Vedder Price

IP Strategies

Trends in patent, copyright, trademark and technology development and protection May 2004

BANKRUPTCY PROTECTIONS FOR THE NONBANKRUPT INTELLECTUAL PROPERTY LICENSEE AND LICENSOR

Prior to the enactment of certain protections under the Bankruptcy Code, nonbankrupt licensees of intellectual property (i.e., patents, computer software, etc.) who may have expended hundreds of thousands of dollars developing the product covered by the license, were left with a rejected license and a valueless unsecured claim. Further, nonbankrupt licensors of computer software embedded in equipment (i.e., telecommunications switching equipment or copiers) were unable to collect royalties if the bankrupt licensee sold the equipment without advising the licensor. In the bankruptcy arena, as a general rule, a trustee (or debtor-in-possession) may assume or reject an executory contract to which the debtor is a party.[1] While intellectual property licenses, such as patent and computer software licenses, are executory contracts,[2] certain protections exist in the context of intellectual property licenses that afford the nondebtor party certain exceptions to the general rule. As discussed below, both licensees and licensors of intellectual property licenses can turn to the Bankruptcy Code for protection if the other party to the license files a bankruptcy petition.

Debtor as the Licensor—Section 365(n) of the Bankruptcy Code

Pursuant to section 365(n) of the Bankruptcy Code, if the debtor-in-possession or trustee rejects an intellectual property contract, the licensee may elect to (a) treat the contract as terminated if the rejection "amounts to such a breach as would entitle the licensee to treat such contract as terminated by virtue of its own terms, applicable nonbankruptcy law, or an agreement made by the licensee with another entity"; or (b) "retain its rights (including a right to enforce any exclusivity provision of such contract, but excluding any other right under applicable nonbankruptcy law to specific performance of such contract) under such contract and any agreement supplementary to such contract, to such intellectual property (including any embodiment of such intellectual property to the extent protected by applicable nonbankruptcy law), as such rights existed immediately before the case commenced" for the duration of the contract and any period for which the contract may be extended by the licensee. 11 U.S.C. § 365(n).

When enacted in 1988, section 365(n) "struck a fair balance between the interests of the bankrupt and the interests of a licensee of the bankrupt's intellectual property." *In re Prize Frize, Inc.*, 32 F.3d 426 (9th Cir. 1994). Therefore, if the licensee chooses to retain

IN THIS ISSUE

its rights under the license, the licensee must continue making royalty payments to the licensor pursuant to the terms of the license agreement. 11 U.S.C. § 365(n)(2). Furthermore, "license fees" paid for the use of technology, patent and proprietary rights are considered to be "royalty payments" and therefore must be paid if the licensee wishes to retain its rights under section 365(n). *Prize Frize*, 32 F.3d at 429.

Unfortunately, the licensee may not be entitled to updates or improvements to the intellectual property that are developed after the rejection of the license. The rights of the licensee, if the licensee chooses to retain them under section 365(n), are as they existed prior to the filing of the bankruptcy petition. *See, e.g., In re Matusalem*, 158 B.R. 514, 521 (Bankr. S.D. Fla. 1993). Pursuant to the terms of section 365(n)(1)(B), the rights retained by the licensee are limited to the passive obligations of the debtor-licensor—the licensee has no right to specific performance of obligations under the license other than the exclusivity provisions. Accordingly, legal scholars have posited that the debtor-licensor has no obligation to improve or update the intellectual property at issue subsequent to the rejection of the license. *See* Madlyn Gleich Primoff and Erica G. Weinberger, *E-Commerce and Dot-Com Bankruptcies: Assumption, Assignment and Rejection of Executory Contracts, Including Intellectual Property Agreements, and Related Issues under Sections 365(c), 365(e) and 365(n) of the Bankruptcy Code*, 8 AM. BANKR. INST. L. REV. 307, 343 (Winter 2000). For example, a licensee acting under section 365(n) has no right to seek specific performance from the debtor-licensor regarding any post-rejection upgrades or patches on software that is subject to the license. *In re Centura Software Corp.*, 281 B.R. 660, 669 (Bankr. N.D. Cal. 2002).

". . . parties to intellectual property licenses . . . should be aware of and, as appropriate, exercise their rights under the Bankruptcy Code when the other party to the license files a petition for bankruptcy protection"

Exclusion of Trademarks from the Protection of the Bankruptcy Code

Trademarks are not included within the definition of "intellectual property" and, therefore, are not protected by Section 365(n). The Bankruptcy Code defines "intellectual property" to mean: "(a) trade secret; (b) invention, process, design, or plant protected under title 35; (c) patent application; (d) plant variety; (e) work of authorship protected under title 17; or (f) mask work protected under chapter 9 of title 17; to the extent protected by applicable nonbankruptcy law." 11 U.S.C. § 101(35)(A). Because the definition of "intellectual property" unambiguously excludes trademarks from its definition, courts have been forced to deal the harsh result of allowing debtor-licensors to reject trademark licenses without the protection of section 365(n) for the trademark licensee. *See, e.g., In re HQ Global Holdings, Inc.*, 290 B.R. 507, 511 (Bankr. D. Del. 2003).

In *HQ Global Holdings*, the court acknowledged that "[t]rade names, trademarks, and other proprietary marks are expressly excluded from the definition of 'intellectual property'" in the Bankruptcy Code and ruled that the licensee of certain "trade names, trademarks, service marks, logos, emblems, insignia, and other indicia of origin" was left with only a claim for rejection damages under section 365(g)(1) when the debtor opted to reject the licensing agreement. *Id.* at 513. The *HQ Global Holdings* court further noted that "there is no authority for any transition period" for the licensee to phase out the use of the marks—although the court did accept the debtor's offer to allow the licensee thirty days to cease using the marks. *Id.* at 514.

Section 365(n) is the exception to the general rule regarding rejection of executory contracts whereby a debtor-in-possession or trustee may reject an executory contract if the rejection benefits the estate. *See, e.g., HQ Global Holdings,* 290 B.R. at 511 (decision to reject executory contract is "governed by the business judgment standard" under which "the sole issue is whether the rejection benefits the estate") (internal citations omitted). Accordingly, if a debtor-licensor chooses to reject a trademark license, the licensee is left with an unsecured claim for damages under the license.

Debtor as the Licensee

Bankrupt licensees often attempt to sell equipment (like telecommunication switching equipment or copiers) without assuming the computer software license embedded therein, leaving the nonbankrupt licensor without royalties. A licensor is also afforded some protection by the Bankruptcy Code when a licensee files for bankruptcy. A debtor-licensee's right to use intellectual property that is subject to a license which embodies copyrighted and/or patented technology is limited by section 365(c)(1) of the Bankruptcy Code. Section 365(c)(1) limits the power of a debtor to assume and assign an executory contract if applicable law prohibits assumption and assignment.[3] Patent and copyright laws are "applicable law," and patent and copyright laws prohibit assignment since the identity of the third party is material. *See In re Access Beyond Technologies, Inc.*, 237 B.R. 32, 48 (Bankr. D. Del. 1999); *Perlman v. Catapult Entertainment, Inc. (In re Catapult Entertainment, Inc.)*, 165 F.3d 747, 749–50 (9th Cir. 1999).

Particularly in a situation where a debtor-licensee is attempting to assume and assign a license agreement or is attempting to sell equipment with computer software that is subject to a license agreement, the licensor may block the sale (or maintain negotiating power) by withholding its consent to the assumption and assignment of the contract. Therefore, to the extent that the debtor-licensee contemplates the sale (or the assumption and assignment) of such a license, the debtor must obtain the consent of the licensor if the license is necessary to operate the equipment.

Conclusion

While the system is not perfect, parties to intellectual property licenses (which by definition exclude trademark licenses) should be aware of and, as appropriate, exercise their rights under the Bankruptcy Code when the other party to the license files a petition for bankruptcy protection. Please feel free to consult your counsel at Vedder Price to discuss these issues.

VICTORY OVER *LEMELSON*

A federal district court in Las Vegas, Nevada held that 14 patents purportedly covering bar code and machine vision technology held by the estate of inventor Jerome Lemelson were invalid, not infringed and unenforceable. *Symbol Technologies, Inc. v. Lemelson Medical, Educational & Research Foundation, Ltd.*, Case No. CV-S-01-701-PMP (D.Nev. Jan. 23, 2004). In the decision, the federal district court found the Lemelson patents to be unenforceable due to prosecution laches and found that Symbol's and Cognex's products did not infringe even under Lemelson's own claim construction.

The *Symbol Technologies* decision invalidates all of the active patents said to relate to machine vision and bar code technology held by the Lemelson Foundation. The decision marks the first time any challenger has obtained a court decision against the Lemelson Foundation. The decision could also affect other related cases currently pending in federal court in Arizona, where the Lemelson Foundation is suing a large number of companies that use bar-code readers.

Over the past 15 years, at least 900 blue-chip companies signed license agreements with Lemelson regarding the machine vision and bar code patents. As a result, the Lemelson Foundation has received royalty payments in excess of $1.5 billion. Bar code patent royalties represent virtually all of Lemelson's revenues over the past 15 years. These existing license agreements might now be called into question in view of the District of Nevada decision.

Judge Pro found no evidence to support the assertion that the patent claims filed in 1963 (and those subsequently based on the 1963 application) were supported by the 1954 original filing. Judge Pro found that Lemelson had not provided, in his original application, a sufficient written description to adequately describe the bar code or machine vision systems described in subsequent applications. This meant that the subsequently filed applications cannot claim priority to the earlier 1954 application. Further, Judge Pro found that certain claims in the '918 patent, filed in 1972, had previously been anticipated in a 1965 patent issued to a different inventor.

The court also held that a person of ordinary skill in the art could not practice the inventions claimed by Lemelson, and, as result, the claims were invalid for lack of enablement. This led, in part, to Judge Pro's ruling that the patent claims in U.S. Patent 4,511,918 (issued to Lemelson in 1985)—and all subsequent claims based on that patent—were unenforceable and that Cognex's and Symbol Technologies' products did not infringe.

"The Symbol Technologies decision invalidates all of the active patents said to relate to machine vision and bar code technology held by the Lemelson Foundation."

Another important issue before the trial court in the *Symbol* case is whether Lemelson is estopped from enforcing his patents against third parties based on a doctrine known as prosecution laches estoppel. In his ruling, Judge Pro noted that there had been an 18–39 year delay between the original 1954 patent filing and the patents that issued in 1992 that more clearly pointed to bar code and machine vision systems. The Court stated, "At a minimum, Lemelson's delay in securing the asserted claims amounts to culpable neglect as he ignored the duty to claim his invention properly . . . . If the defense of prosecution laches does not apply under the totality of circumstances presented here, the Court can envision very few circumstances under which it could . . . . In sum, Lemelson's delay in securing the asserted patent claims is unexplained and unreasonable."

RECENT CAFC PATENT DECISIONS

Prosecution History of Subsequent Patent Is Relevant to the Claim Interpretation of an Earlier Issued Patent

The Federal Circuit held that statements made during the prosecution of a subsequent patent application are relevant to the claim interpretation of an earlier issued patent. *Microsoft Corp. v. Multi-Tech Systems, Inc.* (Feb. 3, 2004). The court distinguished its 1999 ruling in *Georgia-Pacific Corp. v. United States Gypsum Co.*, where the same court rejected the argument that the patentee was bound, or estopped, by a statement in connection with a later application. Judge Randal Rader argued in his dissent that the majority disregards the holding of *Georgia Pacific* by applying, for the first time, the prosecution history of one patent to limit the claims of a related patent that was allowed before the creation of the prosecution history at issue. ***Practice Tip*: During the preparation of a subsequent related patent application, applicants are urged to take great care when making statements that may later be used to limit the claims of an earlier patent, especially if they share a common specification.**

FESTO and Prosecution History Estoppel

Affirming summary judgment that Impax did not infringe Glaxo's patent, the Federal Circuit held that an amendment to Glaxo's claim raises the presumption of prosecution history estoppel that Glaxo surrendered the range of equivalents with respect to all claims reciting HPMC, even those unamended during prosecution. *Glaxo Wellcome, Inc. v. Impax Labs, Inc.* (Jan. 29, 2004). Glaxo narrowed claims in their application during prosecution to explicitly claim its sustained release agent (HPMC) to overcome an enablement rejection. Following *Festo*, the court reasoned that because Glaxo disclosed only HPMC, an applicant is not excused "from failing to claim 'readily known equivalents' at the time of application nor is an applicant allowed to rebut the *Festo* presumption by invoking its own failure to include a known equivalent in its disclosure." ***Practice Tip*****: During the preparation of a patent, applicants are urged to disclose potential or "readily known equivalents" in order to avoid surrendering claim equivalents.**

Claim Construction; Means-Plus-Function; Willfulness; Damages

The Federal Circuit affirmed the district court's finding that Wal-Mart's product willfully infringed after selling off its remaining inventory. The Federal Circuit also affirmed the district court's damages award of $464,280 but refused to enhance damages or award attorneys' fees. *Golight, Inc. v. Wal-Mart Stores, Inc., et al.* (Jan. 20, 2004). Despite Wal-Mart's arguments, the majority refused to construe the limitation "horizontal drive means for rotating said lamp unit in a horizontal direction" to require the capability to rotate through 360 degrees. Regarding damages, evidence "that Wal-Mart continued to sell off its remaining inventory even after it had learned of its possible infringement" was sufficient to support the willfulness finding. Further, the court stated that there was "no admissible evidence in this case that Wal-Mart took appropriate action after receiving the cease and desist letter to establish a reasonable belief that its actions were not infringing . . . ." ***Practice Tip*****: In response to receiving a cease and desist letter, a party must carefully consider its actions, such as selling of remaining inventory, in order to avoid a potential finding of willful infringement and possible enhanced damages.**

Doctrine of Equivalents

The Federal Circuit held that the presumption of prosecution history estoppel, as required by *Festo*, does not apply where the amended claim language is not part of the limitation that is the subject of the equivalents infringement allegation. *Ericsson, Inc. v. Harris Corp.* (Dec. 9, 2003). The majority held that, although *Harris* added language during prosecution to the claim that "disables" speech signal amplifiers, the relevant claim language requires "speech signal amplifiers" within the apparatus to "only supply power to the telephone set when the receiver is off-hook." The court reasoned that the "only supply power" limitation was never amended and, therefore, cannot be subject to the *Festo* presumption. The Federal Circuit reversed the district court's grant of judgment as a matter of law ("JMOL") that Harris did not infringe Ericsson's '222 patent. The court affirmed the district court's denial of JMOL awarding Ericsson damages in the amount of $3.5 million for lost profits due to lost sales; $645,000 for lost profits due to price erosion; and $136,000 as a reasonable royalty. ***Practice Tip*****: Great care should be taken when amending claim language in order to avoid the *Festo* presumption when a narrowing amendment is required.**

Inherent Anticipation

Affirming the denial of summary judgment of invalidity, the Federal Circuit held that a claimed characteristic is inherently anticipated if the characteristic is a necessary feature or result of a prior-art embodiment and if the characteristic is itself sufficiently described and enabled, even if the characteristic was unknown at the time of the invention. *The Toro Company v. Deere & Co.* (Jan. 20, 2004). To establish inherent anticipation, the reference must have sufficiently described and enabled at least one embodiment that necessarily featured or resulted in the subject matter embraced in the claims. However, neither description nor contemporaneous recognition of these necessary features or results is required.

Legislative Developments; Collaborative Research and Development

The House of Representatives on March 10, 2004, passed legislation (H.R. 2391) to amend title 35 of the United States Code "to promote cooperative research involving universities, the public sector, and private enterprises." The bill makes changes to title 35, section 103 (nonobviousness) so that "subject matter developed by another person and a claimed invention shall be deemed to have been owned by the same person or subject to an obligation of assignment to the same person" subject to certain conditions. The changes to the patent law will encourage collaborative research and development by researchers from multiple organizations. The "Cooperative Research and Technology Enhancement (CREATE) Act of 2004," if made into law, was prompted by the Federal Circuit's obviousness ruling in *OddzOn Products Inc. v. Just Toys Inc*. (Fed. Cir. 1997). The Federal Circuit held in *OddzOn* that section 103(c) of the Patent Act proscribes the use of section 102(f) prior art to find obviousness only where the subject matter of the prior art and the claimed invention were "owned by the same person." As a result, the implication of the court's holding in *OddzOn* is that section 102(f) prior art may be used to find obviousness where the subject matter of the prior art and the claimed invention were not owned by the same person.

As amended and approved, the bill inserts into 35 U.S.C. § 103(c) a special definition of "owned by the same person" under certain conditions. Those conditions are: (a) the joint R&D agreement must have been in effect before the claimed invention was made; (b) the claimed invention was made as a result of activities within the scope of the joint research agreement; and (c) the patent application disclosed or is amended to disclose the names of the parties to the joint research agreement. The term "joint research agreement" means a written contract, grant or cooperative agreement entered into by two or more persons or entities for the performance of experimental, developmental or research work in the field of the claimed invention.

Followup on Knorr-Bremse

As a followup to our previous newsletter, and in a closely watched case, the *en banc* Federal Circuit heard oral arguments on February 5, 2004 on whether the law of willfulness needs to be changed, including the precedent regarding drawing adverse inferences with regard to willful patent infringement. *Knorr-Bremse Systeme Fuer Nutzfahrzeuge GmbH v. Dana Corp*. (oral argument Feb. 5, 2004). We will report any released decision in our next newsletter.

[1] An "executory contract" is "a contract under which the obligation of both the bankrupt and the other party to the contract are so far underperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other." *In re Columbia Gas Sys. Inc.*, 50 F.3d 233, 239 (3d Cir. 1995). Whether a contract is executory is determined when the bankruptcy petition is filed. *Id.* at 240.

[2] *See, e.g., In re Access Beyond Technologies, Inc.*, 237 B.R. 32, 43 (Bankr. D. Del. 1999) (a patent license is executory because licensor's continuing promise to refrain from suing the licensee for patent infringement is material); *Everex Systems v. Cadtrack Corp. (In re CFLC, Inc.),* 89 F.3d 673, 677 (9th Cir. 1996); *Patient Education Media, Inc.,* 210 B.R. 237, 241 (Bankr. S.D.N.Y. 1997).

[3] Section 365(c) of the Bankruptcy Code provides, in relevant part:

> The trustee may not assume or assign any executory contract or unexpired lease of the debtor, whether or not such contract or lease prohibits or restricts assignments of rights or delegation of duties, if—
>
> (1)(A) applicable law excuses a party, other than the debtor, to such contract or lease from accepting performance from or rendering performance to an entity other than the debtor or the debtor in possession, whether or not such contract or lease prohibits or restricts assignment of rights or delegations of duties; and
>
> (1)(B) such party does not consent to such assumption or assignment.

VEDDER, PRICE, KAUFMAN & KAMMHOLZ, P.C.

We welcome your suggestions for future articles. Please call **Angelo J. Bufalino**, the Intellectual Property and Technology Practice Chair, at (312) 609-7850 with suggested topics, as well as other suggestions or comments concerning materials in this newsletter.

Executive Editor: **Angelo J. Bufalino**, Contributing Authors: **Douglas J. Lipke, Themi Anagnos** and **Allyson Broderick Russo**.

About Vedder Price

Vedder Price is a national, full-service law firm with approximately 210 attorneys in Chicago, New York and Livingston, New Jersey.

Technology and Intellectual Property Group

Vedder, Price, Kaufman & Kammholz, P.C. offers its clients the benefits of a full-service patent, trademark and copyright law practice that is active in both domestic and foreign markets. Vedder Price's practice is directed not only at obtaining protection of intellectual property rights for its clients, but also at successfully enforcing such rights and defending its clients in the court and before federal agencies, such as the Patent and Trademark Office and the International Trade Commission when necessary.

We also have been principal counsel for both vendors and users of information technology products and services. Computer software development agreements, computer software licensing agreements, outsourcing (mainly of data management via specialized computer software tools, as well as help desk-type operations and networking operations), multimedia content acquisition agreements, security interests in intellectual property, distribution agreements and consulting agreements, creative business ventures and strategic alliances are all matters we handle regularly for our firm's client base.

Chicago
222 North LaSalle Street
Chicago, Illinois 60601
312/609-7500
Fax: 312/609-5005
Contact: Robert J. Stucker

New York
805 Third Avenue
New York, New York 10022
212/407-7700
Fax: 212/407-7799
Contact: Neal I. Korval

New Jersey
354 Eisenhower Parkway, Plaza II
Livingston, New Jersey 07039
973/597-1100
Fax: 973/597-9607
Contact: John E. Bradley

www.vedderprice.com