

DISTRICT COURT JUDGES' ROUNDTABLE

DELAWARE LAWYER

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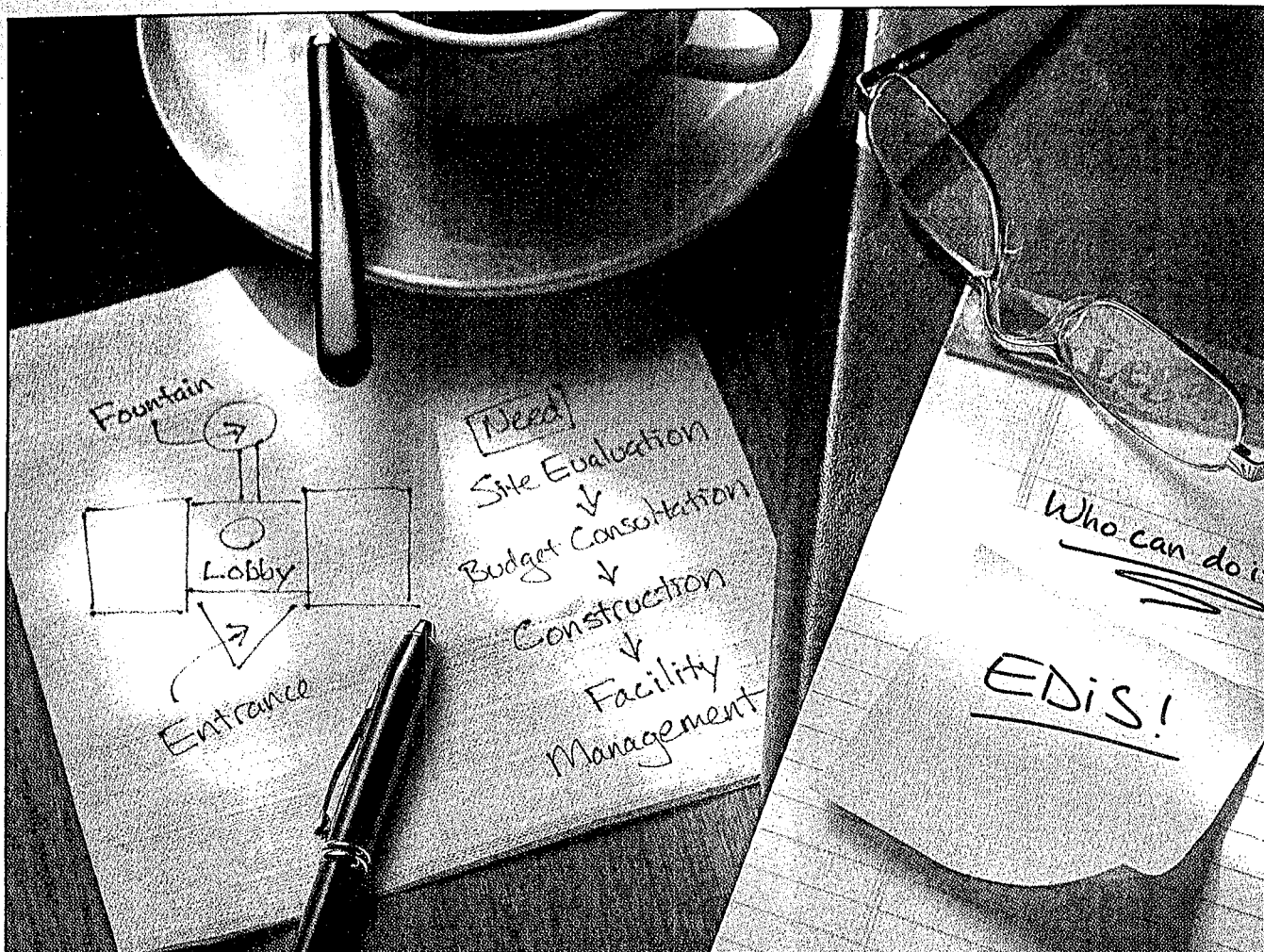
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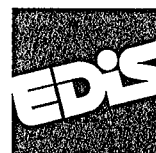
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CONTENTS

FEATURES

6

PATENT LITIGATION
IN THE DISTRICT OF DELAWARE:
THE JUDGES' PERSPECTIVE

16

THE DISTRICT OF DELAWARE:
AN IDEAL VENUE FOR
PATENT LITIGATORS

John E. Kidd

Keeto H. Sabharwal

18

e-BOOM OR e-BUST?
"BUSINESS METHOD" PATENTS AND
THE FUTURE OF DOTCOMMERCE

William J. Marsden, Jr.

J. Andrew Huffman

23

TRADEMARKS IN CYBERSPACE

Thomas C. Grimm

Karen Jacobs Loudon

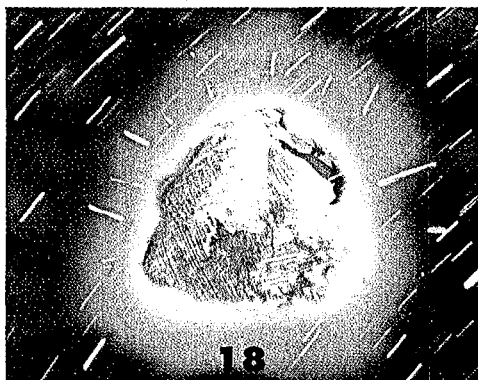
Julia Heaney

30

THE INTERSECTION OF PATENT LAW
AND BANKRUPTCY:
WHAT EVERY PRACTITIONER SHOULD KNOW

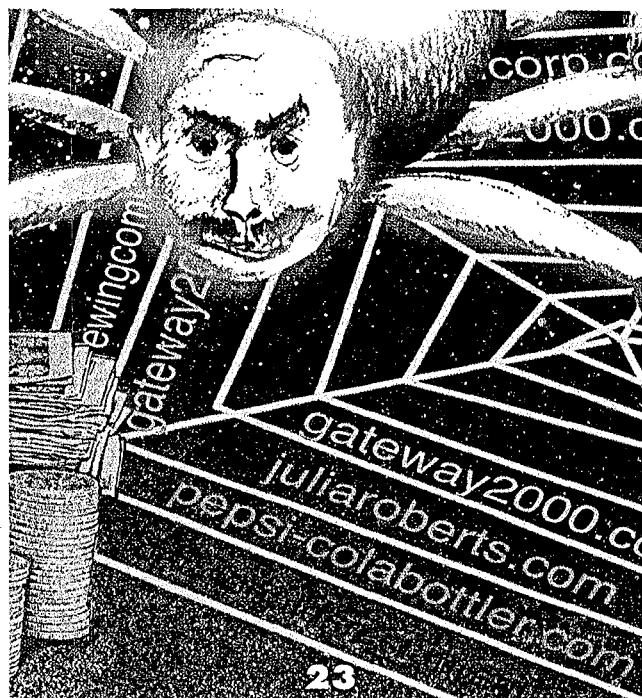
Donald F. Parsons, Jr.

John D. Pirnot



18

The New Gold Rush



23

The Law of Domain Names

EDITOR'S NOTES

2

NOTE FROM THE CHAIR

2

CONTRIBUTORS' PAGE

3

Cover: from left Judge Roderick R. McKelvie,
Judge Joseph J. Farnan, Jr.,
Judge Gregory M. Sleet, Chief Judge Sue L. Robinson

Cover photograph by Luigi Ciuffetelli

EDITOR'S NOTES

In the summer of 1999, the Board of Editors met over dinner to discuss possible topics for future issues of Delaware Lawyer. As an occasional reviewer of books for this magazine who had not attended any of the previous long-range planning meetings, it did not occur to me that by partaking of a free dinner I was putting myself at great risk of being selected as a future Issue Editor. During the brainstorming session, I suggested that the prevalence of patent litigation in the Delaware District Court seemed like a worthy subject for an issue. Someone else suggested that the issue be assigned to me. My lack of experience in patent litigation was no defense. For many months I looked forward to this Winter 2000/2001 issue with dread.

To my surprise, being Issue Editor was an entirely pleasant responsibility. Everyone I called was willing to contribute an article. Every author turned in well-researched, finely-honed submissions, most on subjects I did not know existed. The District Court bench agreed to participate in a unique, on-the-record discussion of patent law litigation — and also agreed to pose for photos with a mousetrap. Judge McKelvie provided helpful logistical support. The issue proceeded on schedule, and I got to take a respite from writing book reviews. I even had time to appeal an administrative ruling by the CLE Commission that a book review is not entitled to CLE credit.

I hope you find the articles as intriguing as I did. We begin with the Judges' roundtable discussion. Its insights are a must-read for all patent law litigators, and for any lawyer who appears before any Court. The focus on Delaware patent law practice then shifts to the outsider-perspective provided by John Kidd and Keeto Sabharwal. The three feature articles on substantive intellectual property law each have a cutting-edge twist. William Marsden and Andrew Huffman analyze the booming business in business method patents. Tom Grimm, Karen Jacobs Loudon and Julie Heaney continue the journey into cyberspace with a look at the law of domain names and metatags. Finally, Don Parsons and J.D. Pirnot take us to the underbelly of patent law, by examining what happens when a high-flying patent holder goes bankrupt. Mercifully, there is no book review. Enjoy.



Joel Friedlander

NOTE FROM THE CHAIR

As the newly-appointed Chair of the Board of Editors of Delaware Lawyer magazine, I am excited to begin my tenure with this, our first issue of the 21st century. (Yes, I am among those purists who maintain that the new millennium begins on January 1, 2001!) To the best of my recollection, it has been over 10 years since we devoted an entire issue to the subject of Intellectual Property. Many of the hot topics addressed in this issue — domain names, metatags, even Markman hearings — have only entered the IP lexicon in the past decade. Joel Friedlander has done a splendid job in assembling this group of timely articles. It is truly an issue no Delaware lawyer should miss.

I will close this Note with a special message of appreciation on behalf of the Board to our outgoing Chair, Bill Wiggin. Bill came "out of retirement" a few years ago to resume his stewardship of the Board of Editors. We are all indebted to him for having done so. We will miss his erudition and sharp editorial skills, as well as his boundless enthusiasm and sly wit. Thank you, Bill, for showing us a level of excellence to which we will continue to aspire!



Karen L. Pascale

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Thomas C. Grimm is a partner at Morris, Nichols, Arsht & Tunnell whose practice is concentrated in the areas of general commercial and intellectual property litigations. Tom has represented predominately corporate clients in diverse areas of litigation, including partnership law, complex commercial disputes and patents and trademarks. Tom received a B.B.A. from the University of Notre Dame in 1977 and a J.D., cum laude, from Villanova University in 1980.

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John E. Kidd is a partner, global leader, in the Intellectual Property and Technology Group at Clifford Chance Rogers & Wells. He graduated with a B.S. in physics from LeMoyne College and received his J.D. from Georgetown University Law School. Mr. Kidd is a former Patent Examiner. After five years as a trial attorney with the US Department of Justice and the US Copyright Office, Mr. Kidd has been in private practice for the last 30 years and has concentrated his practice intellectual property trials. Mr. Kidd is a frequent speaker and author on intellectual property litigation, jury trials, trial strategy and alternative dispute resolution.



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William J. Marsden, Jr. is the managing principal of the Delaware office of the national intellectual property law firm Fish & Richardson P.C. His practice emphasizes intellectual property and trade secret litigation, including extensive jury and bench trial experience in the Delaware federal and state courts. He is the former Chair of the Delaware State Bar Association's Intellectual Property Law Section and was recently recognized by the National Law Journal as one of the Top Ten Litigators in Delaware.



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CORRECTION TO FALL ISSUE 2000

In the Fall 2000 issue, a printer's error resulted in several text flow errors in Richard A. Forsten's article, "Land Use 'Reform' and the Law of Unintended Consequences: Are We Headed Where We Want to Go?"

- On the page jump between pages 5 and 7, text was erroneously deleted. The sentence beginning at the top of page 7 should read: "But, now multiply that result 50 or 100 times over – the end result is that more property must be developed in order to provide the same amount of shopping or office space."
- The last two lines of text on page 7 were erroneously repeated at the top of page 25.
- On the page jump between pages 25 and 26, text was erroneously deleted. The text beginning at the bottom of page 25 and continuing at the top of page 26 should read: "Newer businesses, when faced with the choice of either buying and improving an existing, non-conforming property or buying and improving an undeveloped property will more often opt for the undeveloped land. As a result, more undeveloped land is developed and existing, non-conforming properties are not recycled."
- The last two lines of text on page 26 were erroneously repeated at the top of page 27.

The Board of Editors sincerely regrets these errors. For a corrected reprint of Mr. Forsten's article, please write to: Delaware Lawyer, Attention: Chair, Board of Editors, c/o Today Media, Inc., 3301 Lancaster Pike, Suite 5-C, Wilmington, Delaware 19805.

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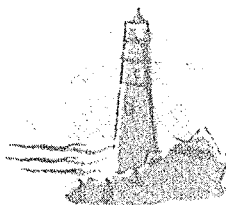


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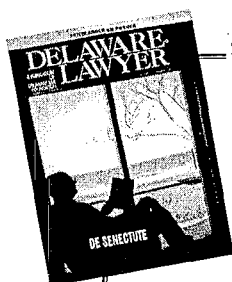
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PATENT LITIGATION IN THE DISTRICT OF DELAWARE: THE JUDGES' PERSPECTIVE

In recent years, the number of intellectual property cases filed in Delaware District Court has increased to the point where each of the district judges now has more than 30 patent cases pending. That is more than twice the number of patent cases per authorized judgeship pending in any other district in the country.

At the request of Delaware Lawyer, Judges Robinson, Farnan, McKelvie, Sleet and Thyng sat down and discussed on the record some of the challenges they face in managing individual patent cases, and the Court's overall patent litigation caseload.

There are at least two aspects of these cases that are relatively unique. First, each patent case involves scientifically complex issues. Almost by definition, the scientific issues in one patent case are different from those found in every other patent case. Each patent case therefore poses an educational challenge to all of the participants — the lawyers, the Judge and the jury. Second, a legal rule has developed in recent years which requires the Court to "construe" the meaning of a patent before the liability issues are submitted to the jury.

The judges have adopted different methods for educating themselves and having the lawyers educate them on the technology behind each patent. They are also experimenting with different approaches on when and how to resolve disputes over the meaning, or construction, of claims in a patent. Much of the discussion that follows focuses on the timing and content of the claim construction hearing (often called Markman hearings because of the name of the case that gave rise to such hearings) and on the oral, written and video submissions (often called tutorials) that aid the Court in the task of claim construction.

Finally, certain patent lawyers will tell you the real reason

why they file here is to get the benefit of Magistrate Judge Thyng's skills in mediating settlements of these cases. In this discussion, she talks about the relationships between these issues and her work as a mediator.

JUDGE McKELVIE: Have you settled into a practice on when you resolve claim construction?

CHIEF JUDGE FARNAN: The practice of deciding claim construction questions, to the extent that it's a practice, is sometime after the close of discovery up until the prayer conference, but very, very rarely before the close of discovery. And in the window from post-discovery to prayer conference, it typically is done in conjunction with the pretrial conference.

JUDGE McKELVIE: You've done some, or at least one recently during a trial; is that right?

CHIEF JUDGE FARNAN: Right.

JUDGE McKELVIE: And how did it happen that you did it during the trial as opposed to —

CHIEF JUDGE FARNAN: Basically the parties requested it. You don't want to become a sword for either side, while at the same time you want to accommodate their ability to litigate fairly. And both sides wanted to know the construction before their experts testified.

In that case, I would have held off on the claim construction until the prayer conference because it was so obvious. It was really a litigation strategy, but since both sides asked for it, I gave it to them by an order during the course of the trial.

JUDGE McKELVIE: I tried it during the trial a couple of times and it just didn't work out well at all for me, so I've pulled back. But I find the best time for me is during the pretrial conference.

CHIEF JUDGE FARNAN: Right.

JUDGE McKELVIE: I've got the pretrial order in. I know what the case is all about. I hold the pretrial conference. I tend to hold it in the morning, then go right to claim construction, and then we go on to argue the summary judgment motions all in one day, if I can do it. And if I can't do it, I roll it into two days. That tends to work out. I find it works out very well for me.

I am getting requests lately asking to do claim constructions earlier in a case. There may be discovery disputes where one party thinks it can knock out a whole theory of the case if I do claim construction. I'm reluctant to do it because it ends up complicating a case, but I'm going to give it a try, see what happens.

CHIEF JUDGE FARNAN: Before the close of discovery?

JUDGE McKELVIE: Before the close of discovery.

I'm doing it in one or two cases right now where a large block of discovery will be relevant only if I adopt a particular construction of a claim.

In the past, I've had a very hard time doing claim construction early. I just don't have enough information about what the patent is all about. Don't know what the defenses are.

CHIEF JUDGE FARNAN: Do you have any method or inquiry that allows you to know before the close of discovery whether or not claim construction will affect the parties' expert witness' opinion? In other words, how you construe a particular term in a claim will actually have a serious impact on an expert's opinion.

JUDGE McKELVIE: This has to do a little bit with people taking alternative theories into trial, an issue I think the Federal Circuit may not appreciate. We want to get the case ready to be tried, and if we resolve claim construction one way, it may blow out certain expert testimony. I encourage the parties to set out alternative theories in with their expert reports on claim construction with the idea that if I adopt the other side's claim construction, their expert has their response to it already built into the report.

CHIEF JUDGE FARNAN: So that's how you avoid knocking out a party's expert case?

JUDGE McKELVIE: Well, I tell them ahead of time they have to be able to deal with the other party's claim construction. If I go that way, they need to know what they're going to do with it. It does not happen too often that people have a backup position, but some-

times people do.

The difficulty is sometimes I will go plaintiff, plaintiff, defendant, defendant, and end up with a mixed claim construction, which neither party may have anticipated, but I don't recall that anybody has asked to re-do expert reports in light of that.

I've had lawyers talk about not doing expert reports until after claim construction is done. But I discourage that. I want the expert reports done. I want to see what they say and what the impact of the claim construction will be on summary judgment and on validity before I do the claim construction.

I am more comfortable when I have it all laid out in front of me and, if I make a particular ruling, I will have a sense from the expert reports, which I ask them to give me as part of the pretrial process, I have a sense of what the practical effect of that claim construction will be. As a consequence, I no longer have to write many opinions on summary judgment on literal infringement. Once the parties have the claim constructions, they then either agree judgment as a matter of law is appropriate on a particular claim construction, or agree that it's not, and preserve the issue for appeal.

CHIEF JUDGE FARNAN: Yes. Also, the reason I asked that question was because there was a lot of thought when *Markman* first issued that it would drive the disposition of cases. I don't think it has. I think people are still capable of carving out a litigation position, and I do a little bit of what Rod does: Give them the opportunity to have an alternative theory. And I find that it still allows them to, to the extent they want, litigate their position, particularly in cases that are hotly contested.

JUDGE McKELVIE: With multiple patents, multiple claims, doctrine of equivalents, usually some theory of liability will survive.

JUDGE ROBINSON: When do you schedule the pretrial conference?

JUDGE SLEET: Mine is at least a couple of weeks.

JUDGE McKELVIE: In my scheduling order that I enter at the very beginning of the case, I schedule the trial a year from the date of the filing of the complaint.

I need about six weeks between the pretrial conference and the trial if I'm going to get out a written opinion on claim construction, which is the way for me to do the best job I can on claim construction: Hold the pretrial and then

write something.

Usually it takes me two to three weeks to get that opinion out and that gives the lawyers two to three weeks to digest it before trial.

JUDGE ROBINSON: So you do all of that after the pretrial, as opposed to issuing your decision and then having a pretrial to see what's left in the case?

JUDGE McKELVIE: Correct.

JUDGE SLEET: As you all might imagine, my position is evolving all the time and I'm trying to learn from all of you, and as well as members of the patent bar as to what they think makes sense. And I've heard now, in at least three — I think three successive cases, I've had a request — and I've acceded to the request — to do claim construction after the close of fact discovery, but before the close of expert discovery, because they've said that they would prefer their experts not to have to opine in the alternative.

This may have to be stricken. I don't know whether I'm walking into a trap or whether this is a good thing.

JUDGE McKELVIE: My sense is that there are good reasons why lawyers and clients would want to do that, and some of them are economic. That is, they incur tremendous expenses with expert reports. There is pressure by certain parties to get claim construction as early as possible. I just find that I'm uncomfortable doing claim construction before I have a sense of what the case is all about. So I've found that while an early decision on claim construction be preferable for the parties, or for the lawyers, or for the experts, it makes life much more difficult for me.

JUDGE SLEET: Because you had no context?

JUDGE McKELVIE: Because I didn't have a context. I don't think there's any requirement that the parties — there's certainly no requirement that they file the expert reports. And I frequently have to ask the parties, give me copies of the expert reports. I want to read them.

But I find it very helpful in understanding what the case is all about to get the expert reports and read them to give me a sense of issues on infringement and validity.

While I can understand why parties would like to have claim construction before the expert reports are in, I've found it — I find it very difficult to do that. Actually, I've also found that it

causes that Whack-A-Mole problem which is, once you do claim construction, people start coming up with new theories and new approaches and —

CHIEF JUDGE FARNAN: It's like motions for partial summary judgment used to be in other kinds of cases. You put out a decision because you're trying to resolve something you think is truly in dispute. And then, for the remainder of the case, all you hear about is, the rule of law in this case is, and then you get a different context or a better understanding or more information that would aid in your decision. By then everyone is pointing you to your claim construction opinion and it restricts your ability to be as even-handed as you may like to be.

JUDGE ROBINSON: I try to get my summary judgment/claim construction decisions done before the pretrial, so that at the pretrial, which is just several weeks before trial, theoretically the parties will have some time to digest the decisions. But even in that setting, I feel as though I should be saying in my summary judgment decisions, for purposes of these proceedings, this is the claim construction, because at trial, there could be other information that, again, the context changes somewhat from summary judgment to trial, and you have a better understanding and it still might change.

I'm not sure when it is written in stone until the prayer conference, but I don't think I have the wherewithal to wait until the prayer conference to do it all.

JUDGE SLEET: You're saying your construction might change?

JUDGE ROBINSON: Well, I don't know. I just hate to say "This is it" when there could be a better context provided somehow or other.

CHIEF JUDGE FARNAN: Well, to my knowledge, there's no Judge on this Court that has a technical background. Most of the lawyers that appear before us, if not all of them, have a technical background.

Our background comes from the lawyers bringing in experts who may be from the same university and in the same department, who will testify that the patent language means different things.

They read the words of the patent and construe them differently, and this is after a lifetime of study, a lifetime of practice, and more and more they are experts who do not have any forensic background. They come purely out of academia.

You wonder why in the world anyone

would expect us as common law judges to be able to give our best judgment of what the patent claims mean at an earlier point in the litigation rather than a later stage.

It seems to me if the experts can disagree about the words, I need as much time as possible to become knowledgeable.

JUDGE McKELVIE: This issue also comes up with motions for preliminary injunctions. Clients ask whether Judges are open to preliminary injunctions. I find I'm very uncomfortable making decisions in the context of a motion for a preliminary injunction both because the information is new to me, and because a defendant is being forced to respond to a complaint before it has had extensive discovery or had an opportunity to develop affirmative defenses on the validity of the patent.

Since the decision by the Federal Circuit in *Vitronics*, I've noticed that lawyers aren't offering expert testimony at claim construction hearings. They're doing more argument on claim construction. They're concerned the Federal Circuit will reverse us if we rely on extrinsic evidence. Are you finding that lawyers aren't asking for hearings on claim construction any more, just argument?

JUDGE ROBINSON: Especially when you roll it into a summary judgment process like I do, it is argument generally, and so it's oral argument on summary judgment and claim construction is part of that process. So in my cases, they don't. I don't have a separate claim construction procedure like some Judges may.

JUDGE McKELVIE: Are you finding people asking for evidentiary hearings?

JUDGE SLEET: Not evidentiary hearings, but they do want to argue, so I have been conducting hearings and listening to —

CHIEF JUDGE FARNAN: They definitely want to argue and I think what has supplanted the evidentiary hearing is the tutorial.

JUDGE McKELVIE: Right.

JUDGE SLEET: It harkens back to what you said earlier about these lawyers having, in many instances, having highly technical backgrounds. They are very capable of articulating, and expounding upon the technology themselves.

JUDGE McKELVIE: I issued a claim construction opinion a week or so ago where we used one or two of the demonstratives from the tutorial in an opinion on claim construction. It demonstrated to me the lawyers' argument, lawyers' presentation can help

illustrate technology so that you can understand it.

CHIEF JUDGE FARNAN: You used a demonstrative from the tutorial?

JUDGE McKELVIE: — in my claim construction. The defendant gave an illustration of what one embodiment of the invention would be, so that the audience could understand what the words might show if you saw a picture.

And I wanted the audience to understand that but I did not adopt it as a matter of evidence. I used it as an illustration. That came from a videotape that I asked for as a tutorial on the technology. I don't know if you ask for videotapes.

JUDGE ROBINSON: We haven't yet.

JUDGE McKELVIE: You tried your tutorial one time.

JUDGE ROBINSON: I've done tutorials periodically, and I've now rolled them into the summary judgment process, because I don't find my discovery disputes require a knowledge of the technology. So it's just an extra trip and extra money in terms of having people come. So it's kind of thrown into the whole mix of summary judgment claim construction, explain the technology.

JUDGE McKELVIE: Do you get that from your arguments, then, claim construction argument, or do you do a tutorial?

JUDGE SLEET: I'm getting it from the claim construction arguments. I've not actually been — only on one occasion I think have I been offered a tutorial. I've not requested it as a matter of course. Maybe I should.

But the lawyers certainly seem to feel comfortable that they're able to educate me, to the extent that I'm educable, by argument on that, and demonstratives.

JUDGE McKELVIE: So what's happening with claim construction and settlement? Everybody said after *Markman* came out that cases would be settled much more quickly after claim construction. Is that happening?

MAGISTRATE THYNGE: Well, most of my mediations occur though before the claim construction actually occurs. I think a couple of things are happening in the mediation process, at least in cases where I meet with counsel and the parties on more than one occasion. When it is very early in the case, they're using me as a guinea pig for the rest of the Judges to get a feel from me regarding their claim construction positions. Counsel and the parties get a read from me as to whether I'm understand-

ing what they're saying and whether it makes any sense.

I also get the tutorial and the videotape frequently. I know of occasions where a videotape is provided and I have asked them questions about it. I guess from my questions, counsel realized that the videotape really wasn't particularly helpful and have revised it before submitting it to you.

So I think they're using me a little bit in the early stages of the process as a way to educate themselves as to how the rest of the Bench or a particular Judge may react.

JUDGE McKELVIE: After claim construction, do parties come back to you to discuss settlement?

MAGISTRATE THYNGE: Depends upon how much time is left before trial, how much time they have and it depends on my schedule.

I try to think ahead. My firm belief is the earlier the mediation the better. Through the initial mediation, I obtain a better understanding of the case and the dynamics of what is occurring with a party, as well as between the parties. That way, if the case does not resolve during the first mediation attempt, which is frequently the case in a patent matter, then the parties have the opportunity to revisit mediation closer to trial and after the claim construction decision. That opportunity may be missed if the first mediation attempt occurs at the end of discovery or after all discovery is completed. Continued mediation after that time period is difficult, in part because of my schedule and counsel trial prep.

JUDGE McKELVIE: Do you get followup comments from the lawyers after settlement so that you can see the impact of a claim construction decision?

MAGISTRATE THYNGE: Sometimes they do, sometimes they don't. Clearly, in a couple of cases I know that claim construction had a direct effect in allowing the parties to settle the case after previously participating in mediation. But there's no consistent pattern that I can say, because I don't have enough feedback to comment upon that. I really don't.

JUDGE ROBINSON: I remember a couple years ago, I remember you, Rod, brought a case to our attention, *Exxon Chemical Patents, Inc. v. Lubrizol Corp.*, [64 F. 3d 1553, 1555 (Fed. Cir. 1995)], where the Federal Circuit specifically said, Judges, you can't just rely on what the lawyers give you as the proper claim construction. You've got to do your own independent review. But I've

found that when you again take those words to heart and don't specifically use the lawyers' proposals word for word, claim construction does not seem to resolve issues.

I've never been informed that it's the claim construction that settles cases or issues.

MAGISTRATE THYNGE: No, it's not.

JUDGE McKELVIE: Do you tell the lawyers what to file on claim construction or do you rely primarily on summary judgment briefing to set the issues? Some Judges ask for claim charts and set a schedule for counsel to follow on settling out claim construction contentions.

JUDGE ROBINSON: I just wait for summary judgment briefing and I have a separate page limitation on claim construction, but I don't tend to dictate what lawyers — how lawyers want to litigate.

JUDGE McKELVIE: Greg?

JUDGE SLEET: But I've had them ask me, Rod.

JUDGE McKELVIE: For the charts?

JUDGE SLEET: For the charts.

MAGISTRATE THYNGE: I get charts all the time in mediation.

JUDGE SLEET: They want to do charts, and it seems helpful to know what the disputed terms are.

JUDGE ROBINSON: It would be easy, I suppose, to get a chart, the two charts, to not write anything long like I tend to, and just check the best option.

JUDGE SLEET: I've taken to, and tried to accommodate this process of after close of fact discovery before expert reports to writing an order. Not a lot of analysis. This means this, this means that. It does not mean that some analysis hasn't gone into it, but I'm not putting it down necessarily on paper.

JUDGE McKELVIE: You do that during the trial? You need to because you don't have time to write an opinion.

CHIEF JUDGE FARNAN: Right.

JUDGE SLEET: I've asked lawyers. I said, Do you care? Do you care how I opine on a particular subject? They say, Not really, Judge. We just want to know.

JUDGE McKELVIE: The bottom line on the claim construction?

JUDGE SLEET: Yes.

JUDGE McKELVIE: I find the most helpful thing for me on claim construction is a file wrapper, to just sit down and read it from beginning to end, because that will, more often than not, help me understand the technology and resolve the disputes, at least give me a

comfortable feeling that I understand the context for the dispute.

So I don't ask for briefing. I don't ask for claim construction charts. I don't look to the summary judgment briefing to resolve claim construction. As a matter of fact, the longer I'm on the bench, the more I see summary judgment briefing as a dialogue between lawyers.

JUDGE ROBINSON: Or ships passing in the night.

JUDGE McKELVIE: Yes. Frequently ships passing in the night, but it's really one client talking to another. And if I find there's information in there that causes me to believe I need to take some action, I will. But, more often than not, I will read the briefing, put it aside and keep the case on track to a trial.

JUDGE SLEET: So you simply ask them for the file wrapper?

JUDGE McKELVIE: I ask them to give me the expert reports and the file wrapper. I read those. I ask them to see if they can agree on a structure before the Markman hearing, so that we can talk about who's going to present what, how much time is it going to be, and what their positions are going to be. Usually the lawyers will agree, which says to me the lawyers aren't asking us to adopt something like the local rules they have in California, where it gives a time frame and structure for claim construction.

JUDGE ROBINSON: You just said the Markman proceeding. You're still talking about this pretrial proceeding?

JUDGE McKELVIE: I see it as a part of the trial. I look at claim construction as determining what the jury instruction is going to be. It's an evidentiary matter where I resolve disputes for the purpose of instructing the jury on the meaning of the claim.

JUDGE SLEET: That's your view, isn't it?

CHIEF JUDGE FARNAN: That is. I don't know if the Federal Circuit thinks that, but I think there are evidentiary considerations. I think we have to be careful and remain within the principles enunciated by the Federal Circuit while at the same time getting as much information as we can to try and give our best judgment on what a term means.

But I believe most Judges would probably think that there is a weighing required of the evidentiary considerations presented by parties in a claim construction dispute.

JUDGE ROBINSON: So basically what you all are saying is that the focus should be the trial, and summary judg-

ment shouldn't be the main focus. Summary judgment may or may not be appropriate after the claim construction, but that's not really your focus at that point. It's just secondary.

JUDGE McKELVIE: I read the briefing — for example, on a motion for summary judgment on literal infringement. But I won't feel compelled to write a decision on it one way or the other. And as we actually work in chambers on opinions, we'll talk about whether, in resolving a claim construction opinion, we also need to write a summary judgment opinion.

And I will frequently say, Why don't we just do claim construction and we'll see what the parties say. More often than not, we don't have to write a summary judgment decision on literal infringement because once claim construction is out there, the parties say, all right, we'll take it, and we'll preserve our position for appeal.

It may save time and energy to issue a claim construction opinion and see if the parties agree it's resolved.

CHIEF JUDGE FARNAN: What percentage of patent cases have you found are amenable to summary judgment?

JUDGE McKELVIE: I've done it in a couple of cases. But if I look back on the cases, I think I've done it more often as JMOL, after trial. And what that tells me is at that point I'm very comfortable about what the case is about, because I've heard the evidence at trial and it's a situation where I just think the jury has made a mistake and I have to take the issue away from the jury. That's a long and expensive process to get me there, but I'm much more comfortable with it after I've heard the evidence, got the transcript, read the briefing and sat and looked at it quietly in chambers.

Before trial on summary judgment, I am not as comfortable with what's going on in the case.

CHIEF JUDGE FARNAN: So I think we all agree that the percentage of cases is very small in which you would grant summary judgment, particularly before trial.

Knowing that and apparently not being able to convince lawyers not to file those motions, probably means, as Rod has said, that there's conversation going on in the papers, which is helpful, but we should never feel compelled to act prematurely, because what the process may have become is an information vehicle for the Court.

JUDGE McKELVIE: You've just

done a lot more work.

CHIEF JUDGE FARNAN: That's the legacy instinct. Lawyers prepare these voluminous, intelligent set of papers, and we feel we must respond to them.

But what we should remember is that we are decision-makers attempting to move the case toward a fair disposition.

When you read some summary judgment opinions, they do nothing more than regurgitate everything that's been written by the attorneys. The Judge doesn't provide any independent analysis of the issues. They decide the issues as presented, which is an advocacy presentation of the issues, and then they give them an answer, which generally is: Application denied.

JUDGE McKELVIE: I don't see much point in writing an opinion denying summary judgment.

JUDGE SLEET: You just issue an order?

JUDGE McKELVIE: At the pretrial conference counsel ask about the pending motions for summary judgment and I say, I've read the briefing and I'm going to deny the motions.

I do think it is helpful to push a little bit on when defendants go to trial with nine theories of defense. They just go through the Code and list everything they can come up with. I've told lawyers, I don't think it helps them at the trial with a jury or a judge to bring all their cats and dogs in front of the jury. I do think it's a good idea to put some pressure on the lawyers to pick and choose the defenses they really have, and talk about it in the context of judgment as a matter of law as we get up to trial.

A similar issue, is plaintiffs are taking advantage of our forcing the case to trial, piling in a number of patents and a number of claims and trying to make life way too complicated for a defendant. So I'm forcing plaintiffs to narrow the case that gets to trial.

It's not necessarily a summary judgment issue, but it is a trial management issue, where I think we should step in and tell a plaintiff I am not going to let you take five patents and eighteen claims to the jury.

JUDGE SLEET: How are you doing that?

JUDGE McKELVIE: Just announcing to the lawyers early on, You'd better look and see what you want to take to trial. Reach some agreement on how we can do it procedurally, taking certain patents and putting them aside, dropping certain claims. Both parties will

want to respond to that. A plaintiff isn't going to want multiple trials anyway, so counsel will end up picking a couple of claims that they may think are their best claims. They may do it after claim construction.

CHIEF JUDGE FARNAN: They may single out just certain products of the defendant.

JUDGE McKELVIE: Correct.

JUDGE SLEET: You might tell them you've got two patents. I'm going to let you try two patents to this jury?

JUDGE McKELVIE: We also do it another way, which is to say, you've got 20 hours or 22 hours to put your case on.

JUDGE SLEET: I do that.

JUDGE ROBINSON: I think we all do that.

JUDGE McKELVIE: But we need to be careful as that can put a lot of pressure to defendant, as a plaintiff may try to go to trial on multiple patents and claims. I will take my 22 and put in six patents.

JUDGE SLEET: That's a good point.

MAGISTRATE THYNGE: I don't think personally claim construction decisions necessarily cause a case to settle. There's a lot of other outside forces that influence where parties are, where they are before you go to the pretrial.

I do think, though, that they use it in the initial phase of the case, in the initial mediation process, as kind of an excuse or kind of a concern that we don't have this information, so are we selling ourselves short. I don't believe that. I truly don't believe that. I think they've got a pretty good idea by the time they sit down in a mediation conference with me and in light of what they provide me in submissions, both sides have got a pretty good idea of what a patent means and what the language means and what they do and don't have with their experts.

Maybe they don't have their experts completely on board and they don't have all the discovery complete and the discovery that they frequently harp on at the time of the mediation is, we don't have the economic information.

That's even before they've completed the fact discovery.

CHIEF JUDGE FARNAN: You had some lawyers in mediation and they called me up while they were in your mediation, and I think they wanted you not to know they had called me. And they said, Judge, this summary judgment — the summary judgment motion is pending. You know, if we had a decision.

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And I said, I've read the papers, but I don't want to give you a decision. If you want to come down, I will give you a tentative decision which I'm not bound to. Then you can bring that information to your client and let your client know that we talked to the Judge and this is what he's thinking about doing.

MAGISTRATE THYNGE: Advantage.

CHIEF JUDGE FARNAN: Really what the client wanted to do was — well, if I could win that, but if I can't, if the Judge is not going to give me that ruling, I don't want to go forward. I just want to get out of this litigation and move on.

MAGISTRATE THYNGE: Oh, absolutely. And I have found more and more that the attorneys seem to try to protect the client from me or from the mediation process. And whether that's intentional or not, I can't say, because how they view their responsibilities being the advocate for the client.

CHIEF JUDGE FARNAN: Right.

MAGISTRATE THYNGE: I've found, though, that the principals frequently are chomping at the bit to talk to one another face to face, because they want to get to the economic issues and how they, too, as competitors are going to fit into a market. And they've got plans not just on this — relying upon this case for decision on what's going to happen to their businesses, they've got a five- or ten-year plan that they're thinking about. This case plays a part into it and how much it may be interfering with that or how much it's just a thorn in their side.

JUDGE SLEET: We're not informed about a lot of that which you are talking about, about the business issues. We don't have that context.

CHIEF JUDGE FARNAN: No.

MAGISTRATE THYNGE: I emphasize more the business issues, because realistically, if they're looking for me to do a claim construction or make a decision based on their submissions of 20 pages plus, and I will get six inches of attachments sometimes in a patent case, and expect me to read it and then be able to just off the cuff give an opinion, I'm not going to do that.

JUDGE SLEET: Sometimes it's a lever within negotiation. You just don't know quite often.

MAGISTRATE THYNGE: It is.

CHIEF JUDGE FARNAN: Let me ask this question. In the article that appeared recently about bankruptcy, they talked about Houston developing some rules and actually developing in their

court a panel of judges who will handle Chapter 11's, kind of an expert group of judges. I'm not sure whether that was an opt-out or that was an assignment situation, but they now have selected judges that the Bar apparently is comfortable with doing mega Chapter 11's.

In our District, we have a substantial number of intellectual property filings, and I think, Rod, your sense is that it's as high as anywhere else or at least co-equal.

JUDGE McKELVIE: Percentage-wise.

CHIEF JUDGE FARNAN: Percentage-wise.

JUDGE McKELVIE: That's right.

CHIEF JUDGE FARNAN: In Houston one of the judges accused his colleagues of self-promotion and pandering to the Bar to get the work. He thought the Court was too cozy with the Bar.

When I came on the bench, patent cases had been filed since Judge Wright was on the bench.

Do any of you think that because of our Intellectual Property Advisory Committee activities that we're perceived as being engaged in self-promotion and pandering to the Bar, or the business community? Is that a topic for this discussion?

JUDGE McKELVIE: Yes. One issue would be, do we have a reputation of favoring one side, which would have to be the plaintiffs in patent infringement cases, which would have to be more often than not the patent owners?

I don't get any sense of that at all. I think early on, with the jury trials, early on during the period when people were trying cases to juries, the statistics tended to show that patent owners would, more often than not, be successful in front of a jury, but I think that's actually evened up now in front of juries. I don't think I've heard anybody say we're pro-patent or anti-patent in this court.

If it's a question of our relations to the Bar, I don't know what we would do different to pander to them. I think people know that we like — that we believe in prompt trials here, and that we tell lawyers that we find the cases interesting and enjoy doing them. But I don't know that I've actually heard any criticism of our Court for doing anything improper.

JUDGE SLEET: I have not been around long enough to hear any criticism, but in the short time I certainly have not heard any. You asked could we be accused. Sure. Could be, for no other reason than because of the Advisory Committee. Are you talking about the dinner? The annual meeting?

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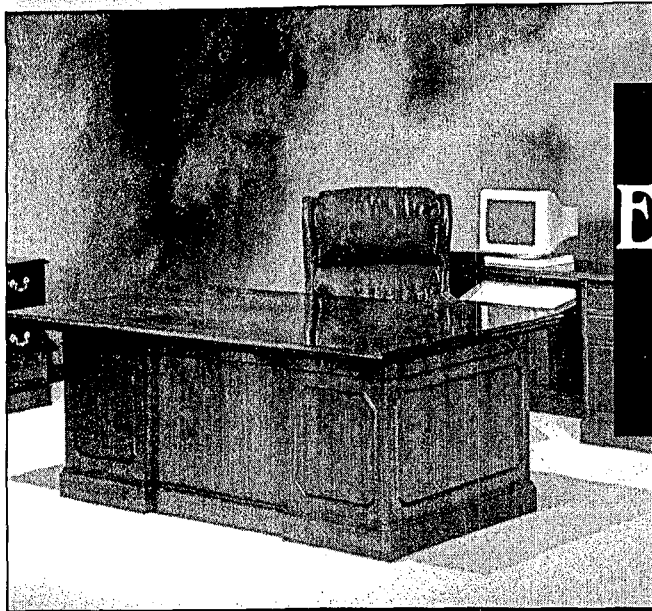


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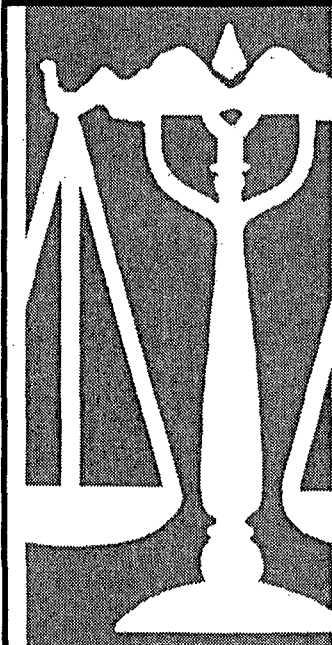
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CHIEF JUDGE FARNAN: Yes. And the whole idea of having an Advisory Committee for Intellectual Property while we don't have advisory committees, for example, for civil rights cases.

JUDGE SLEET: Right.

CHIEF JUDGE FARNAN: We don't have advisory committees for motor vehicle diversity cases. We don't have an advisory committee for criminal cases. So you all know, among our colleagues outside the District there's been criticism of the court both in the bankruptcy and in the patent area.

MAGISTRATE THYNGE: The only thing I've heard is that we're getting the cases because there's an expertise here, to some extent. There's not an expertise necessarily technical, but we've had enough familiarity with patent cases — it's a comfort level. I joked at one time that, based upon the referrals I was getting from the Judges for purposes of mediation, I was really wondering if there were any other cases being filed in this District besides patent and job discrimination.

So the numbers to me, from what comes through to me for the mediation purposes are two areas, job discrimination and patent litigation.

JUDGE McKELVIE: I like patent cases. I'm actually happy that the number of cases being filed is up.

CHIEF JUDGE FARNAN: It's interesting work.

MAGISTRATE THYNGE: But that could be true in almost any case you have, whether you're talking about securities, job discrimination —

JUDGE McKELVIE: I'm seeing it with the Chapter 11 cases now. They're very interesting and a lot of fun, but they're taking up a lot of time.

JUDGE SLEET: Joe, I heard you mention, I think some time ago, in a conversation, maybe at a Judges' meeting, one of the reasons you thought we were getting the filings was because the District Judges themselves are handling all phases of the cases.

JUDGE FARNAN: My personal view is that there is no one Judge in this District that is promoting either the District or their courtroom. I think the cases are filed here because lawyers and their clients are interested in predictability, and they feel comfortable with how we handle their cases.

I think that the Judges in the District work as hard on other kinds of cases as we do on the patent cases. And it just happens that the venue creates a lot more patent cases than in other districts.

Also lawyers feel more comfortable with judges who are comfortable in the patent area.

MAGISTRATE THYNGE: I can say one thing, too. You're talking about the pandering and the attention given, at least from the mediation end. It wasn't a patent case that I ended up having nine separate meetings in to get a case resolved; it was a property damage case. And —

JUDGE SLEET: Which one might that be?

MAGISTRATE THYNGE: I think you can think of which one it is, Greg, with no problem.

Well, the other thing is, too, at least from the standpoint of hands on, and I have a very hands-on approach with mediation. I don't care whether the case is a patent case, a job discrimination case, a property damage or personal injury case. If, as a result of the first meeting that we have for the mediation process, the matter does not resolve, those parties aren't walking away with the idea that now we'll just continue on the litigation track. I keep in contact with them, whether it's through teleconferences with counsel or teleconferences with the principals.

Personal injury cases, that's a little difficult to do, or job discrimination cases,

it's difficult to do. But you keep in contact with them to find out where they are in the litigation, how that litigation is going to influence their ability to resolve the case, what changes may have happened within the companies, or within the client's perspective about settlement.

And that type of follow-up is done whether it's patent or job discrimination. In fact, to be honest with you, there's probably more telephone time that I have with counsel on job discrimination cases than there are with patent cases, because you're following up on what proposals are out there and what will work with the client or where the client, the individual client is at, how their life is changed and how that change may have influenced their perspective of what a company offered in settling a case on job discrimination. Either they're tired of litigation or it's taken more out of them.

JUDGE SLEET: Part of the predictability — it comes from individual cases, and what I was referring to when I mentioned your comment earlier, Joe, I thought what you were saying was the litigants like the fact that they get to deal directly with the District Judges presiding over the case.

CHIEF JUDGE FARNAN: That's

certainly part of it.

JUDGE SLEET: And they can get some sense of predictability. Rather than — we only have one Magistrate Judge, and she obviously couldn't — even if we wanted to, there's no way that she should be burdened with a lot of the pretrial and case management aspects of our patent cases. So litigants, the parties, deal directly with the Presiding Judge on these important issues. I think that helps them in terms of their predictability, helps them in terms of managing their budgets and their cases.

MAGISTRATE THYNGE: I agree with you, Greg, although I have to admit I love some of the discovery disputes in patent cases. I find them very interesting and enjoyable.

JUDGE SLEET: You've helped me a couple of times.

MAGISTRATE THYNGE: Clearly, with summary judgment motions involving claim construction, one side will be dissatisfied with any decision I would render, so they just have another bite at the apple which, due to the time constraints of counsel and the Court and the expense, doesn't make any sense.

CHIEF JUDGE FARNAN: All right. ♦

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THE DISTRICT OF DELAWARE: AN IDEAL VENUE FOR PATENT LITIGATORS

We have a confession — we like litigating patent cases in Delaware.

“Why Delaware?” you may ask.

The answer is simple: the Delaware District Court is one of the nation’s premier trial courts for the resolution of major patent disputes. Its jurists are among the most knowledgeable and experienced in patent matters. Best of all, they appear to enjoy adjudicating these cases.

Let’s be honest. Patent cases can be exceptionally trying for judges and juries. The fact issues are often extremely complicated and very technical. The trier of

fact has to grapple with scientific terms with an obscene number of syllables and hyphens (such as 1-1-di-chloro-1-fluoroethane), convoluted and confusing claim language (“providing an aqueous polishing composition ... wherein the salt is the reaction product of a reaction selected from the group consisting of a reaction between an acid and a base and a reaction between an acid and a metal, wherein the salt includes a cationic component and an anionic component”), and technology that no one except the inventor or a Ph.D. in the relevant field understands. Even before attempting to decipher the meaning of the patent claims, judges must wade through the often lengthy prosecution history of the patent(s) at issue before the United States Patent and Trademark Office. That paperwork can contain a maze of divisional, continuation and continuation-in-part patent applications, each filled with a seemingly endless string of anticipation, obviousness and/or indefiniteness rejections, amendments and appeals. And if that weren’t enough, the patent and patent history must then be analyzed within the unique terminology of

patent law, such as “literal infringement,” “doctrine of equivalents,” “anticipation,” “obviousness,” “double patenting,” “prosecution history estoppel,” and “claim construction.”

A typical patent case involves a series of motions that require the Judge to master the intricate case-specific facts. The Judge must also decide how best to manage the trial so that the jury can receive an instant education on these same issues. Patent law cases have sometimes been considered unsuitable for trial by jury.

But fear not, patent-law comrades. The Delaware District Court provides the intellectual property haven that we covet. Not only do the judges have a strong command of patent procedures and terminology, but they have also manifested a willingness to continually innovate and to ensure that their cases are handled fairly and efficiently.

Consider this: the number of patent cases being filed in Delaware has grown substantially. In the early to mid-1990s, there were approximately 80 pending IP cases in the Delaware District Court. In 1998, nearly 100 patent cases were filed in Delaware District Court which represented about 10 percent of its docket. By the end of 1999, there were more than 150 intellectual property cases on the Delaware District Court docket and the majority were patent infringement cases. This high volume of patent cases has enabled the judges in the district to understand and expand upon the nuances of patent litigation. These judges have promulgated a large, extremely influential body of law which addresses nearly every facet of patent litigation. The decisions from these patent cases have been relied upon by federal courts throughout the nation, including the appellate courts. In fact, Delaware District Court cases appealed to the Federal Circuit appear to be affirmed more often than the average for all patent appeals to that court.

The Delaware Judges have also taken an extremely progressive and pragmatic approach to adjudicating patent cases. Among other things, the Court examines ways to make patent trials more efficient and comprehensible to a lay jury. For example, the Delaware District Court generally limits patent trials to two weeks in an effort to encourage counsel to utilize their time efficiently and mitigate the hardship on jurors who are forced to leave their jobs.

Judge Roderick McKelvie, a well-known patent jurist, encourages counsel to use "transition statements" to introduce evidence and put it in context in order to enhance juror understanding. Judge McKelvie has also eliminated sidebars during jury trials and requires that such issues be addressed either at the beginning or the end of the trial day, a technique that maximizes time with the jury.

In an effort to prevent overly expansive expert testimony that may usurp the jury and judge's roles, Judge Sue L. Robinson issued guidelines regarding the testimony of patent law experts. Judge Robinson as well as the other Delaware judges restrict the scope of patent law expert testimony to practice and procedure in the Patent and Trademark Office rather than legal issues and conclusions.

Another example of the Delaware District Court's progressive litigation approach is its formidable mediation program. Magistrate Judge Mary Pat Thyne, who is formally trained in mediation techniques, has implemented several effective mediation procedures, including the preparation of detailed, confidential mediation statements, which have facilitated the resolution of patent disputes without recourse to an lengthy and often expensive patent litigation trial. In fact, nearly all patent cases filed in Delaware are referred to Judge Thyne.

The Delaware Judges are also eager to receive feedback from practitioners. Twice a year, an Advisory Committee comprised of judges and outside and in-house counsel meets to discuss how the Court can try patent and other intellectual property cases more efficiently. The Advisory Committee has also adopted a uniform set of jury instructions, which are made available to counsel and are used in virtually every

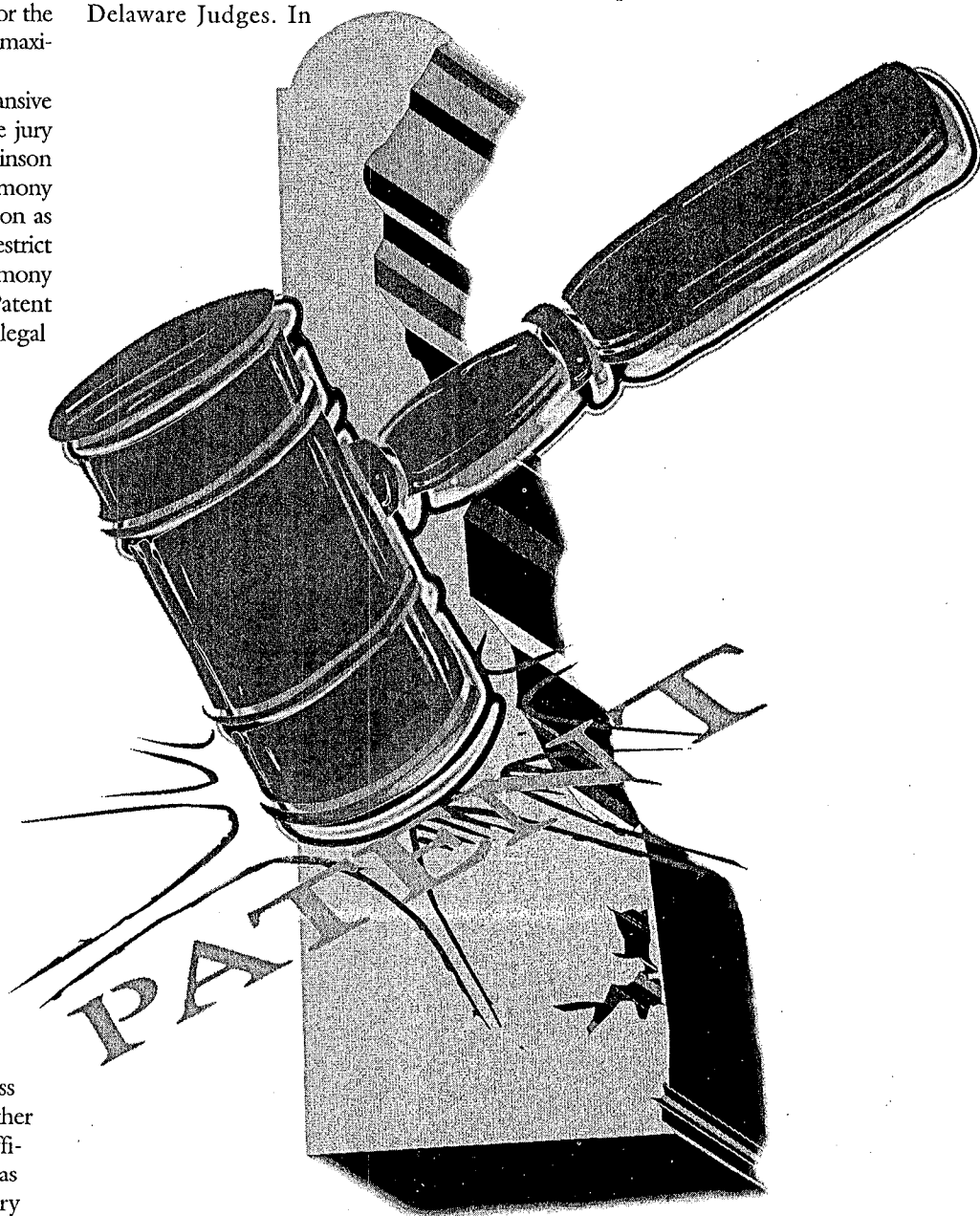
patent jury trial in Delaware.

The experience with, and considerable knowledge of, patents and patent law also extends to the Delaware practitioners. Wilmington has a surprisingly large number of intellectual property specialists. Their assistance is invaluable when trying a patent case.

In some jurisdictions, local counsel is nothing more than a "drop box" for pleadings. Not so in Delaware. The local practitioners understand the substantive and procedural aspects of patent law. More importantly, because the Delaware bar is small, many of these lawyers appear often in District Court. They can serve as a tremendous resource for understanding the temperament, whims, likes and dislikes of the Delaware Judges. In

short, the Delaware lawyers understand patent law, they know their judges, and their advice is important when litigating in this jurisdiction.

One trend to keep in mind: Delaware is understandably becoming an increasingly popular venue for filing patent lawsuits and its popularity shows no signs of abatement. In fact, Delaware was recently cited as the 9th most popular venue out of 92 venues for litigating patent disputes. As a result, the Delaware docket is becoming increasingly crowded. Accordingly, the judges may become less inclined to defer to plaintiffs who elect to file their disputes in Delaware. Even so, Delaware remains an ideal venue for companies and lawyers seeking to litigate patent disputes. ♦



William J. Marsden, Jr.
J. Andrew Huffman

e-BOOM OR e-BUST? "BUSINESS METHOD" PATENTS AND THE FUTURE OF DOTCOMMERCE



The Great Gold Rush of '99

he metaphors are now ubiquitous. "I tell you, it's a gold rush," says Joe Zier of KPMG.¹ The National Law Journal publishes a similar diagnosis: "*State Street Bank* ... has given birth to the greatest land rush the U.S. Patent and Trademark Office [PTO] has ever known."² Publisher and patent policy gadfly Tim O'Reilly likewise calls the phenomenon "a land grab."³

What the commentators are talking about is the great surge in popularity of software- and Internet-related patents, particularly the so-called "business method" patents which the textbooks said were unpatentable until 1998, when the U.S. Court of Appeals for the Federal Circuit — the national appellate court for patent law cases — decided *State Street Bank v. Signature Financial Group*.⁴ To be sure, a liberalizing trend in the range of "statutory subject matter" — i.e., what can properly be patented — had been apparent for years in the development of Federal Circuit case law. But with *State Street*, the gold rush prospecting seemed to begin in earnest. How did this happen? What does it mean to law and business? Where are we headed? This article seeks to shed some light on these questions, even if they cannot all be answered definitively.

"Any New and Useful Process ..."

The patent laws enacted by Congress under the express authority of Article I, Section 8 of the Constitution provide that "[w]hosoever invents or discovers any new and useful process, machine, manufacture, or composition of matter, or any new and useful improvement thereof, may obtain a patent therefor, subject to the conditions and requirements of this title."⁵ Historically, the apparent breadth of this statute has been tempered by judicially recognized exclusions. For example, abstract ideas, laws of nature, naturally occurring phenomena, natural forces, principles, mere chemical formulas, systems

of bookkeeping, fundamental truths, original causes, motives, printed matter, mathematical algorithms, and business methods are some of the categories that the courts traditionally considered beyond the proper scope of the patent laws.

Classically, computer software unassociated with physical elements or process steps fell outside the scope of the patent statute because it was considered either the implementation of a mathematical algorithm, or a business method, or both. The PTO dutifully tried to enforce this understanding by rejecting patent applications it thought were primarily directed to software. But as the world's computer-dependent economies grew even more so, the considerable wealth at stake in software-related innovation finally earned this art a seat at the table.

A harbinger that the floodgates were about to open was the "Harvard mouse" biotechnology case decided by the Supreme Court two decades ago. With sweeping language the Court declared that the patent laws are designed to protect "anything under the sun that is made by man."⁶ This decision fueled a continually broadening concept of statutory subject matter in several technical arts, including the field of software. One of the early software cases in this trend was a decision from our own U.S. District Court for the District of Delaware, holding that a computerized system of cash management was patentable under 35 U.S.C. § 101.⁹ Albeit with some ambiguity, the case law continued developing in this area until the Federal Circuit's milestone *In re Alappat* opinion finally expressly permitted the patenting of software as long as the patent claimed something more than an abstract idea.¹⁰ The same year, that court's *In re Lowry* opinion held broadly that data structures encoded in computer memory constituted patentable subject matter.¹¹ In the wake of these decisions, the PTO at last relented from its stance against software patenting and issued new guidelines for examining computer-related inventions.¹²

Business Method Patents Come of Age

Despite these significant legal shifts, the inertia of business as

usual kept much of the focus of patent law on the "machines" and "manufactures" invented in the country's old standby, industrial base sorts of companies. Hardware still ruled the marketplace, and consequently the docket of new patent applications as well. Software leader Microsoft owned only five patents in 1990.¹³ Very few financial institutions owned patents during the early 1990's, and "new economy" companies were, well, new.

When the State Street Bank in Boston began charting an ambitious course to dominate information-age banking by leveraging its vast store of information through aggressive investment in technology (more than a third of its 17,000+ employees now work directly in information technology),¹⁴ it ran into Signature Financial's U.S. Patent No. 5,193,056. The '056 patent disclosed and claimed a general purpose computer executing a "hub and spoke" financial management program to determine the proportionate share held by each of several funds in a common investment portfolio, to track daily activity affecting the portfolio's assets, and to allocate fluctuations in the portfolio value to each of the member funds. At the trial court, State Street won a motion for summary judgment that the '056 patent was invalid for a failure to claim statutory subject matter. Specifically, the district court held that the patent improperly attempted to claim an unpatentable mathematical algorithm or method of doing business.¹⁵

The Federal Circuit reversed the district court's judgment in an opinion written by the late Judge Giles Rich, holding that the claimed "transformation of data ... constitutes a practical application of a mathematical algorithm, formula, or calculation, because it produces a useful, concrete and tangible result — a final share price momentarily fixed for recording and reporting purposes and even accepted and relied upon by regulatory authorities and in subsequent trades."¹⁶ Even more significant was the Federal Circuit's decision to "take this opportunity to lay this ill-conceived [business method] exception to rest."¹⁷ Thus, the exclusion of business methods from the range of patentable subject matter was officially revoked, and the courts' previous indications that computer software inventions required some "physicality" connection to be patentable were downplayed. Subsequent decisions, including an appeal in a Delaware case,¹⁸ followed suit, cementing the reality that a pure method of doing business can now constitute patentable subject matter.

The Internet Explosion

Although Signature Financial's patent was not explicitly related to the Internet, the Federal Circuit's *State Street* decision and its progeny happened to coincide with the explosion of the new Internet "e-conomy," and consequently earned heightened attention by the entire patent bar, new Internet startup companies, the media, investors, and the marketplace at large. Suddenly it appeared both legal and sensible for a company to invest in patent protection not only for its specific technological innovations, but for core elements of its underlying business model.

It has been appropriately observed that "e-commerce patents can hit the bottom line more directly" because now they can be written with "platform independence" — a closer connection to the actual conduct of a company's business than to whatever technical tools happen to be used today for implementing that business.¹⁹ In an environment of constant technological evolution and ever-changing infrastructure, the feature of platform independence can help prevent a patent from becoming obsolete by the time the PTO prints it. That is the positive side of business method patentability: a company can preserve its competitive edge and protect the essence of its real innovations even while, *e.g.*, Linux vies with Windows for operating system acceptance, or twisted pair, coaxial cable, fiber optics, wireless, and satellite all jockey to win the contest for favorite data pipeline.

Microsoft now has over 1,350 issued patents, and hundreds of other software companies are following similarly aggressive patenting strategies.²⁰ The total number of software patents issued during the 1990s is estimated at 40,000 to 80,000 (depending in part on how the genre is defined), with an estimated 20,000 issued in 1999 alone.²¹ Business method patents issued so far include patents for Priceline.com's reverse auction business model, Amazon.com's one-click shopping, methods of presenting charges for electronic payment, affiliate marketing methods, frequent-user incentives for Internet usage, Internet advertising, and more. Jay Walker has founded Walker Digital with the express business aim of simply securing, licensing, and otherwise exploiting patents. Former cellular phone maker Qualcomm gave up its manufacturing operations to focus instead on licensing its communications technology patents to other manufacturers, and saw its stock value skyrocket. Allan Konrad

has sued dozens of corporate giants on a patent allegedly related to remote database access (all Internet access?). Other companies that have leapt into the fray include IBM (one of the early exploiters of software patenting), Geoworks (with a patent said to cover any wireless device providing WAP-compliant Internet access), Sightsound.com (which claims rights to all music downloading on the Internet), Juno and 24/7 Media (with web advertising patents), Coolsavings.com (electronic coupons and rebates), and even British Telecom (which has unearthed a 1980s patent of its own that purportedly covers the Internet hyperlink).

The Value of a Good Patent

The feature of platform independence has the obvious benefit of securing a broader property right to the owner of the carefully crafted patent. As long as the patent applicant does not overreach by seeking claims so broad that they ultimately render the patent invalid in view of the prior art,²² it can pursue broader and stronger patent rights under the new paradigm of business method patenting than it would previously have expected. Such a patenting strategy can provide several important business benefits.

The first realm of patent value is "offensive" — *i.e.*, the right to affirmatively enforce a patent against infringers. Many times an accused infringer will capitulate without the need for expensive litigation and accept a license under the patent, paying the patent owner royalties or other concessions for the right to practice the patented invention. In other cases the accused infringer is unwilling to pay-for a license or stop the alleged infringement, and litigation is required to enforce the patent. A patent owner who successfully asserts its patent in federal court is nearly always entitled to a permanent injunction to keep the infringer from continuing to infringe, and can also be entitled to substantial damages to compensate for the economic harm of past infringement. These damages can include direct lost profits, lost profits due to price erosion, and other provable compensatory damages, "but in no event less than a reasonable royalty."²³ In addition, if the infringement is proven to be willful, the court may treble the compensatory damages and may award attorney fees to the patent owner.

A second area of patent value may be less obvious than the first. Besides the

potential for direct economic and competitive benefit from affirmatively enforcing a patent, a company may wish to own patents for "defensive" reasons. Although a patent does not in and of itself convey the right to freely practice an invention (it conveys the right to exclude others from practicing it), it can have a useful deterrent effect. If a competitor is considering asserting some of its patents against you, it may think twice about doing so when it sees that you have a respectable intellectual property arsenal of your own. One potential result is that the competitor will simply leave you alone; another is that it may approach you in a threatening way, only to back down after the counter-threat becomes clear. The latter case often results in cross-licenses of both parties' patents. The benefits of an intelligent defensive patent strategy may never be perfectly measurable, but, like an insurance policy, the risk-benefit balance can be well worth the necessary investment.

A third way patents can be valuable to their owners is in the financial markets. This aspect of patent value is somewhat related to both of the previous aspects, yet significant enough to be mentioned in its own right. Potential investors generally are much more comfortable funding a "great idea" when there are assurances that the idea can be legally protected from possible johnny-come-lately competitors. A company's stock valuation can fluctuate dramatically in sympathy with either good or bad intellectual property news. Too often, unfortunately, investors become so obsessed with the mere idea of patent protection that the sheer number of patents a company owns, as opposed to a rational assessment of each patent's legitimate strength and breadth, carries the day.

An entire cottage industry has sprung up to consult on and attempt to quantify questions of patent valuation, but in general terms the value of a patent portfolio will be measured simply by assessing the

above three aspects of patent value as thoroughly as reasonably available information permits. (In addition, on the defensive side, consultants in the "patent busting" line of work offer their search-and-destroy services to help accused infringers seek out prior art that might invalidate the patents that trouble them.)

Critics Challenge Business Method Patents

The benefit of broad patent rights to their owners is thus quite clear, at least qualitatively if not always quantitatively. But some notable objectors have argued that there is also a dark side to liberalizing the standards for patentability, and to business patents in particular. A prominent economist wrote in a leading national newspaper that "Congress should declare a moratorium on the offensive use of software and business method patents," and decried the issuance and enforcement of such patents as an unsa-



The Great Gold Rush of '99

very government regulatory burden on free commerce.²⁴ Jeff Bezos, wunderkind CEO of Amazon.com, and Time magazine's 1999 Man of the Year, drew so much criticism for his company's infamous "one-click shopping" patent that he conceded in a public letter "it's possible that the current rules governing business method and software patents could end up harming all of us," and called for an assortment of substantial patent system reforms.²⁵ Other critics fall at various points along a scale ranging from calling for the abolition of software and business method patents to recommending a few modest adjustments to PTO procedures.

Some of the maelstrom of criticism probably comes from business people who wish they had "been there first" to patent some of the very innovations they now question. But the primary objections of the most persuasive critics generally fall into three categories: (a) patents in these fields will create barriers to commerce and innovation that outweigh the purported good of such patents; (b) patents are being issued for trivial or obvious advances, or that are clearly anticipated by prior art; and (c) PTO patent examining resources are inadequate to properly police the patenting process. The category (b) and (c) objections overlap somewhat, and remedies proposed with such objections tend to focus more on the "how" of business method patenting than on the underlying questions of "why" or "whether." The category (a) objections, on the other hand, can amount to assaults on the driving philosophy of the patent system as a whole and, potentially, the constitutional foundation for the present system.

The outgoing chair of the American Bar Association's Section of Intellectual Property Law responds to the public disparagement of business method patents with some skepticism, comparing the current boom of e-commerce innovation to nineteenth-century economy-changing breakthrough inventions such as Morse's telegraph patent and Bell's telephone patent. "[T]here is no need to deviate far from the principles of patent law that have served us so well for over two centuries," he concludes.²⁶

The Patent Office Responds to Critics

Criticism of quality control in the patent examination process arises in part from the ever-increasing workload of the PTO examiner corps. The total numbers of U.S. patent applications continue to soar, and the numbers of software and

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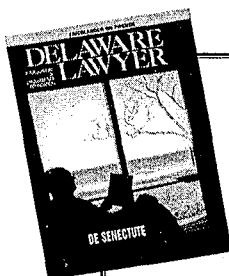
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business method patent applications are rising even more quickly. To cope with this pressing workload, the PTO has implemented performance standards for its examiners that put a premium on efficiency — *i.e.*, the number of applications processed in a certain time period. Examiners must meet a specified biweekly quota to maintain satisfactory job performance, and must exceed their quotas to qualify for certain bonuses.

A further aggravating circumstance is the limited availability of non-patent prior art resources to the PTO examiners (*e.g.*, software that may have been widely used in industry but was never patented). This ailment may generally hamper examination of software patent applications, but it is especially acute in the relatively young business methods field. The newer the art, generally the less prior art is readily available. These factors may create an environment in which effective quality control over the patent examination process can be challenging.

The critics' voices have not fallen entirely on deaf ears. The PTO itself has spent a great deal of time and effort trying to answer and ameliorate some of the publicly expressed concerns, although some critics might characterize the PTO's curative measures as mere whitewashing. Among the reforms being proposed and implemented by the PTO are the following:²⁷

- an examiner training program that will have senior examiners spending half their time with younger examiners in the art class to which many business method patents are assigned (Class 705);
- a special training manual for Class 705 examiners;
- specialized prior art search strategy training, guided by a new, experienced search strategy advisory panel;
- increased availability to examiners of commercial databases with non-patent prior art;
- daily circulation of "new and interesting" information on business methods to Class 705 examiners;
- technical training in matters especially pertinent to business method patents, including networking and electronic commerce;
- making industry field trips (*e.g.*, to Wall Street), conferences, and seminars available to examiners to help keep them current in their technical and business awareness;
- increased hiring goals in specialties

Continued on page 28

Thomas C. Grimm
 Karen Jacobs Louden
 Julia Heaney¹

TRADEMARKS IN CYBERSPACE

The World Wide Web is developing faster than most anyone dreamed. And just as the Web presents new business opportunities for e-commerce entrepreneurs, it also poses new problems for judges, lawyers and clients about the uses and abuses of trademarks. Counseling an e-commerce entrepreneur about these problems requires an understanding of "traditional" trademark law, some new trademark law, and the ways in which trademarks are used on the Web. This article discusses two of those uses: domain names and metatags.

Domain Names

Domain names are the addresses by which Web site owners stake their claim in cyberspace. Web sites for businesses typically contain ".com" at the end of their name, which is referred to as the .com domain. The registration system for domain names is separate from the system for obtaining a federal trademark registration. For domain names, the governing body charged with coordinating the domain name system is the Internet Corporation for Assigned Names and Numbers ("ICANN"). ICANN grants accreditation to private companies to sell domain name registrations in the .com domain. There currently are more than 20 such accredited registrars in the United States. A Web site owner also may apply for trademark registration of its domain name (including the .com suffix) with the United States Patent and Trademark Office, but this is not necessary per se to protect against infringement of a non-domain name mark. The trademark "Coca-Cola" is sufficient to prevent others from using the domain name "Coca-Cola.com."

A trademark must be distinctive to be entitled to federal trademark registration. It must serve to distinguish the goods of the trademark owner from the goods of others. Marks that

are merely descriptive of a product's qualities cannot be registered unless the owner demonstrates that the mark has acquired "secondary meaning" so that consumers have come to associate the mark with a particular source. For example, the name "Bagels & Donuts" is descriptive, but among Wilmingtonians the name may have acquired secondary meaning if they associate it with a particular store which sells bagels and donuts.

Traditionally, the question whether a trademark is infringed turns on a multi-factor test which seeks to determine whether the defendant's use of a trademark creates a "likelihood of confusion" among consumers as to the source of the defendant's goods. The descriptiveness of a mark is often an important factor for a court to consider. Descriptive marks typically are not considered to be as strong as arbitrary or suggestive marks. For example, "Corian" is an arbitrary word that has become a very strong trademark.

For purposes of counseling an e-commerce entrepreneur who is choosing a new domain name or purchasing an existing one, many of the same trademark considerations apply as when counseling a traditional business about the selection of a new name or slogan. Thus, a trademark search which encompasses Web sites should be undertaken to avoid adopting a domain name that incorporates another's trademark. A domain name may consist of generic or descriptive terms (e.g., bagels and donuts) that describe what a Web user may find if he or she accesses that particular site. Nevertheless, if a certain trademark consisting of these same terms has taken on "secondary meaning" among consumers, it may be protected by trademark law.

This issue was brought to light recently in *Washington Speakers Bureau, Inc. v. Leading Authorities, Inc.*,² an unpublished Fourth Circuit decision that upheld a district court order requiring Leading Authorities to relinquish certain domain names. Leading Authorities, a competitor with Washington

Speakers Bureau in the lecture-booking business, had purchased numerous domain names, including four that used variants of "Washington" and "speakers." Even though the words "Washington" and "speakers" are common nouns with distinct meanings when used separately, the Fourth Circuit rejected the argument that "Washington Speakers" is generic and not protectable. The Fourth Circuit upheld the district court's decision requiring Leading Authorities to relinquish the disputed marks. It found that the mark "Washington Speakers Bureau" was descriptive, but had acquired secondary meaning and that Leading Authorities' four domain names were "colorable imitations of that mark, the use of which was likely to confuse consumers as to the source or sponsorship of its Web site."³

Domain names are not always chosen to promote an existing business. Now that so much business is conducted on the Web, a memorable domain name can itself translate into valuable consumer recognition and revenue growth. The relative ease of creating a domain name that can attract Web-browsers has led to the creation of a market for domain names, with some domain names selling for more than a million dollars. The prospect of enormous profits from domain name sales has led to the creation of a new entrepreneur known as the "cybersquatter."

A cybersquatter is a person who purposefully registers a domain name similar or identical to the trademark of another in the hope of selling the name for a profit. Because domain names not already in use can be registered for as little as \$70, trademark owners, corporations and public figures may find that their own names have already been registered to cybersquatters. Therefore, when a trademark owner attempts to register a domain name that incorporates its trademark, it may find that it must first purchase the domain name from a cybersquatter for a hefty price. Certain cybersquatters have been known to resort to extortion when the trademark owner is not interested in purchasing the domain name. For example, Gateway2000 paid \$100,000 to a cybersquatter for the use of "gateway20000.com" to stop the cybersquatter from displaying pornographic materials at the site.⁴

Traditional trademark law did not provide a ready remedy to protect trademark owners against this new breed of entrepreneur. As a result, in 1999 Congress passed the Anticybersquatting

Consumer Protection Act ("ACPA").⁵ The ACPA amended the Trademark Act of 1946 to provide that a person (i.e., potential cybersquatter) will be liable under the Act if he or she "has a bad faith intent to profit from the mark" (including a personal name) and "registers, traffics in or uses a domain name" that is "identical or confusingly similar to or dilutive of that mark."⁶ Violators of the ACPA may have their domain names cancelled or may be forced to transfer ownership to the trademark owner. The Act also allows for *in rem* jurisdiction over cybersquatters. This was thought necessary to ensure jurisdiction against cybersquatters who, to avoid detection, may give misleading information about themselves when registering for domain names. The constitutionality of this "in rem" procedure recently was upheld by a district court in *Caesars World, Inc. v. Caesars-Palace.Com*.⁷

*Sporty's Farm L.L.C. v. Sportsman's Market, Inc.*⁸ was the first appellate case to interpret the substantive provisions of the ACPA. Prior to the enactment of the ACPA, Sporty's Farm (which sells Christmas trees) had filed a declaratory judgment action seeking the right to use "sporty.com" as a domain name. Sportsman's Inc. (which is in the mail order business and uses "sporty's" as a trademark), counterclaimed under the Federal Trademark Dilution Act ("FTDA"), contending "sporty's" was its trademark. The district court found for Sportsman's under the FTDA, granting an injunction requiring the transfer of the domain name.

During the pendency of Sporty Farm's appeal, the ACPA was enacted. Applying the ACPA, the Second Circuit found that "sporty's" was a distinctive mark and the domain name was "identical or confusingly similar" to the "sporty's" mark. For Sportsman's to prevail under the ACPA, it had to show that Sporty's Farm acted with a "bad faith intent to profit" from the popularity of the mark. Sporty's Farm's CEO had testified that it derived its name from childhood memories of a dog named Spotty who lived on a farm — an explanation the Second Circuit found "more amusing than credible." Applying the ACPA factors (and a few other factors not found in the statute), the Court determined that the domain name was registered with a bad faith intent. One of the important factors the Court considered was that Sporty's Farm had purchased the domain name before it even started its business,

which indicated an intent to profit from the "Sporty's" trademark. In addition, because the name was originally purchased by the parent corporation, the court felt the parent created the subsidiary, "Sporty's Farm," to protect itself from an infringement suit. Thus, the court applied the ACPA to affirm the district court injunction granted under the FTDA. A statutory bar against retroactivity prevented damages from being awarded.

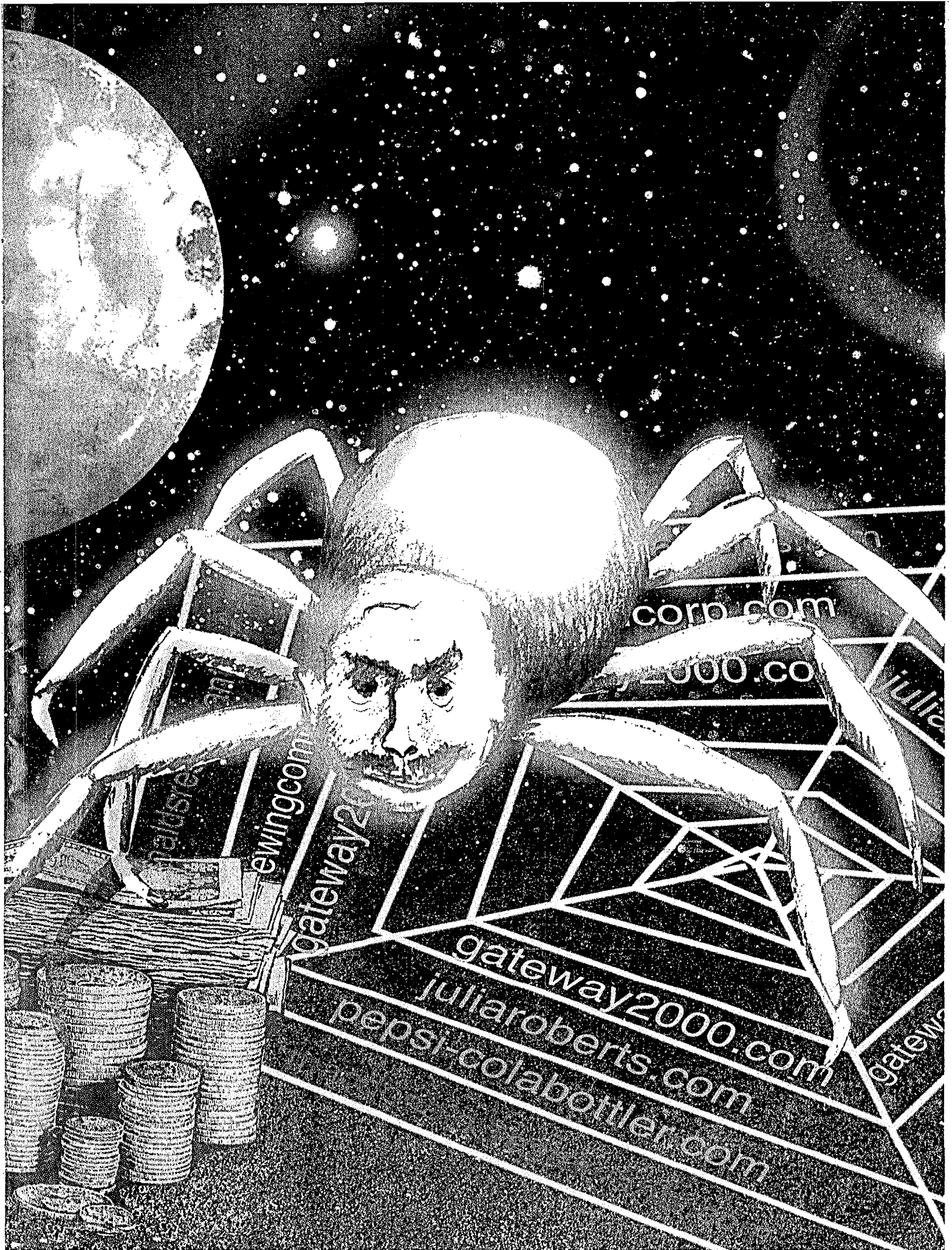
Other courts have utilized this same approach, breaking the analysis into a trinity of issues: (1) is the mark distinctive or famous?; (2) is the domain name identical or confusingly similar to the mark?; and (3) is there bad faith intent to profit? A plaintiff must prevail on all three factors to maintain a claim under the ACPA.

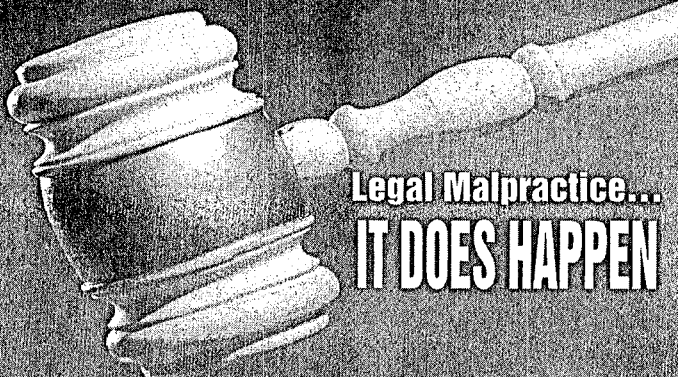
The ACPA is not the only tool available to a trademark owner to combat a cybersquatter. In January 2000, ICANN enacted its Uniform Domain Name Resolution Policy, which allows a trademark owner to file a complaint with ICANN (for \$1000) to require transfer of ownership of the domain name. To prevail under the ICANN procedure, the trademark owner must prove that: (1) the domain name is confusingly similar to its mark; (2) the registrant has no rights or legitimate interest in the name; and (3) the registrant is using the domain name in bad faith.

The ICANN procedure is limited because it provides only for the transfer of a domain name. No damages may be awarded. Nevertheless, the ICANN policy has its advantages. There can be no dispute over jurisdiction because anyone who registers a domain name automatically consents to be subject to ICANN's procedures and policies. Proceeding under the ICANN policy can also save litigation costs and provide fast results. Disputes are generally resolved within 60 days.

Metatags

A metatag is a piece of code rooted in the hypertext mark-up language ("HTML") of a Web site, invisible to the Web site viewer. It may consist of one word, a series of words, or even a trademark. Like the way a library patron indexes a card catalog, internet search engines use metatags to retrieve Web sites for the Web user. Metatags pose very different trademark issues from domain names. While a trademark owner may be entitled to prevent others from using its descriptive mark in a domain





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name, it cannot prevent others from using descriptive or generic words in a metatag to truthfully direct Web browsers to the goods and services they provide. In trademark law parlance, this is called "fair use."

Take the example of "Bagels & Donuts," which may have acquired secondary meaning in Wilmington entitling the trademark owner to prevent another from using the domain name "bageland-donuts.com." Nonetheless, the trademark owner probably could not prevent other retailers of bagels and donuts from using the descriptive words "bagels" and "donuts" as metatags. As a matter of fair use, these retailers must be permitted to use these descriptive words to direct Web browsers to their Web sites where they sell bagels and donuts.

On the other hand, a trademark owner should be able to prevent another from using its non-descriptive mark in a metatag. For example, McDonald's should be able to prevent another from using the mark "Big Mac" as a metatag. Because "Big Mac" is not descriptive, a hamburger retailer has no legitimate need to use the mark to direct browsers to the goods it provides, and it may be fairly presumed that the retailer is attempting only to trade off the famous McDonald's mark.

The Ninth Circuit addressed the use of trademarks as metatags in *Brookfield Communications Inc. v. West Coast Entertainment Corp.*⁹ The Ninth Circuit held that West Coast could not use the term "MovieBuff," a registered trademark of Brookfield, as a metatag. In analyzing the likelihood of confusion from West Coast's use of "MovieBuff" as a metatag, the court recognized that any search using the term "MovieBuff" most likely would include West Coast's and Brookfield's Web sites among the results, and that a Web user would be able to distinguish Brookfield's Web site from West Coast's because of Brookfield's domain name, "moviebuff.com." Nevertheless, the Court found that West Coast's use of the metatag "MovieBuff" constituted trademark infringement because West Coast's use of the trademark would capture initial consumer attention, even if no actual sale were completed as a result of the confusion. The Court held, however, that West Coast could use the words "movie" and "buff" as metatags, thus acknowledging that Brookfield had the right to use these descriptive words in their generic sense.

In another metatag case, a district

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court refused to enjoin a Web site owner who intentionally used a trademark of another as a metatag to accurately describe what the Web browser would find at the site. In *Playboy Enterprises Inc. v. Welles*,¹⁰ Playboy contended that a former Playmate of the Year, Terri Welles, infringed Playboy's trademarks by using them to direct Web browsers to a Web site that contained photographs of Ms. Welles and her "Playmate of the Year" title, even though her Web site included a disclaimer stating that the site was not endorsed by or affiliated with Playboy Enterprises. The court concluded that "[i]t is clear that defendant is selling Terri Welles and only Terri Welles on the Web site." Because Welles used the trademarks in a manner to describe herself, the Court found this to be "fair use."

Why did Playboy lose and Brookfield prevail? In both cases, the defendants were using another's trademark as a metatag, yet the courts arrived at different conclusions, applying a similar standard. Ultimately, the difference boils down to a factually intensive inquiry into what is fair use. Ms. Welles, as a former Playboy playmate, was found to have the right to use certain trademark terms to accurately describe herself. On the other hand, it is not fair use to use marks as metatags in a manner not calculated merely to describe the goods or services that one offers, but rather to "cash in" on the notoriety of another's mark. While the standard applied in these cases is less than satisfying in terms of predictability of outcome, this flexibility is probably necessary to distinguish between the various legitimate and illegitimate ways that creative entrepreneurs may use metatags.

In that regard, and others, Internet trademark lawyering is not so different from disputes respecting older forms of intellectual property.

FOOTNOTES

1. The authors extend their special thanks to Brent Lewis and Elizabeth Beyer for their invaluable assistance with this article.
2. 2000 U.S. App. LEXIS 14669 (4th Cir. June 27, 2000).
3. *Id.* at *3.
4. Hearing on "Cybersquatting and Consumer Protection: Ensuring Domain Name Integrity" Before the Senate Comm. on the Judiciary, 106th Cong. (July 22, 1999) (opening statement of Sen. Spencer Abraham).
5. 15 U.S.C. § 1125(d) (1999).
6. *Id.*
7. 2000 U.S. Dist. LEXIS 2671 (E.D. Va. Mar. 3, 2000).
8. 202 F.3d 489 (2nd Cir. 2000).
9. 174 F.3d 1036 (9th Cir. 1999).
10. 78 F. Supp. 2d 1066 (S.D. Cal. 1999). ♦

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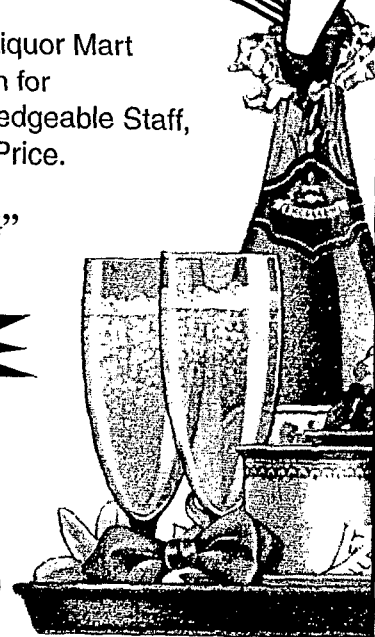
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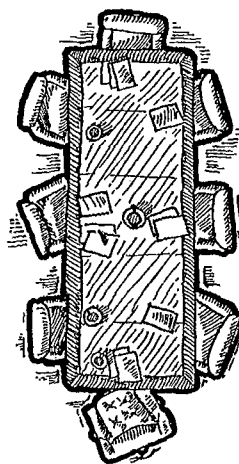
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relating to business method

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- an additional level of review for allowed applications in Class 705 before such applications are issued as patents;
- expanded internal PTO sampling of applications for quality review;
- ongoing consultation with industry "customers" with the goal of improving the examination process.

It is too early to tell whether these measures will have a significant effect on the patent examination process, but is certainly possible that some of them will have beneficial effects and will strengthen the patent system.

Strategic Outlook

As the patenting of business methods spreads seismic ripples through every corner of the economy, what's an e-commerce company to do? For that matter, what's an "old economy" company to do? While the policy debates can be quite interesting, and likely will eventually have some sort of tangible effect on the system of patent law, one commentator has hit the nail on the head. "So who is right? The answer: it doesn't matter."²⁸ There is too much to be gained — and perhaps more important, too much to be lost — to sit on the sidelines and wait for public policy debates to resolve themselves. If a company is not trying to secure patent coverage for its online business model and any enabling systems or methods related to its business model, it may already be too late. Its competitors — even would-be competitors who may not yet have appeared on the radar screen — could already be patenting those very "inventions" out from under it.

This brings us back to the metaphors quoted at the beginning of the article. The gold rush analogy is too weak, because the rights secured by letters patent often yield more than a single windfall. These rights last for twenty years from the date of the patent application, potentially dominating a niche of the fast-moving new economy for longer than the niche exists! The land rush analogy is a bit stronger, conveying the idea of more durable property rights, but even this metaphor may be too weak.

Maybe the metaphors of full-scale warfare are onto something? No, let us try to soothe the passions rather than

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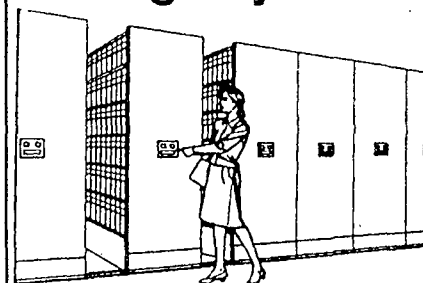
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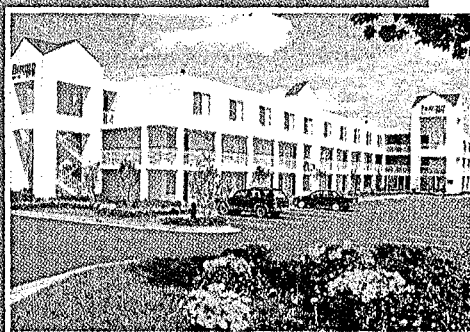
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inflame them. Back to our original analogy: In this gold rush, it may pay to give heed to two popular variations of the "Golden Rule" — (1) He who has the gold makes the rules, and (2) Do unto others before they do unto you. And a final word to the legal professional: This could be a good time to be in the business of selling picks and shovels.

FOOTNOTES

1. Quoted in *Patent Wars*, THE ECONOMIST Apr. 8, 2000 at 75, 76.
2. *Bar Reacts to Bezos Patent Reform Plan*, NAT'L L.J., Mar. 27, 2000, at A1, A12.
3. Quoted in *Patently Absurd?*, DELAWARE VALLEY COMPUTERUSER May 2000, at 18, 21.
4. 149 F.3d 1360.
5. 35 U.S.C. § 101.
6. See generally 1 D. Chisum, PATENTS §§1.01-1.03 (2000).
7. *Diamond v. Diehr*, 450 U.S. 175 (1981); *Parker v. Flook*, 437 U.S. 584 (1978); *Gottschalk v. Benson*, 409 U.S. 63 (1972).
8. *Diamond v. Chakrabarty*, 447 U.S. 303, 309 (1980).
9. *Paine, Webber v. Merrill Lynch*, 564 F. Supp. 1358 (D. Del. 1983).
10. 33 F.3d 1526 (Fed. Cir. 1994)(en banc).
11. 32 F.3d 1579 (Fed. Cir. 1994).
12. Examination Guidelines for Computer-Related Inventions, 61 Fed. Reg. 7478 (1996).
13. *Protecting Software*, NAT'L L.J., May 8, 2000, at B7.
14. *Cash Machine*, WIRED, June 2000 at 269, 272.
15. *State Street Bank v. Signature Financial Group*, 927 F. Supp. 502 (D. Mass. 1996).
16. *State Street Bank v. Signature Financial Group*, 149 F.3d 1360 (Fed. Cir. 1998).
17. *Id.*
18. *AT&T Corp. v. Excel Communications*, 172 F.3d 1352 (Fed. Cir. 1999).
19. *E-Commerce Patents and Shifting Balances in Patent Law*, IEEE COMMUNICATIONS MAGAZINE, July 2000, at 106, 108.
20. See generally *Patent Upending*, WIRED, June 2000, at 208.
21. *Id.* at 220; see also G. Aharonian, PAT-NEWS e-mail newsletter #20000324, patent-news@world.std.com (citing, *inter alia*, estimates published by Profs. M. Lemley and L. Lessig).
22. "Prior art" means publicly available material that is relevant to the subject matter of a patent application and could potentially relate to the issue of whether or not an applicant's claimed invention is new and not obvious.
23. 35 U.S.C. § 284.
24. L. Lessig, *Online Patents: Leave Them Pending*, WALL ST. J., Mar. 23, 2000.
25. <http://www.amazon.com/cxec/obidos/subst/misc/patents.html>.
26. G. Maier, *From the Chair*, ABA SEC. OF INTELL. PROP. L. BULL., May 2000, at 1,2.
27. A USPTO White Paper: *Automated Financial or Management Data Processing Methods (Business Methods)*, July 19, 2000, <http://www.uspto.gov/web/menu/busmethp/index.html>.
28. M. Plotkin, *Mind Your Own Business Method*, E-COMMERCE L. WKLY., April 13, 2000, at 423, 424. ♦

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THE INTERSECTION OF PATENT LAW AND BANKRUPTCY: WHAT EVERY PRACTITIONER SHOULD KNOW

The transactions of a typical business client today are increasingly likely to implicate many diverse aspects of the law. For example, no understanding of the value of a client's assets would be complete without assessing the importance of intellectual property to the client's business, either as a source of royalty income in the case of an owner or of critically needed technology in the case of a licensee. Also, few practitioners today can afford to structure a business transaction without considering the potential consequences of a subsequent filing for bankruptcy by one of the parties. Given the explosive growth over the

last decade in both patent litigation and bankruptcy proceedings in the Delaware courts, a large number of Delaware lawyers are likely to know something about one or the other of those fields. This article attempts to broaden the perspective of those attorneys and the numerous other practitioners who generally advise business clients by examining the basic interrelationships between bankruptcy and patent law.

The fundamental goal of the patent system is to bring advances in technology and design into the public domain. The Patent Code encourages public disclosure of new and useful ideas by granting to an inventor the exclusive right to practice an invention for a period of years. As a result, a central concern of the patent system is the protection of a patentee's right to exercise exclusive control over use of its invention during the term of the patent.

The principal objective of the Bankruptcy Code is to make the best use of a debtor's estate in order to maximize payments to creditors and, in the case of Chapter 11, to help the debtor reorganize and provide it with a "fresh start." In view of these pragmatic goals, the concerns and policies of intellectual property law are often of secondary importance in a bankruptcy proceeding.

Indeed, when issues involving patent rights arise in bankruptcy, the results dictated by the Patent Code and the Bankruptcy Code can be directly at odds. The intersection of these two federal schemes has created a number of controversial and unsettled issues that have been the subject of disparate treatment by the courts.

"Back Door" License Assignment

One example of the tension between patent law and bankruptcy law is the issue of the assumption and assignment of a patent license held by a debtor in bankruptcy. Bankruptcy law generally views a patent license as an executory contract, which a trustee ordinarily may assume or assign under § 365(c) of Chapter 11 of the Bankruptcy Code without consent of the other party to the contract, even in the face of a contractual provision that prohibits or limits assignment. Patent law, however, generally prohibits assignment of a patent license without the assignor's assent as an expression of the patentee's exclusive right to control use of the invention, including the identity of licensees.² Because a patent license may be among a debtor's most valuable assets, the ability of the patent owner to preclude distribution and use of this asset can frustrate the objectives of the bankruptcy process. Yet, if patent law yields to bankruptcy law, the potential exists for a patent holder's competitor to acquire a debtor's license interest and thus gain "back door" access to the patented technology.⁴

Courts are split as to whether the policies of patent law or bankruptcy law prevail in this instance. In *In re CFLC Inc.*,³ the Ninth Circuit joined the Sixth and Seventh Circuits in holding that federal patent law governs the assignability of non-exclusive patent licenses and prohibits assignment over the patent owner's objection. Noting that § 365(c)(1) of the Bankruptcy Code proscribes assignment under circumstances where "applicable law" excuses a party from accepting performance from anyone other

than the debtor, the court reasoned that patent law excuses a patentee from accepting performance under a non-exclusive patent license from anyone other than the original licensee, *i.e.*, the debtor. As a result, the debtor in *CFLC* could not assign the license to a third party absent the patent owner's consent. To hold otherwise, said the court, would burden the patent licensing system with the constant risk that any granted license could someday inure to the patentee's most dreaded competitor.

The First Circuit, however, in *Institute Pasteur v. Cambridge Biotech Corp.*,⁵ held that a patentee's objection did not prevent assumption of a license by a debtor in conjunction with a sale of the debtor's stock to the patentee's principal competitor. Under an "actual" performance standard for applying the contract assumption provisions of the Bankruptcy Code, the court held that assumption was not prohibited where the patentee was unable to establish that it would not receive the "benefit of its bargain." Moreover, while not disputing the applicability of federal patent law to the issue of license assignability, the court distinguished *CFLC* on the grounds that the assignment in that case was to "an entirely different corporation." Because the debtor in *Institute Pasteur* intended to utilize the patented technology by assumption as the same corporate entity that operated pre-petition, the patentee was not excused under § 365(c)(1) of the Bankruptcy Code from accepting performance.

The Ninth Circuit again addressed the issue of unsanctioned license assumption in *Perlman v. Catapult Entertainment Inc.*⁶ Unlike the circumstances in *CFLC* where the debtor had sought to assign a patent license to a third party, the debtor in *Catapult Entertainment* filed a plan of reorganization merely seeking to assume a pre-petition license. Cognizant of the First Circuit's holding in *Institute Pasteur* and many lower court opinions in accord, the Ninth Circuit rejected the "actual" test as an abandonment of statutory language in favor of judicial lawmaking. Instead, the court held that the literal language of § 365(c)(1) of the Bankruptcy Code precludes a debtor-in-possession from assuming an executory contract where "applicable law" bars assignment to a hypothetical third party, even where the debtor has no intention of assigning the contract. In other words, because patent law excuses a patent licensor from accepting performance from a hypothetical assignee, a patent license is *per se* not assumable regardless of whether any assignment is contemplated.⁷

Critics of the Ninth Circuit standard argue that it disproportionately empowers a patent owner over other parties in bankruptcy, in some cases allowing it to wield at its whim the very key to reorganization. Opponents of the First Circuit standard continue to warn of the danger for surreptitious acquisition of a patentee's valuable intellectual property by competitors. One proposed solution is to allow a non-exclusive patent license to "ride-through" a reorganization, which would avoid the harsh result of the absolute bar on assumption as well as the pitfalls of unauthorized assignment.⁸ Under this scenario, the *Catapult Entertainment* debtor could have enjoyed continued use of the patented technology as it emerged from reorganization, while the unwelcome acquisition of patent rights by a competitor, as in *Institute Pasteur*, might have been avoided by a contractual provision terminating the license upon a change of ownership of the licensee.⁹

License Rejection

Prior to enactment of the Intellectual Property Bankruptcy Protection Act of 1988 ("IPBPA")¹⁰ a patent licensor that went into bankruptcy had a virtually unfettered right to reject the license as an executory contract, thus stripping the licensee of its right to continued use of the patented technology without infringing the patent. In accordance with bankruptcy interests, rejection of an existing license may allow a debtor-licensor to maximize the value of the intellectual property by licensing to others or renegotiating the original license under more favorable terms. However, an abrupt and unilateral license rejection could have potentially disastrous consequences on a licensee's business. The intent of the IPBPA was to protect a debtor-licensor's ability to rehabilitate without interrupting the licensee's right to use the intellectual property. To that end, the IPBPA provides that while the debtor may elect to reject the license together with any affirmative duties that it might have under the license, the licensee may retain the right to use the patent under the terms of the original agreement while continuing to make royalty payments.

A problem not addressed by the IPBPA is the potential inability of a licensee to prevent infringement by others following a patentee's rejection of the license. Typically, one of a patentee's affirmative duties under a license agreement is the obligation to enforce the patent against infringers. Indeed, in the case of a non-exclusive license, the licensee must necessarily rely on

the patentee to enforce the patent because a non-exclusive licensee has no standing to sue for patent infringement, even if the patentee is joined as a party to the action.¹¹ If a debtor-patentee rejects its duties under a non-exclusive license, the licensee has no means by which to prevent unauthorized parties from practicing the patented technology without paying a royalty, thereby placing the licensee at a competitive disadvantage and making the patent essentially worthless.

A non-exclusive licensee's only recourse may be to seek equitable relief to preclude the debtor from rejecting the license. Courts generally will uphold a debtor's decision to reject a license agreement provided it constitutes a good faith exercise of business judgment that may benefit the estate, a deferential standard that almost always results in approval of the debtor's decision. Yet, in a case decided prior to enactment of the IPBPA, *In re Petur U.S.A. Instrument Co.*,¹² a bankruptcy court refused to permit rejection of a patent license where the damage to the licensee was "grossly disproportionate" to any benefit derived by the debtor or creditors. The court held that equity would not sanction the "ruination of an otherwise profitable, successful and ongoing business," particularly in view of the court's doubts as to the debtor's ability to reorganize. The availability of such equitable relief is uncertain, however, given the enactment of the IPBPA as well as the fact-specific nature of equitable considerations.

Perfection of Interest

A creditor's security interest in a patent may entitle the creditor to priority in a bankruptcy proceeding, provided the interest has been perfected. Historically, liens on patents have been perfected by filing in accordance with the system of federal registration of assignments in the Patent and Trademark Office. Substantial disagreement now exists among courts, however, regarding the requirements for properly perfecting a security interest in intellectual property.

A prominent case is *In re Peregrine Entertainment*,¹³ in which Judge Kozinski of the Ninth Circuit, sitting in the District Court by designation, held that security interests in copyrights are perfected only by filing with the Copyright Office. According to Judge Kozinski, the methods of perfection specified in Article Nine of the U.C.C. are supplanted by the existence of a federal registration system and state law fil-

ings are therefore ineffective. Many reviewers and other courts have concluded that, by the same reasoning, security interests in patents may only be perfected by filing in the Patent Office.¹⁴

Recently, however, the Bankruptcy Appellate Panel of the Ninth Circuit decided in *In re Cybernetic Services, Inc.*¹⁴ that a security interest in a patent is perfected by filing under the U.C.C. and not under the Patent Act. The Panel rejected the premise that provisions for registration of assignments in the Patent Office constitute a federal preemption of state law for purposes of recording security interests. The Panel noted that the term "assignment" under patent law refers not to creation of a security interest but to a transfer of title, and that the Patent Office records security interests on a discretionary basis only. Moreover, unlike the Copyright Act which expressly regulates security interests, the Patent Act is silent with respect to perfection and priority of interests or judgment liens. The Panel thus concluded that because provisions for filing in the Patent Office do not constitute a preemptive national registration system, a security interest in a patent is perfected only if recorded in accordance with Article 9 of the U.C.C.

In view of this controversy, commentators not surprisingly recommend that creditors file security interests in patents under both the state and federal systems.¹⁶

Myriad Intersecting Issues

The above discussions illustrate just three examples of the many unsettled issues arising from the confluence of intellectual property law and bankruptcy law. Other issues include:

Fraudulent or Preferential Transfers. Special considerations arise when an infringement action or dispute over licensing rights is settled at a time when one of the parties to such settlement is or may be insolvent. Such a settlement may be challenged as a fraudulent transfer in a subsequent bankruptcy case on the basis that debtor received inadequate consideration for rights transferred or releases given. A settlement of pre-petition claims may also be challenged as a preferential transfer if it occurs within 90 days prior to the date of filing of the bankruptcy petition. Coupling a settlement of pre-petition claims arising out of an infringement or licensing dispute with an agreement by the debtor to take a license going forward offers some protection to the non-debtor

licensor because access to the licensed technology may constitute "new value" for all or a portion of the consideration received as part of the settlement.

Infringement Adjudication. When a proof of claim is filed in a bankruptcy action asserting a claim for patent infringement, the bankruptcy court may adjudicate the merits of the patent dispute. While parties to an infringement action may normally demand a trial by jury, a claimant is generally deemed to have waived its Seventh Amendment right to a jury trial by filing a proof of claim seeking the equitable remedy of recovery from a debtor's estate. Moreover, because the Bankruptcy Code requires the liquidation of all contingent or unliquidated claims, claims arising out of an infringement or licensing dispute may be amenable to estimation under §503(c) of the Bankruptcy Code.

Scope of the Automatic Stay. It is clear that under § 362(a) of the Bankruptcy Code, actions brought on account of patent infringement (or for a declaration of patent invalidity) that accrue prior to the filing of a bankruptcy petition are stayed. However, less clear are a plaintiff's rights to initiate or continue an action for patent infringement when such infringement commences or is ongoing following the petition date.

Trademarks and Copyrights. Proceedings in bankruptcy may of course involve intellectual property other than patents, including trademarks, copyrights, and even trade secrets. Because each involves a separate statutory scheme which grants a particular scope of protection supported by unique policy considerations, each gives rise to its own distinctive intersections with bankruptcy law. For example, the IPBPA expressly excludes trademarks from the scope of its provisions that allow a licensee the continued use of licensed intellectual property following a debtor-licensor's rejection of the license. Mechanisms for perfection of security interests also differ significantly for trademarks and copyrights, with at least one court characterizing the subject of perfecting a lien on a trademark as "a trap for the unwary."¹⁷

Conclusion

Intellectual property may be among the most valuable assets owned or used by a business client today. Understanding the basic interrelationships between bankruptcy and patent law can be important in ensuring that a client reaps the benefit of a bargain into which it has

entered. In particular, an appreciation for the consequences of bankruptcy is necessary when drafting agreements involving intellectual property assets such as patent licenses. In Delaware, where both intellectual property and bankruptcy practices are flourishing, attorneys from each discipline should understand when the specialized expertise of the other is needed.

FOOTNOTES

1. The authors gratefully acknowledge the contributions to this article by Gregory W. Werkheiser, an associate in the Bankruptcy Law Group at Morris, Nichols, Arsht & Tunnell.

2. "It has long been held by federal courts that agreements granting patent licenses are personal and not assignable in the absence of express language." *PPG Industries, Inc. v. Guardian Industries Corp.*, 597 F.2d 1090, 1093 (6th Cir.), cert. denied, 444 U.S. 930 (1979).

3. See Virginia P. Henschel, "Back Door" Access to Patented Technology, 17 AM. BANKR. INST. J. 40 (Feb. 1998).

4. 89 F.3d 673 (9th Cir. 1996).

5. 104 F.3d 489 (1st Cir. 1997).

6. 165 F.3d 747 (9th Cir. 1999).

7. See Gregory G. Hesse, *Ninth Circuit Slams Shut the "Back Door" Access to Patented Technology*, 1999 ABI JNL LEXIS 41 (Apr. 1999); see also *In re Access Beyond Technologies, Inc.*, 237 B.R. 32, 48 (Bankr. D. Del. 1999) (rejecting the "actual test" in concluding that "[t]he language of section 365(c)(1) ... clearly and unambiguously prohibits the assumption of" a license agreement).

8. Mark R. Campbell and Robert C. Hastie, *Executory Contracts: Retention Without Assumption in Chapter 11 — "Ride-Through" Revisited*, 2000 ABI JNL LEXIS 41 (Mar. 2000).

9. Also unsettled is the issue of a debtor-licensee's continued use of intellectual property under a license after the commencement of a bankruptcy case but prior to the assumption or rejection of the license. In order to assume and assign an executory contract, the debtor must provide adequate assurance of future performance. Where the debtor demonstrates an inability to give adequate assurance by failing to make post-petition payments, for example, a licensor may attempt to protect itself by moving under § 362(d)(1) of the Bankruptcy Code to lift the automatic bankruptcy stay "for cause" in order to terminate the license immediately, or under § 365 of the Bankruptcy Code to compel immediate assumption or rejection.

10. Pub. L. No. 100-506, codified at §§ 101(a)(52) and 365(n) of the Bankruptcy Code.

11. See *Ortho Pharmaceutical Corp. v. Genetics Institute, Inc.*, 52 F.3d 1026, 1031 (Fed. Cir. 1995).

12. 35 B.R. 561 (Bankr. W.D. Wash. 1983).

13. 16 U.S.P.Q.2d 1017 (C.D. Cal. 1990).

14. See Paula Morris and Bradley Jensen, *Protection of Intellectual Property Rights Against Bankruptcy*, 80 J. PAT. & TRADEMARK OFF. SOC'Y 779, 787 (Nov. 1998).

15. 239 B.R. 917 (B.A.P. 9th Cir. 1999).

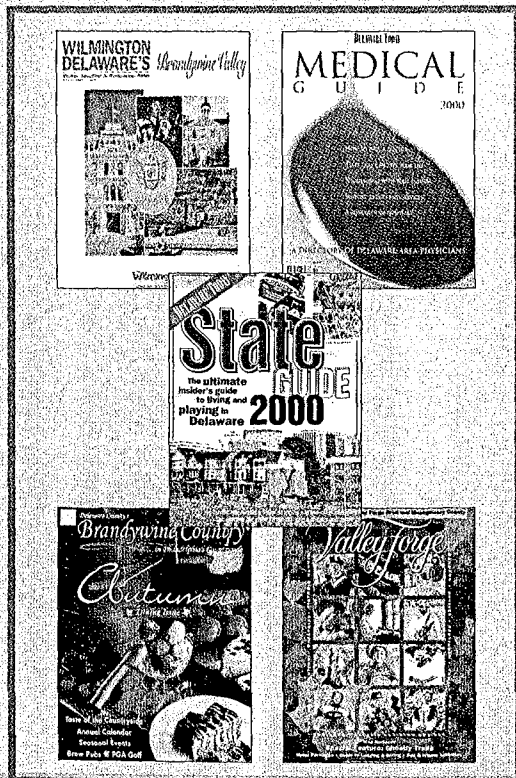
16. Stuart M. Riback, *Intellectual Property Licenses: The Impact of Bankruptcy*, 576 PLI Patents, Copyrights, Trademarks, and Literary Property Course Handbook Series 199, at 215 (Oct.-Nov. 1999); Morris & Jensen, *supra* n.13, at 787.

17. *In re Together Dev. Corp.*, 227 B.R. 439 (Bankr. D. Mass. 1998). ♦

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