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INTELLECTUAL PROPERTY NEWS
SPRING 2010

FUNCTION FOLLOWS FORM - ENFORCEMENT OF RESTRICTIVE COVENANTS AFTER COMPANY ACQUISITION MAY HINGE ON STRUCTURE OF THE DEAL

By Susan V. Metcalfe and Alan R. Boynton, Jr.

In late 2009 and early 2010, Pennsylvania state and federal appellate courts clarified the ability of employers to assign non-competition agreements as part of a merger or sale of a company. In both cases, the court distinguished between a stock sale and an asset sale. Both courts held that non-competition agreements with employees could be assigned, even without the employee's consent, if the change in ownership of the company is effected through a stock, rather than an asset, acquisition.

The holding of the courts in both cases was not a given. Previously, two lower court decisions, in Cumberland County and Dauphin County reached contrary conclusions. These lower court decisions applied what they believed to be the analysis of the 2002 Pennsylvania Supreme Court in *Hess v. Gebhard*, in which the court refused to enforce a non-competition agreement of an insurance salesman who resigned after his employer was sold to a new company. Noting that restrictive covenants must be construed narrowly because they restrain an employee's right to earn a living, the *Hess* court pointed out that an employee may be willing to sign a restrictive covenant as a condition of working for one employer but not another. It then held that restrictive covenants are not enforceable by an acquiring company unless the non-competition agreement specifically permits the employer to do so.

The decision in *Hess* involved an asset purchase agreement. Thereafter, questions were raised as to whether the same analysis would apply to a stock sale of a company. As noted above, some courts determined there was no difference. The Dauphin County Court opined, "unless an employee explicitly agreed to an assignability provision, an employer may not treat him as some chattel to be conveyed, like a filing cabinet, to a successor firm."

That approach was recently rejected by both state and federal appellate courts. In late 2009, in *J. C. Ehrlich Co., Inc. v. Martin*, the Superior Court of Pennsylvania noted the transaction at issue "merely accomplished a stock purchase, not the sale of Ehrlich's assets." As the employee's company remained the same (albeit under different ownership) and his duties and responsibilities did not change, the new owners could enforce the agreement that he had signed with Ehrlich.

Then in 2010, the Third Circuit Court of Appeals solidified this approach in *Zambelli Fireworks Manufacturing Co. v. Wood*. In *Zambelli*, the defendant was a highly trained pyrotechnics expert who designed, sold, and executed specially choreographed fireworks displays. Resigning after the owners of the privately held company sold their interests, he argued that his non-competition agreement was unenforceable because he never agreed to allow his employer to assign it and did not want to work for the new owners. The court disagreed, reasoning that Pennsylvania courts have historically held the transfer of a corporation's stock does not destroy the corporate entity, and therefore Zambelli's employer did not actually change.

Taking the logic of *Ehrlich* and *Zambelli* one step further, a Pennsylvania trial court recently applied the analysis to the change in ownership of a limited liability company (LLC). In *American Home Supply Mid-Atlantic v. Gannon*, the Court of Common Pleas of Lackawanna

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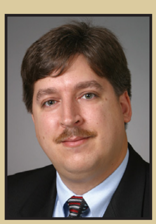
FEDERAL CIRCUIT HOLDS USPTO MISCALCULATING PATENT TERM ADJUSTMENTS

By Brian T. Sattizahn

In early 2010, the Court of Appeals for the Federal Circuit issued a ruling that the United States Patent and Trademark Office (USPTO) was miscalculating patent term adjustments on issued patents. The Court stated that the USPTO's method of calculating a patent term adjustment was contrary to the plain language of the statute providing for patent term adjustments.

A patentee can obtain an adjustment of a patent term, i.e., an extension of the patent term past twenty (20) years from the effective filing date of the patent, due to USPTO delays occurring during the prosecution of the application. A patentee can obtain an adjustment in the patent term for A) delays in the occurrence of specific prosecution matters, e.g., the USPTO taking more than fourteen (14) months after the filing of an application to issue a first response, or where B) the patent application being pending more than three (3) years. The USPTO had been treating these two delays as exclusive of each other, i.e., a patentee could only get the longer of the term provided for under the calculation of (A) or the calculation of (B). The Court stated that this method of calculating a patent term adjustment was not proper and that the correct method included accounting for delays calculated under both (A) and (B). Specifically, a patentee is entitled to a patent term adjustment for delays occurring under both (A) and (B), except that calculated delays occurring under (A) more than three years from the filing date would not be counted because they would overlap with calculated delays occurring under (B).

In view of the Court's ruling, the USPTO has established a relatively simple procedure for patentees to request a recalculation of a patent term adjustment based on the court's ruling without having to pay a fee. However, any request for recalculation of a patent term adjustment under this procedure must occur within one hundred eighty (180) days of the grant of the patent. Finally, the USPTO has stated that patents issued on and after March 2, 2010 will have patent term adjustments calculated in accordance with the Court's ruling and will not be eligible for the simplified procedure. ■



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County determined the purchase of a membership interest in an LLC "was synonymous to a stock sale rather than an asset sale."

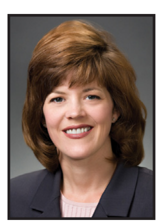
These cases highlight what can be a critical issue in the purchase of a business. A substantial portion of a company's value may consist of intangibles such as good will, trade secrets, customer information, and the specialized training and intellectual capital of its employees. Non-competition agreements are a key tool in a company's arsenal for protecting these intangibles. When acquiring a company, the buyer has a strong interest in making sure non-competition agreements are in place and will be enforceable after the acquisition. Key employees—who might bristle at a change in control or management—may be tempted to go to work for a competitor, substantially reducing the value of the newly acquired business.

Ehrlich and *Zambelli* give guidance on one aspect of how a transaction can or should be structured. If enforcement of non-competition agreements is a critical aspect of the acquisition, the purchaser should seriously consider whether a purchase of stock is a viable approach. If it is not, the purchaser should look closely at whether the existing non-competition agreements contain provisions permitting the employer to assign the agreements to another party. Absent such authorization, the purchaser should not count on acquiring the ability to enforce the restrictions. Conversely, to ensure maximum value of its assets at the time of a sale, a seller of a business would be wise to ensure that its key employee non-competition agreements contain assignment clauses.

If a deal must proceed as an asset purchase, and key employees do not have assignment provisions in their agreements, the prospective buyer may consider other options, such as:

- asking the seller to execute new restrictive covenants with key employees before the acquisition is concluded or even announced (making certain adequate consideration is provided);
- using the adequacy of the restrictive covenants as a bargaining point to negotiate a better purchase price; or,
- drafting contract provisions for post-sale price adjustments should key employees voluntarily leave within a certain timeframe.

Ultimately, no matter what form the final deal takes, good planning is essential. ■



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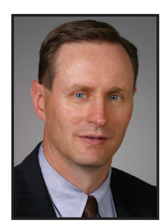

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BIG 12 EXPANSION (OF ITS TRADEMARK PORTFOLIO)

By Brian P. Gregg

The college football blogs are rife with rumors of conference expansions and the wave of team reshuffling should certain teams change conferences. The Big 10 (which has 11 teams) is rumored to be seeking anywhere from one to three teams. Quotes from Big 12 commissioner Howard Beebe suggest the Big 12 is content with its moniker matching its conference roster and will not add teams. Nonetheless, the Big 12 seems to be hedging its bets or at least trying to block the Big 10 from being able to remove its mathematical misnomer in the event it expands to 14 teams.

Since 1997 the Big 12 has maintained an application at the United States Patent and Trademark Office (PTO) for the BIG 14 trademark. None of the Big 12's applications for BIG 14 have matured into registrations because the Big 12 has never been able to show a use of the BIG 14 mark in commerce within the window of time afforded its applications. In effect, the Big 12 keeps sitting on the BIG 14 mark by filing a new application every time its former application expires. The Big 12's latest application was filed in September 2009. Curiously, Big 12 assistant commissioner Bob Burda was quoted in that same month as saying, "We license and protect a whole array of names just so we can be protected if the landscape of the conference were to ever change." Surely, Burda's statement elicited a collective groan from the Big 12's trademark attorneys because trademarks cannot be reserved on mere speculation that one may someday have a use for a mark.

Trademark applications can be applied for based on the applicant's actual use of the mark in commerce or based on its "bona fide intent to use a mark in commerce at the time of application." Trademark applications, and the resulting registered marks, are subject to attack based on claims of fraud or lack of bona fide intent to use the mark in commerce. This area of trademark law recently went through a bit of an upheaval with respect to fraud. For some time the Trademark Trial and Appeal Board (TTAB), the PTO's administrative tribunal, applied a virtual strict liability standard to claims of fraud. This resulted in a number of registered marks being cancelled on the basis of fraudulent procurement when an applicant obtained a registration for goods or services which did not exactly match those on which it used its mark. In October 2009, in *Bose v. Hexawave*, the TTAB did a near about-face, removing the "knew or should have known" standard and replacing it with essentially no standard. Despite this change, the Big 12's long-standing practice of keeping an unregistered application lodged at the PTO seems hardly innocent and is arguably an abuse of the trademark filing system. Unless the Big 12 has some (and it doesn't take much) evidence it intended to use the mark BIG 14 when it filed its most recent application in 2009, its claim to the BIG 14 mark may be as sure a bet as Mike Leach returning to the sidelines at Texas Tech. ■

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SPEAKING ENGAGEMENTS

Shawn Leppo presented at the WTC International Trade Conference on May 27. He conducted a 45 minute session on Intellectual Property with a focus on international concerns.

Rebecca Finkenbinder and **Mike Doctrow** attended the International Trademark Association meetings in Boston on May 22-26.

Mike Doctrow will present Social Media and the Law on July 8 at the McNees Business Breakfast Briefing in Lancaster.

Geoff White will speak at the International Activated Carbon Conference on October 12 in Pittsburgh.

Bruce Wolstoncroft presented at the 4th Annual Intellectual Property Law Institute on April 15 and 16, in Philadelphia, PA. The one hour session, co-presented with Larry Schroepfer of InterDigital, was on the Anatomy of a License.

Mike Doctrow, **Rebecca Finkenbinder** and **Harvey Freedenberg** presented a seminar to the Central PA Chapter of ACC called, The Informed In-House Counsel: Influencing Process and Progress, on April 16 in Grantville, PA.

Geoff White and **Andrew Oltmans** were instructors at the Pittsburgh Conference for Analytical and Applied Spectroscopy (PITTCON) from February 28 - March 5 in Orlando, FL.

Carmen Santa Maria presented at the ASM Engineering Society on March 10.

FEDERAL CIRCUIT ISSUES RULING ON DAMAGES FOR FALSE MARKING

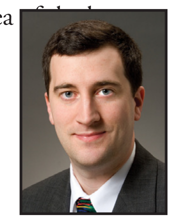
By Shawn K. Leppo

In one of its last opinions of 2009, the Federal Circuit issued a panel decision in *Forest Group, Inc. v. Bon Tool Co.*, a case involving the scope of potential damages to a plaintiff bringing an action under the Patent Act's false marking statute, 35 U.S.C. §292, and what constitutes an "offense" under that statute.

The two elements of a false marking claim are (1) marking an unpatented article with (2) an intent to deceive the public. If both are shown, the defendant shall be fined up to $500 "per offense."

In *Bon Tool*, the Federal Circuit held the "offense" for which a plaintiff may recover up to $500 is for each unpatented item that is falsely marked, setting aside case law going back more than one hundred years that the "offense" constituted each independent decision to falsely mark a product and that multiple markings pursuant to that decision constituted a continuous, but single offense (for example, where a falsely marked product was mass produced). Earlier decisions rationalized that falsely marking one large, expensive machine should not be punished differently than falsely marking many small, inexpensive items as long as there was only a single decision to do so. The Federal Circuit distinguished this earlier case law, noting that the statute at the time of many of the earlier decisions imposed a minimum fine of $100, while the current statute imposes a maximum fine of $500.

The Federal Circuit panel stressed that despite the significant change in how this statute would be construed going forward, it did not mean that a court must fine those guilty of false marking that maximum $500 per article marked. While it did not offer much guidance on how a proper penalty should be determined, it stated that by allowing a range of penalties, district courts should exercise discretion that strikes a balance between encouraging enforcement to discourage false marking and imposing disproportionately large penalties, and specifically noted a court could determine that a fraction of a penny per article is a proper penalty. In a recent decision on remand from the federal circuit's ruling, the trial judge imposed a fine of $180 for each of the 38 falsely marked articles, representing a forfeiture of all of the revenue earned on these products. The appellate court's decision seems to have given trial judges little guidance and much discretion in the evolving area



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