IDEAS ON INTELLECTUAL PROPERTY LAW

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Losing control

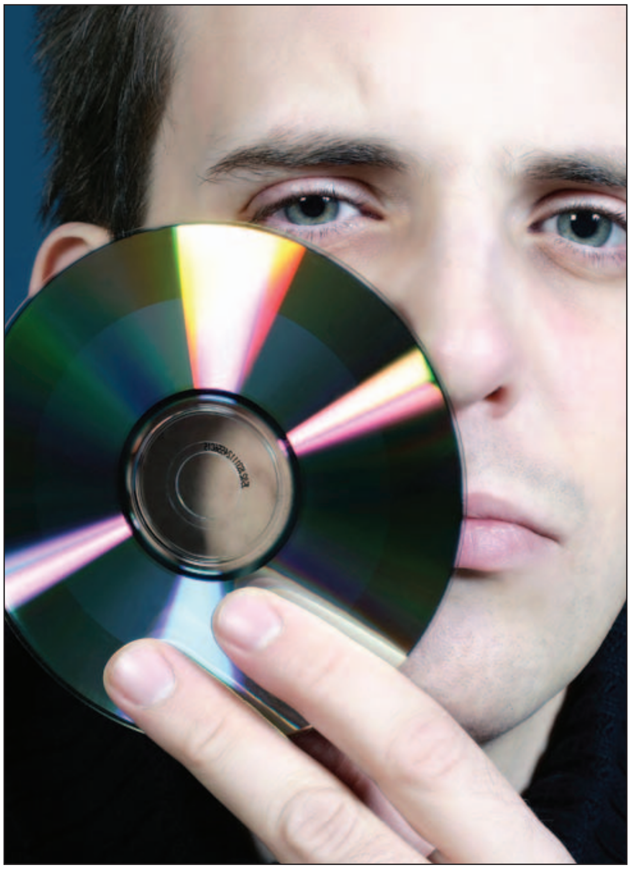
Ninth Circuit examines distribution's role in copyright case

Like parents, copyright holders often reach a point when they must release their creations out into the big, bad world. Unlike parents, though, copyright holders can retain some control over their creations through licensing agreements.

But simply labeling an arrangement as a license won't ensure control. In *UMG Recordings, Inc. v. Augusto*, the U.S. Court of Appeals for the Ninth Circuit examined the role and nature of distribution of the work in determining whether a copyright holder retains control.

Unintended recipient

UMG, one of the world's largest music companies, regularly ships promotional CDs to a large group of recipients, including music critics and radio programmers. The recipients haven't necessarily agreed or requested to receive the CDs, and UMG doesn't seek payment.



Troy Augusto wasn't among UMG's intended recipients but managed to obtain eight of these copyrighted CDs. After he sold them on eBay, UMG sued him for copyright infringement, claiming that it had granted the recipients licenses only to use the CDs and had retained ownership and the right to control distribution. Neither Augusto nor the recipients, therefore, were entitled to sell the CDs.

Augusto argued that UMG's distribution of the CDs represented a transfer of ownership of the physical CD to the recipients, making the CDs subject to the "first sale" doctrine. This doctrine allows one who has acquired ownership of a copy to sell or otherwise dispose of that copy without the copyright holder's permission. The district court agreed and dismissed the case. UMG appealed.

Transfer of power

On appeal, the Ninth Circuit explained that the first sale doctrine applies not only when a copy is first sold, but also when a copy is given away or title is otherwise transferred. Once a copyright owner transfers title in a particular copy, it loses its exclusive right to control that copy's distribution and can't prevent its resale.

The court noted that not every transfer of possession of a copy transfers title; copyright holders can create licensing agreements that permit use of a copy without transferring title. UMG asserted that the "promotional statement" included on most of the CDs at issue created a license. Specifically, the statement said:

> This CD is the property of the record company and is licensed to the intended recipient for personal use only. Acceptance of this CD shall constitute an agreement to comply with the

> terms of the license. Resale or transfer of possession is not allowed and may be punishable under federal and state laws.

Some of the CDs were labeled only with "Promotional Use — Not for Sale." But, as the court noted, merely labeling an arrangement a license rather than a sale doesn't settle the issue.

Controlling behavior

In determining whether UMG's actions created a license with the recipients of its CDs or whether ownership of the CDs was transferred, the Ninth Circuit focused largely on the nature of UMG's distribution of the CDs. For example, the CDs were sent to the recipients without any previous formal arrangement and weren't numbered. In addition, no attempt was made to keep track of where each particular copy went or what use was made of it.

Merely labeling an arrangement a license rather than a sale doesn't settle the issue.

The court also pointed out that the shorter version of the promotional statement didn't even claim to create a license. The longer statement was flawed in how it purported to secure the recipient's agreement:

> It is one thing to say ... that "acceptance" of the CD constitutes an agreement to a license ... but it is quite another to maintain that "acceptance" may be assumed when the recipient makes no response at all.

The Ninth Circuit found no evidence that the recipients had agreed to a license and, thus, no evidence that the terms of the promotional statement established licenses. It also noted that UMG didn't require recipients to return the CDs. The failure to require return alone may not establish a sale, but it's another indication that UMG had no control over the CDs after shipment.

Unordered Merchandise statute also favored defendant

Along with its primary decision in *UMG Recordings, Inc. v. Augusto* (see main article), the U.S. Court of Appeals for the Ninth Circuit also held that, because the CDs distributed by UMG were "unordered merchandise," the recipients could dispose of them as they desired under the federal Unordered Merchandise statute.

The law provides that merchandise mailed without the prior express request or consent of the recipient may be treated by the recipient as a gift. The recipient has the right to retain, use, discard or dispose of it in any manner it sees fit — without any obligation to the sender. (Although the statute refers to "mailed" merchandise, the Federal Trade Commission has applied it to other types of shipment.)

Thereby, the statute granted UMG's recipients the right to treat the CDs as their own without any obligation to UMG. As such, the statute is "utterly inconsistent" with the terms of the license UMG claimed. Therefore, shipping the unordered CDs to the recipients made them owners, not licensees, for purposes of the first sale doctrine.

UMG contended that the statute didn't apply because the company didn't try to extract payment from the recipients. The court, however, found that the statute doesn't require "bullying" for payment. Merely sending the unordered merchandise triggers the statute's protections.

Transfer of possession

The Ninth Circuit concluded that UMG's transfer of possession of the CDs to the recipients — without meaningful control or knowledge of the status of the CDs after shipping — constituted a transfer of title. As a result, UMG lost its exclusive right to control distribution. ❍

Facts > rules

Federal Circuit rejects familiar formula for patent damages

Patent infringement cases can produce some eye-popping damages awards. But, in *Uniloc USA Inc. v. Microsoft Corp.*, the U.S. Court of Appeals for the Federal Circuit made it clear that these awards must be based on the facts of the case rather than an abstract analytical tool such as the "25% rule."

Closing the window(s)

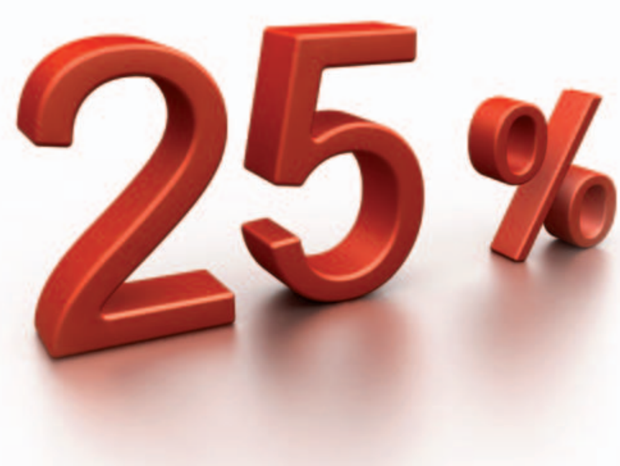
Uniloc holds a patent on a registration system that deters the unauthorized copying of software. The company sued Microsoft, claiming that Microsoft's Product Activation feature — which acts as a gatekeeper for its Word XP, Word 2003 and Windows XP software — infringed its patent.

The jury returned a verdict of willful infringement and awarded Uniloc $388 million in damages. But the district court ordered a new trial on damages based on the improper use of the "entire market value" rule, which allows for the recovery of patent infringement damages based on the value of the entire product that contains an infringing component. Uniloc appealed.

The Federal Circuit concluded that expert testimony based on the 25% rule is inadmissible because the rule is "a fundamentally flawed tool for determining a baseline royalty rate in a hypothetical negotiation."

Applying the rule

The jury's award was based on the testimony of Uniloc's expert witness, who indicated that damages should be about $565 million. To reach that figure, he applied the 25% rule. As the Federal Circuit explained, the rule is a tool that has been used to estimate the reasonable royalty rate that the manufacturer of a product using the patent would be willing to offer the patentee in a hypothetical negotiation for a license. It suggests the licensee pay a royalty rate equaling 25% of its expected profits for the product that incorporates the patent.



According to the Federal Circuit, it had "passively tolerated" the use of the rule in the past when the rule's acceptability wasn't the focus of the case. Similarly, lower courts have "invariably" admitted evidence based on the 25% rule, largely because of its widespread acceptance or because its admissibility was uncontested.

Deeming it irrelevant

Here, however, the court squarely addressed the admissibility of the rule, evaluating it in light of *Daubert* and other landmark Supreme Court rulings on the admissibility of expert testimony. The Federal Circuit concluded that expert testimony based on the 25% rule is inadmissible because the rule is "a fundamentally flawed tool for determining a baseline royalty rate in a hypothetical negotiation."

Specifically, the rule fails to tie a reasonable royalty rate to the facts of the case at issue; it says nothing about the particular technology, industry or parties. Because Uniloc's expert's starting point of a 25%

royalty had no relation to the case facts, the court deemed it arbitrary, unreliable and irrelevant.

Checking the estimate

Uniloc's expert applied the "entire market value rule" to "check" whether his original estimate was reasonable. Specifically, he compared his original estimate with his calculation of Microsoft's approximate total revenue of $19.28 billion for the infringing Office and Windows products. As a result of this comparison, he testified that his calculated royalty represented only 2.9% of that revenue and was, therefore, reasonable.

As the court noted, the "entire market value" rule allows a patentee to assess damages based on the entire market value of the infringing product only where the patented feature 1) creates the "basis for customer demand" or 2) "substantially create[s] the value of the component parts." It was undisputed that Product Activation did neither.

The Federal Circuit found that this case provided a good example of the danger of admitting evidence of a defendant's entire market value where the patented component doesn't create the basis for customer demand. The disclosure that a company has made $19 billion in revenue from an infringing product can't help but skew the damages horizon for the jury — regardless of the patented component's actual contribution to the revenue.

Establishing a foundation

Patentees must establish a factual foundation for damages that considers factors that would actually play a role in royalty negotiations. As this case shows, abstract rules alone won't cut it in court. ❍

Eek! "Naked licensing" leads to lost trademarks

"Freecyclers" are people who encourage others to pass on their goods rather than disposing of them. Unfortunately for one group of freecyclers, this generous approach to life doesn't always fly in the world of intellectual property. In fact, in *Freecycle-Sunnyvale v. The Freecycle Network*, the U.S. Court of Appeals for the Ninth Circuit found that lack of control over the use of trademarks can amount to abandonment of those rights.

The bare facts

The Freecycle Network (TFN) is an umbrella nonprofit group dedicated to the practice of freecycling, a locally based activity primarily coordinated by online groups. TFN allows member groups to use three trademarks: 1) Freecycle, 2) The Freecycle Network and 3) a logo. It relies on local moderators to regulate use of the trademarks.

FreecycleSunnyvale was a TFN member group that used the logo and Freecycle mark. In November 2005, TFN sent e-mails to FreecycleSunnyvale ordering it to cease and desist using the name and logo. FreecycleSunnyvale filed a declaratory action seeking

a finding of noninfringement based on a defense of "naked licensing."

Naked licensing occurs when a licensor fails to exercise adequate quality control over its licensee's use of a licensed trademark and, as a result, the trademark may no longer represent the quality of the product or service consumers have come to expect. In other words, by not enforcing the terms of the trademark's use, the licensor may forfeit its rights to enforce the exclusive nature of the trademark. In this case, the district court sided with FreecycleSunnyvale, and TFN appealed.

A matter of control

On appeal, the Ninth Circuit considered whether, by allowing FreecycleSunnyvale to use the trademarks with so few restrictions, TFN had entered into a naked license resulting in the abandonment of the trademarks. The court began by noting that the lack of an agreement with provisions restricting or monitoring the quality of goods or services produced under a trademark supports a finding of naked licensing.

TFN and FreecycleSunnyvale had no express licensing agreement. So, even if, as TFN contended, its e-mailed admonition to FreecycleSunnyvale's founder not to use the trademarks for commercial purposes constituted an implied licensing agreement, that e-mail contained:

- No contractual right to inspect or supervise FreecycleSunnyvale's services, and
- No ability to terminate the license if FreecycleSunnyvale used the trademarks for commercial purposes.

Courts have excused the lack of a contractual right to control quality in other cases, but only where the licensor demonstrated actual control through inspection or supervision. The Ninth Circuit found that TFN's alleged quality control standards weren't enforced or effective in maintaining consistency.

On appeal, the Ninth Circuit considered whether, by allowing FreecycleSunnyvale to use the trademarks with so few restrictions, TFN had entered into a naked license resulting in the abandonment of the trademarks.

Finally, the court held that TFN and FreecycleSunnyvale didn't enjoy the type of close working relationship that allowed TFN to rely on FreecycleSunnyvale's quality control measures. Regardless, reliance on a licensee's own quality control efforts is insufficient to overcome a finding of naked licensing without other indicia of actual control.

The naked truth

This case illustrates, once again, why trademark holders must take affirmative steps to maintain the quality of their marks. If they don't, they could lose the right to enforce those marks. ❍

Can a patentee establish liability for joint infringement?

Direct infringement of a method patent requires a single party to perform every step of the claimed method. But what about when a patented method requires more than one party to perform the necessary steps? How can a patentee establish that a defendant is liable for such joint infringement? The U.S. Court of Appeals for the Federal Circuit gave its answer in *Akamai Technologies, Inc. v. Limelight Networks, Inc.*

A tangled web

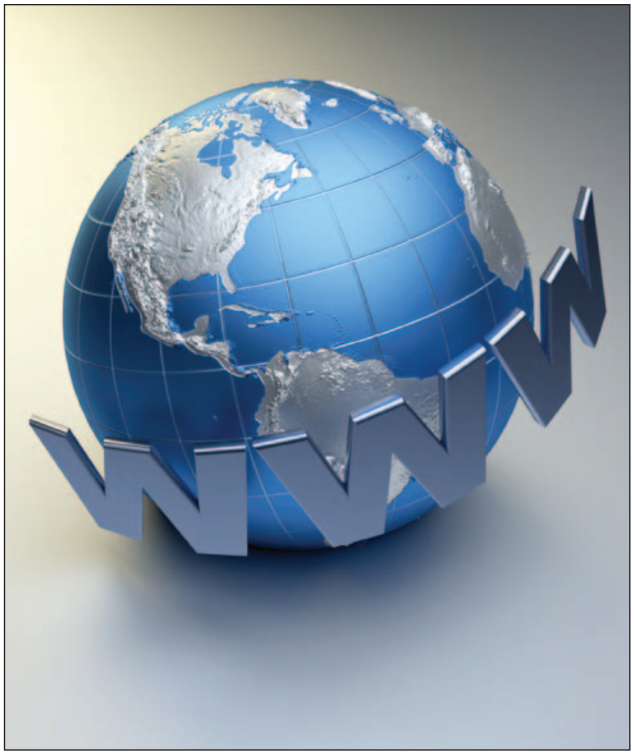
Akamai holds three patents related to a method for storing website content. As part of the method, individual embedded objects on a website (such as videos) are stored by a hosting service. Most of the steps in the patented claims are performed by the hosting service, but the website owner generally must tag the embedded objects so they direct visitors from their websites to the hosting site to retrieve those objects.

Akamai sued Limelight, a competing hosting service, for patent infringement. Because Limelight itself doesn't perform all of the steps of the asserted patent claims (the website owners do the tagging), Akamai pursued a theory of joint liability at trial. After the trial court entered a judgment of noninfringement, Akamai appealed.

Control or direction

Joint infringement generally can't occur unless one party exercises "control or direction" over the entire process such that every step is attributable to the controlling party. The Federal Circuit clarified that joint infringement can be found only when: 1) one party is contractually obligated to the other to perform the steps, or 2) the parties who perform the method steps have an agency relationship.

Limelight's standard form contract with its customers explains that the customer will have to perform the tagging step if they decide to take advantage of Limelight's service for embedded objects. But, the court pointed out, the company doesn't obligate customers to perform the step. Furthermore, the court found that customers didn't perform the tagging as Limelight's agents. Instead, they acted principally for their own benefit and under their own control.



Alleviating joint pain

The Federal Circuit offered some words of advice for patentees. Recognizing the difficulty of proving infringement of claims that must be infringed by multiple parties, it pointed out that such concerns can usually be offset by proper claim drafting. A patentee should try to structure its patent claims to capture infringement by just a single party. ❍

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Protecting Trademarks in the Social Media Age

By Kyle T. Peterson

Many common examples of trademark infringement that are found in traditional "brick & mortar" settings can also be found online. Since companies that fail to police their trademark rights risk losing them, it is imperative to monitor relevant social media sites for third party misappropriation of their trademarks, and deal creatively with potential infringements.

U.S. trademark laws have a long history of safeguarding against the improper suggestion of affiliation or sponsorship of goods and services. In the social media context, this type of infringement can occur when fake online profiles or "fan pages" are established in the name of businesses or prominent individuals. Brand owners need to control third party use of their trademarks as usernames on these sites. An easy way to determine whether a trademark or username is being used on multiple social media platforms at once is to conduct a search on a website like KnowEm (www.knowem.com).

A common obstacle to enforcing trademark rights in the social media context is that the current legal framework has not kept pace with technology. One powerful tool, the Uniform Domain Name Dispute Resolution Policy (UDRP), which governs trademark-based domain name disputes, only addresses trademark infringement in second-level domain names (e.g., the "microsoft" in www.microsoft.com). For example, if someone owns the domain name "www.microsoftupdates.com," the UDRP requires the domain name registrant to submit to an arbitration procedure through which Microsoft may be able to force the transfer of the domain name from the registrant on the basis of Microsoft's senior trademark rights to the word MICROSOFT. Many social networking sites assign users personalized sub-domains that appear as part of the Internet web address (i.e., www.facebook.com/username) rather than second-level domain names. This means that a brand owner is not able to stop the unauthorized use of its trademark in a personalized Facebook sub-domain by relying on the enforcement procedures of the UDRP. For example, a Facebook user that registers the username "microsoftupdates," and has the Internet web address of www.facebook.com/microsoftupdates could not be compelled by the UDRP to surrender that username on the basis of Microsoft's pre-existing trademark rights.

One of the best options for companies whose trademarks are misused on social media sites is to report the misuse directly to the social media site. Most social media platforms have their own dispute resolution process and terms of use policies to prevent trademark misuse or infringement, or to address them when they are reported. However, such procedures are only beneficial if the brand owners use them. It remains the trademark owner's responsibility to be proactive in finding and reporting such trademark misappropriation.

It is important to recognize that a trademark owner's rights stop at the borders of the jurisdiction in which it has registered or otherwise established common law trademark rights. However, the worldwide scope of social media creates a significant problem due to the territorial limitations of such rights. A U.S. business with a U.S. trademark may not have any legal recourse to stop a non-U.S. company from using its name. Similarly, the non-U.S. company may be prohibited from having any marketing activities in the United States.

Brand owners wishing to extend their trademark policing efforts to the social media context should work with trademark counsel to identify their company's critical trademarks, as well as probable areas for abuse in social media outlets. It is necessary to determine whether to register domain names, individualized URLs and usernames corresponding to these trademarks and coordinate monitoring efforts to review social networking sites for infringement.

For more information about protecting your brand in the context of social media, contact Kyle Peterson. Kyle can be reached at (612) 252-1554 or peterson@ptslaw.com.

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