

Intellectual Property and Tech Transactions Update

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Notable Developments

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Notable Developments

Supreme Court Hears Challenge to *Inter Partes* Review Proceedings

On November 27, 2017, the Supreme Court heard oral argument in *Oil States Energy Services, LLC v. Greene's Energy Group, LLC*, No. 16-712, a dispute challenging the constitutionality of the Leahy-Smith America Invents Act ("**AIA**") *inter partes* review ("**IPR**") process. Oil States Energy Services, LLC ("**Oil States**") claims that Congress violated the Seventh Amendment and Article III of the Constitution when it established the IPR process, allowing the U.S. Patent and Trademark Office ("**USPTO**") to review and invalidate issued patents. According to Oil States, the USPTO has the authority to correct errors in the patents it issues, but the IPR process exceeds the USPTO's authority because an IPR resembles a trial.

During oral argument, the Justices appeared to be somewhat divided in their views. For example, Justices Kagan and Sotomayor challenged Oil States' argument for a distinction based on whether the IPR process is trial-like. Justice Kennedy suggested that Congress's authority to reduce the life of all patents by statute implies Congress also has the authority to create procedures for reviewing patents. Chief Justice Roberts offered a more limited view on the authority of Congress when he commented that the government's authority to grant a right does not mean that the government necessarily has an unqualified right to retract such right. Justices Breyer and Gorsuch both analogized the IPR process to other administrative proceedings but in opposing ways, with Justice Breyer suggesting that the IPR process is constitutional like other widely used administrative proceedings and Justice Gorsuch suggesting that all administrative proceedings, including IPR proceedings, that are not closely associated with an Article III court could be unconstitutional. The Supreme Court's opinion is not expected until next year.

A transcript of the oral argument is available [here](#).

Supreme Court Reviews Patent Trial and Appeal Board's Authority to Grant *Inter Partes* Review for Only a Portion of Petitioner's Challenged Claims

On November 27, 2017, the Supreme Court heard oral argument in *SAS Institute Inc. v. Matal*, No. 16-969, a dispute over whether the Patent Trial and Appeal Board (“PTAB”) has the authority to grant an IPR for some but not all of a petitioner’s challenged claims. Under 35 U.S.C. § 318, the PTAB is required to “issue a final written decision with respect to the patentability of any patent claim challenged by the petitioner.” According to SAS Institute Inc. (“SAS Institute”), the PTAB’s practice of granting an IPR for only certain challenged claims violates § 318 because it results in a final written decision that does not address all challenged claims.

During oral argument, Justice Alito and Chief Justice Roberts appeared to acknowledge SAS Institute’s interpretation of § 318 while Justices Sotomayor and Kagan expressed skepticism of such interpretation. Justice Kagan challenged SAS Institute’s statutory interpretation as an attempt to circumvent the Supreme Court’s prior ruling in *Cuozzo Speed Technologies, LLC v. Lee*, 136 S.Ct. 2131 (2016) that the PTAB’s decision to institute an IPR is unreviewable. Similarly, Justice Kagan appeared to be unpersuaded by SAS Institute’s argument, remarking that giving the PTAB broad authority under *Cuozzo* seemed incongruous with limiting the PTAB’s authority to selectively institute an IPR. Justice Breyer did not reject SAS Institute’s statutory interpretation but remarked that the PTAB’s interpretation was “very practical.” Justice Kennedy proposed that the issue might be resolved by the PTAB granting an IPR on selected claims on the condition that the petitioner remove the other claims from its petition. Justice Gorsuch opined that while § 318 gives the PTAB broad authority over whether to grant an IPR, it does not appear to confer discretion to the PTAB to initiate an IPR on a claim-by-claim basis. The Supreme Court’s opinion is not expected until next year.

A transcript of the oral argument is available [here](#).

Supreme Court Overturns Federal Circuit’s Exceptions to Patent Exhaustion Upon Sale

On May 30, 2017, the Supreme Court issued a decision in *Impression Products, Inc. v. Lexmark International, Inc.*, 581 U.S. ____ (May 30, 2017), holding: (i) in a unanimous decision, that “once a patentee decides to sell—whether on its own or through a licensee—that sale exhausts its patent rights, regardless of any post-sale restrictions the patentee purports to impose, either directly or indirectly through a license”; and (ii) in a 7-1 decision, that “[a]n authorized sale outside the United States, just as one within the United States, exhausts all rights under the Patent Act.”

Lexmark International, Inc. (“Lexmark”), a designer and manufacturer of toner cartridges, had sued Impression Products, Inc. (“Impression”), a remanufacturer of toner cartridges, in 2010, claiming that Impression infringed its patent rights by (i) refurbishing and reselling cartridges originally sold in the U.S. by Lexmark under an express restriction on subsequent reuse or resale and (ii) importing cartridges originally sold by Lexmark outside the U.S. Impression moved to dismiss all claims against them.

The district court granted Impression’s motion to dismiss the infringement with regard to the domestic cartridges, but denied the dismissal of the imported cartridges infringement. Both parties appealed. The Federal Circuit ruled in favor of Lexmark on both claims, citing its decisions in (i) *Mallinckrodt, Inc. v. Medipart, Inc.*, 976 F.2d 700 (1992), which held that patent infringement suits could be used to enforce expressly stated, lawful restrictions on post-sale use or resale, and (ii) *Jazz Photo Corp. v. International Trade Commission*, 264 F.3d 1094 (2001), which held that foreign sales did not result in patent exhaustion.

The Supreme Court reversed, citing the doctrine of patent exhaustion established in the Patent Act. For cartridges sold domestically with restrictions on post-sale use or resale, the Supreme Court cited *Quanta Computer, Inc. v. LG Electronics, Inc.*, 553 U.S. 617 (2008) as holding that the sale of an item, whether by a patent holder or through an authorized licensee, “terminates all patent rights to that item.” In that case, a company, with authorization from the patentee, sold products under contracts requiring

purchasers to use those products with other parts that the company manufactured. When a buyer that disregarded the restriction was sued for infringement, the Supreme Court held that the patentee's rights had been exhausted because the authorized sale "took its products outside the scope of the patent monopoly."

For cartridges sold internationally, the Supreme Court cited *Kirtsaeng v. John Wiley & Sons, Inc.*, 568 U.S. 519 (2013), an analogous copyright case, and found that the common law restraint on alienation applies equally to foreign sales in prohibiting patent rights from remaining with an item once title has passed.

Justice Ginsburg dissented on the issue of international patent exhaustion and argued that a foreign sale does not exhaust a U.S. inventor's U.S. patent rights because the patent law is territorial and a sale abroad operates independently of the U.S. patent system. In Justice Ginsburg's view, *Kirtsaeng* is not applicable in this case because "[t]he Patent Act contains no analogue to 17 U.S.C. § 109(a), the Copyright Act first-sale provision analyzed in *Kirtsaeng*" and "[m]ore importantly, copyright protections, unlike patent protections are harmonized across countries."

The Supreme Court's opinion is available [here](#).

TC Heartland and Recent Lower Court Decisions Regarding Patent Venue Rules

On May 22, 2017, the Supreme Court issued a decision in *TC Heartland LLC v. Kraft Foods Group Brands LLC*, 137 S.Ct. 1514 (2017), restricting venue in patent infringement cases by holding that the term "resides" in the patent venue statute, 28 U.S.C. § 1400(b), as applied to domestic corporate defendants, refers only to the state of incorporation. The Supreme Court's decision reverses a long-standing interpretation from the U.S. Court of Appeals for the Federal Circuit by re-establishing patent venue rules as distinct from general venue rules.

Kraft Foods Group Brands LLC ("**Kraft**") initially sued TC Heartland LLC ("**TC Heartland**") in the U.S. District Court for the District of Delaware. TC Heartland moved to dismiss or transfer venue, arguing that the court did not have jurisdiction as it did not reside in Delaware under *Fourco Glass Co. v. Transmirra Products Corp.*, 353 U.S. 222 (1957), in which the Supreme Court held that for purposes of § 1400(b), a domestic corporation resides only in its state of incorporation. Section 1400(b) provides that a "civil action for patent infringement may be brought in the judicial district where the defendant resides, or where the defendant has committed acts of infringement and has a regular and established place of business." The Court in *Fourco* determined that the inclusion of corporate residence in § 1400(b) merely recodified the portions of earlier patent venue statutes that permitted suit in a district where a corporation was an inhabitant. At the time that § 1400(b)'s predecessor was instituted, a corporation was understood to inhabit only the state in which it was incorporated. TC Heartland ships products into Delaware but neither has a place of business nor is incorporated there.

In its opinion denying TC Heartland's petition for a writ of mandamus, the Federal Circuit reaffirmed its conclusion in *VE Holding Corp. v. Johnson Gas Appliance Co.*, 917 F.2d 1574 (1990), that post-*Fourco* amendments to the general venue statute, 28 U.S.C. § 1391, had effectively amended § 1400(b), giving § 1400(b) the same definition of "reside" as contained in § 1391(c). Under the § 1391(c) definition, a patent plaintiff could file suit wherever a defendant made sales. Given that the District of Delaware was able to exercise personal jurisdiction over TC Heartland under § 1391(c), the Federal Circuit concluded that TC Heartland resided in Delaware for purposes of § 1400(b) and therefore jurisdiction existed.

The Supreme Court, in an 8-0 opinion written by Justice Thomas, rejected the Federal Circuit's interpretation and found that *Fourco* is still good law. The Supreme Court concluded that, absent a clear statement of intent, there was no indication that Congress's amendments to § 1391 for venue in general cases were meant to alter the meaning of § 1400(b), as interpreted by *Fourco*, and that Congress had not ratified the Federal Circuit's decision in *VE Holding Corp.* The Supreme Court further stated that the basis for *VE Holding Corp.* was undermined by insertion of a savings clause in § 1391 following *Fourco*,

as well as changes to the language of § 1391 that now make it more similar to the version of the statute in effect at the time of *Fourco* than to the version in effect at the time of *VE Holding Corp.* Therefore, the Supreme Court concluded its decision in *Fourco* is still sound and the definition of “resides” for domestic corporate patent defendants under § 1400(b) remains limited only to a state of incorporation.

The *TC Heartland* decision raises two new issues that lower courts are beginning to address. First is the issue of what impact *TC Heartland* will have on already pending patent suits. Under the Federal Rules of Civil Procedure, the defense of improper venue is waived unless asserted in the pleadings or by motion prior to pleading. However, a party may assert an intervening change in law as a defense to waiver. Several district courts have held that *TC Heartland* does not constitute a change in law because it merely reaffirms the Supreme Court’s interpretation of § 1400(b) as stated in *Fourco*, and therefore pending cases may not rely on *TC Heartland* to assert improper venue after the defense has already been waived. However, on November 15, 2017 in *In Re Micron Technology, Inc.*, No. 17-138 (2017), the Federal Circuit held that *TC Heartland* was an intervening change of law, and therefore parties that failed to raise the defense of improper venue in reliance on *VE Holding Corp.* have not waived the defense. The court opined, “*TC Heartland* changed the controlling law in the relevant sense: at the time of the initial motion to dismiss, before the Court decided *TC Heartland*, the venue defense now raised by Micron (and others) based on *TC Heartland*’s interpretation of the venue statute was not ‘available.’” The Federal Circuit granted Micron’s petition for a writ of mandamus and remanded the case to the Massachusetts District Court to reconsider Micron’s motion to dismiss or transfer for improper venue.

The second issue arising in the wake of *TC Heartland* is the scope of the second clause of § 1400(b), “regular and established business.” On September 21, 2017, in *In re Cray Inc.*, 871 F.3d 1355 (2017), the Federal Circuit held that a corporation does not have a regular and established business in a district if it merely permits two employees to work remotely from that district and set forth a three part test to determine if proper venue may be established through regular and established business: “(1) there must be a physical place in the district; (2) it must be a regular and established place of business; and (3) it must be the place of the defendant.” The Federal Circuit found that a virtual space or electronic communications in a district are insufficient to render a corporation subject to venue within that district. It remains to be seen what impact the *Cray* decision will have on the ability of patent plaintiffs to establish venue.

The Supreme Court’s *TC Heartland* opinion is available [here](#). The Federal Circuit’s *Cray* opinion is available [here](#).

Supreme Court Rules that Certain Design Features of Cheerleading Uniforms can be Protected by Copyright

On March 22, 2017, in *Star Athletica, L.L.C. v. Varsity Brands, Inc.*, 580 U.S. ____ (2017), the U.S. Supreme Court held that certain decorative elements of the cheerleading uniforms sold by Varsity Brands Inc. and its subsidiaries (collectively, “**Varsity**”) were “separable” from the underlying garment and, therefore, could be eligible for copyright protection. Historically, courts and scholars have focused on whether two-dimensional design features of useful articles are physically and/or conceptually separable from the utilitarian function of the article in order to justify copyright protection, and such courts and scholars have used several different (and conflicting) approaches to conceptual separation. In finding in favor of Varsity, the Supreme Court addressed these conflicting approaches by setting out a new separability test and extended copyright protection to industrial designs in a decision that may impact the apparel industry. The Supreme Court’s decision may encourage apparel designers to apply for copyright registrations for their designs when they otherwise would not have sought such protection and may ultimately lead to a greater number of infringement suits being brought in the fashion industry (or in other instances in which products have both utilitarian and decorative elements). The decision’s influence on the fashion industry and copyright infringement suits is already apparent with the recent lawsuit filed by Puma SE (“**Puma**”) against Forever 21 Inc. (“**Forever 21**”) in which Puma cited *Star Athletica* and claimed

that Forever 21 infringed its copyright in the designs of one of its lines of shoes. However, due to the lack of guidance as to how the Supreme Court's new separability test should be applied, it is unclear whether such suits will be more likely to succeed on the merits.

Varsity is a U.S.-based designer and manufacturer of cheerleading uniforms. It had designed and incorporated certain stripe, chevron and other two-dimensional graphic designs into its cheerleading uniforms and subsequently registered such designs with the U.S. Copyright Office. In 2010, Varsity sued Star Athletica, L.L.C. ("**Star Athletica**"), another seller of cheerleading uniforms, in the U.S. District Court for the Western District of Tennessee for infringing certain of Varsity's design copyrights. The question before the court was whether Varsity's uniform designs were excluded from protection under copyright law as "useful items." Star Athletica argued that the applicable designs were ineligible for copyright protection because they were (i) functional and, in the alternative, (ii) not separable from the uniforms' function. The district court granted summary judgment for Star Athletica on Varsity's copyright infringement claims, holding that the applicable copyrights were invalid because the design elements were not physically or conceptually separable from the functional purpose of the uniforms. Varsity then appealed to the U.S. Court of Appeals for the Sixth Circuit, which reversed the district court's decision, holding that Varsity's designs were conceptually separable, and therefore copyrightable, because they are (i) more akin to fabric designs (which can exist independently of an article's functional purpose) than dress designs and (ii) purely aesthetic.

The Supreme Court affirmed the Sixth Circuit's decision but provided a new test for separability, acknowledging that there had been "widespread disagreement" among lower courts over the appropriate test. Under the Supreme Court's two-part test, for a feature to be deemed separable, such feature must (i) "be perceived as a two- or three-dimensional work of art separate from the useful article" and (ii) still qualify as protectable expression when "imagined separately from the useful article into which it is incorporated." This new test closely tracks § 101 of the Copyright Act, which states that features are separable when they "can be identified separately from, and are capable of existing independently of, the utilitarian aspects of the article." The Supreme Court explicitly declined to consider additional factors beyond the statute in applying this test and notably eliminated the distinction between physical and conceptual separability described in the legislative history of § 101. As a result, uncertainty remains around how the Supreme Court's separability test should be applied and the two dissenting Justices reached the opposite outcome when applying the majority's two-part test to Varsity's designs. The Supreme Court also emphasized that, in the immediate case, the only features of the cheerleading uniforms eligible for copyright protection are the actual two-dimensional designs, and that Varsity would "have no right to prohibit any person from manufacturing a cheerleading uniform of identical shape, cut, and dimensions to the ones on which the decorations in this case appear."

The Supreme Court's opinion is available [here](#).

District Court Rules that Open Source Software Distributors can Enforce Licenses Through Breach of Contract as well as Copyright Infringement

On April 25, 2017, in *Artifex Software, Inc. v. Hancom, Inc.*, No.16-cv-06982-JSC (N.D. Cal.), the U.S. District Court for the Northern District of California ruled that owners of copyrighted software that distribute such software under an open source license might be able to enforce violations of the terms of such license as both a breach of contract and copyright infringement.

Artifex Software Inc. ("**Artifex**") distributed Ghostscript, which is a software product that interprets files written in PDF for display on computer screens or for printing, under the GNU General Public License (the "**GPL**"), and Hancom Inc. ("**Hancom**") incorporated Ghostscript into its own word processing software. Artifex sued Hancom for breach of contract and copyright infringement because Hancom did not make the source code of its own product available under the GPL, as required by the terms of the GPL when licensees do not specify to end-users that the licensed software is part of their product. Artifex offered Ghostscript under a dual licensing model—giving licensees the option to either pay for a commercial

license or make the source code of its product available as required by the GPL license—a model that has been adopted by many software providers due to the flexibility it provides between developing free software and monetizing such software.

Hancom moved to dismiss the lawsuit on several grounds, including by arguing that the mere use of code under an open source license does not form a contract and that copyright damages are unavailable because Hancom is based in South Korea and Artifex failed to plead any facts that would exclude Hancom's actions from the extraterritorial limits of the Copyright Act. The court's ruling denied Hancom's motion to dismiss on all grounds, allowing both the breach of contract and copyright infringement claims to proceed.

With respect to the breach of contract claim, the court held that the complaint sufficiently pled the existence of a contract between Artifex and Hancom because the GPL expressly requires that licensees agree to its terms if they distribute the licensed software. Regarding Artifex's allegation of harm, the court relied on Federal Circuit precedent in *Jacobsen v. Katzer*, 535 F.3d 1373 (Fed. Cir. 2008), which provides that "[t]he lack of money changing hands in open source licensing should not be presumed to mean that there is no economic consideration" because "[t]here are substantial benefits, including economic benefits, to the creation and distribution of copyrighted works under public licenses that range far beyond traditional license royalties," to rule that Hancom's use of Ghostscript without either obtaining a commercial license or complying with the GPL may have cost Artifex either a licensing fee or the ability to advance and develop Ghostscript through open source distribution. The breach of contract claim subsequently survived a motion by Hancom for summary judgment as well.

With respect to the issue of copyright damages, the court held that the complaint did not indicate that the infringing acts only occurred outside of the United States and that it is unreasonable to assume, as Hancom asserted, that the infringing activity only took place in South Korea. The court's ruling instead suggested that Hancom's distribution of its software via the Internet could itself comprise domestic infringement of the Ghostscript copyright.

The district court's decision is available [here](#).

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