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Inequitable Conduct as a Defense to Patent Infringement in the Wake of *Therasense:* Defining "Materiality" and "Specific Intent"

On May 25, 2011, the U.S. Court of Appeals for the Federal Circuit issued a landmark decision changing the standards for proving inequitable conduct as a defense to patent infringement. In *Therasense, Inc. v. Becton, Dickinson & Co.*, the court held that to establish inequitable conduct an accused infringer must prove, first, that the patentee acted with specific intent to deceive or made a deliberate decision to withhold information from the United States Patent and Trademark Office ("PTO"); and, second, that "but for" the patentee's misrepresentations or omissions, the PTO would not have issued the patent.

Therasense addressed a patent for disposable blood glucose test strips developed for the treatment of diabetes. The patentee sought to claim glucose strips that lacked a membrane on the electrode used for testing, over prior art stating that a membrane was "optionally, but preferably" included on the test strip. Because the patentee also owned the prior art, the Examiner required a declaration that the prior art had required a membrane. The patentee's R&D director averred that a person of ordinary skill would understand the prior art's use of "optionally, but preferably" language as requiring a membrane, and the Examiner allowed the claims. During the earlier prosecution of the European counterpart to the same prior art, the patentee had, however, submitted a declaration, from the same expert, stating that the prior art *did not* require a membrane. When the patentee asserted the patent against Becton, Dickinson & Co., the alleged infringer argued that it was unenforceable due to the patentee's inequitable conduct by failing to disclose properly the prior art to the PTO.

History of Inequitable Conduct

Inequitable conduct is an equitable defense to patent infringement that, if proved, bars enforcement of a patent. The doctrine originated with Supreme Court cases that applied the common-law doctrine of unclean hands to dismiss patent infringement cases involving egregious misconduct by the patentee,

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INSIDE

Quinn Emanuel Launches Washington, D.C. Office to Serve IP Clients

The firm has opened an office in Washington, D.C., its sixth office in the U.S. The D.C. office will represent clients in Section 337 investigations before the International Trade Commission and in IP matters on the East Coast. Paul Brinkman, Alan Whitehurst and Alex Lasher, formerly with Alston & Bird, have joined the D.C. office as partners. Longtime Quinn Emanuel partner Jon Corey has moved from Los Angeles to D.C. to become the office's managing partner.

Brinkman, formerly the head of Alston & Bird's ITC practice and now the head of Quinn Emanuel's ITC practice, is a graduate of the University of Virginia Law School, where he served on the *Virginia Law Review*. He clerked for Chief Judge James Turk of the Western District of Virginia and served as co-chair of the ABA Customs Law Committee. Brinkman is listed in the *Who's Who of Patent Lawyers*, the *Who's Who of Trade Lawyers* and *The Best Lawyers in America*. He is ranked a leader in his field by *Chambers*. Whitehurst, formerly head of Alston & Bird's IP practice in D.C., specializes in patent litigation and has extensive experience in complex, technical litigation. He holds M.S. and E.E. degrees from Duke, where he also earned his law degree. Lasher, who also specializes in Section 337 actions, earned his B.A. from University of Virginia and J.D. from American University. Q

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including the suppression of evidence, perjury and the submission of false evidence to the PTO. Inequitable conduct gradually evolved to encompass misconduct broader than unclean hands, including the simple failure to disclose of information to the PTO. Inequitable conduct also acquired a powerful remedy: unenforceability of the entire patent rather than mere dismissal of the instant suit.

The Increase of Inequitable Conduct Claims

Federal courts have long required inequitable conduct claimants to show that the applicant misrepresented or omitted material information with the specific intent to deceive the PTO. Over time, the showing needed to establish the "materiality" and "specific intent" prongs of inequitable conduct weakened as courts promoted full disclosure to the PTO. Before *Therasense*, courts evaluated intent and materiality together on a "sliding scale," that allowed a finding that a patent was unenforceable if the record contained a strong showing of materiality and a reduced showing of intent, or vice versa.

Whether caused by or coincidental to the evolution of the standard governing claims of inequitable conduct, the frequency of inequitable conduct defenses alleged in patent infringement cases has increased, leading to an expansion of discovery into pre-filing corporate practices, disqualification of prosecuting attorneys from the patentee's litigation team, and, presumably, a lower probability of settlement. Inequitable conduct allegations "increase[d] the complexity, duration and cost of patent infringement litigation that [was] already notorious for its complexity and high cost" and frequently triggered antitrust and unfair competition claims, as well as additional litigation over the crime-fraud exception to attorney-client privilege.

The *Therasense* court concluded that then-current standards for proving inequitable conduct placed an undue strain not only on the judiciary, but also on the patent system as a whole. According to the court, patent applicants frequently disclosed too much prior art for the PTO to consider meaningfully, and failed to explain the significance of the prior art they disclosed, all out of fear that to do otherwise would risk an inequitable conduct claim. That risk was substantial because the remedy for inequitable conduct is the "atomic bomb of patent law." Unlike validity defenses, which are specific to a particular claim, a finding of inequitable conduct regarding single claim renders the entire patent unenforceable and the problem cannot be solved by reissue.

Therasense* *Set New Standards for "Materiality" and "Intent"

To "redirect a doctrine that has been overused to the detriment of the public," the *Therasense* court decided to "tighten the standards for finding both [the] intent and [the] materiality" required to prove inequitable conduct. *Therasense* eliminated the sliding scale, holding that "intent and materiality are separate requirements" that must be evaluated independently.

Under *Therasense*, the accused infringer must show intent by proving that the patentee acted with the specific intent to deceive the PTO. In cases involving nondisclosure of information, the accused infringer must show by clear and convincing evidence that the applicant made a deliberate decision to withhold known material prior art; it is insufficient that the applicant "should have known" of the materiality of the undisclosed prior art. The *Therasense* court conceded that, because direct evidence of deceptive intent is rare, "the district court may infer intent from indirect and circumstantial evidence" so long as the specific intent to deceive is "the most reasonable inference able to be drawn from the evidence." In cases where multiple reasonable inferences can be drawn, a court cannot find intent to deceive. The party alleging inequitable conduct bears the burden to prove by clear and convincing evidence a threshold level of intent to deceive before the patentee need offer good faith explanation.

The Federal Circuit had previously attempted to reduce inequitable conduct claims by modifying only the intent prong of the analysis. *See, e.g., Kingsdown Med. Consultants, Ltd. v. Hollister Inc.*, 863 F.2d 867, 876 (Fed. Cir. 1988). In *Therasense*, the court also adjusted the standard for materiality.

Therasense held that, to establish a claim of inequitable conduct, the accused infringer must show "but-for materiality." When an applicant fails to disclose prior art, the prior art is "but-for" material if the PTO would not have approved the patent had it known of it. To determine patentability in this context, the court "should apply the preponderance of the evidence standard and give claims their broadest reasonable construction."

The "but-for" test may be similar to a determination of invalidity. If a claim is invalidated based on a deliberately withheld reference, that reference would necessarily be material because invalidity "requires clear and convincing evidence," a higher evidentiary burden than used in prosecution at the PTO. Even if a district court does not invalidate a claim based on a deliberately withheld reference, the reference may nevertheless qualify as material if it would have blocked the patent's issuance under the PTO's evidentiary standard.

Therasense adopted "but-for" materiality to ensure that inequitable conduct would be applied only when the "patentee's misconduct resulted in the unfair benefit of receiving an unwarranted claim." If the patent would have issued anyway, the patentee did not obtain an unfair advantage from the misconduct, and enforcement would not injure the public.

In adopting its new standard for materiality, *Therasense* expressly declined to use the PTO's Rule 56 definition, which covers *any information* that "refutes or is inconsistent with" any position the applicant took regarding patentability. The court rejected that definition because "even if information would be rendered irrelevant in light of subsequent argument or explanation by the patentee, it could still be considered material." Because Rule 56 encompasses anything "marginally relevant" to patentability, its low standard of materiality would "inevitably result in patent prosecutors continuing the existing practice of disclosing too much prior art of marginal relevance and patent litigators continuing to charge inequitable conduct in nearly every case as a litigation strategy."

The Exception to "But-For" Materiality: Affirmative Egregious Acts

Although the but-for rule must generally be satisfied to satisfy the materiality prong of inequitable conduct under *Therasense*, the court recognized an exception for affirmative acts of "egregious misconduct." In cases such as the filing of an unmistakably false affidavit, the misconduct is deemed material. The court's exception incorporates elements of the early unclean hands cases decided by the Supreme Court. These cases addressed "deliberately planned and carefully executed schemes to defraud the PTO and the courts," observing that "a patentee is unlikely to go to great lengths to deceive the PTO with a falsehood unless it believes that the falsehood will affect issuance of the patent." Because the exception does not apply to mere nondisclosure of prior art references or the failure to disclose such references in an affidavit, claims of inequitable conduct based on such omissions still require proof of but-for materiality. By creating an exception to punish affirmative egregious acts without penalizing immaterial omissions, *Therasense* seeks to strike a balance between encouraging honesty before the PTO and preventing unfounded accusations of inequitable conduct that the *Therasense* majority believed have "plagued" courts and the U.S. patent system as a whole.

Practical Implications of Therasense

The *Therasense* court was closely divided, and what constitutes inequitable conduct may ultimately be decided by the Supreme Court. In the meantime, the heightened standard required to show "materiality" makes it more difficult for accused infringers to establish inequitable conduct as a defense to patent infringement. The *Therasense* dissent argued that the heightened standard is too restrictive, and makes inequitable conduct a redundancy because only invalid claims could be held unenforceable:

> Under this court's new rule, an applicant who conceals information with the intent to deceive the PTO will be free to enforce his patent unless it can be proved by clear and convincing evidence that the new patent would not have issued but for the fraud. Even though the majority justifies its new rule in part by asserting that it will improve the prosecution of patents before the PTO, I am convinced that the new rule is likely to have an adverse impact on the PTO and the public at large, a view that – significantly – is shared by the PTO itself.

It remains to be seen whether or not the heightened materiality standards announced by the *Therasense* majority will result in the adverse consequences predicted by the dissent. Even if the new materiality standard reduces the incentives to make a full initial disclosure to the PTO, the test will likely ease the burden on the patent system and courts created by "overdisclosure" to the PTO and the proliferation of inequitable conduct claims. In turn, the use of the new *Therasense* standard may allow the courts and the PTO to focus on the most egregious and potentially damaging cases of patent infringement, that were the most deserving of scrutiny in the first place. Q

New Trend Admitting Wiretap Evidence in Insider Trading Cases

Until recently, the use of wiretap evidence was limited to the prosecution of crimes that are specifically enumerated in Title III of the Omnibus Crime Control and Safe Streets Act of 1968, codified at 18 U.S.C. 2510-2522. Such evidence has typically been admitted primarily in drug cartel, alien smuggling and organized crime cases, but until now it has not been used in securities fraud cases. The times have changed. In the last several months, federal courts have twice upheld the use of wiretap evidence in insider trading prosecutions. Defendants Raj Rajaratnam and other ex-Galleon Group traders were found guilty of securities fraud by juries that listened spellbound to damning evidence from wiretapped telephone calls. Although the use of wiretap evidence is still generally prohibited in insider trading and other cases not enumerated in Title III, these recent rulings suggest that the reliance on wiretap evidence may be allowed in *any* case in which the wiretap was authorized in the investigation of an enumerated crime, even if that crime is not itself prosecuted.

Wiretaps and Congressional Goals

Congress' intent in passing Title III was to strike a balance between allowing wiretapping as an investigative tool and safeguarding the privacy of the general public and investigative targets. Wiretapping is one of the most invasive tools in law enforcement's arsenal, and Title III reflects a strong Congressional desire to circumscribe its use. *See, e.g., Berger v. New York*, 388 U.S. 41, 63 (1967) ("Few threats to liberty exist which are greater than that posed by the use of eavesdropping devices."); *Gelbard v. United States*, 408 U.S. 41, 48 (1972) (*quoting* S. Rep. No. 1097, 90th Cong., 2d Sess., 66 (1968)); U.S. Code Cong. & Admin. News, p. 2153 ("To assure the privacy of oral and wire communications, [T]itle III prohibits all wiretapping and electronic surveillance by persons other than duly authorized law enforcement officers engaged in the investigation or prevention of *specified types* of serious crimes, and only after authorization of a court order obtained after a showing and finding of probable cause.") (emphasis added). Accordingly, Title III enumerates the only types of predicate offenses upon which law enforcement may rely in seeking authorization for a wiretap.

Title III requires government agents monitoring calls via wiretap to avoid listening to, or to "minimize" the interception of, calls that are not authorized for interception. *See* 18 U.S.C. § 2518(5). Title III also provides a suppression remedy for those unlawfully subjected to the interception of their wire or oral communications, but courts avoid applying the remedy harshly, *see* 18 U.S.C. § 2515 and *Scott v. United States*, 436 U.S. 128 (1978), instead employing a generous reasonableness analysis when determining whether or not to suppress wiretap evidence.

Expansion of Wiretap Use to Insider Trading Prosecutions

Securities fraud (insider trading) is not among the enumerated offenses. Nonetheless, in *United States v. Rajaratnam*, 2010 WL 4867402, *1 (S.D.N.Y. Nov. 24, 2010), Judge Richard Holwell held that evidence obtained from wiretaps was admissible at trial. He reasoned that because wire fraud is an authorized crime under Title III, and because the government used wiretaps to investigate a fraudulent insider trading scheme using interstate wires, the wiretap evidence was admissible at trial. Judge Holwell carefully avoided ruling that wiretaps are generally permissible in insider trading cases. Rather, he held that evidence of securities fraud discovered through a wiretap based on an authorized crime under Title III (wire fraud, in this case) was permissible. If securities fraud is committed without the use of a wire, Title III will preclude the use of wiretapping. *Rajaratnam*, at *6 n.8.

Even though Judge Holwell attempted to circumscribe the potential reach of *Rajaratnam*, his opinion may prove to be the gateway to broader usage of wiretapping in white-collar and other cases. In fact, his ruling was followed in another securities fraud case, *U.S. v. Goffer*. The defendants advanced two arguments against the admission of wiretapped conversations. First, they argued that Title III prohibited the use of wiretaps because securities fraud is not an enumerated predicate offense. Second, they contended that the government had to comply with Title III's minimization requirement. Defendants' Reply Memorandum in Further Support of their Joint Motion to Dismiss and Suppress, *U.S. v. Goffer*, No. 10-CR-0056 (RJS), ECF 115 (Dec. 17, 2010). The government had intercepted nearly 200 personal calls between one of the defendants, Craig Drimal, and his wife. Judge Richard Sullivan characterized the interception of martial communications as "disgraceful," "egregious," "an embarrassment generally," and "inexcusable and disturbing," especially because many intimate calls were monitored by agents long after they realized that the conversations did not relate to their investigation, with one six-minute call being monitored for at least four minutes. *Goffer*, Memorandum and Order, ECF 179 (Apr. 20, 2011).

Notwithstanding his distaste for the government's conduct, however, Judge Sullivan did not suppress any relevant intercepted calls, either on the grounds of illegality, or as a sanction for the government's misconduct. He summarily rejected the defendants' arguments that the wiretapping was illegal due to the lack of an authorized predicate offense. And, notwithstanding the government's voyeuristic intrusion into private calls, he found that, "on the whole, the wiretap was professionally conducted and generally well-executed." *Id*. The wiretap evidence was subsequently introduced at trial.

Civil, as Well as Criminal, Cases to Be Affected

This innovative use of wiretap evidence may begin to change the legal landscape in certain civil cases, as well. The Securities Exchange Commission brought a civil action against Rajaratnam, parallel to his criminal prosecution. It sought to obtain wiretap evidence from Rajaratnam and his co-defendant, Danielle Chiesi, obtained in the criminal case and disclosed to Rajaratnam and his co-defendants. District Judge Jed Rakoff, presiding over the S.E.C. action, ruled that the S.E.C. was entitled to its production. *S.E.C. v. Galleon Mgmt., LP*, 683 F. Supp. 2d 316 (S.D.N.Y. 2010).

On appeal, the Second Circuit held that, "nothing in Title III bars the use of the fruits of authorized wiretaps obtained in the pursuit of investigations of suspected crimes that are listed in Title III in securities fraud or insider trading proceedings." *S.E.C. v. Rajaratnam*, 622 F.3d 159, 173 (2d Cir. 2010). On remand, Judge Rakoff held that whatever privacy interests the defendants had were outweighed by the S.E.C.'s right of access to the wiretap intercepts, and therefore ordered Rajaratnam and Chiesi to disclose it. *S.E.C. v. Galleon Mgmt., LP*, 2011 WL 1770631 (S.D.N.Y. May 20, 2011).

In light of *Goffer, Rajaratnam,* and Fed. R. Evid. 403 as applied in the civil context, it seems likely that Judge Rakoff will permit the introduction of wiretap evidence.

The impact of his ruling may be felt even by those who are not the intended subjects of wiretaps. The *New York Times* has reported that the S.E.C. may file a federal enforcement proceeding against Rajat Gupta, the former managing director of McKinsey & Company and an alleged co-conspirator with Raj Rajaratnam. *See* Peter Henning, *Focus on Insider Trading Becomes More Intense*, DealBook (August 8, 2011, 3:50 pm), http://dealbook.nytimes.com/2011/08/08/focus-on-insider-trading-becomes-more-intense/. If it does so, it will almost certainly seek to admit wiretap evidence gleaned during the Rajaratnam investigation that allegedly reveals the nature of Gupta's involvement in insider trading. *Id.* Assuming the S.E.C. files suit and satisfies the requirements of the "co-conspirator exception" to the hearsay rule, Gupta could find himself in a difficult position in court, defending himself against statements made by Rajaratnam during a wiretapped telephone call to which he was not a party. *Id.*

Implications for the Future

Rajaratnam could be interpreted as rendering admissible in *any* criminal proceeding wiretap evidence collected in the investigation of an authorized crime under Title III. Federal prosecutors pursuing insider trading cases have certainly taken notice of U.S. Attorney Preet Bharara's success in prosecuting Wall Street insiders, and will seek to apply his innovative strategy. Bharara "took wiretaps for a test drive, and I'd say it was a resounding success," opined Stephen Miller, a former federal prosecutor. *See* Larry Neumeister & Tom Hays, *Wiretaps Key in Conviction of Ex-Hedge Fund Giant*, ABC News (May 12, 2011), http://abcnews.go.com/US/wireStory?id=13585543.

Judge Rakoff has already permitted wiretap evidence to be used in prosecuting an insider-trading case against James Fleishman of Primary Global Research, LLC. Memorandum, *United States v. Fleishman*, No. 11-CR-32 (JSR), ECF 115 (Aug. 31, 2011). Fleishman had argued that there was insufficient probable cause for the wiretaps, which targeted 104 Primary Global telephone line users, because there was no showing that all 104 individuals had engaged in wrongdoing. *See* Andrew Longstreth, *Expert-networking Defendant Challenges Wiretap*, Reuters (Aug. 2, 2011, 9:25 am), http://www.reuters.com/article/2011/08/02/us-fleishman-wiretap-idUSTRE77103T20110802. However, Fleishman declined to challenge the wiretaps' validity on the grounds that insider trading is not an enumerated predicate offense under Title III.

Meanwhile, U.S. Attorney Bharara has made it clear his office will continue to prosecute insider trading cases based on wiretap evidence. When insider traders adopt "the methods of common criminals, such as the use of anonymous cell-phones, we have no choice but to treat them as such. To use tough tactics in these circumstances is not being heavy-handed; it is being even-handed," Bharara stated in remarks to the New York City Bar last year. *See* Bruce Carton, *SDNY's Bharara Focuses on Insider Trading, Wiretaps*, Compliance Week (Oct. 27, 2010) http://www.complianceweek.com/sdnys-bharara-focuses-on-insider-trading-wiretaps/article/191929/.

Insiders using non-public information should consider carefully a question Bharara has posed: "Today, tomorrow, next week, the week after, privileged Wall Street insiders who are considering breaking the law will have to ask themselves one important question: Is law enforcement listening?" United States Attorney Preet Bharara, Prepared Remarks for Press Announcement (October 16, 2009).

Patent Litigation Update:

Knowledge Required For Induced Infringement, But It May Be Established Via Willful Blindness: In *Global-Tech Appliances, Inc. v. SEB S.A.*, 131 S. Ct. 2060 (2011), the Supreme Court held that knowledge is the applicable standard for imposing liability under Section 271(b) of the Patent Act, which concisely provides that "[w]hoever actively induces infringement of a patent shall be liable as an infringer." Of equal importance, it held that the willful blindness doctrine (developed in criminal cases) can be applied to establish knowledge in civil patent infringement cases.

Global-Tech reverse-engineered an SEB-patented deep fryer to make and market a competing deep fryer, but argued that it did not "actively" induce infringement because it was unaware of SEB's patent and also had obtained a legal opinion that it had a right to use its product (albeit, without informing its attorney that Global-Tech had copied SEB's commercially available fryer). SEB responded that Global-Tech's re-engineering of the SEB fryer was sufficient to support a claim of active inducement.

The Supreme Court concluded unanimously that induced infringement under Section 271(b) requires knowledge that the induced acts constitute patent infringement. In doing so, the Court rejected the Federal Circuit's holding that deliberate indifference to a known risk that a patent exists would constitute active inducement. It is now insufficient simply to show that the defendant knew there was a chance its activities could violate a patent, but paid no attention to the attendant risk.

Nevertheless, the Supreme Court affirmed the Federal Circuit's judgment, holding that Global-Tech's actions supported a finding of knowledge under the doctrine of willful blindness. Willful blindness requires a showing that: "(1) the defendant must subjectively believe that there is a high probability that a fact exists and (2) the defendant must take deliberate actions to avoid learning of that fact." With implications that may reach far beyond the field of civil patent litigation, the Court's opinion suggests that criminal statutes requiring proof of knowing or willful conduct are satisfied by proof of willful blindness under the Court's articulated standard.

Patent Invalidity Defenses Must Always Be Proven By "Clear And Convincing Evidence": In *Microsoft Corp. v. i4i Ltd. Partnership*, 131 S. Ct. 2238 (2011), the Supreme Court held that Section 282 of the Patent Act, which provides that "[a] patent shall be presumed valid," requires that an invalidity defense be proven by clear and convincing evidence, even if the defense rests on evidence never considered by the PTO during the examination process.

Having failed at trial to prove patent invalidity under the contested clear and convincing standard, Microsoft argued that an infringement defendant need only prove invalidity by a preponderance of the evidence. In the alternative, Microsoft argued that a preponderance standard must at least apply if an invalidity defense is based on evidence that was not before the PTO, and questioned why deference should be given to the PTO with respect to evidence the PTO never considered.

The Supreme Court affirmed the Federal Circuit's opinion, holding that clear and convincing evidence is the correct standard. The Court acknowledged that Section 282 does not expressly articulate a standard of proof, but concluded that because Judge Cardozo's 1934 opinion in *RCA* adopted a clear and convincing standard, the Patent Act, enacted in 1952, implicitly incorporated that standard through the use of the phrase "presumed valid," which had a settled common law meaning.

The Court also rejected Microsoft's alternative argument, concluding that Congress would have made it expressly clear if Congress had intended that a lower standard be applied to evidence that was not before the PTO. The Court did, however, recognize that (i) a jury could consider that the PTO had no opportunity to evaluate specific evidence, (ii) such evidence could be weighed more heavily, and (iii) the party asserting invalidity might therefore more easily satisfy its burden under the clear and convincing evidence standard.

Federal Circuit Streamlines Rules for Contempt Proceedings for Designing Around an Injunction: In *TiVo Inc. v. EchoStar Corp.,* 646 F.3d 869 (Fed. Cir. 2011), the Federal Circuit outlined new rules for contempt proceedings against a new or modified product when the original product has been barred by permanent injunction. The new rules effectively lower the burden for initiating such proceedings, but arguably raise the threshold required to establish the contempt itself.

After a jury found Echostar infringed TiVo's DVR software patent, the district court entered a permanent injunction requiring in part that EchoStar disable certain infringing features for products placed with end users. TiVo later persuaded the district court to find EchoStar in contempt based on design-around activities it initiated as an alternative to the disabled features.

The Federal Circuit rejected Echostar's argument that a finding of contempt is improper when a defendant has engaged in diligent and good faith efforts to avoid violating an injunction. In doing so, it overruled the two-part contempt inquiry established in *KSM*, which required that a district court first decide whether a contempt hearing is an "appropriate setting." Doing so required that the redesigned product first be compared with the original to determine whether there was "more than a colorable difference" between them such that "substantial open issues with respect to infringement" existed. After that, the court was required to determine whether the redesigned product was also infringing. The Federal Circuit's new test combines the two parts of the inquiry into one, leaving that appropriateness determination to the trial court's sound discretion.

The new test also arguably increased the threshold for an actual finding of contempt by clarifying that the colorable difference consideration is not determined by simply judging whether the redesigned product continues to infringe, but rather by focusing on differences between the infringing features of the original product and the modified features of the newly accused product.

Finally, the majority held that a vagueness defense to contempt may be waived if not raised by the defendant at the first opportunity, suggesting that it might be wise to challenge ambiguities in an injunctive order when it is granted rather than within the context of a contempt proceeding.

Federal Circuit to Revisit "Control or Direction" Standard for Joint Infringement: On April 20, 2011, the Federal Circuit granted an *en banc* rehearing petition for *Akamai Technologies, Inc. v. Limelight Networks, Inc.*, 629 F.3d 1311 (Fed. Cir. 2010), to address the following question: If separate entities each perform separate steps of a method claim, under what circumstances would that claim be directly infringed and to what extent would each of the parties be liable?

In *Akamai*, the defendant did not perform some steps of the plaintiff's patented method itself, instead instructing its customers to perform those steps if they wanted to take advantage of the defendant's services. Drawing on past Federal Circuit opinions in *BMC Resources* and *Muniauction*, which stated that joint infringement could be found only when one party was under the "control or direction" of the other party, the court held that "as a matter of Federal Circuit law … there can only be joint infringement when there is an agency relationship between the parties who perform the method steps or when one party is contractually obligated to the other to perform the step."

Judge Newman's dissent in *McKesson Technologies, Inc. v. Epic Systems Corp.*, 98 U.S.P.Q.2d 1281 (Fed. Cir. 2011), a similar case involving patient/physician interactive Websites requiring the actions of both patients and physicians to perform all the steps in the patented method, attacked the decision in *Akamai* and related cases and pushed for an *en banc* hearing to resolve the conflicting precedents addressing joint infringement. She highlighted the conflicts by contrasting recent Federal Circuit cases applying the "single-entity rule" with older cases that analyzed such joint or contributory infringement under traditional tort theories (which required only participation, collaboration, or combined actions to find liability). Judge Newman also argued that the rule would withhold patent protection from technologically advanced methods that increasingly involve interaction between multiple entities.

Oral argument for the *en banc* rehearing is scheduled for November 18, 2011.

Securities Litigation Update:

Supreme Court Redefines "Makers" of Untrue Statements as Those With Ultimate Authority: The Supreme Court's decision in *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296 at 2302 (2011), in the final weeks of the 2010-2011 term, turned on the meaning of a single word. Securities and Exchange Commission (SEC) Rule 10b-5 states that it shall be unlawful for "any person . . . [t]o ***make*** any untrue statement of material fact . . . in connection with the purchase or sale of any security." Securities Exchange Act, 15 U.S.C. § 78j(b) (1994). At issue was the scope of potential primary liability for actors involved in "mak[ing]" misleading statements under Rule 10b-5. The Court held that "[f]or purposes of Rule 10b-5, the maker of a statement is the person or entity with ultimate authority over the statement, including the content and whether and how to communicate it." *Id.* This narrow definition of "make" has significance well beyond *Janus* because it impacts the extent to which a public company's affiliates, officers, directors and outside professionals, including accountants, lawyers and investment advisers, may face liability under the federal securities laws for false or misleading statements issued by the company. After *Janus*, only the company itself faces primary liability under Rule 10b-5.

Background and Posture

Janus' corporate structure was consequential to the outcome of the litigation. Janus Capital Group, Inc. (JCG), is a publicly traded asset management company and the sixteenth largest mutual fund complex in the United States, with more than four million mutual fund investors. *Company Profile*, Janus Capital Group, http://press.janus.com/company-profile.cfm (last visited July 26, 2011). Janus Capital Management

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LLC (JCM), JCG's wholly owned subsidiary, serves as an investment adviser and administrator for the Janus mutual fund family. In this capacity, officers and employees of JCG and JCM participated in the preparation and dissemination of prospectuses issued by Janus Investment Fund (JIF), a separate legal entity with a separate board of trustees, and owned entirely by mutual fund investors. Although JIF was legally separate from JCM, the entities were closely related. For instance, each of JIF's officers was also a JCM employee. *Janus,* 131 S. Ct. at 2302 (Breyer, J., dissenting).

The alleged misstatements giving rise to the litigation were exposed in September 2003 following an investigation by the New York Attorney General's Office into "market timing," which refers to the short-term, "in and out" trading in mutual-fund shares to, *inter alia*, exploit stale prices for stocks listed on foreign exchanges. *New York v. Canary Capital Partners*, (N.Y. Sup. Ct. Sept. 3, 2003). In prospectuses issued between 2001 and 2003, JIF represented that its policy was to discourage or prohibit market timing.

As a result of its investigation, however, the New York Attorney General filed a complaint against the Canary Capital Partners, LLC hedge fund, alleging that it had colluded in a market-timing scheme with JIF. *See id*. Ultimately Janus paid $225 million in 2004 to settle claims by regulators that it had failed to disclose the trading arrangements to long-term investors. *See* James Vicini & Ross Kerber, *Top Court Rules for Janus in Securities Case*, Reuters (June 13, 2011, 11:38 AM), http://www.reuters.com/article/2011/06/13/us-janus-lawsuit-court-idUSTRE75C3CC20110613. This disclosure caused investors to withdraw nearly $14 billion from various Janus funds. As a result, JCG's stock price fell substantially.

First Derivative Traders, representing a class of stockholders in JCG, subsequently filed a private Rule 10b-5 securities class action in the District of Maryland. The district court dismissed the action, but the Court of Appeals for the Fourth Circuit reversed, holding that First Derivative had adequately pled its complaint. JCG and JCM then filed a petition for certiorari, which the Court granted.

Supreme Court Decision

In a 5-4 decision, the Supreme Court reversed the Fourth Circuit holding that the plaintiffs had failed to state a claim. Justice Thomas, joined by Chief Justice Roberts and Justices Scalia, Kennedy, and Alito, held that the "maker" of a misstatement under Rule 10b-5 is the person or entity with ultimate authority over the statement. According to the majority, this narrow view of primary liability followed directly from the Court's holding in Central *Bank of Denver, N.A. v. First Interstate Bank of Denver, N A.* 511 U.S. 164 (1994), which held that Rule 10b-5's private right of action excludes suits against aiders and abettors who contribute "substantial assistance" to the making of a statement but do not actually make it. An "expanded" right of action would undermine the distinction between "primary violators" and "aiders and abettors" by rendering the potential class of aiders and abettors practically non-existent.

The majority rejected the definition of "make" proposed by the United States, appearing as amicus. The government contended that "make" should properly be defined as "create," allowing primary liability to extend to any person who provides misleading or false information that is later issued as a public statement. *Janus,* 131 S. Ct. at 2303 - 2304. The majority argued that this meaning was inconsistent with *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.,* 552 U.S. 148 (2008), which rejected a private 10b-5 suit against companies involved in deceptive transactions, even when information about those transactions was subsequently incorporated into false public statements. In relying on *Stoneridge*, the majority refused to distinguish *Janus* on the basis of the "uniquely close relationship between a mutual fund and its investment advisor." (Justice Thomas noted that he would "decline this invitation to disregard the corporate form." *Janus,* 131 S. Ct. at *2304 - 2305.) *Janus* thus sets a bright-line rule limiting primary liability *exclusively* to the company or individual with "ultimate authority over the statement." *Id*. at *13.

Applying its narrow definition of "make" to JCM, the majority held that JIF was the exclusive "maker" of the alleged misstatements in the prospectuses. Only JIF had the statutory obligation to file the prospectuses with the SEC, and notwithstanding that JCM may have been "substantially involved" in drafting the impugned sections of the prospectuses, their issuance remained "subject to the ultimate control" of JIF. *Id*. at *23. JCM acted only as a "speechwriter," but, "[e]ven when a speechwriter drafts a speech, . . . it is the speaker who takes credit—or blame—for what is ultimately said." *Id*. at *13-14.

Justice Breyer, in a dissent joined by Justices Ginsburg, Sotomayor, and Kagan, argued that "[n]either common English usage nor this Court's earlier cases limit the scope of [the word 'make'] to those with 'ultimate authority' over a statement's content." *Id*. at *26 (Breyer, J., dissenting). In the minority's view, the bright-line rule articulated by the majority is willfully blind to the practical exercise of agency in the making of public statements. "Every day," the minority noted, "hosts of corporate officials make statements with content that more senior officials or the board of directors have 'ultimate authority' to control. So do cabinet officials make statements about matters that the Constitution places within the ultimate authority of the President." *Id*. at *27-28 (Breyer, J., dissenting). Accordingly, the minority suggested that the determination of a statement's "maker"—and susceptibility to primary liability—ought to "depend[] upon the circumstances." *Id*. at *26 (Breyer, J., dissenting). On the facts presented, the minority concluded that the facts alleged brought JCM within the scope of Rule 10b-5 because its "involvement in preparing and writing the relevant statements could hardly have been greater." *Id.* at *44 (Breyer, J., dissenting).

Reflections and Impact

The decision has already been criticized by certain commentators, which ascribe it to the Court's hostility to the implied private right of action under Rule 10b-5. In dissent, Justice Breyer envisioned that "guilty management" might make materially false statements, that "fools both board and public into believing they are true." *Janus,* 131 S. Ct. at *2310 – 2311. Under the *Janus* bright-line rule, the manager would not be liable as a Rule 10b-5 primary violator because he did not "make" the statement. Neither could he be pursued by the SEC as an "aider and abettor" because there would be "no other primary violator [he] might have tried to 'aid' or 'abet.'" (Under the Private Securities Litigation Reform Act of 1995, the SEC is authorized to prosecute "aiders and abettors" pursuant to section 10(b), but Congress did not provide a private cause of action against aiders and abettors). Professor Jeffrey Gordon has commented that "the decision exacerbates the problem of 'agency capitalism'—the tendency of the managing agents to pursue their own objectives at the expense of the ultimate beneficiaries." Gordon, *supra* note 23. In his view, the majority's reasoning ignores one of the principal lessons of the financial crisis, which is that the "purported gatekeepers to the financial system—accountants, lawyers, credit rating agencies, underwriters—often pursued their immediate economic interests at the expense of their critical gate-keeping function." *Id.*

Janus appears to foreclose the potential for primary 10b-5 liability for false statements on the part of outside professionals, such as accountants, attorneys and investment advisers, who assist companies in issuing SEC filings and public statements. *Janus* also seems to shield from primary liability officers of a company who are not themselves vested with "ultimate authority" to issue a public statement. The decision will likely encourage litigants to seek recourse through other avenues of liability for actors who participated in, but did not actually utter, false public statements. One avenue may be found in section 20(b) of the Securities Exchange Act of 1934, which provides for "control person" liability for a company, even when its board had no knowledge of the underlying fraud, if any of its agents had such knowledge. Another lies in state common law claims, such as fraud and aiding and abetting fraud, which remain unaffected by the Court's restrictive statutory interpretation of Rule 10b-5.

Entertainment Litigation Update:

***Supreme Court Strikes Down Law Prohibiting Sale of Violent Video Games to Minors*:** The Supreme Court ended its term by striking down a California ban on violent video games. *Brown v. Entertainment Merchants Ass'n*, 564 U.S. __, 131 S. Ct. 2729 (June 27, 2011). The majority opinion reinforced that First Amendment protection does not depend on the medium of communication. Thus, video games are entitled to the same protection as *Grimm's Fairy Tales*, and attempts to restrict their content will be subject to strict scrutiny.

California passed a law prohibiting the sale or rental of violent video games to minors. The law defined the restricted games as those "in which the range of options available to a player includes killing, maiming, dismembering, or sexually assaulting an image of a human being, if those acts are depicted" in a manner that is "patently offensive to prevailing standards in the community as to what is suitable for minors" and that "causes the game, as a whole, to lack serious literary, artistic, political, or scientific value for minors." The definition blended two tests the Supreme Court had adopted in prior decisions, one adopting a restriction on obscene materials specific to minors (*Ginsberg v. New York*, 390 U.S. 629 (1968)), and the other governing obscenity generally and permitting the standard for restrictions on obscene material to be based on "community standards" (*Miller v. California*, 413 U.S. 15 (1973)). However, the California statute applied these standards to depictions of violence rather than depictions of nudity or sexually explicit conduct.

In striking down the law, the majority acknowledged that the government may adopt limits on materials available to minors that are more restrictive than the limits that may be applied to adults. However, it held that in doing so the government is limited to areas that traditionally have been the subject of restrictions on speech, such as obscene depictions of "sexual conduct." Relying on *United States v. Stevens*, 559 U.S. ___, 130 S.Ct. 1577 (2010), in which it struck down a statute prohibiting violent "crush" videos, the Court held that

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Arbitration Victory for Toshiba

The firm recently won a complete victory for Toshiba Corporation in an AAA/ICDR arbitration in New York. Toshiba brought several claims against Coby Electronics Co., Ltd., a Chinese manufacturer of consumer DVD players, for breach of a patent license, and included claims for royalties due under the license agreement. The claims, with interest, totaled over $18 million. Additionally, Toshiba sought a declaration that the release for past patent infringement contained in the license was null and void.

Toshiba is the authorized licensor for the DVD6C Licensing Group ("DVD6C"). DVD6C licenses over 5,000 DVD patents on behalf of nine major companies (Hitachi, Mitsubishi Electric, Panasonic, Samsung, Sanyo, Sharp, Toshiba, Warner and JVC). In 2008, Toshiba entered into a license with Coby, which permitted Coby to practice the DVD6C members' essential DVD patents and released it from claims of past patent infringement. But Coby only intermittently rendered royalty reports and failed to pay royalties on the sales it reported. In addition, Toshiba suspected that Coby was reporting only a fraction of the DVD players it was actually selling. Following an investigation into Coby's export/import practices, the firm presented evidence that Coby had sold over ten times the number of DVD players it had reported to Toshiba.

In a 40-page decision, the arbitral tribunal awarded Toshiba $18.5 million in damages for breach of contract plus continuing interest at the rate of 2% per month until the award is paid in full. The tribunal also declared the release for past patent infringement null and void. And the tribunal found that Toshiba was the prevailing party, entitling it to recover all its reasonable attorneys' fees and costs. Hence, Toshiba was accorded the full relief it sought on every claim it asserted in the arbitration.

The decision is significant in that it demonstrates that IP licenses may be enforced through arbitration against Chinese entities that fail to report accurately the sales of royalty-bearing products manufactured in China and sold worldwide. This is important because China is a signatory to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards.

Preliminary Injunction Victory in Ninth Circuit

The firm recently achieved another victory for Google in a long-running copyright infringement case brought by adult entertainment company Perfect 10. Seven years ago, Perfect 10 sued Google in the Central District of California for copyright infringement and other claims based on Google's (1) linking to allegedly infringing copies of Perfect 10's images through its core Web Search Service, and (2) display of thumbnail-sized copies of Perfect 10's images through its Image Search service. Perfect 10 later added new claims related to Google's Blogger web log hosting service. All told, the suit alleged over two million infringements of tens of thousands of claimed copyrighted works.

In 2009, Quinn Emanuel filed motions for summary judgment regarding Google's entitlement to safe harbor under the Digital Millennium Copyright Act (17 U.S.C. § 512). While those motions were pending, Perfect 10 tried to leapfrog them by filing a motion for a preliminary injunction–its second in the case–seeking to shut down Google's core business. Perfect 10's motion was based on theories of direct, contributory and vicarious copyright infringement directed to Google's Web Search, Image Search, web caching feature, and Blogger hosting service. Quinn Emanuel mounted a vigorous opposition, arguing that Perfect 10 was not likely to prevail on the merits and that Perfect 10 neither was entitled to a presumption of irreparable harm nor could demonstrate such harm.

The district court agreed and granted Google's summary judgment motions with respect to the vast majority of the DMCA notices Perfect 10 had sent to Google. The court concluded that nearly all the notices failed to comply with the DMCA's requirements in multiple respects, and that without adequate notice of copyright infringement under the DMCA, Google was entitled to safe harbor protection. The ruling disposed of well over 98 percent of Perfect 10's expansive copyright infringement claims. The court also denied Perfect 10's preliminary injunction motion on all counts.

Perfect 10 appealed both decisions to the Ninth Circuit, arguing that the ordinarily-unappealable order granting Google partial summary judgment of DMCA safe harbor was inextricably intertwined with the denial of its preliminary injunction motion. Quinn Emanuel vigorously defended both lower court victories. Earlier this month, the Ninth Circuit held that Perfect 10 was not entitled to a presumption of irreparable harm in connection with its preliminary injunction motion, and had not offered sufficient evidence demonstrating such harm. The Ninth Circuit also left Google's DMCA summary judgment victory intact.

Importantly for copyright defendants, the decision reversed a long line of Ninth Circuit cases holding that copyright plaintiffs are entitled to a presumption of irreparable harm, finding those cases irreconcilable with the Supreme Court's 2006 decision in *eBay v.*

MercExchange. It also preserved the district court's DMCA summary judgment order. As a result of this significant victory, Google has no damages exposure for approximately 2 million alleged infringements that Perfect 10 claimed with respect to Google's Search and Blogger services. The decision also offers practical guidance to both copyright owners and internet service providers regarding the proper application of the DMCA and reinforces Ninth Circuit precedent confirming that the copyright owner–not the service provider–bears the burden to sufficiently identify alleged copyright infringements on the web. Q

(Entertainment Update continued from page 9)

"new categories of unprotected speech may not be added to the list by a legislature that concludes certain speech is too harmful to be tolerated." The majority noted that there was no longstanding tradition in the U.S. of restricting children's access to depictions of violence, citing examples of violent material in *Grimm's Fairy Tales* and Homer's *The Odyssey*. Thus, the restriction on violent video games was subject to "strict scrutiny," the most demanding test imposed under constitutional law for the validity of restrictions on speech.

The Court concluded that California's law failed to satisfy strict scrutiny because (i) California could not show a direct link between violent video games and harm to minors; (ii) the law was under-inclusive, singling out video-game providers and not addressing other providers, such as booksellers, cartoonists and movie producers; and (iii) the law provided only marginal benefits beyond those provided by existing, voluntary regulations undertaken by the industry.

The Hurt Locker: In March 2010, just days before *The Hurt Locker* won the Best Picture "Oscar" at the Academy Awards, Master Sgt. Jeffrey Sarver sued the producers, director and screenwriter, alleging that he was the source of the main character, title and other aspects of the film. Sgt. Sarver alleged claims for defamation, breach of contract, intentional infliction of emotional distress and misappropriation of his right of publicity.

The screenwriter, Mark Boal, was embedded with Sgt. Sarver's unit in Iraq and spent a month profiling him for a *Playboy Magazine* story entitled "The Man in the Bomb Suit." Sgt. Sarver alleged that Boal had no right to use his life in drafting the screenplay for *The Hurt Locker*. Although Boal acknowledged that his character bears some resemblance to Sgt. Sarver, he argues that because the film contains numerous creative elements, it merits protection under the First Amendment.

In deciding the defendants' motion to dismiss District Judge Jacqueline Nguyen (recently nominated for appointment to the Ninth Circuit) recently issued a tentative ruling of significant consequence. She agreed that the defamation, breach of contract and intentional infliction of emotional distress claims should be dismissed, but her tentative ruling allowed Sgt. Sarver to pursue a claim for misappropriation of name and likeness.

Sarver argues that the remaining claim represents the "essence of this case." Attorneys for the defendants argue that if Judge Nguyen maintains her tentative ruling, it would have a chilling effect on future films based on real world events. The ruling will be closely watched by industry insiders.

In Re NCAA Student-Athlete Name: Former NCAA football and basketball student-athletes have filed an antitrust lawsuit against Electronic Arts, Inc. (EA), the second largest U.S. video game publisher, and against the NCAA and the Collegiate Licensing Company (CLC). *In Re NCAA Student-Athlete Name and Likeness Licensing Litigation*, No. 09-1967, (N.D. Cal. 2009). The suit concerns EA's "NCAA Football," "NCAA Basketball" and "NCAA March Madness" video game franchises, which are distributed pursuant to license agreements with CLC, the NCAA and NCAA member institutions. The plaintiffs contend that the video games unlawfully use their images, likenesses and names by creating virtual football and basketball players that EA designed to resemble actual student-athletes. EA omits student-athletes' names in the video games but the plaintiffs allege that EA, with the knowledge of the NCAA and CLC, designed the games to allow consumers to upload rosters created by third parties that supply their names.

The plaintiffs allege that the defendants have violated § 1 of the Sherman Act's proscription on restraint of trade by participating in a (1) price-fixing conspiracy to set at zero dollars the price paid to the plaintiffs and putative class members to use their images, likenesses and names; and (2) "group/boycott/refusal to deal" conspiracy to use their images, likenesses and names.

Ruling on EA's motion to dismiss, the court held on July 28th that the allegations were sufficient to state a claim for conspiracy to restrain trade. The court also found significant the plaintiffs' allegations that, in addition to agreeing to abide by the NCAA's rules prohibiting the compensation of current student-athletes, EA also agreed not to offer compensation to

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former student-athletes. Because NCAA rules do not prohibit former student-athletes from receiving compensation for use of their images, likenesses and names, the agreement exceeded the requirements of the NCAA's rules and policies and satisfied the requirement that the plaintiffs plead the existence of a price-fixing agreement. The litigation continues. Q

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