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Patents / Preliminary Injunctions

Intra-Circuit Split Continues as Federal Circuit Denies Rehearing *En Banc*
by Kevin P. Shortsle

In denying the plaintiffs' petition for rehearing *en banc*, the Court of Appeals for the Federal Circuit left open an intra-circuit split as to the proper standard in assessing the likelihood of success factor when deciding preliminary injunction motions in patent infringement cases. *Kimberly-Clark Worldwide, Inc. v. First Quality Baby Products, LLC*, Case No. 10-1382 (Fed. Cir., Sept. 29, 2011) (order denying rehearing *en banc*) (Newman, J., joined by O'Malley, J., and Reyna, J., dissenting).

At the district court, plaintiffs Kimberly-Clark won a preliminary injunction. First Quality appealed. On appeal, a panel comprised of Judges Dyk, Friedman and Prost reversed the district court for three of the four patents-in-suit holding that the district court abused its discretion in granting the injunction. The panel found that because First Quality's defenses were not "substantially meritless" or did not "lack substantial merit," Kimberly-Clark failed to establish a likelihood of success on the merits, which precluded the injunction. The Federal Circuit subsequently denied Kimberly-Clark's petition for rehearing *en banc*.

In dissent, Judge Newman, joined by Judges O'Malley and Reyna, argued that the panel applied a different standard than the traditional standard for issuing preliminary injunctions. Instead of applying the traditional standard that plaintiffs must show they will likely succeed on the merits, the panel adopted a standard that no preliminary injunction will be granted if the defendant raises a defense that does not "lack substantial merit." This standard, Judge Newman argued, is inconsistent with every other circuit court of appeals. All the other circuits require consideration of a movant's

likelihood of success on the merits considered with the other equitable factors, *i.e.*, irreparable harm to the movant in the absence of preliminary relief, balance of harms tipping in the movant's favor or whether an injunction is in the public interest. Judge Newman argued that under the panel's standard a preliminary injunction would be denied "merely because the non-movant has raised an argument worthy of consideration." According to Judge Newman, the effect of the "lack substantial merit" standard is that all preliminary injunctions will likely be denied, even when the other factors weigh in the movant's favor.

Judge Newman also argued that the panel's standard is inconsistent with the presumptions and burdens at trial. Since the defendant's burden at trial is the same as their burden during the preliminary injunction stage (clear and convincing evidence), the panel's "lack substantial merit" is in conflict with this evidentiary standard. As Judge Newman stated, "a defense that does not 'lack substantial merit' is of a different order than a defense that is likely to succeed by clear and convincing evidence." Judge Newman also found the panel's opinion inconsistent with the Supreme Court's holding in *eBay Inc. v. MercExchange, LLC*, in which the Court held that traditional principles of injunctions applied with equal force to patent cases. Finally, Judge Newman argued that the panel failed to demonstrate how the district court abused its discretion in granting the preliminary injunction.

Judge O'Malley, writing separately, argued that the panel deviated from the normal standards of assessing whether to grant preliminary injunctions in three ways: the panel's test of whether the assertion of invalidity is "substantially meritless" is not the same test as the likelihood of success test that controlling rules and case law mandate; the panel relied on one factor rather than balancing all four factors; the panel gave no deference to the district court where deference was due. Consequently, Judge O'Malley argued that the panel's holding "virtually mandates denial of all such [preliminary injunction] motions," which is inconsistent with the other circuit courts of appeals and the Supreme Court's holding in *eBay*.

Practice Note: At the district court, whether attempting to defeat or obtain a preliminary injunction, both standards should be considered since the outcomes of appeals at the Federal Circuit are panel-dependent.

Patents / Injunctions

Post-*eBay* Demise of the Presumption of Irreparable Harm for Awarding Injunctive Relief

by W. Sutton Ansley

The U.S. Court of Appeals for the Federal Circuit has now clarified an issue that has festered for the past five years: whether the presumption of irreparable harm for granting injunctive relief survived the Supreme Court's ruling in *eBay v. MercExchange*. Settling this issue once and for all, the Federal Circuit has concluded that "*eBay* jettisoned the presumption of irreparable harm as it applies to determining the appropriateness of injunctive relief." *Robert Bosch LLC v. Pylon Mfg. Corp.*, Case No. 11-1096 (Fed. Cir., Oct. 13, 2011) (O'Malley, J.) (Bryson, J., dissenting).

The case was brought by Bosch the alleging infringement of four patents covering "beam-type wiper blades." These "beam blades," which provide better performance during inclement weather than their traditional bracketed brethren, were sold by both Bosch and Pylon. After a jury found infringement by Pylon, Bosch moved for entry of a permanent injunction. The district court denied this motion on the grounds that Bosch failed to demonstrate that it would suffer irreparable harm without a permanent injunction. Specifically, the district court based its determination on three factors: the fact that Bosch had "fail[ed] to define a relevant market; the existence of additional competitors; and the non-core nature of Bosch's wiper blade business in relation to its business as a whole." Bosch appealed.

Before specifically analyzing the district court's decision to deny Bosch's motion, the Federal Circuit addressed the uncertainty surrounding the effect of *eBay* on the presumption of irreparable harm presumption. Although the Supreme Court's opinion in *eBay* had expressed that "broad classifications" and "categorical rule[s]" are inappropriate for deciding whether to grant injunctive relief, the Supreme Court did not explicitly address whether a presumption of irreparable harm should still follow from a finding of patent infringement. According to the Federal Circuit, *eBay* did in fact eliminate this presumption. However, the Federal Circuit went on to caution that *eBay* did not suggest that courts lean *against* findings of irreparable harm. Rather, the Federal Circuit cautioned that courts should be mindful of "the fundamental nature of patents as property rights granting the owner the right to exclude."

Having resolved the ambiguity left in *eBay*'s wake, the Federal Circuit focused on the district court's denial of Bosch's motion for injunctive relief. According to the Federal Circuit, the district court's reliance on the three factors mentioned above amounted to legal error. The Federal Circuit emphasized that "other infringers … in the marketplace does not negate irreparable harm." Moreover, "the fact that an infringer's harm affects only a portion of a patentee's business says nothing about whether that harm can be rectified." In fact, the Federal Circuit found that Bosch would suffer irreparable harm despite these factors. It based this finding on evidence establishing "that the parties directly compete for customers in each of the relevant distribution channels;" that Bosch had "lost market share" due to Pylon's infringement; and Pylon's likely inability to satisfy a monetary judgment against it.

Patent Infringement

Post-*Therasense*: Inequitable Conduct Really Is a Higher Standard
by Jeremy T. Elman

In its first post-*Therasense* case (see*IP Update*, Vol. 14, No. 6) addressing the issue of inequitable conduct, the U.S. Court of Appeals for the Federal Circuit affirmed the district court's holding that an applicant who had intentionally failed to update a Petition to Make Special, in which it sough to expedite examination, did not commit inequitable conduct because the failure was not the type of action that would have prevented the patent from issuing under the heightened standard for inequitable conduct. *Powell v. Home Depot, Inc.*, Case Nos. 10-1409, 1416 (Fed. Cir., Nov. 14, 2011) (Prost, J.).

Michael S. Powell presented a "saw guard" prototype to Home Depot to prevent employees from harm while cutting lumber for customers. After Home Depot ordered eight productions units for use and testing, Powell filed an application for a patent on his saw guard invention. Around the same time and unbeknownst to Powell, Home Depot contracted with another company, Industriaplex, to produce identical copies of Powell's invention for approximately $700 less per unit. Mr. Powell continued to negotiate with Home Depot while prosecuting his patent, but eventually could not reach an agreement.

Powell brought suit against Home Depot, alleging that it infringed his patent, covering radial arm saw guards that are installed in every Home Depot store location throughout

the United States. A jury determined that Home Depot infringed and awarded $15 million and damages (later enhanced by $3 million). Later, in a bench trial, the district court determined that Powell had not committed inequitable conduct. Among the issues on appeal to the Federal Circuit, Home Depot challenged the judge's finding of no inequitable conduct.

The inequitable conduct issue focused on Powell's filing of a Petition to Make Special during prosecution, which he filed to seek expedited review on the grounds that his ongoing negotiations with Home Depot obligated him to manufacture and supply saw guards embodying the claims. However, before the petition was granted, it became clear that Home Depot would not be contracting with Powell and would use another company to supply saw guards. Powell did not update his Petition to Make Special to show that he was no longer obligated, and the U.S. Patent and Trademark Office (USPTO) granted the petition.

The district court determined that Powell intentionally failed to inform the USPTO that he was not obligated to manufacture but that Home Depot had failed to prove by clear and convincing evidence that the patent should be unenforceable based on a balance of the equities.

The Federal Circuit, noting that its *Therasense* decision raised the bar for proving inequitable conduct, held that Powell had not committed inequitable conduct. Rather, the Federal Circuit panel held that Powell's conduct failed the "but-for" materiality standard. Powell's conduct was not the type of "unequivocal act" that was affirmatively egregious misconduct, false as filing an unmistakably false affidavit.

Practice Note: Post-*Therasense*, a patent applicant's inequitable conduct will render a patent unenforceable only where the patent would not have issued "but for" the inequitable conduct. Even knowingly omitting information to the USPTO will not satisfy this standard absent "affirmatively egregious conduct." For the earlier claim instruction portion of this case, see *IP Update*, Vol. 14, No. 7. .

Patents / Claim Construction

Claim Construct Tension Persists at Federal Court
by David Beckwith

The U.S. Court of Appeals for the Federal Circuit denied a petition for rehearing *en banc*, over the spirited dissent of Judges Moore, Rader and O'Malley. The petition sought *en banc* review of the panel opinion in *Retractable Technologies, Inc. v. Becton, Dickinson and Co.*, (*IP Update*, Vol. 14, No. 7) and addressed the claim construction tension between broadly drafted claims and a narrow invention as presented in the accompanying written description. *Retractable Technologies, Inc. v. Becton, Dickinson and Co.*, Case No. 10-1402 (Fed. Cir., Oct. 31, 2011) (Order) (Moore, J., dissenting, joined by Rader, C.J.) (O'Malley, J., dissenting).

In the panel decision, the Federal Circuit had affirmed in part and reversed in part the district court's determination that a syringe body could include a multi-part structure. The panel majority noted that the specification indicates what was invented, and the claim language should not be interpreted to extend the invention beyond that set forth in the written description.

Two separate dissenting opinions were filed from the refusal to grant rehearing. In the first dissent Judge Moore identified this case a vehicle to address two principles: the role of the specification in construing claims and, specifically, whether the invention as described in the specification should be used to rewrite the ordinary meaning of claim language to better capture what was invented and whether deference should be given to the district court in the claim construction process. In answering the first principle, Judge Moore explained that if the claims are broadly drafted beyond what is disclosed in the specification that is a problem of validity, not claim construction. In Judge Moore's opinion, claims should not be rewritten to better conform to what the court discerns to be the "invention" of the patent. Specifically, the plain and ordinary meaning of claim language should not be broadened or narrowed unless the inventor acted as his own lexicographer or intentionally disclaimed claim scope. As explained by Judge Moore, changing the plain and ordinary meaning of claim terms to tailor the scope of the claims to the perceived invention is not supported by the *en banc* decision in *Philips*.

In addressing the principle of de novo review of claim construction, Judge O'Malley (who recently arrived at the Federal circuit from the U.S. District Court for the Northern District of Ohio) would revisit and reverse the en banc decision in *Cybor Corp. v. FAS Techs.,* concerning the standard of review applied to district court claim construction decisions. As explained by Judge O'Malley, the U.S. Supreme Court has referred to

claim construction as a "mongrel" practice involving both legal and factual inquiries. Yet under current Federal Circuit precedent, zero deference is given to the district court's detailed factual inquiries concerning the point of view of one skilled in the art at the time of the invention.

Practice Note: The two separate dissents from the denial of *en banc* review, including the views of the chief judge of the circuit, suggest that both legal principles may soon be the focus of additional Federal Circuit or Supreme Court analysis.

Patents/ Indefiniteness

Algorithm Written in Prose Provides Sufficient Structure for a Means-Plus-Function Claim Term
by Theresa M. Dawson

In a patent infringement case involving two touchscreen device patents brought against nine manufacturers and/or sellers of laptop computers, tablet computers and handheld devices, the U.S. Court of Appeals for the Federal Circuit reversed the district court's judgment of invalidity with respect to three claims, but affirmed the judgment of non-infringement as to all defendants. *Typhoon Touch Techs., Inc. v. Dell, Inc., et al.*, Case No. 09-1589 (Fed. Cir., Nov. 4, 2011) (Newman, J.).

The district court's judgment of invalidity was based on its conclusion that the claim term "means for cross-referencing," a term written in the statutory form authorized by 35 U.S.C. § 112 ¶ 6, was indefinite. Typhoon conceded that the structure to support the term is not explicitly disclosed in the specifications of the two patents. The district court referred to this "concession" in its opinion and further relied on Federal Circuit precedent for the premise that a means-plus-function term is indefinite (under 35 U.S.C. § 112, ¶ 2) when the specification "simply describes the function to be performed, not the algorithm by which it is performed." Typhoon appealed.

The Federal Circuit took issue with the district court's apparent narrow definition of the term "algorithm," explaining that the term should be understood more broadly to mean "[a] fixed step-by-step procedure for accomplishing a given result; usually a simplified procedure for solving a complex problem, also a full statement of a finite number of

steps." The Court further indicated that a patentee need not include computer code in the specification for a computer-implemented procedure in order to comply with the requirements of § 112, ¶ 2. Instead, a procedural algorithm may be expressed "in any understandable terms including as a mathematical formula, in prose, or as a flow chart, or in any other manner that provides sufficient structure."

Applying these criteria, the Federal Circuit concluded that the term "means for cross-referencing" was supported by sufficient structure in the specifications and thus not indefinite. Specifically, the Court concluded that the specifications of the two patents recite in prose a four-step algorithm for computer-implemented cross-referencing. The Court further found that defendants presented no evidence that a programmer of ordinary skill in the field would not understand how to implement the recited function.

Although it reversed the judgment on invalidity, the Federal Circuit affirmed the district court's holding that the defendants were not liable for infringement. Typhoon stipulated to judgment of non-infringement based on the district court's constructions of three claim terms as requiring a device to actually perform, or be configured or programmed to perform, each of the functions stated in the claims. On appeal, Typhoon argued that the district court injected a "use" requirement into the apparatus claims and that it was sufficient if a device was merely capable of being configured or programmed to perform the functions stated in the claims. The Federal Circuit rejected Typhoon's arguments and confirmed the district court's constructions.

Practice Note: A claim limitation related to a computer-implemented procedure written in statutory means-plus-function form can avoid invalidity for indefiniteness so long as the specification recites clearly in prose or otherwise the steps to be implemented by persons skilled in computer programming.

Patents / Declaratory Judgment Jurisdiction

Licensees Entitled to Seek Declaratory Judgment Despite a License
by Philip Ou

The U.S. Court of Appeals for the Federal Circuit found that the district court erred in granting a motion to dismiss for lack of subject-matter jurisdiction, concluding that a

controversy existed notwithstanding an existing license between the parties. *Powertech Technology Inc. v. Tessera, Inc.,* Case No. 10-1489 (Fed. Cir., Sept. 30, 2011) (Dyk, J.).

The plaintiff, Powertech Technology, Inc. (PTI) is a licensee of various patents assigned to Tessera, Inc., including the patent-in-suit, which is directed to a process of semiconductor chip packaging. In 2007, Tessera filed a complaint against various parties before the International Trade Commission (ITC) and in the U.S. District Court for the Eastern District of Texas, alleging infringement of several Tessera patents, including the patent-in-suit, through the importation and sale of certain semiconductor chips. Tessera licensed Powertech to manufacture both of the groups of accused semiconductor chips that were in issue before the ITC and in the Texas action. Though Powertech was not named as a defendant in the above action, some of the accused companies were customers who directly or indirectly purchased their accused chips from Powertech.

During the pendency of the ITC investigation, Powertech continued to make royalty payments "under protest" to Tessera because it believed certain accused chips did not infringe Tessera's patent and that the patent was invalid. Powertech subsequently filed a declaratory action for non-infringement and invalidity of the patent in the U.S. District Court for the Northern District of California. Tessera responded by filing a motion to dismiss for lack of subject-matter jurisdiction; arguing that no controversy could exist so long as Powertech remained a licensee of the patent in question.

The district court granted Tessera's motion, finding that Powertech's products could not have been at issue in the ITC action because "PTI's products [were all] manufactured pursuant to a license with Tessera." The court also concluded that no actual controversy arose from the license agreement itself because Powertech was required to pay royalties irrespective of whether its products were covered by the patent. Finally, the district court, acting *sua sponte*, held that even if an actual controversy existed, the court would decline to hear the case because judicial efficiency favored hearing the action with the pending E. D. Texas district court action. Powertech appealed.

The Federal Circuit reversed, rebuffing Tessera's argument that Powertech must be in breach of its license agreement to create a case or controversy. Rather, as the Court explained, under the Supreme Court *MedImmune* decision Powertech need not be in breach of its license to challenge the validity or infringement of the patent. Moreover,

the Federal Circuit noted that in the ITC action, Tessera alleged that Powertech had underpaid its royalties or paid them late. These allegations alone created a controversy as to whether certain sales of PTI's products were unlicensed and infringing.

The Federal Circuit also concluded that the dispute between Powertech and Tessera as to whether the license agreement required royalty payments to be tied to valid patent coverage was sufficient to support declaratory judgment jurisdiction.

Finally, the Federal Circuit noted that the district court erred in finding that if a controversy existed, the dispute should be heard as part of Tessera's action in Texas. Reasoning that the forum selection clause in Powertech's license agreement clearly called for disputes to be filed in California, the Court found the district court's refusal of jurisdiction of the action to be an abuse of discretion.

Patents / Inter Partes Reexamination

***Inter Partes*Estoppel Provision Applies Only After All Appeals Have Been Exhausted**
by Amol Parikh

In a matter of first impression, the U.S. Court of Appeals for the Federal Circuit revived the defendant's invalidity case finding that the estoppel provision governing *inter partes* reexamination is triggered not when the reexamination is completed, but only after all appeal rights have been exhausted. *Bettcher Indus., Inc. v. Bunzl USA, Inc. et al.*, Case Nos. 10-1038, -1046 (Fed. Cir., Oct. 3, 2011) (Linn, J.).

Bettcher filed a patent infringement action against Bunzl alleging infringement of a patent directed to a power-operated knife used principally in the meat packing and other commercial food-processing industries. After Bettcher filed suit, and while the proceedings were pending before the district court, Bunzl requested *inter partes* reexamination of the asserted patent in the U. S. Patent and Trademark Office (USPTO). In due course, the reexamination was initiated; the examiner ultimately declined to adopt the grounds of rejection proposed by Bunzl and issued a Right of Appeal Notice. Bunzl appealed to the Board of Patent Appeals and Interferences (Board).

When the examiner issued the Right of Appeal Notice, Bettcher requested the district court exclude certain invalidity references under the estoppel provision of 35 U.S.C. § 315(c). Under § 315(c):

A third-party requester whose request for an *inter partes* reexamination results in an order under § 313 is estopped from asserting at a later time, in any civil action [under the United States patent laws] the invalidity of any claim finally determined to be valid and patentable on any ground which the third-party requester raised or could have raised during the *inter partes* reexamination proceedings.

Bettcher argued that Bunzl was estopped from asserting these references in the district court because the examiner had determined that the references did not invalidate the claims of the asserted patent. Bettcher argued that the estoppel provision took effect as soon as the examiner finished the reexamination and issued the Right of Appeal Notice. The district court agreed and found that the issuance of a Right of Notice of Appeal "finally determined" the claims to be valid thereby triggering the estoppel provision. As a result, the district court granted Bettcher's request to exclude the references at trial. Bettcher appealed.

On appeal, Bettcher argued that the district court wrongly interpreted the estoppel provision by holding it applies at the conclusion of examination when the examiner issued the Right of Appeal Notice. Recognizing that when the estoppel provision attaches is a question of first impression, the Federal Circuit noted that the parties' arguments require the Court to decide the meaning of "finally determined" in § 315(c) in view of the statute, the legislative framework, the related regulations and the legislative history.

Turning first to the language of the statute, the Court noted that § 315(a) and (b) allow patent owners and third-party requesters to appeal the examiner's decision to the Board and the Federal Circuit. The estoppel provision of subsection (c) falls directly after sections (a) and (b). The Court found that the placement of the estoppel provision immediately after subsections (a) and (b) strongly suggests that the phrase "finally determined" refers to the stage of the proceedings after the events contemplated by subsections (a) and (b) have run their course. Because subsections (a) and (b) each state that the parties may appeal to the Board and to Federal Circuit, the Court found

that the plain language of the statute implies that estoppel requires exhaustion of all appeal rights.

Next, the Court analyzed the framework of reexamination proceedings. During an appeal, the Board can assert new grounds of rejection provided that the patent owner has an opportunity to respond. The Court found that because the addition of new grounds of rejection on appeal entitles the patent owner to continue prosecution before the examiner, the structure of the reexamination proceeding suggests that reexamination is not final prior to exhaustion of all appeal rights.

The Court then turned to Bettchers's argument that regulations discussing the Right of Appeal Notice establish that the phrase "final determination" in § 315 refers to the Right of Appeal Notice. Bettcher argued that because 37 C.F.R. § 1.953 and 41.61(a)(2) treat the Right of Appeal Notice as a "final action" and "final decision," the phrase "finally determined" in § 315 must refer to the Right of Appeal Notice. The Court summarily rejected this argument, finding 37 C.F.R. § 1.953 and 41.61(a)(2) in no way address the application of any estoppel and do not purport to interpret or define the statutory language of § 315.

Finally, the Court reviewed the legislative history. The legislative history of an uncodified "fact" estoppel notes that "estoppel arises after a final decision in the *inter partes* reexamination or a final decision in any appeal of such reexamination." Bettcher argued that this language from the legislative history distinguishes final decisions from reexaminations from final decisions in any appeal of such reexaminations, such that the estoppel provision of § 315(c) should be read to apply as soon as there is a final decision in a reexamination (*i.e.*, Right of Appeal Notice). The Court rejected this argument, going as far as to say it was at a loss to understand how this argument helps Bettcher. Instead, the Court found that the legislative history of the uncodified "fact" estoppel proves that it applies only after all appeals are exhausted and, if anything, it suggests that that the estoppel provision of § 315(c) also applies after all appeals are exhausted.

Patents / Written Description and Trade Secret

Trade Secret or Patent, Not Both
by Hasan Rashid

Delineating patent protection from trade secret protection with reference to the same accused product, the U.S. Court of Appeals for the Federal Circuit upheld a finding of lack of written description support while also finding misappropriation of valid trade secret. *Atlantic Research Marketing Sys. v. Troy*, Case Nos. 11-1002, -1003 (Fed. Cir., Oct. 6, 2011) (Prost, J.).

Atlantic Research, founded by Richard Swan, owns the patent-in-suit directed to free-floating handguards for rifles. A free-floating handguard solves the problem of attaching an ancillary device to a rifle without touching the rifle barrel. In 2002, Swan met Stephen Troy, who soon became Swan's employee and "right-hand man." Troy signed a nondisclosure agreement as part of his employment. In 2003, however, Swan's and Troy's relationship went sour, and Troy began a new company, Troy Industries, which competes with Atlantic Research.

Atlantic Research brought suit for patent infringement and trade secret misappropriation. Regarding the former, the district court invalidated the asserted claims of the '245 patent on summary judgment for lacking written description support for the claimed subject matter. The trade secret claim, however, went to the jury. The jury found a valid trade secret and misappropriation. The jury agreed that Swan developed a prototype for a free-floating handguard having a single rifle support point, which Swan showed to Troy. The jury disbelieved Troy's testimony that Troy came up with the design of the accused products while vacationing in Turkey. Atlantic Research appealed.

On appeal, the Federal Circuit upheld the invalidity holding of the district court. The Court agreed that, although the plain meaning of the asserted claim required only one support point (like Troy's handguard), the only disclosed designs in the written description required two support points. Atlantic Research argued that he district court erred on its claim construction arguing that, although the "barrel nut" support was expressly recited in the independent claim, it did not mean the claim did not also include

a two-support handguard system. The Federal Circuit noted the absence of any disclosure of a single-point handguard support system and that the originally issued claims were directed to such a two-support system. In fact the claims in suit were added by reissue to eliminate the second handguard support from the claim. The Federal Circuit also noted that Atlantic Research, during Markman, argued for a construction that did not require a second support. The Federal Circuit concluded that the district court correctly found that the claim was directed to an undisclosed single point support system that was invalid for failure to satisfy the written description requirement.

The Court commented on the mutual exclusivity of protecting an idea through trade secret law and protecting an invention through patent law. Upholding the jury's trade secret misappropriation finding, the Federal Circuit noted the inherent tension Atlantic Research created by arguing that its patent has proper support for a singly supported handguard and that a singly supported handguard is an Atlantic Research trade secret. The Court even found additional support for its invalidity decision in the fact that Atlantic Research asserted the design to be a trade secret.

The case was remanded, however, because the Court reversed the district court's denial of Troy's motion for a mistrial. The motion was based on the one juror's bringing from home and showing other jurors a plumbing clamp to assist in deliberations.

Practice Note: A patentee-plaintiff must be careful when concurrently asserting a trade-secret claim because in some regards the two bodies of law offer mutually exclusive protections.

Patents / Claim Construction

"One," But Not the One and Only
by Charles J. Hawkins

The U.S. Court of Appeals for the Federal Circuit affirmed a lower court's summary judgment ruling of infringement of certain patent claims, concluding that the lower court had properly construed disputed claim terms leading to the finding. *IGT v. Bally Gaming Int'l, Inc.*, Case Nos. 10-1364, -1365 (Fed. Cir., Oct. 6, 2011) (Moore, J.).

The plaintiff IGT alleged infringement by Bally Gaming of two patents relating to systems for controlling networked gaming devices, which are connected to floor controllers that monitor gaming activity. The patents describe methods for rewarding players over and above the normal device payouts. IGT accused Bally of infringing the claims of these patents when Bally offers two promotions—Power Rewards and Power Winners. The district court, after construing a number of claim terms, determined, as a matter of law, that the Power Rewards promotion infringed certain claims of both patents and that the Power Winners promotion infringed the claims of one of the patents. Bally appealed the lower court's ruling, arguing that the district court erred in its claim construction, *inter alia*, of the claim term "one."

The Federal Circuit reviewed the lower court's claim constructions *de novo*. One of the asserted claims required "issuing a command over the network to *one* of said preselected gaming devices" and "paying at said *one* gaming device in accordance with the command." Bally, disagreeing with the lower court's construction, argued that the term "one" should be construed to mean "one and only one," *i.e.,* that the command must be sent to one and only one machine during a promotional period. Bally argued that its products do not infringe because they pay at more than one gaming device.

The Federal Circuit disagreed. The court construed the term "one" in the context of the words that surrounded it, *i.e.,* as the term is used in the claim. In the Court's view, the claim covered a system in which a single command is issued to a single gaming device and causes that same device to pay in response to the command. The Court rejected Bally's argument that attempted to limit the number of commands that could be issued to discrete gaming devices. Nothing in the limitation, concluded the Court, required issuing only one command to only one machine. Therefore, the Federal Circuit agreed with the lower court's construction of "one" and affirmed the ruling of summary judgment of infringement.

The Federal Circuit went on to analyze four other disputed claim terms that Bally argued were incorrectly construed by the lower court. In each case, the court concluded that, the district court had correctly construed the terms. Although the court modified the construction of a term that IGT argued was misconstrued, it declined to reverse the lower court's finding of non-infringement.

Patents / Damages / ANDA

Parties' Contract Trumps Patent Act to Deny Prejudgment Interest
by Daniel R. Foster

Notwithstanding that the federal common law provides for pre-judgment interest, the U.S. Court of Appeals for the Federal Circuit overturned a district court award of prejudgment interest in light of the parties' agreement to limit actual damages. *Sanofi-Aventis, et al. v. Apotex Inc. and Apotex Corp.*, Case No. 11-1048 (Fed. Cir., Oct. 18, 2011) (Moore, J.) (Newman, J., dissenting).

Sanofi sells a drug under the brand name Plavix. In 2001, Apotex filed an Abbreviated New Drug Application (ANDA) with the United States Food and Drug Administration (FDA) seeking approval for the sale of generic version of Plavix and asserting that the Sanofi patent that covered Plavix was invalid.

In 2002 Sanofi filed an infringement action against Apotex. Apotex admitted infringement but counterclaimed that the patent was invalid and unenforceable. The case was subject to the office action 30-month-stay provision of ANDA. In January 2006, the FDA gave Apotex final approval to sell its generic product. Before the FDA approval the parties began negotiating a settlement agreement, which was entered in March 2006. Under the March 2006 Settlement Agreement, Sanofi granted Apotex a future license under the patent, which would allow Apotex to begin sale of its generic product several months before the patent expired. Sanofi also agreed that it would not launch its own generic version of Plavix during the period of Apotex's license. After the U. S. Federal Trade Commission rejected certain provisions of the March 2006 Settlement Agreement, the parties negotiated further, entering a second settlement agreement in May 2006. Under the terms of the May 2006 Settlement Agreement, Sanofi's "actual damages" as a result of any infringement by Apotex were set as "50% of Apotex's net sales." Under the terms of the May 2006 Settlement Agreement, Sanofi also agreed that it would not seek increased damages under 35 U.S.C. § 284.

After Apotex began selling its generic product, Sanofi moved for a preliminary injunction which was granted. Apotex made over $884 million in net sales before the injunction was entered. The district court, in a subsequent bench trial, held that the patent was

not invalid and was not unenforceable. The district court later determined that Sanofi was entitled to $442 million in damages (50 percent of Apotex's net sales of $884 million), plus $107 million in prejudgment interest. The district court determined that because only "damages" were limited by the parties' agreement, the separate award of interest (a distinct category of relief) was appropriate. Sanofi appealed.

Reviewing the decision for an abuse of discretion, the Federal Circuit concluded that the parties intended that the phrase "actual damages" include *all* damages necessary to compensate Sanofi for Apotex's infringement. Moreover, the Court concluded that the parties' inclusion of a separate interest provision in another section of the May 2006 Settlement Agreement further supported its conclusion that when the parties agreed upon the amount of "actual damages" they intended this to be the total damages necessary to compensate Sanofi for Apotex's infringement.

Judge Newman dissented, declaring that the May 2006 Settlement Agreement did not alter the general rule that prejudgment interest is awarded on damages for patent infringement. Although the May 2006 Settlement Agreement explicitly limits damages, it does not in any way restrict an award of interest on those damages. In Judge Newman's opinion, the parties' silence should not be interpreted as removing Sanofi's right to receive the interest to which it is entitled by statute and precedent.

Patents / Interference

Proof that the Claimed Invention Worked Is Required for Reduction to Practice
by Robert H. Underwood

In reviewing a district court action under 35 USC § 146 subsequent to an interference decision of the Board of Patent Appeals and Interferences (Board), the U.S. Court of Appeals for the Federal Circuit concluded that the district court may take new evidence and determine priority *de novo*. The Court also found that evidence showing reduction to practice of the invention must include a showing that the invention worked for its intended purpose. *Streck Inc. v. Research & Diagnostics Systems Inc.*, Case No. 11-1045 (Fed. Cir., Oct. 20, 2011) (Newman, J.).

The technology at issue relates to "control compositions" that are used to ensure the accuracy of blood analysis instruments. Both Streck and Research & Diagnostics Systems (R&D) make such control compositions.

Streck sued R&D for infringement of three patents. R&D defended by alleging that its employee, Dr. Alan Johnson, was the first inventor of the invention claimed in the Streck patents. The jury found that R&D did not prove by clear and convincing evidence that Johnson was the first to invent, and judgment was entered against it. Concurrently, Streck and R&D were involved in an interference proceeding in the U.S. Patent and Trademark Office (USPTO) involving five Streck patents (including the three patents at issue in the district court) and a pending patent application by R&D naming Johnson as the inventor. After the Board awarded priority to R&D, who was the junior party in the interference, Streck filed a §146 action that was assigned to the same judge who tried the infringement case. The district court overturned the Board decision and awarded priority to Streck after considering the USPTO interference record as well as new evidence. R&D appealed both the infringement and priority decisions, but in this case the Federal Circuit addressed the priority issue only.

R&D raised several procedural issues on appeal, including the authority of the district court to have and consider the new evidence Streck did not introduce at the USPTO Board. The Federal Circuit affirmed, explaining that in a §146 proceeding a court is authorized to take evidence that was not presented to the Board and to conduct a *de novo* determination of priority. The Court also held that R&D, the junior party in the *de novo* proceeding, properly bore the burden of persuasion and that the preponderance of the evidence standard used by the court was appropriate.

On the merits of the priority case, it was not disputed that Streck's inventors were the first to conceive the invention. R&D alleged that its inventor actually reduced the invention to practice before the Streck inventors and that the Streck inventors were not diligent from the time of their conception up to the time of their reduction to practice. In the district court, the priority issue hinged on whether R&D's showing of an actual reduction to practice included a showing that the invention worked for its intended purpose. The court concluded that R&D's alleged reduction to practice was based on experiments that were intended to show the stability of components of the control

compositions over time, but did not show that the control compositions worked for the intended purpose, *i.e.*, to determine the accuracy of blood analysis instruments.

The Federal Circuit affirmed the district court's award of priority to Streck, stating that while the "intended purpose need not be explicitly included in the count of the interference … establishing actual reduction to practice requires demonstration that the invention worked for its intended purpose."

Practice Note: The Federal Circuit's holding that a district court can conduct *de novo* determination of priority in a §146 action echoes its conclusion, made in the context of a §145 action, in *Hyatt v. Kappos*, an *en banc* Federal Circuit case now being considered by the Supreme Court. The Federal Circuit and noted that §145 and §146 are parallel provisions and are to be treated similarly. The Supreme Court is expected to take up the *Hyatt* case in 2012.

Patents / Licenses (Bankruptcy)

Patent Protection of Section 365(n) of the U.S. Bankruptcy Code Extended to U.S. Licensees of Foreign Debtors
by Toby H. Kusmer

In a case of first impression that has important implications for parties who acquire intellectual property rights under international license agreements, the U.S. Bankruptcy Court for the Eastern District of Virginia held that the protections of Section 365(n) of the U.S. Bankruptcy Code applied to licensees of U.S. patents in a Chapter 15 case, despite the fact that those protection were not available under the foreign law applicable to the foreign debtor. *In re Qimonda A*G, Case No. 09-14766 (Bankr. E.D. Va., Oct. 28, 2011) (Mitchell, Bankruptcy J.).

Qimonda AG, a German semiconductor memory device manufacturer, filed for bankruptcy in Germany in January 2009. Debtor Qimonda's assets included approximately 4,000 U.S. patents and 6000 foreign patents, mostly relating to computer memory and semiconductor process technology. Key manufacturers of semiconductor (DRAM and flash) memory devices held non-exclusive licenses under the Qimonda's patents as a part of various royalty-free, cross-licensing, licensing and joint-development arrangements.

The German court-appointed insolvency administrator then petitioned to the Virginia bankruptcy court under Chapter 15 of the U.S. Bankruptcy Code for recognition of the German bankruptcy proceeding. Chapter 15 allows a foreign debtor's representative to commence a proceeding in a United States bankruptcy court to administer U.S. assets of a debtor's estate. The Virginia court granted the petition, making the U.S. bankruptcy laws, including § 365 of the U.S. Bankruptcy Code, applicable to the proceeding. Section 365 provides an important safeguard to licensees, *i.e.*, if a debtor rejects an existing intellectual property license (one qualifying as an "executory contract"), then the licensee has the right to elect to terminate the license or continue to exercise its rights for the remaining term of the license.

As part of liquidating Qimonda's assets for the benefit of the creditors, the German bankruptcy administrator found that Qimonda's patent license agreements were no longer favorable to Qimonda and thus proposed to relicense Qimonda's patents under new royalty-bearing agreements at reasonable and non-discriminatory royalty rates. Accordingly, the administrator notified Qimonda's various licensees that they were "non-performing" as required under German law in order to terminate the licenses and also filed a motion with the Virginia bankruptcy court to clarify that § 365(n) did not apply if such rights were exercised under German law. (German law does not contain any protections equivalent to those in § 365 of the U.S. Bankruptcy Code.) Several of Qimonda's licensees opposed the motion, arguing that the licensees would then be subject to infringement claims. The bankruptcy court granted the German bankruptcy administrator's motion, and Qimonda's licensees appealed to a U.S. district court. The district court affirmed-in-part, but remanded the case to determine whether the licensees would be "sufficiently protected" if § 365(n) did not apply and whether restricting the applicability of § 365(n) was "manifestly contrary to the public policy of the United States."

On remand, the bankruptcy court balanced the interests of the debtor and the licensees to determine if the licensees' interests were sufficiently protected. Testifying that the semiconductor industry is characterized by a "patent thicket," the licensees explained that entering into cross-licensing, licensing and joint-development agreements provided them with freedom to operate. Without the protection of § 365(n), however, and the resulting return to uncertainty, investment to build fabrication plants and an increase the "hurdle rate," the initial threshold required to proceed with product development, are

significantly effected, the licensees testified. Economic experts testifying on behalf of the German bankruptcy administrator argued that there was no reason to believe that the licensees' research and development would be affected by a decision that § 365(n) does not apply. First, the economic experts explained that the administrator was committed to re-licensing the patent portfolios for reasonable and non-discriminating royalties (a small percentage of the manufacturers R&D annual budget, which was estimated to be approximately 3.6 percent). Second, changing the cross-license agreements from one in which non-monetary value flows in both directions to one in which the licensees pay cash would change the form of the agreement, but not the value. Third, the economic experts testified that design freedom provided by the cross-license agreements would not be completely realized because the industry is still the subject of frequent patent disputes. Finally, § 365(n) would only preserve the U.S. patent licenses and not licenses to the foreign patents, which would need to be the subject of a new license.

Ultimately, the bankruptcy court ruled that § 365(n) applies to the Chapter 15 proceeding to extent that U.S. patent licenses are involved. Addressing the first issue raised by the district court for remand, whether the licensees would be "sufficiently protected" if § 365(n) did not apply, the bankruptcy court held that balancing the debtor and creditor interests weighed in favor of imposing the restrictions of § 365(n) on the German bankruptcy administrator. The court noted that the application of § 365(n) results in less value to the bankrupt estate, the U.S. patents can still be licensed to parties not yet licensees and to the extent permitted by German law, the administrator will still be able to fully monetize the non-U.S. patents. In contrast, without § 265(n) protection, Qimonda's licensees would suffer greater hardship because they had made substantial investments in U.S. research and manufacturing facilities in reliance on the freedom to operate provided by the licenses.

Concerning the second issue raised by the district court for remand, whether restricting the applicability of § 365(n) was "manifestly contrary to the public policy of the United States," the bankruptcy court determined that declining to apply § 365(n) in the context of the semiconductor industry would adversely threaten U.S. public policy favoring technological innovation. The court was persuaded by testimony that the resulting uncertainty resulting from the failure to apply § 365(n) would slow the pace of innovation, to the detriment of the U.S. economy, "severely impinging" on an important

statutory protection accorded licensees of U.S. patents, thus undermining fundamental U.S. public policy promoting technological innovation. Therefore, the bankruptcy court concluded that to the extent German law would allow cancellation of the U.S. patent licenses that would be manifestly contrary to U.S. public policy.

Practice Note: While the decision establishes precedent that § 365 applies to Chapter 15, it is hard to determine to what extent the decision will apply to other Chapter 15 proceedings. Given the magnitude of the industry, the large number of patents involved, the number of affected parties and amount of investment, future courts may limit the case's applicability. Time will tell.

Patents / Utility

UK Supreme Court Steps Into line with Europe, but Rejects U.S. Approach
by Hiroshi Sheraton and Robert Lundie Smith

The UK's highest court recently considered the provisions of the European Patent Convention (EPC) centering on the "susceptible of industrial application" requirement in the context of a patent describing a DNA sequence for a new protein, Neutrokine-α, which was a member of a group of similar proteins known as the TNF ligand superfamily. The patent disclosed that the protein was a member of the superfamily and provided an extremely long list of potential applications for which the protein could be used, but did not provide any experimental evidence to support them. *Human Genome Sciences v. Eli Lilly*, Case No. 2011 UKSC 51 (UK Supreme Court, Nov. 2, 2011) (Neuberger, L. J.).

The European equivalent of the U.S. utility doctrine (codified in 35 U.S.C. § 101) can be found in Articles 52(1) and 57 of the EPC. Article 52(1) provides that European patents must be "susceptible of industrial application" and Article 57 explains that "susceptible of industrial application [means] it can be made or used in any kind of industry, including agriculture."

Eli Lilly challenged the validity of the patent for lack of industrial applicability both in opposition proceedings before the European Patent Office (EPO) and before the English High Court. At first instance in both the EPO and the UK the patent was invalidated for lack of industrial applicability.

In the English Court, Justice Kitchin referred to the wide-ranging and speculative list of possible uses for the protein and the lack of a proven practical industrial use. He concluded that the "functions" of Neutrokine-α "were, at best, a matter of expectation and then at far too high a level of generality to constitute a sound or concrete basis for anything except a research project."

In stark contrast, the Technical Board of Appeal of the EPO later upheld the patent. The Board's reasoning was that the fact that certain properties of Neutrokine-α were shared with all members of the superfamily group meant that the specification provided a "plausible" statement, supported by post-published evidence, that Neutrokine-α had particular biological properties.

Coming back to the UK, the Court of Appeal—having considered the appeal decision in the EPO—once again rejected the patent on grounds of lack of industrial applicability. Lord Justice Jacob concluded that "[i]t is not good enough to say this protein … probably has a pharmaceutical use. Such a statement is indeed plausible, but is of no real practical use. You are left to find out what that use is."

Against this background, the Supreme Court conducted a thorough review of EPO case-law on industrial applicability and held that the EPO had developed clear and consistent jurisprudence on industrial applicability that did not require a practical use to be demonstrated. In particular, the case law supported that the requirement of a plausible and specific possibility of exploitation can be at the biochemical, cellular or biological level. The English High Court and Court of Appeal had therefore applied the wrong test to industrial applicability, and the Supreme Court upheld the patent.

Lord Justice Neuberger commented on the desirability of applying EPO jurisprudence in the UK. He commented that "where the [EPO] has adopted a consistent approach to an issue in a number of decisions, it would require very unusual facts to justify a national court not following that approach." Although there might be cases in which national courts and the EPO would come to different conclusions based on different evidence, he did not consider this to be such a case.

Lord Justice Neuberger also considered the relevance of U.S. case law and noted the utility requirements set by the U.S. Court of Appeals for the Federal Circuit in *Fisher* that "an invention is useful to the public as disclosed in its current form" as opposed to

"proving useful at some future date after further research." Ultimately however, while there had been moves to harmonize patent law over the past 50 years or more, he considered that there were significant and fairly fundamental differences between the wording of the relevant articles of the EPC and 35 USC § 101. The UK Supreme Court thus saw risks in looking to U.S. jurisprudence and therefore relied solely upon the jurisprudence of the EPO.

Practice Note: This decision marks a further move of the UK courts toward following EPO case law more rigidly than has historically been the case and will go some way to ensure that future decisions in the UK are more in line with European jurisprudence. Practitioners might also note the very different standards of utility applied in the U.S. (which must show utility in its disclosed form) and the perhaps lower hurdle of industrial applicability in Europe (which, so long as "plausible," can be satisfied by reference to underlying biological mechanisms).

Patents / Reverse Payment Settlements

FTC Staff Report Summarizes Recent Pay-for-Delay Settlements
by James Buchanan Camden

On October 25, 2011, the Federal Trade Commission (FTC) Bureau of Competition staff released a report providing an overview of recent settlements filed with the FTC concerning patent disputes between brand and generic pharmaceutical companies. (http://www.ftc.gov/opa/2011/10/mma.shtm). Such settlements must be filed with the FTC under the Medicare Prescription Drug, Improvement, and Modernization Act of 2003.

According to the FTC staff report, 28 of the 156 final settlements filed with the FTC in fiscal year 2011 were potential reverse payment, or "pay-for-delay," agreements in which the branded pharmaceutical company both provided some type of compensation to the generic and "restricted the generic's ability to market its product." The FTC has long been opposed to pay-for-delay settlements because they can delay the entry of lower-cost generics to market, thereby potentially increasing prescription drug costs for consumers.

The 28 potential pay-for-delay settlements identified by the FTC staff in FY 2011 "involved 25 different branded pharmaceutical products with combined annual U.S. sales of more than $9 billion." Of those 28 settlements, 18 involved generics eligible for 180-day "first-filer" exclusivity, meaning these generics were the first to challenge the patent of the branded drug and were eligible for 180 days of market exclusivity for their generic equivalent. This first-filer exclusivity is provided by the Hatch-Waxman Act, passed by Congress to promote the entry of generic equivalent drugs to the market by granting market exclusivity to those companies first to challenge the patent of a branded drug. The FTC finds pay-for-delay settlements involving potential first-filers particularly troublesome because if a first-filer is delayed entry to the market, other generic manufacturers may also be blocked until the first-filer enters the market.

Notably, compensation provided to a generic as part of a settlement might not take the form of a cash payment. Of the 18 settlements in which a generic was eligible for first-filer exclusivity, 10 included either an agreement by the branded drug company not to compete with an authorized generic equivalent drug or an exclusive license for the generic company to market the authorized generic equivalent drug. An authorized generic—the branded drug manufacturer's generic version of its own drug—can be sold during the generic first-filer's 180-day exclusivity period because the branded drug manufacturer has already received FDA approval for its product. In such circumstances, not only does a pay-for-delay settlement delay the entry of the generic to the market, thus shielding the branded drug from competition with a lower-cost generic for the duration of the delay, but once the generic enters the market, it does not face competition from other authorized generics during the 180-day exclusivity window.

Overall, the report found that pay-for-delay settlements have been increasing in recent years, with the FTC receiving almost as many potential pay-for-delay settlements in the past two fiscal years as the total number of such agreements filed between FY 2004 and FY 2009.

Practice Note: The FTC's distaste for pay-for-delay settlements is unlikely to abate. Indeed, the FTC has challenged certain pay-for-delay settlements in court, winning only one challenge when the branded drug company's patents had terminated. The FTC has lobbied Congress to restrict pay-for-delay agreements through legislation that presently is pending. Clients need to be alert that entering into pay-for-delay

agreements will likely draw the attention of the FTC as there appears to be a strong policy of the FTC to challenge these settlements. Also, see the report on the California *Cipro* cases in this edition of *IP Update*.

Patents / Pay-for-Delay

California Appeals Court Rejects Antitrust Challenge to "Pay-for-Delay" Settlement of Patent Infringement Suit
by Lincoln Mayer

Foreclosing the most promising non-federal venue for plaintiffs challenging "pay-for-delay" settlements, whereby branded drug makers pay generic companies to delay marketing of generic versions of branded medications, a California state appeals court affirmed summary judgment for defendants Bayer AG and Barr Pharmaceuticals in a "pay-for-delay" case brought under state antitrust law. *In re Cipro Cases I & II*, Case No. D056361 (Cal. Ct. App., Oct. 31, 2011) (Nares, J.).

Bayer's patent on antibiotic Cipro was set to expire at the end of 2003. In 1991, Barr challenged the validity of the patent pursuant to the Hatch-Waxman Act, which gives an incentive to the first drug manufacturer to successfully dispute a patent in the form of 180 days to exclusively market a generic version of the drug. Bayer promptly sued Barr for patent infringement. In 1997, the parties reached a settlement under which Bayer ultimately paid Barr $398 million to accept the validity of Bayer's Cipro patent and to defer introducing a generic version of the drug for the duration of the patent.

Following the settlement, Bayer filed a request for reexamination of the patent with the U.S. Patent and Trademark Office (USPTO), which confirmed the patent's validity. Bayer also successfully fought off several challenges to the patent from other generic drug makers. In 2000 and 2001, direct and indirect purchasers of Cipro sued in federal district courts alleging that Bayer and Barr's reverse payment settlement violated the antitrust laws. The courts consolidated the cases as a Multidistrict Litigation in the U.S. District Court for the Eastern District of New York, and that court granted summary judgment to defendants, noting that the settlement had not prevented other generic drug companies from challenging the patent's validity. The U.S. Court of Appeals for the Federal Circuit (in the indirect purchaser case) and the U.S. Court of Appeals for the

Second Circuit (in the direct purchaser case) affirmed because the competitive restraint was within the scope of the patent. Since a patentee had the right to exclude all competition with its patent, it could choose to pay competitors to acquiesce in that exclusion.

Adopting the reasoning of the 2d Circuit and Federal Circuit in parallel federal litigation to the California case, the court concluded that as long as the patent was not procured by fraud and the enforcement suit was not objectively baseless, the settling parties could agree to restrain competition within the scope of the patent. In applying California's antitrust statutes, the Cartwright Act and Unfair Competition Law, the court found that the federal appellate courts that have upheld such reverse payment settlements to be more persuasive than the one federal appellate court that has not. In siding with the Second and Federal Circuits, the Court distinguished a U.S. Court of Appeals for the Sixth Circuit case that found a reverse payment settlement involving the drug Cardizem to be illegal *per se*. There, the generic drug maker had agreed not to market other bioequivalent or generic versions of the drug that were not at issue in the litigation and further agreed to not introduce a generic version during its 180-day exclusivity period. The California court deemed such concessions to be beyond the scope of the patent and differentiated the cases on that basis. The court further concluded that *per se* treatment was inappropriate because, among other reasons, judicial policy favored encouraging settlement.

Practice Note: For now, the decision significantly bolsters the staying power of reverse-payment settlements. The decision adds to the growing weight of authority supporting the validity of these settlements under antitrust law. The court's decision is binding only on state trial courts, however and not on subsequent panels of the state appellate courts. The FTC, having lost a challenge to a similar pay-for-delay settlement in the U.S. Court of Appeals for the Eleventh Circuit, has recommended that Congress pass legislation banning the practice. See note on the October 25, 2011 FTC report regarding this practice in this edition of *IP Update*.

Trademarks / Subject-Matter Jurisdiction

Broad Covenant Not to Sue Negates Jurisdiction over Counterclaims for Non-Infringement and Cancellation of Trademark
by Rita Weeks

The U.S. Court of Appeals for the Second Circuit ruled that, in a trademark context under the Supreme Court's 2007 decision in *MedImmune v. Genentech*, a covenant not to sue deprives the district court of declaratory judgment jurisdiction. *Nike, Inc. v. Already, LLC*, Case No. 11-314 (2d Cir., Nov. 10, 2011) (Lohier, J.). In this case, a plaintiff trademark owner delivered to a trademark infringement defendant a covenant not to sue accompanied by plaintiff's voluntary dismissal of its trademark claims and the district court ruled that under the circumstances, it was divested of subject matter jurisdiction over the defendant's counterclaims for declaratory judgment.

In 1982, plaintiff Nike, Inc. designed a shoe called "Air Force 1." It has sold millions of pairs each year since. In 2009, Nike sued defendant Already, LLC for federal and state infringement and dilution of Nike's registered "Air Force 1" trade dress. Defendant Already filed counterclaims seeking a declaratory judgment that Nike's registered trademark was invalid, that Already did not infringe the mark, as well as for cancellation of the associated U.S. trademark registration.

Eight months after it had filed the infringement suit, Nike delivered to Already a "covenant not to sue," which covered all of Already's alleged infringing designs, past and present, as well as future sales of present designs. Nike then moved to dismiss its complaint with prejudice. Nike also moved to dismiss Already's counterclaims without prejudice on the ground that the district court lacked subject matter jurisdiction. Defendant Already argued that a "case or controversy" persisted despite Nike's covenant not to sue, claiming that Nike's litigation—and Nike's trade dress registration itself—constituted a "continuing libel" against Already by causing it to appear that the defendant had infringed and was continuing to infringe Nike's trade dress. The district court sided with Nike and dismissed Already's counterclaims for lack of subject-matter jurisdiction, holding that the covenant ended the controversy between the parties. Already appealed to the 2d Circuit.

On appeal, the 2d Circuit held as a matter of law that Nike's delivery of the covenant to Already divested the district court of subject-matter jurisdiction, thus affirming the district court. The 2d Circuit explained that whether a covenant not to sue eliminates a justiciable case or controversy in a declaratory judgment action involving a trademark, courts must consider three factors: "(1) the language of the covenant, (2) whether the covenant covers future, as well as past, activity and products; (3) evidence of intention

or lack of intention, on the part of the party asserting jurisdiction, to engage in new activity or to develop new potentially infringing products that arguably are not covered by the covenant." Applying those factors, the 2d Circuit easily agreed with the district court that no actual case or controversy existed in this case. The 2d Circuit pointed to the broad language of Nike's covenant not to sue, noting that it covered both present and future products. The court determined that "the breadth of the Covenant renders the threat of litigation remote or nonexistent even if [the defendant] continues to market and sell these shoes or significantly increases their production." Moreover, the court explained that "[g]iven the similarity of [the defendant's] designs to [the plaintiff's registered trade dress] and the breadth of the Covenant, it is hard to imagine a scenario that would potentially infringe [the plaintiff's registered trade dress] and yet not fall under the Covenant."