



OUTSIDE COUNSEL

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Federal Circuit Makes Enforcing Intellectual Property Rights Harder

A recent Federal Circuit case regarding the assignability of consent judgments in intellectual property cases may have significant effects on the practice of intellectual property law.

Intellectual property, like other forms of property, can be sold or transferred. Patents and copyrights are freely transferable; even ownership of a trademark can be transferred, not “in gross” (i.e., as a separate property right) but certainly along with the goodwill of an ongoing business. Such transfers are routine where companies merge or are bought out by other companies.

Intellectual property is becoming more heavily litigated than other forms of property; the value of IP over tangible assets continues to grow rapidly. Like most civil cases, most intellectual property cases settle and often such settlements include a consent injunction or a consent judgment including injunctive relief. An oft-infringed piece of intellectual property—e.g., a famous trademark—potentially could be the subject of hundreds of consent injunctions.

What if such a case is settled and then the intellectual property is transferred to a third party? Can the successor third party now enforce the consent injunction if violated—say, through a motion for contempt? One might have assumed that



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with the transfer of property, comes the transfer of the right to enforce the consent injunction related to that property.

Yet recently, the U.S. Court of Appeals for the Federal Circuit in *Thatcher v. Kohl's Department Stores, Inc.*, 397 F3d 1370 (Fed. Cir. 2005), ruled just the opposite: a consent injunction cannot be enforced by the plaintiff's successor absent an express provision permitting assignment of the right to enforce. If that ruling stands, and at least for now, both intellectual property litigators and transactional lawyers must take it into account in their work.

The Facts

The *Thatcher* case facts are straightforward. Mark Thatcher developed the TEVA(r) sandal and apparently conducted an active business therein in the mid-1990s. In 1997, he brought suit in the U.S. District Court for the Northern District of Illinois against Kohl's Department Stores, alleging patent infringement, copyright infringement, trade dress infringement and unfair competition from Kohl's sales of allegedly infringing footwear. The case was settled with the entry of a consent judgment, which recited that the trade dress was valid

and enjoined Kohl's and its “servants, employees and successors-in-interest” from selling sandals employing Thatcher's trade dress or violating its patents.

In 2002, Deckers Outdoor Corp. acquired all intellectual property rights in the TEVA(r) sandal from Thatcher, including the patents and trade dress, and including “all contracts, claims, rights, causes of action [and] judgments” related to the intellectual property. The next year it discovered that Kohl's was selling another sandal Deckers believed infringed on these rights. It filed a motion for a “rule to show cause” (similar to an Order to Show Cause) for contempt and other relief.

Reasoning

The district court denied the application. Relying on the “four corners” rule set forth in *United States v. Armour & Co.*, 402 US 673 (1971), the court found that the consent judgment did not expressly indicate that it was assignable, and hence Deckers lacked standing to bring such a motion.

The Federal Circuit held that U.S. Court of Appeals for the Seventh Circuit law applied in interpreting consent judgments: they are a “carefully crafted settlement agreement between the parties,” are a form of contract and are interpreted under contract rules. (Other circuits generally follow some variation of this rule.) Since there was no choice-of-law provision, Illinois law applied. Illinois, like most jurisdictions, follows the “four corners rule” and, if a contract is unambiguous, it cannot be varied by extrinsic evidence.

Deckers relied upon the Seventh Circuit

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case of *Plumb v. Fluid Pump Service*, 124 F3d 849 (7th Cir. 1997), for the proposition that, where silent, consent judgments, like contracts, should be freely assignable. The Federal Circuit disagreed, relying on the *Armour* case about construction of consent judgments, although that case did not deal with assignability of consent judgments directly. The following passage was particularly important to the decision:

Consent decrees are entered into by parties to a case after careful negotiation has produced agreement on their precise terms. The parties waive their right to litigate the issues involved in the case and thus save themselves the time, expense, and inevitable risk of litigation. Naturally, the agreement reached normally embodies a compromise; in exchange for the saving of cost and elimination of risk, the parties each give up something they might have won had they proceeded with the litigation. Thus the decree itself cannot be said to have a purpose; rather the parties have purposes, generally opposed to each other, and the resultant decree embodies as much of those opposing purposes as the respective parties have the bargaining power and skill to achieve. For these reasons, the scope of a consent decree must be discerned within its four corners, and not by reference to what might satisfy the purposes of one of the parties to it.... [T]he instrument must be construed as it is written, and not as it might have been written had the plaintiff established his factual claims and legal theories in litigation. (402 US at 681-82).

Given this general rule of strict construction, the Federal Circuit held that silence on the issue “is the functional equivalent of the parties’ express intent to exclude the language of assignment.” The Federal Circuit also found telling that: (1) Thatcher had included language binding the defendants’ successors, but no language related to his own successors

and (2) in another consent judgment with Wal-Mart around the same time, both parties bound their “successors and assigns.”

Criticisms and Problems

• **Contract Law.** The *Thatcher* decision flies in the face of elementary contract law. It is generally accepted throughout the United States that contractual rights are freely assignable unless there is a special reason not to permit it. Thus, a leading contract treatise states:

Generally, all contract rights may be assigned in the absence of clear language expressly prohibiting the assignment and unless the assignment would materially change the duty of the obligor or materially increase the obligor’s burden or risk under the contract or the contract involves obligations of a personal nature. 29 Williston on Contracts §74:10 (4th ed. 2004)

Similarly, the Restatement (Second) of Contracts states:

- (2) A contractual right can be assigned unless
- (a) the substitution of a right of the assignee for the right of the assignor would materially change the duty of the obligor, or materially increase the burden or risk imposed on him by his contract, or materially impair his chance of obtaining return performance, or materially reduce its value to him, or
- (b) the assignment is forbidden by statute or is otherwise inoperative on grounds of public policy, or
- (c) assignment is validly precluded by contract.
- (§317(2))

Unless barred by contract or some public policy, contracts are assignable unless the assignment will work a material change in the contract. The classic example is personal service contracts. As one court whimsically explained, if one contracted with Luciano

Pavarotti to sing at a concert, that party could not be forced to accept performance of the contract by Michael Jackson.¹

If a consent decree is to be interpreted as a contract, it is difficult to see why it cannot be assigned. The typical consent decree or consent judgment in an intellectual property case has as its core a promise to refrain from doing something, i.e., acts of infringement of the asserted intellectual property rights or some subset thereof. The consent judgment considered in *Thatcher* is typical: the defendants bound themselves not to sell products embodying a particular trade dress or violating such a patent. What material difference would it make to them that the owner of that trade dress and patent changed?

Assignment of Rights

The general rule permitting assignment of contractual rights has particular force where the rights pertain to a piece of property or to a business. For example, the Restatement provides the following as an example of a permitted assignment:

B sells his business to A and makes a valid contract not to compete. A sells the business to C and assigns to C the right to have B refrain from competition. The assignment is effective with respect to competition with the business derived from B. The good will of the business, with contractual protection against its impairment, is treated as an assignable asset. [§317, illustration 6.]

That illustration has been followed in case law.²

Or, as another example, suppose the owner of a house contracts with a builder to build a patio. By law, there is an implied covenant that the contract will be performed in a reasonably good and workmanlike manner. If the owners discover that the patio has been negligently built, they have a cause of action for breach of that implied promise. Now suppose the house is sold; the new owners do not discover the defect until some time after moving in. The

contractor cannot avoid liability by claiming that he only contracted with the original owners; to the contrary, the contractual rights and duties are freely assignable, and, given that the prior owners have no interest in the house, it will be presumed that the contract of sale include an assignment as to any rights with respect to the property. The New Jersey Supreme Court so held in the 1984 case *Aronsohn v. Mandara*, 98 NJ 92, 484 A2d 675 (1984). The court analogized this to real property covenants that run with the land. As a matter of public policy, contractual agreements that relate to the land should be considered connected to it and flow from its ownership. "The benefits of such covenants touch and concern the property and should flow with the ownership despite the absence of privity between the contractor and the present owner." *Id.*, 98 NJ at 101, 484 A2d at 679.

One wonders why this public policy should not apply to agreements (including consent judgments) concerning intellectual property. Why did Kohl's agree to any consent injunction whatsoever? Presumably because Thatcher's claims of trade dress and patent infringement had at least some chance of success. Thatcher's claims flowed from his alleged ownership of intellectual property. Why shouldn't agreements which touch upon such property not be held to follow the ownership of the property?

Enforcement

Another problem, not considered by the Federal Circuit, is who, if anyone, can now enforce the Consent Judgment? Although not discussed in either the Federal Circuit opinion nor that of the district court, Deckers' papers in the district court indicate that it supplied a "Ratification" by Mark Thatcher of its motion under Rule 17(c), where he not only ratified the motion but agreed to join in it as a co-movant.³

It is puzzling that this was overlooked by both courts. Deckers argued that it was

the "real party in interest" and it should therefore have standing to enforce the consent judgment. But, if the right to enforce was not assignable, then perform that means that Mark Thatcher retained that right and he should be able to do so. That would be an odd result, since Mr. Thatcher no longer owned the patents and trade dress which underlay the consent judgment. But, given that he joined the motion, at least one of them should have had standing.

The Federal Circuit decision leaves unclear who, if anyone, could enforce the consent decree. Could Deckers have avoided the whole situation simply by including Mr. Thatcher as a co-movant in the first place? Or did the injunction in effect dissolve upon transfer of the intellectual property rights?

Future: Suggestions, Issues

At present, the *Thatcher* case appears to be the only federal appellate decision on point, and practitioners should at least be careful to heed the implicit warning therein.

For litigators, both Settlement Agreements and Consent Judgments should contain the "magic words" permitting assignment. For example, one might add clauses stating that "The rights contained in this [Settlement Agreement] [Consent Judgment], including the right to enforce it, shall be freely assignable to the fullest extent permitted by law."

For transactional counsel, when reviewing intellectual property (either for valuation, merger or simply when performing an audit), apart from the property itself and any licenses thereof, one should also review any consent judgments related to the intellectual property to ensure that they have the "magic words." If they do not, then preferably one should request that the parties thereto agree to an assignment. If they do not, then at minimum one should require that the seller agrees to join in any contempt motion or motion to enforce the consent judgment as a co-movant.

Other practitioners may also be affected. The recently passed Sarbanes-Oxley amendment requires enhanced disclosures about intellectual property. Query whether the *Thatcher* decision affects the value of a corporation's assets and the content of such disclosures.

Bankruptcy cases often involve complex issues of assignment of intellectual property and intellectual property licenses. If the intellectual property has been the subject of a consent judgment, then its assignability becomes another issue.

Finally, if the Federal Circuit rule announced in *Thatcher* stands, query whether the assignee can make any use of the prior judgment. While Deckers cannot bring a contempt motion against Kohl's, it can certainly bring new action for patent and trade dress infringement for the new allegedly infringing activities. As noted, the first consent judgment recited that Mr. Thatcher had valid trade dress rights. Can Deckers rely on this order under the law of collateral estoppel? The Federal Circuit has held that collateral estoppel or issue preclusion can apply to consent judgments, if the parties intended to give the judgment preclusive effect. See *Foster v. Hallco Mfg. Co.*, 947 F2d 469, 480-83 (Fed. Cir. 1991). Assuming such intent were found as between Mr. Thatcher and Kohl's, may Deckers rely on it as Mr. Thatcher's assignee or "privity"? Or does the rule announced in the *Thatcher* opinion limit such intent to the immediate parties to the consent judgment?

1. See *Matter of Midway Airline, Inc.*, 6 F3d 492, 495 (7th Cir. 1993).

2. See *Equifax Svcs., Inc. v. Hitz*, 905 F2d 1355, 1361 (10th Cir. 1990); *On-line Techs. v. Perkin Elmer Corp.*, 141 FSupp2d 246 (D.Conn. 2001).

3. See Motion for Reconsideration, *Thatcher v. Kohl's Dept. Stores*, No.97-C-4746, Dkt. No. 48.