Commercial Law Adviser

BUSINESS LAWS, INC.
11630 Chillicothe Road
Chesterland, Ohio 44026

Editor: William A. Hancock
Phone: (440) 729-7996 • Fax: (440) 729-0645
E-mail: inquiry@businesslaws.com

April 2005 ● Issue No. 208

In This Issue:

Letter from the Editor

Dear Subscribers:

We begin this issue with another data processing contract gone bad. The way we read the court of appeals decision, there were many things that both parties did which did not represent good sales or procurement practices, so the case provides us with many counseling points. Of course, the case involves the inevitable embarrassing e-mail and that, in itself, serves as a reminder that counsel should constantly remind everyone that, if business deals end up in litigation, so will all of their e-mails.

The next case involves an attempt by Lexmark to foreclose competition in the recycling of its toner cartridges. We emphasize the concurring opinion. We consider it must reading for any counsel asked for advice on programs that try to assure the company of continuing profits from consumable and replacement parts.

Unsolicited ideas continue to generate litigation. We report on a case and provide some suggestions. Best efforts clauses seem to fall into the same category — they can be the source of disagreements, but are often appropriate anyway. We then provide a trade dress case involving Gateway, and a trademark case involving the name CITIZENS for banks. We thought these cases contained interesting counseling points.

We conclude with a highly publicized case, in which the Federal Circuit reversed previous precedent and held that there should be no adverse inferences in a patent infringement case just because a company would not disclose legal advice which it received, nor because it never asked for advice in the first place.

Very truly yours,

William A. Hancock

William A. Hancock
Editor

DATA PROCESSING DISASTER

*William A. Hancock**

I. Background

The case of *American Trim v. Oracle Corp.,* 383 F.3d 462 (6th Cir. 2004), shows us that a large software acquisition transaction can still turn out to be a disaster even if it involves highly qualified people and reputable companies.

American Trim was formed in 1996 as a joint venture between Alcoa, Inc. and Superior Metal Products, Inc. It manufacturers and sells component parts to automobile and appliance manufacturers, including Ford, General Motors, and others. These customers require their major suppliers to process orders using electronic data interchange (EDI) systems. This enables companies to exchange information and monitor the status of orders electronically. Both of American Trim's joint venture partners had EDI systems, but they did not communicate effectively with each other. In addition, the whole system was in need of improvement. American Trim wanted what is called an ERP system — Enterprise Resource Planning — which integrates many functions, such as financial accounting, human resources, payroll, manufacturing planning, and EDI.

Oracle is a supplier of business software including a suite of ERP programs called ORACLE APPLICATIONS. However, that product was not really made for the automotive business. Oracle was in the process of trying to develop a specific automotive business product, but it did not yet have one.

Judging from the court's opinion, Oracle may not have been entirely candid about exactly what it did and did not have in its negotiations with American Trim. One of the key events in the negotiation was a demonstration of the system, which American Trim attended at the Oracle facility. As things finally turned out, it appeared this "demonstration" was really not a demonstration of an actual product, but rather a simulation. In fact, an Oracle employee wrote an e-mail stating, "[t]o be honest, if you were an American Trim person attending that demo, you would have believed that you were being sold an automotive solution."

In any event, it is painfully easy to summarize what happened after that.

— American Trim paid Oracle over $1.75 million for the system, some support, and training fees.

— Oracle delivered twenty-five to thirty CDs which American Trim said, "looked like somebody went through the warehouse and picked up one of everything they had just to ship it," but Oracle never delivered a system with the automotive content because it did not have one.

— After the typical series of, "we will have it ready in a couple of weeks" conversations, which went on for a couple of months, American Trim threw in the towel and asked for its money back.

* *William A. Hancock is Editor and Publisher at Business Laws, Inc. and a member of the Ohio and California Bars.*

— Oracle refused. American Trim sued for fraud, and a jury awarded American Trim $3 million in actual damages and another $10 million in punitive damages.

— Oracle appealed to the Sixth Circuit, but the Sixth Circuit upheld the lower court's ruling on all points.

II. Some Counseling Lessons

A. The Specifications

We did not see an actual copy of the contract between Oracle and American Trim, but since not much was made of it, one has to assume that there was not much in the way of specifics about what the suite of programs was supposed to do. There were some negotiations which resulted from the fact that the first contract Oracle sent did not state anything about the automotive component. American Trim objected, and Oracle resubmitted the contract which now had a statement that the contract included "Oracle Automotive CARaS." This was a term Oracle was using to refer to the integration of its existing programs with another program. During the litigation, the American Trim executive who bought the program testified that, "at the time he thought American Trim was purchasing Oracle Automotive because he thought the term was synonymous with 'Oracle Automotive CARaS.' "

In hindsight, it was probably a mistake to spend over $1 million on a program on the basis that the company "thought" one description was synonymous with another and neither term appears to have been defined in the agreement.

Thus, ***our first counseling suggestion*** has to be to try to do a much better job with the description of what the company is buying or licensing and what its functions are supposed to include. Lawyers may not fully understand all the jargon, but it would appear that counsel has the responsibility to make sure someone in the organization understands it and can state with some degree of certainty that the descriptions in the contract correspond with the descriptions of what the company wants and needs.

B. The Demonstration

First, there was a slide show, which we assume was something akin to a POWERPOINT presentation. That was described in the litigation. Therefore, we have ***our next counseling point*** from the seller's perspective — the slides that go with a presentation are likely to be introduced into court, and those preparing and using the slides should prepare them accordingly. There was nothing here that indicated any "smoking guns" in the slide presentation, but taken as a whole, it did appear to portray a functioning system. There were apparently some qualifications of some of the points on the slide presentation in the written materials, but there again, ***we have another counseling point*** — a picture is worth a thousand words, and the content of slides is likely to outweigh the fine print which may be distributed along with the slides. The conclusion has to be that slide presentations should be considered advertisements and, like all advertisements, considered as a whole. Even if every single element is true but the picture one gets from the collection is misleading, there should be some changes.

Another serious problem with the demonstration was that it apparently represented a demonstration of an actual working program but it was, in reality, a simulation. That, along with the e-mail admission from the Oracle employee, may well be the single biggest element in the large verdict and punitive damages.

Then we have the testimony of the American Trim representative who witnessed the demonstration — "Yes, I saw it demonstrated along with the people from American Trim. Now, you know, quite bluntly, I don't know exactly what I saw, but I saw transactions going from a work station to the server and going through the Oracle system … ." Some computer demonstrations can indeed be mind-numbing experiences. Attending a demonstration with the net result being that you have to testify that "quite bluntly, I don't know exactly what I saw …" is probably not helpful and may be counterproductive.

C. The Acceptance Period

We refer to this as the "acceptance period" rather than the "acceptance test" because it appears as though that is exactly what it was. The contract American Trim signed called for acceptance to take place fifteen days after delivery. There was no mention of any specific tests or any procedures to see whether American Trim received what it thought it bought. We also remind

readers that what was shipped was a box of twenty-five to thirty CDs which appeared to be "one of everything they had."

The point of acceptance is a very crucial event in the life of any contract. Before that point, the buyer/licensee has very few obligations and important remedies, including simply returning the product. After the point of acceptance, that all changes, and the buyer must "pay at the contract rate for any goods accepted" and generally pursue whatever contractual remedies it may have — which may be few or none if the buyer has signed the seller's form. However, businesspeople are sometimes not so familiar with this very important concept. ***Our counseling suggestion*** is to be sure the appropriate people in the company understand its importance and, hopefully, include some type of meaningful acceptance testing and criteria which are actually implemented. Note that here, for example, there did not appear to be any attempt at sufficient testing to see whether what was shipped by Oracle was what American Trim intended to buy.

D. The Fraud Aspect

This, as it turns out, was the savior for American Trim and the big problem for Oracle. Had the case been limited to contract issues, it is likely that American Trim would have had little, if any, success as the contract did not appear to contain much in the way of specifications, and there did not appear to be any attempt at a meaningful acceptance procedure. However, once the fraud claim is made, those contract limitations are no longer applicable. Here, the basic fraud appeared to be fairly simple. Oracle promised an integrated automotive program and never provided it. That still, however, leaves another element of the fraud claim — justifiable reliance. In this case, it simply turned out that the jury at the lower court level concluded that American Trim actually and justifiably relied on Oracle's misrepresentation that Oracle Automotive was available for purchase and entered into the agreement on that basis. The appellate court found that there was sufficient evidence in the record to justify that conclusion. In this discussion, the court of appeals again referred to that "to be honest …" e-mail which was probably one of the reasons that caused this case to turn out the way it did.

E. The Final Meeting

Toward the end of 1998, the parties had a final meeting where American Trim asked Oracle for the return of its money. This was later followed up by a series of letters. The meeting was described as hostile and contentious. The letters which followed were basically exercises in finger-pointing with each party blaming the other for what both parties certainly should have recognized as a bad situation. Shortly after this meeting, the lawsuit was filed. It would appear that this final meeting, where the very people involved in the transaction were obviously at odds with each other, was not followed up by any future meetings by other executives or by any attempt at mediation or any other alternative dispute resolution (ADR) procedures. In hindsight, perhaps some efforts along those lines would have been helpful.

III. Summary and Conclusion

In our view, this case reminds us of these five points:

1. Specifications are important. Using company terms such as "Oracle Automotive" and relying on those largely undefined terms to describe what is being bought or sold is an invitation to misunderstanding and dispute.

2. Demonstrations of computer programs can be problematic for both sides. Certainly, the demonstrator should be fair and honest about exactly what is being demonstrated — is it an actual operation or a simulation? On the other hand, those attending demonstrations should not leave without even being able to describe what they saw.

3. Acceptance testing procedures are important. Buyers who accept a simple blanket fifteen-day period and then let that period go by without doing any testing are jeopardizing their legal position.

4. Fraud is always a wild card in cases like this, and internal e-mails may be the reason that brings it into play. Here we had that "to be honest …" e-mail which may have been a substantial contributor to the jury verdict of fraud and punitive damages.

5. ADR provisions in contracts of this type are often a good idea. Of course, the provisions have to be accompanied by appropriate use and implementation. ■

THE DIGITAL MILLENNIUM COPYRIGHT ACT

*William A. Hancock**

I. Protecting Your Turf

A. Background

A steady income stream from replacing consumable parts on your products is very attractive and generally profitable. However, maintaining this monopoly can be difficult. Others will want to sell those consumable parts too — and that can also be a profitable market. Toner cartridges for computer printers are one of the best examples of this battleground. *Lexmark International v. Static Control Components,* 387 F.3d 522 (6th Cir. 2004), illustrates some of the weaponry which can be used.

Lexmark makes printers and has sold a lot of them. Some of the printers use a toner cartridge, which is a consumable item. Lexmark hit on the following program to try to protect its income stream from these replacement cartridges.

— There would be two prices. One price would be lower if you agreed to use the cartridge only once and return it to Lexmark for recycling. The other price would be higher if you did not agree to this.

— The cartridges were essentially the same, except that the one with the lower price had a computer chip which was proprietary to Lexmark. If you had someone else refill that lower-priced cartridge, it simply would not work in Lexmark's printers.

— In addition to the computer chip, the cartridge required a "toner loading program" for which Lexmark claimed a copyright. It was just about as simple a program as one could imagine. In fact, it had fewer commands than the name of this case.

The attack on the Lexmark printer cartridge fort came from Static Control Components. Static Control made a computer chip which mimicked the Lexmark chip, copied the toner loading program, and sold those products to companies interested in selling remanufactured toner cartridges — including those for Lexmark's printers. The net effect of this was to circumvent the Lexmark program. One could pay the lower price and then have the lower cost companies refill the cartridge even though the buyer had promised to use the cartridge only once.

Lexmark mounted counterattacks on a number of fronts. We simplify this forty-one-page opinion, which tells more than one might want to know about the details of computer programming, to focus on what appeared to be the two main issues worthy of discussion for planning and counseling purposes.

1. Counterattack 1 — Static Control copied the toner loading program, and that was copyright infringement.

2. Counterattack 2 — the Static Control chip was illegal because its only function was to "circumvent a technological measure that effectively controls access to a work." That, according to the Digital Millennium Copyright Act (DMCA), made it illegal.

The counterattacks occurred in the federal district court where Lexmark asked for an injunction on the basis of these and other theories. The district court felt that Lexmark had a fairly good chance of winning its case on the merits, so the district court did grant the injunction. However, the Lexmark district court victory was short-lived. The Sixth Circuit reversed basically all of it. There were three judges at the court of appeals level — and three separate opinions. Further, the actual holding of the court of appeals is simply that the lower court should not have granted the preliminary injunction

* *William A. Hancock is Editor and Publisher at Business Laws, Inc. and a member of the Ohio and California Bars.*

— the issue of the merits of these complex matters remains to be decided. For that reason and others, one cannot hold up the *Lexmark* case as the law of the land, but we suggest it does provide some useful guidance.

B. Was the Toner Loading Program Copyrightable?

Basically, this program was very short but required in order to get the printer to turn on. It executed each time the printer was powered on, and each time the door for the toner cartridge was opened and closed. Static Controls admitted "slavishly" copying it, so there was no question about that. However, is a program such as this an "idea" which is not copyrightable, or the "expression of an idea" which is copyrightable?

The relevant law is § 102 of the copyright law. Section 102(b) provides that "in no case does copyright protection for an original work of authorship extend to any idea, procedure, process, system, method of operation, concept, principle or discovery, regardless of its form." Some have said this section creates an "elusive boundary line" between idea and expression, and utilitarian computer programs are said to hover more closely to that boundary line than aesthetic works.

Two other aspects of copyright law are often used to try to figure out on which side of the line something falls. The first is "merger." This doctrine provides that, if specific words are essential to operating something or where there is only one way or very few ways of expressing the idea, the idea and expression are said to have "merged" and no copyright protection is available. The other doctrine, *scènes à faire,* which basically means "scenes that must be done," holds that, when external factors constrain the choice of expression, the expression is not copyrightable. In the computer-software context, the doctrine means that the elements of a program dictated by practical realities may not be protected.

Generally, the court pointed out that so-called lockout codes fall on the functional idea rather than the original expression side of copyright and are, therefore, not protectable. Basically, that is what happened at the court of appeals level in this case. A majority of the court simply felt that, given the facts of the case and the copyright law as a whole, this toner loading program was probably not copyrightable. That ultimate issue will have to be decided on remand. Meanwhile, the feeling of the court of appeals that success on the part of Lexmark was unlikely led them to reverse the lower court on the preliminary injunction ruling.

II. What Does the Digital Millennium Copyright Act Protect?

The DMCA was enacted for a fairly clear and specific purpose — pirating music, movies, and video games. The theory was that, since these items are so easily copied, manufacturers would want to have some encryption device or procedure to protect them. These devices or procedures would either prevent making a copy of the product or, if a copy was made, prevent using that copy in an unauthorized way.

The language of the statute, as far as it is relevant here, prevents circumventing technological measures which control access to a "work" meaning something which is protected by copyright. Here, the "work" was the printer engine program which both parties agreed was protected by copyright. The question was whether or not the Static Control chip was a "device" that was used to circumvent an "effective control" for access to a "work."

On the basis of the technology involved, the court of appeals simply felt that the chip did not do that. The printer engine program was in the printer itself, not in the cartridge. The formality which gave the user of the Lexmark printers access to this program was the purchase of the printer. The Lexmark security devices in its cartridges did nothing to change the program or make it unavailable other than through this one approach. The court said it was like saying that a house was protected when only the back door was locked but the front door remained open. It should be noted that a great deal of the opinion was devoted to this, and each side brought forth cases which seemed to support their views. The DMCA can be quite a complex statute when applied where it was not intended, such as here. We suspect we have not heard the end of this argument.

A. The Concurring Opinion

1. Is the Lexmark Approach Basically Illegal?

The concurring opinion is must reading for any corporate counsel faced with either side of this basic issue. That opinion agreed with the holding, but said that it

should have gone farther as it should not be possible to tinker with the details of exactly what Lexmark did or did not do in order to circumvent the holding and achieve the same result. In other words, it seemed to say to Lexmark — "you just cannot do what you want to do."

Perhaps more significantly, it seems to tell all other companies that they cannot do anything like this either. The DMCA was just not intended to facilitate companies achieving a monopoly over components or consumable parts.

2. Text of the Concurring Opinion

I write separately to emphasize that our holding should not be limited to the narrow facts surrounding either the Toner Loading Program or the Printer Engine Program. We should make clear that in the future companies like Lexmark cannot use the DMCA in conjunction with copyright law to create monopolies of manufactured goods for themselves just by tweaking the facts of this case: by, for example, creating a Toner Loading Program that is more complex and "creative" than the one here, or by cutting off other access to the Printer Engine Program. The crucial point is that the DMCA forbids anyone from trafficking in any technology that "is primarily designed or produced for the ***purpose*** of circumventing a technological measure that effectively controls access to a (protected) work." 17 U.S.C. § 1201(2)(A) (emphasis added). The key question is the "purpose" of the circumvention technology. The microchip in SCC's [Static Control Component's] toner cartridges is intended not to reap any benefit from the Toner Loading Program — SCC's microchip is not designed to measure toner levels — but only for the purpose of making SCC's competing toner cartridges work with printers manufactured by Lexmark.

By contrast, Lexmark would have us read this statute in such a way that any time a manufacturer intentionally circumvents any technological measure and accesses a protected work it necessarily violates the statute regardless of its "purpose." Such a reading would ignore the precise language — "for the purpose of" — as well as the main point of the DMCA — to prohibit the pirating of copyright-protected works such as movies, music, and computer programs. If we were to adopt Lexmark's reading of the statute, manufacturers could potentially create monopolies for replacement parts simply by using similar, but more creative, lockout codes. Automobile manufacturers, for example, could control the entire market of replacement parts for their vehicles by including lockout chips. Congress did not intend to allow the DMCA to be used offensively in this manner, but rather only sought to reach those who circumvented protective measures "for the purpose" of pirating works protected by the copyright statute. Unless a plaintiff can show that a defendant circumvented protective measures for such a purpose, its claim should not be allowed to go forward. If Lexmark wishes to utilize DMCA protections for (allegedly) copyrightable works, it should not use such works to prevent competing cartridges from working with its printer.

Reading the DMCA in *pari materia* with the rest of the copyright code supports this interpretation. The DMCA should be used as part of the copyright code as it applies to computer software codes and other digital media. To this extent, the specific "purpose" language of the DMCA modifies the more abstract language of the previous copyright law. As the court explains, the fair use exception in copyright law explicitly looks to the purpose of the one making the copy in determining whether or not such copying violates the statute, and the DMCA itself contains a reverse engineering exception that also demonstrates Congress's aim merely to prevent piracy. I agree with the court that both exceptions apply to SCC's actions in this case. But we should be wary of shifting the burden to a rival manufacturer to demonstrate that its conduct falls under such an exception in cases where there is no indication that it has any intention of pirating a protected work. *See, e.g.,* Lawrence Lessig, *Free Culture* 187 (2004) (noting the danger that "in America fair use simply means the right to hire a lawyer to defend your right to create"). A monopolist could enforce its will against a smaller rival simply because the potential cost of extended litigation and discovery where the burden of proof shifts to the defendant is itself a de-

terrent to innovation and competition. Misreading the statute to shift the burden in this way could allow powerful manufacturers in practice to create monopolies where they are not in principle supported by law. Instead, a better reading of the statute is that it requires plaintiffs as part of their burden of pleading and persuasion to show a purpose to pirate on the part of defendants. Only then need the defendants invoke the statutory exceptions, such as the reverse engineering exception. In this case, even if the Toner Loading Program were protected by copyright, and even if the access to the Printer Engine Program were "effectively" controlled, there has been no showing that SCC circumvented the authentication sequence for the purpose of accessing these programs. Indeed, the proof so far shows that SCC had no interest in those programs other than ensuring that their own cartridges would work with Lexmark's printers.

Finally, this reading of the DMCA is also supported by the provision in the Constitution that grants Congress the power to regulate copyright. Article I, § 8, of the Constitution gives Congress the power to regulate copyright in order to "promote the Progress of Science and useful Arts." U.S. Const. art. I, § 8, cl. 8. Congress gives authors and programmers exclusive rights to their expressive works (for a limited time) so that they will have an incentive to create works that promote progress. Lexmark's reading of the extent of these rights, however, would clearly stifle rather than promote progress. It would allow authors exclusive control over not only their own expression, but also over whatever functional use they can make of that expression in manufactured goods. Giving authors monopolies over manufactured goods as well as over their creative expressions will clearly not "promote the Progress of Science and the useful Arts," but rather would stifle progress by stamping out competition from manufacturers who may be able to design better or less expensive replacement parts like toner cartridges.

For these additional reasons, I concur in the court's opinion reversing the judgment of the district court. On remand the first question should be whether Lexmark can show the requisite "primary purpose" to pirate a copyrighted work rather than to ensure that their own cartridges work with Lexmark's printer. If not, its case against SCC should be dismissed.

B. Counseling Point from the Dissent

1. Shrink-Wrap Licenses

For our final counseling point on this case, we turn to the very end of the dissenting opinion. The dissent basically said it thought the majority was wrong on a number of issues, including the fact that it not adequately consider the shrink-wrap license Lexmark put with its toner cartridges which were bought on the lower price, single-use basis. The comment was in footnote 10 which we reproduce below. The main point for this discussion is that, while counsel should probably consider that most shrink-wrap licenses are probably enforceable, the issue remains somewhat contentious.

2. Text of Footnote 10

SCC contends that such shrink-wrap agreements are not enforceable. In support of this, at least one *amicus* brief cites a 2001 Federal Circuit court decision that held there must be a "meeting of the minds" in order for restrictions in the agreement to be enforceable. *Jazz Photo Corp. v. Int'l Trade Comm.,* 264 F.3d 1094, 1108 (Fed. Cir. 2001), *cert. denied,* 536 U.S. 950 (2002). Other circuits have upheld the validity of shrink-wrap agreements. *See, e.g., ProCD, Inc. v. Zeidenberg,* 86 F.3d 1447 (7th Cir. 1996) (holding that terms inside a box of software bind consumers who use the software after an opportunity to read the terms and to reject them by returning the product). Here, the shrink-wrap agreement was clear and the district court could find that it supports the conclusion that there was a meeting of the minds and the agreement is enforceable. To wit: "This all-new cartridge is sold at a special price subject to a restriction that it may be used only once. Following this initial use, you agree to return the empty cartridge only to Lexmark for remanufacturing and recycling. If you don't accept these terms, return the unopened package to your point of purchase. A regular price cartridge without these terms is available." Finally, I note this case is factually different from *Hewlett-Packard Co. v. Repeat-O-Type Stencil Mfg. Corp. Inc.,* 123 F.3d. 1445 (Fed. Cir. 1997), in which the shrink-wrap agreement contained only a warning against refilling, and did not condition the sale on a promise not to refill. ■

UNSOLICITED IDEAS

*William A. Hancock**

I. Case Discussion

The case of *Grosso v. Miramax,* 383 F.3d 965 (9th Cir. 2004), reminds us that receiving unsolicited ideas without an appropriate agreement with the presenter in advance can create disputes.

Jeff Grosso made a presentation to Miramax about a movie involving gambling and poker which he called the "Shell Game." When Miramax came out with the movie *Rounders* — which had a similar theme — Grosso sued Miramax on two theories. One was that *Rounders* infringed his copyright on the "Shell Game," and the other was a state law claim for breach of an implied contract based on the theory that Grosso intended to be compensated for his idea.

The trial court granted summary judgment against Grosso and in favor of Miramax on the copyright claim. After a detailed examination, the court determined that the works were not substantially similar.

> The works do not have substantially similar genre, mood, and pace; their themes, settings, and characters are different; their plots and sequences of events are not parallel. Both works have poker settings but the only similarities in dialogue between the two works come from the use of common, unprotectable poker jargon.

However, Miramax was not as successful on the implied contract claim. It did get the claim dismissed at the lower court level because that court said it was preempted by the Copyright Act. Since there was no copyright violation, the implied contract claim had to fail also. The court of appeals, however, disagreed and reinstated the implied contract claim. Miramax will now have to defend that separately. The court stated as follows:

> Grosso's state law claim is for breach of implied contract. It seeks compensation not for the actual written script, but for the idea allegedly embodied in the script and shared with Miramax. *See Desny v. Wilder,* 299 P.2d at 257 (Cal. 1956). We conclude that the district court erred in holding the claim preempted by the Copyright Act and in granting Miramax's motion to dismiss under Federal Rule of Civil Procedure 12(b)(6).

In *Desny,* 299 P.2d at 257, the California Supreme Court explained that where an idea is furnished by one party to another, a contract sometimes may be implied even in the absence of an express promise to pay. The court held that a contract exists where "the circumstances preceding and attending disclosure, together with the conduct of the offeree acting with knowledge of the circumstances, show a promise [to pay] of the type usually referred to as 'implied' or 'implied in fact.' " *Id.* at 270. The *Desny* rule is justified on the theory that the bargain is not for the idea itself, but for the services of conveying that idea. *See Donahue v. Ziv Television Programs, Inc.,* 54 Cal. Rptr. 130, 140 (Ct. App. 1966).

To establish a *Desny* claim for breach of implied-in-fact contract, the plaintiff must show that the plaintiff prepared the work, disclosed the work to the offeree for sale, and did so under circumstances from which it could be concluded that the offeree voluntarily accepted the disclosure knowing the conditions on which it was tendered and the reasonable value of the work. *See Faris v. Enberg,* 158 Cal. Rptr. 704, 709 (Ct. App. 1979). Grosso's complaint mirrors the requirements of *Desny* and states that "the idea was submitted by plaintiff to defendants with the understanding and expectation, fully and clearly understood by defendants that plaintiffs would be reasonably compensated for its use by

* *William A. Hancock is Editor and Publisher at Business Laws, Inc. and a member of the Ohio and California Bars.*

defendants." We conclude that the complaint stated a *Desny* claim.

With respect to preemption, the Copyright Act, 17 U.S.C. § 301, establishes a two-part test. Claims under state law are preempted where: (1) the work at issue comes within the subject matter of copyright, and (2) the state law rights are "equivalent to any of the exclusive rights within the general scope of copyright." …

The dispositive preemption issue in this case is whether the rights protected by a *Desny* claim are equivalent to the rights protected by copyright. To survive preemption, the state cause of action must protect rights that are qualitatively different from the rights protected by copyright: the complaint must allege an "extra element" that changes the nature of the action. *Del Madera,* 820 F.2d at 977. Our prior decision in *Landsberg v. Scrabble Crossword Game Players, Inc.,* 802 F.2d 1193, 1196-97 (9th Cir. 1986), supports treating the implied promise to pay required by *Desny* as an "extra element" for preemption purposes. In *Landsberg,* the defendants used the plaintiff's idea for a SCRABBLE strategy book without paying the expected compensation, and we applied California law to affirm a judgment of liability on a *Desny* claim. We explained that:

> The contract claim turns not upon the existence of a [copyright] … but upon the implied promise to pay the reasonable value of the material disclosed.

II. Samples

A. Sample of an Appropriate Policy

Policy on Ideas Submitted by
Persons Outside the Company

SUBMITTING YOUR IDEA

Company and its affiliated companies frequently receive ideas or inventions from people who are not our employees. Since we are always searching for ways to improve our operations and our services to the public, we are glad to consider these ideas — with one condition. They must be submitted in accordance with our established procedure, outlined below, which protects both the submitter of the idea and Company.

Here, then, is what you should do to have your idea considered:

AGREEMENT

After you have read this policy, read the enclosed Idea Submission Agreement. If this Agreement is acceptable to you, please fill in the blanks, sign it, and return it to us. If you have already sent in your idea, we will retain the material you sent, but we will not review it until we receive a signed Agreement from you.

OUR RELATIONSHIP WITH YOU

In our search for improvements in all of our operations, we carry on a very substantial research program. It is quite possible, for that reason, that your idea may already be known to us or available to us from someone else. Ordinarily the information we develop is kept secret until we are ready to make a public disclosure — usually after we have patent protection. So it is quite possible, without your being aware of it, that your idea is already known to us or available to us from someone else. We also have free access to much information from such sources as expired patents, publications, and products sold or used publicly. We cannot, then, agree to treat your idea as secret or confidential. If we did, it might prevent our effectively using information available to us and our competitors from other sources. For this reason, no confidential relationship will be established, either expressly or by implication, between you and Company.

PROTECTION

We are interested primarily in helpful ideas or inventions that have been patented or are patentable. When we spend time and money developing something, we do not want it copied by our competitors. Since we cannot assume any obligation regarding the reception, retention, and consideration of an idea from outside the company, it is important for you to protect your idea before you formally submit it to us. The U.S. patent laws provide the preferred method of protection.

HOW TO SUBMIT AN IDEA

Here are the three best ways to submit an idea to us:

1. As a U.S. patent.

2. As an application for a patent, which has been filed in the U.S. Patent and Trademark Office. You may send a copy of the application, but omit the claims, date, and serial number.

3. As a written description including a sketch or drawing, when appropriate, which has been signed, dated, and witnessed by someone who has read and understood your description. Since we cannot agree to return or safeguard any material, we suggest that you keep the original and send us a copy.

IF WE ARE INTERESTED

Whether your idea will eventually be used depends on a great many factors, among them how practical it is, what possible markets exist, and whether it can be adapted to our operation. Until we have made a complete investigation and entered into a written contract with you, we can assume no obligation of confidence, and we can pay no compensation whatsoever. If your idea interests us, we may negotiate for the purchase of, or rights under, your patents covering the idea. Such an attempt to reach agreement will not, however, impose any obligations on either party. Should there be a misunderstanding before you sign a written contract, you will derive protection for your interests solely from remedies existing under the U.S. patent laws.

IF WE ARE NOT INTERESTED

If we decide, after reviewing your idea, that we are not interested, we will let you know as soon as possible. Please remember, though, that our decision is based on factors that often include proprietary information about our Company. We cannot, then, agree in advance to give you specific reasons for our decision.

Thank you for thinking of us and good luck with your idea.

B. Sample Submission Agreement

Idea Submission Agreement

I have read Company's policy concerning Ideas Submitted by Persons Outside of Company, and in accordance with such policy submit, for Company's evaluation, information relating to _____ (Identify idea submitted.)

Unless a formal written contract is subsequently entered into, I agree that no obligation of any kind is assumed by, nor may be implied against, Company in connection with the submission of this information, and then the only obligation assumed shall be that expressly stated in such contract. I further agree that no relationship of trust or confidence exists, nor is such relationship created or implied between Company and the undersigned in connection with the submission of my idea. These terms shall apply to all additional disclosures submitted incidental to the original submission.

I do not, by this submission, grant any rights under any patents I now have or may later obtain covering the above identified idea. However, I realize that an unpatented idea may have little or no value since it can be freely copied as it is put into use. Therefore, in consideration of Company evaluating my idea, I hereby release Company, and its officers, directors, and employees, from any liability for its use, if any, except such liability as may accrue under valid patents now or hereafter issued, or under a written contract as herein provided.

I also understand that, in evaluating ideas, it is often necessary to refer submitted material to a number of different persons in Company and its affiliated companies. Because positive identification of the contents of submitted material might be needed in case of any misunderstanding, I acknowledge that Company reserves the right to make copies and retain any material which I submit.

Date: _____

Name: _____

Address: _____
_____
_____

Witness: _____ ■

BEST EFFORTS CLAUSES

*William A. Hancock**

Exactly what does a "best efforts" clause mean? By its very nature, the clause is vague and indefinite, but is it so vague and indefinite that it is void? Probably not.

The case of *Hinc v. Lime-O-Sol Co.,* 382 F.3d 716 (7th Cir. 2004), is illustrative. Hinc had experience in the paint industry and saw a problem in certain situations that caused "tannin bleeding" which resulted in brown surface stains on painted exteriors. This sometimes caused companies to have to repaint entire commercial complexes — at great cost. Hinc embarked on a program to develop a solution and came up with a product which contained two ingredients. First, was his own secret ingredient, and the other was a shower cleaning product made by Lime-O-Sol (LOS). His first use of the product was for Sherwin-Williams, and he cleaned up a paint job which would have otherwise cost Sherwin-Williams $100,000 to repaint.

Hinc went to LOS and made a deal. He would retain ownership of his secret ingredient, but disclose it to LOS. LOS would put it together with its shower cleaner, and Hinc would be paid $10 per gallon sold. For the details of the marketing of the product, the parties simply used a best efforts clause. It provided as follows: "This is a best efforts agreement on the part of Lime-O-Sol and Thomas P. Hinc to market such product in a manner that seems appropriate."

LOS never did any marketing — in fact, it is not even clear that it ever made any product. Hinc sued LOS for breach of contract on the theory that it did not use its "best efforts" to market the product. LOS defended by saying that the clause was too vague to be enforceable, and the lower court agreed.

However, on appeal, the Seventh Circuit said no — it was enforceable. It remanded the case back to the lower court for further proceeding, but did hold that LOS had breached the "best efforts" clause because LOS did not use any effort at all. That, as it turned out, was LOS's downfall. Had LOS done anything, it is likely that the court would not have been able to say that its efforts were not "appropriate."

> The phrase "in a manner that seems appropriate," is obviously indefinite and could mean different things to different people, but we do not believe that the clause as a whole is so vague as to be unenforceable as a matter of law. LOS, which drafted this provision of the contract, agreed to put forth its "best efforts" to market (the product) and required the same of Hinc. "Best efforts," as commonly understood, means, at the very least, some effort. It certainly does not mean zero effort — the construction LOS urges here to escape any obligation under its contract.

One court's definition of "best efforts," which is often quoted, is as follows:

> "Best efforts" is what is reasonable in the circumstances. What constitutes best efforts may be determined by the parties' intentions. Best efforts does not require unreasonable, unwarranted or impractical efforts and expenditures of time and money out of all proportion to economic reality. Best efforts is equal to a good faith effort to meet one's obligations. The defendants are allowed to give reasonable consideration to their own interest. The defendants were required to do what was contemplated and what was reasonable under all of the circumstances, and to perform their activities with a good faith effort to the extent of their capabilities. (*Macksey v. Egan,* 633 N. E. 2d 408 (Mass. App. Ct. 1994).)

* *William A. Hancock is Editor and Publisher at Business Laws, Inc. and a member of the Ohio and California Bars.*

Commentary

Most of the best efforts clause cases we have read do hold that the clause means something, but it is difficult to say exactly what. Therefore, the following rules seem to emerge.

— There is really only one general rule which can be stated with some certainty. If a party agrees to use its best efforts and then does nothing (or perhaps even does things which are contrary to the objective of the contract such as handling goods of a competitor when the best efforts clause relates to sales of a product), the courts hold there has been a breach. As this court said — best efforts does not mean zero efforts.

— On the other hand, if one party obligated to use its best efforts does something in furtherance of that, but the other party feels it was not enough, the outcome of the case simply depends on all of the facts. Many courts will rarely say that whatever was done was not enough. However, there are enough exceptions to that generality to require that the statement be qualified. For example, we have an entire chapter in our **LAW OF PURCHASING (Second)** book on best efforts clauses, and some of those do state that whatever was done was not up to the best efforts standard in the contract.

— The following points can be and have been used by the courts and the parties to establish some specific meaning to a best efforts clause:

  — past dealings between the parties;

  — custom and usage of the trade or industry; and

  — whether one of the parties has a certain degree of expertise. (If so, a best efforts standard may be held to include exercising that level of expertise properly.)

— For counseling purposes, it is always much better to provide as many specifics in the contract as possible. However, there is a contrary argument. That contrary argument is that, if a contract includes both a best efforts clause and specifics, the general best efforts clause is going to be limited by the specifics. Those with this view would then say that the best efforts clause adds nothing substantial to the specifics. Those who prefer the approach of including as many specifics as possible counter that the point of any contract is not to win a legal case, but to avoid disputes by spelling out for each party exactly what is required.

Below is a compendium of randomly selected best efforts clauses, without any implication as to their merit; they are simply clauses we have seen.

> The buyer will use its best efforts to promote and maintain a high volume of sales.

> The bottler shall devote its best efforts to sale and promotion of sales of the beverages within and only within the territory so as to achieve maximum distribution and sale for the beverages within the territory.

> Buyer shall use its best efforts to direct its Suppliers to use [marketplace provider] as the third-party aggregator for Buyer purchases. Buyer agrees to the use of customary and reasonable letters, meetings and other communications designed to lead to the acceptance by such suppliers of [the marketplace provider] as Buyer's electronic purchasing intermediary.

> Best Efforts: At all times while this agreement is in effect, Licensee shall use its best efforts to exploit the License granted throughout the Territory, including but not limited to, selling a sufficiently representative quantity of all styles, fabrications, and colors of the Licensed Products; offering for sale the Licensed Products so that they may be sold to consumer on a timely basis, maintaining a sales force sufficient to provide effective distribution throughout all areas of the Territory; and cooperating with the Licensor's and any of its Licensees' marketing, merchandising, sales, and anticounterfeiting programs.

The Licensee will sell, and will use its best efforts to cause its jobbers, wholesalers, and distributors to sell, Licensed Products solely to better department stores, boutiques, and speciality shops whose merchandise, presentation, and service are characterized by high-quality presentation and display of Licensed Products and a high level of customer service which builds brand loyalty and preserves the Licensor's brand image.

Licensor will use its reasonable commercial efforts to implement such enhancements within the proposed schedule.

Commercially reasonable efforts means the level of efforts and resources required to carry out clinical or regulatory development, manufacturing, or commercialization, as applicable, of Product in a manner consistent with the efforts that a similarly situated pharmaceutical company would typically devote to a product of similar market potential, profit potential, and strategic value. ■

TRADE DRESS AND TRADEMARK

*William A. Hancock**

I. A Trade Dress Case

A. Trade Dress on Other Products

The case of *Gateway, Inc. v. Companion Products, Inc.,* 384 F.3d (8th Cir. 2004), reminds us that protected trade dress can extend beyond the main product for which it is used.

Gateway sells computers using a trade dress in its advertising which involves black and white cows and black and white cow spots. It uses this trade dress extensively in all of its advertising — and has for a number of years.

Companion Products makes stuffed animals — called STRETCH PETS. STRETCH PETS have an animal's head and an elastic body that can wrap around the edges of computer monitors. One of those is "Cody Cow" which is a black and white stuffed animal and, while the black and white spots are not exactly the same as Gateway's, they are very close. The product is successful — the Eighth Circuit opinion reports sales of 7,000 of them.

Gateway sued Companion Products on a number of trademark theories — the one the Eighth Circuit discussed was trade dress. The court began with a listing of the requirements for a trade dress case:

(1) inherently distinctive or acquired distinctiveness through secondary meaning;

(2) nonfunctional; and

(3) its imitation would result in a likelihood of confusion in consumers' minds as to the origin of the product.

The main issue here is Requirement No. 3 — likelihood of confusion. Gateway did not have any trouble introducing evidence that its trade dress was distinctive, people associated it with computers, and it was nonfunctional. Gateway spent over $1 billion in the United States alone on its advertising featuring these black and white cow spots. The question was whether anyone would be confused as to the origin of the stuffed animals — Companion Products clearly labeled them with its own name.

The law on this basically provides that one looks at various factors — the exact listing of which depends on

* *William A. Hancock is Editor and Publisher at Business Laws, Inc. and a member of the Ohio and California Bars.*

the court. In general, however, the factors are elements like

(1) the strength of the mark;

(2) the similarity between the marks;

(3) the competitive proximity of the products;

(4) the infringer's intent to confuse;

(5) evidence of actual confusion; and

(6) the degree of care reasonably expected of potential customers.

Each side can usually generate its own arguments on all of these points — but, if the plaintiff does a good job on Factor 5, that will usually carry the day. That happened here. Gateway conducted a nationwide survey to determine actual confusion. Gateway testified that approximately 39 percent of the people surveyed erroneously believed that Gateway manufactured or sponsored "Cody Cow." That rate was considerably in excess of what other cases have allowed — which in this circuit have apparently ranged from 11 percent to 49 percent.

B. Summary and Conclusion

The above discussion is incomplete, but in our view represents a fair presentation of how counsel should consider the trade dress law to operate in cases like this. If the facts were simply as outlined above, we suggest the result would be the same as the actual case. Trade dress protection extends not only to the product for which it has been traditionally used, but also to related or extended products. For example, a trade dress for the name of an Italian restaurant can extend to the jar of spaghetti sauce. Even without any additional facts, the maker of stuffed animals who chooses a cow, and then colors it black and white just like Gateway computers, is obviously trying to tap into some of that $1 billion advertising Gateway spends on its trade dress. This is certainly true when the stuffed animals are specifically designed to go around a computer screen. If the case would have involved regular stuffed animals without this particular function, it might have been closer — but certainly could have come out the same way.

This case, however, presented an additional feature which we have observed in quite a few of the cases involving various subjects we have described. Companion Products did not just happen on this black and white cow spot design. In fact, it was specifically prepared for Gateway; Companion Products specifically made a proposal to Gateway to sell the product to Gateway, and Gateway declined. Companion Products, however, went ahead anyway. Note that Factor 4 of the elements of a trade dress case is the infringer's intent to confuse — and evidence such as the initial presentation to Gateway in the record causes that element to come out strongly on the side of Gateway. We have seen the same basic procedure in copyright cases. Someone will ask for permission to use a portion of a copyrighted work which use is arguably fair, the copyright owner will decline, and the person asking goes ahead anyway. Most of those cases hold no fair use and infringement in part because of the initial request and rejection.

Another factor in this case was that Gateway not only uses the black and white cow spot approach on the boxes for its computers but also on CD holders, three-ring binders, and other similar accessories that one might find in a computer store. There was no report in the opinion we read that Gateway had its own stuffed animal, but these other ancillary products with the same trade dress make the step from computer boxes to stuffed animals more logical.

Our final point is to highlight the importance of the Gateway survey. As a practical matter, if counsel is asked to try to do something about a situation such as this, a survey is likely to be required, and it is likely to be somewhat costly. This fact should be disclosed to management up front as it may play a role in their views and decisions as to the amount of harm the infringement is actually causing.

II. A Trademark Case

A. Introduction

What happens if the company wants to change its name? Alternatively, depending on which side of the fence you are on, what happens if the big guys come to town and want to take your name? The case of *Citizens Financial Group v. Citizens National Bank of Evans*

City, 386 F.3d 110 (3d Cir. 2004), illustrates this problem.

Citizens National Bank of Evans City, Pennsylvania, was founded way back in 1878 and now has about sixteen branches in northwestern Pennsylvania. To try to prevent the inevitable confusion this case involves, we will call this bank "Small Old Citizens Bank." Citizens Financial Group is a subsidiary holding company of the Royal Bank of Scotland. In July 2001, it purchased the retail banking operations of Mellon Bank and shortly thereafter announced that it was changing its name to Citizens Bank. Mellon had some branches in northwestern Pennsylvania. We will call this bank "New Big Citizens Bank."

When Small Old Citizens Bank found out New Big Citizens Bank was coming to town and changing all its branch names to Citizens Bank, a certain amount of justifiable panic set in. There did not appear to be much in the way of informal discussions to try to work things out — at least, if there were, none were described in the Third Circuit opinion. Instead, the action started with Small Old Citizens Bank sending a cease-and-desist letter to New Big Citizens Bank requesting that it not use the word "citizens" in its name in western Pennsylvania. New Big Citizens Bank responded with a declaratory judgment action wanting the court to say that Small Old Citizens Bank could not prevent New Big Citizens Bank from using the word "citizens" in its name.

B. Basic Trademark Rules

We use the case principally as a vehicle for reminding subscribers of a few basic trademark rules which would appear to make situations such as this virtually impossible to resolve to the satisfaction of both sides. The best that can be done to avoid litigation is some type of compromise.

Rule 1. Confusion is the watchword. The first rule of trademark law is that its basic purpose is to prevent confusion as to the source of goods or services. Each side made arguments about that issue here but, in reality, there is no way that two banks can operate in the same territory using the word "citizens" in their names without some confusion. Each side acknowledged that there was confusion with some Small Old Citizens Bank customers trying to make deposits in New Big Citizens Bank branches and vice versa, etc. Rule 1 (plus common sense) tells us that something has to give in this dispute.

Rule 2. Use trumps registration. Thus, even though New Big Citizens Bank had a federal registration for its trademarks which included the word "citizens," Small Old Citizens Bank could prevent it from using the word "citizens" in Small Old Citizens Bank territories if such use would result in consumer confusion (which it certainly did).

Rule 3. Overall image is what counts — not details. Rule 3 is sort of a corollary to Rule 1. In judging confusion, one looks at the trademarks and trade names as a whole — the total picture. Here, for example, the real name of Small Old Citizens Bank was Citizens National Bank, and it had internal policies which stated that, in its advertising the first time its name was used, it should be CITIZENS NATIONAL BANK. After that, it could be shortened to simply CITIZENS. That led the district court to fashion a remedy which basically said that the way out of this problem was that Small Old Citizens Bank could use the name CITIZENS NATIONAL BANK, and Big New Citizens Bank could use the name CITIZENS BANK, even in the same territories.

That district court approach ran afoul of this Rule 3. It simply did not work. People continued to confuse the two banks, and expert witnesses testified that the confusion was likely to continue because adding the word "national" to a bank is simply insufficient to distinguish it from another bank with the same name except for the "national" word.

C. Summary and Conclusions

The full opinion in this case deals with many technical and evidentiary issues, but it clearly ends up stating that Big New Citizens Bank simply cannot use the word "citizens" for its branches in Small Old Citizens Bank territories. There is a requirement for further proceedings to draw some boundaries on exactly what those territories or relevant markets are, but, subject to that, the Big New Citizens Bank network is going to have to operate with some other name in a large portion of western Pennsylvania. Also, the injunction of the lower court requiring Small Old Citizens Bank to always use the word "national" in its name is vacated. ■

PATENT INFRINGEMENT

*William A. Hancock**

This case, *Knorr-Bremse System v. Dana,* 383 F.3d 1337 (Fed. Cir. 2004), is noteworthy, in part, because it took the court three pages just to list the lawyers who participated. One reason for that was the court invited *amicus* briefs. This is an *en banc* opinion because the entire panel of the Federal Circuit thought it appropriate to consider the case of the interaction between the attorney-client privilege and willful infringement under the patent law.

The patent dispute was between Knorr-Bremse, a German corporation which manufacturers air disk brakes for tractor-trailer trucks. Dana sells similar devices which it imports from Haldex Brake Products AB in Sweden. Knorr-Bremse thought Haldex (and, therefore, Dana) infringed some of its patents and, after litigation, its claim was upheld. There was infringement. The issue was whether or not it was "willful infringement" which, under the patent law, can subject the infringer to treble damages and attorneys' fees.

The key element of the case involved the extent to which either Dana or Haldex obtained any legal opinion on the legality of what it was doing. Clearly, both had knowledge of the Knorr-Bremse claims, so both were on notice of a potential issue. Haldex did consult counsel but refused to disclose the opinions it received citing the attorney-client privilege. Dana never consulted counsel but simply relied on Haldex. Applying Federal Circuit precedent, the lower court said that this created an adverse inference that the opinions which were received were unfavorable to Dana and Haldex, and based in part on that adverse inference, the lower court held the infringement was willful.

Dana and Haldex only appealed the willful infringement aspect of the case — which resulted in the lower court awarding Knorr-Bremse attorneys' fees for a certain portion of the litigation. The Federal Circuit, *en banc,* reversed all previous precedent and said there should not be an adverse inference on the willful infringement issue from either failing to disclose the content of opinions of counsel or from not obtaining an opinion in the first place. Thus, the question of whether or not there was willful infringement here remains undecided, but the lower court is now instructed to decide the issue without the benefit of the adverse inferences it drew the first time.

Quotes from the case:

> ***Question 1:*** When the attorney-client privilege and/or work-product privilege is invoked by a defendant in an infringement suit, is it appropriate for the trier of fact to draw an adverse inference with respect to willful infringement?
>
> The answer is no. Although the duty to respect the law is undiminished, no adverse inference shall arise from invocation of the attorney-client and/or work-product privilege. …
>
> ***Question 2:*** When the defendant had not obtained legal advice, is it appropriate to draw an adverse inference with respect to willful infringement?
>
> The answer, again, is no. The issue here is not of privilege, but whether there is a legal duty upon a potential infringer to consult with counsel, such that failure to do so will provide an inference or evidentiary presumption that such opinion would have been negative.

Of course, all this leaves a very important issue unaddressed. Even if there is no legal duty to get a legal opinion, should counsel recommend one anyway? We suspect this will be a subject and issue for frequent discussion in future literature and seminars. ■

* *William A. Hancock is Editor and Publisher at Business Laws, Inc. and a member of the Ohio and California Bars.*