session, 1988), Compilation of General Comments and General Recommendations Adopted by Human Rights Treaty Bodies, U.N. Doc. HRI/GEN/1/Rev.6 at 142 (2003).

37. "Exploring the Contours of the Rights to Freedom of Expression and Privacy on the Internet," Memorandum, *Berkeley Law International Human Rights Clinic* 26 (March 15, 2007) [hereinafter *Berkeley Memorandum*] (on file with author).

38. *Siracusa Principles*, *supra* note 35, ¶ 15.

restriction at the relevant time, but that such law is not "arbitrary or unreasonable."[39] To guard against arbitrariness, tribunals have required that laws restricting privacy be precise and narrowly tailored.[40] The United Nations Human Rights Committee has further elaborated:

> legislation must specify in detail the precise circumstances in which such interferences may be permitted. A decision to make use of such authorized interference must be made only by the authority designated under the law, and on a case by case basis.[41]

National laws enabling interferences with privacy and expression must also contain sufficient procedural safeguards and remedies to guard against abuse.[42] In cases where private communications are monitored, courts evaluating the sufficiency of procedural safeguards have often required approval by a judicial body, such as the issuance of a warrant.[43]

The "prescribed by law" requirement provides ICTs a relatively objective means of evaluating government directives to take actions that interfere with privacy and expression. If national law does not provide for the specific interference, it is *prima facie* arbitrary. Likewise, laws lacking the requisite specificity and safeguards—requiring filtering of broad categories of content or surveillance of Internet communications on a generalized basis without adequate procedural safeguards, for example—are inconsistent with international human rights law.

b) Interferences Must Further A Legitimate Societal Aim

International human rights law permits interferences with privacy and expression only to the extent they further a legitimate aim of the state.[44] Legitimate aims include: "national security," "public order" and "public health or morals."[45] These otherwise broad categories have been precisely defined by international bodies[46] and narrowly construed by courts.[47]

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39. *Id.* ¶ 16.

40. Malone v. The United Kingdom, 8691/79 Eur. Ct. H.R. 10, ¶ 68 (1984); Kruslin v. France, 11801/85 Eur. Ct. H.R. 10, ¶ 33 (1990); *Berkeley Memorandum, supra* note 37, at 35.

41. *See* United Nations Human Rights Committee, General Comment No. 16, *supra* note 36, ¶ 8.

42. *Siracusa Principles, supra* note 35, ¶¶ 31, 34, 70.

43. *Berkeley Memorandum, supra* note 37, at 41.

44. *Siracusa Principles, supra* note 35; *Berkeley Memorandum, supra* note 37.

45. ICCPR, *supra* note 28, art. 19(3).

46. *Siracusa Principles, supra* note 35, ¶¶ 29-32 (national security), 22-24 (public order, 25-26 (public health), 27-28 (public morals).

47. *See e.g.*, Sunday Times v. UK (No. 1), Eur. Ct. H.R., Series A No. 30 (1979) (observing that exceptions to the freedom of expression guaranteed by European Conven-

National security is an extremely narrow ground for interference, applicable only in the face of existential threats to the state. The *Sircausa Principles* define its limited scope: "National security may be invoked to justify measures limiting certain rights only when they are taken to protect the existence of the nation or its territorial integrity or political independence against force or threat of force."[48] "[M]erely local or relatively isolated threats to law and order" do not, therefore, justify interference.[49] Moreover, national security may only be invoked to restrict privacy and expression when accompanied by sufficient procedural safeguards and remedies to guard against abuse.[50]

Importantly, political speech critical of the government, the system of government, or even advocating for non-violent political change, may not be restricted on national security grounds.[51] Human rights tribunals have held that governments must endure a high level of public scrutiny and criticism.[52]

Public order is defined as "the sum of rules which ensure the functioning of society or the set of fundamental principles on which society is founded."[53] The *Siracusa Principles* further specify that, because respect for human rights forms a part of public order, public order must be "interpreted in the context of the purpose of the particular human right which is limited on this ground."[54]

Public health may be invoked to limit certain rights when necessary to address "serious threat[s] to the health of the population or individual[s]."[55] With respect to public morals, the *Siracusa Principles* clarify:

> Since public morality varies over time and from one culture to another, a state which invokes public morality as a ground for restricting human rights, while enjoying a certain margin of discretion, shall demonstrate that the limitation in question is *essential*

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tion on Human Rights shall be narrowly construed); *Berkeley Memorandum, supra* note 37, at 26.

48. *Siracusa Principles, supra* note 35, ¶ 29.

49. *Id.* ¶ 30.

50. *Id.* ¶ 31.

51. Johannesburg Principles on National Security, Freedom of Expression and Access to Information, principle 7(a), 1996, U.N. Doc. E/CN.4/1996/39.

52. Castels v. Spain, 1798/85 Eur. Ct. H.R. 48 (1992); Exploring the Contours of the Rights to Freedom of Expression and Privacy on the Internet," *Berkeley Memorandum, supra* note 37, at 27.

53. *Siracusa Principles, supra* note 35, ¶ 22.

54. *Id.* ¶ 23.

55. *Id.* ¶ 25.

> to the maintenance of respect for fundamental values of the community.[56]

c) Interferences Must Be Necessary

Interferences with privacy and expression rights must not only further a legitimate societal aim, but be *necessary* to its achievement.[57] To fulfill the necessity requirement, interferences must be as narrow as possible and proportionate to the societal interest at stake.[58] The necessity requirement substantially parallels the U.S. Supreme Court's "least restrictive means" jurisprudence with respect to the First Amendment.[59] It is doubtful that blanket-filtering requirements to restrict access to broad categories of information will *ever* satisfy the necessity requirement. It is likewise doubtful that, even where legitimately restricted content is identified precisely, blunt technological means for filtering (URL-level filtering, for example) will satisfy this narrow necessity requirement.

In addition to narrowness, the European Court of Human Rights has interpreted the *proportionality* component of necessity to require a high degree of causal certainty that failure to restrict the expression targeted by the government would in fact have the adverse societal consequences asserted.[60] Because Internet filtering constitutes a prior restraint on expression,[61] "call[ing] for the most careful scrutiny,"[62] it follows that filtering

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56. *Id.* ¶ 27 (emphasis added).

57. *See* European Convention for the Protection of Human Rights and Fundamental Freedoms, arts. 8(2) (privacy) and 10(2), Nov. 4, 1950, 4.XI.1950 U.N.T.S. 222 (permitting interference with these rights only as "necessary in a democratic society . . ."); ICCPR, supra note 28, at art. 19(3); *Siracusa Principles*, *supra* note 35, ¶ 10.

58. *Siracusa Principles*, *supra* note 35, ¶ 10.

59. *Berkeley Memorandum*, *supra* note 37, at 31. *See also* Reno v. ACLU, 521 U.S. 844, 874 (1997) (applying the least restrictive means test and striking down two provisions of the Communications Decency Act of 1996 aimed at shielding children from obscene material on the Internet).

60. *See* Sunday Times v. UK (No. 1), Eur. Ct. H.R., Series A No. 30, ¶¶ 65-67 (1979) (considering the consequences of dissemination of information subject to an injunction, and comparing these consequences to the public interest in access to the information).

61. *See* Ctr. for Democracy & Tech. v. Pappert, 337 F.Supp.2d 606, 656 (E.D. Pa. 2004) (holding that a statutory procedure requiring ISPs to remove offensive content *without prior judicial determination* was an administrative prior restraint). As traditionally defined, prior restraint refers to orders forbidding certain communications that are issued before the communications occur. Alexander v. United States, 509 U.S. 544, 549 (1993). Yet the Supreme Court has also deemed state-mandated *removal* of protected expression from circulation to be an "administrative prior restraint." Bantam Books Inc., v. Sullivan, 372 U.S. 58, 70-71 (1963).

62. Observer v. United Kingdom, 13585/88 Eur. Ct. H.R. 49, ¶ 60 (1991)

will only be permissible where the blocked information is almost certain to cause harm to a legitimate societal interest.

2. *Standards of Accessorial Liability for State Persecution*

Yahoo!'s provision of Shi Tao's identifying information to Chinese authorities was inconsistent with his internationally protected right to privacy because the vagueness of the "state secrets" assertion was not sufficient to justify this interference on national security grounds.[63] Yet when Chinese authorities, enabled by this information, kidnapped, arbitrarily detained, and tortured Shi Tao, Yahoo! became exposed to accessorial liability for these human rights abuses. Unlike the violation of Shi Tao's right to privacy, these human rights violations are actionable in U.S. federal courts.

The Alien Tort Claims Act (ATCA) grants federal district courts subject matter jurisdiction over "civil action[s] by an alien for a tort only, committed in violation of the law of nations or a treaty of the United States."[64] Originally enacted as part of the Judiciary Act of 1789, this provision lay dormant for nearly two centuries until successfully invoked by citizens of Paraguay to hold Paraguayan officials civilly liable for grave human rights violations.[65] The statute has since been employed by victims of human rights abuses to sue both state officials[66] and transnational corporations[67] in U.S. federal courts.

The Supreme Court has addressed the ATCA only once, in *Sosa v. Alavarez-Machain*.[68] In a decision that perhaps raised as many uncertainties as it resolved, the Supreme Court at once confirmed the viability of the ATCA and defined the limits of its reach. The ACTA was solely a jurisdictional grant, the Supreme Court clarified, and does not supply a cause of action.[69] A cause of action must come from the "law of nations:" customary international law or treaties to which the United States is a par-

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63. *See supra*, Section I.B.1.c).

64. 28 U.S.C. § 1350.

65. Filartiga v. Pena-Irala, 630 F.2d 876 (2d Cir. 1980). On remand, the district court for the Eastern District of New York awarded compensatory and punitive damages as well as attorney fees to Plaintiffs for the torture and death of their brother and son. Filartiga v. Pena-Irala, 577 F.Supp. 860 (E.D.N.Y. 1984).

66. *See, e.g.*, *In re* Estate of Marcos, 25 F.3d 1467 (9th Cir. 1994) (ATCA suit against the former President of the Philippines).

67. *See, e.g.*, Khulumani v. Barclay Nat'l Bank Ltd., 504 F.3d 254 (2d Cir. 2007) *aff'd* without opinion, 128 S. Ct. 2424 (2008) (ATCA suit against banks for aiding and abetting Apartheid in South Africa).

68. 542 U.S. 692 (2004).

69. *Id.* at 714.

ty. *Sosa* further clarified that only a "narrow class" of international norms "accepted by the civilized world and with a specificity comparable to the features of the 18th-century paradigms recognized by the court" are actionable under the ATCA.[70] This "narrow class" of international norms[71] includes, *inter alia*, torture, extrajudicial killing,[72] and prolonged arbitrary detention in some circumstances.[73]

That ICT companies would commit these grave human rights abuses is of course almost beyond contemplation.[74] Moreover, because these offenses only violate the "law of nations" when committed by or with a

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70. *Id.* at 725, 729.

71. *See* RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 702 (1987) ("A state violates international law if, as matter of state policy, it practices, encourages or condones . . . (c) murder . . . (d) torture . . . (e) prolonged arbitrary detention . . . .").

72. Definitions of torture and extrajudicial killing are found in the Torture Victim Protection Act of 1991 (TVPA), 28 U.S.C. § 1350 (note). Extrajudicial killing is defined as:

[A] deliberated killing not authorized by a previous judgment pronounced by a regularly constituted court affording all the judicial guarantees which are recognized as indispensable by civilized peoples. Such term, however, does not include any such killing that, under international law, is lawfully carried out under the authority of a foreign nation.

Torture is defined in part as:

[A]ny act, directed against an individual in the offender's custody or physical control, by which severe pain or suffering (other than pain or suffering arising only from or inherent in, or incidental to, lawful sanctions), whether physical or mental, is intentionally inflicted on that individual for such purposes as obtaining from that individual or a third person information or a confession, punishing that individual for an act that individual or a third person has committed or is suspected of having committed, intimidating or coercing that individual or a third person, or for any reason based on discrimination of any kind.

This definition of torture is virtually identical to that in Article 1 of the Convention against Torture and Other Cruel, Inhuman or Degrading Treatment or Punishment, *supra* note 33.

73. Arbitrary detention is "detention of an individual not pursuant to law." Ralph G. Steinhardt, *Laying One Bankrupt Critique to Rest:* Sosa v. Alvarez-Machain *and the Future of International Human Rights Litigation in U.S. Courts*, 57 VAND. L. REV. 2241, 2300 (2004). It must be acknowledged that the Supreme Court held in *Sosa v. Alvarez-Machain* that "a single illegal detention of less than a day, followed by the transfer of custody to lawful authorities and a prompt arraignment" was not actionable under the ATCA. 542 U.S. at 738. However, § 702 THE RESTATEMENT (THIRD) ON FOREIGN RELATIONS LAW OF THE UNITED STATES specifies that *prolonged* arbitrary detention violates international law, and it is therefore likely that arbitrary detention for longer periods will be actionable under the ATCA.

74. The possibility seems especially remote given that ICT employees technically need not even be present in all countries in which they operate; Internet and communication products and services can be made available literally with the flip of a switch.

state,[75] they would not be actionable in U.S. courts under ATCA if carried out entirely by ICTs without state involvement. Rather, ICTs face accessorial liability under the ATCA for aiding and abetting human rights violations committed by states. ICTs expose themselves to such liability when they provide state authorities with user-identifying information, with knowledge that the state intends to use the information to commit human rights violations. The ATCA aiding and abetting standards articulated below are of great importance to ICTs because, unlike the ultimate offenses carried out by states, aiding and abetting concerns conduct within the control of companies.

a) Aiding and Abetting Standard

A broad consensus exists among courts[76] and commentators[77] that corporations may be liable for aiding and abetting grave international law violations committed by states. Beyond this, the consensus fractures into divergent approaches to the *source* and *content* of the standard for aiding and abetting liability under the ATCA. This split exists not only between circuits, but within appellate panels. In *John Doe I v. Unocal Corporation*, the Ninth Circuit agreed that private corporations may be accessorily liable under the ATCA for human rights abuses committed by states.[78] Judge Pregerson's majority held that the standard for aiding and abetting in ATCA cases is found in international law.[79] Looking principally to the constitutive statutes of the International Criminal Tribunals for the Former Yugoslavia and Rwanda and the jurisprudence of these tribunals—as evidence of customary international law—the *Unocal* majority held that aiding and abetting liability can be imposed for "knowing practical assistance or encouragement which has a substantial effect on the perpetration of the crime."[80]

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75. Certain international norms, such as the prohibition on genocide or piracy, however, do not require state action to constitute a violation of international law. *See, e.g.*, Kadic v. Karadzic, 70 F.3d 232, 239 (2d Cir. 1995).

76. Khulumani v. Barclay Nat'l Bank Ltd., 504 F.3d 254, 260 (2d Cir. 2007), *aff'd* without opinion, 128 S. Ct. 2424 (2008); John Doe I v. Unocal Corp., 395 F.3d 932, 951 (9th Cir. 2002) *vacated by* 395 F.3d 978 (9th Cir. 2003); Bowoto v. Chevron Corp., No. C99-02506, 2006 U.S. Dist. LEXIS 63209, 18-19 (N.D. Cal. Aug. 26, 2006).

77. *See, e.g.*, Brief of International Law Scholars as Amici Curiae, Khulumani v. Barclay Nat'l Bank Ltd., 504 F.3d 254 (2d Cir. 2007); Chimène I. Keitner, CONCEPTUALIZING COMPLICITY IN ALIEN TORT CASES, 60 HASTINGS L.J. __ (forthcoming 2008).

78. 395 F.3d at 962-63.

79. *Id.* at 947.

80. *Unocal*, 395 F.3d at 947. Judge Pregerson derived this standard principally from the ICTY's decision in Prosecutor v. Furundzija, IT-95-17/1-T (Dec. 10, 1998), *reprinted in* 38 I.L.M. 317 (1999).

Judge Reinhardt concurred in the existence of accessorial liability, but maintained that federal judges, in ascertaining the correct standard, should "look to traditional civil tort principles embodied in federal common law, rather than to evolving standards of international law."[81] A similar divide emerged from the Second Circuit in *Khulumani v. Barclay Nat'l Bank Ltd.*,[82] the most recent appellate decision to grapple with accessorial liability of corporations under the ATCA. Despite their agreement that aiding and abetting survived the Supreme Court's *Sosa* decision and remains a viable theory of liability, Judges Katzmann and Hall could not agree as to the appropriate source of the standard. Judge Katzmann engaged in an extensive survey of customary international law before concluding that the appropriate standard is found in Article 25(3)(c) of the Rome Statute of the International Criminal Court.[83] Judge Katzmann articulated the following standard:

> [A] defendant may be held liable under international law for aiding and abetting the violation of that law by another when the defendant (1) provides practical assistance to the principal which has a *substantial effect* on the perpetration of the crime, and (2) does so with the *purpose* of facilitating the commission of that crime.[84]

Judge Hall disagreed as to both the source and content of this standard. In Judge Hall's view, "a federal court should resort to its traditional source, the federal common law, when deriving the standard."[85] Looking to the common law, Judge Hall identified Section 876(b) of the Restatement (Second) of Torts as the appropriate standard for aiding and abetting under the ATCA. According to this standard, a corporation aids and abets if it "knows that the other's conduct constitutes a breach of duty and gives substantial assistance or encouragement to the other."[86] Applying Section 876(b) of the Restatement to ATCA civil aiding and abetting claims, Judge Hall explained that "liability should be found only where there is evidence that a defendant furthered the violation of a clearly established

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81. *Unocal*, 395 F.3d at 965 (Reinhardt, J., concurring). Judge Reinhardt identified three common law theories of accessorial liability: joint venture, agency, and reckless disregard. *Id.* at 969.

82. 504 F.3d 254, 256 (2d Cir. 2007).

83. *Id.* at 275-77 (Katzmann, J., concurring).

84. *Id.* at 277 (emphasis supplied).

85. *Id.* at 286 (Hall, J., concurring).

86. *Id.* at 287 (Hall, J., concurring) (quoting RESTATEMENT (SECOND) OF TORTS, § 876(b) (1979)).

international law norm in one of three ways," the first being most directly relevant to ICT operations:

> (1) by knowingly and substantially assisting a principal tortfeasor, such as a foreign government or its proxy, to commit an act that violates a clearly established international law norm; (2) by encouraging, advising, contracting with, or otherwise soliciting a principal tortfeasor to commit an act while having actual or constructive knowledge that the principal tortfeasor will violate a clearly established customary international law norm in the process of completing that act; or (3) by facilitating the commission of human rights violations by providing the principal tortfeasor with the tools, instrumentalities, or services to commit those violations with actual or constructive knowledge that those tools, instrumentalities, or services will be (or only could be) used in connection with that purpose.[87]

The disagreement as to the appropriate source of the aiding and abetting standard is doubtless due to the existence of suitable standards *both* at common law and in customary international law,[88] and persuasive arguments supporting the primacy of either.[89] Yet for ICTs seeking to order their affairs to avoid ATCA liability, the source of the standard is of little importance; it is the *content* that determines whether or not their conduct falls within the scope of aiding and abetting. In this sense, the aiding and abetting standards applied in ATCA cases from both international and federal common law are very similar.[90] The material difference is whether it is sufficient that a company, at the time it provides assistance, has *knowledge* of the government's intent to engage in torture, extrajudicial killing or arbitrary detention, or whether the company must act with the *purpose* of facilitating these grave human rights violations. To illustrate the outcome-determinative difference of the knowledge and purposefulness stan-

87. *Id.* at 288-89 (Hall, J., concurring).

88. Brief of International Law Scholars as Amici Curiae, *Khulumani v. Barclay Nat'l Bank Ltd.*, 504 F.3d 254 (2d Cir. 2007) *available at* http://www.cmht.com/pdfs/SAACLawScholars083005.pdf.

89. *See id.* (Demonstrating the existence of suitable standards for aiding and abetting both in customary international law and the federal common law, and articulating the case for the latter); Chimène I. Keitner, *Conceptualizing Complicity In Alien Tort Cases*, 60 HASTINGS L.J. __ (forthcoming 2008) (arguing that doctrinal coherence dictates that customary international law is the appropriate source of the standard for aiding and abetting).

90. Indeed, in identifying the standard for the majority in *Doe v. Unocal*, Judge Pregerson consciously adjusted the customary international law formulation so as to bring it in line with the common law standard codified in Section 876(b) of the Restatement (Second) of Torts. *See* 395 F.3d at 951.

dards in a likely scenario, each is applied to the Shi Tao case below.[91] Because Yahoo! settled the case before any judgment on the merits of the ATCA claims, it is instructive to work through the merits of the claims here.

b) Application of Aiding and Abetting Standards to the Shi Tao Case

The factual circumstances of the Shi Tao case represent the most likely scenario in which a U.S. ICT company would be exposed to ATCA liability. Applying the knowledge standard—and assuming plaintiffs were able to prove the factual allegations of arbitrary detention and torture—it is possible that Yahoo! would have been held liable under the ATCA for aiding and abetting these acts of the Chinese government. That the internationally proscribed acts were committed by the Chinese government satisfies international law's state action requirement.[92] Moreover, a reasonable fact finder could probably find that the company's provision of personally identifiable information—without which Shi Tao presumably could not have been identified—fulfills the "substantial effect" element of the aiding and abetting standards.[93] Aiding and abetting liability would thus turn on whether plaintiffs could prove that Yahoo! *knew* that the Chinese government intended to kidnap and torture Shi Tao at the time it handed over the

91. Plaintiffs in the Shi Tao case asserted several claims in addition to those under the ACTA, including claims under the Torture Victim Protection Act of 1991 (TVPA), 28. U.S.C. § 1350 (note), The Electronic Communications Privacy Act, 18 U.S.C. § 2701 *et seq.* (2006), and California Business & Professional Code §§ 17200 *et seq.* It is noteworthy that there is a split of authority as to whether the term "individual" in the TVPA encompasses corporations, or is limited to natural persons. Two California district courts recently held that the TVPA does not apply to corporations. Mujica v. Occidental Petroleum Corp., 381 F. Supp. 2d 1164, 1175-76 (C.D. Cal. 2005) (observing that the TVPA's use of the word "individual" to describe *both* the perpetrator and object of torture, and reasoning that a corporation cannot be the object of torture); Bowoto v. Chevron Corp., 2006 U.S. Dist. LEXIS 63209, 6 (N.D. Cal. 2006). *But see*, Sinaltrainal v. Coca-Cola Co., 256 F. Supp. 2d. 1345, 1358-59 (S.D. Fla 2003) (holding that "individual" as used in the TVPA includes corporations); Estate of Rodriquez v. Drummond Co., Inc., 256 F. Supp. 2d. 1250, 1267 (N.D. Ala. 2003) (same).

92. Note that in the case of international norms requiring state action, a private actor may be liable as an aider and abettor of an offense for which it could not be the principal. For purposes of ATCA liability, this technicality is "of no moment." *Khulumani*, 504 F.3d at 281-82, 289.

93. A decision of the Nuremberg Tribunal—evidencing international custom—established that provision of identifying information, coupled with the knowledge that the identified individuals would be executed upon discovery, was sufficient to convict the defendant as an accessory. United States v. Ohlendof, 4 TRIALS OF WAR CRIMINALS BEFORE THE NUREMBERG MILITARY TRIBUNALS UNDER CONTROL COUNCIL LAW No. 10, 1, 569 (1949), cited in Brief of Int'l Law Scholars, *supra* note 88.

user information. Plaintiffs attempted to imply such knowledge from public reports that Chinese dissidents routinely faced arbitrary detention and torture, and particularly from a 2002 letter from Human Rights Watch, addressed to Yahoo! executives, warning the company of these conditions and that "[t]here is a strong likelihood that Yahoo will assist in furthering such human rights violations."[94] Whether Yahoo! had sufficient knowledge at the relevant time would have likely been at least a disputed question of material fact, and allowed the Plaintiffs to present their case to a jury. In any case, in the aftermath of the Shi Tao case, it will be difficult for ICTs to deny a *general* knowledge of the possible consequences of their actions. This general knowledge, while probably not sufficient for liability, may elevate ICTs' duty of care in responding to government demands for user information.

By contrast, it is highly unlikely that Yahoo! would have been found liable under the purposefulness standard for aiding and abetting. Whereas an argument can at least be made that Yahoo! knew the Chinese government intended to persecute the subject of its "state secrets" inquiry, there is no indication that Yahoo! furnished the user information *with the purpose of facilitating* acts of torture and arbitrary detention. Nor is it foreseeable that ICTs would act with such purpose. Allegations of purposeful aiding and abetting of human rights violations have thus far involved companies conspiring with governments to protect their physical investments[95]—a factual scenario not particularly relevant to ICTs.

Yet ICTs, in assessing risk and formulating policies for responding to government requests for user information, should plan as though their conduct will be judged against a knowledge standard for aiding and abetting. Although federal courts are not at this time bound to apply the knowledge standard as a matter of precedent, the weight of persuasive authority points in this direction. In *Doe I v. Unocal Corp.*, all three judges on the Ninth Circuit panel applied a knowledge standard, albeit from difference sources.[96] The decision lacks precedential force—it was vacated by an or-

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94. *Shi Tao complaint*, *supra* note 6 at ¶ 29; Letter from Kenneth Roth, Executive Director, Human Rights Watch, to Terry Semel, Chairman and CEO, Yahoo! Inc. (Jul. 30, 2002) *available at* http://www.hrw.org/press/2002/08/yahoo-ltr073002.htm.

95. *See Unocal*, 395 F.3d. 932 (9th Cir. 2002) (Burmese villagers alleged murder, rape, torture and forced labor in connection with the construction of a gas pipeline); *Bowoto*, 2006 U.S. Dist. LEXIS 63209 (N.D. Cal. 2006) (Involving human rights violations committed by Nigerian security forces against protesters on a Chevron oil platform).

96. 395 F.3d 932. Writing for the majority, Judge Pregerson, joined by Judge Tashima, applied a knowledge standard sourced from international law. *Id.* 947. Concurring Judge Reinhardt identified three federal common law theories of accessorial liability: joint venture, agency, and reckless disregard. *Id.* at 969. Reckless disregard is most rele-

der granting an *en banc* rehearing, and the case settled before rehearing[97]—but the District Court for the Northern District of California recently applied this standard in *Bowoto v. Chevron*.[98] Judge Katzmann's concurrence in the Second Circuit's *Khulumani* decision remains the only support for a purposefulness standard, and there is reason to doubt its adoption by other courts. Acknowledging that international criminal tribunals apply a knowledge standard, Judge Katzmann nevertheless concluded that such a standard is insufficiently "well-established and universally recognized," "particularly in light of the higher standard articulated in the Rome Statute."[99] Yet it is not clear that the Rome Statute does articulate a higher standard: subsection (d)(ii) of the Article cited by Judge Katzmann states a knowledge standard.[100] Judge Katzmann's position does not seem to be that the knowledge standard adopted by international criminal tribunals is not well-established so much as the narrower standard he adopts is *more* well-established.[101] There remains a substantial likelihood that judges looking to international law for an ATCA aiding and abetting standard will be satisfied with the knowledge standard's prevalence in international criminal jurisprudence, as were the Ninth Circuit in *Doe v. Unocal* and the Northern District of California in *Bowoto v. Chevron*. Where judges look instead to the federal common law, the knowledge standard of

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vant to ICT operations and, like the knowledge standard articulated by the majority, does not require purposefulness. *Id.* at 975. Reckless disregard "occurs when a party is aware of (or should be aware of) an unreasonable risk, yet disregards it, thereby leading to harm to another." *Id*. at 974.

97. Doe I v. Unocal Corp., 395 F.3d 978 (9th Cir. 2003) (granting rehearing en banc), *vacated*, 403 F.3d 708 (9th Cir. 2005) (granting parties' stipulated motion to dismiss).

98. 2006 U.S. Dist. LEXIS 63209, 18-19 (N.D. Cal. 2006).

99. *Khulumani*, 504 F.3d at 278-79 (Katzmann, J., concurring).

100. Article 25 of the Rome Statute of the International Criminal Court provides in relevant part:

(c) For the purpose of facilitating the commission of such a crime, aids, abets or otherwise assists in its commission or its attempted commission, including providing the means for its commission;

(d) In any other way contributes to the commission or attempted commission of such a crime by a group of persons acting with a common purpose. Such contribution shall be intentional and shall either:

(i) Be made with the aim of furthering the criminal activity or criminal purpose of the group, where such activity or purpose involves the commission of a crime within the jurisdiction of the Court; or

(ii) Be made in the knowledge of the intention of the group to commit the crime;

Rome Statute of the International Criminal Court, July 17, 1988, 2187 U.N.T.S. 90, *available at* http://untreaty.un.org/cod/icc/statute/romefra.htm.

101. *Khulumani*, 504 F.3d at 277 n. 12 (Katzmann, J., concurring).

Section 876(b) of the Restatement will most likely apply. In either case, ICTs expose themselves to risk of aiding and abetting liability when they provide identifying user information to a state actor with knowledge that it intends to arbitrarily detain, torture, or summarily execute the identified user.

C. Consequences of Noncompliance

The spectrum of consequences for noncompliance with the global law divides into two categories: legal and non-legal consequences. The availability of civil damages is familiar, although it may come as a surprise to some that ICTs may be civilly liable in U.S. courts for human rights violations committed by foreign governments. Such legal consequences will only arise in cases in which ICTs knowingly enable grave human rights abuses. A separate set of non-legal consequences flow from ICT interference with free expression and privacy rights. Although less immediate than civil damages, these consequences may substantially impair their long-term competiveness.

Although not actionable in U.S. courts,[102] ICT interference with free expression and privacy rights—such as filtering Internet content or intercepting communications—carries consequences that may be equally harmful to ICTs' long-term interests. ICT operations are subject to constant, global scrutiny enabled in part, somewhat ironically, by their own technologies. NGOs such as Human Rights Watch, Amnesty International, and Reporters Without Borders have carefully monitored the human rights implications of ICT operations in repressive states, and generated public awareness through reports[103] and press releases[104] detailing ICT interferences with fundamental human rights. Mainstream media outlets such as the New York Times[105] and the BBC[106] have broadcast NGO allegations

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102. In *Sosa*, the Supreme Court held that the ICCPR could not supply a cause of action under the ATCA because the treaty is not self-executing. Sosa v. Alvarez-Machain, 542 U.S. 692, 735 (2004). It is not likely that a U.S. court would recognize customary international law rights of privacy and expression as being sufficiently definite to be actionable under the ATCA.

103. *See, e.g.*, Human Rights Watch, *supra* note 3; AMNESTY INT'L, UNDERMINING FREEDOM OF EXPRESSION IN CHINA: THE ROLE OF YAHOO!, MICROSOFT AND GOOGLE, (2006); Reporters Without Borders, *supra* note 15.

104. *See, e.g.*, Press Release, Human Rights Watch, China: Internet Companies Aid Censorship, Aug. 8, 2006, *available at* http://www.hrw.org/en/news/2006/08/08/china-internet-companies-aid-censorship.

105. *See, e.g.*, Kristof, Yahoos, *supra* note 16; Tina Rosenberg, *Building the Great Firewall of China, With Foreign Help*, N.Y. TIMES, Sep. 18, 2005, § 4 at 11.

106. *See, e.g.*, Nembi Mutch, *Net Giants 'Still Failing China,'* BBC NEWS, Dec. 18, 2006, http://news.bbc.co.uk/2/hi/technology/6191171.stm (last visited Dec. 20, 2008).

worldwide, and bloggers have cited human rights abuses as evidence that the once-infallible technology giants are in fact no different than "evil" corporate America.[107] Yahoo! has suffered the most intense public scrutiny in part because of the grave human rights abuses endured by Shi Tao and Wang Xiaoning, and because they were defendants in an ATCA suit for these abuses in the Northern District of California.

ICT operations in China have also been the subject of scrutiny by both houses of Congress. Members of the House Committee on International Relations questioned executives of Yahoo!, Google, Microsoft and Cisco about their China operations in February 2006.[108] After an NGO published online the Bejing State Security Bureau's request for Shi Tao's identifying information[109]—which contradicted Yahoo! General Counsel Michael Callahan's prior testimony that the company was not aware of the nature of the request[110]—Yahoo! executives were again summoned to testify in a hearing titled: "Yahoo! Inc.'s Provision of False Information To Congress."[111] Most recently, in May 2008, Yahoo!, Google, Microsoft and Cisco testified before the Senate Subcommittee on Human Rights and the Law, which urged the companies to quickly move forward with a code of conduct.[112]

Because the international rights to freedom of expression and privacy mirror sacred guarantees in the United States Constitution, allegations of their abuse carry particular moral force. This may be even more true in the progressive, globally-minded communities in northern California and Washington that are home to leading ICTs and many of their stakeholders. That international human rights are expressed as *law*—codified in treaties, and enforced by international tribunals—means that even extrajudicial allegations of human rights abuses are made, and judged, within a quasi-legal framework wherein the NGOs play the prosecutorial role, and frame their allegations according to international norms. The "jury" includes ICT stakeholders such as users, investors, business partners, employees and

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107. *See, e.g.*, Iain Thompson, *Google hands over user information in India: 'do no evil' motto looking increasingly strained*, vunet.com, May 20, 2008, http://www.vnunet.com/vnunet/news/2217063/google-handing-user-information (last visited Feb 2, 2009).

108. Internet in China, *supra* note 18.

109. Beijing State Security Bureau, *supra* note 1.

110. Internet in China, *supra* note 18 (Testimony of Michael Callahan, General Counsel of Yahoo! Inc.).

111. Yahoo! Inc.'s Provision of False Information to Congress, Hearing Before H. Comm. On Foreign Affairs, 110th Cong. (2007).

112. Global Internet Freedom: Corporate Responsibility and the Rule of Law, Hearing Before S. Subcomm. on Human Rights and the Law, 110th Cong. (2008) (Opening Statement of Chairman Senator Dick Durbin).

their families. These parties ultimately reach a verdict of "right" or "wrong."[113] This is not to say that the public dialog following allegations of human rights abuses is conducted with the evidentiary discipline of the courtroom. Rather, it shows that many international human rights are familiar and somewhat intuitive in western, liberal democracies. It is against this intuitively-understood standard that ICTs are judged.

Public association with human rights abuses impairs two of ICT companies' most valuable assets: their brand and human capital. These assets are uniquely valuable to ICT companies, making them more sensitive to the non-legal consequences of human rights violations than other sectors of the economy.

1. Brand Consequences

The brands of the leading ICTs are among the most valuable in the world: Interbrand's 2008 rankings value the Microsoft brand at $59 billion in third place, Google's at $25.5 billion in tenth place, and Yahoo's at $5.5 billion in sixty-fifth place.[114] Trust, a component of brand value, is vitally important to ICT companies.[115] Google's Code of Conduct goes so far as to state: "Our reputation as a company that our users can trust is our most valuable asset, and it is up to all of us to make sure that we continually earn that trust."[116] Professor Tim Wu agrees with Google's assessment, observing: "One reason [Google is] good at the moment is they live and die on trust, and as soon as you lose trust in Google, its over for them."[117] Users necessarily entrust their private communications and user data to ICTs. It is not difficult to imagine that the way a company handles demands by one government to restrict content or turn over user information will affect the trust of users worldwide.

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113. The accountability framework is somewhat different for ICT participants in The Global Network Initiative, the subject of Part II below. International human rights standards are incorporated into a code of conduct. Adherence to these standards is publicly judged through a process of independent assessments.

114. Interbrand, "Best Global Brands List 2008," http://www.interbrand.com/best_global_brands.aspx?langid=1000.

115. Geoff Lye, Google: Don't Be Evil, SustainAbility *Radar*, December 2005/January 2006 Issue, http://www.sustainability.com/downloads_public/insight_radar/leader_article1.pdf.

116. Google, *Code of Conduct*, http://investor.google.com/conduct.html (last visited Mar. 1, 2009).

117. Jeffrey Rosen, *Google's Gatekeepers*, N.Y. TIMES, Nov. 30, 2008, at MM50.

2. *Human Capital Consequences*

A company's brand—the images evoked by its trademark—is also important for recruiting.[118] The long-term success of ICT companies, perhaps more than any other business, depends on their ability to recruit, motivate and retain the very best of a highly educated workforce. ICTs compete on their ability to innovate: to continually push the limits of technology, design and business models. To attract and retain the creative minds to fuel this engine of innovation, ICTs offer employment perks unmatched by any industry.[119] Google's legendary perks in particular have made it a career destination.[120] Yet as Google grows and the economy slows, Google's employee benefits have begun to look increasingly mortal.[121] As the rate at which it mints new millionaires declines, Google's "do no evil" ethos may become increasingly important in competing for talent.

Public association with human rights abuses almost certainly impairs ICTs' ability to recruit and motivate top talent. Two studies of students in top MBA programs demonstrate that social responsibility factors prominently in employer preferences.[122] For the MBA students surveyed, the ethical reputation of a company was the fourth-most-important consideration, and approximately 70% reported willingness to forego financial benefit to work for an employer that respects outside stakeholders.[123] It is likewise conceivable that employee enthusiasm and pride that underpins productivity and innovation—in which ICTs invest heavily—erodes when companies act contrary to the values of employees and their commu-

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118. INTERBRAND, BEST GLOBAL BRANDS 2008, http://www.interbrand.com/images/BGB_reports/BGB_2008_US_Format.pdf.

119. On recruiting, Google Co-founder Larry Page has said, "Google is organized around the ability to attract and leverage the talent of exceptional technologists and business people." Google, "Google Jobs," http://www.google.com/support/jobs/bin/static.py?page=gettingintogoogle.html (last visited Feb. 7, 2009).

120. Google topped Fortune's "100 Best Companies to Work For" list in both 2007 and 2008. FORTUNE, "100 Best Companies to Work For 2008," http://money.cnn.com/magazines/fortune/bestcompanies/2008/ (last visited Dec. 19, 2008).

121. See, e.g., Joe Nocera, On Day Care, Google Makes a Rare Fumble, N.Y. TIMES, Jul. 5, 2008, at A1.

122. David B. Montgomery & Catherine A. Ramus, Including Corporate Social Responsibility, Environmental Sustainability, and Ethics in Calibrating MBA Job Preferences, Stanford Research Paper No. 1981 (2007), *available* at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1077439; David B. Montgomery & Catherine A. Ramus, Corporate Social Responsibility Reputation Effects on MBA Job Choice, Stanford Research Paper No. 1805 (2003), *available at* http://www.google.com/support/jobs/bin/static.py?page=about.html&about=top10.

123. Montgomery & Ramus, Including, *supra* note 122, at 14; Montgomery & Ramus, Corporate, *supra* note 122, at 14.

nity.[124] Pride in association with a leading technology company can be quickly replaced by shame when that company is associated with human rights abuses in the headlines. And, as Yahoo! executives learned—from Representative Tom Lantos' much publicized "moral pygmies" charge[125]—the humiliation of association with human rights abuses is felt most acutely at the highest levels.

The above does not, of course, prove that the involvement of Yahoo!, Google, and Microsoft in restrictions on free expression and privacy has prevented these companies from recruiting talented employees or caused users to reject their products. Empirical evidence is nonexistent at this point. But it does illustrate why these companies are *uniquely* sensitive to public association with human rights abuses. Over time, even minor blemishes to a brand have the potential to *measurably* alter the perceptions of key consumers and top talent, substantially affecting the long-term competitiveness of a company.

II. RESPONSES OF PRIVATE, GOVERNMENTAL, AND NONGOVERNMENTAL ACTORS

The Shi Tao case was a watershed event, sparking public awareness of both the human consequences of Internet repression and the quandary facing U.S. ICTs operating in repressive states. At the urging of Congress,[126] leading ICTs began a two-year collaboration with NGOs, academics, and investors leading ultimately to the Global Network Initiative in October 2008. The State Department established the Global Internet Freedom Task Force (GIFT) to coordinate interagency efforts to "address challenges to the freedom of expression and the free flow of information on the Internet."[127] And Representative Christopher Smith (R-NJ) introduced H.R.

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124. *See* Pitts, *supra* note 21 (Former Nokia general counsel reflecting on the competitive advantages resulting from the company's social responsibility initiatives, including "energizing, motivating and recruiting stellar employees, spurring innovating designs and technologies, nurturing trust and enthusiasm among all stakeholders, and building the global brand that represented Nokia's remarkable success.").

125. The late Representative Tom Lantos said of Yahoo! senior executives, "while technologically and financially you are giants, morally you are pygmies." Internet in China, *supra* note 18.

126. Internet in China, *supra* note 18, at 4 (Rep. Smith remarked, "I, and many of my colleagues on both sides of the aisle, would welcome leadership by the corporations to develop a code of conduct which would spell out how they could operate in China and other repressive countries like Vietnam while not harming citizens and respecting human rights.").

127. Press Release, U.S. Dep't of State, State Summary of Global Internet Freedom Task Force (Dec. 20, 2006) (on file with author).

275: Global Online Freedom Act of 2007,[128] a bill that would jointly establish executive-branch mechanisms for promoting "Internet freedom" globally and delineate minimum standards for U.S. ICT companies[129] operating in "Internet Restricting Countries"[130] backed by civil and criminal sanctions. Title II of the proposed legislation proscribes both censorship of Internet content and the provision of personally identifiable information to the authorities of Internet-restricting countries. Section 201 prohibits U.S. businesses from "locating" within an Internet-restricting country "any electronic communication that contains any personally identifiable information." Section 202 prohibits U.S. businesses that collect personally identifiable information from providing such information "to any foreign official of an Internet-restricting country," except for "legitimate foreign law enforcement purposes as determined by the Department of Justice."[131]

Although endorsed by human rights NGOs Amnesty International and Reporters Without Borders, the Global Online Freedom Act has met fierce resistance on a number of fronts.[132] Opposition has come not only from industry groups, but from the Center for Democracy and Technology, which is concerned that the mandates of the proposed law would be unworkable for ICTs, and thus do "more harm than good" to Internet freedom.[133] With the passing of a powerful ally, Tom Lantos, the bill's passage in its present form appears doubtful.[134] Despite the uncertain future of the Global Online Freedom Act, the possibility of legislation remains. In a statement welcoming the Global Network Initiative, Senator Richard Durbin added, "Congress should follow the lead of the private sector by

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128. Global Online Freedom Act of 2007, H.R. 275, 110th Cong. (2007).

129. "United States Businesses" includes both companies with their principal place of business with the U.S. and their foreign subsidiaries to the extent that the U.S. parent controls or cooperates with the foreign subsidiary. *Id.* § 3(11)(c).

130. "Internet Restricting Countries" are those designated as such by the President of the United States on an annual basis. *Id.* § 3(6).

131. "Legitimate foreign law enforcement purposes" is defined as "for purposes of enforcement, investigation, or prosecution by a foreign official based on a publicly promulgated law of reasonable specificity that proximately relates to the protection or promotion of the health, safety, or morals of the citizens of that jurisdiction." *Id.* § 8(A).

132. Bennet Kelley, *Cyber legislation part of Capitol's spring fever.* 28 JOURNAL OF INTERNET LAW 11 2008; Letter from Brian A. Benczkowski, Principal Deputy Assistant Attorney General, United States Department of Justice, to Howard L. Berman, Acting Chairman, House Committee on Foreign Affairs, (May 19, 2008) (on file with author).

133. Memorandum, Ctr. for Democracy & Tech., Analysis of the Global Online Freedom Act of 2008 [H.R. 275]: Legislative Strategies to Advance Internet Free Expression and Privacy around the World at 2 (May 2, 2008), *available at* http://www.cdt.org/international/censorship/20080505gofa.pdf.

134. Kelley, *supra* note 132.

considering Internet freedom legislation that would complement the code of conduct."[135] Members of the European Union Parliament have also proposed draft legislation modeled closely on the Global Online Freedom Act.[136] Whether internet freedom legislation will be enacted will likely depend on the success of the Global Network Initiative.

A. Global Network Initiative

The most promising response to the ICT quandary is the Global Network Initiative launched in October of 2008. With the stated mission of "protecting and advancing freedom of expression and privacy in information and communication technology," the Initiative is the result of a two-year collaboration among leading ICTs (Google, Yahoo! and Microsoft), human rights organizations, academics and investors.[137] The structure of the Initiative and the obligations of its members are set out in its three constitutive documents. The Principles on Freedom of Expression and Privacy[138] outline high-level obligations of participating companies to protect and advance the freedom of expression and privacy. The Principles are explicitly grounded in international human rights law; obligations are justified by reference to the provisions of the International Covenant on Civil and Political Rights and the Universal Declaration of Human rights discussed above.[139] A second document, the Implementation Guidelines,[140] delineates more precise, concrete obligations of participating companies. Whereas the Principles announce such broach duties as to "respect and protect the freedom of expression of users by seeking to avoid and minimize the impact of government restrictions,"[141] the Implementation Guidelines give specific content to this obligation—companies must interpret restrictions narrowly and challenge them where inconsistent with in-

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135. Press Release, Office of Sen. Dick Durbin, Durbin Statement of Final Approval on Long Awaited Internet Code of Conduct (Oct. 28, 2008), *available at* http://durbin.senate.gov/showRelease.cfm?releaseId=304621.

136. Commission Proposal for a Directive of the European Parliament and of the Council Concerning the EU Global Online Freedom Act, COM (2008), available at http://www.julesmaaten.eu/_uploads/EU%20GOFA.htm (last visited March 1, 2009).

137. Press Release, Global Network Initiative, *supra* note 27.

138. GLOBAL NETWORK INITIATIVE, PRINCIPLES ON FREEDOM OF EXPRESSION AND PRIVACY, *available at* http://www.globalnetworkinitiative.org/cms/uploads/1/GNI_-_Principles_1_.pdf (last visited Dec.19, 2008).

139. *See supra* Section I.B.1.

140. GLOBAL NETWORK INITIATIVE, IMPLEMENTATION GUIDELINES FOR THE PRINCIPLES ON FREEDOM OF EXPRESSION AND PRIVACY, *available at* http://www.globalnetworkinitiative.org/cms/uploads/1/GNI_-_Implementation_Guidelines_1_.pdf (last visited Dec. 19, 2008).

141. PRINCIPLES, *supra* note 138, at 2.

ternational human rights law, for example.[142] Read together, the Principles and the Implementation Guidelines prescribe a standard of conduct for ICTs.

A third document, the Governance, Accountability and Learning Framework,[143] establishes a multi-stakeholder Organization to coordinate and advance the Initiative. Companies are to report their progress and challenges in implementing the Principles, and will ultimately be held accountable through independent assessments administered by the Organization.[144] In this regard the Organization resembles the international and regional bodies established by human rights treaties to further their implementation and enforcement. The Organization will be run by a full-time professional staff and governed by a Board equally representing company and non-company participants.[145]

The Governance, Accountability and Learning Framework lays out a three-phase roadmap to full operational capacity by 2012.[146] The first two-year phase involves capacity building for both companies and the Organization.[147] The Organization is to recruit new participants, prepare for the independent assessments of the next phase, and provide human rights expertise to participating companies.[148] Companies are to use the first phase to implement the Principles into their policies and operations.[149] Beginning in the second phase, independent assessors—appointed by companies according to criteria set by the Organization—will evaluate each company's success in implementing and operationalizing the principles.[150] In the second phase this assessment is limited to a review of policies and practices, and expands to encompass actual cases in the third phase.[151] In the later phases the Organization is to receive the concerns of both companies and interested parties and evolve the Principles as necessary.[152] At every stage, recruiting new company participants is an objective of the

142. IMPLEMENTATION GUIDELINES, *supra* note 140, at 5.

143. GLOBAL NETWORK INITIATIVE, GOVERNANCE, ACCOUNTABILITY AND LEARNING FRAMEWORK, *available at* http://www.globalnetworkinitiative.org/governanceframework/index.php (last visited Feb. 2, 2009).

144. *Id.*

145. *Id.*

146. *Id.*

147. *Id.*

148. *Id.*

149. GOVERNANCE, *supra* note 143.

150. *Id.*

151. *Id.*

152. *Id.*

Organization, and the Framework provides for the admission of new participants.[153]

1. *ICT Obligations Under Global Network Initiative*

The obligations of participating companies under the Global Network Initiative divide roughly into three categories. Most detailed are those duties that arise in the face of government-imposed restrictions on freedom of expression and privacy. Participating companies are also obligated to take proactive measures—to implement internal policies, governance structures and training—that enable them to fulfill the first set of obligations. This second set of obligations is less particular, leaving more discretion to the companies. Finally, participating companies commit to multi-stakeholder collaboration, such as engaging governments and cooperating in independent assessments.

The most substantial obligations arise where companies face the quandary here described: where governments demand that ICTs restrict freedom of expression and privacy. The Principles broadly state these obligations:

> Participating companies will respect and protect the freedom of expression rights of their users when confronted with government demands, laws and regulations to suppress freedom of expression, remove content or otherwise limit access to information and ideas in a manner inconsistent with internationally recognized laws and standards.[154]

An identical provision substitutes "privacy" for "freedom of expression."[155] The Implementation Guidelines give specific content to the obligation to "respect and protect" freedom of expression and privacy. When required by governments to restrict communications, remove content, or provide personal information to governmental authorities, companies commit to:

> • Require that governments follow established domestic legal processes when they are seeking to restrict freedom of expression.

153. *Id.*
154. PRINCIPLES, *supra* note 138, at 2.
155. *Id.*

> • Interpret government restrictions and demands so as to minimize the negative effect on freedom of expression.[156]
>
> • Interpret the governmental authority's jurisdiction so as to minimize the negative effect on freedom of expression.[157]
>
> [. . .]
>
> • Request clear written communications from the government that explain the legal basis for government restrictions to freedom of expression [or demand for personal information], including the name of the requesting government entity and the name, title and signature of the authorized official.
>
> [. . .]
>
> • Seek clarification or modification from authorized officials when government restrictions appear overbroad, not required by domestic law or appear inconsistent with international human rights laws and standards on freedom of expression.[158]

These obligations call for gentle-to-mildly-aggressive pushback on governmental directives that interfere with privacy and freedom of expression. Participating companies must *require* governments to explicitly justify their directives within the framework of international human rights law. That is, interferences with privacy and expression must be *prescribed by law* and *necessary* to achieve a *legitimate societal aim*.[159] Where governments fail to so justify their directives, or where justifications are not satisfactory, participating companies are obligated to respond more aggressively. In some cases they must:

> Challenge the government in domestic courts or seek the assistance of relevant government authorities, international human rights bodies or non-governmental organizations when faced with a government restriction that appears inconsistent with domestic law or procedures or international human rights laws and standards on freedom of expression.[160]

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156. The section of the Implementation Guidelines specifically concerning *privacy* requires participating companies to "narrowly interpret and implement government demands that compromise privacy." IMPLEMENTATION GUIDELINES, *supra* note 140, at 6.

157. The Implementation Guidelines acknowledge that "the nature of jurisdiction on the Internet is a highly complex question that will be subject to shifting legal definitions and interpretations over time." *Id.* at 5.

158. *Id.*

159. *See supra* Section I.C.1.

160. IMPLEMENTATION GUIDELINES, *supra* note 140, at 5.

The Implementing Guidelines acknowledge, "it is neither practical nor desirable" to challenge every restriction, and permit companies to consider the cost and projected efficacy of a challenge in choosing their battles.[161]

In addition to obligations arising in relation to *specific* governmental directives, the Initiative obligates participating companies to "respect and protect" users' privacy and expression rights more generally. With respect to expression, this entails, "seeking to *avoid* or *minimize* the impact of government restrictions on freedom of expression."[162] One important step toward fulfilling this general obligation is for companies to free themselves from voluntary commitments to restrict free expression and privacy. The Implementation Guidelines provide:

> Participants will refrain from entering into voluntary agreements that require the participants to limit users' freedom of expression or privacy in a manner inconsistent with the Principles. Voluntary agreements entered into prior to committing to the Principles and which meet this criterion should be revoked within three years of committing to the Principles.

This provision is likely directed at the "self-discipline pact" the Chinese Information Ministry required ICTs to sign in 2002, committing ICTs "not to produce or disseminate harmful texts or news likely to jeopardise national security and social stability, violate laws and regulations, or spread false news, superstitions and obscenities."[163]

Participating companies must also "employ protections with respect to personal information in all countries where they operate in order to protect the privacy rights of others." The Implementation Guidelines elaborate:

> Participating companies will assess the human rights risks associated with the collection, storage, and retention of personal information in the jurisdictions where they operate and develop appropriate mitigation strategies to address these risks.[164]

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161. *Id.*

It is recognized that it is neither practical nor desirable for participating companies to challenge in all cases. Rather, participating companies may select cases based on a range of criteria such as the potential beneficial impact on freedom of expression, the likelihood of success, the severity of the case, cost, the representativeness of the case and whether the case is part of a larger trend.

Id.

162. PRINCIPLES, *supra* note 138, at 2 (emphasis added).

163. Reporters without Borders, *supra* note 15, at 1 (quotations omitted).

164. IMPLEMENTATION GUIDELINES, *supra* note 140, at 6.

This obligation appears vague compared to company obligations relating to specific governmental directives and leaves almost total discretion to companies as to its implementation. At least one participant has suggested that there would be little value in providing greater specificity—for example, by limiting where servers may be located—because such rules would quickly become irrelevant given the rapid pace of technological change.[165]

One of the more challenging realities addressed by the Initiative is that U.S. ICTs frequently do business in Internet restricting countries with and through local business partners and subsidiaries whose operations affect the freedom of expression and privacy. For example, Yahoo! holds a 40% stake in leading Chinese ICT Alibaba.com, and Yahoo! CEO Jerry Yang[166] occupies a seat on Alibaba's four-person board.[167] Skype partners with Chinese ICT TOM Online, which was recently discovered to have logged user information and text messages concerning sensitive subjects on an unsecured server in China.[168] The Initiative accordingly obligates participating companies to facilitate implementation of the Principles by their business partners and subsidiaries.

> Participating companies will implement these Principles wherever they have operational control. When they do not have operational control, participating companies will use best efforts to ensure that business partners, investments, suppliers, distributors and other relevant related parties follow these Principles.[169]

This sets up two tiers of responsibility: participating companies are responsible for *implementing* the Principles wherever they have "operational

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165. *See* Geoffrey Fowler, *Parsing the Google, Yahoo, Microsoft "Global Network Initiative*, W.S.J. CHINA JOURNAL, Oct. 28, 2008, http://blogs.wsj.com/chinajournal/2008/10/28/parsing-the-google-yahoo-microsoft-global-network-initiative/trackback/ (last visited Nov. 2, 2008) (suggesting that the rapid pace of technological development motivated the vagueness of some obligations).

166. Jerry Yang resigned as CEO of Yahoo! Inc. on November 17, 2008, and, at time of writing, it is unclear who will occupy his seat on the Alibaba board. Brad Stone and Claire Cane Miller, *Jerry Yang, Yahoo Chief, Steps Down*, N.Y. TIMES., Nov. 17, 2008, at B1.

167. Press Release, Yahoo! Inc., Yahoo! And Alibaba.com Form Strategic Partnership In China (Aug. 11, 2005), *available at* http://docs.yahoo.com/docs/pr/release1256.html (last visited Nov. 12, 2008).

168. John Markhoff, *Skype Text is Monitored in China*, N.Y. Times, Oct. 2, 2008, at C1; Nart Villeneuve, Breaching the Trust: An analysis of surveillance and security practices on China's TOM-Skype platform, a joint report of *Information Warfare Monitor* and *ONI Asia*, (2008), http://www.infowarmonitor.net/breach ingtrust.pdf.

169. PRINCIPLES, *supra* note 138, at 3.

control," but have a less outcome-oriented obligation to use "best efforts" where they do not. "Operational control," the trigger of the duty to implement the Principles, is defined as:

> [T]he power, directly or indirectly, to direct or cause the direction of the management and policies of the entity. This may be by contract, ownership of voting stock or representation on the Board of Directors or similar governing body.[170]

"Best efforts" is defined as:

> The participating company will, in good faith, undertake reasonable steps to achieve the best result in the circumstances and carry the process to its logical conclusion.[171]

ICT commitments under the Initiative extend not only to the companies' relationships with governments, but with users as well. Participating companies are obligated to communicate to their users the instances in which they restrict access to Internet content as well as their policies for retention and provision of personal information to governmental authorities. More specifically, companies must disclose the laws that require them to restrict content, the companies' policies and procedures for responding to government demands to restrict or remove content, and to:

> Give clear, prominent and timely notice to users when access to specific content has been removed or blocked by the participating company or when communications have been limited by the participating company due to government restrictions. Notice should include the reason for the action and state on whose authority the action was taken.[172]

Participating companies must likewise disclose to users what *personal information* they collect, the laws and policies that may require them to provide this information to government authorities, and the companies' policies and procedures for responding to such governmental demands.[173]

Finally, the Implementation Guidelines prescribe internal measures participating companies should take to enable them to fulfill their primary obligation to safeguard free expression and privacy. Boards and senior management of participating companies are to incorporate the human rights impact assessments in reviewing company operations, evaluating

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170. *Id.* at 5, n.10.
171. *Id.* Annex A.
172. IMPLEMENTATION GUIDELINES, *supra* note 140, at 6.
173. Id. at 7.

potential markets, as well existing and potential partners, suppliers and investors.[174] Companies are to:

> Adopt policies and procedures to address how the company will respond in instances when governments fail to provide a written directive or adhere to domestic legal procedure. These policies and procedures shall include a consideration of when to challenge such government demands.[175]

Government demands implicating users' freedom of expression and privacy are to be "overseen and signed-off by an appropriate and sufficiently senior member of the company's management."[176] And companies are to provide training to employees at all levels—including employees of partners where "appropriate and feasible"—in the companies' policies and procedures for protecting free expression and privacy.[177]

2. *Accountability for Obligations Under Global Network Initiative*

Accountability for compliance with the Principles is accomplished through a process of independent assessments.[178] Informed by company reporting and their own investigation, independent assessors will evaluate each company's compliance with the Principles.[179] A public determination will ultimately be made as to whether or not the companies are in compliance with their obligations.[180]

The accountability mechanism will progress in three phases over the next four years. Participating companies are given until 2011 to implement the Principles, and are subject to no assessment until this time. During this first phase, the Board of the Organization is to approve independence and competence criteria for the selection of independent assessors.

In the second phase, commencing in 2011, independent assessments of company *processes* will be conducted. Each company will select one or several independent assessors who meet the Board's criteria for independence and competence. The first round of independent assessments will take the following form:

> To initiate the independent assessment, each company will prepare a detailed report describing its internal processes that im-

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174. *Id.* at 1-2.
175. *Id.* at 5.
176. *Id.* at 3.
177. *Id.* at 4.
178. *See* GOVERNANCE, *supra* note 143, at 2-3.
179. *Id*. at 3-4.
180. *Id*. at 3-5.

> plement the Principles. The independent assessors will review the company's report as a baseline and also review the companies' internal implementation processes in operation. Based on these reviews the independent assessors will prepare a written evaluation of the company's internal processes that implement the Principles.[181]

In addition to their reporting obligations, companies agree to provide sufficient access to enable independent assessors to perform their own investigation.[182] It bears emphasis that this first assessment in 2011 and the companies' reporting leading to it will be limited to *process*: whether participating companies have implemented the Principles in their operations as required by the Principles and Implementation Guidelines. It is unclear from the Governance, Accountability and Learning Framework whether the results of this first assessment—the verdict of whether or not individual companies are in compliance with the Principles—will be made public.[183]

The accountability mechanism comes fully into effect in the third phase.[184] The scope of company reporting and independent assessments expands to include actual cases—company responses to specific government demands—and the effectiveness of company responses. Independent assessors are also permitted to consider information brought to their attention by third parties at this stage, creating a possible role for NGOs in the assessments.[185] From these assessments, the Board of the Organization will *publicly* determine whether each company is in compliance with the Principles.[186]

3. *Civil Society Reception of the Global Network Initiative*

The civil society participants in the Global Network Initiative reacted with cautious optimism to the Initiative's launch.[187] The sentiment of NGO participants is aptly captured by the reaction of Human Rights

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181. *Id*. at 3.

182. *Id.*

183. The Framework does specify "the Organization will produce a report outlining its activities during the year, including a *description* of the independent assessment process." *Id.* at 4 (emphasis added). When compared to the description of Phase 3—where, under the Independent Assessment heading, it is explicitly stated that the determination will be made public—it appears there will be no public determination until 2012.

184. At this time the Organization will accredit a pool of qualified Independent Assessors. *See id.* at 4-6.

185. *Id.* at 4.

186. *Id.*

187. Global Network Initiative, *supra* note 137.

Watch. "This initiative is an important opportunity to ensure respect for human rights in the ICT industry. The hard work is still ahead, but this is an important step forward."[188] However, two major human rights NGOs that participated in the two-year gestation of the Initiative distanced themselves just before its unveiling, contending that it does not go far enough. Amnesty International issued a statement recognizing the progress of the Initiative, but concluding that it is "not yet strong enough for Amnesty International to endorse."[189] Reporters Without Borders cited "loopholes" and "weak language on the central points" as the reason for its withdrawal of official support.[190] More specifically, it criticized the absence of an outright prohibition on ICT compliance with repressive local laws, stating that "[u]nder these principles, another Shi Tao case is still possible."[191] It also criticized the extent of discretion left to companies—such as when they will challenge government demands—and the possibility that participating companies will skirt their obligations under the Initiative through local business partnerships.[192]

B. Assessing The Global Network Initiative

The Global Network Initiative is a positive step toward alleviating the quandary facing ICTs operating in Internet-restricting countries. It should be evident from Part I that ICTs simply cannot afford to acquiesce, as a matter of policy, to repressive local regulations that breach the global law to which they are simultaneously accountable. The Initiative helps companies to comply with this global law to the maximum extent possible, first by distilling vast bodies of international human rights law into relatively concrete, actionable obligations that can be incorporated into company policies and operations. The Initiative is also structured to enable collective action where individual action would be impracticable by creating a so-called "cartel of values"[193] among participating companies. It should

188. Arvind Ganesan, Director, Business and Human Rights Program, Human Rights Watch, quoted in Oct. 28, 2008 press release, *supra* note 137.

189. Bobble Johnson, *Amnesty Criticises Global Network Initiative for Online Freedom of Speech*, GUARDIAN, Oct. 30, 2008, *available at* http://www.guardian.co.uk /technology/2008/oct/30/amnesty-global-network-initiative.

190. Reporters Without Borders for Press Freedom, "Why Reporters Without Borders is not endorsing the Global Principles on Freedom of Expression and Privacy for ICT companies operating in Internet-restricting countries" (Oct. 28, 2008) http://www.rsf.org/print.php3?id_article=29117.

191. *Id*.

192. *Id.*

193. Ralph Steinhardt, *Corporate Responsibility and the International Law of Human Rights: The New* Lex Mercatoria, *in* NON-STATE ACTORS AND HUMAN RIGHTS 202-203 (Philip Alston ed., 2005).

enable greater resistance by ICTs by overcoming two collective action problems: if all participating companies adhere to obligations, none should suffer competitive disadvantages vis-à-vis each other, and the unified front brings greater market power to bear on governments.

But Human Rights Watch was correct to observe that the hard work lies ahead. This hard work is the implementation and operationalization of the Principles by participating companies, and diplomatic engagement with Internet-restricting countries. The Principles will be little more than a public relations exercise if not faithfully implemented by participating companies, and meaningfully enforced by the Organization. Critics of the Principles are correct that they leave much discretion to companies as to the *means* of fulfilling key obligations. Yet concerns that this discretion amounts to "loopholes" may be premature. Independent assessments, properly conducted, can correct for any "play" in the rules. The obligations contained in the Principles and Implementation Guidelines should not be read in isolation but, like a statute or treaty, construed in light of their object and purpose—articulated in the Preamble and high-level obligations—and the body of international human rights law incorporated by reference. Approached in this way, companies that act contrary to the *spirit* of the Principles cannot escape the scrutiny of independent assessors by relying on vague or "optional" language. The Principles, together with the Implementation Guidelines and the international human rights law underlying both, provide sufficient standards to assess whether participating companies have in good faith met their *overall* obligations to respect and protect the freedom of expression and privacy. If participating companies are able to exploit vague or discretionary provisions to evade their obligations, it will be a failure not of the Principles, but the independent assessors.

Faithfully implemented and enforced, the upside potential of the Initiative is to press the protection of free expression and privacy to the limits of private action. Even Google, Yahoo! and Microsoft, standing shoulder to shoulder under the Initiative, do not likely possess the market power to flatly refuse all cooperation with the Chinese government.[194] Yet it is

194. In pursuit of a durable solution to this quandary, Google has requested that the U.S. government treat Internet censorship as a trade barrier. Posting by Andrew McLaughlin, Google Public Policy Blog, http://googlepublicpolicy.blogspot.com/2007/06/censorship-as-trade-barrier.html (June 22, 2007, 15:36 PST). Taking a similar tack, the European Parliament has passed a resolution calling on the European Union to treat Internet censorship as a trade barrier. European Parliament resolution of 19 February 2008 on the EU's Strategy to deliver market access for European companies, EUR. PARL.

equally likely that the companies have not reached the limit of their power to push back on demands to restrict free expression and privacy—by interpreting restrictions narrowly and requiring governments to justify demands according to international human rights standards, for example. At best, the Initiative can enable ICTs to recover this lost ground between their present practices and the full extent of their private potential to resist governmental directives inconsistent with human rights.

Two recent incidents of state-mandated interference with expression and privacy illustrate the means available to ICTs to mitigate such interferences, the limits of private action, and the varying willingness of leading ICTs to explore this limit. In the United States, Google successfully challenged a subpoena[195] for millions of user search queries. The Department of Justice subpoenaed leading U.S. search engines for samplings of search terms and URLs to aid its prosecutions under the Child Online Protection Act of 1998.[196] Whereas America Online, Yahoo! and MSN reportedly complied with the subpoena,[197] Google challenged the subpoena, persuading the District Court for the Northern District of California to narrow the disclosure mandate to eliminate user search queries.[198]

In Argentina, numerous public figures have secured temporary restraining orders against Yahoo! Argentina and Google Argentina to block search results containing their names.[199] Both Yahoo! and Google challenged the restraining orders in Argentinean courts, but have implemented them differently, according to the OpenNet Initiative.[200] Whereas Yahoo! Argentina eliminated *all search results* for individual celebrity names and did not provide notice of filtering to users until November 10, 2008, Google Argentina implemented the orders more narrowly and consistently provided notice to users that search results were limited by court order.[201]

DOC. (2007/2185(INI)), *available at* http://www.europarl.europa.eu/sides/getDoc.do?type=TA&language=EN&reference=P6-TA-2008-0053.

195. Subpoena Duces Tecum, ACLU v. Gonzales, No. 98-5591 (Ed. Pa. Aug. 25, 2005), *available at* http://www.google.com/press/images/subpoena_20060317.pdf.

196. Katie Hafner and Matt Richtel, *Google Resists U.S. Subpoena of Search Data*, N.Y. TIMES, January 20, 2006, at A1.

197. *Id.*

198. Order Granting In Part And Denying In Part Motion To Compel Compliance With Subpoena Duces Tecum, Gonzales v. Google, Inc., No. CV 06-8006, (N.D. Cal. Mar. 17, 2006).

199. Firuzeh Shokooh Valle and Chistopher Soghoian, *Adios Diego: Argentine Judges Cleanse the Internet*, OpenNet Initaitive Blog, Nov. 11, 2008, http://opennet.net/blog/2008/11/adiós-diego-argentine-judges-cleanse-internet (last visited Nov. 29, 2008).

200. *Id.*

201. *Id.*

Although the court orders ultimately led to far-reaching Internet censorship, the pushback by the ICTs—court challenges, narrow interpretation, and transparency to users—resulted in *less* interference with expression than unquestioning compliance with government commands.

The Globlal Network Initiative provides for the type of private resistance undertaken by Google and Yahoo! in the U.S. and Argentina, but with the advantages of coordination and uniformity. Uniform responses to government demands, absent in the above examples, may be achieved through the uniformity of participants' obligations under the Initiative, and the potential for the Organization to facilitate information sharing among otherwise fierce competitors, formulating coordinated responses to shared problems. Such a uniform approach to government-imposed restrictions on free expression and privacy by the present participants may even drive market-based convergence around this approach by non-participants. Such market-driven convergence is presently playing out as Yahoo!, Google, Microsoft, and Ask.com race to outdo one another in adopting more privacy-oriented practices for handling user data, competing for the user trust that is crucial to brand value.[202] A uniform approach by three leading ICTs may spark similar competition.

Would a Shi Tao case still be possible under the Global Network Initiative, as Reporters Without Borders has cautioned?[203] Perhaps. Private ICTs do not have the power to completely resist demands for information a government is determined to obtain. But in resisting to the limits of private action as prescribed by the Principles, ICTs raise the cost for governments of obtaining information contrary to human rights norms, and the cost of imposing restrictions on expression and privacy more generally. We cannot know whether the Shi Tao tragedy would have been averted using the means of private resistance prescribed by the Global Network Initiative; we know only that such tragedies have occurred, and continue to occur,[204] under prevailing ICT policies.

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202. *See, e.g.*, Nate Anderson, *Yahoo Outdoes Google, Will Scrub Search Logs After 90 Days*, ARS TECHNICA, Dec. 17, 2008, http://arstechnica.com/news.ars/post/20081217-yahoo-outdoes-google-will-scrub-search-logs-after-90-days.html (last visited Dec. 18, 2008).

203. Reporters Without Borders, *supra* note 190.

204. In February 2008, Yahoo! was again sued under the ATCA for aiding and abetting the persecution of Chinese dissidents by furnishing the Chinese government with user-identifying information. Complaint, Cunzhu et al v. Yahoo! Inc. et al, No. C08-01068 (N.D. Cal. Feb. 22, 2008), *available at* http://docs.justia.com/cases/federal/district-courts/california/candce/3:2008cv01068/200778/1/ (last visited Mar. 1, 2009).

In any case, to dismiss the Global Network Initiative as futile for its inability to resolve the most difficult cases would be shortsighted. Short of wholesale defiance of sovereign commands, many opportunities for valuable improvement of Internet freedom remain squarely within reach for private actors. Just as ICT resistance *mitigated* the adverse effect of the Argentinean court orders on free expression, ICTs—guided by the Principles of the Global Network Initiative and the creativity that has defined their success—have the potential to incrementally improve free expression and privacy *everywhere* they operate by questioning, challenging, and narrowing repressive regulations. In providing a roadmap and support apparatus for compliance with the global law, the Global Network Initiative offers ICTs the best available solution to both moral and business quandaries.

ADDITIONAL DEVELOPMENTS—CYBERLAW

DUDNIKOV V. CHALK & VERMILION

514 F.3d 1063 (10th Cir. 2008)

In a case involving a copyright dispute over an eBay auction, the Tenth Circuit overturned the District Court of Colorado's grant of a motion to dismiss due to lack of personal jurisdiction. The Tenth Circuit held that Colorado had specific jurisdiction over the defendant because of his interactions with the Colorado plaintiff via eBay. The plaintiff's eBay auction item substituted Betty Boop and her dog "Pudgy" for the elegant woman walking a regal dog in the famous work owned by the defendant copyright holder. The defendant issued a notice of claimed infringement (NOCI) to eBay in California, prompting eBay to remove the auction listing. The plaintiff offered to refrain from selling the disputed fabric in exchange for a withdrawal of the NOCI, to which defendant responded by threatening a federal suit. Plaintiffs filed suit in the United States District Court of Colorado, seeking declaratory judgment that their eBay auction item did not infringe defendant's copyright. The district court granted the defendant's motion to dismiss for lack of personal jurisdiction, and the plaintiff appealed to the Tenth Circuit.

To determine whether Colorado had personal jurisdiction over the defendant, the Tenth Circuit formulated and applied a five-part test based on Supreme Court law—the defendant must have (1) committed an intentional action, (2) expressly aimed at the forum state, (3) with knowledge that the brunt of the injury would be felt in the forum state, (4) the plaintiff's injuries arose out of the defendant's forum-related activities, and (5) the traditional notions of fair play and substantial justice are not offended.

The court held that the defendant's NOCI filing was an intentional act aimed at the plaintiff in Colorado, as was his threat to bring suit within ten days if the plaintiff did not take down the item from action. Furthermore, the court aligned itself with a ruling by the Ninth Circuit by holding that the intentional act did not need to be wrongful, since such a requirement would be tantamount to an assessment of the merits of a case. Though the defendant argued that he sent the NOCI to eBay in California, the court reasoned that the defendant did so with the intent to remove the auction listed by the plaintiff's business in Colorado. From this, the court determined that the defendant's actions were expressly aimed at Colorado,

and that he knew that the injury would be felt in the forum state. The Court further reasoned that the defendant knew that plaintiff was located in Colorado since such notice was provided on his eBay listing. The Tenth Circuit then concluded that sending a NOCI to eBay and threatening lawsuit via email—the forum-related activities of the defendant—were both but-for and proximate causes of the plaintiff's alleged injury because the merits of the plaintiff's declaratory judgment suit dealt directly with the same issue of copyright infringement. Accordingly, the first four factors of the test for Colorado's personal jurisdiction over the defendant were satisfied.

Finally, the court evaluated whether Colorado's jurisdiction over the defendant would offend notions of fair play and substantial justice by considering (1) the defendant's burden, (2) the forum state's interests in the dispute, (3) the plaintiff's interest in receiving convenient and effectual relief, (4) the judicial system's interest in efficiently resolving controversies, and (5) the shared interest of the several states in furthering social policy. The court decided that none of these factors weighed definitively in favor of the defendant. Thus, the Tenth Circuit found that personal jurisdiction was proper, and reversed the decision of the lower court.

CYBERBULLYING

On June 30, 2008, Missouri updated the state's harassment law to criminalize online harassment, known as "cyberbullying." More than a dozen states prohibit cyberbullying, but Missouri is the first state to authorize imprisonment for infractions.

The revised law redefines "harassment" in section 565.090 of the Revised Statutes of Missouri to include electronic communication that "frightens, intimidates, or causes emotional distress to [another] person." Previously the state considered only telephonic and written communication to be modes of harassment. The penalty for harassment is imprisonment for up to one year, unless the act is committed by a person older than twenty upon a person younger than seventeen, which carries a sentence of up to four years.

Missouri adopted the new law following public outcry after the infamous 2006 suicide of thirteen year old Megan Meier. Meier received nasty messages through myspace.com, a popular social networking site, supposedly from a boy named Josh. "Josh," in fact, did not exist, but was a fake profile created by a fellow classmate and the classmate's mother, Lori Drew, who communicated with Megan through the fake account for over a month. The communications culminated in Megan's death.

Missouri prosecutors determined that they were unable to use the state harassment statute as it existed in 2006 to prosecute Lori Drew, but there was significant public pressure to find a way to hold Drew accountable. Federal prosecutors stepped in and charged Drew, using an unconventional application of the Computer Fraud and Abuse Act (CFAA), 18 U.S.C. § 1030. The CFAA is typically used to prosecute hackers and electronic information theft. Prosecutors charged Drew with violating the MySpace terms of service (TOS), which required truthful and accurate registration, refraining from using information from MySpace to harass others, refraining from solicitation of information from a minor, and refraining from promoting false or misleading information.

In an amicus brief supporting the defendant's motion to dismiss, the Electronic Frontier Foundation criticized the Justice Department for applying the CFAA this way, particularly for using TOS violations for criminal prosecutions. Websites typically use TOS agreements to maintain a contractual right to remove troublesome users, not to prosecute criminal matters.

Law professor and former federal prosecutor Orin Kerr also objected to this application of the CFAA and joined Drew's defense team pro bono in October 2008. Kerr cautioned that a successful prosecution in the Drew

case would allow the federal government to "bring charges against anybody who uses the internet. And Congress never intended that." Drew was charged with one felony count of conspiracy and three felony counts of unauthorized computer access. The jury acquitted Drew of the three charges regarding unauthorized computer access because they felt the prosecution's evidence did not meet the maliciousness required for a conviction, and instead convicted Drew of three misdemeanor counts of unauthorized computer access. However, the jury was deadlocked with regard to the conspiracy charge, leaving an opportunity for a retrial upon that issue. The defense filed a Rule 29 motion for directed acquittal that remains undecided.

Missouri's revised state harassment law is intended to simplify prosecution of acts such as those of Lori Drew.

RAMBUS V. F.T.C. IN THE CONTEXT OF STANDARD-SETTING ORGANIZATIONS, ANTITRUST, AND THE PATENT HOLD-UP PROBLEM

By Joel M. Wallace

In April 2008, a panel of the Federal Court of Appeals for the District of Columbia overturned the decision of the Federal Trade Commission (FTC) in an antitrust suit against Rambus, Inc. (Rambus).[1] The line of cases leading up to the D.C. Circuit's decision[2] demonstrated the willingness of the FTC and federal courts to apply principles of antitrust liability to parties that misdirect or otherwise interrupt the standards-setting process. The D.C. Circuit, however, "call[s] into question the ability of the antitrust agencies and private plaintiffs to challenge standard-setting deception on Sherman Act grounds."[3]

Standard Setting Organizations (SSOs) play an increasingly important role in today's technology and consumer electronics industries by allowing firms to shift their resources into developing end-user applications for technology, as opposed to focusing their resources on establishing competing formats. Unfortunately, nefarious firms may attempt to undermine the process by either demanding excessive royalties after participation or by withholding relevant patents until after the standard is set. Thus, abuse of the standard-setting process has become a large concern for SSOs, firms participating in the process, and consumers[4] affected by increased technology prices. If SSOs are not able to punish deceptive behavior, then either fewer firms will be willing to subject themselves to SSO commitments or more firms will join SSOs without an intention to abide by their rules. Hamstringing the efforts of SSOs to set clearer rules at the outset of negotiations are fears that the FTC will invalidate the product of such negotiations as anticompetitive restraints on trade.

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1. Rambus, Inc. v. F.T.C., 522 F.3d 456, 469 (D.C. Cir. 2008), *cert. denied*, 129 S. Ct. 1318 (2009).

2. *See, e.g.*, *In re* Dell, 121 FTC 616 (1996); *infra* Section I.C.2.a.

3. Wilson D. Mudge & Marni B. Karlin, *The District of Columbia Circuit Court's Decision In* Rambus *Overturns The FTC Finding Of Monopolization*, 20 INTELL. PROP. & TECH. L.J. 11, 13 (2008).

4. As represented by the FTC.

This Note makes three arguments: (1) the D.C. Circuit's decision is inconsistent with precedent and could cripple the standard setting process by preventing punishment of parties that purposely deceive SSOs; (2) SSOs should require royalty commitments from their members at the outset of the standard-setting process, however, they must be mindful to not over-regulate, thus discouraging the use of their procompetitive processes or hindering innovation; and (3) SSO participants and non-participants should challenge the enforceability of secret patents held by participants during the standard-setting process under the doctrine of waiver.

Part I discusses the standard-setting process, the relevant statutory frameworks, and previous litigation relating to antitrust liability in the SSO context. Part II delves into the *Rambus* litigation by examining the facts and rulings in the FTC and D.C. Circuit. Part III first analyzes the D.C. Circuit opinion. Then, it addresses the ability of SSOs to protect their members from holdup using royalty commitments and the ability of defendants to protect themselves using the equitable defense of waiver.

I. BACKGROUND

This Part explores the problem of patent hold-up in the SSO process, as well as the various notable cases associated with the problem. Section I.A. describes the role of SSOs in the technology sector and the commonly understood motivation behind patent hold-up by SSO members. Section I.B. examines the patent and antitrust legal regimes to establish some context for the ongoing battle between the two doctrines. Finally, Section I.C. traces the development of case law in the field of standards-setting deception over the last decade.

A. Standard Setting Organizations and the Hold-up Problem

Uniform product standards expand downstream markets for complementary products, thus broadening the market for the industry as a whole and benefiting end-users.[5] When a new technology is first developed, several equally viable alternative implementations of that technology may exist. However, each particular embodiment of the technology holds little value on its own because downstream providers may delay incorporating it or consumers may be hesitant to accept any one version of the new technology for fear that their format may lose out.[6]

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5. *See* Peter S. Menell, *Tailoring Legal Protection for Computer Software*, 39 STAN. L. REV. 1329, 1331 (1987) (describing the value of uniform product standards in broadening the availability of complementary products in the software industry).

6. *See id.* at 1340-41.

Adding further complication, some technologies rely on the so-called "network effect" to provide value to users through widespread adoption.[7] Today, products such as DVDs, music players, and computers all rely on the network effect to encourage consumers to purchase products that fit within that network. For example, if a consumer were to buy an audio compact disc, she would not worry if that disc will be compatible with the CD player in her car, computer, or elsewhere because the CD format has been established already as the de facto standard physical music media. During the transition to that standard, however, that same CD may have held less value to the same consumer if she owned a car equipped with a cassette tape player.[8]

To help bridge this gap, industry participants may form an SSO to establish a single version of the technology, thus helping the entire industry by building on the positive externalities of the network effect and allowing downstream producers to devote resources to research and development of more widely useable consumer goods.[9] An SSO can also speed the transition from an old to a new standard by foregoing the sometimes drawn-out process of having the market choose a preferred embodiment of a technology.[10] SSOs seek the optimal implementation of a technology based on both efficacy and cost. To ensure that quality technologies can be implemented cheaply, SSOs often require their members to both disclose their intellectual property rights (IPR) in the underlying technology and to commit to a license if their IPR is used in the new standard.[11]

Great care is necessary in the standards-setting process because once a standard is set the industry is "locked-in" to that specific implementation of the technology.[12] The FTC cautioned, "when a firm engages in exclu-

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7. A "network effect" exists when the network of interoperable devices drives the value of components compatible with the network. The telephone system is the paradigmatic example of a technology that utilizes a network effect to establish its large value. The value of a telephone network with a single telephone is practically nothing. However, as more users are added to the network, each provides value to the other users. *Id.* at 1340.

8. *See id.* at 1340-44 (describing the increased value of interoperable products).

9. Mark A. Lemley, *Ten Things to Do About Patent Holdup of Standards (And One Not To)*, 48 B.C. L. REV. 149, 154-55 (2007).

10. An example of a long and costly war over de facto standards was the standard war between Blu-Ray and HD DVD over the format for next-generation video playback technology. *See, e.g.*, Dawn C. Chmielewski, *DVD format war appears to be over*, L.A. TIMES, Jan. 5, 2008 at C1; CNN, *Toshiba quits HD DVD 'format war'*, Feb. 21, 2008, http://www.cnn.com/2008/BUSINESS/02/19/toshiba.hdd/index.html.

11. *See* Mark A. Lemley, *Intellectual Property Rights and Standard-Setting Organizations*, 90 CALIF. L. REV. 1889, 1904-06 (2002).

12. *See, e.g.*, Lemley, *supra* note 9, at 154-55.

sionary conduct that subverts the standard-setting process and leads to the acquisition of monopoly power, the procompetitive benefits of standard setting cannot be fully realized."[13] This creates a hold-up problem: a firm possessing IPR in the underlying technology threatens enforcement of its patent rights after the standard is in place to extract supracompetitive fees from firms producing goods that use or are compatible with the standard at issue.

Currently, the digital technology industry relies heavily on industry standards, which, in turn, rely heavily on patented technologies.[14] If an industry standard implicates a patent, then that patent owner should either be compensated or be able to deny the use of her property.[15] These two rights form the basis of the "hold-up problem." On its face, neither of these "problems" is illegal, or even discouraged. While the time and cost associated with changing an industry standard may be large, if an SSO chose a standard without adequate due diligence, then patents implicated by that standard should be able to be enforced legally.[16]

This simple premise becomes more complicated when one considers the possibility that the patent owner may take an active role in the negotiation and establishment of the industry standard. As one author put it, the owner of a town's only well would not be acting illegally to charge higher prices for water during a drought; monopoly pricing could lead to the search for alterative sources of water or other innovations in the field of efficiency of use.[17] However, if the well owner also has the power to cause a drought, he may be liable for antitrust violations if he charges high, drought-based prices regardless of the weather.[18]

The hold-up problem normally occurs in one of two scenarios. First, a firm will participate in an SSO and agree to "Reasonable and Non-Discriminatory" (RAND) or "Fair and Reasonable and Non-Discriminatory" (FRAND) licensing terms, then under threat of suit,

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13. Opinion of the Commission, *In re* Rambus, Inc., FTC No. 9302, Slip op. at 3 (F.T.C. Aug. 2, 2006) [hereinafter Liability Opinion] (Public Record Version), *available at* http://ftc.gov/os/adjpro/d9302/060802commissionopinion.pdf.

14. Justin (Gus) Hurwitz, *The Value of Patents in Industry Standards: Avoiding License Arbitrage with Voluntary Rules*, 36 AIPLA Q.J. 1, 3 (2008).

15. *See* 35 U.S.C. § 271 (2006) (stating the exclusionary rights of a patent holder). Patents covering industry standards are actually thirteen times more likely to be litigated than similar patents that do not cover any standard. Lemley, *supra* note 9, at 154-55.

16. *See* Hurwitz, *supra* note 14, at 3. Adoption by competitors, in the standard-setting context or not, is exactly the type of exclusion expressly granted by the Patent Act. *See also infra* Section I.B.1 for a discussion of the patent legal regime.

17. Hurwitz, *supra* note 14, at 3.

18. *Id.*

charge rates much higher than other SSO participants regarded as "reasonable."[19] Second, a firm will not disclose material patents until after the industry standard is set, then attempt to extract large royalty payments under threat of an injunction or infringement damages.[20]

The first form of hold-up is primarily based on the lack of a universally accepted and standard understanding of the meaning of RAND and FRAND commitments.[21] Few SSOs define the term "reasonable" or establish means to resolve disputes over its meaning.[22] In determining the meaning of "reasonable," courts have applied numerous different tests[23] or not enforced the term at all based on its indeterminate nature.[24] Because licensing terms are not known when the final vote is taken and the industry is locked in to a particular technology, the patent owner can unilaterally impose burdensome license terms at ex post rates after adoption.[25] They can extract these onerous rates because of the seller's artificially created market power.[26]

The second form of hold-up is tied to patent disclosure rules in SSOs. In a perfect world, SSOs would mandate that all participants exhaustively search their patent portfolios and then disclose all patents and pending applications that cover the standard or related technologies.[27] The SSO would enforce the rule using contract provisions providing for severe penalties for non-disclosure, such as withholding royalties. However, a mandatory disclosure policy would discourage participation in the SSO by

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19. *Id*. at 3-4. A RAND commitment may also be interpreted as a covenant to license in the future, thus removing the threat of injunction from royalty negotiations. Lemley, *supra* note 9, at 157-58.

20. Hurwitz, *supra* note 14, at 3-4; *see also* 35 U.S.C. §§ 283-84 (2006) (establishing injunctive relief and monetary damages as the remedy for patent infringement). The third possibility is that a non-participant to an SSO may hold patents that read on the chosen standard and demand high fees or refuse licenses altogether. This problem is rare and the case law discussed here would likely not be applicable to those facts.

21. Anne Layne-Farrar, A. Jorge Padilla & Richard Schmalensee, *Pricing Patents for Licensing in Standard-Setting Organizations: Making Sense of FRAND Commitments*, 74 ANTITRUST L.J. 671, 678-79 (2007).

22. Lemley, *supra* note 11, at 1964-65.

23. Layne-Farrar, Padilla & Schmalensee, *supra* note 21, at 680-85 (discussing the use of *Georgia-Pacific* factors borrowed from infringement damages cases in some instances, but a Numeric Proportionality test in other instances).

24. *See* Townshend v. Rockwell Int'l Corp., 55 U.S.P.Q.2d 1011, 1018 (N.D. Cal. Mar. 28, 2000).

25. Robert A. Skitol, *Concerted Buying Power: Its Potential for Addressing the Patent Holdup Problem in Standard Setting*, 72 ANTITRUST L.J. 727, 728 (2005).

26. *Id.*

27. Joseph Farrell et. al., *Standard Setting, Patents, and Hold-Up*, 74 ANTITRUST L.J. 603, 629 (2007).

firms because of the fear of liability for breach of contract, or worse, treble damages related to antitrust violations for interference with a procompetitive process.[28] Thus, an SSO can only base its choice of standards on the likelihood of being held-up by undisclosed patents, while simultaneously securing RAND commitments from all participants on the disclosed patents. And so most current SSOs have voluntary disclosure standards, which have historically been easily abused.[29]

B. Relevant Antitrust Legal Regimes

Given the possible grave impacts of holdup on the standards-setting process and on consumers, many practitioners, scholars, and government officials have attempted to rectify the problem. Because of the alleged effects on the competitive process, these solutions invariably turn to Antitrust law. This Section first provides a brief background to relevant antitrust doctrines from patent law. Next, it turns to relevant antitrust doctrines stemming from sections 1 and 2 of the Sherman Act and section 5 of the Federal Trade Commission Act.

1. Antitrust Implications of a Patent Right

A patent grants the right to its owner to exclude others from making, selling, offering for sale, importing or practicing a specific product or process for a term of twenty years from the date of filing the application,[30] but does not confer the positive right on the patentee to practice the invention herself.[31]

The rights granted by a patent are commonly described as a "monopoly" but this is not a precisely accurate description.[32] First, a patentee may not be able to practice the invention described in the patent because other patents may exist on essential sub-components of the final product.[33]

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28. *Id.* at 625-27, 646.

29. *See, e.g.*, *In re* Dell Corp., 121 FTC 616 (1996); Broadcom Corp. v. Qualcomm Inc., 501 F.3d 297 (3d Cir. 2007); Liability Opinion, *In re* Rambus, FTC No. 9302 (F.T.C. Aug. 2, 2006). *See generally* Lemley, *supra* note 11 (demonstrating the wide variety of IPR disclosure policies and discussing both the reasoning behind lax policies and the rampant abuses of those policies).

30. 35 U.S.C. § 271 (2006) (stating the exclusionary rights of a patent holder); 35 U.S.C. § 154 (2006) (describing the term of an issued patent).

31. ROBERT P. MERGES, PETER S. MENELL & MARK A. LEMLEY, INTELLECTUAL PROPERTY IN THE NEW TECHNOLOGICAL AGE 126-27 (4th ed. 2007).

32. HERBERT HOVENKAMP, MARK D. JANIS & MARK A. LEMLEY, IP & ANTITRUST § 4.2(a) at 4-8 (2005 & 2007 Supp.); *see* Mark A. Lemley, *A New Balance Between IP and Antitrust*, 13 SW. J. L. & TRADE AM. 237, 246-47 (2007).

33. These other patents are commonly referred to as "blocking patents." MERGES, MENELL & LEMLEY, *supra* note 31, at 126-27.

Without a license to use the sub-component, the patentee may never be able to commercialize the disclosed invention of her own patent. Second, the scope of the rights granted by a patent are intimately bound to the language of the claims recited in the patent.[34] If a competitor can achieve the same result as a patented invention by designing a product that functions in a substantially different way or by a substantially different means, then that competitor cannot legally be excluded.[35] The possibility of a design-around means that a patent grants no more than a stake in the game of technological competition—far from a government-granted monopoly. If a patentee attempts to institute monopoly pricing when other goods in the market serve the same or similar functions, then consumers will likely switch to these "substitute goods" reducing the patent's value to the patentee.[36]

2. Antitrust Law

"The guiding principle of modern antitrust law is that competition is generally desirable in order to achieve economic efficiency," and thus it attempts to protect competition and the competitive process from interferences in the free market.[37] Importantly, the law has never made monopoly itself illegal, but instead punishes anticompetitive behavior designed to illegitimately increase market power.[38]

a) Sherman Act Section 1

Section 1 of the Sherman Act provides that: "[e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade . . . is declared to be illegal."[39] The text of the statute could be read to cover almost all contracts since they in some way restrict free trade by fore-

34. 35 U.S.C. § 112 para. 2 (2006) (requiring that the claims "particularly point[] out and distinctly claim[] the subject matter which the applicant regards as his invention"); Phillips v. AWH Corp., 415 F.3d 1303, 1312 (Fed. Cir. 2005) (en banc) ("It is a 'bedrock principle' of patent law that 'the claims of a patent define the invention to which the patentee is entitled the right to exclude.'" (quoting Innova/Pure Water, Inc. v. Safari Water Filtration Systems, Inc., 381 F.3d 1111, 1115 (Fed. Cir. 2004))); MERGES, MENELL & LEMLEY, *supra* note 31, at 125.

35. *See* Warner-Jenkinson Co. v. Hilton Davis Chem. Co., 520 U.S. 17, 39-40 (1997); Graver Tank & Mfg. Co. v. Linde Air Products Co., 339 U.S. 605, 610 (1950).

36. HOVENKAMP, JANIS & LEMLEY, *supra* note 32, at 4-9. ("My patent grant creates an antitrust 'monopoly' only if it succeeds in giving me the exclusive right to make something for which there are not adequate market alternatives and for which consumers would be willing to pay a monopoly price.")

37. Lemley, *supra* note 32, at 241.

38. *Id.* at 247.

39. 15 U.S.C. § 1 (2006).

closing options that otherwise would be available.[40] However, courts generally read its language narrowly to avoid this problem. In fact, the Supreme Court has read section 1 as only prohibiting unreasonable restraints of trade.[41]

SSOs often fear being charged with antitrust violations because they are purposefully sacrificing market competition, albeit for procompetitive downstream benefits.[42] SSOs literally involve an agreement among competitors to control access to downstream markets, actions which technically fall within section 1 of the Sherman Act as a collective restraint on trade.[43] SSOs generally only demand "reasonable" license commitments from members because they fear that, despite the potential benefits to consumers, ex ante discussion of licensing fees could be considered price fixing.[44]

However, because the Sherman Act exists to encourage competition, courts will not find section 1 violations in all cases of concerted action out of the desire to not chill procompetitive behavior.[45] Alternatively, SSOs must also be wary of allowing anticompetitive harm to the competitive process via holdup by participants.[46] Refusing to act in the face of obvious anticompetitive threats could raise the specter of section 1 liability for SSOs.[47]

b) Sherman Act Section 2

Section 2 of the Sherman Act provides that: "[e]very person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce

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40. Nat'l Soc'y of Prof'l Eng'rs v. United States, 435 U.S. 679, 687-88 (1978).

41. *See* Standard Oil Co. of N.J. v. United States, 221 U.S. 1, 103 (1911).

42. *See* Skitol, *supra* note 25, at 736 (providing examples of procompetitive benefits of SSOs).

43. *See* 15 U.S.C. § 1.

44. Lemley, *supra* note 9, at 161-62. Recent actions by the DOJ and FTC strongly indicate that ex ante negotiations would not be considered per se price fixing violations of the Sherman Act. *See infra* Section III.B.1.

45. *See* InterVest, Inc. v. Bloomberg, L.P., 340 F.3d 144, 161 (3d Cir. 2003).

46. *See* Skitol, *supra* note 25, at 743.

47. *Id.* (discussing the implications of Am. Soc. of Mech. Eng'rs v. Hydrolevel Corp., 456 U.S. 556 (1982), and Allied Tube & Conduit Corp. v. Indian Head, Inc., 486 U.S. 492 (1988), for holding SSOs accountable for their lack of adequate safeguards against holdup). Antitrust liability for SSOs who willfully undermine the competitive process has been found, but the extent that that liability would extend to SSOs who simply retain policies that have been exploited in the past is unclear and beyond the scope of this Note. *See id.*

. . . shall be deemed guilty."[48] This section is also read more narrowly than its language would allow. The offense of monopolization requires proof that a firm (1) possesses monopoly power, and (2) willfully acquired or maintained that monopoly power.[49] Courts have expressly granted immunity from section 2 for businesses that possess a monopoly due to "superior skill, foresight and industry,"[50] while punishing businesses that actively acquire or maintain a monopoly through anticompetitive conduct. Anticompetitive conduct has been defined as "excluding rivals on some basis other than efficiency,"[51] taking actions not explainable by "valid business reasons,"[52] and more recently, as "a willingness to forsake short-term profits to achieve an anticompetitive end."[53] This illegal "market power" is defined as "the power to raise prices or exclude competition in the relevant market."[54]

The Supreme Court identified actionable conduct based on section 2 of the Sherman Act in *NYNEX Corp. v. Discon, Inc.*[55] There, a provider of local telephone service, a lawful monopoly, fraudulently charged customers for "removal service" of replacing outdated switching components. The service provider switched from Discon to another, higher-priced firm which passed the costs to the provider, then to the consumers.[56] At the end of each year the removal service company would give a 'rebate' to the phone provider offsetting their higher costs, but consumers were still charged the higher rate.[57] Since Discon refused to take part in the rebate "game" they were driven out of business.[58] The Court held that the plain-

48. 15 U.S.C. § 2 (2006).

49. United States v. Grinnell Corp., 384 U.S. 563, 570-71 (1966) (finding monopolization through market allocations, acquisitions of competitors, and predatory pricing).

50. United States v. Aluminium Co. of Am., 148 F.2d 416, 430 (2d Cir. 1945).

51. Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585, 605 n.32 (1985) (finding monopolization by using market power to exclude competitors from cooperative pricing without a valid business reason).

52. Eastman Kodak Co. v. Image Technical Servs., Inc., 504 U.S. 451, 483 (1992) ("[R]espondents have presented evidence that Kodak took exclusionary action to maintain its parts monopoly and used its control over parts to strengthen its monopoly share of the Kodak service market. Liability turns, then, on whether "valid business reasons" can explain Kodak's actions.").

53. Verizon Commc'ns, Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 409 (2004).

54. HERBERT HOVENKAMP, MARK D. JANIS & MARK A. LEMLEY, IP & ANTITRUST § 1.2 at 1-7 (2001 & Supp. 2005).

55. 525 U.S. 128, 139-40 (1998).

56. *Id.* at 132.

57. *Id.*

58. *Id.*

tiff failed to meet their burden because they could only show harm to a single competitor, and not the entire process.[59]

Actions by SSO participants that undermine the competitive process have been held to be actionable section 2 violations.[60]

c) FTC Act Section 5

In contrast with the Sherman Act, which focuses on protecting the competitive process, section 5 of the Federal Trade Commission Act expressly focuses on protecting consumers from unfair trade practices.[61] Section 5 provides that: "[u]nfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce, are hereby declared unlawful."[62] The terms are not statutorily defined, so the FTC has wider latitude to respond to new forms of unfair competition.[63] The FTC has declared that section 5 imposes liability on firms that act to hurt consumers, but whose acts do not rise to the level of Sherman Act violations.[64]

C. Cases Involving Deception in the Standard-Setting Process

Prior to the D.C. Circuit's decision in *Rambus*,[65] the FTC and courts had punished participants that had willfully misled the organizations or competitors during the standard-setting process. The case law concerning antitrust violations in the context of SSOs, beginning with the *In re* Dell decision in 1995, had relied on liability under the Sherman Act.[66] More recently, the FTC utilized section 5 of the FTC Act against an SSO par-

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59. *Id.* at 135; *see also id.* at 137 ("The freedom to switch suppliers lies close to the heart of the competitive process that the antitrust laws seek to encourage.").

60. *See, e.g.*, *infra* Section I.C.1 for discussion of *In re* Dell, 121 FTC 616 (1996); *infra* Section I.C.2 for discussion of United States v. Microsoft Corp., 253 F.3d 34 (D.C. Cir. 2001) (en banc) (per curiam), *cert. denied*, 534 U.S. 952 (2001).

61. TAMMY HINSHAW ET AL, 54 AM. JUR. 2D MONOPOLIES & RESTRAINTS OF TRADE § 1154 (2008).

62. 15 U.S.C. § 45 (2006).

63. *See* 15 U.S.C. §§ 45(a)-(b); TAMMY HINSHAW ET AL, 54 AM. JUR. 2D MONOPOLIES & RESTRAINTS OF TRADE § 1154 (2008).

64. *See* Statement of the Federal Trade Commission, *In re* Negotiated Data Solutions LLC, File No. 0510094, at 2-3 (Jan. 23, 2008), *available at* http://www.ftc.gov/os/caselist/0510094/080122statement.pdf; *see also* discussion on *In re* N-Data *infra* Section I.C.5.

65. Rambus, Inc. v. FTC, 522 F.3d 456 (D.C. Cir. 2008).

66. *See In re* Dell Corp., 121 FTC 616 (1996); *see also* Broadcom Corp. v. Qualcomm Inc., 501 F.3d 297 (3d Cir. 2007); *In re* Rambus, Liability Opinion, FTC No. 9302 (F.T.C. Aug. 2, 2006).

ticipant that had engaged in deceptive behavior.[67] The cases detailed below constitute litigations specific to alleged acts of deception in the context of high-technology standards setting.

1. Sherman Act Section 2 Cases

Either the Department of Justice[68] or private parties[69] may file Sherman Act complaints. The possibility of enjoining anticompetitive behavior and obtaining treble damages for the amount of injuries sustained as a result of the violation incentivizes private enforcement.[70] The Department of Justice may punish violations as felonies, subject to large fines and imprisonment.[71]

a) *United States v. Microsoft*

United States v. Microsoft Corp.[72] is one of the few cases to directly tackle the question of the link between anticompetitive behavior and the creation or acquisition of monopoly power in the context of section 2 liability.[73] Importantly, instead of disrupting a formalized standard-setting process, Microsoft used deception to maintain its position as the de facto standard among computer operating systems at that time.[74]

The Court of Appeals for the District of Columbia ruled that Microsoft had induced software developers to write programs that would function only on Microsoft products.[75] Developers wrote such programs because they relied on Microsoft's promises that it would cooperate with potential rivals, such as Netscape and Java, to ensure interoperability.[76] The D.C.

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67. *See* Statement of the Federal Trade Commission, *In re* Negotiated Data Solutions LLC, No. 0510094, at 1 (F.T.C. Jan. 23, 2008), *available at* http://www.ftc.gov/os/caselist/0510094/080122statement.pdf; 15 U.S.C. § 45 (2006).

68. 15 U.S.C. § 4 (2006).

69. 15 U.S.C. § 26 (2006).

70. 15 U.S.C. § 15 (2006); 1 HOLMES, INTELLECTUAL PROPERTY AND ANTITRUST LAW § 5.1 (2008).

71. 15 U.S.C. § 1-2 (2006).

72. 253 F.3d 34 (D.C. Cir. 2001) (en banc) (per curiam). For a survey of the U.S. and European antitrust actions against Microsoft, *see* Amanda Cohen, Note, *Surveying the Microsoft Universe*, 19 BERKELEY TECH. L.J. 333 (2004).

73. J. Thomas Rosch, FTC Comm'r, Section 2 and Standard Setting: Rambus, N-Data & the Role of Causation at LSI 4th Antitrust Conference on Standard Setting & Patent Pools (Oct. 2, 2008), at 6, *available at* http://www.ftc.gov/speeches/rosch/081002section2rambusndata.pdf.

74. *Id.* at 7.

75. *Microsoft*, 253 F.3d at 76 ("[E]ven Java 'developers who were opting for portability over performance unwittingly wrote Java applications that ran only on Windows.'") (internal citations omitted).

76. *Id.* at 76.

Circuit admonished Microsoft for "serv[ing] to protect its monopoly of the operating system in a manner not attributable either to the superiority of the operating system or to the acumen of its makers, and therefore was anticompetitive."[77] Microsoft asserted that the Government's evidence was insufficient to prove that but-for Microsoft's actions, Netscape and Java would have actually become competitors in the operating system market.[78] After pointing out that no case supported the necessity of proving but-for causation, the D.C. Circuit proclaimed that causation can be inferred from exclusionary conduct aimed at competing substitutes, while drawing all inferences against the defendant so that they may "suffer the uncertain consequences of its own undesirable conduct."[79]

The court found that the exclusion of nascent threats was "reasonably capable of contributing significantly to a defendant's continued monopoly power," and that Java and Netscape "reasonably constituted nascent threats" at the time of Microsoft's deceptive acts. Thus, Microsoft had violated section 2 of the Sherman Act.[80]

b) *Broadcom v. Qualcomm*

The highly contentious battle between mobile phone component manufacturers Broadcom and Qualcomm[81] originated as a patent infringement suit filed by Qualcomm in the Southern District of California.[82] In response, Broadcom separately brought an action for antitrust violations under section 2 of the Sherman Act in the District of New Jersey.[83] Qualcomm owned more than 1,400 patents that implicated one of the major standards for mobile phone networks, Code Division Multiple Access (CDMA).[84] Broadcom alleged that Qualcomm used its power over the CDMA standard (1) to threaten phone manufacturers with the loss of pric-

77. *Id.* at 77.

78. *Id.* at 78-79.

79. *Id.* at 79 (quoting 3 AREEDA & HOVENKAMP, ANTITRUST LAW ¶ 651c, at 78).

80. *Id.* at 79, 118-19.

81. Both companies make chipsets for computer networking equipment, mobile phones, and other consumer electronics. Broadcom, "Company Fact Sheet" 1, *available at* http://www.broadcom.com/docs/company/company_factsheet.pdf (last visited Dec. 19, 2008); Qualcomm, "Who We Are — Our Businesses," http://www.qualcomm.com/who_we_are/businesses/index.html (last visited Dec. 19, 2008).

82. Complaint, Qualcomm Inc. v. Broadcom Corp., No. 05-CV-1958, 2005 WL 5176496 (S.D. Cal. Oct. 14, 2005); *see infra* Section I.C.4.

83. Broadcom Corp. v. Qualcomm Inc. (*Broadcom I*), No. 05-3350, 2006 WL 2528545 (D.N.J. Aug. 31, 2006); *see also* Ashley Vance, *Broadcom finds an antitrust suit for Qualcomm*, THE REGISTER, Jul. 5, 2005, http://www.theregister.co.uk/2005/07/05/broadcom_anti_qualcomm/.

84. *Broadcom I*, 2006 WL 2528545 at 2.

ing benefits if they purchased chipsets from Qualcomm competitors, (2) to induce companies to exclusively purchase Qualcomm chipsets by offering reduced royalty rates in return, and (3) to manipulate SSOs in order to ensure that the third generation (3G) standard could also be controlled by Qualcomm's patents.[85]

After the New Jersey district court dismissed the case for failure to state a claim, the Federal Court of Appeals for the Third Circuit overturned the decision finding that an intentionally false promise to license technology on FRAND terms, coupled with an SSO's reliance on that promise, qualifies as actionable anticompetitive conduct.[86] Based on this test, Qualcomm's alleged activity was sufficient to sustain Broadcom's claims of monopolization and attempted monopolization under section 2 of the Sherman Act.[87]

2. FTC Cases

Under section 5 of the FTC Act, the FTC can bring Sherman Act complaints on behalf of consumers.[88] While private citizens or the Department of Justice may also file Sherman Act causes of action, only the FTC may pursue claims under the FTC Act.[89] The following cases demonstrate both the scope and power of FTC enforcement in the realm of standard setting.

a) *In re Dell*

The seminal decision from the FTC regarding deceptive practices toward SSOs is *In re Dell*.[90] The case concerned the industry standard for VL-bus, "a mechanism to transfer instructions between the computer's central processing unit and its peripherals, such as a hard disk drive or video display hardware."[91] The Video Electronics Standards Association (VESA) established the standard for VL-bus.[92] Dell, along with virtually

85. *Id.*; *see* Second Amended Complaint, Broadcom Corp. v. Qualcomm Inc., No. 05-3350, 2007 WL 4910067 (D.N.J. Nov. 2, 2007).

86. Broadcom Corp. v. Qualcomm Inc. (*Broadcom II*), 501 F.3d 297, 314 (3d Cir. 2007) (basing its ruling in part on the FTC's Liability Opinion in *Rambus*).

87. *Id.* at 315, 318.

88. 15 U.S.C. § 45(a)(1) (2006) ("Unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce, are hereby declared unlawful.").

89. TAMMY HINSHAW, ET. AL., 54 AM. JUR. 2D MONOPOLIES AND RESTRAINTS OF TRADE § 1235 (2008).

90. *In re* Dell Corp., 121 FTC 616 (1996).

91. Press Release, Fed. Trade Comm'n, Dell Computer Settles FTC Charges: Won't Enforce Patent Rights for Widely Used Computer Feature (Nov. 2, 1995), *available at* http://www.ftc.gov/opa/1995/11/dell.shtm [hereinafter FTC/Dell Press Release].

92. *Id.*

all major U.S. hardware and software manufacturers, had participated in VESA and certified that it knew of no patents that would read on the standard.[93] After the standard became wildly successful, Dell contacted other VESA members and informed them of a 1991 patent that read on the VL-bus standard and requested licenses.[94]

After the FTC filed a complaint against Dell, it found that Dell's affirmative act of deception led the VESA to believe they were selecting a non-proprietary, open standard. Had VESA known of the patent, they likely would have adopted a different standard to avoid implicating Dell's patent.[95] Citing the damage done to the VL-bus standard, as well as the chilling effect on SSOs in general, the Commission found that Dell had "unreasonably restrained competition."[96] Dell settled the charges by agreeing to not enforce its patent against manufacturers using the VL-bus standard.[97]

b) *In re Negotiated Data Solutions*

The FTC filed a complaint against Negotiated Data Solutions (N-Data) under section 5 of the FTC Act[98] for conduct that did not rise to the level of a Sherman Act violation.[99] The complaint alleged that the Institute of Electrical and Electronic Engineers (IEEE) received a promise from a SSO participant, National Semiconductor Corporation (National), to license its NWay technology at a one-time royalty of $1,000 per license to manufacturers and sellers of products including the technology.[100] The NWay technology now underpins the entire Ethernet standard. N-Data procured the patents related to NWay from National, knowing of the licensing promise, but then refused to comply with the commitment.[101] N-Data contacted several manufacturers and demanded royalties far in excess of those originally agreed to between IEEE and National.[102]

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93. *Id.*
94. *Id.*
95. *Id.*
96. *Id.*
97. *Id.*
98. 15 U.S.C. § 45(a)(1) (2006) ("Unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce, are hereby declared unlawful.").
99. Press Release, Fed. Trade Comm'n, FTC Challenges Patent Holder's Refusal to Meet Commitment to License Patents Covering 'Ethernet' Standard Used in Virtually All Personal Computers in U.S., (Jan. 23, 2008), *available at* http://www.ftc.gov/opa/2008/01/ethernet.shtm [hereinafter FTC/N-Data Press Release].
100. *Id.*
101. *Id.*
102. *Id.*

Citing the chilling effect of such behavior on the entire standard-setting process, the Commission noted:

> the FTC's authority to stop anticompetitive conduct that does not rise to the level of a Sherman Act violation is unique among federal agencies—and the cost of ignoring this particularly pernicious problem is too high. Using our statutory authority to its fullest extent is not only consistent with the Commission's obligations, but also essential to preserving a free and dynamic marketplace.[103]

The complaint additionally alleged that consumers would be hurt by N-Data's actions by being forced to pay higher prices.[104] N-Data agreed to settle the complaint by not enforcing the patent unless it first offered the terms originally agreed to by National and the IEEE.[105]

3. *Patent Law and SSO Interference*—Qualcomm v. Broadcom

Concurrent with the antitrust litigation action, Qualcomm pursued claims of patent infringement against Broadcom in the Southern District of California.[106] The claims alleged that Qualcomm's patent claims covered the H.264 video compression standard developed by the Joint Video Team (JVT) SSO. Qualcomm also claimed that Broadcom's products used the H.264 standard, so they infringed the patents at issue.[107] Broadcom countered by asserting the affirmative defense of waiver as a consequence of silence in the face of a duty to speak.[108] Broadcom argued that Qualcomm had participated in JVT negotiations[109] but had purposefully withheld the existence of its patents despite having knowledge that they "reasonably

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103. *Id.* (internal quotes omitted).

104. Complaint, at 6-7, *In re* Negotiated Data Solutions, LLC, No. C-4234, (F.T.C. Jan. 23, 2008), *available at* http://www.ftc.gov/os/caselist/0510094/080122complaint.pdf.

105. FTC/N-Data Press Release, *supra* note 99.

106. Complaint, *supra* note 82, at 1.

107. Qualcomm, Inc. v. Broadcom Corp. (*Qualcomm I*), 539 F. Supp. 2d 1214, 1218 (S.D. Cal. 2007). Qualcomm's alleged that U.S. Patent Nos. 5,452,104 and 5,576,767 covered the key video compression and encoding systems in the H.264 standard. *Id.* at 1215-16.

108. *Id.* at 1216.

109. Qualcomm consistently denied its involvement with JVT until the last day of trial when on cross-examination a witness indicated that evidence existed that would prove that Qualcomm had participated. After trial, over two hundred thousand pages of previously undisclosed documents were turned over leading to an award of attorney's fees and sanctions on six Qualcomm attorneys. Qualcomm Inc. v. Broadcom Corp. (*Qualcomm II*), 548 F.3d 1004, 1009-10 (Fed. Cir. 2008).

might be necessary" to practice the H.264 standard.[110] The district court found in favor of Broadcom and held the patents unenforceable against the world based on the equitable doctrine of waiver.[111] Qualcomm appealed the ruling to the Court of Appeals for the Federal Circuit; the Federal Circuit limited the district court's remedy by finding the patents unenforceable only against products practicing the H.264 standard.[112]

Importantly, the Federal Circuit clarified the equitable defense of waiver. The court explained that while intentional concealment of IPR from an SSO does not constitute "true waiver," the act of non-disclosure with knowledge of an SSO policy that required disclosure constitutes conduct inconsistent with an intent to enforce its rights that would induce others to reasonably believe that those rights were relinquished, and thus constitutes an "implied waiver."[113] The court held that since Qualcomm knew that JVT's policy required disclosure of relevant patents, then acted to shield its relevant patents from disclosure, then planned to extract fees from manufacturers of H.264-compliant products, its misconduct warranted an application of the equitable doctrine of implied waiver to all H.264-compliant products.[114]

II. THE RAMBUS LITIGATION

In the wake of these cases, the FTC again sought to hold liable a manufacturer that allegedly used deception during the standard-setting process to gain market advantages over its competition. The series of cases relating to Rambus and its computer memory products has become one of the most scrutinized litigations relating to the standard-setting process and possible antitrust violations. This Section will follow the dispute, from the facts that set the antitrust suit in motion, through the FTC complaint and adjudication, and finally to the D.C. Circuit's decision.

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110. *Id.* at 1018 (citing Rambus Inc. v. Infineon Techs. AG, 318 F.3d 1081, 1104 (Fed. Cir. 2003), for the proposition that "reasonably might be necessary" is an objective standard that does not require that the patents ultimately are necessary to practice the standard in question).

111. *Qualcomm I*, 539 F. Supp. 2d at 1249.

112. *Qualcomm II*, 548 F.3d at 1026.

113. *Id.* at 1019-22.

114. *Id.* at 1022. The Federal Circuit limited the unenforceability of the patents only to H.264-compliant products because the misconduct that gave rise to the equitable defense (non-disclosure before the JVT) bore no connection to products that were not H.264-compliant but may infringe Qualcomm's patents. *Id.* at 1026.

A. Rambus's Technology and Role in the Standard-Setting Process

Rambus, Inc. was founded by two inventors, Michael Farmwald and Mark Horowitz, who worked together to develop a solution to the growing "memory bottleneck"[115] problem of the late 1980s.[116] Farmwald and Horowitz developed a faster architecture for dynamic random access memory (DRAM). After founding Rambus in March 1990, they filed Patent Application No. 07/510,898 (the '898 application) on April 18, 1990.[117]

Simultaneously, the Joint Electron Device Engineering Council (JEDEC) was standardizing DRAM technologies for the computer memory industry. Rambus attended its first JEDEC meeting in December 1991 as a guest, and then began participating formally in February 1992.[118] In May 1993, JEDEC approved the standard for synchronous DRAM (SDRAM), which included two of the four technologies over which Rambus later asserted patent rights—programmable CAS latency and programmable burst length.[119]

The SDRAM standard was not adopted as quickly or as widely as anticipated so JEDEC decided to begin work on a next-generation SDRAM standard, which ultimately became the double data rate (DDR) SDRAM standard.[120] In October 1995, JEDEC solicited opinions from its members, including Rambus, about features to be included in the new standard.[121] Rambus attended its last meeting in December 1995, in which participants discussed the standard.[122] They formally withdrew from JEDEC by letter dated June 17, 1996, saying (among other things) that the terms on which

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[115] The "memory bottleneck" problem refers to the inability of a central processor to access RAM fast enough to retrieve the information needed to make calculations and then write the output back into RAM. *See, e.g.*, Anthony Cataldo, *MPU designers target memory to battle bottlenecks*, EE TIMES, Oct. 19, 2001, *available at* http://www.eetimes.com/story/OEG20011019S0125.

116. Rambus, Inc. v. FTC, 522 F.3d 456, 459 (D.C. Cir. 2008).

117. *Id.* The '898 application contained a sixty-two page written description, 150 claims and fifteen technical drawings. Pursuant to 35 U.S.C. § 121 (2006), and under direction by the Patent and Trademark Office (PTO), the original application was split into eleven separate applications. Rambus later amended some of these applications and filed additional continuation and divisional applications. *Id.* at 459-60.

118. *Id.* at 460.

119. *Id.*

120. *Id.*

121. *Id.*

122. *Id.*

Rambus intended to license its proprietary technology "may not be consistent with the terms set by standards bodies, including JEDEC."[123]

The features ultimately approved by JEDEC in 1999 included the two technologies mentioned previously, as well as two new technologies, on-chip phase lock and delay lock loops and dual-edge clocking, over which Rambus asserted patent rights.[124] According to the FTC investigation:

> Rambus refused to disclose the existence of its patents and applications, which deprived JEDEC members of critical information as they worked to evaluate potential standards. . . . Rambus also went a step further: through its participation in JEDEC, Rambus gained information about the pending standard, and then amended its patent applications to ensure that subsequently-issued patents would cover the ultimate standard. Through its successful strategy, Rambus was able to conceal its patents and patent applications until after the standards were adopted and the market was locked in.[125]

Rambus notified DRAM manufacturers that it held patent rights to the technologies contained within the SDRAM and DDR SDRAM standards, and that the continued manufacture, sale, or use of products that met the standard infringed its rights.[126] Several manufacturers signed license agreements with Rambus while others did not, and several separate patent infringement cases ensued.[127]

B. Procedural History

On June 18, 2002, the Federal Trade Commission filed a complaint against Rambus under section 5(b) of the FTC Act[128] and section 2 of the Sherman Act, claiming that Rambus engaged in unfair competition and unfair or deceptive acts or practices in violation of the acts.[129] The FTC alleged that Rambus breached JEDEC policies requiring participants in the standard-setting process to disclose patent interests related to standardization efforts and also alleged that the disclosures Rambus did make were

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123. *Id*.

124. *Id*.

125. Liability Opinion, *In re* Rambus, Inc., FTC No. 9302, Slip op. at 4-5 (F.T.C. Aug. 2, 2006).

126. Rambus, Inc. v. FTC, 522 F.3d 456, 460 (D.C. Cir. 2008).

127. *Id.*; *see, e.g.*, Rambus, Inc. v. Infineon Techs. AG, 155 F. Supp. 2d 668 (E.D. Va. 2001), *rev'd in part, vacated in part*, 318 F.3d 1081 (Fed. Cir. 2003), *cert. denied*, 540 U.S. 874 (2003).

128. 15 U.S.C. § 45(b); *see supra* Section I.B.2.

129. *Rambus*, 522 F.3d at 461.

misleading.[130] The FTC claimed Rambus unlawfully monopolized four technology markets in which its patented technologies competed with alternative innovations that could have been selected by the standard setting organization.[131]

The administrative law judge (ALJ) hearing the case dismissed it in its entirety, stating that Rambus had not violated JEDEC rules when it withheld information, and that there was insufficient evidence that had Rambus fully disclosed its patent information, JEDEC would have standardized an alternative technology.[132] That decision was appealed to the Federal Trade Commission, which vacated the administrative rulings of fact and law.[133] The FTC found that the JEDEC policies required members to disclose patents and patent applications relevant to the technologies, plus possible future research directions.[134]

The ALJ had found, in part, that proof of whether alternative technologies would have been adopted absent Rambus's silence was inconclusive, and therefore ruled in favor of Rambus.[135] The Commission stated that the ALJ had erred as a matter of law because inevitability is an affirmative defense that must be pled and proven by the defendant.[136] The FTC explicitly based its ruling on the D.C. Circuit's decision in *Microsoft*.[137] The Commission re-examined the evidence relating to the superiority and lower cost of the adoption of Rambus's technology cited by the ALJ, and, citing the same inconclusive nature of the evidence, found that Rambus had not met the burden of proof for its affirmative defense.[138]

The Commission's ruling centered on the monopolization claim, holding that "but for Rambus's deceptive course of conduct, JEDEC either would have excluded Rambus's patented technologies from the JEDEC DRAM standards, or would have demanded RAND assurances [i.e., assurances of 'reasonable and nondiscriminatory' license fees], with an op-

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130. *Id.*
131. *Id.*
132. *Id.*
133. *Id.*
134. Liability Opinion, *In re* Rambus, FTC No. 9302, Slip op. at 51-53.
135. Initial Decision, *In re* Rambus Inc., FTC No. 9302, Slip op. at 206-07 (FTC Feb. 23, 2004), *available at* http://www.ftc.gov/os/adjpro/d9302/040223initialdecision.pdf [hereinafter ALJ Decision].
136. Liability Opinion, *In re* Rambus, Inc., FTC No. 9302, Slip op. at 81 (citing 3 AREEDA & HOVENKAMP, ANTITRUST LAW, ¶ 650c, at 69 and United States v. Microsoft Corp., 253 F.3d 34, 79 (D.C. Cir. 2001)).
137. *Id.*
138. *See* Liability Opinion, *In re* Rambus, Inc., FTC No. 9302, Slip op. at 82-96.

portunity for *ex ante* licensing negotiations."[139] Rambus's deceptive acts increased its "acquisition of monopoly power."[140]

The Commission requested additional briefing by both parties to separately determine the appropriate remedy and final order.[141] Interestingly, the Commission did not order Rambus to license its technology royalty-free because there was insufficient evidence to prove that absent Rambus's deception, JEDEC would have chosen a non-proprietary standard.[142] Instead, the Commission imposed "reasonable royalty rates," based on what it believed would have been the result of negotiations between Rambus and manufactures before JEDEC committed to the standard.[143] The order also limited Rambus's royalty collection to three years.[144]

After a motion for rehearing was denied by the Commission, Rambus petitioned the D.C. Circuit Court of Appeals to review the Commissions Final Order and Denial of Reconsideration.[145]

C. D.C. Circuit Court's Analysis

Rambus presented to the D.C. Circuit two bases for overturning the FTC's decision. First, it argued that the Commission erred in its finding that Rambus's actions had violated JEDEC rules.[146] Second, it argued that even if the JEDEC rules had been violated, "the Commission found the consequences of such nondisclosure only in the alternative: that it prevented JEDEC *either* from adopting a non-proprietary standard, *or* from

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139. *Id.* at 74.

140. *Id.* at 68.

141. *Id.* at 119-20.

142. Rambus, Inc. v. FTC, 522 F.3d 456, 462 (D.C. Cir. 2008). *But see* Statement of Commissioner J. Thomas Rosch, Concurring in Part and Dissenting in Part from the Commission Opinion on Remedy, *In re* Rambus, FTC No. 9302, (Feb. 5, 2007) at 4, *available at* http://www.ftc.gov/os/adjpro/d9302/070205roschstmnt.pdf (stating that "strong evidence" existed "that if JEDEC had been aware of the potential scope of Rambus's patent portfolio, it would have adopted standards that would have avoided Rambus's patents").

143. *Rambus*, 522 F.3d at 462.

144. Opinion of the Commission on Remedy, *In re* Rambus, FTC No. 9302, Slip op. at 22-23 (F.T.C. Feb. 5, 2007), *available at* http://www.ftc.gov/os/adjpro/d9302/070205 opinion.pdf [hereinafter Remedy Opinion].

145. Petition for Review of Final Orders of the Federal Trade Commission, Rambus, Inc. v. F.T.C., Nos. 07-1086, 07-1124 (consolidated) (D.C. Cir. Nov. 21, 2007), *available at* http://www.ftc.gov/os/adjpro/d9302/071121ftcappealbrief.pdf. The appeal generated numerous *amici* briefs from numerous sources. These include a joint *amici* brief from the Attorneys General of 32 states. Brief of Ohio and 31 Other States and Commonwealths as *Amici Curiae* in Support of Respondent Federal Trade Commission, Rambus, Inc. v. F.T.C., Nos. 07-1124, 07-1086 (consolidated) (D.C. Cir. Nov. 28, 2007).

146. *Rambus*, 522 F.3d at 462.

extracting a RAND commitment from Rambus when standardizing its technology."[147] Because the latter alternative is not an antitrust violation, according to Rambus, then no basis for liability existed.

The D.C. Circuit found the second of these arguments persuasive, set aside the Commissions order, and remanded the case.[148] In reaching its conclusion, the court applied the Sherman Act, and reviewed the Commission's order de novo.[149]

Liability for monopolization requires, "the willful acquisition or maintenance of [monopoly] power [in the relevant market] as distinguished from growth or development as a consequence of a superior product, business acumen, or historical accident."[150] Rambus did not dispute that it had a monopoly in the four disputed technologies through its patent rights, but rather denied that it had engaged in exclusionary conduct that made its acquisition of the market power unlawful.[151]

Conduct is only considered exclusionary if it has an anticompetitive effect: "[the conduct] must harm the competitive *process* and thereby harm consumers. In contrast, harm to one or more *competitors* will not suffice."[152] The court stated that the burden of proof falls squarely on the party asserting that a competitor has used anticompetitive practices.[153] The court was "not convinced" that the Commission had carried its burden of proving that Rambus's conduct had an anticompetitive effect because there was insufficient evidence that had Rambus fully disclosed its intentions, JEDEC would not have still chosen Rambus's technology and secured RAND licensing.[154]

The court accepted that Rambus had engaged in deceptive practices, but clarified that:

> [e]ven if deception raises the price secured by a seller, but does so without harming competition, it is beyond the antitrust laws' reach. Cases that recognize deception as exclusionary hinge, therefore, on whether the conduct impaired rivals in a manner

147. *Id.*
148. *Id.* at 462, 469.
149. *Id.* at 462.
150. *Id.* at 463 (quoting Verizon Commc'ns, Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 407 (2004)); United States v. Microsoft Corp., 253 F.3d 34, 50 (D.C. Cir. 2001).
151. *Rambus*, 522 F.3d at 463.
152. *Id.* (quoting *Microsoft*, 253 F.3d at 58) (emphasis in original).
153. *Id.*
154. *Id.* at 464.

> tending to bring about or protect a defendant's monopoly power.[155]

The court distinguished Rambus's conduct from Microsoft's in *Microsoft*.[156] There, Microsoft had deceived software developers, causing them to believe that Microsoft's development tools could be used to create cross-platform applications, when in fact they could only be run by Microsoft's Windows.[157] The court focused its analysis on the harm to the competitive process instead of the deception alone.[158]

The court decided that the facts of *Rambus* more closely resembled those of *NYNEX Corp. v. Discon, Inc.*,[159] where the Supreme Court addressed antitrust implications of a lawful monopoly that used deceptive practices to raise prices.[160] The D.C. Circuit stated, "an otherwise lawful monopolist's use of deception simply to obtain higher prices normally has no particular tendency to exclude rivals and thus to diminish competition."[161]

Next, the court distinguished *Rambus* from the contemporaneous case involving antitrust violations and standard-setting bodies, *Broadcom Corp. v. Qualcomm Inc.*[162] In that case, strong evidence indicated that but for *Qualcomm*'s false promises, the SSO would have chosen a non-proprietary technology. Without similar evidence in *Rambus*, the court held that the burden of proof had not been met.[163]

Finally, the court addressed concerns raised by scholars and practitioners that nondisclosure can lead to higher royalties which can distort competition in downstream markets.[164] Again, relying on *NYNEX*, the court dismissed those concerns by stating "an otherwise lawful monopolist's end-run around price constraints, even when deceptive or fraudulent, does not alone present a harm to competition in the monopolized market."[165]

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155. *Id.*
156. *Id.*
157. *See supra* Section I.C.2.
158. *Rambus*, 522 F.3d at 463-64.
159. 525 U.S. 128 (1998); *see supra* Section I.B.2.b.
160. *Rambus*, 522 F.3d at 464.
161. *Id.*
162. 501 F.3d 297 (3d Cir. 2007); *see supra* Section I.C.3
163. *Rambus*, 522 F.3d at 466-67. The court also noted that since *Broadcom II* relied in part on the reasoning of the FTC decision in *Rambus*, which the court was now overturning, the 3rd Circuit opinion had little persuasive authority. *Id.*
164. *Id.* at 466.
165. *Id.* (quoting 2 HOVENKAMP ET. AL., IP & ANTITRUST § 35.5 at 35-47 (Supp. 2008)).

The FTC filed for an en banc rehearing of the case, but was denied.[166] They filed a *writ of certiorari* on November 24, 2008,[167] which was denied on February 23, 2009.[168]

III. DISCUSSION

Part III will focus on the legal errors in the D.C. Circuit's ruling and what recourse SSOs and participants have in the wake of the Supreme Court's denial of *certiorari*. Section III.A argues that the D.C. Circuit's decision was based on numerous legal errors. Section III.B examines possible actions that SSOs and participants can use regardless of the Supreme Court's decision in *Rambus.* Section III.B.1 proposes a set of licensing rules to supplant RAND and FRAND, based on a recent rule proposal by two larger SSOs. These proposed rules are intended to provide more stability and certainty for both SSOs and their participants. Further, Section III.B.2 explores the possibility of increased reliance of equitable defenses for defendants using standards accused of infringing previously undisclosed patents.

A. The D.C. Circuit Appeal Was Incorrectly Decided

The reasoning in the decision by the Circuit Court of Appeals for the District of Columbia was flawed in several ways. First, the D.C. Circuit's causation analysis directly contradicted its previous en banc ruling in *Microsoft*. Second, the D.C. Circuit incorrectly relied on *NYNEX v. Discon* because it related to a firm that used deception after gaining monopoly power instead of using deception to gain that power in the first place. Further, the court's opinion incorrectly focused on whether Rambus's actions violated JEDEC's bylaws, which was unnecessary to determine the legal issue at hand. Finally, the opinion contradicted the clearly articulated public policy goals of antitrust laws, which are to protect the competitive process among firms vying for market superiority.

1. The D.C. Circuit conflated the FTC's liability and damages opinions on the issue of causation and misapplied its own ruling from Microsoft

The central fault of the D.C. Circuit's analysis was the misapplication of its own decision in *Microsoft* regarding the proof of causation necessary

166. Order denying petition for rehearing en banc, Rambus Inc. v. FTC, No. 07-1086, Slip op. at 1, (Aug. 26, 2008) (per curiam).

167. Petition for A Writ of Certiorari, Rambus Inc. v. FTC, No. 07-1086 (Nov. 24, 2008), *available at* http://www.ftc.gov/os/caselist/0110017/081124rambuspet.pdf.

168. FTC v. Rambus, Inc., 129 S. Ct. 1318 (2009).

to support a claim of anticompetitive conduct.[169] The *Rambus* court held that there was insufficient evidence to prove that Rambus's lack of disclosure directly caused JEDEC to adopt their memory technology.[170] However, in reaching this conclusion, the court placed the burden of proving causation on the plaintiff.[171] In *Microsoft*, the court stated that it would not require proof of causation by the plaintiff because "neither plaintiffs nor the court can confidently reconstruct a product's hypothetical technological development in a world absent the defendant's exclusionary conduct."[172] The D.C. Circuit explicitly stated that these types of inferences should be drawn against a deceptive defendant.[173] The FTC's Liability Opinion relied on this *Microsoft* court's exact statement of the law in its findings against Rambus.[174]

The D.C. Circuit's opinion also conflated the FTC's liability and damages opinions. While the Commission did state that Rambus's designs might have been chosen and constrained by the RAND commitment had they been disclosed,[175] it did so in the damages opinion only to show that Rambus was entitled some royalty.[176] This statement was not sufficient to support the D.C. Circuit's opinion that JEDEC's choice of Rambus's technology was equally likely as not. The Commission had noted explicitly that the totality of the evidence indicated that "[a]lternative technologies were available" and that "it likely would have been possible for members to design around Rambus's patents."[177]

Finally, the D.C. Circuit ignored the harm to the competitive process inherent in the deceptive acts of Rambus, regardless of the technical superiority of its products. While engaging in hold-up using a technically superior product would not distort the choice of technology, it will inflate the

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169. *See* Rosch, *supra* note 73, at 4 (Oct. 2, 2008) (stating "the clearest key to understanding the appellate decision is causation").

170. *Rambus*, 522 F.3d at 463.

171. *See id.*

172. United States v. Microsoft Corp., 253 F.3d 34, 79 (D.C. Cir. 2001); *see also supra* Section I.C.2.

173. *Id.* at 79.

174. Liability Opinion, *In re* Rambus, Inc., FTC No. 9302, Slip op. at 82-96.

175. Remedy Opinion, *In re* Rambus Inc., FTC No. 9302, Slip op. at 17.

176. *Id.* at 22-24. The decision to allow a limited royalty was in contrast to the *In re* Dell decision decided a decade earlier. There, the FTC had no doubt that but-for Dell's deceptive conduct a different standard would have been chosen because of the SSO's clear preference for an open standard. *See supra* Section I.C.1.

177. Remedy Opinion, *In re* Rambus Inc., FTC No. 9302, Slip op. at 18; George S. Cary, Paul S. Hayes & Larry C. Work-Dembrowski, *Antitrust Implications of Abuse of Standard-Setting*, 15 GEO. MASON L. REV. 1241, 1254 n.99 (2008).

royalties paid for the licenses.[178] The D.C. Circuit's opinion stopped its analysis after determining that deception was not a but for cause of JEDEC's decision to incorporate Rambus's technology.[179] Instead, the proper analysis under *Microsoft* would have also considered the possibility that JEDEC might have decided that Rambus's technology was superior, but upon determining that the licensing fees demanded would be cost-prohibitive, they would have (1) chosen to design around the Rambus patents, (2) not adopted any standard, or (3) selected a less advanced standard.[180] In fact, part of the economic harm of hold-up is that users may make "inefficient investments to partially protect themselves" from predatory behavior.[181] Deceptive conduct leading to this type of economic harm has previously been held a section 2 violation when it leads to the acquisition of monopoly power.[182] The circuit court expressly acknowledged that Rambus's receipt of higher royalties is likely to directly result in higher downstream prices for consumers, but dismissed this concern.[183] This would appear to be the harm to the "competitive process" the Supreme Court stated antitrust law is intended to remedy.[184] Thus, under the D.C. Circuit's earlier formulation of a section 2 violation in *Microsoft*, Rambus had illegally monopolized the relevant market of DDR SDRAM memory.

2. *The D.C. Circuit's Reliance on* NYNEX v. Discon *was misplaced*

The D.C. Circuit relied heavily on *NYNEX*, despite the facts being inapposite.[185] In *NYNEX*, the telephone company engaged in deceptive behavior only after it was granted a legal monopoly.[186] In *Rambus*, however, the deceptive behavior occurred before the standard was selected.[187] The court did not deny that Rambus engaged in deceptive behavior. Instead it decided that since JEDEC may have adopted the same technology

178. Farrell, *supra* note 27, at 615.

179. Rambus, Inc. v. FTC, 522 F.3d 456, 466-67 (D.C. Cir. 2008).

180. *See* Farrell, *supra* note 27 at 615; Cary, *supra* note 177, at 1253-54 ("Under a proper Section Two analysis, all such alternatives should be evaluated when determining whether challenged conduct that avoids any of these constraints is anticompetitive.").

181. *See* Farrell, *supra* note 27, at 615.

182. *See* Cary, *supra* note 177, at 1255; ALJ Decision, *In re* Rambus Inc., FTC No. 9302, Slip op. at 150 (finding that Rambus possessed monopoly power in the relevant technology markets).

183. *Rambus*, 522 F.3d at 466.

184. *See* Spectrum Sports, Inc. v. McQuillan, 506 U.S. 447, 458 (1993); Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 225 (1993).

185. *See supra* Section I.B.2.b.

186. *Rambus*, 522 F.3d at 466.

187. *Id.* at 459-60.

absent any deception, Rambus had not "unlawfully monopolized the relevant markets."[188] *NYNEX* does not address the issue of using deception to gain monopoly power in any way, which was at the heart of the *Rambus* dispute. Additionally, *NYNEX* does not address the standards-setting process. Cases dealing with standard setting point to the unique situation of an entire industry coming together to make decisions that directly affect consumers and competitors in the market.[189]

Additionally, regardless of when the deception occurred, NYNEX's monopoly was government granted and not subject to market competition. The D.C. Circuit analogized this government monopoly to Rambus's patent rights.[190] As discussed previously, the rights granted by a patent are far from a government granted monopoly.[191] At most, the government granted Rambus the right to exclude others from using their specific solution to the SDRAM memory bottleneck problems, but not the right to exclude any of the numerous alternative technologies considered by JEDEC.[192]

3. *Requiring a violation of JEDEC bylaws was unnecessary to determine the legal issues before the court*

Finally, the D.C. Circuit erred by finding that since Rambus did not technically violate JEDEC rules, they did not engage in exclusionary or anticompetitive behavior without analyzing whether its deceptive behavior had affected the competitive process. While SSOs' rules may provide a benchmark for "bad acts" in disputes,[193] they should not be dispositive as to whether a firm has engaged in anticompetitive behavior.[194] Hiding the terms on which the technology will be available undermines the competitive process by manipulating buyers, here SSOs and their participants, into a deal they did not knowingly choose.[195] Requiring an SSO rule violation as a predicate for a Sherman Act violation creates a scenario where the same anticompetitive conduct may impose liability for an SSO that chose

188. *Id.* at 466-67.

189. *See generally* Allied Tube & Conduit Corp. v. Indian Head, Inc., 486 U.S. 492 (1988); Am. Soc'y of Mech. Eng'rs v. Hydrolevel Corp., 456 U.S. 556 (1982).

190. *Rambus*, 522 F.3d at 440-42.

191. *See supra* Section I.B.1.

192. *See* Liability Opinion, *In re* Rambus Inc., FTC No. 9302, Slip op. at 79-96 (discussing the plethora of alternative technologies considered by JEDEC that would have equally solved the memory bottleneck problem without implicating Rambus's patents).

193. *See supra*, Section I.C.4; Skitol, *supra* note 25, at 732.

194. Farrell, *supra* note 27, at 609, 657-58; Skitol, *supra* note 25, at 732.

195. Farrell, *supra* note 27, at 609.

to address the issue, but not for an SSO that ignored the problem—a nonsensical outcome.[196]

As the FTC noted, deception in the standard-setting process is especially likely to harm the competitive process regardless of whether SSO rules are violated. SSOs are based on maximizing efficiencies through cooperative behavior of market competitors.[197] Deception undermines these efficiencies by obscuring information necessary to make informed decisions, which harms the selection process.[198] Further, the standard-setting process has "unique potential to skew the competitive process by aligning supply and demand in a prescribed direction."[199] Deception during the standard-setting process can lead to anticompetitive harm that offsets the efficiency gains that justify the existence of SSOs in the first place.[200] Regardless of whether an SSO's rules require disclosure, a finding of active deception by a member warrants a section 2 violation if that deception harmed the standard-setting process.[201]

4. *The D.C. Circuit's decision was incorrect as a matter of public policy*

The D.C. Circuit's decision reduces the effectiveness of antitrust law as a deterrent to wielding patent rights to hold up the standard-setting process. First, such a decision may curtail aggressive prosecution of deceptive activity in the SSO context by the FTC.[202] The D.C. Circuit's formulation of a section 2 violation requires a high burden of proof for the causation element, thus increasing the burdens on the plaintiff.[203] Without effective public enforcement, higher costs may be passed on to consumers. As FTC Commissioner Rosch stated: "if we allow firms to manipulate or distort the process then we risk the very efficiencies we are looking to capture."[204] Those efficiencies, detailed above, benefit consumers by allowing for efficient investment in technologies that will be viable for longer peri-

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196. Skitol, *supra* note 25, at 732-33.
197. Liability Opinion, *In re* Rambus Inc., FTC No. 9302, Slip op. at 33.
198. *Id.*; *see* Rosch, *supra* note 73, at 15.
199. Liability Opinion, *In re* Rambus Inc., FTC No. 9302, Slip op. at 33.
200. *Id.*
201. Farrell, *supra* note 27, at 657; Liability Opinion, *In re* Rambus Inc., FTC No. 9302, Slip op. at 33.
202. *See* Rosch, *supra* note 73, at 2, 14-15.
203. *Id.* at 10 ("The D.C. Circuit's decision in *Rambus* is a potentially dramatic shift away from *Microsoft* and towards a much more demanding standard in terms of establishing causation.").
204. *Id.* at 15.

ods of time, and will increase in value through the network effect of a larger user base.[205]

A potential solution to inadequacies in Sherman Act enforcement authority may be reliance on FTC Act section 5 enforcement.[206] The N-Data case[207] illustrated the possibility of using section 5 when the Sherman Act fails to provide a cognizable claim for enforcement.[208] There, the FTC highlighted the "special role" of section 5 in providing it with enforcement authority to police actions on the fringes of anticompetitive behavior.[209] Commissioner Rosch explicitly stated: "I think it is safe to say that section 5 is on the table."[210] The D.C. Circuit anticipated such a result and, in dicta, openly warned the FTC against resuming its action against Rambus under section 5 by stating that the Commissions findings regarding the nature of JEDEC's bylaws would preclude such an action.[211]

Unfortunately, FTC Act section 5 violations may not be enforced by private actions.[212] Therefore, if section 5 violations are the only cognizable claims against deceptive SSO participants, the FTC would be forced to unilaterally police all SSO negotiations and possible malfeasance. Congress expressly encouraged private antitrust litigation in the Clayton Act to deter behavior that harms the public interest in the free competitive process.[213] This public interest is negatively impacted by the D.C. Circuit's decision because of the inability of private citizens and SSO participants to deter sharp practices under the court's overly restrictive formulation of causation. The FTC's formulation of section 2 liability strikes the best balance, and should have been followed by the D.C. Circuit.

The possibility of antitrust liability will improve the SSO process. An emboldened FTC, with increased likelihood of prosecution, will encourage more and better disclosure during the standard-setting process by participants.[214] Further, because disclosure policies will likely have more teeth,

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205. *See supra* Section I.A.
206. *See supra* Section I.C.2.
207. *See supra* Section I.C.2.b.
208. *See supra* notes 98-105 and accompanying text.
209. *See supra* note 103 and accompanying text.
210. Rosch, *supra* note 73, at 15.
211. Rambus, Inc. v. FTC, 522 F.3d 456, 467-69 (D.C. Cir. 2008).
212. TAMMY HINSHAW, ET. AL., 54 AM. JUR. 2D MONOPOLIES AND RESTRAINTS OF TRADE § 1235 (2008).
213. Fortner Enterprises v. U.S. Steel Corp., 394 U.S. 495, 502 (1969); TAMMY HINSHAW, ET. AL., 54 AM. JUR. 2D MONOPOLIES AND RESTRAINTS OF TRADE § 330 (2008).
214. Thomas J. Scott, Jr., Stephen T. Schreiner & Inge A. Osman, *Proscribed Conduct for Patent Holders Participating in Standard-Setting Organizations*, 20 INTELL. PROP. & TECH. L.J. 14, 14, 18-19 (2008).

SSO participants would be compelled to send participants with a greater knowledge of their firm's patent portfolio.[215] Both of these factors would enhance the efficiency of the standards-setting process by ultimately allowing for a more informed choice by participants and the SSO.[216]

B. Possible Solutions for SSOs

This Section examines the possible actions by market participants and SSOs in the wake of the Supreme Court's decision to not review the D.C. Circuit's *Rambus* decision. Section III.B.1 examines the feasibility of requiring ex ante license negotiations in the standards-setting process. Section III.B.2 explores the strategy of focusing on equitable defenses by defendants accused of infringing patents intentionally withheld from the standards-setting process.

1. Disclosure and Ex Ante Negotiations

This Section examines one possible solution to the hold-up problem presented by the Department of Justice in response to VITA and IEEE's requests for business review letters—ex ante licensing negotiations.

Most, but not all, SSOs today require that participants will license disclosed patents on RAND terms.[217] Under current RAND schemes, if a firm discloses its patents and they are incorporated into the standard, then the firm collects a "reasonable" fee from each user of the standard.[218] If that same firm fails to disclose its patents and they are incorporated into the standard, then under current rules the patent-holder would be eligible for *no less than* a reasonably royalty in an infringement action against standard adopters.[219] Importantly, in the second scenario, a "reasonable royalty" would be the floor for recovery by a firm using deception, while a firm acting in good faith would be *capped* at the reasonable rate. The possibility for greater damages by the deceptive firm greatly incentivizes non-disclosure, even if they are likely to be caught.[220]

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215. *Id.*

216. *See supra* notes 178-184 and accompanying text.

217. Lemley, *supra* note 11, at 1904-06 (finding twenty-nine of thirty-six SSOs studied used RAND conditions).

218. *Id*. at 1906.

219. 35 U.S.C. § 284 (2006) ("[T]he court shall award the claimant damages adequate to compensate for the infringement, but *in no event less than a reasonable royalty* for the use made of the invention by the infringer.") (emphasis added).

220. Farrell, supra note 27, at 660-61. To deter attempts at hold-up via non-disclosure based on this incentive, deception could be punished by either awarding royalties at rates less than ex ante "reasonable" levels, or by completely withholding fees.

A system that encourages ex ante negotiations of licensing fees during the selection of the technology could avoid hold-up by locking in the value of the royalties at the outset, thus destroying the ability of non-disclosing parties to calculate royalties in an ex post world where the technology becomes more valuable than it was at the time of selection.[221] The DOJ recently allowed two SSOs, VITA and IEEE, to include provisions that require participants to "publicly commit to their most restrictive licensing terms" and to "consider[] potential licensing fees" during the standard-setting process.[222] After sending the letters, a representative from the DOJ Antitrust Division stated in a public speech that:

> [t]he message is that United States enforcers see antitrust and intellectual property as complementary forces, not forces in tension, and we support a high degree of licensing freedom. DOJ and the FTC are not in the business of endorsing particular approaches to intellectual property licensing; instead, in standard setting . . ., we intervene only where a practice imposes a restraint on competition *and* is likely to harm long-term efficiency and the competitive process itself.[223]

Importantly, these speeches and letters signal a focus by both the DOJ and FTC on reinforcing the efficiencies gained by using SSOs for standards setting.

Both the VITA and IEEE policies would require participants to disclose patents and patent applications at the request of the SSO.[224] One critical difference between the two alternatives is that the VITA policy mandates that all participants' non-disclosed patents or applications will be licensed royalty-free if they cover the standard.[225] The IEEE policy,[226] in

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221. Lemley, *supra* note 9, at 158, 161-62; *see* Skitol, *supra* note 25, at 733. Generally, SSOs forbid any discussion of specific licensing terms during the standard-setting process. *Id*. at 728-29.

222. Letter from Thomas O. Barnett, Assistant Att'y Gen., U.S. Dep't of Justice, to Michael A. Lindsay, at 10 (April 30, 2007), *available at* http://www.usdoj.gov/atr/public/busreview/222978.pdf [hereinafter IEEE Letter]; *see* Letter from Thomas O. Barnett, Assistant Att'y Gen., U.S. Dep't of Justice, to Robert A. Skitol (Oct. 30, 2006), *available at* http://www.usdoj.gov/atr/public/busreview/219380.pdf [hereinafter VITA Letter].

223. Gerald F. Masoudi, Dep. Assistant Att'y Gen., U.S. Dep't. Of Justice, Antitrust Enforcement and Standard Setting: The VITA and IEEE Letters and the "IP2" Report, Address Before the Spring Meeting of the American Intellectual Property Law Association (May 10, 2007) at 1-2, *available at* http://www.usdoj.gov/atr/public/speeches/223363.htm (emphasis in original).

224. IEEE Letter, *supra* note 222, at 5-7; VITA Letter, *supra* note 222, at 4-6.

225. VITA Letter, *supra* note 222, at 4-6, 9.

essence, maintains the ability of a participant to not disclose its relevant patents, but such an action would alert all SSO members to that member's actions, thus allowing the selection of an alternative technology and preventing ambush.[227]

Each proposed SSO policy would also allow discussion of maximum royalty rates during the process of selecting a standard.[228] The disclosure of maximum royalty rates would change the selection of standard from one of choosing the preferred technology without reference to the cost of that technology, to one where participants can make an informed choice between less elegant but cheaper solutions and more elegant but possibly costlier alternatives.[229] If SSO rules require the disclosure of a maximum licensing fees to be part of a technology proposal, then it provides a much stronger basis for a waiver argument to be made later in the event of an attempted hold-up. An SSO participant could argue the refusal to disclose either the patents or the maximum fee constituted a waiver of the desire to enforce that patent or to receive compensation.[230] While the defense is far from certain to be accepted, the pleading would at least be grounded in the rules of the SSO.

Neither policy requested the ability for participants to negotiate specific licensing terms during the standard-selection process.[231] However, the DOJ included a footnote in the IEEE Letter stating that the Antitrust Division would "typically apply a rule-of-reason analysis to joint negotiations of licensing terms in the standard-setting context."[232] This statement indicates a willingness to allow full ex ante negotiations by SSO participants. This conclusion is further supported by the DOJ and FTC's jointly prepared study on the patent holdup problem.[233] The study examined the antitrust issues raised by allowing ex ante royalty negotiations and con-

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226. The IEEE policy requires participants to either (1) declare they have no essential patents, (2) declare they hold essential patents but commit to royalty-free licensing, (3) commit to RAND licensing, (4) commit to maximum price terms, or (5) refuse to provide any assurance to the SSO. IEEE Letter, *supra* note 222, at 3. The responses would be publicly available, and participants may discuss the relative costs of proposed alternatives, although they could not discuss specific royalty rates. *Id.* at 8.

227. Skitol, *supra* note 25, at 729.

228. Masoudi, *supra* note 223; IEEE Letter, *supra* note 222, at 5-7; VITA Letter, *supra* note 222, at 4-6, 8.

229. VITA Letter, *supra* note 222, at 9.

230. *See* Section III.B.2 *infra*.

231. Masoudi, *supra* note 223.

232. IEEE Letter, *supra* note 222, at 11 n.47.

233. U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, ANTITRUST ENFORCEMENT & INTELLECTUAL PROPERTY RIGHTS: PROMOTING INNOVATION AND COMPETITION 33-57 (2007), *available at* http://www.usdoj.gov/atr/public/hearings/ip/222655.pdf.

cluded that because of the "strong potential for procompetitive benefits" the DOJ and FTC would review such negotiations under the rule of reason as opposed to declaring such negotiations *per se* violations of section 1 of the Sherman Act.[234]

The implementation of an ex ante licensing scheme could offer challenges to SSOs as they are currently structured.[235] Generally SSO negotiations solely include technical personnel such as engineers; they do not include lawyers or business representatives.[236] However, given the impacts of anticompetitive behavior on the industry and consumers, firms should be responsible for protecting the competitive process by including representatives that can make informed choices with regard to the relative costs of the proposed technologies.[237]

2. *Equitable defenses: estoppel and waiver*

Strengthening the availability of the equitable defenses of estoppel and waiver to defendants sued by plaintiffs who engaged in deceptive non-disclosure encourages disclosure while protecting against hold-up.

The Federal Circuit's decision in *Qualcomm II*[238] may provide a beacon of hope for SSOs and firms that incorporate standards into their products.[239] There, the court held that when an SSO participant chooses to not disclose a patent in the face of either a rule or custom requiring disclosure, then that participant has waived its right to enforce the patent against other firms practicing the standard.[240] This decision was consistent with previous cases where courts dismissed the claims of plaintiffs alleging patent infringement when the plaintiff chose not to acknowledge the infringing activity for an extended period of time.[241]

An expansion of the defense of waiver can provide enforcement of SSO rules for non-participants. As Professor Lemley noted in his survey of SSO rules and IPR policies, SSO participants would be able to enforce disclosure requirements against other participants via doctrines of contract law, but non-participants could not assert contract-based defenses based

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234. *Id.* at 53-54. *See* Cal. Dental Ass'n v. Fed. Trade Comm'n, 525 U.S. 756, 779 (1999) (discussing the categories of analysis in antitrust cases).

235. *See* DOJ & FTC, *supra* note 233, at 50.

236. *See id.*; Lemley, *supra* note 11, at 1907.

237. *See* Skitol, *supra* note 25, at 734.

238. *Qualcomm II*, 548 F.3d 1004 (Fed. Cir. 2008).

239. *See supra* Section I.C.4.

240. *Qualcomm II*, 548 F.3d at 1019-22.

241. *See, e.g.*, Stambler v. Diebold, Inc., 11 U.S.P.Q.2d 1709 (Fed. Cir. 1988); A.C. Aukerman Co. v. R.L. Chaides Constr. Co., 960 F.2d 1020 (Fed. Cir. 1992).

on the plaintiff's nefarious behavior during the standard-setting process.[242] The Federal Circuit's expression of the implied waiver doctrine, however, indicates that non-participants may be able to rely on equitable to defeat an infringement suit. A non-participant could point to the patent owner's silence during the standard-setting process, and replace its lack of privity with a constructive reliance on that silence.

Unfortunately, equitable defenses can only be raised *after* an infringement suit has been filed. In the end, these defenses only affect conduct within SSOs by attempting to reduce the enforceability of patents that are knowingly withheld. However, as evidenced by Rambus's extraction of royalty payments from several firms before filing suit, many firms will not wish to risk a multi-million dollar litigation to determine whether they may continue doing business as they had before the suit.[243] The difficulties of proving intentional misconduct may limit the effectiveness of the waiver defense enough to encourage settlement instead of obtaining a court-ordered limit on the asserted patent. On the other hand, because the accused infringer would have some equitable ammunition against the patent holder, the licensing negotiations would be less tilted toward the patentee.

IV. CONCLUSION

The D.C. Circuit's decision in *Rambus* was inconsistent with previous precedent. Indeed, the issue of causation in antitrust actions involving standard setting has not been thoroughly addressed in any Supreme Court decision. The appropriate standard for causation and the burden of persuasion on the issue of inevitability need to be conclusively addressed. Given the important nature of standards in today's technological society and economy, the authority of SSOs in facilitating standard selection and adoption should be buttressed. Despite the outcome in *Rambus*, SSOs can begin to change their rules in order to effectively deal with the hold-up problem before it starts. SSOs should closely examine the next rounds of standardization within the IEEE and VITA to see if ex ante license negotiations will alleviate the problem of holdup in standard setting. Further, standard-practicing defendants accused of infringing previously non-disclosed patents should begin to assert the equitable defenses of waiver and estoppel to force secretive patent holders to defend their actions before courts of law.

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242. Lemley, *supra* note 11, at 1914-18.
243. Rambus, Inc. v. FTC, 522 F.3d 456, 460 (D.C. Cir. 2008).

"YOUR LAPTOP, PLEASE:" THE SEARCH AND SEIZURE OF ELECTRONIC DEVICES AT THE UNITED STATES BORDER

By Sunil Bector

Since September 11, 2001 there has been an increased emphasis on border security concurrent with a period of "near exponential growth" in portable information technology.[1] Laptops and other electronic devices that contain vast amounts of sensitive data now play a central role in our daily lives and cannot easily be left behind during international travel.[2] Yet many travelers are unaware that this data may be exposed during searches of electronic devices at the border.[3] Indeed, according to Susan Gurley, the Executive Director of the Association of Corporate Travel Executives, ninety-four percent of respondents to a membership poll "were unaware that Customs or border officials can confiscate laptops for days, weeks or indefinitely."[4] If even frequent business travelers are ignorant of the extent of these border searches, lay travelers are not likely better informed.

Court cases dealing with laptop searches often have less sympathetic facts than the average criminal case. Many, for example, involve possession of child pornography, and a court inclined to give an expansive reading to the Fourth Amendment in such cases may allow an odious criminal to go unpunished. Nevertheless, the precedents established in these highly charged cases affect the privacy of all travelers. Consider a parent of a young child returning from an international business trip. The man is ran-

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1. *See Do Privacy Rights Extend to International Travelers? Warrantless Border Searches of Electronic Devices*, 7 Privacy & Sec. L. Rep. (BNA) 279 (Feb. 25, 2008) [hereinafter *Do Privacy Rights Extend to International Travelers?*]; *see also* YULE KIM, CONG. RESEARCH SERV., CRS REPORT NO. RL31826, PROTECTING THE U.S. PERIMETER: "BORDER SEARCHES" UNDER THE FOURTH AMENDMENT 1 (2008).

2. *Do Privacy Rights Extend to International Travelers?*, *supra* note 1.

3. *Travel Executives Seek Guidance on Laptop Seizure, Content Review by Border Agents*, 5 Privacy & Sec. L. Rep. (BNA) 1502 (Oct. 30, 2006) ("The information that U.S. government officials have the right to examine, download, or even seize business travellers' [sic] laptops came as a surprise to the majority of our members.").

4. *Id.*

domly selected for an inspection when he enters the United States and the customs official turns on his laptop to discover his desktop background image depicts a naked child frolicking in a kiddie pool, which, unbeknownst to the customs officer, is the traveler's own two-year-old son. Concerned that he might possess or traffic in child pornography, the customs official confiscates his laptop, copies the contents of his hard drive, and interrogates him for several hours.[5] Satisfied that he has committed no crime, the customs official releases him. Yet, what becomes of the copied contents of the hard drive? In copying his hard drive the official may have copied trade secrets or other protected communications, in addition to personal files such as photographs and e-mails. These are some of the privacy interests at stake.

This Note will argue that invasive, suspicionless laptop searches at the border are untenable in a society where huge quantities of digital files cross the borders on laptops and digital media with increasing frequency. It is unlikely that federal courts will find stronger protection for such devices without new federal laws because, in general, searches at the border are constitutional under the Fourth Amendment.[6] In addition, most federal courts have conferred broad authority to Customs and Border Patrol (CBP) officials to search electronic devices at the border.[7] Thus, this Note contends that Congress, through legislation, should direct the Department of Homeland Security (DHS) to promulgate specific regulations regarding electronic device search and seizures at the border. This Note concludes that the Travelers' Privacy Protection Act of 2008 is a strong bill that, coupled with some additional provisions, could adequately protect the privacy of travelers while still being deferential to the government's interest in protecting its borders.

Part I of this Note lays the foundation of the border search exemption to the Fourth Amendment and considers the complexity of classifying searches as "routine" or "non-routine." Part II reviews the relevant federal appellate case law describing searches of electronic devices at the border.

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5. This hypothetical scenario is not at all farfetched. *See* Neal Matthews, How a Photo Can Ruin Your Life, PopPhoto.com, May 4, 2007, http://www.popphoto.com/popularphotographyfeatures/4130/how-a-photo-can-ruin-your-life.html (noting that the interpretation of the intent of the content is what is often used to prosecute people).

6. *See infra* Parts I, II.

7. *Id.* Further, one's Fifth Amendment right against compelled self-incrimination may also be implicated when an individual is compelled to furnish a computer password as part of a laptop border search. *See Do Privacy Rights Extend to International Travelers*, *supra* note 1; *see also*, Declan McCullagh, *Judge orders defendant to decrypt PGP-protected laptop*, CNET NEWS, Feb. 26, 2009, http://news.cnet.com/8301-13578_3-10172866-38.html.

It also discusses *People v. Endacott*, a recent California Court of Appeal case, which gives insight into the facts and considerations necessary to analyzing cases involving electronic device searches. Part III details recent changes in the DHS's official policy regarding border searches and argues that legislation is required to implement a more transparent and just process. Part IV outlines and evaluates legislation proposed in both the 110th and early 111th Congresses and suggests guidelines for future legislation that would balance the privacy interests of travelers with the strong governmental security interest in investigating electronic storage devices.

I. THE FOURTH AMENDMENT IN THE BORDER SEARCH CONTEXT

The Fourth Amendment prohibits unreasonable search and seizure,[8] but the "border search exception" typically allows government officials to search electronic devices at the border without a warrant or probable cause.[9] Thus, Customs and Border Patrol (CBP) agents may, under current federal law, conduct "routine" searches of electronic devices without a warrant, though it is unclear what constitutes a routine search.[10] When conducting particularly invasive searches, customs officials may need to meet a higher "reasonable suspicion" standard.[11] A report released by the Congressional Research Service addresses the vagueness surrounding the degree of suspicion required to conduct a border search of an electronic storage device, noting that:

> The issue that federal courts have been confronting recently is whether the border search exception applies to electronic storage devices and, if it does, whether a laptop border search is routine or non-routine, and if found to be non-routine, what degree of suspicion or cause is needed to justify the search to satisfy the Fourth Amendment.[12]

The Fourth Amendment of the United States Constitution requires that any search warrant be supported by probable cause, with the warrant particularly describing the place to be searched and the persons or things to

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8. U.S. CONST. amend. IV.

9. *See infra* Section I.A.

10. *Seized Laptop Contents May Be Unencrypted, Contents Shared, Under Border Patrol Policy*, 7 Privacy & Sec. L. Rep. (BNA) 1148 (Aug. 4, 2008) (reporting on United States v. Arnold, 523 F.3d 941 (2008)).

11. YULE KIM, CONG. RESEARCH SERV., CRS REPORT NO. RL34404, BORDER SEARCHES OF LAPTOPS AND OTHER ELECTRONIC STORAGE DEVICES 3 (2008).

12. *Id.* at 4.

be seized.[13] Probable cause refers to the amount of suspicion necessary for a warrant to issue, which rests somewhere between bare suspicion and the evidence needed to convict at trial.[14] An inquiry into whether one has a Fourth Amendment right not to be searched consists of two steps: (1) whether a defendant has a subjective expectation of privacy, and (2) whether society deems that the defendant's expectation of privacy is reasonable.[15] This reasonableness requirement has generally been interpreted to mean that warrantless searches are *per se* unreasonable.[16]

A. The Border Search Exception

Searches and seizures that occur at the border are exempt from these stringent Fourth Amendment warrant requirements because of the strong governmental interest in maintaining secure borders.[17] This border search

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13. U.S. CONST. amend. IV. The Constitution provides:

> The right of the people to be secure in their persons, houses, papers, and effects, against unreasonable searches and seizures, shall not be violated, and no Warrants shall issue, but upon probable cause, supported by Oath or affirmation, and particularly describing the place to be searched, and the persons or things to be seized.

Id.

14. BLACK'S LAW DICTIONARY 1239 (8th ed. 2004). Black's Law Dictionary defines it as "a reasonable ground to suspect that a person has committed or is committing a crime or that a place contains specific items connected with a crime." *Id.*

15. *See* Katz v. United States, 389 U.S. 347, 361 (1967) (Harlan, J., concurring) ("[T]he rule that has emerged from prior decisions is that there is a twofold requirement, first that a person have exhibited an actual (subjective) expectation of privacy and, second, that the expectation be one that society is prepared to recognize as 'reasonable.'").

16. *Id.* at 357. The Court stated:

> Over and again this Court has emphasized that the mandate of the [Fourth] Amendment requires adherence to judicial processes, and that searches conducted outside the judicial process, without prior approval by judge or magistrate, are *per se* unreasonable under the Fourth Amendment—subject only to a few specifically established and well-delineated exceptions.

Id. (citations omitted).

17. *See* United States v. Flores-Montano, 541 U.S. 149, 153 (2004) ("It is axiomatic that the United States, as sovereign, has the inherent authority to protect, and a paramount interest in protecting, its territorial integrity."); United States v. Ramsey, 431 U.S. 606, 616 (1977) ("[S]earches made at the border, pursuant to the long-standing right of the sovereign to protect itself by stopping and examining persons and property crossing into this country, are reasonable simply by virtue of the fact that they occur at the border . . . ."); *see also* Jennifer M. Chacón, *Border Searches of Electronic Data*, LEXISNEXIS EXPERT COMMENTARY, June 30, 2008, at 3 ("The Supreme Court [] has upheld routine, suspicionless searches of the luggage of arriving passengers 'no matter how great the

exception, one of a number of exceptions to the Fourth Amendment, permits warrantless searches to be conducted at the border without probable cause.[18] The border search exception is based on the rationale that the governmental interest in protecting sovereign borders is far more important than an individual's privacy interest.[19] Although Congress and the federal courts assumed the exception, it was not formalized until 1977[20] when the Supreme Court, in *U.S. v. Ramsey*, approved a warrantless search conducted by a customs officer.[21] The customs agent searched a suspicious envelope at the border and found heroin.[22] The Court indicated that the official had a "reasonable cause to suspect," a standard less stringent than probable cause but sufficient for the purposes of the search.[23] "Reasonable cause to suspect" seems identical to "reasonable suspicion,"[24] which is defined as "a particularized and objective basis, supported by specific and articulable facts, for suspecting a person of criminal activity."[25]

Since *Ramsey*, the border search exception has "been expanded to not only persons, objects, and mail entering the United States by crossing past a physical border, but also to individuals and objects departing from the United States and to places deemed the 'functional equivalent' of a border, such as an international airport."[26] The functional equivalent of a border is generally defined as the first practical detention point after crossing a border, or the final port of entry.[27] The expansion of *Ramsey* is justified because, apart from the impossibility of one's physical presence at the border, it is otherwise equivalent to a border search.[28] A three-part test, established by the Eleventh Circuit, determines whether a search occurs at the border's functional equivalent by evaluating the circumstances around the search as opposed to its location.[29] Thus, a search occurs at the functional equivalent of a border when: (1) reasonable certainty exists that a border was crossed, (2) there was no opportunity for the object of the search to

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traveler's desire to conceal the contents may be.'" (quoting United States v. Ross, 456 U.S. 798 (1982)).

18. *Ramsey*, 431 U.S. at 619.
19. *See supra* note 17.
20. KIM, *supra* note 11, at 1-2.
21. *Ramsey*, 431 U.S. at 619.
22. *Id.* at 609.
23. KIM, *supra* note 11, at 2 (citing *Ramsey*, 431 U.S. at 614).
24. *Id.*
25. BLACK'S LAW DICTIONARY 1487 (8th ed. 2004); *see also* Terry v. Ohio, 392 U.S. 1 (1978).
26. KIM, *supra* note 11, at 2.
27. KIM, *supra* note 1, at 7-8.
28. *Id.* at 8.
29. United States v. Hill, 939 F.2d 934, 937 (11th Cir. 1991).

have changed materially since the crossing, and (3) the search occurred as soon as practicable after crossing the border.[30]

In addition, the "extended border search" doctrine may also expand the border search exception beyond traditional borders and their functional equivalents.[31] In this regard, warrantless searches may be conducted if: (1) there is a reasonable certainty that a border crossing has occurred, (2) there is a reasonable certainty that the object being searched has not changed condition since crossing the border, and (3) there is a reasonable suspicion that criminal activity has occurred.[32] The third element of this test is more stringent than the functional equivalent test because the extended border search doctrine infringes more on one's reasonable expectation of privacy.[33] Nevertheless, while searches and seizures at the border and its functional equivalents are exempt from the Fourth Amendment warrant requirement, they still must be "reasonable."[34]

B. Routine v. Non-Routine Searches

Courts have categorized border searches as "routine" or "non-routine,"[35] a distinction based on the intrusiveness of the search in relation to the privacy interests of the individual being searched.[36] This can be a misleading distinction, however, because this does not seem to apply to vehicular searches.[37] Yet, generally, the more intrusive a search, the more likely it is to be considered non-routine.[38] Strip searches and body cavity searches, for example, are likely to be considered non-routine, whereas luggage searches and pat-downs are typically deemed routine.[39] Still, the Supreme Court has refused to develop a balancing test using a "routine" and "non-routine" framework, and instead notes that the terms are merely descriptive.[40]

The routine/non-routine distinction was first discussed in *United States v. Montoya de Hernandez*, where the Court found that the overnight deten-

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30. *Id.*
31. KIM, *supra* note 1, at 8.
32. United States v. Yang, 286 F.3d 940, 946 (7th Cir. 2002) (citations omitted).
33. KIM, *supra* note 1, at 8.
34. Marsh v. United States, 344 F.2d 317, 324 (5th Cir. 1965) ("Border searches are, of course, not exempt from the constitutional test of reasonableness.").
35. KIM, *supra* note 11, at 2.
36. *See* KIM, *supra* note 1, at 7.
37. *See* United States v. Flores-Montano, 541 U.S. 149 (2004); *see also infra* text accompanying notes 45-49.
38. *See* United States v. Irving, 452 F.3d 110, 123 (2d Cir. 2006).
39. *See* United States v. Montoya de Hernandez, 473 U.S. 531, 551 (1985).
40. United States v. Arnold, 523 F.3d 941, 945 (9th Cir. 2008).

tion of a traveler was non-routine, but justified by custom officials' "reasonable suspicion" that the traveler was smuggling drugs.[41] The Court determined that the detention was non-routine because, in part, the detention was "long, uncomfortable, and humiliating."[42] The Court held that such non-routine searches could be justified based on a "reasonable suspicion" of the officer,[43] a lower threshold than probable cause. Though *Montoya de Hernandez* dealt with the issue of detention, lower federal courts adopted the rationale of the Supreme Court, holding that routine searches may be conducted without suspicion.[44]

The Supreme Court further delineated the routine/non-routine designation and search justification standard in *United States v. Flores-Montano*.[45] The Court held that disassembly and inspection of a vehicle gas tank at the border was routine and thus did not require reasonable suspicion.[46] Although time-consuming disassembly is atypical, the Court defined a routine search as one that does not implicate increased privacy considerations.[47] Because there was no increased privacy concern surrounding the contents of an automobile gas tank, the court classified the search as routine.[48] *Flores-Montano* thus "illustrates that extensive, time-consuming and potentially destructive searches of objects and effects can be considered 'routine' and can be conducted without any necessary ground for suspicion."[49]

"Non-routine" is vaguely defined because courts typically decide what is non-routine on a case-by-case basis without resorting to a bright-line rule.[50] "Nonetheless, the holding in *Flores-Montano* indicates that, unlike

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41. *Montoya de Hernandez*, 473 U.S. at 531.
42. *Id.*
43. *Id.*
44. *See* KIM, *supra* note 11, at 3.
45. United States v. Flores-Montano, 541 U.S. 149, 153 (2004).
46. *Id.* at 152.
47. *Id.* at 154.
48. *Id.* ("It is difficult to imagine how the search of a gas tank, which should be solely a repository for fuel, could be more of an invasion of privacy than the search of the automobile's passenger compartment."). Moreover, the government's interest in protecting its borders was supported by strong facts:

> [S]mugglers frequently attempt to penetrate our borders with contraband secreted in their automobiles' fuel tank. Over the past 5 ½ fiscal years, there have been 18,788 vehicle drug seizures at the southern California ports of entry. Of those 18,788, gas tank drug seizures have accounted for 4,619 of the vehicle drug seizures, or approximately 25%.

Id. at 153 (citations omitted).

49. KIM, *supra* note 11, at 3.
50. *Id.*

a search of a person's body, intrusiveness may not be a dispositive factor when determining whether the search of a vehicle or personal effects is non-routine." [51] Non-routine searches require "reasonable suspicion," which in turn requires "specific and articulable facts which, taken together with rational inferences from those facts, reasonably warrant that intrusion."[52] In order to afford travelers more privacy rights, at least two commentators have recommended that laptop border searches require reasonable suspicion, [53] with one of these commentators arguing that these searches be classified as non-routine.[54]

II. THE FOURTH AMENDMENT AS APPLIED TO BORDER SEARCHES OF COMPUTERS AND OTHER ELECTRONIC DEVICES

While the Supreme Court has yet to address the Fourth Amendment protection afforded to border searches of electronic storage devices, [55] many lower courts have concluded that such searches fall under the border search exception.[56] Recent cases address whether the border search exception applies to electronic storage devices, whether these searches are routine or non-routine, and what degree of suspicion is needed to justify a non-routine search.[57] Additionally, border searches of such devices are occurring more frequently because electronic storage devices are increasingly pervasive.[58] The degree of suspicion needed to conduct a search, however, is still unclear. Despite deeming laptop searches routine, courts have also determined that the factual situations in most of these cases justified requiring reasonable suspicion to conduct a search.[59] Three major

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51. *Id.* at 3-4.

52. Terry v. Ohio, 392 U.S. 1, 21 (1978).

53. *See* Christina Coletta, *Laptop Searches At The United States Borders And The Border Search Exception To The Fourth Amendment*, 48 B.C. L. REV 971 (2007); John Nelson, *Border Confidential: Why Searches of Laptop Computers at the Border Should Require Reasonable Suspicion*, 31 AM. J. TRIAL ADVOC. 137 (2007).

54. *See* Coletta, *supra* note 53.

55. Since there is no Circuit split, it seems unlikely that the Supreme Court will address the issue anytime soon. *But see* KIM, *supra* note 11, at 8 (suggesting that the Supreme Court may find laptop searches to be a suitable vehicle to outline controlling factors that determine routine v. non-routine searches).

56. *Id.* at 4; *see, e.g.*, United States v. Romm, 455 F.3d 990, 997 (9th Cir. 2006); United States v. Irving, 452 F.3d 110, 123 (2d Cir. 2006); United States v. Ickes, 393 F.3d 501, 505 (4th Cir. 2005).

57. KIM, *supra* note 11, at 4.

58. *Id.*

59. *Id.*

federal appellate cases have addressed the issue of warrantless laptop searches at the border. *United States v. Ickes* stands for the proposition that laptop searches at the border do not violate the First and Fourth Amendments.[60] *United States v. Arnold* goes further by expressly stating that reasonable suspicion is not required for border searches of electronic storage devices,[61] while *United States v. Romm* extends the border search exception to deleted files that are recovered by customs officials.[62] *People v. Endacott*, a recent California Court of Appeal case, exemplifies these rules.[63]

A. Laptop Searches Do Not Violate the First and Fourth Amendments

In *United States v. Ickes*, the Fourth Circuit held that the warrantless search of Ickes's van, including his computer and disks, did not violate the First or Fourth Amendments.[64] Upon entering the United States from Canada, John Ickes's van was subject to a "cursory" routine search after informing a U.S. Customs Inspector that he was returning from vacation, even though his van "appeared to contain 'everything he owned.'"[65] The inspector instituted a more comprehensive search after viewing a suspicious video of a tennis match focusing excessively on a young ball boy,[66] and found marijuana paraphernalia, a previous arrest warrant, a computer, seventy-five computer disks, and a photo album depicting child pornography.[67] After being charged with transporting child pornography, Ickes filed a motion to suppress the recovered evidence, arguing that the warrantless search of his van violated both the Fourth and First Amendments, invoking the latter by arguing that the search involved expressive material.[68] The Fourth Circuit upheld the warrantless search of Ickes's vehicle under the border search exception[69] and dismissed the First Amendment claim for its untenable national security implications and administrative burdens.[70] Ickes complained that the sweeping ruling meant that "any per-

60. *Ickes*, 393 F.3d at 502.
61. 523 F.3d 941, 946 (9th Cir. 2008).
62. *Romm*, 455 F.3d 990, 1006 (9th Cir. 2006).
63. 79 Cal. Rptr. 3d 907, 908-910 (Ct. App. 2008).
64. *Ickes*, 393 F.3d at 502.
65. *Id.*
66. *Id.*
67. *Id.* at 503.
68. *Id.* at 503-05.
69. *Id.* at 505.
70. *Id.* at 506 ("[N]ational security interests may require uncovering terrorist communications, which are inherently 'expressive.' Following Ickes's logic would create a sanctuary at the border for all expressive material—even for terrorist plans.").

son carrying a laptop computer . . . on an international flight would be subject to a search of the files on the computer hard drive."[71] The court, noting that "Customs agents have neither the time nor the resources to search the contents of every computer,"[72] responded that "[a]s a practical matter, computer searches are most likely to occur where—as here—the traveler's conduct or the presence of other items in his possession suggest the need to search further."[73] Thus, the court noted that computer searches would likely only occur upon reasonable suspicion due to practical considerations.[74] However, the court did not *require* reasonable suspicion to conduct laptop searches.

B. Laptop Searches Do Not Require Reasonable Suspicion

In *United States v. Arnold*, the Ninth Circuit went further than the *Ickes* court by expressly holding that electronic storage device searches at the border do not require reasonable suspicion.[75] Leading up to this important decision, the United States District Court for the Central District of California held that officers must have reasonable suspicion to conduct a laptop search.[76] Michael Arnold returned from the Philippines to Los Angeles International Airport, where CBP officials selected him for questioning and subjected him to a luggage search.[77] During the luggage search, the CBP officials asked Arnold to turn on his computer, which he did. After a search of his desktop files revealed an image of two nude women,[78] ICE agents were summoned to further question Arnold. They eventually released Arnold but seized his computer and other electronic storage devices on suspicion of possession of child pornography.[79] Arnold argued

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71. *Id.* at 506-07.

72. *Id.* at 507. While this is not the court's main point, it is likely that scanning software will become faster and more efficient as time goes on, thereby making it more likely that every computer can be searched.

73. *Id.*

74. *Id.* The court continues:

> However, to state the probability that reasonable suspicions will give rise to more intrusive searches is a far cry from enthroning this notion as a matter of constitutional law. The essence of border search doctrine is a reliance upon the trained observations and judgments of customs officials, rather than upon constitutional requirements applied to the inapposite context of this sort of search.

Id.

75. United States v. Arnold, 523 F.3d 941, 946 (9th Cir. 2008).

76. United States v. Arnold, 454 F. Supp. 2d 999, 1001 (C.D. Cal. 2006).

77. *Arnold*, 523 F.3d at 943.

78. "The government [did] not present[] evidence that the photo depicted minors." *Arnold*, 454 F. Supp. 2d at 1001 n.1.

79. *Arnold*, 523 F.3d at 943.

that this evidence should be suppressed because the search was conducted without reasonable suspicion, to which the government replied that (1) the border search exception applied, and (2) reasonable suspicion was present.[80] The court did not believe reasonable suspicion existed due to the inadequacy of the government's testimony at trial,[81] and concluded that a laptop search required reasonable suspicion.[82] The district court specifically held that the search of Arnold's laptop was non-routine,[83] a move lauded by at least two commentators advocating for more a more stringent standard for electronic data searches.[84]

However, on appeal, the Ninth Circuit overruled the district court, determining that the intrusiveness of a laptop search is not significant enough to invoke the reasonableness requirement of the Fourth Amendment.[85] Arnold argued that reasonable suspicion was necessary because laptops can store huge quantities of information and, thus, they are more comparable to one's home or the human mind than a closed container.[86] The court, noting the long history enabling border searches of closed containers without particularized suspicion,[87] likened laptops to other pieces of property and held that no reasonable suspicion is needed to search laptops or other electronic storage devices.[88] The court rejected Arnold's analogy equating a laptop search to that of a home and concluded that a search cannot be "particularly offensive" simply due to the object's sto-

80. *Id.*

81. *Arnold*, 454 F. Supp. 2d at 1004. "[T]he government . . . [did] not provide[] the Court with any record of the search that was completed at or near the time of the incident." *Id.* Moreover, a "memorandum, written nearly a year after the search, . . . [was the CBP official's] only memorialized account of the incident." *Id.* The court noted that "[a] search is reasonable in scope only if it is no more intrusive than necessary to obtain the truth respecting the suspicious circumstances." *Id.* at 1003 (citation omitted).

82. *Arnold*, 523 F.3d at 943.

83. *Arnold*, 454 F. Supp. 2d at 1003.

84. *See* Coletta, *supra* note 53; Nelson, *supra* note 53.

85. *Arnold*, 523 F.3d at 946.

86. *Id.* at 944.

87. *Id.* at 945.

88. *Id.* at 946. This is not to say that all property can be searched at the border without reasonable suspicion. The court stated that the Supreme Court has carved out two exceptions to this rule. One, if the search involves "exceptional damage to property" or, two, if the search is carried out in a "particularly offensive manner." *Id.* at 946. The court determined that neither of these exceptions applied. *Id.* at 947.

rage capacity.[89] Both a petition for rehearing and a petition for rehearing en banc were denied.[90]

C. Deleted Files May be Recovered by Customs Officials

In *United States v. Romm*, the Ninth Circuit held that recovering deleted files on a laptop computer with neither a warrant nor probable cause fell under the border search exception to the Fourth Amendment.[91] Stuart Romm's laptop was first searched by Canadian officials while trying to enter Canada after agents discovered that he had a criminal history.[92] The search revealed child pornography websites in the laptop's web browser history and Romm was denied entry to Canada and deported to Seattle.[93] In Seattle, Romm was detained by Immigration and Customs Enforcement (ICE) officials, and he agreed to a deeper inspection of his laptop.[94] ICE officials recovered deleted child pornography on Romm's laptop, the results of which Romm unsuccessfully tried to suppress at trial.[95]

The Ninth Circuit reasoned that: (1) international airport terminals are the "functional equivalent[s]" of borders, thereby allowing customs officials to search deplaning passengers, and (2) the search of Romm's laptop was supported by reasonable suspicion.[96] Romm argued that the search should be considered non-routine, but the court declined to address this contention on procedural grounds as Romm raised this argument for the first time in his reply brief.[97]

D. *People v. Endacott*

In *People v. Endacott*, the Second Appellate District Court of Appeal of California used *Flores-Montano*, *Ickes*, and *Arnold* to conclude that a search of the defendant's electronic devices was valid under the border search exception.[98] The defendant, Endacott, arrived from Thailand at Los

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89. *Id.* at 947.

90. *See New House Bill Would Ban Border Searches of Laptops Based on U.S. Sovereign Authority*, 7 Privacy & Sec. L. Rep. (BNA) 1115 (July 28, 2008) [hereinafter *New House Bill*].

91. 455 F.3d 990, 1006 (9th Cir. 2006).

92. *Id.* at 994.

93. *Id.*

94. *Id.* Canada's Border Services Agency tipped off U.S. Customs, informing them that Romm had (1) been denied entry into Canada, and (2) was possibly in possession of illegal images.

95. *Id.* at 996.

96. *Id.* at 996-97.

97. *Id.* at 997 ("[A]rguments not raised by a party in its opening brief are deemed waived") (quotations omitted).

98. People v. Endacott, 79 Cal. Rptr. 3d 907, 908-910 (Ct. App. 2008).

Angeles International Airport on September 29, 2006.[99] Endacott was interrogated during a routine customs inspection, during which he revealed that he had been in Thailand for four months resting, visiting a friend, and seeking employment.[100] The customs agent thought it unusual that Endacott carried plastic cases and arrived in a leather jacket and gloves when returning from such a warm climate.[101] The customs agent sent Endacott for secondary inspection where another agent received a "binding declaration" from Endacott averring that he was the owner of all items in his possession.[102] Because Thailand is a country "considered to be a high risk for child pornography," Endacott's two laptop computers were searched for pictures and videos.[103] The search queries produced images of preadolescent nude females whom Endacott identified as fourteen-year-old models.[104] Endacott claimed that the images were legal because they were obtained from a "legal website."[105] Agents confiscated Endacott's computers and other digital media and Endacott provided consent for additional searches.[106] Two days later a special agent discovered thousands of "images of pubescent and prepubescent girls in various states of undress" on one of the laptops.[107] A search of two external hard drives turned up over ten thousand additional images.[108] The court held that the searching of Endacott's belongings was valid under the border search exception.[109] While the trial court held that the search was "without probable cause or even a reasonable suspicion," the search was upheld as a routine border search.[110]

Endacott argued that (1) his laptop search violated the Fourth Amendment because there was no reasonable suspicion, and (2) the expressive materials hosted on his laptop entitled it to greater protection than other articles searchable at borders.[111] The court dismissed the first claim by citing the Supreme Court in *United States v. Flores-Montano*[112] and held that

99. *Id.* at 908.
100. *Id.*
101. *Id.*
102. *Id.* Endacott later consented to a search of his computers and digital media.
103. *Id.*
104. *Id.*
105. *Id.*
106. *Id.*
107. *Id.*
108. *Id.*
109. *Id.*
110. *See id.*
111. *Id.* at 908-09.
112. 541 U.S. 149, 152 (2004) ("[S]earches made at the border, pursuant to the longstanding right of the sovereign to protect itself by stopping and examining persons

border searches are reasonable simply because they occur at the border.[113] The court countered Endacott's second claim by citing the Fourth Circuit in *United States v. Ickes*,[114] where the court rejected a similar expressive materials argument by noting that expressive materials could contain terrorist communications and that creating an exception for such materials would "defeat the purpose of the border search doctrine, which is to allow the sovereign to protect itself."[115] The court then cited two cases holding that computers should be treated like other containers for the purposes of search and seizure laws.[116] The court ended with an analogy:

> Indeed, the human race has not yet, at least, become so robotic that opening a computer is similar to a strip search or body cavity search. Of course viewing confidential computer files implicates dignity and privacy interests. But no more so than opening a locked brief case, which may contain writings describing the owner's intimate thoughts or photographs depicting child pornography. A computer is entitled to no more protection than any other container. The suspicionless border search of Endacott's computer was valid.[117]

Thus, the *Endacott* case is simply one of the latest in a line of decisions affirming warrantless electronic device searches.

III. THE DEPARTMENT OF HOMELAND SECURITY AND ITS BORDER SEARCH POLICIES

Because numerous courts have vindicated CBP's broad authority to search individuals and their electronics at the border,[118] it is relevant to examine how CBP obtained its authority. Much of it came from the Homeland Security Act,[119] passed in 2002, which established the Department of Homeland Security to, among other things, "prevent terrorist attacks within the United States, . . . carry out all functions of entities transferred to the Department, . . . [and] monitor connections between illegal drug

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and property crossing into this country, are reasonable simply by virtue of the fact that they occur at the border." (quoting United States v. Ramsey, 431 U.S. 606, 616 (1977))).

113. *See Endacott*, 79 Cal. Rptr. 3d at 909.

114. 393 F.3d 501 (4th Cir. 2005).

115. *Endacott*, 79 Cal. Rptr. 3d at 909.

116. *Id.* at 909.

117. *Id.*

118. *See supra* Part II.

119. Homeland Security Act of 2002, Pub. L. No. 107-296, 116 Stat. 2135 (codified as amended in scattered sections of U.S.C.).

trafficking and terrorism."[120] The Act established the Directorate of Border and Transportation Security, who is responsible for:

> [p]reventing the entry of terrorists and the instruments of terrorism into the United States. . . . [s]ecuring the borders . . . [and] [e]stablishing and administering rules . . . governing the granting of visas or other forms of permission . . . to enter the United States to individuals who are not a citizen or an alien lawfully admitted for permanent residence in the United States,[121]

as well as "ensuring the speedy, orderly, and efficient flow of lawful traffic and commerce."[122] Pursuant to the Homeland Security Act, the United States Customs Service, Transportation Security Administration, and several other agencies were transferred to the DHS.[123] Because the DHS now effectively controls the borders, it is important to consider its border search policies.

On July 16, 2008, the DHS, in an effort to be more transparent,[124] publicized its "long-standing" policy regarding border searches of documents, computers, and other electronic devices, stating that:

> [i]n the course of a border search, and absent individualized suspicion, officers can review and analyze the information transported by any individual attempting to enter, reenter, depart, pass through, or reside in the United States, subject to the requirements and limitations provided herein. Nothing in this policy limits the authority of an officer to make written notes or reports or to document impressions relating to a border encounter.[125]

The five-page document, in essence, confers authority to border officials to peruse electronic devices without any suspicion of criminal activity whatsoever. DHS officials are entitled to "detain" electronic devices for a "reasonable period of time," on-site or off-site.[126] The policy does not define a "reasonable period of time."[127] Further, absent individualized

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120. 6 U.S.C. § 111 (2006).
121. 6 U.S.C. § 202 (2006).
122. *Id.*
123. 6 U.S.C. § 203 (2006).
124. Ellen Nakashima, *Expanded Powers to Search Travelers at Border Detailed*, WASH. POST, Sept. 23, 2008, at A2.
125. U.S. Customs & Border Prot., Policy Regarding Border Search of Information (July 16, 2008), U.S. Customs and Border Protection, http://www.cbp.gov/linkhandler/cgov/travel/admissibility/search_authority.ctt/search_authority.pdf.
126. *Id.*
127. *Id.*

suspicion, officials may share copied information with other Federal agencies or entities in order to "seek translation and/or decryption assistance."[128] Officers can, for example, seek assistance from the NSA to break any encrypted files on one's electronic device even if there is no suspicion of criminal activity. With supervisory approval, and with reasonable suspicion, customs officials may also seek assistance from other agencies and entities if subject matter experts are required to investigate the information.[129] These agencies are entitled to retain the information for the period of time needed to offer assistance.[130] If probable cause develops during this initial search, officials are authorized to seize documents and devices.[131]

Further, the policy outlines how the DHS intends to protect sensitive information. If officials encounter business or commercial information, "all reasonable measures to protect that information from unauthorized disclosure" shall be taken.[132] No further detail is provided on what constitutes "reasonable measures," however.[133] If the attorney-client privilege is invoked, "special handling procedures" may apply, though "legal materials are not necessarily exempt from a border search."[134] Finally, if no probable cause exists after conducting a search, copies of all information retained must be destroyed unless the matter relates to immigration, though the time frame for destruction is not defined.[135]

The Asian Law Caucus (ALC) and Electronic Frontier Foundation (EFF) have criticized the DHS's policy for the lax privacy protection required for searches and seizures, also noting that these practices deviate significantly from previous government practices.[136] According to the ALC, search polices were first enacted in 1986 by the Reagan administration to counter lawsuits initiated by U.S. citizens interrogated and searched after returning from Nicaragua.[137] In 1986, border search policy enabled officials to detain materials based on reasonable suspicion of illegal activi-

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128. *Id.*
129. *Id.*
130. *Id.*
131. If the information concerns immigration, no probable cause is needed. *Id.*
132. *Id.*
133. *Id.*
134. *Id.*
135. *Id.*
136. *See* Bob Egelko, *Feds Give Customs Agents Free Hand to Seize Travelers' Documents*, S.F. CHRON., Sept. 24, 2008, at A6; *see also* Nakashima, *supra* note 124 (noting that from 1986 until 2007, probable cause was necessary to copy materials crossing the border).
137. Egelko, *supra* note 136.

ty, or seize and copy materials if there was probable cause to do so.[138] The Clinton administration updated border search policies in 2000 but made no significant changes.[139] The next significant change came in July 2007 when the Bush administration eliminated the reasonable suspicion requirement, removing a significant barrier to border searches.[140] Previously, customs agents could "glance" at documents in order to ascertain whether illegal goods were being trafficked without any suspicion, but reasonable suspicion was required to confiscate and read any documents.[141] The ALC protested:

> For more than 20 years, the government implicitly recognized that reading and copying the letters, diaries, and personal papers of travelers without reason would chill Americans' right to free speech and free expression . . . . But now customs officials can probe into the thoughts and lives of ordinary travelers without any suspicion at all.[142]

Jennifer Chacón, a law professor at the University of California, Davis, notes that CBP's broad authority carries three potential risks.[143] First, international travelers have no assurance that information on their electronic storage devices will not be reviewed or stored by the government.[144] Second, business travelers using company computers may be held accountable for the contents of those computers, regardless of whether they created it.[145] Third, border searches without reasonable suspicion may lead to searches that are arbitrary, unnecessary, or involve racial profiling.[146] Indeed, the ALC has noted that they have received increasing reports from travelers complaining of being questioned about their religious and political persuasions.[147]

David Cole, a law professor at Georgetown University, succinctly addresses the privacy issues surrounding laptop searches:

> It's one thing to say it's reasonable for government agents to open your luggage . . . . It's another thing to say it's reasonable

138. Nakashima, *supra* note 124.
139. Egelko, *supra* note 136.
140. Nakashima, *supra* note 124.
141. Egelko, *supra* note 136.
142. *Id.*
143. Chacón, *supra* note 17, at 9.
144. *Id.* at 9-10 (footnote omitted).
145. *Id.* at 10 (footnote omitted).
146. *Id.*
147. Nakashima, *supra* note 124.

> for them to read your mind and everything you have thought over the last year. What a laptop records is as personal as a diary but much more extensive. It records every Web site you have searched. Every e-mail you have sent. It's as if you're crossing the border with your home in your suitcase.[148]

Legislative reform should attempt to address all these issues.

IV. LEGISLATIVE ATTEMPTS AT REFORM

Concerned by the high level of intrusion constitutionally allowed during border searches, compounded with little privacy protection afforded to travelers under DHS policy, privacy advocates have urged the DHS to establish rules requiring reasonable suspicion of illegal activity prior to searching electronic devices.[149] In response to pressure from advocacy groups and their own concerns, elected representatives have responded to critics of the DHS's border search policies by introducing various legislative proposals in the 110th and 111th Congresses.[150]

A. Proposed Legislation[151]

Elected officials proposed four bills in 2008. Representative Zoe Lofgren, a Democrat from California, introduced the "Electronic Device Privacy Act of 2008" (110 H.R. 6588) on July 23, 2008 (Lofgren bill).[152] The following week, on July 31, 2008, eleven bipartisan co-sponsors, including New York Democrat Representative Eliot Engel, introduced the "Securing Our Borders and Our Data Act of 2008" (H.R. 6702) in the House (Engel bill).[153] Rep. Engel reintroduced this bill unchanged in the 111th Congress on January 7, 2009.[154] On September 11, 2008, nine Democrats, including California Representative Loretta Sanchez, introduced the "Border Security Search Accountability Act of 2008" in the House (H.R. 6869) (Sanchez bill).[155] Finally, on September 26, 2008, the United States House

148. Ellen Nakashima, *Clarity Sought on Electronics Searches*, WASH. POST, Feb. 7, 2008, at A1.

149. *New House Bill*, *supra* note 90.

150. Because none of these proposals passed in 2008, elected officials will have to reintroduce legislation in the 111th Congress in 2009.

151. Section IV.A includes legislation introduced prior to March 1, 2009.

152. Electronic Device Privacy Act of 2008, H.R. 6588, 110th Cong. (2008). *See also New House Bill*, *supra* note 90.

153. *Senate, House Democrats Offer Bills To Limit Border Searches of Laptops*, 7 Privacy & Sec. L. Rep. (BNA) 1437 (Oct. 6, 2008) [hereinafter *Senate, House Democrats*].

154. Securing Our Borders and our Data Act of 2009, H.R. 239, 111th Cong. (2009).

155. *Senate, House Democrats*, *supra* note 153.

and Senate introduced the "Travelers' Privacy Protection Act of 2008," which appears to be the strongest and most comprehensive of the group (Feingold bill).[156]

The Lofgren bill, which had no co-sponsors as of September 30, 2008,[157] would prevent CBP agents from conducting warrantless border searches of laptop computers and other electronic devices.[158] Officials would be unable to rely solely on sovereign authority, often cited by courts, to conduct laptop searches. Instead, border officials would have to be granted the authority specifically by statute.[159] Support of this bill, as evinced by a lack of co-sponsors, seems unlikely since the sixteen-line text of the bill completely eradicates the ability of officials to search electronic devices by drawing on the authority of the United States based on its power as sovereign. Although this bill does afford ample privacy protection to travelers crossing the border in that they will likely not be searched at all, it does not appear to confer any authority on United States border officials to investigate non-routine scenarios based on reasonable suspicion. However, the bill does add the caveat that searches based on other lawful authority will not be prohibited.[160] Still, the bill seems politically unfeasible and thus is not likely to move.

The Engel bill, along with the Sanchez bill, both task the Secretary of the DHS with promulgating regulations on laptop border searches.[161] Under the Engel bill, electronic data searches must be supported by reasonable suspicion, seizures must be based on some constitutional authority other than the power of the sovereign, officers must be appropriately trained to prevent damage to and deletion of data from devices, and travelers may be required to turn on devices to ensure they are operational.[162] Searches must be conducted in the presence of a supervisor, and travelers may request that the search be conducted privately.[163] The bill also outlines issues that the DHS must consider, such as policies for protecting the

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156. Travelers' Privacy Protection Act of 2008, S. 3612, 110th Cong. § 4 (2008), Travelers' Privacy Protection Act of 2008, H.R. 7118, 110th Cong. § 4 (2008). The Act was introduced in the Senate by Wisconsin Senator Russell Feingold.

157. *Id.*

158. H.R. 6588 § 2; *see also New House Bill*, *supra* note 90.

159. *New House Bill*, *supra* note 90.

160. H.R. 6588 § 2.

161. Border Security Search Accountability Act of 2008, H.R. 6869, 110th Cong. § 2 (2008); Securing Our Borders and Our Data Act of 2008, H.R. 6702, 110th Cong. § 2 (2008); *see also Senate, House Democrats*, *supra* note 153.

162. Securing Our Borders and Our Data Act of 2008, H.R. 6702, 110th Cong. § 2 (2008).

163. *Id.*

integrity of data, for the duration, location, and other circumstances surrounding seized data, for the sharing of downloaded information with other agencies, and for the rights of an individual to ensure return of confiscated data.[164] The DHS is also required to give a receipt to those whose device has been seized providing contact information to follow-up, and the DHS must place all these rules on its public website.[165] Finally, the DHS must conduct an annual study of searches and seizures, including the number of searches and seizures, the race, gender, and national origin of the travelers subject to those searches, the type of searches conducted, and the results of the searches.[166] These findings must then be presented to Congress.[167]

The Sanchez bill builds on the Engel bill in its specificity of the rules to be considered. Any information determined to be commercial, ranging from trade secrets to attorney-client privilege, "shall be handled consistent with the laws, rules, and regulations governing such information and shall not be shared with a Federal, State, local, tribal, or foreign agency unless it is determined that such agency has the mechanisms in place to comply with such laws, rules, and regulations."[168] While the Engel bill *requires* searches to be conducted in front of a supervisor, the Sanchez bill merely states that supervisors must be present "to the greatest extent practicable."[169] However, the Sanchez bill allows, "where appropriate," travelers to be present when their electronic device is being searched.[170] While both bills require officials to be trained, the Sanchez bill also provides for an auditing mechanism to ensure that officials are conducting searches in accordance with the rules. Further, the Sanchez bill requires the DHS to outline limitations on warrantless searches, such as the length of time electronic devices could be detained absent probable cause, and requires the destruction of information after a specified time period.[171] If information is copied, shared, retained, or entered into a database, the owner of said information must be notified in writing, absent national security implications. Moreover, DHS officials must also prepare both a privacy impact assessment as well as a civil liberties assessment of the proposed rules.

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164. *Id.*
165. *Id.*
166. *Id.* § 3.
167. *Id.*
168. H.R. 6869 § 2.
169. *Id.*
170. *Id.*
171. *Id.*; *see also Senate, House Democrats*, *supra* note 153.

The other provisions in the Sanchez bill are similar to the Engel bill. Overall, the Sanchez bill is stronger than both the Engel and Lofgren bills.

The Feingold bill, which aims to provide standards for border search and seizures of electronic devices,[172] incorporates many elements of the previous bills while also building on them, thereby making it the most comprehensive and specific bill in the group. The bill covers "law-abiding"[173] citizens and legal residents of the United States and requires that CBP officials have reasonable suspicion before searching electronic devices and probable cause before seizing equipment.[174] The Act disputes that the privacy of information stored in laptops is akin to that of "closed containers" on several grounds.[175] The Act emphasizes that laptops "can contain the equivalent of a full library of information about a person,"[176] and that "searches of electronic equipment [are] more invasive than searches of physical locations or objects."[177] Further, the legislation discourages profiling, stating that "[t]argeting citizens and legal residents of the United States for electronic border searches based on race, ethnicity, religion, or national origin is wholly ineffective as a matter of law enforcement and repugnant to the values and constitutional principles of the United States."[178] This finding is enforced by a prohibition on profiling in the bill, though it is diluted somewhat by creating an exception for profiling when a customs official has reasonable suspicion based on other factors.[179] Procedurally, all searches would require prior authorization by a supervisor and the scope of the search would be limited to the reasonable suspicion recorded.[180] The bill also requires that copies of information retained by customs officials or other agencies conscripted to help evaluate the information be destroyed within three days if no seizure occurs.[181] Perhaps most unique to the Feingold bill is its enforcement procedures. The bill not only provides for compensation measures for damages due to a search, but also enables civil actions for violations of the bill, giving the

172. Travelers' Privacy Protection Act of 2008, S. 3612, 110th Cong. § 4 (2008); Travelers' Privacy Protection Act of 2008, H.R. 7118, 110th Cong. § 4 (2008).

173. It is not clear what is meant by "law-abiding."

174. S. 3612 § 4(a); H.R. 7118 § 4(a).

175. S. 3612 § 2(4); H.R. 7118 § 2(4).

176. S. 3612 § 2(4)(A); H.R. 7118 § 2(4)(A).

177. S. 3612 § 2(4)(C); H.R. 7118 § 2(4)(C).

178. S. 3612 § 2(8); H.R. 7118 § 2(8).

179. S. 3612 § 7(b); H.R. 7118 § 7(b).

180. S. 3612 §§ 5(a)(1), 5(b)(3)(c)(1); H.R. 7118 §§ 5(a)(1), 5(b)(3)(c)(1).

181. S. 3612 § 5(b)(3)(e)(2); H.R. 7118 § 5(b)(3)(e)(2).

Feingold bill actual teeth compared to the other bills.[182] Plaintiffs' attorney fees are also available at a judge's discretion.[183]

B. Better Legislation

Ideal legislation would combine elements of the Sanchez bill with the Feingold bill, along with a few other substantive changes. The Feingold bill, alone, is a good compromise between the strong governmental interest in protecting the borders and the privacy interests retained by individuals that are recognized and protected by the Fourth Amendment. The bill allows government officials to conduct searches without the onerous burden imposed by the warrant requirement, but imposes additional restraints on government officials to keep them from abusing this power.[184] For instance, under the bill the government may only retain electronic devices for a limited amount of time, absent probable cause.[185] The Feingold bill takes profiling seriously by explicitly prohibiting it, albeit with a large exception, but also enabling plaintiffs to protest alleged profiling with favorable evidentiary rules.[186] The Feingold bill also provides a timetable for returning seized devices to individuals and for destroying copied materials.[187] Further, the bill covers electronic devices generally, rather than covering only laptops—a provision crucial to address technological innovation as portable electronic devices increase in capacity and prevalence.[188]

While the Feingold bill adds a number of effective limitations on government intrusion, there are further structural changes that could strengthen the bill by providing additional privacy protections without compromising the government's interests. Ideal legislation would detail not only when materials are eliminated, but how they are eliminated, as the Sanchez bill provides. The Feingold bill requires that the DHS maintain detailed records of each border search, but it makes no provision for making

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182. S. 3612 § 12; H.R. 7118 § 12. Moreover, in an effort to stymie profiling, the bill provides that "proof that searches of the electronic equipment of United States residents at the border have a disparate impact on racial, ethnic, religious, or national minorities shall constitute prima facie evidence of the violation." S. 3612 § 12(a)(4); H.R. 7118 § 12(a)(4).

183. "In any civil action filed under paragraph (1), the district court may allow a prevailing plaintiff reasonable attorney's fees and costs, including expert fees." S. 3612 § 12(a)(5); H.R. 7118 § 12(a)(5).

184. S. 3612 § 5; H.R. 7118 § 5.

185. S. 3612 § 5(e); H.R. 7118 § 5(e).

186. S. 3612 § 12(a)(4); H.R. 7118 § 12(a)(4).

187. S. 3612 § 6; H.R. 7118 § 6.

188. S. 3612 § 3(4); H.R. 7118 § 3(4).

information available to Congress or the public.[189] The release of such records could act as an additional safeguard to check the power of CBP officials. Further, provisions in the Sanchez bill could boost the Feingold bill by explicitly establishing requirements for commercial information, such as trade secrets, attorney-client privilege, and work product. By far the biggest loophole in any proposed legislation thus far, however, is that they neglect to cover non-U.S. citizens or residents. For example, under the Feingold bill, an Indian employee of a multinational corporation could be subject to a more intrusive search than an American employee, even though a search of either of their laptops might reveal trade secrets.

V. CONCLUSION

The governmental interest in searching electronic devices is strong. Laptop searches seek both physical contraband, such as drugs and weapons, as well as information contraband, such as international espionage and child pornography. Using the latter as an example, single, white, male, non-business travelers to Southeast Asia are sometimes suspected to be sex tourists. Because trying to prove child molestation, an extraterritorial law, is nearly impossible since the government has to prove that the defendant engaged in or had the intent to engage in molestation, and because child molesters tend to horde pornography, it is much easier to search the laptops of suspicious individuals at the border. Instead of pursuing child pornographers internationally, why not just search them at the border? Child pornography possession is a strict liability crime; this is the easiest way.

Yet, there are immense privacy issues at stake as electronic devices hold lifelong libraries of information. Moreover, this is not solely a border search issue but one of profiling. Given the DHS's recent clarification of their broad authority to conduct electronic device border searches, and given the court's willingness to confer broad authority to CBP officials, it is up to Congress to set the standard by which the country can ensure its security while simultaneously protecting the privacy rights of travelers.[190]

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189. S. 3612 § 5(a)(2); H.R. 7118 § 5(a)(2).

190. That said, the DHS's own Data Privacy and Integrity Advisory Committee, in a letter dated February 5, 2009, recommended to DHS Secretary Janet Napolitano that the DHS integrate privacy protections into the border search process. *See* Letter from J. Howard Beales, Chair, DHS Data Privacy & Integrity Advisory Comm., to Janet Napolitano, Sec'y, DHS (Feb. 5, 2009), *available at* http://www.dhs.gov/xlibrary/assets/privacy/privacy_dpiac_letter_sec_and_acpokropf_2009-02-05.pdf. The Committee states:

Strengthening the Travelers' Privacy Protection Act by incorporating provisions from the Border Security Search Accountability Act, as well as providing privacy protection for non-U.S. citizens and residents, will ensure that the government has adequate reach to protect the homeland country while also securing sufficient privacy rights for travelers. In the interim, it may very well be best for international travelers to either leave their laptops and electronic storage devices at home, or wipe them of confidential information before traveling.[191]

> While certain DHS components may have legal authority to conduct border searches, there is a significant difference between looking at paper documents and searching through the volume of digital information that can be carried by travelers. The Privacy Office should have a role in reviewing current policies and practices for searches and seizures of digital information and developing guidelines to integrate privacy protections into these processes.

Id. Still, legislation is the better solution since it is enforceable and has reporting provisions. *See supra* Part IV.

191. Indeed, some companies are advising their employees not to carry confidential information with them on international trips. *See* Nakashima, *supra* note 148.

ADDITIONAL DEVELOPMENTS—PRIVACY

CRAWFORD V. MARION COUNTY ELECTION BOARD

128 S. Ct. 1610 (2008)

The Supreme Court of the United States, in a 6-3 decision, affirmed the judgment of the Seventh Circuit upholding an Indiana election law (SEA 483) that requires citizens voting in person to present government issued photo identification. Justice Stevens authored the lead opinion, joined by the Chief Justice and Justice Kennedy. Justice Scalia, joined by Justices Thomas and Alito, concurred in the judgment but offered a concurring opinion.

Known as the "Voter ID Law," SEA 483 requires citizens voting in person on election day to present photo identification issued by the government. SEA 483 applies to in-person voting in both primary and general elections, but not to absentee voting. Although the statute requires citizens voting in person to present photo identification, in-person voters without appropriate photo identification can cast provisional ballots which will only be counted if appropriate photo identification is provided or an affidavit is submitted to the circuit court clerk within ten days of the election. Concurrent with the passing of SEA 483, Indiana began providing free photo identification to individuals over the age of eighteen who do not have a driver's license.

The petitioners, consisting of two organizations representing the Democratic Party, two elected officials, and several nonprofit organizations, alleged that SEA 483 violated the Fourteenth Amendment and should be facially invalidated because the requirement of photo identification disenfranchised and burdened voters. In support of their allegations, the petitioners presented as evidence a report detailing the number of registered voters without photo identification, along with depositions of people who experienced hardship in obtaining identification cards. The district court found the report to be unreliable, and a majority of the Supreme Court agreed.

The lead opinion applied the balancing test used in *Anderson v. Celebrezze*, 460 U.S. 780 (1983). In *Anderson*, the Court ruled that a balancing approach should be applied to voting restrictions which protect the integrity of the electoral process. As justification for the burden of SEA 483, the respondents argued that the statute reflected intentions of Congress to enhance the integrity of elections, as evidenced by the

National Voter Registration Act and the Help America Vote Act. Additionally, respondents argued that prevention of voter fraud through SEA 483 was needed to counteract the inaccuracy of Indiana's registered-voters lists. Finally, the respondents contended that the Voter ID Law would inspire greater public confidence in the integrity of the voting system, thus encouraging greater voter participation.

The lead opinion determined that SEA 483 did not impose excessively burdensome requirements on any class of voters and was justified on its face by the State's valid interest in protecting the integrity and reliability of the electoral process. Although it rejected the petitioner's broad facial attack of the statute that would invalidate its application in all situations, the lead opinion left open the door for a fact-based challenge to the statute as applied to a particular voter.

The concurring opinion agreed with the lead opinion's ultimate judgment but disagreed with its approach. In particular, the concurring opinion concluded that before applying the balancing test used in *Anderson*, it was necessary to first determine if the challenged law severely burdens the right to vote. Absent such a finding, it would be inappropriate to apply the balancing test to resolve the statute's application on a record-by-record basis. The concurring opinion found that SEA 483 is a generally applicable, nondiscriminatory voting regulation that does not severely impact the right to vote, and accordingly it is facially valid. Moreover, because the concurrence determined that the law did not impose a severe burden on voting, it determined that a voter would not have a valid equal-protection complaint based on the law's effect on the individual voter.

Both dissenting opinions agreed that the photo ID requirement imposed a disproportionate burden upon voters without valid state issued identifications. However, Justice Breyer would have invalidated the statute because less restrictive alternatives existed to the achieve the state's purpose, while Justice Souter and Justice Ginsburg would have invalidated it on the grounds that the State failed to factually show that threats to its interests outweighed the burden imposed upon the right to vote.

QUON V. ARCH WIRELESS OPERATING CO.

554 F.3d 769 (9th Cir. 2009)

The United States Court of Appeals for the Ninth Circuit voted to deny defendants' petition for rehearing en banc of a decision in which a Ninth Circuit panel found, among other things, that the City of Ontario and the Ontario Police Department had violated the Fourth Amendment by auditing the text of pager communications made by an employee.

Jeffrey Quon was a SWAT police officer employed by the City of Ontario Police Department (Department). The Department assigned Quon an alphanumeric pager, which he used for work and personal communications. Quon repeatedly exceeded his allotted usage limit, triggering an audit by the Department. The Department obtained the full text of the messages Quon had sent and received from Arch Wireless Operating Co. (Arch) and discovered that Quon had sent a number of personal and sexually explicit messages. Quon brought an action against the Department, the City of Ontario, and the chief and sergeant of the Department, alleging violations of the Fourth Amendment and California constitutional privacy rights. Quon also brought an action against Arch alleging violations of the Stored Communications Act. A district court dismissed these claims on summary judgment and at trial. On appeal, the Ninth Circuit held that the chief of police was entitled to qualified immunity, but that Arch had violated the Stored Communications Act, and the City and Department had violated Quon's Fourth Amendment rights because he had a reasonable expectation of privacy and the search was unreasonable as a matter of law.

The Department petitioned for rehearing en banc on the Fourth Amendment issue, and the full court voted to deny the petition. Dissenting, Judge Sandra S. Ikuta denied that a reasonable expectation of privacy existed on the facts of the case and criticized the panel's decision for using, according to Judge Ikuta, a "least intrusive means" test in determining the scope of reasonable searches. Judge Ikuta argued that the leading Supreme Court case (*O'Connor v. Ortega*, 480 U.S. 709 (1987)) mandated a practical approach in which a court should consider the "operational realities of the workplace" when determining whether an expectation of privacy was reasonable. Here, because a policy existed that communications could be audited at any time, and the Department issued the pagers to Quon primarily for SWAT activities, which could be highly charged, the "operational realities" allowed no reasonable expectation of privacy. Further, in Judge Ikuta's view, the panel decision determined the scope of a reasonable search by a "least intrusive means" test, which

would require an employer to always use the least intrusive methods of performing searches, a test which has been rejected by the Supreme Court and the majority of circuits.

Criticizing the dissent as "seriously flawed," Judge Kim McLane Wardlaw responded that the panel opinion did not depart from the *O'Connor* case-by-case approach for determining reasonable expectation of privacy, where the determination of reasonableness is made "'under all the circumstances.'" Here, an expectation of privacy was reasonable because the Department had no official policy covering the use of the pagers. Moreover, the informal policies and practices of the Department, according to which text messages would not be audited if overages were paid, and upon which Quon relied, also justified a finding of a reasonable privacy expectation. Judge Wardlaw further denied that the Ninth Circuit panel had applied a "less intrusive test" for determining the reasonable scope of a search, as Judge Ikuta claimed, but rather had applied the two prongs of *O'Connor* properly. Thus, Judge Wardlaw affirmed that the audit was reasonable "at its inception" because it was conducted for the work-related purpose of determining overages, but stated that the methods of the audit were "excessively intrusive in light of the noninvestigatory object of the search."