

# VEDDER PRICE

# IP Strategies

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

May 2005

## INTELLECTUAL PROPERTY DUE DILIGENCE INVESTIGATION

Given the current business environment, in which the value of a company and its competitive advantages are likely heavily dependent upon its intellectual property, it is crucial that a company take reasonable steps to make sure it has rights to its important intellectual property and that it properly protects said property. By conducting periodic audits of its intellectual property, a company can ensure that this property is adequately protected to preserve the company's earnings and growth potential resulting from the intellectual property. The audit can identify if there are areas in which the company should improve its intellectual property protection or if the company is potentially infringing a third party's intellectual property.

Further, if a company is a party to almost any transaction with another company that involves or affects intellectual property (whether in the sale of its assets or stock, in an investment or public offering, a joint venture, licensing or otherwise), the other party to that transaction will likely perform due diligence on the company's intellectual property to determine what intellectual property the company owns or has rights to use and the value of such intellectual property. Prior to such time, the selling party should conduct due diligence on itself to make sure that its intellectual property is in order and the representations and warranties that it will make in the transaction are accurate.

Due diligence performed as part of an internal intellectual property audit may be less extensive than when a third party transaction is involved, and the details on the level of review deemed necessary and desirable often depend on the dollar amount involved in the transaction. Nonetheless, the investigating party must

assure itself through its review that it understands the United States and foreign intellectual property owned, used or being developed; the rights it is getting; what is necessary to ensure it protects and captures all of such rights; what actual or potential problems are involved with the intellectual property; and whether it wants to seek an appropriate adjustment to the dollar amount involved in the transaction if the results of its due diligence inquiry are not satisfactory. Further, the due diligence review should have as a key goal that the investigating company obtain all of the rights that are crucial to the accomplishment of its purpose for the transaction. Although the specific due diligence plan and request for information will be tailored to the nature of the company's business and the purpose for the due diligence review, certain fundamental inquiries are involved in all due diligence investigations, and these are briefly described below.

Due diligence involves gathering relevant documents (both from the company involved and from publicly available sources), reviewing the gathered documents, meeting with and asking questions of knowledgeable persons, and following up on inconsistent or incomplete information. The team performing a due diligence investigation will often be comprised of the business people involved, as well as their attorneys, accountants, and

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appraisers. It is important that the team commence their review of the intellectual property as early in the transaction as possible in order to allow for follow-up investigations and adjustment to the consideration involved in a transaction if the results of the due diligence investigation are not satisfactory to the investigating company.

The due diligence team will seek to identify the intellectual property owned, used or being developed by the company, any problems or limitations relating to such ownership or use, the value of the intellectual property, the potential licensing and strategic uses of the intellectual property, the likelihood of infringement of other third parties' rights and by other third parties of its intellectual property rights, and any potential liability for infringing third parties' intellectual property rights. The team should also review whether the company has any intellectual property litigation pending or threatened against it. Although most of this information can be provided by the company, we strongly recommend that the investigating company perform certain pending lawsuit searches on the company to uncover any undisclosed pending litigation as well as certain other searches, as described below, because it is not uncommon for a company to think it possesses certain intellectual property rights and for the rights it actually possesses to differ from its expectations.

Although the specifics of the review of chain of title will vary depending upon the type of intellectual property involved (e.g., patents, copyrights, trade marks, domain names, etc.), ownership of intellectual property can be confirmed by counsel reviewing the chain of title from the creator of the intellectual property (whether an employee of the company or not), through previous owners, if any, to the company being investigated, and determining if any assignments or licenses have been recorded. In this review, it is important to determine whether the intellectual property was acquired or licensed from a third party. Also, the company's agreements with its employees and independent contractors should be reviewed to ascertain that all such persons are fully assigning or licensing intellectual property created by them to the company so that the company truly owns or has rights to use such intellectual property.

The company will typically provide a list of and details regarding its intellectual property as part of the due

diligence process. However, it is important that the investigating company perform independent searches to identify the company's intellectual property and whether the intellectual property has been properly registered and maintained. The independent searches will also review publicly available records to determine whether ownership, licenses or assignments have been recorded and if any security interests or other liens have been filed against the intellectual property.

In addition, if the company has procured the right to use the intellectual property from a third party, rather than owning the intellectual property outright, the investigating party will need to procure from the company the contracts granting the company the rights to use the intellectual property, and examine those contracts to determine the scope of the company's rights and, conversely, what limitations have been imposed on the company's use of the intellectual property. Furthermore, all contracts entered into by the company relating in any way to its intellectual property should be reviewed by the investigating company to determine whether the contracts can be assigned by the company or whether the rights conveyed under such contracts depend upon a third party's rights.

The economic value of the intellectual property can be estimated by the investigating company, its counsel, accountants and appraisers, and will reflect the nature and scope of the intellectual property rights of the company (and the strength of the property and the limitations thereon), its enforceability, whether the intellectual property fully protects the products embodying the intellectual property so that the products cannot be easily duplicated by competitors, and the potential liabilities associated with the intellectual property. The information used to compute the economic value of the intellectual property can also assist the business people in determining its strategic value and the strategic opportunities available for the intellectual property. Any weaknesses identified in the investigation and valuation process can be addressed in transaction negotiations by potential adjustments to the consideration involved and the resulting documentation.

The investigating company should also have its counsel review samples of the company's products in detail, including the products' specifications, characteristics, manufacturing processes and advertising materials in order to uncover whether any third party's

intellectual property is being infringed. The due diligence team should also review the company's website, public disclosures and press releases and other press regarding the company, and have discussions with the company's knowledgeable persons to determine whether there are inventions that have not been formally registered or that may not be sufficiently protected.

Lastly, the due diligence team should review the company's methods for protecting its intellectual property, especially its trade secrets, from use by third parties or disclosure to unintended recipients. Disclosure to third parties (including independent contractors) should be reviewed and particularly should only be made pursuant to confidentiality and non-disclosure/non-use agreements between the company and the third party. Employees of the company should also be subject to confidentiality obligations, and should be reminded of those obligations periodically and upon their departure from the company.

While due diligence can appear to be a daunting task, an investigating company, by working with its attorneys and other advisors, can gain valuable insight into the risk involved in a target company's intellectual property and what actions can be taken to minimize and clean up that risk.

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## RECENT FEDERAL CIRCUIT PATENT DECISIONS

### *Star Fruits S.N.C. v. U.S.*

**No. 04-1160 (Fed. Cir., Jan. 3, 2005)**

The District Court for the District of Virginia granted the Patent Office's motion for summary judgment, finding that the Patent Office did not act unlawfully when it held Star Fruits' patent application abandoned for failure to respond to a Requirement for Information under 37 C.F.R. § 1.105 ("Information Requirement"). The Federal Circuit affirmed.

Star Fruits filed a patent application directed to a variety of peach tree. The PTO issued an Information Requirement seeking "any information available regarding

the sale or other public distribution of the claimed plant variety anywhere in the world." Star Fruits, however, declined to provide any information responsive to the Patent Office's request. In support of its refusal, Star Fruits stated that the information was "not material to patentability." Star Fruits further made clear in its response that the refusal to provide the information was because it viewed a prospective rejection based on the information as contrary to law, anticipated a rejection under 35 U.S.C. § 102 if it complied with the Information Requirement, and sought to prevent the Patent Office from making the rejection.

The Examiner held the case abandoned for failure to submit a bona fide response to the Information Requirement. The Director of the Patent Office found that the Examiner's request was not unreasonable or unnecessary and denied a 37 C.F.R. § 1.181 Petition ("Petition") filed by Star Fruits in support of its refusal. Star Fruits filed suit and the District Court found that the Petition was the only available administrative check on the discretion of the Patent Examiner. However, the District Court stated that, because the Director concluded the requirement was proper, Star Fruits should have complied with the Information Requirement. Star Fruits appealed the Director's decision to the Federal Circuit under the Administrative Procedures Act ("APA").

The Federal Circuit stated that the Information Requirement may require submission of information as may be reasonably necessary to properly examine the application, and that the required information may go beyond the general information requirement under 37 C.F.R. § 1.56. The Federal Circuit further stated that neither the use of the Information Requirement by the Patent Office nor the Director's denial of Star Fruits' Petition was an abuse of discretion. The Federal Circuit, however, held that the District Court erred to the extent that it viewed the Petition as the "exclusive administrative check" on the Examiner's discretion because district courts have the power to review final actions of the Patent Office. The Federal Circuit stated that, although a patent applicant may challenge the Director's decision under the APA, it is "unlikely that many requirements for information will be unreasonable or beyond the scope of Section 1.105."

***Practice Tip:* It is unlikely that many requirements for information will be unreasonable or beyond the scope of § 1.105. Therefore, when faced with an information request under § 1.105, the prudent course of action in most circumstances is to provide the requested information.**

***Bruno Indep. Living Aids, Inc. v. Acorn Mobility Servs. Ltd.***

**No. 04-1114 (Fed. Cir., Jan. 11, 2005)**

The District Court for the Western District of Wisconsin awarded Acorn attorneys' fees predicated on Bruno's inequitable conduct where Bruno failed to disclose to the Patent Office information about a prior art device it had disclosed to the U.S. Food and Drug Administration ("FDA") while its patent application was pending, and failed to offer a credible explanation for the nondisclosure. The Federal Circuit affirmed.

In seeking FDA approval to sell its own stairlift device, an embodiment covered by its then-pending patent application, Bruno provided a letter to the FDA with information about a commercial "Weckalator" stairlift. In a paragraph labeled "Substantial Equivalence" in the FDA letter, Bruno's Director of Engineering claimed that Bruno's stairlift was "similar in design and function" to the Weckalator. Bruno did not, however, disclose the Weckalator to the Patent Office during prosecution of U.S. Patent No. 5,203,405 ("the '405 patent").

In affirming the District Court's decision, the Federal Circuit found no clear error in the District Court's findings on materiality and intent. Affirming the District Court's materiality determination, the Federal Circuit noted that the Weckalator was not cumulative to prior art considered by the Patent Office and that, had the Examiner known about the Weckalator, Bruno could not have advanced certain arguments it made to distinguish its claims from cited prior art. Additionally, the Federal Circuit concluded that there was sufficient evidence, based upon which a fair inference of deceptive intent could be drawn in view

of the high materiality of the Weckalator. Bruno argued that the claim it made to the FDA regarding the "substantial equivalence" of its stairlift and the Weckalator was made only for the purpose of securing FDA approval and had no bearing on whether Bruno appreciated the materiality of the Weckalator. The Federal Circuit found this distinction to be disingenuous in light of the fact that the FDA submission was prepared by a person who was also involved in the prosecution of the '405 patent.

***Practice Tip:* A patent applicant should disclose to the Patent Office all known information that is or may be relevant to the subject matter of a patent application. Also, when in doubt whether certain information is relevant, the prudent course of action is to disclose the information. This case also highlights that, under an inequitable conduct analysis, intent may be implied by the facts and circumstances of the case regardless of the applicant's actual intent.**

***Merck & Co., Inc v. Teva Pharms. USA, Inc.***

**No. 04-1005 (Fed. Cir., Jan. 28, 2005)**

The Federal Circuit vacated a judgment of the District Court for the District of Delaware, holding that the District Court erred in its claim construction and that the properly construed claims were obvious over the prior art.

The relevant claims of U.S. Patent No. 5,944,329 ("the '329 patent") relate to methods for treating osteoporosis by orally administering alendronate monosodium trihydrate on a weekly dosing interval. The relevant claim recites administering "about 70 mg of alendronate monosodium trihydrate, on an alendronic acid basis." The specification of the '329 patent discloses the following:

Because of the mixed nomenclature currently in use by those or [sic] ordinary

skill in the art, reference to a specific weight or percentage of bisphosphonate compound in the present invention is on an active weight basis unless otherwise indicated herein. For example, the phrase ‘about 70 mg of bone resorption inhibiting bisphosphonate selected from the group consisting of alendronate, pharmaceutically acceptable salts thereof and mixtures thereof, on an alendronic acid weight basis’ means that the amount of bisphosphonate compound selected is calculated based on 70 mg of alendronic acid.

The District Court relied upon the above section of the specification in concluding that Merck had acted as its own lexicographer, and therefore construed the term “about 70 mg” to mean the amount of derivative compound that gives “exactly 70 mg” of the active compound. Accordingly, the District Court concluded that prior art articles suggesting weekly doses of 80 mg did not render the claim obvious. The Federal Circuit reversed, holding that the term “about” should be given its ordinary meaning of “approximately.” The Federal Circuit stated that if a patentee acts as his own lexicographer in redefining the meaning of a particular claim term away from its ordinary meaning, he must clearly express that intent in the written description. In the present case, however, the passage in Merck’s specification, as relied upon by the District Court, was ambiguous because it can easily be interpreted as a way of explaining what is meant by the phrase “on an alendronate acid active basis” rather than as a way of radically defining the term “about.”

***Practice Tip:* Absent a definition in the written description, claim terms are given their ordinary meaning. However, if the patentee defines a claim term in the written description, the definition should be clear and unambiguous. Because “about” and “substantially” are inherently ambiguous, a patentee should clearly define these terms in the written description to avoid claim construction problems in litigation.**

*Lisle Corp. v. A.J. Mfg. Co.*

**Nos. 04-1275, -1346 (Fed. Cir., Feb. 11, 2005)**

A.J. appealed a decision of the District Court for the Northern District of Illinois granting Lisle’s motion for summary judgment of infringement, denying A.J.’s motion for judgment as a matter of law (“JMOL”) of noninfringement, and denying A.J.’s motion for summary judgment of invalidity. The Federal Circuit affirmed.

Lisle’s patent relates to a tool for the removal of inner tie rods in automobile rack and pinion steering control systems. On appeal, A.J. argued that the District Court erroneously construed the terms “retainer” and “said retainer being detachably cooperative with the tabs to rotate the disk and a tie rod engaged therewith” and, therefore, incorrectly granted summary judgment of infringement. With respect to “retainer,” A.J. put forth a narrow interpretation of the term, arguing that it should be limited to a specific embodiment illustrated in the figures. The Federal Circuit, however, affirmed the District Court’s construction because the broad description of the retainer’s configuration and shape throughout the patent specification clearly anticipated a wide range of applications on many different tie rod configurations. The Court further rejected A.J.’s construction of “detachably cooperative . . .” because the patent employed a “common-sense meaning” of that claim limitation. Although the Federal Circuit clarified the District Court’s claim construction, it refused to employ A.J.’s “hyper-technical” proposed construction because the disclosed tool of the patent specification is incapable of operating in accordance with such a construction.

With respect to invalidity, A.J. argued that the District Court erred when it denied its motion for JMOL based upon prior public use. Over thirty months before filing the patent application, Lisle distributed prototypes of its tool to mechanics in Nebraska without placing any restrictions on the prototypes’ use or entering into any formal confidentiality agreements with the mechanics. A.J. argued that Lisle failed to demonstrate the requisite level of control over the mechanics’ work to support an experimental use defense. However, one of the

coinventors of the patented tool testified that a prior working relationship existed with the mechanics, such that the mechanics knew that their use of the prototype was experimental. The coinventor also testified that he periodically obtained testing feedback from the mechanics and modified the prototype accordingly, and that the feedback was reported to Lisle's management. The Federal Circuit held that the evidence was sufficient for a reasonable jury to find that Lisle rebutted the prima facie case of public use, and, thus, upheld the District Court's denial of A.J.'s motion for JMOL.

***Practice Tips:*** The experimental use of a product covered in a patent application should be covered by a confidentiality agreement. Absent a confidentiality agreement or clear facts that indicate experimental use of a product, a court will look at the facts and circumstances surrounding the use to determine whether it is experimental. Indicia of "experimental use" may include a history of prior experimental use with the same parties, the implementation of clear and consistent control procedures regarding such use, the incorporation of a number of product improvements based on the use, and the existence of feedback from the users. While the above factors may bolster any experimental use defense when it is not clear from the facts, an executed confidentiality agreement expressly defining the relationship of the parties and the nature of the secret and experimental use of the product is recommended to avoid unnecessary litigation.

***Eolas Techs. Inc. v. Microsoft Corp.***

**No. 04-1234 (Fed. Cir., March 2, 2005)**

Microsoft appealed a decision granting final judgment to Eolas after a jury found that Microsoft infringed claims 1 and 6 of Eolas' U.S. Patent No. 5,838,906 ("the '906 patent") and further induced U.S. users of Microsoft's Internet Explorer web browser to infringe claim 1 of the '906 patent. Additionally, the District Court applied 35 U.S.C. § 271(f) to include foreign sales of Internet Explorer in the royalty awarded to Eolas. Although the Federal Circuit vacated the District Court's decision and remanded the case for further proceedings consistent with its opinion, the Court affirmed the District Court's holding that "components," as utilized in § 271(f)(1), includes software code on golden master disks, as used by computer manufacturers to load software onto new hard drives.

In the underlying action, Eolas alleged infringement of claims 1 and 6 of the '906 patent by Microsoft. Specifically, Eolas alleged that certain aspects of Microsoft's Internet Explorer browser incorporated its invention, directed at a method and apparatus for providing a fully interactive web browser environment. In other words, the patent provided users a method of playing games and viewing, among other things, news clips over the Internet. Microsoft denied infringement and asserted that the claims were invalid, as being anticipated and obvious under 35 U.S.C. §§ 102 and 103, and further unenforceable due to inequitable conduct.

In support of its invalidity contention, Microsoft presented evidence that a web browser called Viola taught all of the claim limitations at issue, was in public use more than one year before Eolas' invention, and therefore anticipated or rendered obvious Eolas' patent. The District Court, however, found as a matter of law that the inventor of the Viola web browser abandoned, suppressed or concealed the web browser within the meaning of § 102(g) because the inventor disclosed a version of the Viola web browser to two engineers at Sun Microsystems Corporation ("Sun") and later modified the web browser. The District Court further held that Microsoft's testimony regarding the capabilities of the Viola web browser was conclusory and therefore

held the patent valid. The Federal Circuit, however, stated that the District Court erroneously concluded that the modified version of the Viola browser was a new invention and that the original version of the web browser was abandoned. In support thereof, the Court noted that the inventor of the Viola web browser, within 24 hours of showing the web browser to the two Sun engineers, posted an improved version of it on a publicly accessible internet site and notified the two Sun engineers that a new version was available for download. The Federal Circuit held that the inventor of the web browser was simply improving and perfecting the browser. In fact, both versions contained the same contested features. Therefore, the Court remanded to determine whether the unmodified and modified Viola web browsers are prior art references under §§ 102 or 103.

Microsoft based its unenforceability contention on an inequitable conduct defense. Microsoft alleged that one of Eolas' inventors knew of the Viola web browser and later-developed papers related to the browser, but did not disclose any information regarding the web browser to the Patent Office. The District Court found that the inventor's knowledge of the Viola web browser was not enough to trigger his obligation to bring it to the attention of the Examiner. Specifically, the District Court determined that Viola software product was not prior art and, thus, not material. The Federal Circuit disagreed, stating that the Viola browser, a software product, and not the later-developed Viola paper and other related material, constituted prior art. Similar to the invalidity proceeding, the Federal Circuit remanded the case and instructed the District Court to, among other things, treat the software product as potential prior art under § 102(b).

The Federal Circuit next tackled the issue of whether software code made in the United States and exported abroad is a "component of the patented invention" under § 271(f). Generally, § 271(f)(1) assigns liability to one who supplies from the U.S. a substantial portion of uncombined components of a patented invention, and such person actively induces the combination of the components of the patent invention outside the U.S. in a manner that would infringe if the activity occurred within the U.S. Because Microsoft provided foreign computer manufacturers with golden master disks for duplication of Internet Explorer on manufactured computer systems,

Eolas claimed royalty damages for both foreign and domestic sales of Microsoft's Windows operating systems loaded with Internet Explorer.

On appeal, Microsoft argued that "components," as used in the Patent Act, must be identical to the "components" of physical machines. Finding no support in the language or the legislative history of § 271(f) for such an interpretation by Microsoft, the Federal Circuit specifically stated that § 271(f) does not impose a requirement of "tangibility" on any component of a patented invention. Because the statutory language is not limited to patented machines or patented physical structures, every component of every form of invention deserves the protection of § 271(f). Therefore, the Federal Circuit affirmed the District Court's holding that "components" includes software code on golden master disks.

***Practice Tips: Although 35 U.S.C. § 100 categorizes an "invention" as "any new and useful process, machine, manufacture or composition of matter," software code may be considered an invention if claimed as a method, while software code in conjunction with a physical structure, such as a disk, may be qualify as an invention if claimed as a machine or manufacture. Therefore, "components," as used in § 271(f), is not limited to structural or physical components. Those who induce foreign entities to combine patented software with other patentable components in a manner that would infringe if performed in the U.S. are also liable under the Patent Act.***

## LEMELSON FOLLOW-UP

In our previous newsletters, we reported on the status of the litigation involving the Lemelson patents. The Federal Circuit has now scheduled oral argument for this matter on June 5, 2005. We will continue to provide update reports in our future newsletters.

## VEDDER, PRICE, KAUFMAN &amp; KAMMHOLZ, P.C.

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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.

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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 courts 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.

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