

# TEXAS INTELLECTUAL PROPERTY LAW JOURNAL

INTELLECTUAL PROPERTY LAW SECTION OF THE STATE BAR OF TEXAS  
THE UNIVERSITY OF TEXAS SCHOOL OF LAW

SALE OR LICENSE? *UMG v. AUGUSTO*, *VERNOR v. AUTODESK*, AND THE FIRST SALE  
DOCTRINE

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*Lital Helman*

STATE BAR SECTION NEWS



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## ARTICLES

- SALE OR LICENSE? *UMG v. AUGUSTO, VERNOR v. AUTODESK*, AND THE FIRST SALE DOCTRINE 1  
*Vivian F. Wang*
- THE AFTERMATH OF *TS TECH*: THE END OF FORUM SHOPPING IN PATENT LITIGATION AND IMPLICATIONS FOR NON-PRACTICING ENTITIES 29  
*Mark Liang*
- UNREPRESENTATIVE RANDOMIZATION: AN EMPIRICAL STUDY OF JUDGING PANELS OF USPTO APPEALS TO THE CAFC 79  
*Thomas Froats*
- PULL TOO HARD AND THE ROPE MAY BREAK: ON THE SECONDARY LIABILITY OF TECHNOLOGY PROVIDERS FOR COPYRIGHT INFRINGEMENT 111  
*Lital Helman*
- STATE BAR SECTION NEWS 167

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**JOURNAL ANNOUNCEMENTS**

The *Texas Intellectual Property Law Journal* would like to congratulate the newly appointed Articles Editors: Brian Talbot Cumings, Robert Hopkins, Shannon M. Kidd, and Michelle Friedman Murray.

The *Journal* would also like to congratulate several of its editors for their outstanding contributions to this issue: Katy Hutchinson, James Quigley, and Mimi Yu.

Additionally, the *Journal* would like to welcome Adam Smoot in his new capacity as a Chief Articles Editor.

Finally, mark your calendars for the *Journal's* Twelfth Annual Intellectual Property Law Symposium, which will be held at The University of Texas School of Law on Friday, February 18, 2011. For more information, please see pages vii and viii.

## TEXAS INTELLECTUAL PROPERTY LAW JOURNAL

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The *Texas Intellectual Property Law Journal* is published in cooperation with the State Bar of Texas three times per year at the University of Texas School of Law. The *Journal* is the official journal of the State Bar of Texas Intellectual Property Law Section.

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The *Journal's* vision is to be the leading intellectual property law journal at the premiere IP law university. We want to be *the* forum of choice for intellectual property law practitioners, professors, and students around the globe. Our primary focus will center on providing significant and innovative contributions to U.S. intellectual property law.

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The *Journal* hosts an annual symposium on a current topic in intellectual property law. These symposia have been the source of many of the *Journal's* valued articles. Their purpose is to promote awareness of the development and formation of intellectual property law and to forge closer ties among practitioners, judges, scholars, and students. We welcome your interest in these events. The *Journal* hosted the Eleventh Annual Intellectual Property Law Symposium on February 19, 2010, at the University of Texas School of Law.

The *Journal's* Twelfth Annual Intellectual Property Law Symposium will be held at The University of Texas School of Law on Friday, February 18, 2011. Visit our Symposium website at [www.ipsymposium.com](http://www.ipsymposium.com) for more information about the upcoming Symposium, or visit our *Journal* website at [www.tiplj.org](http://www.tiplj.org) for archived presentation materials from past Symposia. Participants will be able to earn MCLE credit and can register using the form on the following page or by visiting our Symposium website. For additional symposium information, such as sponsorship or presentation opportunities, please contact the *Journal's* Symposium Editors at [symposium@tiplj.org](mailto:symposium@tiplj.org).

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# Sale or License? *UMG v. Augusto*, *Vernor v. Autodesk*, and the First Sale Doctrine

Vivian F. Wang\*

Introduction.....	2
Part I: Procedural Posture of <i>UMG Recordings, Inc. v. Augusto</i> and <i>Vernor v. Autodesk, Inc.</i> .....	4
A. <i>UMG Recordings, Inc. v. Augusto</i> .....	4
B. <i>Vernor v. Autodesk, Inc.</i> .....	5
C. “Inconsistent and Unpredictable” Precedents.....	6
Part II: What are the Copyright Holders’ Motivations?.....	8
A. Preventing “User Substitution”.....	9
B. Preventing “User Proliferation”.....	12
C. The Answer Consistent with the Goals of Copyright Law.....	14
1. Promo CDs.....	15
2. Software CDs.....	15
Part III: The Legal Tests: The <i>Wise</i> Test Is Wiser.....	19
A. The <i>Wise</i> Test.....	20
B. The <i>Wall Data</i> Test.....	24
Part IV: What Next? Congressional Action, or Self-Cure by the Industry?.....	26
Conclusion.....	28

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## Introduction

Under the first sale doctrine, the owner of a particular copy of a copyrighted work is entitled to sell or otherwise dispose of that copy without the authority of the copyright owner.<sup>1</sup> As the Supreme Court explained in *Bobbs-Merrill Co. v. Straus*, which established the first sale doctrine at American common law before it was codified in the Copyright Act, “[t]he purchaser of a book, once sold by authority of the owner of the copyright, may sell it again, although he could not publish a new edition of it.”<sup>2</sup> The doctrine recognizes that “[o]wnership of a copyright . . . is distinct from ownership of any *material object* in which the work is embodied”<sup>3</sup> and rests on the principle that the copyright owner has received full value for a copy of his work when that copy is first sold.<sup>4</sup> After the first sale, “the policy favoring a copyright monopoly for authors gives way to the policy opposing restraints of trade and restraints on alienation.”<sup>5</sup> Because of the doctrine, libraries, used book stores, movie rental businesses, and half.com can exist.

A mere licensee, however, cannot claim the protection of the first sale doctrine.<sup>6</sup> A licensee infringes the copyright owner’s rights under § 106(3) of the Copyright Act if he attempts to sell, rent, lease, give away, or otherwise “distribute” the work.<sup>7</sup> For example, “a person who has rented a print of a motion picture from the copyright owner would have no right to rent it to someone else without the owner’s permission.”<sup>8</sup> The distinction between an “owner” and a “licensee” is thus of major significance, yet the Copyright Act defines neither term. Two recent cases cur-

<sup>1</sup> 17 U.S.C. § 109 (2006).

<sup>2</sup> 210 U.S. 339, 350 (1908).

<sup>3</sup> 17 U.S.C. § 202 (2006) (emphasis added); *see also* *Stevens v. Royal Gladding*, 58 U.S. 447 (1854) (holding that ownership of the copyright in a map is distinct from ownership of the copperplate bearing the design of the map).

<sup>4</sup> 2 PAUL GOLDSTEIN, GOLDSTEIN ON COPYRIGHT § 7.6.1.1 (3d ed. 2005).

<sup>5</sup> 2 MELVILLE B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT § 8.12[A] (Matthew Bender, rev. ed. 2010); *see also* H.R. REP. NO. 98-987, at 2 (1984), *reprinted in* 1984 U.S.C.C.A.N. 2898, 2899 (“The first sale doctrine has its roots in the English common law rule against restraints on alienation of property. American courts have affirmed the doctrine and distinguished between the owner’s exclusive rights in the copyright and the rights of the owner of an object embodying a work that is under copyright.” (citing *Bobbs-Merrill*, 210 U.S. at 350; *Harrison v. Maynard, Merrill & Co.*, 61 F.2d 689, 690 (2d Cir. 1894); *Zechariah Chafee, Jr., Equitable Servitudes on Chattles*, 41 HARV. L. REV. 945, 982 (1928)).

<sup>6</sup> *See* 17 U.S.C. § 109(d) (2006) (“The privilege[] prescribed by [§ 109(a)] do[es] not, unless authorized by the copyright owner, extend to any person who has acquired possession of the copy or phonorecord from the copyright owner, by rental, lease, loan, or otherwise, without acquiring ownership of it.”).

<sup>7</sup> 17 U.S.C. § 106(3) (2006).

<sup>8</sup> H.R. REP. NO. 94-1476, at 80 (1976).



rently on appeal before the Ninth Circuit grapple with the surprisingly unsettled question of how to determine when a transaction confers ownership of a copy of a copyrighted work for purposes of the first sale doctrine. The two cases are *UMG Recordings, Inc. v. Augusto*, which concerns the transfer of promotional compact disks (promo CDs) of music,<sup>9</sup> and *Vernor v. Autodesk, Inc.*, which concerns the transfer of software CDs.<sup>10</sup> In both cases, the district courts ruled against the copyright holders, finding that when they distributed their CDs, they transferred ownership, thereby subjecting them to the first sale doctrine.<sup>11</sup> UMG and Autodesk both appealed to the Ninth Circuit, which heard arguments in both cases on June 7, 2010.<sup>12</sup>

This paper examines whether routine transfers of promo CDs and software CDs should be treated as transfers of ownership for purposes of the first sale doctrine. It concludes that the answer is an unequivocal “yes” for promo CDs and a more hesitant “yes” for software CDs. Just as consumers of traditional media, such as books, videotapes, and digital video disks (DVDs), a consumer who has paid for the right to use a software CD indefinitely should be able to transfer those rights if he no longer wants to use the software. The problem, however, with applying the first sale doctrine to software CDs is that § 117 of the Copyright Act permits the original user to retain a copy of the software on his hard drive.<sup>13</sup> This loophole allows for the proliferation of the software without compensation to the copyright owner. Nevertheless, this problem should not be grounds for a *court* to refuse to apply the first sale doctrine to software CDs.

Part I of the paper summarizes the procedural posture of *Vernor v. Autodesk* and *UMG Recordings v. Augusto* and sketches out the unsettled state of the law on the issue. Part II compares the functional arguments that the content holders have advanced—which I will describe as “user substitution” arguments and “user proliferation” arguments—to the policies underlying the first sale doctrine and the Copyright Act. This exercise demonstrates that promo CDs and software CDs should both be subject to the first sale doctrine, although such treatment is admittedly im-

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<sup>9</sup> 558 F. Supp. 2d 1055, 1055 (C.D. Cal. 2008).

<sup>10</sup> No. C07-1189RAJ, 2009 U.S. Dist. LEXIS 90906, at \*2 (W.D. Wash. Sept. 30, 2009).

<sup>11</sup> *UMG Recordings*, 558 F. Supp. 2d at 1065; *Id.* at \* 48.

<sup>12</sup> Notice of Oral Argument on June 7th Calendar, *UMG Recordings, Inc. v. Augusto*, No. 08-55998 (9th Cir. Apr. 29, 2010); Notice of Oral Argument on June 7th Calendar, *Vernor v. Autodesk, Inc.*, No. 09-35969 (9th Cir. Apr. 29, 2010).

<sup>13</sup> See 17 U.S.C. § 117(a)(1) (2006); *ProCD, Inc. v. Zeidenberg*, 908 F. Supp. 640, 647–50 (W.D. Wis. 1996), *rev'd on other grounds*, 86 F.3d 1447 (7th Cir. 1996) (noting that software copied onto a hard drive for personal use and not distributed may be entitled to the exception from infringement set out in 17 U.S.C. § 117).

perfect when it comes to software CDs because of § 117 of the Copyright Act. Part III examines the conflicting legal tests for distinguishing between ownership and licenses in the Ninth Circuit. It argues that the *Wise* test,<sup>14</sup> which inquires whether a consumer is required to return the CD to the copyright holder,<sup>15</sup> is superior to the *Wall Data* test,<sup>16</sup> which inquires whether the “copyright owner makes it clear that she or he is granting only a license to the copy of software and imposes significant restriction on the purchaser’s ability to redistribute or transfer that copy.”<sup>17</sup> Part IV considers how copyright holders such as UMG and Autodesk are likely to respond to a ruling that the first sale doctrine applies to their products. Such a ruling will probably accelerate a trend that is already underway, which is that the industries are shifting from distributing their content via physical compact discs to distributing their content via direct download from the Internet.

### **Part I: Procedural Posture of *UMG Recordings, Inc. v. Augusto* and *Vernor v. Autodesk, Inc.***

#### *A. UMG Recordings, Inc. v. Augusto*

*UMG Recordings, Inc. v. Augusto* concerns the transfer of promo CDs.<sup>18</sup> Before the mass-market release of a music album, record companies such as Universal Music Group (UMG) create promo CDs and mail them at no charge to music industry insiders such as music critics, disc jockeys, and radio stations.<sup>19</sup> The promo CDs are similar to the mass-market albums, except that a “promotional CD may contain fewer songs and may not include the artwork included with the new CD.”<sup>20</sup> But unlike mass-market CDs, promo CDs assert that the transaction is a license by labeling with the following, or similar, language:

This CD is the property of the record company and is *licensed* to the intended recipient for personal use only. Acceptance of this CD shall constitute an agreement to comply with the terms of the *license*. Resale or transfer of possession is not allowed and may be punishable under federal and state laws.<sup>21</sup>

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<sup>14</sup> This refers to the approach in *United States v. Wise*, 550 F.2d 1180 (9th Cir. 1977).

<sup>15</sup> See *Wise*, 550 F.2d at 1191–93.

<sup>16</sup> This refers to the approach in *Wall Data Inc. v. Los Angeles Sheriff’s Dep’t.*, 447 F.3d 769 (9th Cir. 2006).

<sup>17</sup> *Wall Data*, 447 F.3d at 785.

<sup>18</sup> 558 F. Supp. 2d 1055, 1055 (C.D. Cal. 2008).

<sup>19</sup> *Id.* at 1058.

<sup>20</sup> *Id.*

<sup>21</sup> *Id.* (emphasis added).

In this case, eBay seller Troy Augusto obtained various UMG promo CDs from secondhand shops and online auctions and then posted them for auction on eBay.<sup>22</sup> UMG brought a copyright infringement claim against Augusto on grounds that it licenses and never transfers ownership of its promo CDs.<sup>23</sup> So according to UMG, neither Augusto nor any other person possessing the promo CDs could be an owner, and therefore, could not be protected by the first sale doctrine.<sup>24</sup> Augusto disagreed.<sup>25</sup> Technically, Augusto did not contend that the promo CDs were “sold” by UMG to the initial recipients, since UMG distributes them at no cost to music industry insiders, but he nevertheless asserted ownership.<sup>26</sup> As the court recognized, the first sale doctrine “does not require a ‘sale’” and can apply “when copies are given away or are otherwise permanently transferred without the accoutrements of a sale.”<sup>27</sup> For example, a gift “qualif[ies] as a ‘first sale’ to the same extent as an actual sale for consideration.”<sup>28</sup> On June 10, 2008, Judge S. James Otero of the Central District of California granted Augusto’s motion for summary judgment, finding the “economic realities of the transaction” demonstrated that “UMG’s distribution of promo CDs to the music industry insiders is properly characterized as a gift or sale, not a license.”<sup>29</sup> UMG appealed.

#### B. *Vernor v. Autodesk, Inc.*

In the other case before the Ninth Circuit, *Vernor v. Autodesk, Inc.*,<sup>30</sup> eBay seller Timothy Vernor acquired CD copies of Autodesk’s copyrighted software program AutoCAD from an architecture firm, Cardwell/Thomas Associates (CTA), at its office sale. CTA had acquired these CDs from Autodesk in 1999 as part of a dispute settlement.<sup>31</sup> In 2002, CTA upgraded its Autodesk software and entered

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<sup>22</sup> *Id.*

<sup>23</sup> *Id.*

<sup>24</sup> See *UMG Recordings, Inc. v. Augusto*, 558 F. Supp. 2d 1055, 1058–59 (C.D. Cal. 2008).

<sup>25</sup> *Id.* at 1059.

<sup>26</sup> *Id.* at 1059–60.

<sup>27</sup> *Id.* at 1059 (quoting 4 WILLIAM F. PATRY, PATRY ON COPYRIGHT § 13:15 (2006)).

<sup>28</sup> *Id.* (quoting 2 PAUL GOLDSTEIN, GOLDSTEIN ON COPYRIGHT § 7.6.1 n.4 (3d ed. 2005)).

<sup>29</sup> *Id.* at 1062. The court also had an alternative ground for its ruling that the promo CDs were gifts. It found that the promo CDs were gifts under the Postal Reorganization Act, *id.* at 1064, which provides that “unordered merchandise” sent via mail “may be treated as a gift by the recipient, who shall have the right to retain, use, discard, or dispose of it in any manner he sees fit without obligation whatsoever to the sender.” 39 U.S.C. § 3009 (2006). UMG has also appealed this alternative ruling, but this paper will not discuss the Postal Reorganization Act.

<sup>30</sup> No. C07-1189RAJ, 2009 U.S. Dist. LEXIS 90906, at \*3 (W.D. Wash. Sept. 30, 2009).

<sup>31</sup> *Id.* at \*10–11.

into an agreement with Autodesk to destroy all copies of the Autodesk CDs it had acquired in 1999.<sup>32</sup> In breach of that agreement, CTA transferred the CDs to Vernor.<sup>33</sup> Vernor then put the CDs up for auction on eBay, and Autodesk sent him takedown notices pursuant to the Digital Millennium Copyright Act, asserting copyright infringement.<sup>34</sup> Autodesk claimed that it only licensed and never sold copies of its software.<sup>35</sup> The standard packaging of its CDs bears a “shrinkwrap” notice that the “software is subject to the license agreement that appears during the installation process or is included in the package.”<sup>36</sup> The standard license agreement accompanying the CDs contains the following key terms: “it limits [the] installation of AutoCAD software to two computers, with a ban on simultaneous use of the software on those computers”; “[i]t prohibits modification or reverse engineering of the software”; “[i]t bars any use or transfer of the software outside the western hemisphere”; “it bars any transfer of the software without Autodesk’s written permission”; it declares that “[t]itle and copyrights to the Software . . . remain with Autodesk”; and it requires “users who obtain the software via an upgrade from Autodesk [] to destroy any copies of older AutoCAD software in his possession.”<sup>37</sup> Vernor filed a declaratory judgment action against Autodesk, asserting that he owned the CDs.<sup>38</sup> On September 30, 2009, Judge Richard A. Jones of the Western District of Washington granted Vernor’s motion for summary judgment.<sup>39</sup> Following the approach of a 1977 Ninth Circuit case, *United States v. Wise*,<sup>40</sup> and rejecting the approach of subsequent Ninth Circuit cases, the court concluded that “the transfer of AutoCAD copies . . . [wa]s a transfer of ownership.”<sup>41</sup> Autodesk has appealed.

### C. “Inconsistent and Unpredictable” Precedents

*Vernor* and *Augusto* are the latest cases in a substantial but conflicting list of cases that address the license-versus-sale question in the context of the first sale

<sup>32</sup> *Id.* at \*5.

<sup>33</sup> *Id.* at \*7 (citation omitted).

<sup>34</sup> *Id.* at \*2 (citation omitted).

<sup>35</sup> *Id.* at \*10.

<sup>36</sup> *Vernor v. Autodesk, Inc.*, No. C07-1189RAJ, 2009 U.S. Dist. LEXIS 90906, at \*2 (W.D. Wash. Sept. 30, 2009) (citations omitted).

<sup>37</sup> *Id.* at \*11 (citations omitted).

<sup>38</sup> *Id.* at \*3, 9.

<sup>39</sup> *Id.* at \*1.

<sup>40</sup> 550 F.2d 1180, 1190–93 (9th Cir. 1977).

<sup>41</sup> *Vernor*, 2009 U.S. Dist. LEXIS 90906, at \*22.

doctrine. *Augusto* seems to be the first case to raise the question with respect to promo CDs, but many cases have previously addressed this issue with respect to software. As Pamela Samuelson summarizes, “There is, oddly enough, no definitive court ruling [on the issue],”<sup>42</sup> and “the case law on whether the first sale rule applies to mass-marketed software is mixed.”<sup>43</sup> William Fisher similarly states, “[T]he law governing the permissibility of resales of software is, to an unusual degree, inconsistent and unpredictable.”<sup>44</sup> Others have echoed Samuelson’s and Fisher’s observations.<sup>45</sup> Some relevant cases have more or less accepted at face value the manufacturers’ characterizations of their software distributions as licenses.<sup>46</sup> Other cases have conducted a somewhat deeper analysis, looking to various characteristics of the “license” agreements. Some of these cases have then concluded that the software copy was licensed,<sup>47</sup> while others have concluded that the software copy was sold.<sup>48</sup>

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<sup>42</sup> Pamela Samuelson, *When is a “License” Really a Sale?*, 52 COMM. ACM 27, 27 (2009).

<sup>43</sup> *Id.* at 29.

<sup>44</sup> William W. Fisher III, *When Should We Permit Differential Pricing of Information?*, 55 UCLA L. REV. 1, 15 (2007).

<sup>45</sup> See, e.g., NIMMER & NIMMER, *supra* note 5, at § 8.12[B][1][d] (noting that there has been “confusion” in case law applying the first sale doctrine to computer software); John A. Rothchild, *The Incredible Shrinking First-Sale Rule: Are Software Resale Limits Lawful?*, 57 RUTGERS L. REV. 1, 48 (2004) (“[C]ourts, as well as commentators and even the Copyright Office, have evinced a good deal of confusion in applying the first-sale doctrine to software copies.”); Michael Seringhaus, *E-Book Transactions: Amazon “Kindles” the Copy Ownership Debate*, 12 YALE J.L. & TECH. 147, 151 (2009) (“Under a variety of circumstances, courts—often sitting in the same judicial circuit—have issued conflicting opinions on the matter of whether software is sold or merely licensed.”).

<sup>46</sup> See, e.g., *Triad Sys. Corp. v. Se. Express Co.*, 64 F.3d 1330, 1333 (9th Cir. 1995), *overruled in part on other grounds by* *Gonzales v. Texaco Inc.*, 344 F. App’x 304 (9th Cir. 2009) (discussing a manufacturer’s switch from selling to licensing its software); *MAI Sys. Corp. v. Peak Computer, Inc.*, 991 F.2d 511, 519 n.5 (9th Cir. 1993) (noting that customers no longer qualify as owners of software once a manufacturer licensed its software); *Davidson & Assocs. v. Internet Gateway*, 334 F. Supp. 2d 1164, 1178 (E.D. Mo. 2004) (“When license terms provide that ownership of the copy remains in the copyright owner, they preclude the transfer of title to the copy of the license.”); *Microsoft Corp. v. Harmony Computers & Elecs., Inc.*, 846 F. Supp. 208, 213 (E.D.N.Y. 1994) (noting that “[e]ntering a license agreement is not a ‘sale’ for purposes of the first sale doctrine”) (citation omitted); *CMAX/Cleveland, Inc. v. UCR, Inc.*, 804 F. Supp. 337, 356 (M.D. Ga. 1992) (concluding that defendants never owned a copy of the software and thus infringed the manufacturer’s copyrights by breaching the license agreement); *ISC-Bunker Ramo Corp. v. Altech, Inc.*, 765 F. Supp. 1310, 1331 (N.D. Ill. 1990) (finding that distribution of software pursuant written licensing agreements precludes licensees from redistributing the software).

<sup>47</sup> See, e.g., *DSC Commc’ns. Corp. v. Pulse Commc’ns., Inc.*, 170 F.3d 1354, 1362 (Fed. Cir. 1999) (holding that the district court improperly concluded that defendants were owners of the software in light of the written agreement); *Adobe Sys. Inc. v. Stargate Software Inc.*, 216 F. Supp. 2d 1051, 1059 (N.D. Cal. 2002) (holding that parties should be free to characterize software distribution as a license and to negotiate and enter into their own terms); *Adobe Sys. Inc. v. One Stop Micro, Inc.*, 84 F. Supp. 2d 1086, 1092 (N.D. Cal. 2000) (concluding the parties formed a licensing agreement

## Part II: What are the Copyright Holders' Motivations?

For a moment, set aside the admittedly discordant case law, and consider instead the functional reasons underlying the copyright holders' objections to the application of the first sale doctrine to copies of their copyrighted works. Content industries, such as those providing mass media, recognizing the stake that they have in these cases, have filed amicus curiae briefs before the Ninth Circuit in these cases. The Motion Picture Association of America (MPAA) and the Software & Information Industry Association (SIIA) have filed amicus briefs in support of Autodesk, and the Recording Industry Association of America (RIAA) has filed an amicus brief in support of UMG.<sup>49</sup> These amici briefs, together with UMG's and Autodesk's appellate briefs,<sup>50</sup> advance a variety of results-oriented arguments as to why the first sale doctrine should not apply in these cases. What exactly are content holders trying to prevent, and how do these motivations compare with the purposes of the first sale doctrine and copyright law as a whole?

The content holders' arguments can be separated into two distinct motivations: First, a desire to prevent downstream "user substitution," and second, a desire to prevent downstream "user proliferation." "User substitution" occurs when a user who has acquired the right to enjoy a copy of a copyrighted work transfers those usage rights to someone else while simultaneously *forfeiting* his own ability to use the work. In other words, the net number of users following such a transaction remains *unchanged* after the transfer of the copy of the copyrighted work. "User pro-

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based on factors such as intent "in entering into the agreement, trade usage, the unique nature of distributing software, as well as the express restrictive language of the contract").

<sup>48</sup> See, e.g., *Krause v. Titleserv, Inc.*, 402 F.3d 119, 124 (2d Cir. 2005) (holding that the defendant owned the software after considering numerous factors); *Softman Prods. Co. v. Adobe Sys. Inc.*, 171 F. Supp. 2d 1075, 1085 (C.D. Cal. 2001) (finding that circumstances suggest the transaction at issue was a sale rather than a license and that many "shrinkwrap license" transactions are similarly sales of goods rather than licenses); *Novell, Inc. v. CPU Distrib., Inc.*, No. H-97-2326, 2000 U.S. Dist. LEXIS 9975, at \*19 (S.D. Tex. May 4, 2000) (finding that the unambiguous agreement was a sales contract but recognizing that possibility of drafting an agreement to avoid the application of the first sale doctrine); *Novell, Inc. v. Network Trade Ctr., Inc.*, 25 F. Supp. 2d 1218, 1230 (D. Utah 1997) (holding that the first sale doctrine applied to the chain of transactions because the attached shrinkwrap license was invalid).

<sup>49</sup> Brief of Amicus Curiae the Motion Picture Association of America, Inc. in Support of Appellant's Position Seeking Reversal on Appeal at 20, *Vernor v. Autodesk, Inc.*, No. 09-35969 (9th Cir. Jan. 12, 2010) (citations omitted) [hereinafter MPAA Amicus Brief]; Brief of Amicus Curiae Software & Information Industry Association (SIIA) in Support of Appellant and Reversal at 7, *Vernor v. Autodesk, Inc.*, No. 09-35969 (9th Cir. Jan. 14, 2010) [hereinafter SIIA Amicus Brief]; Brief for Amicus Curiae Recording Industry Association of America in Support of Reversal at 17, *UMG Recordings, Inc. v. Augusto*, No. 08-55998 (9th Cir. Dec. 22, 2008) [hereinafter RIAA Amicus Brief].

<sup>50</sup> My analysis draws only on the appellate briefs in *UMG Recordings, Inc. v. Augusto* and *Vernor v. Autodesk, Inc.* and does not consider the district court briefs.

liferation,” in contrast, occurs when a user, who has acquired the right to use and benefit from a copy of a copyrighted work, transfers those rights to someone else while simultaneously *retaining* his own ability to enjoy the work. In other words, the net number of users after such a transaction *increases* after the transfer of the copy of the copyrighted work.

#### A. Preventing “User Substitution”

The ability to prevent user substitution benefits the copyright holder in a number of ways. John Rothchild explained that “[w]hen the end user of a good lends, gives, sells, or rents it to somebody else, the manufacturer of the item may lose a sale. . . . In addition, by suppressing competition with its own products, the manufacturer may be able to maintain a higher selling price.”<sup>51</sup> Moreover, the prevention of user substitution facilitates price discrimination. Price discrimination is the practice of “charging different consumers different prices for access to the same good or service” or variants of the same good or service, where the disparity in pricing for the different versions “cannot be explained by differences in the costs of the versions.”<sup>52</sup> Price discrimination usually increases a firm’s profits because it enables the firm to capture more profit from those consumers with higher willingness and ability to pay.<sup>53</sup> Classic examples of price discrimination include airlines charging higher prices for business-class tickets than coach tickets and movie theaters offering student and senior discounts.<sup>54</sup>

As Anthony Reese explained, the first sale doctrine “complicate[s] price discrimination by allowing buyers to . . . engage in arbitrage. If a copyright owner tried to price discriminate in the sale of her works, the buyer of a copy could resell access to the work to a second consumer at a price lower than the price the copyright owner would charge the second consumer directly (but higher than the price the copyright owner charged to the first consumer).”<sup>55</sup> The very existence of the first sale doctrine indicates that preventing user substitution is simply not a goal of copyright law. Instead, the doctrine exists to *promote* user substitution. The Copyright Office, citing the Supreme Court’s reasoning in *Bobbs-Merrill Co. v. Strauss*,

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<sup>51</sup> Rothchild, *supra* note 45, at 15–16.

<sup>52</sup> Fisher, *supra* note 44, at 3.

<sup>53</sup> See Fisher, *supra* note 44, at 3.

<sup>54</sup> Fisher, *supra* note 44, at 4. For a discussion of more examples of price discrimination in industries including transportation, higher education, DVDs, patented medical devices, textbooks, pharmaceuticals, and fashion, see *id.* at 29.

<sup>55</sup> R. Anthony Reese, *The First Sale Doctrine in the Era of Digital Networks*, 44 B.C. L. REV. 577, 625–26 (2003); see also Fisher, *supra* note 44, at 14 (noting that arbitrage would discourage copyright owners from engaging in price discrimination).

noted that allowing the copyright holder to exert “control . . . over resales would not further [the Copyright Act’s] main purpose of protecting the reproduction right.”<sup>56</sup> The Copyright Office added, “[C]ompetition policy is viewed as one of the underlying bases for the first sale doctrine.”<sup>57</sup>

Like UMG and Autodesk, copyright holders in “traditional” media for which the first sale doctrine is well-established—such as books, mass-marketed music CDs, and DVDs—have strong economic reasons to prevent user substitution. It is clear, however, that the copyright holders in these traditional media cannot use copyright law as a means to facilitate price discrimination or suppression of the secondary market. For example, Scholastic Books, an educational publishing company, “regularly sells paperback versions of children’s books to school markets at greatly reduced prices” in comparison to the prices in other retail outlets.<sup>58</sup> Scholastic labels these reduced-price versions with a notice on the back cover: “This edition is for distribution by schools only.”<sup>59</sup> This notice serves to discourage retailers “from buying these books from unscrupulous third parties because doing so reflects poorly on the retailers,” but it does nothing to “prevent purchasers from reselling their copies of books on eBay . . . or to used book stores.”<sup>60</sup> Thus, any control that Scholastic can wield over resale comes from a type of shaming built into industry norms, not from the tools of copyright law.

The movie industry has also found its desires to prevent user substitution inconvenienced by the first sale doctrine. This inconvenience has proven particularly acute with the advent of DVD rental “vending machines” such as those operated by Redbox. Redbox’s grocery store vending machines offer new-release rentals for \$1 per night almost immediately after the movies are first released for sale on DVD. Since “DVD sales historically have been how the studios earn a profit on movies,”<sup>61</sup> and sales traditionally did not have to compete with rentals until a certain period after the movie’s initial release on DVD, Redbox’s business model has made

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<sup>56</sup> U.S. COPYRIGHT OFFICE, DMCA SECTION 104 REPORT: A REPORT OF THE REGISTER OF COPYRIGHTS PURSUANT TO § 104 OF THE DIGITAL MILLENNIUM COPYRIGHT ACT, at 2021 (2001) (citing *Bobbs-Merrill Co. v. Strauss*, 210 U.S. 339, 350–51 (1908)).

<sup>57</sup> *Id.* at 21.

<sup>58</sup> Nancy S. Kim, *The Software Licensing Dilemma*, 2008 BYU L. REV. 1103, 1150 (2008).

<sup>59</sup> *Id.* (internal quotations omitted).

<sup>60</sup> *Id.*

<sup>61</sup> Dawn C. Chmielewski, *Redbox’s \$1 Vending-Machine Video Rentals Worry Studios*, L.A. TIMES, Mar. 30, 2009, at 2, available at <http://articles.latimes.com/2009/mar/30/business/fi-cotown-redbox30?pg=2>.



movie studios “[f]urious about a potential cannibalization of DVD sales.”<sup>62</sup> Because of the first sale doctrine, Redbox can stock its vending machines with freshly released DVDs that it purchases from wholesale and retail sellers. The movie studios seem to have accepted this application of the first sale doctrine and have not attempted to use copyright law to transform their DVD distributions to retailers and wholesalers into “licenses” with a prohibition on “sub-licensing” to Redbox.<sup>63</sup> Instead, the studios have looked to contractual mechanisms for dampening competition from Redbox.<sup>64</sup>

It is debatable whether price discrimination ultimately increases or decreases net social welfare.<sup>65</sup> Copyright law, however, simply does not facilitate price discrimination beyond the first sale. It is quite startling then, that UMG, Autodesk, and their amici in *Augusto* and *Vernor* continued to cling tightly to this price discrimination prevention rationale, which should be dismissed as a red herring. For example, Autodesk argued that “allowing copyright holders . . . to specify that the user is merely licensing the software copy . . . permits software developers to price their software differently for different markets.”<sup>66</sup> The SIIA’s amicus brief in *Vernor* mentioned software manufacturers’ desire to prevent “a university computer store employee or student ‘reselling’ academic-licensed titles as unrestricted consumer software.”<sup>67</sup> The RIAA’s amicus brief in *Augusto* pointed out that that record companies wanted to prevent promo CDs from being “tak[en] . . . out of the

<sup>62</sup> Brooks Barnes, *Movie Studios See a Threat in Growth of Redbox*, N.Y. TIMES, Sept. 6, 2009, at B1, available at <http://www.nytimes.com/2009/09/07/business/media/07redbox.html?r=1&adxnnl=1&adxnnlx=1269198514-GwElauUw9VWQ/eldAa+kVQ>.

<sup>63</sup> See Defendants’ Opening Brief in Support of Their Motion to Dismiss Complaint Pursuant to Rule 12(b)(6) at 15, *Redbox Automated Retail, LLC v. Home Entm’t, LLC*, No. 08-766 (RBK) (D. Del. Dec. 5, 2008) (noting that “there is no allegation that Universal has asserted or threatened any copyright claims against Redbox”).

<sup>64</sup> See, e.g., Alex Dobuzinskis, *Warner, Redbox Strike Deal on DVDs, Avert Lawsuit*, REUTERS, Feb. 16, 2010, at 1 (describing agreement under which Redbox cannot rent new Warner Brothers DVDs until 28 days after their release), available at <http://www.reuters.com/article/idUSN1623984420100216>; Sarah McBride, *Sony Pictures, Redbox Sign Movie Agreement*, WALL ST. J., July 21, 2008, at B6 (describing a deal in which Sony agrees to sell DVDs to Redbox but prohibits Redbox from selling used Sony DVDs to the public), available at <http://online.wsj.com/article/SB124813913097467201.html>.

<sup>65</sup> See, e.g., Fisher, *supra* note 44, at 27 (“In some specific settings, it will turn out that differential pricing is benign. . . . In other settings, discrimination will turn out to be malign.”).

<sup>66</sup> Appellant’s Opening Brief at 44, *Vernor v. Autodesk, Inc.*, No. 09-35969 (9th Cir. Jan. 5, 2010) [hereinafter *Autodesk’s Opening Brief*]; see also Appellant’s Reply Brief at 32, *Vernor v. Autodesk, Inc.*, No. 09-35969 (9th Cir. Feb. 26, 2010) [hereinafter *Autodesk’s Reply Brief*] (“Licensing permits different markets and users to obtain software at varying prices. . . . Different prices . . . can be charged for commercial users, students, educational institutions, and nonprofits . . . as appropriate.”).

<sup>67</sup> SIIA Amicus Brief, *supra* note 49, at 7.

hands of [music industry] insiders” because the industry places special value on those insiders due to their ability to generate publicity for the music.<sup>68</sup> The MPAA’s amicus brief points to the “negative economic impact of forcing copyright owners into single-price models of dissemination.”<sup>69</sup> These arguments are unpersuasive, given that copyright law is unsympathetic to similar claims that could be made by copyright holders in traditional media. There is no principled way to credit copyright holders’ desire to control user substitution when it comes to promo CDs and software CDs but not when it comes to books, mass-marketed CDs, and DVDs.<sup>70</sup>

### B. Preventing “User Proliferation”

The second of the copyright holders’ motivations, the need to prevent user proliferation, is entirely distinct from the desire to prevent user substitution. Preventing user proliferation *is* countenanced by—indeed fundamental to—copyright law. Proliferation requires reproduction, and a copyright holder’s reproduction right under § 106(1) is the “main purpose” of copyright law.<sup>71</sup> The reproduction right prevents one user from legally gaining access to a copyrighted work, copying it, and then keeping a copy or copies for himself while distributing the original copy to another user. Such a scenario could entirely undermine the Copyright Act’s ability to “promote the Progress of Science and useful Arts”<sup>72</sup> since others would be able to reap value from a copyright holder’s work without compensation to the copyright holder.

The content holders’ briefs in *Augusto* and *Vernor* repeatedly pointed to the problem of user proliferation. Autodesk argued that a ruling in its favor would help “protect[] against unauthorized reproductions of the software,”<sup>73</sup> noting that “software users can easily retain . . . the identical working copy of the software loaded on their computers, even after they transfer the physical medium.”<sup>74</sup> UMG’s opening brief similarly argued that treating promo CDs as licensed goods would help re-

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<sup>68</sup> RIAA Amicus Brief, *supra* note 49, at 17. One can view the music insiders as receiving a discounted (i.e. free) version of the CD because of their status, akin to students receiving discounted versions of software because of their status.

<sup>69</sup> MPAA Amicus Brief, *supra* note 49, at 20 (citations omitted).

<sup>70</sup> See Kim, *supra* note 58, at 1149 (“The pricing dilemma faced by software producers is no different from that faced by producers in other industries.”).

<sup>71</sup> U.S. COPYRIGHT OFFICE, *supra* note 56, at 21.

<sup>72</sup> U.S. CONST. art. I, § 8, cl. 8.

<sup>73</sup> Autodesk’s Opening Brief, *supra* note 66, at 48.

<sup>74</sup> Autodesk’s Reply Brief, *supra* note 66, at 28.

strict users from “making multiple, unlawful, digital copies or uploading a copy of the promotional CD to the [I]nternet to be made ‘virally’ and prematurely available to millions of computer users.”<sup>75</sup> The RIAA echoed in its amicus brief, “Because the [p]romotional CDs are digital copies, they can easily be reproduced as perfect physical or virtual copies. . . . [A] single upload of a ‘leaked’ [p]romotional CD to a peer-to-peer file sharing site, from which it could then be globally distributed, could be catastrophic.”<sup>76</sup> The MPAA’s amicus brief in *Vernor* argued that embracing the licensing regime helps copyright owners “limit[] unauthorized reproduction of their copyrighted works.”<sup>77</sup> These concerns are entirely consistent with the purposes behind the Copyright Act.

These arguments, however, must be considered in conjunction with the fact that the first sale doctrine embodies a certain level of risk tolerance for user proliferation. Consider the traditional media to which the first sale doctrine applies. When the original owner of a book is permitted to resell the book to a secondhand bookstore, some users may photocopy the entire book before reselling it. In practice, this may be an infrequent occurrence because it is generally rather time-consuming and labor-intensive to photocopy an entire book. The same rule applies, however, to mass-produced music CDs. The owner of a music album is permitted to resell it despite the possibility that some owners will burn copies of the CD—a very quick and inexpensive process—before doing so. Such infringing activity would probably be diminished if resale were altogether abolished, but in adopting the first sale doctrine, Congress made the judgment that the benefits of user substitution generally outweigh the costs of any user proliferation that occurs from abusing the doctrine.

In certain situations, Congress found that the abuses overshadow the legitimate uses of the first sale doctrine, and it responded by enacting specific exceptions to the doctrine. For example, Congress enacted the Record Rental Amendment of 1984 after recognizing that there was a “direct link between the commercial rental of a phonorecord and the making of a copy of the record without the permission of or compensation to the copyright owners.”<sup>78</sup> The House noted that, according to industry estimates at the time of the amendment, there were approximately 200

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<sup>75</sup> Appellant’s Opening Brief at 33, *UMG Recordings, Inc. v. Augusto*, No. 08-55998 (9th Cir. Dec. 18, 2008) [hereinafter *UMG’s Opening Brief*]; see also Appellant’s Reply Brief at 12, *UMG Recordings, Inc. v. Augusto*, No. 08-55998 (9th Cir. Feb. 25, 2009) [hereinafter *UMG’s Reply Brief*] (expressing concern about the “ease with which digital recordings can be and are copied and ‘virally’ distributed over the [I]nternet, and the resulting harm to copyright owners”).

<sup>76</sup> RIAA Amicus Brief, *supra* note 49, at 1516.

<sup>77</sup> MPAA Amicus Brief, *supra* note 49, at 1819.

<sup>78</sup> H.R. REP. NO. 98-987, at 1 (1984), reprinted in 1984 U.S.C.C.A.N. 2898, 2899.

commercial record rental stores in existence, which rented phonorecords for twenty-four to seventy-two hours for fees of \$0.99 to \$2.50 per album.<sup>79</sup> Tellingly, the stores would also offer blank cassette tapes for sale, and one store even advertised, “Never, ever buy another record.”<sup>80</sup> Similarly, the Computer Software Rental Amendments Act of 1990 was Congress’s response to a “concern that commercial rental of computer programs encourage[d] illegal copying of the rented programs, depriving copyright owners of a return on their investment and discouraging creation of new works.”<sup>81</sup> These two amendments, codified at §109(b) of the Copyright Act, now forbid the owner of a phonorecord or a copy of a computer program from renting, leasing, or lending it for commercial advantage.<sup>82</sup>

These exceptions may seem arbitrary. Why forbid the rental of phonorecords and software CDs, but not the rental of books and movies? Why forbid the rental but not the resale of phonorecords and software CDs? Determining when the abuse outweighs the benefit for a particular type of media and a particular kind of transaction is a judgment that the legislature is suited to make based on data and other evidence. When that determination *is* made, the remedy to the problem is conceptualized as a carveout, an amendment to existing law, rather than an interpretation of it, so a court would seem to lack the authority to institute this kind of remedy. Congress has determined that the abuse outweighs the benefit with respect to the rental of phonorecords and software CDs, but not with respect to resale of the same types of media or to the rental of other types of media such as books and movies.

### C. The Answer Consistent with the Goals of Copyright Law

To summarize, the content holders’ arguments in *Augusto* should be separated into two prongs. The first prong, the anti-user-substitution argument, should be disregarded because it contradicts the purposes of the first sale doctrine. The second prong, the anti-user-proliferation argument, articulates a concern that is consistent with the purposes of the Copyright Act; however, it is in tension with the first sale doctrine’s willingness to tolerate some level of abuse in order to promote user sub-

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<sup>79</sup> *Id.*

<sup>80</sup> *Id.* (internal quotations omitted).

<sup>81</sup> U.S. COPYRIGHT OFFICE, REPORT ON COMPUTER SOFTWARE RENTAL AMENDMENTS ACT OF 1990: THE NONPROFIT LIBRARY LENDING EXEMPTION TO THE “RENTAL RIGHT,” \*1 (1994), available at [http://www.copyright.gov/reports/software\\_ren.html](http://www.copyright.gov/reports/software_ren.html).

<sup>82</sup> 17 U.S.C. § 109(b)(1)(A) (2006) (“[N]either the owner of a particular phonorecord nor any person in possession of a particular copy of a computer program (including any tape, disk, or other medium embodying such program), may, for the purposes of direct or indirect commercial advantage, dispose of, or authorize the disposal of, the possession of that phonorecord or computer program (including any tape, disk, or other medium embodying such program) by rental, lease, or lending, or by any other act or practice in the nature of rental, lease, or lending.”).

stitution. Only Congress can determine when the abuse becomes so severe as to warrant enacting a carveout to the first sale doctrine.

### 1. *Promo CDs*

In light of these observations, *Augusto* presents an easy question. The transfer of promo CDs should be treated as transfers of ownership protected by the first sale doctrine. While UMG and its amici were rightly concerned that promo CDs will be illegally copied, resulting in user proliferation, this concern is no more compelling than it is for mass-marketed CDs. Congress simply has not deemed the potential user proliferation of mass-marketed music CDs sufficiently worrisome to warrant amending the first sale doctrine, and promo CDs seem to be no different. Therefore, just like copyright holders of content in traditional media, UMG and other producers of promo CDs must use their exclusive *reproduction* right as the means to go after those who actually engage in copying before selling the original CD. Producers should not be allowed to avoid the first sale doctrine and use their exclusive *distribution* right to bar all users from transferring promo CDs, regardless of whether the user has actually copied any of the content.

### 2. *Software CDs*

Software CDs, however, present a more difficult question, though the difference may not be readily apparent. In theory, the following kind of software transaction *should* be permitted, consistent with the first sale doctrine: User A pays for a software CD and uses it. When she decides that she no longer wants to use the software, User A should be free to sell the software CD to User B, *assuming* that User A no longer retains her ability to use the software. Forbidding this kind of transaction under copyright law would be contrary to the user substitution policies of the first sale doctrine. At first, this software transaction seems analogous to transactions in other media under the first sale doctrine: if User A bought a CD of Lady Gaga's "The Fame Monster," she should be able to sell it to User B once she tires of the album. We assume that User A has not copied the album onto another CD, her hard drive, or her iPod; if she has, she would be liable for copyright infringement under 17 U.S.C. § 106(1).<sup>83</sup>

The problem arises from the fact that copyright law currently contains a loophole that permits user proliferation when it comes to software CDs. Section 117(a)(1), the "essential step" exemption from a software copyright holder's reproduction right, permits "the *owner* of a copy of a computer program to make . . . another copy . . . of that computer program provided . . . that such a new copy . . . is

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<sup>83</sup> 17 U.S.C. § 106(1) (2006) ("[T]he owner of copyright under this title has the exclusive rights to do and authorize . . . reproduc[ti]on of] the copyrighted work in copies or phonorecords.").

created as an *essential step* in the utilization of the computer program in conjunction with a machine.”<sup>84</sup> Both § 109 and § 117 use the word “owner,” and it has generally been assumed that the meaning of the word is the same for both provisions.<sup>85</sup> Thus, whenever the first sale doctrine applies to a software CD, § 117 also applies.<sup>86</sup> It is also generally accepted that an “essential step” under § 117 includes the copying of the software from the CD to the hard drive of a computer.<sup>87</sup>

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<sup>84</sup> 17 U.S.C. § 117(a)(1) (2006) (emphasis added).

<sup>85</sup> See *Vernor v. Autodesk, Inc.*, No. C07-1189RAJ, 2009 U.S. Dist. LEXIS 90906, at \*37–38 (W.D. Wash. Sept. 30, 2009) (“The court has already noted the presumption that identical terms within the same statute have the same meaning. At least in their briefs, Mr. Vernor and Autodesk agree that the phrases ‘owner of a copy’ in § 117 and ‘owner of a particular copy’ in § 109 have the same meaning. . . . A more detailed review of the legislative history, moreover, strongly suggests that ‘owner’ has the same meaning in § 117 and § 109.”); cf. NIMMER & NIMMER, *supra* note 5, § 8.08[B][1][c] (noting that the significance of distinguishing “between copyright ownership and ownership of the physical good in which the work of authorship is embodied is not limited to Section 117. Cases have misconstrued copyright’s first sale doctrine on the same basis”); see generally U.S. COPYRIGHT OFFICE, *supra* note 56, at v (discussing “the relationship between existing and emergent technology and the operation of sections 109 and 117” without mentioning any distinction between “owner” as used in § 109 and “owner” as used in § 117).

<sup>86</sup> *But see MDY Indus., LLC v. Blizzard Entm’t, Inc.*, No. CV-06-2555-PHX-DGC, 2008 U.S. Dist. LEXIS 53988, at \*30 (D. Ariz. July 14, 2008). MDY involved a § 117 defense but not a first sale defense to software manufacturer Blizzard’s copyright infringement claim. In granting summary judgment for Blizzard, the court refused to consider case law on the meaning of “ownership” in the context of first sale doctrine and considered only case law on the meaning of ownership in the context of § 117. See *id.* at \*30 (“The Court is not free to disregard Ninth Circuit precedent directly on point.”). Nevertheless, commentators have grouped MDY with *Vernor* and *Augusto* in discussing the sale-versus-license issue, and the Ninth Circuit heard oral argument in MDY on the same day as it heard oral arguments in *Vernor* and *Augusto*. Notice of Oral Argument on June 7th Calendar, MDY Indus., LLC v. Blizzard Entm’t, Inc. (9th Cir. Apr. 29, 2010). This paper, however, does not discuss MDY elsewhere because MDY does not present the user substitution and user proliferation concerns in as high relief as *Vernor* and *Augusto*. Unlike *Vernor* and *Augusto*, who wanted to buy and sell copies of compact discs, the defendant in MDY wants a form of access to the copyrighted software. The defendant manufactures a “bot,” a software program that plays Blizzard’s copyrighted computer game for its owner while the owner is away from his computer, *id.* at \*4, which entails copying the computer game from the hard drive to the computer’s random access memory, *id.* at \*10.

<sup>87</sup> See, e.g., *Vault Corp. v. Quaid Software Ltd.*, 847 F.2d 255, 261 (5th Cir. 1988) (“Congress recognized that a computer program cannot be used unless it is first copied into a computer’s memory, and thus provided the § 117(1) exception to permit copying for this essential purpose.”); *Madison River Mgmt. Co. v. Bus. Mgmt. Software Corp.*, 387 F. Supp. 2d 521, 538 (M.D.N.C. 2005) (A “copy made by the very act of installing a program into a computer . . . is privileged.”); NIMMER & NIMMER, *supra* note 5, § 8.08[B][1][b] (“[C]opying navigation software off of CD-ROMs to the hard drive, in order to access more quickly the vast data stored on the CD-ROM, is essential to efficient operation. Given that efficiency lies at the heart of the rationale for computerization in the first place, to forbid such practices—or to limit them to instances in which the copyright owner has explicitly licensed them—represents an impoverished view of users’ rights under Section 117. The trend is to read Section 117 broadly.”) (internal quotations and citations omitted); Robert A. Kreiss, *Section 117 of the Copyright Act*, 1991 BYU L. REV. 1497, 1527 (1991) (“[I]n installing a program on the user’s hard drive is virtually indispensable for efficient use. This is

Therefore, if User A sells her copy of a software CD and yet, retains a copy installed on her hard drive, there seems to be no way to penalize her for the § 117-sanctioned copy on her hard drive. Unlike the music studios, who could at least theoretically use their § 106(1) reproduction right against the user who had copied “The Fame Monster” onto her computer or iPod before selling the album, the copy-right holder of the content of a software CD cannot do so because of § 117. Therefore, software CDs and music CDs are different. Subjecting software CDs to the first sale doctrine, in conjunction with § 117, would mean that user proliferation would be explicitly sanctioned by the Copyright Act. In contrast, with music CDs (of either the mass-produced or promotional variety), no user proliferation can occur as long as consumers do not engage in infringing reproductions of the content. If the first sale doctrine can be consistent with the rest of the Copyright Act only because of the premise that the doctrine does not facilitate proliferation in the absence of consumers’ misbehavior, this fundamental premise is lacking when it comes to transactions involving software CDs.

Surprisingly, Autodesk’s briefing in *Vernor* draws scant attention to this problem. Autodesk does allude to the possibility that user proliferation has occurred, pointing out that “Vernor stated in his eBay listing for these packages that ‘[t]his software is not currently installed on any computer,’ but he did not know whether or not that was true.”<sup>88</sup> The MPAA’s amicus brief in *Vernor* described the problem more explicitly, albeit in a footnote. The MPAA stated that if Vernor was deemed the owner of the AutoCAD CDs,

Vernor could argue that as an owner of the particular copy he could make copies of the Autodesk software as an essential step in the utilization of that software, as could a person that purchases the software from Vernor, who could then give the software to a friend, who could also copy the software, and so on, *ad infinitum*. The net effect of such a scenario would be that Autodesk would have “sold” one copy of the software, and yet the software could be reproduced by multiple transferees, leaving Autodesk with no remedy or ability to stop the copying.<sup>89</sup>

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known by both users and copyright owners. Therefore, as a matter of practical reality this practice falls within the conduct permitted under § 117(1).”).

<sup>88</sup> Autodesk’s Opening Brief, *supra* note 66, at 14; see also Autodesk’s Reply Brief, *supra* note 66, at 28 n.17 (“Vernor, in fact, admitted that he did not know whether CTA had kept copies of the AutoCAD R14 software on its computers.”).

<sup>89</sup> MPAA Amicus Brief, *supra* note 49, at 22 n.11.

In *Augusto*, UMG has also recognized this point, noting that “[t]he owner of computer software has the right to make a copy to use it on a computer” because of § 117.<sup>90</sup>

The *Vernor* court did not grapple much with the user proliferation problem that results from § 117 and the first sale doctrine. The court rightly realized that completely exempting the AutoCAD CDs from the first sale doctrine would lead to the problematic result of foreclosing user substitution in the absence of user proliferation. It observed that “even if CTA had never opened its AutoCAD packages [and] never installed the software on its computer, . . . Autodesk would still take the position that CTA’s resale of those packages was a copyright violation,” a position which made the court uncomfortable.<sup>91</sup> At summary judgment, the court indeed assumed that Vernor had not installed the software on any of his own computers.<sup>92</sup> While recognizing these reasons why it would be problematic *not* to apply the first sale doctrine, the court did not address the user proliferation problems that can result from allowing the first sale doctrine to apply. The court did not explain if or why its ruling should still hold if there was evidence that Vernor had used the CDs to install AutoCAD on his computer before auctioning them on eBay. The court also did not seem troubled by the fact that CTA, the firm that had sold the CDs to Vernor, *had* installed the CDs on its computers and sold the CDs after it had received an “enormous discount” on its upgrade to the next generation of AutoCAD.<sup>93</sup>

The preceding analysis of why it is more problematic to apply the first sale doctrine to software CDs than to promo CDs is based on the assumption that copyright law forbids the copying of the promo CDs under § 106(1) but permits the copying of software CDs onto hard drives under § 117. While these assumptions are generally accepted, they admittedly are not entirely settled. One commentator noted that while the RIAA currently appears to take the position that it is infringement for a consumer to copy music from his CD onto a hard drive, mp3 player, or backup CD, the RIAA had previously argued that such copies are permissible.<sup>94</sup> As

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<sup>90</sup> UMG’s Opening Brief, *supra* note 75, at 36.

<sup>91</sup> *Vernor v. Autodesk, Inc.*, No. C07-1189RAJ, 2009 U.S. Dist. LEXIS 90906, at \*46 (W.D. Wash. Sept. 30, 2009).

<sup>92</sup> *Id.* at \*3 (“There is no evidence . . . that Mr. Vernor used AutoCAD software himself, or even installed it on his computer.”).

<sup>93</sup> *Id.* at \*14 (explaining that the next generation of AutoCAD software “retailed for \$3750, but sold for \$495 as an upgrade”).

<sup>94</sup> Eliyahu R. Babad, *So You’re an Attorney; Tell Me: Can I Backup My CDs Without Being Sued?*, FORDHAM INTELL. PROP. MEDIA & ENT. LAW BLOG, May 14, 2008, <http://iplj.net/blog/archives/135> (“The RIAA used to say that that any copying of copyrighted music onto your personal computer was infringement. It did not matter why or for what purposes you were making the copy. . . .



for software CDs, one court has held that “[t]he copy authorized by Section 117 . . . must be destroyed when the original copyrighted work is resold.”<sup>95</sup> If one takes seriously the possibility that a consumer copying a promo CD onto her hard drive is not infringement, and that § 117 somehow bars the consumer from retaining a hard drive copy of software if she sells the CD that the copy came from, then the implications of applying the first sale doctrine to promo CDs versus software CDs would converge. These views, however, seem difficult to derive from the plain text of the statute. Therefore, such wrinkles notwithstanding, it seems that under prevailing understandings of § 106 and § 117, it is reasonable to expect that the first sale doctrine will affect promo CDs and software CDs differently, as it would result in legally sanctioned user proliferation for only the latter.

### Part III: The Legal Tests: The *Wise* Test Is Wiser

Part II explored what outcomes are consistent with the policies underlying the first sale doctrine and copyright law in general. Under this approach, the promo CDs at issue in *Augusto* should be treated as transfers of ownership. For the software CDs at issue in *Vernor*, however, neither pole of the license-versus-sale dichotomy offers an answer that fully harmonizes with the policies underlying copyright law. Calling transfers of software CDs licenses undermines the first sale doctrine’s user substitution policies. Calling such transfers sales introduces a user proliferation problem that runs counter to the purposes of copyright law, a problem that does not arise in the context of books, music CDs, videos, and DVDs.

Part III, turning away from the policy-based analysis, takes a narrower approach and examines the merits of the specific legal tests proffered in *Augusto* and *Vernor*. The Ninth Circuit has taken a variety of approaches to differentiating between licenses and sales. The *Vernor* court focused primarily on four Ninth Circuit cases—*United States v. Wise*,<sup>96</sup> *MAI Systems Corp. v. Peak Computer, Inc.*,<sup>97</sup> *Triad Systems Corp. v. Southeastern Express Co.*,<sup>98</sup> and *Wall Data Inc. v. Los Angeles*

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Somewhere along the way they changed their position. The RIAA now states on their website that the record companie[s] have ‘never’ objected to copies for personal use. . . . [But] [i]n reply comments to proposed rules from the U.S. Copyright Office, the RIAA . . . stated ‘creating a back-up copy of a music CD is not a non-infringing use[.]’ Once again, the recording industry is fairly clearly stating that the RIAA takes the position that it is illegal to make these back-ups of your own CDs.”).

<sup>95</sup> *Apple Computer, Inc. v. Formula Int’l, Inc.*, 594 F. Supp. 617, 622 (C.D. Cal. 1984).

<sup>96</sup> 550 F.2d 1180 (9th Cir. 1977).

<sup>97</sup> 991 F.2d 511 (9th Cir. 1993).

<sup>98</sup> 64 F.3d 1330 (9th Cir. 1995) *overruled in part on other grounds by* *Gonzales v. Texaco Inc.*, 344 F. App’x 304 (9th Cir. 2009).

*County Sheriff's Department*<sup>99</sup>—and found that these cases constitute “two sets of conflicting precedent.”<sup>100</sup> There is the *Wise* test, and alternatively there is the approach taken by the other three cases, which I will refer to as the *Wall Data* test. The *Augusto* court relied mainly on yet another Ninth Circuit case, *Microsoft Corp. v. DAK Industries, Inc. (In re DAK)*,<sup>101</sup> but *In re DAK*'s approach is fundamentally similar to, and can be discussed along with, the *Wise* test.

Part III argues that the *Wise* test is the superior legal test for resolving the license-versus-sale question because it is more faithful to common law concepts of ownership and is more workable. The *Wall Data* test, in contrast, is flawed because it is circular in its reasoning, and if it were applied in a principled manner, it would make the first sale doctrine vanish altogether.

#### A. The *Wise* Test

*United States v. Wise* involved a prosecution for willful copyright infringement against Woodrow Wise, who had attempted to sell 16 and 35 mm films of copyrighted feature-length movies.<sup>102</sup> In defense, Wise contended that the movie studios routinely distributed the films at issue as sales, thus subjecting the films to the first sale doctrine.<sup>103</sup> The court therefore analyzed the terms of several types of agreements through which the studios had distributed the films to determine whether the transactions were sales or licenses.<sup>104</sup> These included movie studios' agreements with theaters, the military, hotels, television networks, and actors.<sup>105</sup>

*Wise* noted various characteristics of the agreements in its analysis, including whether the movie studio retained title, whether the agreement required the recipient of the film to destroy the transferred copies, and whether the recipient paid a single upfront payment for the film.<sup>106</sup> The *Vernor* court observed, however, that none of those factors proved dispositive.<sup>107</sup> In contrast, there was a single charac-

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<sup>99</sup> 447 F.3d 769 (9th Cir. 2006).

<sup>100</sup> *Vernor v. Autodesk, Inc.*, No. C07-1189RAJ, 2009 U.S. Dist. LEXIS 90906, at \*36 (W.D. Wash. Sept. 30, 2009).

<sup>101</sup> 66 F.3d 1091 (9th Cir. 1995).

<sup>102</sup> *United States v. Wise*, 550 F.2d 1180, 1183–84 (9th Cir. 1977).

<sup>103</sup> *Id.* at 1190.

<sup>104</sup> *Id.* at 1190–92.

<sup>105</sup> *Id.*

<sup>106</sup> *Id.*

<sup>107</sup> *Vernor v. Autodesk, Inc.*, No. C07-1189RAJ, 2009 U.S. Dist. LEXIS 90906, at \*17–19 (W.D. Wash. Sept. 30, 2009).

teristic that appeared *only* in agreements that *Wise* deemed to be a transfer of ownership: “In each instance in which the transferee could, at his election, retain possession of the transferred copy indefinitely, and the copyright holder had no right to regain possession, [*Wise*] found an ownership transfer.”<sup>108</sup> The *Vernor* court therefore regarded this characteristic as dispositive and held that “*Wise* leads to the conclusion that the transfer of AutoCAD copies . . . is a transfer of ownership.”<sup>109</sup> It likened Autodesk’s “license terms” accompanying the AutoCAD CDs to one of the agreements in *Wise*.<sup>110</sup> That agreement also “purported to reserve title in the copy to the copyright holder” and “severely restrict[ed] the use and transfer of the copy,” but did not require the transferee to surrender possession at any point and was deemed to be a sale despite the restrictions in the agreement.<sup>111</sup>

The court’s analysis in *Augusto* noted an “economic realities” test, citing a bankruptcy case, *Microsoft Corp. v. DAK Industries, Inc. (In re DAK)*, but it ended up relying largely on the *Wise* test.<sup>112</sup> Under *In re DAK*, “the fact that [an] agreement labels itself a ‘license’ . . . does not control [the] analysis,” and the court looks instead to indicators of the “economic realities” of the transaction.<sup>113</sup> The *Augusto* court found that a “hallmark” of a license is the owner’s intent to gain repossession, citing *Wise*, and concluded that *Augusto* was protected by the first sale doctrine.<sup>114</sup>

Since the Copyright Act does not define “owner” or “ownership,” one should look to common law and ordinary meanings and understandings of these words.<sup>115</sup>

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<sup>108</sup> *Id.* at \*20–21.

<sup>109</sup> *Id.* at \*22.

<sup>110</sup> *Id.* at \*23.

<sup>111</sup> *Id.* at \*22–23.

<sup>112</sup> *UMG Recordings, Inc. v. Augusto*, 558 F. Supp. 2d 1055, 1060 (C.D. Cal. 2008).

<sup>113</sup> *Id.* at 1060 n.2.

<sup>114</sup> *Id.* *Augusto* also pointed to two other factors that it found indicative of a sale. It found that “[t]he [a]bsence of a [r]ecurring [b]enefit to UMG [s]uggests the [t]ransfer to [m]usic [i]ndustry [i]nsiders [i]s a [g]ift or [s]ale.” *Id.* at 1061 (emphasis omitted). This point is somewhat related, however, to *Wise*’s emphasis on the duration of the recipient’s possession. It drew on *In re DAK*’s observation that most rental arrangements entail recurring benefits to the lessor because payment is typically calculated based on “the duration of the ‘use’ of the property.” *Microsoft Corp. v. DAK Indus., Inc.*, 66 F.3d 1091, 1095 (9th Cir. 1995). The final factor that *Augusto* found indicative of a transfer of ownership was that the only apparent benefit to UMG of treating the transfer of promo CDs as licenses is to restrain trade. *Augusto*, 558 F. Supp. 2d at 1061.

<sup>115</sup> See Rothchild, *supra* note 45, at 17 (“The Copyright Act does not contain a definition of ‘owner’ or ‘ownership,’ and the primary source of legislative history, the 1976 House Report, is not helpful. We must therefore assume that Congress intended the ordinary meaning of the term, taking account of the context and purposes of the statute. State common law may serve as a source of this ordinary meaning. However, a[s] common law ownership is not a well-defined concept . . . reliance upon the non-technical meaning of the term is unavoidable.”) (internal citations omitted).

The *Wise* test comports with common understandings of ownership. The definition of “ownership” in *Black’s Law Dictionary* includes the statement that “[o]wnership rights are . . . permanent.”<sup>116</sup> The entry for “lease,” on the other hand, refers to a “lease term [which] can be for life, for a fixed period, or for a period terminable at will.”<sup>117</sup> *The Uniform Commercial Code* also distinguishes between sales (governed by UCC Article 2) and leases (governed by UCC Article 2A).<sup>118</sup> Corinne Cooper states that one of the “basic assumptions” about how a sale and a lease differ is that “in an unconditional sale, the buyer gets to keep the goods,” whereas “in a lease, the lessor gets the goods back.”<sup>119</sup> Courts have observed that one indication that a transaction is really a sale and not a lease is if the supposed “lessor’s known practice is not to bother with reclaiming the used goods.”<sup>120</sup> A bankruptcy court clarified the term “lease”: “By definition, a lease is an arrangement whereby the use of property is temporarily reserved to one who is not the owner of the property. When the lease term ends, the lessor thereafter ‘can do as he pleases with his property.’”<sup>121</sup> These traditional understandings of ownership with respect to other physical goods has led Reese to conclude that “[i]f the consumer essentially obtains permanent dominion over the physical object that is the copy, the transaction should probably . . . be characterized as a sale.”<sup>122</sup> Rothchild similarly declared that the “critical question is whether the ‘licensee’ of the CD-ROM or floppy diskette has to give it back during its useful life: if not, the transaction is a sale, and the acquirer is the ‘owner’ of the software copy for purposes of sections 109(a) and 117(a).”<sup>123</sup>

The most compelling argument against the *Wise* test that the content holders have raised in *Augusto* and *Vernor* is that the return requirement is “pointless and

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<sup>116</sup> BLACK’S LAW DICTIONARY 1131 (7th ed. 1999) (emphasis added).

<sup>117</sup> *Id.* (emphasis added).

<sup>118</sup> U.C.C. §§ 2, 2A (2007).

<sup>119</sup> Corinne Cooper, *Identifying a Personal Property Lease Under the UCC*, 49 OHIO ST. L.J. 195, 203 (1988); see also Rothchild, *supra* note 45, at 19 (“In a lease or other bailment, the acquirer must return the copy at some point. In a sale-with-restrictions, on the other hand, the acquirer may keep the copy indefinitely, or destroy it with impunity. In ordinary understanding, if you are the ‘owner’ of some item you are free to treat it as badly as you like, and are under no obligation to return it.”).

<sup>120</sup> *Hill v. Bentco Leasing, Inc.*, 708 S.W.2d 608, 610 (Ark. 1986).

<sup>121</sup> *Woodson v. Tom Bell Leasing*, 58 B.R. 379, 385 (Bankr. N.D. Okla. 1986) (quoting *Adelman v. Gen. Motors Acceptance Corp.*, 4 B.R. 801, 805 (Bankr. N.D. Okla. 1980) (emphasis added)).

<sup>122</sup> Reese, *supra* note 55, at 645 (emphasis added).

<sup>123</sup> Rothchild, *supra* note 45, at 35.

inefficient.”<sup>124</sup> Why should a copyright holder be able to transform its distributions of CDs from sales into licenses simply by, but *only* by, requiring users to return the physical discs? As Autodesk stated, “the physical media has almost no value . . . independent from the software contained on the media,” and it would be “economically nonsensical” to require customers to return the CDs, generating postage and processing costs.<sup>125</sup> Similarly, UMG stated that it would be “logistically difficult, expensive, and time consuming” to seek return of its promo CDs, “only to arrange for and pay for their destruction.”<sup>126</sup> Autodesk and UMG argued that instead of incurring such wasteful expenses, their license terms stipulating non-transferability should have the same legal effect of making their transactions licenses.<sup>127</sup>

But a non-transferability requirement and a return requirement do not achieve the same result. Requiring returns proves that a copyright holder intends for the consumer to possess the work for a limited period of time. A non-transferability requirement permits a user to retain the work indefinitely. If duration of possession is the substantive “hallmark” that distinguishes between a license and a sale, a non-transferability clause would not be enough to classify the transaction as a license. It might be more compelling if, rather than prohibiting transfers, the shrinkwrap terms instead required the user to destroy the work after a specified period of time. This scenario is still problematic, however, in that one would question whether the copyright holder was serious about imposing temporal limitations if it did not plan to enforce them. Moreover, UMG candidly admits that it does not want to impose temporal limitations on its recipients because it hopes that the recipients will use the music repeatedly over time (for example, to write reviews of a subsequent album by the same artist or to play the music in a club or on the radio).<sup>128</sup>

Additionally, Autodesk and UMG’s argument is problematic. If shrinkwrap terms forbidding transfers could be sufficient to establish that a transaction is a license rather than a sale, there is no reason that copyright holders in traditional media could not do this as well. It is hard to imagine what would prevent a book publisher or movie studio from imposing similar terms for its products, enabling them to avoid the first sale doctrine as well.

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<sup>124</sup> Autodesk’s Opening Brief, *supra* note 66, at 46.

<sup>125</sup> Autodesk’s Reply Brief, *supra* note 66, at 29–30, 30 n.19.

<sup>126</sup> UMG’s Opening Brief, *supra* note 75, at 6.

<sup>127</sup> *See id.*; Autodesk’s Reply Brief, *supra* note 66, at 29–30, 30 n.19.

<sup>128</sup> UMG’s Opening Brief, *supra* note 75, at 6.

### B. The *Wall Data* Test

A non-transferability clause is central to the *Wall Data* test, the test that Autodesk and UMG embrace in their appellate briefs.<sup>129</sup> The *Vernor* court treated *Wall Data* as part of the “MAI trio,”<sup>130</sup> grouping it with two earlier cases that had readily accepted the distribution of software as licenses. However, *Wall Data* provided the most thorough articulation of the legal test: “Generally, if the copyright owner makes it clear that she or he is granting only a license to the copy of software and imposes significant restrictions on the purchaser’s ability to redistribute or transfer that copy, the purchaser is considered a licensee, not an owner, of the software.”<sup>131</sup> In *Wall Data*, the court found that the defendant could not invoke § 117 because the agreement under which the defendant acquired its software CDs contained “severe restrictions,” making it a licensee, not an owner.<sup>132</sup> The transfer of promo CDs in *Augusto* and of the Autodesk CDs in *Vernor* would certainly be licenses under the *Wall Data* test, given the restrictions on transfers contained in notices conveyed with the CDs. As the *Vernor* court acknowledged, under the *Wall Data* test, “[T]he court would have to conclude that the Autodesk License did not transfer ownership of any software copy.”<sup>133</sup>

The *Wall Data* approach, however, is flawed because it uses circular reasoning. If the purpose of asking whether someone is an “owner” is to determine whether he is entitled to alienate his goods against the copyright holder’s wishes, it does not make sense to look to whether he is restrained in his ability to alienate his goods to determine whether he is an “owner.” If the *Wall Data* test was adopted

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<sup>129</sup> See *id.* at 14–17; UMG’s Reply Brief, *supra* note 75, at 3–12; *id.* at 11 (“The resolution of the issue here is controlled by this Court’s precedent . . . as confirmed by *Wall Data*.”); Autodesk’s Opening Brief, *supra* note 66, at 25–32; Autodesk’s Reply Brief, *supra* note 66, at 4 (“*Wall Data* is the controlling case.”).

<sup>130</sup> See *Vernor v. Autodesk, Inc.*, No. C07-1189RAJ, 2009 U.S. Dist. LEXIS 90906, at \*16 (W.D. Wash. Sept. 30, 2009). The other two cases in the “MAI trio” are *MAI Systems Corp. v. Peak Computer, Inc.*, 991 F.2d 511 (9th Cir. 1993) and *Triad Systems Corp. v. Se. Express Co.*, 64 F.3d 1330 (9th Cir. 1995), *overruled in part on other grounds by* *Gonzales v. Texaco Inc.*, 344 F. App’x 304 (9th Cir. 2009). In *MAI*, the court found that the defendant computer repair company infringed the plaintiff’s copyright in its software programs when the defendant performed repairs that entailed copying the software onto random access memory. The court stated, without any other analysis on the issue, that “[s]ince MAI licensed its software, [its] customers do not qualify as ‘owners’ of the software and are not eligible for protection under § 117.” *MAI*, 991 F.2d at 519 n.5. In *Triad*, the court similarly found that the defendant computer repair company infringed plaintiff’s copyright in its software programs because the software was licensed, not sold. See *Triad*, 64 F.3d at 1333. As in *MAI*, the court in *Triad* accepted the copyright holder’s labeling of the transaction as a “license” without further analysis. See *id.*

<sup>131</sup> *Wall Data Inc. v. Los Angeles Sheriff’s Dep’t.*, 447 F.3d 769, 785 (9th Cir. 2006).

<sup>132</sup> *Id.*

<sup>133</sup> *Vernor*, 2009 U.S. Dist. LEXIS 90906 at \*32.

and applied to traditional media—again, there seems to be no principled way to limit this rule to software or promo CDs—it would virtually eviscerate the first sale doctrine. Content holders would be able to simply contract around the first sale doctrine by giving sufficiently prominent and clear notice that a consumer only “licenses,” rather than “buys,” their product. A book publisher or movie studio could label its products with notices akin to those in *Augusto* and *Vernor*: “[This product] is *licensed* to the intended recipient for personal use only. Acceptance of this [product] shall constitute an agreement to comply with the terms of the *license*. Resale or transfer of possession is not allowed.”<sup>134</sup> Autodesk hastily dismissed this possibility, contending that it is inconsistent with the business models of other media industries,<sup>135</sup> but there is evidence to the contrary. For example, the bar exam preparation company, BarBri, currently uses a form contract that attempts to characterize its distribution of instructional materials as “leases,” presumably in an attempt to prevent downstream user substitution and thus boost enrollment in its courses.<sup>136</sup> Though such notices may be sufficient to create valid contracts between the copyright holder and the first recipient of a copy his work,<sup>137</sup> the legislative history of § 109 indicates that Congress did not intend for parties to be able to contract around the first sale doctrine.<sup>138</sup> The House stated that the existence of the first sale doctrine “does not mean that conditions on future disposition of copies or phonorecords, imposed by a contract between their buyer and seller, would be unenforceable between the parties as a breach of contract, but it does mean that *they could not be enforced by an action for infringement of copyright*.”<sup>139</sup> In other words, Autodesk should be able to bring a breach of contract claim against CTA for selling the AutoCAD CDs to Vernor, but it should not be able to assert a copyright claim

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<sup>134</sup> *UMG Recordings, Inc. v. Augusto*, 558 F. Supp. 2d 1055, 1058 (C.D. Cal. 2008) (emphasis added).

<sup>135</sup> Autodesk’s Reply Brief, *supra* note 66, at 29 (asserting that “there is no evidence . . . to suggest any realistic risk that [book publishers] will suddenly attempt to destroy the secondary market for used books . . . by using shrinkwrap licenses prohibiting resale”).

<sup>136</sup> BarBri, Agreement for California Bar Review Course, Mar. 24, 2010, on file with author, at ¶ 4(a) (stating that BarBri’s instructional materials “shall remain the sole property of BAR/BRI throughout the period of ENROLLEE’S use and possession. Said materials are not offered for sale by BAR/BRI under the terms of this agreement”).

<sup>137</sup> *See, e.g., ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447, 1449 (7th Cir. 1996); Kim, *supra* note 58, at 1126 (“[M]any courts have held that ‘assent occurs when the customer, after purchasing and possessing the product, opens the shrinkwrap, notices the paper agreement contained therein, and declines to return the product. . . . Cases discussing browsewrap agreements have generally held them enforceable if the user had notice of their existence.’”).

<sup>138</sup> *See* H.R. REP. NO. 94-1476, at 79 (1976).

<sup>139</sup> *Id.* (emphasis added).

against CTA or against a downstream purchaser such as Vernor. Accepting the *Wall Data* test would strip this distinction of significance.

#### Part IV: What Next? Congressional Action, or Self-Cure by the Industry?

If courts ultimately find that software CDs and promo CDs are subject to the first sale doctrine, what recourse is available to copyright holders in these industries? The copyright holders can lobby Congress to amend the Copyright Act as it did with the Record Rental Amendment Act of 1984 and Computer Software Rental Amendments Act of 1990.<sup>140</sup> However, music studios would probably have difficulty demonstrating why their promo CDs should be treated differently than mass-marketed music CDs. Software manufacturers, on the other hand, may have a more compelling case to differentiate software CDs from mass-marketed music CDs. In addition to the § 117 loophole, there are other plausible reasons why software *should* be treated differently than other copyrighted media. One possible reason is that users are simply more tempted to pirate software because it is typically more expensive than other types of copyrighted works. When contemplating a \$100+ software package, in contrast to a music album that costs around \$15, consumers' moral hesitations about copyright infringement may be more likely to yield to their desire to save money. Another possible difference is that software manufacturers have reasons to engage in a wider range of price discrimination than traditional media industries. Perhaps facilitating price discrimination in software does result in greater net social efficiency.

If software CDs are subject to the first sale doctrine, software manufacturers are likely to respond by distributing more of their content by direct download from the Internet, rather than by physical compact disks. The transition to Internet distribution of software is already substantially underway. For example, Microsoft has made its Office 2010 suite available for download online.<sup>141</sup> Moreover, it charges up to 30% less for the downloaded version than for the CD version, leading some to predict that it "will ultimately help turn boxed software into an endangered species."<sup>142</sup> Some software is now available via "cloud computing," which refers to accessing "software and data *on* the Internet (a.k.a., the cloud) instead of on your hard drive."<sup>143</sup> As one reporter stated, "Ten years ago if you wanted to do some-

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<sup>140</sup> See 17 U.S.C. § 109 (2006).

<sup>141</sup> Buy Microsoft Office 2010, <http://office.microsoft.com/en-us/buy/?CTT=97> (last visited July 15, 2010).

<sup>142</sup> Preston Gralla, *Office 2010 Will Speed Demise of Boxed Software*, PCWORLD, Jan. 5, 2010, at 1, available at [http://www.pcwORLD.com/article/185954/office\\_2010\\_will\\_speed\\_demise\\_of\\_boxed\\_software.html](http://www.pcwORLD.com/article/185954/office_2010_will_speed_demise_of_boxed_software.html).

<sup>143</sup> Brian Braiker, *Living in the Clouds: Is Computer Software Becoming Obsolete?*, NEWSWEEK, June 10, 2008, at 1, available at <http://www.newsweek.com/2008/06/09/living-in-the-clouds.html> (em-



thing with your PC you needed to buy software and install it[,] . . . [but now] [t]he ascent of Web 2.0 . . . is making that practice obsolete.”<sup>144</sup>

The availability of Internet distribution of software means “fewer works [are] being distributed . . . in the form of copies . . . that are effectively transferable as a practical or legal matter.”<sup>145</sup> This is because “the first sale privilege is generally unavailable in cyberspace.”<sup>146</sup> When User A downloads a software program or a music album from the Internet to his hard drive, the copy of the work that he owns is the copy imprinted on the hard drive inside his computer. Unless User A sells his entire hard drive with the software on it (which should be permissible under the first sale doctrine for all the same user substitution reasons why he should be able to sell a software CD), User A cannot transfer the software or music to User B without infringing the copyright holder’s reproduction rights. Thus, the transition to Internet distribution of software may make the *Vernor* ruling that favors first sale doctrine protection, even if upheld by the Ninth Circuit, “ever less relevant.”<sup>147</sup> Indeed, Autodesk stated in its briefing that it currently distributes AutoCAD both via CD and via Internet download, although it does not disclose what proportion of its sales are generated by each method.<sup>148</sup>

Record companies may also turn to more Internet distribution of promotional music, but its transition may be more difficult than the software industry’s transition. Sony Music UK announced that as of May 2010, it has “switch[ed] to a digital e-card system for the distribution of promotional music” and simultaneously phased out the mailing of promo CDs.<sup>149</sup> Greg Sandoval of CNET reported that the record label EMI Group has also “drastically scaled back the numbers of CDs it sen[ds] out as promos” and now “distributes secure online access where retailers or reviewers can hear songs.”<sup>150</sup> According to *MusicWeek*, there are “several estab-

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phased added); see also Rothchild, *supra* note 45, at 72 (describing software offered through an “application service provider” (ASP), which allows customers to access software “by shipping data across the network to the ASP’s computers”).

<sup>144</sup> Braiker, *supra* note 143, at 1.

<sup>145</sup> Reese, *supra* note 55, at 611.

<sup>146</sup> Justin Graham, *Preserving the Aftermarket in Copyrighted Works: Adapting the First Sale Doctrine to the Emerging Technological Landscape*, 2002 STAN. TECH. L. REV. 1, ¶ 4 (2002).

<sup>147</sup> Thomas A. Hackett, *Where Vernor v. Autodesk Fits Into First Sale Decisions*, 5 SHIDLER J.L. COM. & TECH. 17, \*6 (2009).

<sup>148</sup> Autodesk’s Opening Brief, *supra* note 66, at 9.

<sup>149</sup> *Sony Set for Digital Promo Switch*, MUSICWEEK, Mar. 3, 2010, available at <http://www.musicweek.com/story.asp?sectioncode=1&storycode=1040255&c=1>.

<sup>150</sup> Greg Sandoval, *At EMI, Could Digital Music Kill the “Record” Promo?*, CNET NEWS BLOG, Apr. 10, 2008, [http://news.cnet.com/8301-10784\\_3-9915837-7.html](http://news.cnet.com/8301-10784_3-9915837-7.html).

lished systems in use” for distributing promotional music online, but “the idea of phasing out the CD has created controversy.”<sup>151</sup> For example, one music blogger, referring to digital promos, comments that he “frankly feel[s] less inclined to review something that has such [an] impersonal approach and [so] little effort put into it.”<sup>152</sup> Another music critic, in response to Sony UK’s announcement, predicts that “within a year[,] when they want reviewers to take notice of something they’ll start sending out copies again.”<sup>153</sup> Thus, physical discs still seem to command an aura in the music world, a phenomenon that does not similarly encumber the software industry.<sup>154</sup>

### Conclusion

Promo CDs and software CDs should be no less alienable than other personal property, assuming that the user who sells his CD no longer retains his ability to enjoy the CD’s content. This view is consistent with the first sale doctrine’s policy of promoting user substitution. It is also the result reached by applying the *Wise* test, which is the better of the two opposing legal tests that the parties are championing before the Ninth Circuit. The *Wise* test is faithful to longstanding understandings of ownership with respect to other types of material property, and the *Wise* test is more workable than the *Wall Data* test, which would permit copyright holders to easily contract around the first sale doctrine. It is important to acknowledge, however, that applying the first sale doctrine to software CDs would also facilitate user proliferation, contrary to the purposes of copyright law. This loophole is due to the “essential step” exemption under § 117 of the Copyright Act, which seems to permit a user to sell his copy of a software CD while retaining a copy of the software on his hard drive.<sup>155</sup> While this problem could be cured by amending the Copyright Act, the loophole will eventually lose significance as software manufacturers transition to distributing their products through the Internet. Record companies, on the other hand, may struggle more than software manufacturers in shifting to the Internet model for distributing promotional music.

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<sup>151</sup> *Sony Set For Digital Promo Switch*, *supra* note 149.

<sup>152</sup> Erik Thomas, *My First Editorial for Metal Review and Screw the Digital Age*, METALREVIEW, Mar. 3, 2010, <http://community2.metalreview.com/blogs/editorials/archive/2010/03/03/my-first-editorial-for-metalreview-and-screw-the-digital-age.aspx>.

<sup>153</sup> David Hepworth, *The End of the Promo Copy*, AND ANOTHER THING, Mar. 3, 2010, <http://whatsheonabouthnow.blogspot.com/2010/03/end-of-promo-copy.html>.

<sup>154</sup> Music artist Yelle, whose work EMI Group has successfully distributed exclusively via the Internet, also alludes to the aura of the physical album: “I don’t know when my first EP on vinyl will come out[,] . . . I don’t know whether it will[,] . . . [b]ut I would be really proud if my album will be out in vinyl.” Sandoval, *supra* note 150.

<sup>155</sup> 17 U.S.C. § 117(a)(1) (2006).

# The Aftermath of *TS Tech*: The End of Forum Shopping in Patent Litigation and Implications for Non-Practicing Entities

Mark Liang\*

- I. Introduction..... 30
- II. Non-Practicing Entities and the Eastern District of Texas ..... 32
  - A. The Non-Practicing Entity ..... 32
    - 1. The Business Model..... 32
    - 2. Policy Debate.. ..... 37
  - B. The Center of the Patent Litigation Universe: The Eastern District of Texas ..... 39
    - 1. The Numbers ..... 39
    - 2. The Reasons.. ..... 43
  - C. The Eastern District’s Pre-*TS Tech* § 1404(a) Transfer Practice..... 47
- III. *In re TS Tech*: The Federal Circuit Takes Action ..... 50
- IV. The Eastern District Holds Its Ground ..... 53
  - A. The Transfer Record Since *TS Tech*..... 53
  - B. The Eastern District’s Modified Analysis ..... 55
    - 1. Private Factor 1: Relative Ease of Access to Sources of Proof..... 57
    - 2. Private Factor 2: Availability of Compulsory Process..... 58
    - 3. Private Factor 3: Cost and Convenience of Attendance..... 59
    - 4. Private Factor 4: All Other Practical Problems (Judicial Economy)..... 60
    - 5. Public Factor 1: Administrative Difficulties (Court Congestion) ..... 61
    - 6. Public Factor 2: Local Interest ..... 63
    - 7. Public Factors 3 and 4: Familiarity with Law and Conflicts of Law ..... 63

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V. The Federal Circuit Responds: <i>Genentech, Hoffman, Nintendo</i> .....	64
A. <i>In re Genentech</i> : No Centralized Location Test.....	64
B. <i>Hoffman</i> and <i>Nintendo</i> : No Dispersed Location Test.....	66
VI. Implications of New Venue Law on Non-Practicing Entities .....	69
A. The End of the Eastern District and Forum Shopping?.....	69
B. The End of the Non-Practicing Entity? .....	72
1. Judicial Developments .....	73
2. Congressional Reform Proposals .....	74
3. Leave it to the Courts .....	76
VII. Conclusion .....	77

## I. Introduction

The Federal Circuit closed its 2008 docket with *In re TS Tech USA Corp.*<sup>1</sup> The plaintiff at trial, Lear Corporation, had its principal place of business in Michigan.<sup>2</sup> The petitioners and defendants at trial, collectively “TS Tech,” were from Ohio and Canada.<sup>3</sup> Curiously, Lear filed suit in the Eastern District of Texas. The plaintiff’s choice to pursue trial in Marshall, Texas—population 23,798<sup>4</sup>—posed an inconvenience to all parties and witnesses. The defendants accordingly filed a motion seeking transfer to a closer venue, the Southern District of Ohio, pursuant to 28 U.S.C. § 1404(a).<sup>5</sup> The district judge denied the motion.<sup>6</sup> The Federal Circuit reversed and directed the Eastern District to transfer the case to the Southern District of Ohio.<sup>7</sup>

Over the past decade, the Eastern District of Texas has rocketed to the top of patent venue rankings with respect to filings. In 1990, one patent suit was filed in

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<sup>1</sup> 551 F.3d 1315 (Fed. Cir. 2008).

<sup>2</sup> *Id.* at 1318.

<sup>3</sup> *Id.*

<sup>4</sup> City-Data.com, Marshall, Texas Profile, <http://www.city-data.com/city/Marshall-Texas.html> (last visited Mar. 11, 2010).

<sup>5</sup> *In re TS Tech.*, 551 F.3d at 1318.

<sup>6</sup> *Id.*

<sup>7</sup> *See id.* (granting TS Tech’s petition for writ of mandamus).

the district.<sup>8</sup> In the first ten months of 2007, a national record 312 patent cases were filed against 1,253 defendants.<sup>9</sup> The Eastern District is not home to any major cities or tech hubs.<sup>10</sup> The choice of hundreds of patentees nationwide to pursue their patent suits in the Eastern District constitutes forum shopping.

Forum shopping in the Eastern District is troubling given that many of the district's patentee-plaintiffs are non-practicing entities (NPEs).<sup>11</sup> NPEs are companies that acquire and hold patents.<sup>12</sup> They are "non-practicing" because they do not physically use their patents in producing or selling commercial goods or for research. Rather, NPEs hold patents only to litigate and license them.<sup>13</sup> Archetypically, an NPE will discover a corporation using a technology that may infringe one of the NPE's patents.<sup>14</sup> The NPE will then sue that corporation for infringement with the intent of settling the suit with a licensing agreement.<sup>15</sup> This business model of "search and sue" leads to the pejorative use of the term "patent troll" to refer to NPEs.<sup>16</sup>

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<sup>8</sup> Ted Frank, *There Is a Role for Congress in Patent Litigation Reform*, AM. ENTERPRISE INST. FOR PUB. POL'Y RES.—AEI OUTLOOK SERIES, Feb. 2008, <http://www.aei.org/outlook/27550>.

<sup>9</sup> *Id.*

<sup>10</sup> See U.S. Marshal Service, Eastern District of Texas Courthouse Locations, <http://www.usmarshals.gov/district/tx-e/locations/index.html> (last visited July 8, 2010). The population of each city that hosts an Eastern District of Texas division is as follows: Beaumont, 110,553; Lufkin, 34,530; Marshall, 23,798; Sherman, 38,077; Texarkana, 36,611; Tyler, 97,705. City-Data.com, <http://www.city-data.com> (last visited Mar 11, 2010). The district's largest city is Plano with population 267,480. *Id.*

<sup>11</sup> Daniel P. McCurdy, *Patent Trolls Erode the Foundation of the U.S. Patent System*, SCIENCE PROGRESS, Jan. 12, 2009, <http://www.scienceprogress.org/2009/01/patent-trolls-erode-patent-system>. See *infra* Table 1 in Part II.B.1.

<sup>12</sup> Sannu K. Shrestha, Note, *Trolls or Market-Makers? An Empirical Analysis of Nonpracticing Entities*, 110 COLUM. L. REV. 114, 115 (2010).

<sup>13</sup> Paul B. Hunt, *The Importance of Recent Patent Law Decisions: Bilski and Beyond*, in THE IMPACT OF RECENT PATENT LAW CASES AND DEVELOPMENTS: LEADING LAWYERS ON UNDERSTANDING KEY DECISIONS, COUNSELING CLIENTS ON PATENT REFORM, AND RECOGNIZING UPCOMING ISSUES FACING CONGRESS 1, 5–6 (2009), 2009 WL 2966493.

<sup>14</sup> McCurdy, *supra* note 11.

<sup>15</sup> *Id.*

<sup>16</sup> James F. McDonough III, *The Myth of the Patent Troll: An Alternative View of the Function of Patent Dealers in an Idea Economy*, 56 EMORY L.J. 189, 191 (2006); Shrestha, *supra* note 12, at 114.

Regardless of whether one regards NPEs favorably or unfavorably, there is little dispute that patent litigation is central to the NPE business model.<sup>17</sup> Without it, NPEs have minimal leverage to obtain licensing revenues. NPEs and other patentee-plaintiffs nationwide often choose to litigate in the Eastern District of Texas because the district has proven to be plaintiff-friendly in patent infringement cases. Many thought *TS Tech* signaled the end of the Eastern District's popularity because the decision should have made transfer easier to obtain for defendants.<sup>18</sup> However, since *TS Tech*, the Eastern District continues to deny transfer at essentially the same rate as before the decision by the Federal Circuit. Nevertheless, recent Federal Circuit cases and ongoing patent reform efforts signal that venue rules are changing to the patentee-plaintiff's disadvantage.

This article proceeds as follows. Part II begins by introducing the NPE business model, arguments for and against NPEs, and the Eastern District of Texas' rise as the forum of choice in patent infringement cases. Part III analyzes the *TS Tech* decision specifically. Part IV reviews case law in the year since *TS Tech*, presents data demonstrating that *TS Tech* has had minimal impact on transfer rates in the Eastern District, and analyzes the district's resistance to venue changes. Part V reviews three Federal Circuit decisions from 2009 showing that the appeals court continues to reinforce the appropriate criteria for venue change. Finally, Part VI concludes that forum shopping in general—and the Eastern District of Texas phenomenon in particular—will end in the near future. These developments combined with broader judicial and legislative movements probably signal the end of the NPE as a viable business model.

## II. Non-Practicing Entities and the Eastern District of Texas

### A. The Non-Practicing Entity

#### 1. *The Business Model*

NPEs are rarely the originator of their patents.<sup>19</sup> Most patents held by NPEs are acquired from the patent's original inventors—individuals or small busi-

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<sup>17</sup> See John R. Allison et al., *Extreme Value or Trolls on Top? The Characteristics of the Most-Litigated Patents*, 158 U. PA. L. REV. 1, 31–32 (2009) (revealing that NPEs own more than 50 percent of the most-litigated patents and account for over 80 percent of suits filed involving those patents).

<sup>18</sup> Hunt, *supra* note 13, at 4–5.

<sup>19</sup> See Todd Klein, *EBay v. MercExchange and KSR Int'l Co. v. Teleflex, Inc.: The Supreme Court Wages War Against Patent Trolls*, 112 PENN ST. L. REV. 295, 295–96, 300 (2007) (indicating that “[t]ypically, patent trolls are not inventors themselves”).

nesses<sup>20</sup>—or from a company under financial distress liquidating its patent portfolio.<sup>21</sup> Large NPEs may own hundreds and even thousands of patents.<sup>22</sup> There are approximately 220 NPEs in the United States who have raised around \$6 billion in capital over the past decade.<sup>23</sup> Most NPE-owned patents are in technical fields relating to computers, electronics, software, and business methods.<sup>24</sup> Because NPEs rarely practice their patents, their patents seldom encompass an entire technology or commercial product. Instead, their patents usually cover components of a finished product.<sup>25</sup>

NPEs come in different forms. For instance, Science Progress describes Intellectual Ventures, the largest NPE as measured by patent holdings,<sup>26</sup> as a massive private equity fund with \$5 billion in capital raised from investors.<sup>27</sup> Other NPEs, such as Alliacense and Rembrandt Technologies, are more litigious.<sup>28</sup> They selectively acquire patents that are likely to lead to successful litigation outcomes and high licensing fees.<sup>29</sup> Leanly staffed, their employees are mostly attorneys and accountants, with only a few engineers who examine prior art.<sup>30</sup>

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<sup>20</sup> Shrestha, *supra* note 12, at 115.

<sup>21</sup> See Rebecca A. Hand, *EBay v. MercExchange: Looking at the Cause and Effect of a Shift in the Standard for Issuing Patent Injunctions*, 25 *CARDOZO ARTS & ENT. L.J.* 461, 472–73 (2007) (citing the FTC’s description of NPEs as “design firms that patent their inventions but do not practice them or patent assertion firms that buy patents from other companies (particularly bankrupt ones), not to practice but to assert against others”).

<sup>22</sup> PatentFreedom, Current Research, <https://www.patentfreedom.com/research.html> (last visited Mar. 23, 2010).

<sup>23</sup> Small Business Labs, Patent Trolls Continue to Grow in Number and Power, [http://genylabs.typepad.com/small\\_biz\\_labs/2009/04/patent-trolls-continue-to-grow-in-number-and-power.html](http://genylabs.typepad.com/small_biz_labs/2009/04/patent-trolls-continue-to-grow-in-number-and-power.html) (last visited Mar. 24, 2010) (citing PatentFreedom, <https://www.patentfreedom.com>).

<sup>24</sup> Hunt, *supra* note 13, at 5 (stating that NPE inventions frequently cover business methods); Shrestha, *supra* note 12, at 145.

<sup>25</sup> Elizabeth Pesses, *Patent and Contribution: Bringing the Quid Pro Quo into eBay v. MercExchange*, 11 *YALE J.L. & TECH.* 309, 315 (2008–2009).

<sup>26</sup> McCurdy, *supra* note 11; Intellectual Ventures owns approximately 10,000–15,000 patents. PatentFreedom, *supra* note 22.

<sup>27</sup> McCurdy, *supra* note 11.

<sup>28</sup> *Id.*

<sup>29</sup> *Id.*

<sup>30</sup> Klein, *supra* note 19, at 298.

With ownership rights in hand, NPEs wait for others to infringe their patents.<sup>31</sup> NPEs usually detect possible infringement by reviewing recent patent applications with the United States Patent and Trademark Office (PTO) and scrutinizing the commercial market for products that make unauthorized use of their patents.<sup>32</sup> After identifying a possible infringing use, the NPE will file a patent infringement suit against the infringer, who may be using the patent as a component of a commercial product.<sup>33</sup> The \$1.5–2.5 million cost of defending against a patent litigation suit<sup>34</sup> and the prospect of a permanent injunction or multi-million dollar damage remedy is sufficient in most cases to cause the defendant to settle and agree to a licensing arrangement with the NPE.<sup>35</sup>

NPEs can be strategic in the timing of their patent acquisitions and litigation. NPEs often acquire a ten-year old patent already in common commercial use, or observe an infringing use, but wait years “in hiding” before pursuing litigation against the alleged infringer.<sup>36</sup> By then the infringing use is more widespread.<sup>37</sup> In both cases, the unsuspecting defendant may have invested substantially in the development and production of a product and relied upon the product as a revenue source, only to then learn that the product may infringe the NPE’s patent.<sup>38</sup> Under

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<sup>31</sup> McCurdy, *supra* note 11.

<sup>32</sup> Klein, *supra* note 19, at 300–01; McCurdy, *supra* note 11.

<sup>33</sup> Gregory d’Incelli, *Has eBay Spelled the End of Patent Troll Abuses? Paying the Toll: The Rise (and Fall?) of the Patent Troll*, 17 U. MIAMI BUS. L. REV. 343, 346–47 (2009); Klein, *supra* note 19, at 300–01; McCurdy, *supra* note 11.

<sup>34</sup> Robert R. Willis, *International Patent Law: Should United States and Foreign Patent Laws be Uniform? An Analysis of the Benefits, Problems, and Barriers*, 10 N.C. J.L. & TECH. 283, 304 (2009) (estimating that the cost of defending a patent infringement suit is \$1.5 million); Peter Zura, *Employing Successful Strategies for Patent Litigation*, in RECENT TRENDS IN PATENT INFRINGEMENT LAWSUITS: LEADING LAWYERS ON ANALYZING SIGNIFICANT PATENT INFRINGEMENT CASES AND DEVELOPING SUCCESSFUL LITIGATION STRATEGIES 1, 1 (2010), 2010 WL 543328 (estimating average costs of \$2.5 million for each side in a patent litigation dispute).

<sup>35</sup> d’Incelli, *supra* note 33, at 347.

<sup>36</sup> Klein, *supra* note 19, at 300.

<sup>37</sup> McCurdy, *supra* note 11; see John M. Golden, *Principles for Patent Remedies*, 88 TEX. L. REV. 505, 559–60 n.303 (2010) (citing Richard Schmalensee, *Standard-Setting, Innovation Specialists, and Competition Policy* 5 (Apr. 30, 2009) (unpublished manuscript, on file at <http://ssrn.com/abstract=1219784>) (“[P]atent trolls hide their intellectual property until an opportune time and then emerge to extract royalties.”)).

<sup>38</sup> Shrestha, *supra* note 12, at 122.



such circumstances, the defendant will likely agree to pay the licensing fees demanded by the NPE to avoid an injunction that shuts down its product.<sup>39</sup>

The NPE business model of acquire, detect, sue, and license can be lucrative. For instance, Jerome Lemelson, by filing and amending hundreds of “submarine patents”<sup>40</sup> over many years and threatening suit against hundreds of companies, accumulated \$1.5 billion in royalties.<sup>41</sup> In 2006, the Federal Circuit enjoined Research in Motion (RIM) from using the plaintiff-NPE NTP’s patents, which concerned real-time wireless email technologies.<sup>42</sup> The permanent injunction would have shut down all 4.3 million Blackberries worldwide, effectively destroying RIM’s business.<sup>43</sup> RIM agreed to pay NTP \$612 million to settle and for the right to continue using technology covered by NTP’s patents.<sup>44</sup> Other examples of NPEs acquiring many millions of dollars through litigation abound.<sup>45</sup>

Patent infringement litigation is consequently a central component of the NPE business model.<sup>46</sup> It should come as no surprise that a considerable and rising proportion of patent litigation—twelve to seventeen percent of all patent cases filed between January 1, 2000 and March 21, 2008—is NPE-initiated.<sup>47</sup> However, this eight-year average masks the increase in NPE-initiated cases during that period,<sup>48</sup>

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<sup>39</sup> Shrestha, *supra* note 12, at 122.

<sup>40</sup> See Frank, *supra* note 8 (describing the “submarine patent”).

<sup>41</sup> See Frank, *supra* note 8 (describing the “submarine patent”).

<sup>42</sup> NTP, Inc. v. Research in Motion, Ltd., 418 F.3d 1282, 1287 (Fed. Cir. 2005) (The Eastern District of Virginia was the district court).

<sup>43</sup> Klein, *supra* note 19, at 297.

<sup>44</sup> *Id.*; Associated Press, *Settlement Reached in BlackBerry Patent Case: Research in Motion Pays NTP \$612.5 Million; Devices to Stay On*, MSNBC, Mar. 3, 2006, <http://www.msnbc.msn.com/id/11659304/>.

<sup>45</sup> *E.g.*, Klein, *supra* note 19, at 297–98 (discussing the example of Forgent Networks who acquired patents on video compression technology and, through suits against forty defendants in 2004, accumulated over \$100 million in licensing fees).

<sup>46</sup> See Allison, *supra* note 17, at 24 (noting that NPEs “in the most-litigated-patent set fall almost entirely into only two classes: licensing companies in the business of buying up and enforcing patents (‘trolls’ by virtually anyone’s definition) and companies started by an inventor that do not make products”).

<sup>47</sup> Shrestha, *supra* note 12, at 121.

<sup>48</sup> *Id.* at 146 (noting the increase from 2000 to 2008 in the proportion of patent infringement suits initiated by NPEs).

which rose from under 100 before 2000 to over 450 in 2008 and 2009.<sup>49</sup> NPEs represent over 80 percent of the suits filed involving the most-litigated patents and NPEs own more than 50 percent of the most-litigated patents.<sup>50</sup> A survey of the ten most litigious NPEs shows that the majority of their cases were filed after 2003.<sup>51</sup> NPEs also tend to sue more defendants; the average patentee-plaintiff in 2008 sued 2.38 defendants while NPE-plaintiffs sued 3.96 defendants.<sup>52</sup> This trend has not gone unnoticed by industry executives. Hewlett Packard's<sup>53</sup> general counsel re-

<sup>49</sup> PatentFreedom, *supra* note 22. Another source notes that NPE litigation has risen 300 percent from 2001 to 2009. Wendy Freedman, *Trends and Developments: The Growing Impact of Venue and Economy on Patent Infringement Lawsuits*, in RECENT TRENDS IN PATENT INFRINGEMENT LAWSUITS: LEADING LAWYERS ON ANALYZING SIGNIFICANT PATENT INFRINGEMENT CASES AND DEVELOPING SUCCESSFUL LITIGATION STRATEGIES 1, 8 (2010), 2010 WL 543326.

<sup>50</sup> Allison, *supra* note 17, at 32.

<sup>51</sup> PatentFreedom lists most litigious NPEs by number of patent infringement suits filed. Below is a portion of a table. PatentFreedom, *supra* note 22.

Entity	Number of Cases	% of Cases Since 2003
Acacia Technologies	337	80%
Rates Technology Inc.	139	33%
Ronald A Katz Technology Licensing	129	92%
Millennium LP	110	92%
Plutus IP	77	100%
Sorensen Research and Development Trust	73	88%
General Patent Corp International	72	58%
Cygnus Telecommunications Technology LLC	69	45%
Papst Licensing GmbH	62	55%
F&G Research Inc.	56	91%

Table A: Most Litigious NPEs and Percentage of Their Cases That Came After 2003

<sup>52</sup> Freedman, *supra* note 49, at 8.

<sup>53</sup> Hewlett Packard (HP) is the ninth largest corporation in America by revenue. *Fortune 500: Our Annual Ranking of America's Largest Corporations*, CNN MONEY.COM, May 4, 2009, [http://money.cnn.com/magazines/fortune/fortune500/2009/full\\_list/](http://money.cnn.com/magazines/fortune/fortune500/2009/full_list/) (listing 2009's Fortune 500 companies in order). HP also owns over 30,000 patents. Kim Hart, *Patent Reform Bill Intro-*

marked that the company is consistently a target of patent infringement lawsuits and that “more than half the lawsuits have been filed by non-operating entities.”<sup>54</sup>

## 2. Policy Debate

NPEs have their defenders<sup>55</sup> and detractors<sup>56</sup> who advance arguments for why NPEs are good or bad for society and innovation. Opponents of NPEs start with the premise that the purpose of the patent system is to foster innovation for the ultimate benefit of society. In contrast, most NPEs do not innovate, nor do they practice or commercialize their patents to benefit society.<sup>57</sup> Instead, they acquire patents and then sue corporations and inventors who do innovate and commercialize.

Negative consequences follow. First, detractors assert that NPEs impose a large unjustified cost on the judicial system and defendants because their infringement claims often lack merit and the licensing fees they reap are excessive.<sup>58</sup> Indeed, a PricewaterhouseCoopers study found that NPE-plaintiffs have a lower success rate than non-NPEs—29 percent versus 41 percent.<sup>59</sup> Second, the cost to

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duced in Congress Today, WASH POST ONLINE, March 3, 2009, [http://voices.washingtonpost.com/posttech/2009/03/patent\\_reform\\_bill\\_introduced.html](http://voices.washingtonpost.com/posttech/2009/03/patent_reform_bill_introduced.html).

<sup>54</sup> Hart, *supra* note 53.

<sup>55</sup> See generally McDonough, *supra* note 16; Ho-Sung Chung, Note, *The Supreme Court Unjustly Declares Open Season on Patent Dealers*, 2009 U. ILL. J.L. TECH. & POL’Y 227 (2009); Shrestha, *supra* note 12.

<sup>56</sup> See generally Klein, *supra* note 19, at 297; McCurdy, *supra* note 11.

<sup>57</sup> McCurdy, *supra* note 11.

<sup>58</sup> On frivolous claims, see Michael J. Meurer, *Inventors, Entrepreneurs, and Intellectual Property Law*, 45 HOUS. L. REV. 1201, 1218 (2008) (“Nevertheless, the decline of the public notice function of patents and the expansion of patentable subject matter to include business methods and software have contributed to the success of ‘patent trolls’—parties who obtain patent royalties based on weak or frivolous infringement claims.”); Jennifer Kahalelio Gregory, Comment, *The Troll Next Door*, 6 J. MARSHALL REV. INTELL. PROP. L. 292, 301 (2007) (“A common assertion by victims of Patent Trolls is the infringement claims made against them are frivolous.”). On excessive licensing fees, see Robin M. Davis, *Failed Attempts to Dwarf the Patent Trolls: Permanent Injunctions in Patent Infringement Cases Under the Proposed Patent Reform Act of 2005 and eBay v. MercExchange*, 17 CORNELL J.L. & PUB. POL’Y 431, 438 (2008) (“The questionable business practices of patent trolls extend beyond simple exploitation of general patents for excessive licensing fees.”); Shrestha, *supra* note 12, at 114 (“Critics of these firms have labeled them ‘patent trolls’ and claim that they use weak and vague patents to extract excessive licensing fees or to engage in frivolous infringement litigation against product manufacturers.”).

<sup>59</sup> PricewaterhouseCoopers, *Report on New Patent Litigation Trends and the Increasing Impact of Nonpracticing Entities Released by PricewaterhouseCoopers*, PR NEWSWIRE, Jan. 25, 2009, <http://www.prnewswire.com/news-releases/report-on-new-patent-litigation-trends-and-the-increasing-impact-of-nonpracticing-entities-released-by-pricewaterhousecoopers-82595262.html>.

defendants of defending suits and paying high licensing fees is a significant burden on innovation and the economy.<sup>60</sup> For instance, the \$612 million that RIM paid to NTP, and the billions other defendants pay in licensing fees and litigation, quite possibly cut their R&D and operation budgets. These costs might then be passed on to consumers in the form of higher prices, limited features and services, and reduced future innovation.

Despite these arguments, proponents of NPEs fundamentally disagree with the criticisms of the NPE model.<sup>61</sup> NPEs lawfully acquire and own patents, and in filing infringement claims, NPEs are simply enforcing their government-endowed patent rights.<sup>62</sup> Proponents also argue that NPEs present a number of benefits. NPEs help small inventors from whom they purchase their patents, because many small inventors lack the resources to bring their patented inventions to market.<sup>63</sup> Small inventors also lack the resources to license and enforce their patents, given that litigating a patent suit can cost up to \$4 million.<sup>64</sup> By buying their patents, NPEs provide small inventors with liquidity that rewards small inventors and gives them funds needed to continue inventive activities.<sup>65</sup> NPEs license and enforce the patents they acquire, and grant a percentage of the resulting proceeds to the inventors.<sup>66</sup> NPEs are thus champions of small inventors; without NPEs, large corporations might be free to infringe patent rights at no cost. NPEs also serve a market-clearing function by acting as an exchange for patents.<sup>67</sup> Viewing patents as tradable assets, NPEs' buying and licensing activities helps create a liquid market for patents.<sup>68</sup> This helps accurately price patents, distinguishing valuable patents from worthless ones.<sup>69</sup> By helping small inventors and creating a liquid market for patents, NPEs only help innovation.

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<sup>60</sup> McCurdy, *supra* note 11.

<sup>61</sup> *Id.*

<sup>62</sup> McDonough, *supra* note 16, at 221.

<sup>63</sup> *Id.* at 211; Yuichi Watanabe, *Patent Licensing and the Emergence of a New Patent Market*, 9 HOUS. BUS. & TAX L.J. 445, 451–57 (2009).

<sup>64</sup> Spencer Hosie, *Patent Trolls and the New Tort Reform: A Practitioner's Perspective*, 4 I/S: J.L. & POL'Y FOR INFO. SOC'Y 75, 80 (2008); McDonough, *supra* note 16, at 210.

<sup>65</sup> Shrestha, *supra* note 12, at 130.

<sup>66</sup> *Id.* at 126–27.

<sup>67</sup> McDonough, *supra* note 16, at 211; Shrestha, *supra* note 12, at 128.

<sup>68</sup> Watanabe, *supra* note 63, at 459–61.

<sup>69</sup> *Id.*; Shrestha, *supra* note 12, at 128.

## B. The Center of the Patent Litigation Universe: The Eastern District of Texas

The surge in patent litigation in the Eastern District was made possible by *VE Holding Corp. v. Johnson Gas Appliance Co.*<sup>70</sup> Patent venue is governed by 28 U.S.C. § 1400(b), which provides two options for venue: (1) where the defendant resides and (2) where the defendant commits infringement and maintains an established place of business.<sup>71</sup> In 1988, the general venue provision, 28 U.S.C. § 1391(c), was amended to make venue proper for a corporate defendant where there is personal jurisdiction over them.<sup>72</sup> In *VE Holding*, the Federal Circuit interpreted § 1400(b) in light of the amendments to § 1391(c).<sup>73</sup> The Court held that venue was proper wherever a defendant was subject to personal jurisdiction.<sup>74</sup> Because patent rights are federal, covering all jurisdictions, a patent holder is injured in every district where there is an act of infringement.<sup>75</sup> As a result, personal jurisdiction exists, and therefore venue is proper in every district where there is an infringing use or sale.<sup>76</sup> Because many patents find use in everyday commercial products sold nationwide, *VE Holding* effectively allows patentee-plaintiffs to file their infringement suits anywhere in the country.

Why patentee-plaintiffs have chosen the Eastern District of Texas is discussed in Part II.B.2. Part II.B.1 presents statistics illustrating the magnitude of the Eastern District anomaly.

### 1. The Numbers

The meteoric rise of the Eastern District of Texas reflects the unintended consequences of *VE Holding*'s liberal patent venue rules. In 1990, one patent case was

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<sup>70</sup> 917 F.2d 1574 (Fed. Cir. 1990).

<sup>71</sup> 28 U.S.C. § 1400(b) (2006) ("Any 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.").

<sup>72</sup> 28 U.S.C. § 1391(c) (2006); Alisha Kay Taylor, *What Does Forum Shopping in the Eastern District of Texas Mean for Patent Reform?*, 6 J. MARSHALL REV. INTELL. PROP. L. 570, 574–75 (2007).

<sup>73</sup> *VE Holding*, 917 F.2d at 1575. The prior interpretation of § 1400(b) limited venue to where the defendant resides, or has established a place of business and committed acts of infringement. *Fourco Glass Co. v. Transmirra Prods. Corp.*, 353 U.S. 222, 223, 229 (1957).

<sup>74</sup> *VE Holding*, 917 F.2d at 1584.

<sup>75</sup> Taylor, *supra* note 72, at 576.

<sup>76</sup> *Id.*

filed in the district.<sup>77</sup> Figure 1 shows the increase in patent cases since 2000. In 2007, the district set a standing record for the number of patent cases filed in any district in any year with 368 patent cases.<sup>78</sup> From 2006–2008, the Eastern District led all districts in the number of patent cases filed.<sup>79</sup> The district's predominance over the nation's patent trial docket is anomalous. The other perennial top venues for patent litigation are major population and tech centers. From 1995–1999, before the Eastern District phenomenon, the five most popular districts for patent litigation districts corresponded with major tech hubs: Los Angeles, Silicon Valley, Chicago, New York City, and Boston.<sup>80</sup> A 1999 study demonstrated that some of a district's popularity in patent cases correlated with (a) the population of the district, and (b) the number of patents granted to inventors and companies residing in the district.<sup>81</sup> Excepting the Eastern District, these correlations continue today.<sup>82</sup>

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<sup>77</sup> See Frank, *supra* at note 8, at 3.

<sup>78</sup> See *infra* Figure 1.

<sup>79</sup> See *infra* Figure 1.

<sup>80</sup> Kimberly A. Moore, *Forum Shopping in Patent Cases: Does Geographic Choice Affect Innovation?*, 79 N.C. L. REV. 889, 903–07 (2001) (finding that the top five districts were the Central District of California, Northern District of California, Southern District of New York, Northern District of Illinois, and District of Massachusetts).

<sup>81</sup> *Id.*; Yan Leychkis, *Of Fire Ants and Claim Construction: An Empirical Study of the Meteoric Rise of the Eastern District of Texas as a Preeminent Forum for Patent Litigation*, 9 YALE J.L. & TECH. 193, 200–01 (2006–2007).

<sup>82</sup> See *infra* Figure 1 (exception for the District of Delaware and the District of New Jersey, although Delaware is the place of incorporation for many defendants). See also Reed Albergotti, *The Most Inventive Towns in America*, WALL ST. J., July 22, 2006, at P1, available at <http://online.wsj.com/article/SB115352188346314087.html>. (ranking cities by the number of patents granted in 2005; 12 of the top 20 cities are in California and 2 are in New York).

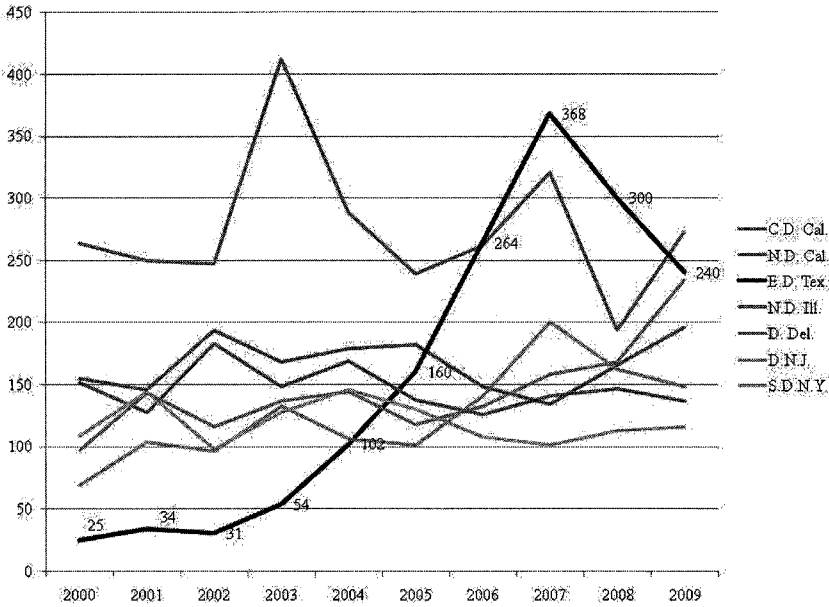


Figure 1: Most Popular Districts by Number of Patent Cases Filed, 2000–2009<sup>83</sup>

Even within the Eastern District of Texas, “judge shopping” occurs. The Eastern District has eight district judges and seven magistrates, yet over 80 percent of patent cases go to four district judges—Judge Ward, Judge Clark, Judge Folsom, and Judge Davis.<sup>84</sup> These judges receive their patent caseload primarily from two divisions, Marshall and Tyler.<sup>85</sup> Marshall is particularly popular. In 2007, the

<sup>83</sup> Data collected from Stanford’s Intellectual Property Litigation Clearinghouse (IPLC). SLS Home, Stanford IP Litigation Clearinghouse, <http://www.law.stanford.edu/program/centers/iplc> (last visited Aug. 3, 2010).

<sup>84</sup> See Leychkis, *supra* note 81, at 206.

<sup>85</sup> Andrew W. Spangler et al., *Litigating in the Eastern District of Texas*, in 922 PRAC. L. INST. PAT., COPYRIGHTS, TRADEMARKS, & LITERARY PROP. COURSE HANDBOOK SERIES 217, 226 (2008); United States District Court, Eastern District of Texas, Directory Information, <http://www.txed.uscourts.gov/Directories/Court/Court.htm> (last visited Mar. 21, 2010).

Marshall division accounted for 60 percent of the district's patent cases, or 10 percent of all U.S. patent cases.<sup>86</sup>

The Eastern District has attracted NPE and non-NPE plaintiffs alike. For example, the plaintiff, Lear, in *TS Tech* was not an NPE.<sup>87</sup> Similarly, non-NPE, Texas Instruments, was one of the first patent holders to see the wisdom of filing in Marshall.<sup>88</sup> Regardless, NPEs file the bulk of their infringement actions in the Eastern District.<sup>89</sup> Moreover, NPEs have preferences for particular Eastern District judges.<sup>90</sup>

District	NPE Filed Cases
E.D. Tex.	332
N.D. Cal.	156
C.D. Cal.	152

<sup>86</sup> See Frank, *supra* note 8, at 3.

<sup>87</sup> See Lear Corporation, About Lear, [http://www.lear.com/jsp/common.jsp?page=al\\_aboutlear](http://www.lear.com/jsp/common.jsp?page=al_aboutlear) (last visited Mar. 22, 2010).

<sup>88</sup> Hosie, *supra* note 64, at 85.

<sup>89</sup> Leychkis, *supra* note 81, at 214; see *infra* Table 1.

<sup>90</sup> Leychkis, *supra* note 81, at 214–15. Table B below is from Leychkis' article showing the filing patterns of five NPEs from 1999–2006. *Id.*

Plaintiff NPE	Judge Ward	Judge Davis	Judge Folsom	Judge Clark	E.D. Tex. Total	All other districts
Ronald A. Katz Technology Licensing, LP	1	--	5	15	21	11
Data Treasury Corp.	--	--	15	--	15	5
Orion IP, LLC	--	11	--	--	11	1
IAP Intermodal, LLC	11	--	--	--	11	--
Rembrandt Technologies, LP	5	--	--	--	5	--

Table B: Where Patent Trolls File Their Suits, Filing Patterns Of Five NPEs Since 1999–2006



S.D.N.Y.	122
N.D. Ill.	100
N.D. Ga.	76
D. Del.	73
E.D.N.Y.	57
D.N.J.	56

Table 1: Cumulative Number of Patent Infringement Suits Filed by NPEs as of August 31, 2008<sup>91</sup>

Table 1 indicates that Marshall is almost a secondary place of business for many NPEs. As seen in Figure 1, the other popular venues for NPEs are populous districts, home to major tech companies, and research universities.<sup>92</sup> The 2008–2009 financial crisis, and ensuing recession, may have reduced the financing that NPEs require to fund litigation. The resulting slight decline in nationwide NPE-filing in 2009<sup>93</sup> may partially explain the decrease in the Eastern District’s 2009 filing numbers.<sup>94</sup>

## 2. *The Reasons*

In 2001, Judge Ward of the Eastern District adopted new patent trial rules combining the Northern District of California’s Local Patent Rules with modifications.<sup>95</sup> These modifications included accelerated timelines, broader discovery requirements, and severe sanctions for non-compliance.<sup>96</sup> Judge Ward’s rules turned

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<sup>91</sup> McCurdy, *supra* note 11.

<sup>92</sup> See Leychkis, *supra* note 81, at 200–01; Moore, *supra* note 80, at 903–07.

<sup>93</sup> PatentFreedom, *supra* note 22.

<sup>94</sup> See *supra* Figure 1. The Eastern District of Texas saw a drop from 300 to 240 filed patent cases from 2008 to 2009.

<sup>95</sup> Taylor, *supra* note 72, at 572 (adding that the rules were uniformly adopted by the rest of the district in 2005).

<sup>96</sup> Spangler, *supra* note 85, at 236–47 (explaining that under the Eastern District’s patent rules, many forms of discovery are mandatory, and providing a detailed list of court sanctions); Taylor, *supra* note 72, at 572–74 (noting that defendants must locate relevant prior art and present their invalidity contentions under a compressed schedule, and the court is rarely willing to allow delay for amendments to contentions; also, discussing tight deadlines for claim construction proposals and hearings).

the Eastern District into one of the nation's fastest rocket dockets. At its prime, in the middle part of the decade, the district had a median filing-to-trial time of just twelve months for patent cases.<sup>97</sup> The national average was two years.<sup>98</sup> The Eastern District has slowed down considerably in recent years,<sup>99</sup> which may partially explain its decline in the number of patent cases filed in 2009.<sup>100</sup> Regardless, discovery still begins early in Eastern District patent cases.<sup>101</sup> Defendants in the Eastern District have only nine months to complete discovery, whereas defendants in Northern California have eighteen.<sup>102</sup> In 2006, the average Eastern District bench trial took 22.3 months versus 37.8 months nationwide; average jury trials took 21.1 months compared to 27.1 months nationwide.<sup>103</sup>

Speed kills defendants. A faster docket saves the plaintiff litigation costs and attorney fees.<sup>104</sup> Limited only by the six year statute of limitations on infringement actions,<sup>105</sup> the plaintiffs can bide their time, build their position, and locate evidence and witnesses before filing their suit.<sup>106</sup> Once hit with the plaintiff's suit, the out-of-town defendant, by contrast, must scramble to complete discovery and construct their case within the district court's tight schedule.<sup>107</sup>

District	Median Time To Termination (days)	Median Filing-To-Trial Time (days)
C.D. Cal.	226	802

<sup>97</sup> Spangler, *supra* note 85, at 234.

<sup>98</sup> Robert M. Parker, *The Eastern District Phenomenon*, 45 THE ADVOC. (TEX.) 27, 28 (2008).

<sup>99</sup> See *infra* Table 2. The current filing-to-trial time is 25.5 months.

<sup>100</sup> See *supra* Figure 1.

<sup>101</sup> Spangler, *supra* note 85, at 234.

<sup>102</sup> Leychkis, *supra* note 81, at 209.

<sup>103</sup> *Id.*

<sup>104</sup> Taylor, *supra* note 72, at 577.

<sup>105</sup> 35 U.S.C. § 286 (2006) ("Except as otherwise provided by law, no recovery shall be had for any infringement committed more than six years prior to the filing of the complaint or counterclaim for infringement in the action.")

<sup>106</sup> Leychkis, *supra* note 81, at 219.

<sup>107</sup> *Id.*; Taylor, *supra* note 72, at 577.

N.D. Cal.	309	1046
<i>E.D. Tex.</i>	367	777
N.D. Ill.	213	894
D. Del.	383	694
D.N.J.	243	998
S.D.N.Y.	234	1031
W.D. Wis.	279	335
E.D. Va.	156	327

Table 2: Median Termination and Trial Times of Top Patent Venues and W.D. Wis. and E.D. Va.<sup>108</sup>

Speed alone does not explain the Eastern District anomaly. In light of the district's recent slowdown, other faster dockets are available.<sup>109</sup> However, the Eastern District has other qualities that draw patentee-plaintiffs nationwide. The district grants summary judgment at a rate of 10 percent.<sup>110</sup> This compares to 40 percent nationwide and 70 percent in the Northern District of California.<sup>111</sup> Of course, a lower summary judgment rate means that cases are more likely to go to trial.

As further proof that trials occur often, consider Table 2. The Eastern District has the second longest termination time, yet one of the shorter filing-to-trial times. A long termination time suggests that cases do not settle early before discovery and pre-trial proceedings. Instead, they frequently extend into discovery and trial. The District of Delaware is another district with this combination of long termination times and short filing-to-trial times. This partially explains why Delaware is also a surprisingly popular patent venue.<sup>112</sup>

<sup>108</sup> Data collected from Stanford's IPLC. SLS Home, *supra* note 83.

<sup>109</sup> See *supra* Table 2. The E.D. Va. and W.D. Wis. reach trial in less than a year and the D. Del. is also faster.

<sup>110</sup> Leychkis, *supra* note 81, at 216.

<sup>111</sup> *Id.*

<sup>112</sup> See *supra* Figure 1 (indicating that the District of Delaware is popular); *supra* Table 2 (indicating that the District of Delaware has the longest termination time and one of the faster time-to-trial times).

Jury trials are always risky propositions for defendants, but especially in the Eastern District.<sup>113</sup> Recent surveys put the patentee-plaintiff win rate at trial in the Eastern District at 90 percent compared to 68 percent nationwide.<sup>114</sup> In the eighteen years preceding 2006, the district never once found a plaintiff's patent invalid.<sup>115</sup> Eastern District juries are perceived as distrustful of large corporations (i.e., defendants in patent infringement suits), with a history of handing out large plaintiff victories in railroad and asbestos cases.<sup>116</sup> Demographic studies show that in the area where presumably most of Marshall's jury pool originates, only 15.5 percent of local residents hold bachelor degrees, 5.1 percent hold graduate degrees, and 21.6 percent never completed high school.<sup>117</sup> A large portion of the district's population is elderly.<sup>118</sup> As a result, juries in the Eastern District tend to view IP rights and infringement actions as akin to trespass on real property.<sup>119</sup> Accordingly, they might be less likely than jurors in larger cities to comprehend the technology or patent policy arguments presented to them.<sup>120</sup>

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<sup>113</sup> See Leychkis, *supra* note 81, at 210 ("To say that juries in the Eastern District of Texas favor patent holders is something of an understatement—quite plainly, an Eastern District jury is the patentee-plaintiff's best friend.").

<sup>114</sup> *Id.*; Adam Shartzter, *Patent Litigation 101: Empirical Support for the Patent Pilot Program's Solution to Increase Judicial Experience in Patent Law*, 18 FED. CIR. B.J. 191, 215–16 (2009). Other sources put the patentee-plaintiff win rate at 88 percent. See Adam D. Kline, *Any Given Forum: A Proposed Solution to the Inequitable Economic Advantage that Arises when Non-Practicing Patent Holding Organizations Predetermine Forum*, 48 IDEA 247, 275 (2008); Frank, *supra* note 8, at 3. *But see* Dorothy R. Auth et al., *Selecting Forum and Venue for Your Patent Litigation*, 997 PRAC. L. INST. PAT., COPYRIGHTS, TRADEMARKS, & LITERARY PROP. COURSE HANDBOOK SERIES 601, 649 (2010) (citing Pacer, finding that the win rate in 2008 is only 71.9 percent in E.D. Tex., C.D. Cal. is only slightly lower at 68 percent, and other popular patent venues vary between 50 to 63 percent); William C. Rooklidge and Renee L. Stasio, *Venue in Patent Litigation: The Unintended Consequences of Reform*, 20 NO. 3 INTELL. PROP. & TECH. L.J., Mar. 2008, at 1, 2 (putting the figure for the Marshall division at 78 percent compared to 59 percent nationwide, citing LegalMetric).

<sup>115</sup> Shartzter, *supra* note 114, at 214–15.

<sup>116</sup> Leychkis, *supra* note 81, at 213–14; *but see* Spangler, *supra* note 85, at 261 (alternatively arguing that the plaintiff-friendly perception is overblown and that jury tendencies in the district vary greatly by division).

<sup>117</sup> Leychkis, *supra* note 81, at 219–20.

<sup>118</sup> *Id.* at 220.

<sup>119</sup> *Id.* at 213.

<sup>120</sup> *Id.* at 220; *but see* Parker, *supra* note 98, at 27 (arguing that Eastern District juries are not pro-plaintiff).

### C. The Eastern District's Pre-*TS Tech* § 1404(a) Transfer Practice

Forum shopping and the Eastern District of Texas anomaly would be largely remedied if the Eastern District granted most motions seeking transfer. Venue transfer is governed by 28 U.S.C. § 1404(a). Under § 1404(a), a case may be transferred for convenience of parties and witnesses to another venue where the case could have been brought.<sup>121</sup> As in *TS Tech*, the vast majority of patent cases on the district's docket involve parties, witnesses, and evidence that reside entirely outside Texas, which weighs in favor of granting transfer.<sup>122</sup> However, the Eastern District of Texas is protective of its docket. In civil cases generally, the district grants transfer motions only one-third of the time as compared to nearly 50 percent nationwide.<sup>123</sup> In patent cases between 2004 and 2008, the Eastern District granted only fifteen out of forty-nine transfer motions or 30.6 percent of the time.<sup>124</sup>

Before *TS Tech*, the Eastern District's analysis of § 1404(a) motions seeking transfer followed Fifth Circuit precedent in form, but not substance. Under *In re Volkswagen AG*, transfer motions are decided using a two-step test.<sup>125</sup> First, the court must determine if the case could have been filed in the proposed transferee forum, meaning venue and personal jurisdiction requirements are satisfied there.<sup>126</sup> The transferee district requested by a defendant is usually where the defendant resides, and under § 1400(b), venue is proper where the defendant resides.<sup>127</sup> Thus, this threshold inquiry is usually satisfied.

Next, the court applies a set of private and public interest factors.<sup>128</sup> The private factors are: "(1) the relative ease of access to sources of proof; (2) the availability of the compulsory process to secure witnesses' attendance; (3) the willing

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<sup>121</sup> 28 U.S.C. § 1404(a) (2006) ("For the convenience of parties and witnesses, in the interest of justice, a district court may transfer any civil action to any other district or division where it might have been brought.").

<sup>122</sup> See *infra* note 180 and accompanying text. My own survey used Westlaw to locate all thirty-four E.D. Tex. patent cases where transfer of venue was sought and decided in 2009. The results show that only three of the cases involved a party from the district.

<sup>123</sup> Leychkis, *supra* note 81, at 216.

<sup>124</sup> See *infra* Table 3 in Part IV.A.

<sup>125</sup> *In re Volkswagen AG*, 371 F.3d 201, 203 (5th Cir. 2004); *Network-1 Sec. Solutions, Inc. v. D-Link Corp.*, 433 F. Supp. 2d 795, 798 (E.D. Tex. 2006).

<sup>126</sup> *In re Volkswagen*, 371 F.3d at 203; *Network-1*, 433 F. Supp. 2d at 798.

<sup>127</sup> 28 U.S.C. § 1400(b); e.g., *Network-1*, 433 F. Supp. 2d at 798.

<sup>128</sup> *In re Volkswagen*, 371 F.3d at 203; *Network-1*, 433 F. Supp. 2d at 798.

witnesses' cost of attendance; and (4) all other practical problems that make the case's trial easy, expeditious, and inexpensive."<sup>129</sup> The public factors are: "(1) the administrative difficulties flowing from court congestion; (2) the local interest in having local issues decided at home; (3) the forum's familiarity with the governing law; and (4) the avoidance of unnecessary conflict of law problems involving foreign law's application."<sup>130</sup> These factors compare the relative convenience of the current forum against the proposed transferee forum.

A review of the Eastern District's application of these factors pre-*TS Tech* shows the district's analyses was cursory at best and disingenuous at worst. In *Tinkers & Chance v. Leapfrog Enterprises, Inc.*, the defendant resided in the Northern District of California, sought transfer there, and alleged that the plaintiff was a California partnership.<sup>131</sup> The court denied transfer.<sup>132</sup> With respect to access to sources of proof, while most of the evidence was in California, the court argued that modern technology made access easy and rendered this factor unimportant as a general matter.<sup>133</sup> With respect to location of witnesses, the court found that the facts were inconclusive because the defendant failed to identify all the potential witnesses that it claimed were in California.<sup>134</sup> The Eastern District of Texas also had a special localized interest in the matter because potential acts of infringement in the district had an effect on the local economy.<sup>135</sup> Finally, the court adopted a strong presumption in favor of the plaintiff's choice of forum.<sup>136</sup>

Other cases show similar results and analyses. In *Symbol Technologies, Inc. v. Metrologic Instruments, Inc.*, the plaintiff resided in New York and the defendant resided in New Jersey; therefore, the defendant moved to transfer to the Southern District of New York.<sup>137</sup> Breezing through the factors, the court noted that while all relevant documentary evidence was located in New York or New Jersey, docu-

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<sup>129</sup> *Network-I*, 433 F. Supp. 2d at 798.

<sup>130</sup> *Id.*

<sup>131</sup> *Tinkers & Chance v. Leapfrog Enter., Inc.*, No. Civ. A. 2:05-CV-349, 2006 WL 462601, at \*1-2 (E.D. Tex. Feb. 23, 2006).

<sup>132</sup> *Id.* at \*1

<sup>133</sup> *Id.* at \*2.

<sup>134</sup> *Id.* at \*3.

<sup>135</sup> *Id.*

<sup>136</sup> *Id.* at \*4.

<sup>137</sup> *Symbol Tech., Inc. v. Metrologic Instruments, Inc.*, 450 F. Supp. 2d 676, 677 (E.D. Tex. 2006).

ments would have to be exchanged regardless of where the case was tried.<sup>138</sup> The court concluded that the Eastern District of Texas was convenient for the New York plaintiff because the plaintiff chose to file in the Eastern District.<sup>139</sup> Since patent cases generally involve third party witnesses from all over the world, cost of attendance and compulsory process factors were neutral.<sup>140</sup> *Network-1 Security Solutions, Inc. v. D-Link Corp.* exhibits similar reasoning.<sup>141</sup> The plaintiff resided in New York.<sup>142</sup> The defendant resided in Taiwan and California and sought transfer to the Southern District of New York.<sup>143</sup> The court advanced the usual reasons: evidence could be exchanged electronically; witnesses may have been from all over the world so New York was no more convenient; the plaintiff's choice of forum was entitled to deference; and the district had a localized interest because the allegedly infringing sales occurred in the district.<sup>144</sup>

Pre-*TS Tech*, the Eastern District granted transfer where extraneous circumstances favored transfer. For example, where the court lacked personal jurisdiction over the defendant or judicial efficiency counseled transfer.<sup>145</sup> Commonly, the defendant in the Eastern District action "first-filed" a declaratory judgment action in the transferee forum against the Eastern District plaintiff that alleged non-infringement and was filed *before* the plaintiff sued for infringement in the Eastern District.<sup>146</sup> Alternatively, there was an ongoing infringement action in the transferee forum concerning the same patents and parties.<sup>147</sup>

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<sup>138</sup> *Id.* at 678.

<sup>139</sup> *See id.*

<sup>140</sup> *Id.* at 679.

<sup>141</sup> 433 F. Supp. 2d 795, 799–802 (E.D. Tex. 2006).

<sup>142</sup> *Id.* at 796.

<sup>143</sup> *Id.* at 796–97.

<sup>144</sup> *Id.* at 799–802.

<sup>145</sup> *E.g.*, *Third Dimensions Semiconductor, Inc. v. Fairchild Semiconductor Int'l, Inc.*, No. 6:08-CV-200, 2008 WL 4179234, at \*2 (E.D. Tex. Sept. 4, 2008) (holding that judicial economy favored transfer due to common issues); *QR Spex, Inc. v. Motorola, Inc.*, 507 F. Supp. 2d 650, 668 (E.D. Tex. 2007) (lacking personal jurisdiction over defendant where defendant did not conduct any infringing sales in the state of Texas).

<sup>146</sup> *E.g.*, *Third Dimensions Semiconductor*, 2008 WL 4179234, at \*1 (granting transfer where defendant filed declaratory judgment action in transferee district on May 17, 2008 at 12:01 AM; plaintiff filed instant action one hour later on May 17, 2008 at 1:00 AM); *O2 Micro Int'l Ltd. v. Monolithic Power Sys., Inc.*, No. 2:04-CV-359, 2006 WL 887391, at \*1 (E.D. Tex. Mar. 28, 2006) (granting transfer where defendant in Eastern District action filed declaratory judgment action

Absent such circumstances, the Eastern District rarely granted transfer. Considerations of convenience seldom mattered. Further, the Federal Circuit affirmed the district's § 1404(a) decisions.<sup>148</sup> “[A] district court’s decision concerning a motion to transfer venue is reviewed for *abuse of discretion*.”<sup>149</sup> Because the district followed the Fifth Circuit’s § 1404(a) precedent, the district’s cursory analysis was not an abuse of discretion.<sup>150</sup>

### III. *In re TS Tech*: The Federal Circuit Takes Action

Given *D-Link*, the odds seemed stacked against petitioner TS Tech when it appealed the Eastern District’s denial to the Federal Circuit.<sup>151</sup> Very little distinguished *TS Tech* from *D-Link* and the many other cases where the Eastern District denied transfer. The plaintiff, Lear Corporation, resided in Southfield, Michigan.<sup>152</sup> The defendants, TS Tech USA Corporation and its two subsidiaries, resided in the Southern District of Ohio and in Canada.<sup>153</sup> Defendants sought transfer to the Southern District of Ohio.<sup>154</sup>

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against plaintiff on May 20, 2004 in transferee forum; plaintiff later filed the current action on October 12, 2004).

<sup>147</sup> *E.g.*, *Chi Mei Optoelectronics Corp. v. LG Phillips LCD Co.*, No. 2:07-CV-176, 2008 WL 901405, at \*1 (E.D. Tex. Mar. 31, 2008) (granting transfer where defendant sued plaintiff in transferee forum for infringement on December 1, 2006 and plaintiff later sued defendant for infringement over patents covering similar technology on May 4, 2007); *Kinetic Concepts, Inc. v. Bluesky Med. Group, Inc.*, No. 2:07-CV-188, 2008 WL 151276, at \*1–2 (E.D. Tex. Jan. 15, 2008) (granting transfer where plaintiff sued defendant in transferee forum for infringement of a first patent and plaintiff later sued defendant in instant action for infringement of another patent that is a continuation of the application of the first patent); *Aventis Pharm. Inc. v. Teva Pharm. USA Inc.*, No. 2:06-CV-469, 2007 WL 2823296, at \*1 (E.D. Tex. Sept. 27, 2007) (granting transfer where plaintiff sued defendant in transferee forum and plaintiff later sued for infringement of another patent related to the same product).

<sup>148</sup> *In re D-Link Corp.*, 183 Fed. App’x. 967, 968–69 (Fed. Cir. 2006) (interpreting 28 U.S.C. §1404(a) to affirm the Eastern District’s denial of defendant’s transfer motion).

<sup>149</sup> *Id.* at 968.

<sup>150</sup> *See id.* at 968–69 (“In reviewing a district court’s ruling on a motion to transfer pursuant to § 1404(a), we apply the law of the regional circuit.”).

<sup>151</sup> *See In re TS Tech. USA Corp.*, 551 F.3d 1315, 1317 (Fed. Cir. 2008).

<sup>152</sup> *Lear Corp. v. TS Tech. USA Corp.*, No. 2:07-CV-406, 2008 WL 6515201, at \*1 (E.D. Tex. Sept. 10, 2008).

<sup>153</sup> *Id.* at \*12.

<sup>154</sup> *Id.* at \*1.



The Eastern District analysis proceeded in customary fashion with one exception. Recall that *Volkswagen* set out four private factors.<sup>155</sup> In *Lear*, the Eastern District added two more factors—“the plaintiffs’ choice of forum” and “the place of the alleged wrong”—citing a prior Eastern District case that predated *Volkswagen*.<sup>156</sup> Under this six-factor test, the Eastern District concluded that the private factors disfavored transfer.<sup>157</sup> Deference to the plaintiff’s choice of forum disfavored transfer.<sup>158</sup> The court strangely found the cost of attendance factor neutral because “neither the plaintiffs nor the defendant are located in Texas.”<sup>159</sup> The place of wrong included the Eastern District, and the remaining private factors were neutral.<sup>160</sup> The public factors weighed against transfer since defendants’ allegedly infringing products were sold in the district.<sup>161</sup> The court therefore denied transfer.<sup>162</sup>

The Federal Circuit ruled that the Eastern District of Texas clearly abused its discretion.<sup>163</sup> Judge Rader’s opinion disagreed with the Eastern District on several key points. First, the district misconstrued the weight of the plaintiff’s choice of forum, incorrectly treating it as a distinct factor.<sup>164</sup> Second, in assessing cost of attendance, the district failed to apply the “100-mile” rule established in *Volkswagen*.<sup>165</sup> Under this rule, “the factor of inconvenience to witnesses increases in direct relationship to the additional distance [beyond 100 miles] to be traveled.”<sup>166</sup> The district disregarded the fact that all the identified key witnesses in Ohio, Michigan, and Canada would need to travel 900 more miles to attend trial in Texas

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<sup>155</sup> See *supra* note 129 and accompanying text.

<sup>156</sup> See *Lear*, 2008 WL 6515201, at \*3 (citing *Mohamed v. Mazda Motor Corp.*, 90 F. Supp. 2d 757, 771 (E.D. Tex. 2000)). *Volkswagen* was decided by the Fifth Circuit in 2004. See *supra* note 126.

<sup>157</sup> See *Lear*, 2008 WL 6515201, at \*1–3.

<sup>158</sup> *Id.* at \*2.

<sup>159</sup> *Id.*

<sup>160</sup> *Id.* (indicating that parties’ briefs indicated compulsory process was neutral and sources of proof could be transported electronically).

<sup>161</sup> *Id.*

<sup>162</sup> *Id.* at \*4.

<sup>163</sup> *In re TS Tech. USA Corp.*, 551 F.3d 1315, 1321 (Fed. Cir. 2008).

<sup>164</sup> *Id.* at 1320.

<sup>165</sup> *Id.*

<sup>166</sup> *Id.*

rather than Ohio.<sup>167</sup> Third, on access to sources of proof, the district erred in deciding this factor was neutral. Most of the evidence was located in or around the transferee forum and none was located in the Eastern District.<sup>168</sup>

Judge Rader also disagreed with the district's common argument that modern technology and electronic storage made the access factor neutral, countering that such an approach rendered this factor superfluous.<sup>169</sup> Discussing public factors, the existence of some infringing sales in the Eastern District was insufficient to give the district any special local interest in the matter.<sup>170</sup> Neither TS Tech nor Lear had any offices in the district and infringing sales occurred nationwide.<sup>171</sup> The effect of TS Tech's alleged infringing sales had "no more or less of a meaningful connection to this case than any other venue."<sup>172</sup>

Pre-*TS Tech*, the Eastern District's § 1404(a) analysis may have been hasty and possibly misleading. Nevertheless, the Federal Circuit took a bold departure from *D-Link* in finding that the district clearly abused its discretion in *TS Tech*.<sup>173</sup> The Federal Circuit's own *VE Holding* allows the plaintiffs to choose where to file.<sup>174</sup> In *TS Tech*, the Federal Circuit acknowledged that the Eastern District's analysis was correct for many factors.<sup>175</sup> As the Federal Circuit concurred in *D-Link*,<sup>176</sup> there is some merit to the Eastern District's contention that in this age of electronic storage and transportation, access of sources of proof can be an insignificant factor in the analysis.

On the other hand, the establishment of the Federal Circuit in 1982 was motivated by a need to unify patent case law across all jurisdictions, preventing the then

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<sup>167</sup> *Id.*

<sup>168</sup> *Id.* at 1321.

<sup>169</sup> *In re TS Tech.*, 551 F.3d at 1321.

<sup>170</sup> *Id.*

<sup>171</sup> *Id.*

<sup>172</sup> *Id.*

<sup>173</sup> *Cf. id.* ("There is no easy-to-draw line separating a 'clear' abuse of discretion from a 'mere' abuse of discretion in all cases . . . Nevertheless, we conclude that TS Tech has met its difficult burden of demonstrating a clear and indisputable right to a writ.").

<sup>174</sup> *VE Holding Corp. v. Johnson Gas Appliance Co.*, 917 F.2d 1575, 1576–83 (Fed. Cir. 1990).

<sup>175</sup> *See In re TS Tech.*, 551 F.3d at 1319–20 (noting that "several factors that the district court afforded no weight . . . were indeed neutral on the facts presented").

<sup>176</sup> *In re D-Link Corp.*, 183 Fed. App'x. 967, 968–69 (Fed. Cir. 2006).

existing practice of plaintiffs picking jurisdictions that were more favorable in their construction of patent laws.<sup>177</sup> Seeing the Eastern District's continuing ascendance from *D-Link* in mid-2006 to its position atop the nation's patent trial docket, the Federal Circuit may have felt compelled to enforce its mandate. The Eastern District's failure to obey Fifth Circuit law on § 1404(a) gave the Federal Circuit an opportunity to find an abuse of discretion.

#### IV. The Eastern District Holds Its Ground

One might expect a reduction in patent filings in the Eastern District of Texas following *TS Tech*. While patentee-plaintiffs can file there, there is no guarantee the case will not be transferred out. Indeed, the Eastern District saw a decline in the number of patent cases filed in 2009,<sup>178</sup> perhaps due to plaintiff apprehension concerning new transfer rules. In addition, the district saw a spike in transfer requests in patent cases, from nineteen in 2008 to thirty-four in 2009.<sup>179</sup>

##### A. The Transfer Record Since *TS Tech*

The dataset in Tables 3, 4a, and 4b was compiled by using Westlaw to search for all Eastern District of Texas patent cases where the court decided a § 1404(a) motion.<sup>180</sup> Before *TS Tech*, the district granted transfer in 30.6% of cases (fifteen of forty-nine). Since *TS Tech*, the grant rate is 34.1% (fourteen of forty-one cases).

<sup>177</sup> John B. Owns, Student Note, *Judge Baer and the Politics of the Fourth Amendment: An Alternative to Bad Man Jurisprudence*, 8 STAN. L. & POL'Y REV. 189, 195 (1997); Christopher G. Wilson, Note, *Embedded Federal Questions, Exclusive Jurisdiction, and Patent-Based Malpractice Claims*, 51 WM. & MARY L. REV. 1237, 1251 (2009).

<sup>178</sup> See *supra* Figure 1 in Part II.B.1.

<sup>179</sup> See *infra* Table 3.

<sup>180</sup> I searched all federal cases using the query: [("1404" & "TRANSFER" & "VENUE") & "PATENT" & "INFRINGEMENT" & DA(AFT 2000) & PR("E.D. TEX")]. I ignored results from before 2004 since very few transfer motions were filed before 2004. For 2009, I supplemented this with a second query: ["TRANSFER" & "VENUE" & ("GENENTECH" "TS TECH") & PR("E.D. TEX")] to check for cases citing the Federal Circuit's decision in *In re TS Tech*. Finally, I supplemented all searches by searching Westlaw's Federal Patent Cases database (FIPAT-CS) using the following query: [PR("E.D. TEX") & "TRANSFER" /S "MOTION" & "VENUE" & DA(AFT 2003)]. I went through every case to assure that it was a patent case or if there were other reasons to not include it in my data (e.g. while a transfer motion was filed, the court never ruled on the motion). This method is concededly not complete and Westlaw may take many months before an order or decision is uploaded to its database). An analysis of Stanford IPLC's, which is more up to date, indicates that a few of the district's transfer orders are very brief (i.e. are not memoranda orders that explain the facts, law, and reasoning) and may contain strings that my search queries did not capture. However, my data collection method, while under-inclusive, should approximate grant/deny trends and is consistent across years and judges.

The data, therefore, reveals a trivial change in results. The inertial effect of the plaintiff's initial filing choice is still significant.

Year	Transfer Requested	Transfer Granted	Transfer Denied
2004	3	1	2
2005	6	1	5
2006	8	1	7
2007	13	7	6
2008	19	5	14
2009	34 <sup>181</sup>	11–13 <sup>182</sup>	21
2010 <sup>183</sup>	7	1	6

Table 3: E.D. Tex.'s Transfer Record in Patent Cases from 2004 to 2009

Examining the post-*TS Tech* results by date and judge reveals little. It is conceivable that the Eastern District would only gradually become acclimated to *TS Tech*. In May 2009, the Federal Circuit confirmed and clarified its § 1404(a) transfer rules in *In re Genentech, Inc.*<sup>184</sup> Yet Table 4a, *infra*, indicates no progression over the course of the year. The grant rate in the first half of 2009 was 35.3 percent. The rate since then is 33.3 percent. Table 4b, *infra*, which tracks tendencies by judge, exposes no trends that the small sample size cannot account for.

<sup>181</sup> There were three cases where transfer was favored but under unique circumstances. One case was stayed pending action in transferee district, with the court noting that the factors favored transfer. *Sanofi-Aventis Deutschland v. Novo Nordisk, Inc.* (*Sanofi II*), 614 F. Supp. 2d 772, 773–74 (E.D. Tex. 2009). In another case, transfer was granted for the California defendants, but not the TX defendants. *Balthasar Online, Inc. v. Network Solutions, LLC.*, 654 F. Supp. 2d 546, 553 (E.D. Tex. 2009). In a third case, both parties sought transfer. *Digital-Vending Serv., Int'l. LLC v. Univ. of Phoenix, Inc.*, No. 2:08-CV-91-TJW-CE, 2009 WL 3161361, at \*3–4 (E.D. Tex. Sept. 30, 2009) (granting plaintiff's motion to transfer to E.D. Va. and denying defendant's motion to transfer to D. D.C.).

<sup>182</sup> *Sanofi II*, 614 F. Supp. 2d at 773–74; *Balthasar*, 654 F. Supp. 2d at 553; *Digital-Vending*, 2009 WL 3161361, at \*3–4.

<sup>183</sup> Because I used Westlaw, the data from 2010 is incomplete.

<sup>184</sup> 566 F.3d 1338, 1341–48 (Fed. Cir. 2009).

Date Range	Grants	Denials
Jan.–Mar. '09	4	6
Apr.–June '09	2	5
Jul.–Sept. '09	5	6
Oct.–Dec. '09	2	4
Jan.–Mar. '10	0	5
Apr.–June '10	1	1

Table 4a: E.D. Tex.'s Transfer Record in Patent Cases Since *TS Tech* by Date Range

Judge	Grants	Denials
J. Clark	2	3
J. Davis	2	4
J. Folsom	3	2
J. Ward	3	8
M.J. Everingham	3	4
M.J. Love	1	7

Table 4b: E.D. Tex.'s Transfer Record in Patent Cases Since *TS Tech* by Judge

The next section explains how the Eastern District incorporated the *TS Tech* holding, yet still denied transfer motions at similar rates.

#### B. The Eastern District's Modified Analysis

The Eastern District of Texas's use of a six private factor test in *Lear* was unusual. In most pre-*TS Tech* cases, the district followed the analysis required by *Volkswagen* and enforced in *TS Tech*. *TS Tech*, therefore, did little to change the form of the analysis.<sup>185</sup> Post-*TS Tech*, the court still begins by examining whether venue is proper in the transferee district.<sup>186</sup> The court then applies the four private and four public factors. In accordance with *TS Tech* though, the court now recog-

<sup>185</sup> Cf. *MHL Tek, LLC v. Nissan Motor Co.*, No. 2:07-CV-289, 2009 WL 440627, at \*2 (E.D. Tex. Feb. 23, 2009).

<sup>186</sup> *Deep Nines, Inc. v. McAfee, Inc.*, No. 9:09-CV-89, 2009 WL 3784372, at \*2 (E.D. Tex. Nov. 10, 2009); *Orinda Intell. Prop. USA, Inc. v. Sony Corp.*, No. 2:08-CV-323, 2009 WL 3261932, at \*2 (E.D. Tex. Sept. 29, 2009) (finding venue proper in transferee forum because infringing sales occurred there); *Emanuel v. SPX Corp./OTC Tools Div.*, No. 6:09-CV-220, 2009 WL 3063322, at \*3 (E.D. Tex. Sept. 21, 2009); *Centre One v. Vonage Holding Corp.*, No. 6:08-CV-467, 2009 WL 2461003, at \*5 (E.D. Tex. Aug. 10, 2009); *Konami Digital Entm't Co. v. Harmonix Music Sys., Inc.*, No. 6:08-CV-286, 2009 WL 781134, at \*3 (E.D. Tex. Mar. 23, 2009).

nizes that it is no longer good law to use *Lear*'s six-factor test and to consider the plaintiff's choice of forum as a distinct factor.<sup>187</sup>

However, the district's application of the factors might not be in line with the spirit of *TS Tech*. Summarizing *TS Tech*'s holding in informal terms, if the facts and parties have no relation with the Eastern District of Texas (other than infringing sales that also occur nationwide), then the case should be transferred. The Eastern District's post-*TS Tech* approach softens this informal holding. Since *TS Tech*, eleven cases have involved a Texas plaintiff. In ten of eleven, transfer was denied though the plaintiff was not necessarily from the Eastern District, there were no Texas defendants, and most witnesses and evidence were outside of Texas.<sup>188</sup>

Moreover, even in cases bearing no relation to Texas, if the parties, witnesses, and evidence were scattered geographically, then transfer was usually denied.<sup>189</sup> The Eastern District argued that such cases were not "regional" in nature, meaning the cases were not localized around the transferee forum. Therefore, the Eastern

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<sup>187</sup> *Fujitsu Ltd. v. Tellabs, Inc.*, 639 F. Supp. 2d 761, 765 (E.D. Tex. 2009); *Motiva LLC v. Nintendo Co.*, No. 6:08-CV-429, 2009 WL 1882836, at \*2 (E.D. Tex. June 30, 2009); *MHL Tek*, 2009 WL 440627, at \*3.

<sup>188</sup> *Medidea, LLC v. Smith & Nephew, Inc.*, No. 2-09-CV-378-TJW, 2010 WL 1444211 (E.D. Tex. Apr. 12, 2010); *Medidea, LLC v. Zimmer Holdings, Inc.*, No. 2-09-CV-258-TJW, 2010 WL 796738, at \*1 (E.D. Tex. Mar. 8, 2010); *Personal Audio, LLC v. Apple, Inc.*, No. 9:09-CV-111, 2010 WL 582540, at \*1 (E.D. Tex. Feb. 11, 2010); *Acceleron, LLC v. Egenera, Inc.*, 634 F. Supp. 2d 758, 763 (E.D. Tex. 2009) (noting that plaintiff was a one-person NPE incorporated in Delaware with its principal place of business in Tyler, Texas); *Emanuel*, 2009 WL 3063322 at \*1; *Ver-sata Software Inc. v. Internet Brands, Inc.*, No. 2:08-CV-313, 2009 WL 3161370, at \*1 (E.D. Tex. Sept. 30, 2009); *ICHL, LLC v. NEC Corp. of Am.*, Nos. 5:08-CV-65, 5:08-CV-175, 5:08-CV-177, 2009 WL 1748573, at \*1-2 (E.D. Tex. June 19, 2009) (indicating that the defendant argued that none of the parties resided in Texas while the plaintiff asserted that it had a direct connection to the Eastern District); *Aloft Media, LLC v. Yahoo!, Inc.*, No. 6:08-CV-509, 2009 WL 1650480, at \*1 (E.D. Tex. June 10, 2009); *MHL Tek*, 2009 WL 440627 at \*1. In the one case that was transferred, both the plaintiff and one defendant were from the transferee forum. *Techradium, Inc. v. Athoc, Inc.*, No. 2:09-CV-275-TJW, 2010 WL 1752535, at \*24 (E.D. Tex. Apr. 29, 2010).

<sup>189</sup> *Deep Nines*, 2009 WL 3784372, at \*4; *Emanuel*, 2009 WL 3063322, at \*4-5, \*7-9 ("Even if Plaintiff has no connection to the Eastern District of Texas, the Defendant has still failed to demonstrate that there is a localized focus of people, events, and evidence in or near the District of Minnesota."); *Aloft*, 2009 WL 1650480, at \*3, \*5 (explaining that the cost of attendance factor "may weigh against transfer or be neutral when the relevant witnesses are spread throughout the country or the world"); *Motiva*, 2009 WL 1882836, at \*6 ("Here, while Defendants rely heavily on the fact that there are no documents and witnesses located in Texas, they ultimately fail to meet their burden-proof that this case is clearly more conveniently tried in the Western District of Washington."); *Konami*, 2009 WL 781134, at \*4-5 (finding the cost of attendance and sources of proof factors neutral because the evidence and witnesses were from varied locations across the world).

District is as convenient a forum as any other.<sup>190</sup> The district often distinguishes *TS Tech* on this ground.<sup>191</sup> An overview of how the Eastern District analyzes each private and public factor post-*TS Tech* follows.

*1. Private Factor 1: Relative Ease of Access to Sources of Proof*

The district's analysis of the location and costs of procuring evidence demonstrates disinclination against transfer. First, if any identified sources of proof are located in Texas—not just the Eastern District—this may weigh against transfer, even if most evidence is located elsewhere.<sup>192</sup> Only in instances where no evidence was located in the district, evidence was not geographically scattered,<sup>193</sup> and evidence was localized around the transferee forum did this factor favor transfer.<sup>194</sup> Second, the court sometimes found transfer disfavored by relying on the fact that the defendant failed to specifically identify evidence<sup>195</sup> or if the relevancy of identified evidence was unclear.<sup>196</sup> This reasoning was inconsistently applied; in one

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<sup>190</sup> *ICHL*, 2009 WL 1748573, at \*6 (“[C]ourts which have denied transfer motions have focused on the lack of a common regional geographic area in and around the proposed transferee forum.”); *MHL Tek*, 2009 WL 440627, at \*4 (“The central location of this Court in relation to the parties involved in this suit makes it, at the very least, as convenient a location as the Eastern District of Michigan.”).

<sup>191</sup> *Motiva*, 2009 WL 1882836, at \*6 (“Though the Court acknowledges that this is a close case, it is readily distinguishable from cases such as *In re Genentech* and *TS Tech*. In those cases, it was undisputed that the vast majority of identified documents and witnesses were located in and around the transferee court.”); *Konami*, 2009 WL 781134, at \*4 (“Unlike *Volkswagen II* and *TS Tech*, here all of the documents and physical evidence are not located in and around the destination venue.”); *J2 Global Comm., Inc. v. Protus IP Solutions, Inc.*, Nos. 6:08-CV-211, 6:08-CV-262, 6:08-CV-263, 2009 WL 440525, at \*4 (E.D. Tex. Feb. 20, 2009) (“[T]his case is distinguishable from *TS Tech* where the transferee district was much more convenient for all of the parties.”).

<sup>192</sup> *Mediostream, Inc. v. Microsoft Corp.*, No. 2:08-CV-3690, 2009 WL 3161380, at \*3 (E.D. Tex. Sept. 30, 2009); *ICHL*, 2009 WL 1748573, at \*7.

<sup>193</sup> The court denies transfer where the evidence is dispersed geographically. *Mondis Tech. Ltd. v. Top Victory Elec. (Taiwan) Co.*, No. 2:08-CV-478 (TJW), 2009 WL 3460276, at \*3 (E.D. Tex. Oct. 23, 2009); *Versata*, 2009 WL 3161370, at \*3; *Konami*, 2009 WL 781134, at \*9; *MHL Tek.*, 2009 WL 440627, at \*2; *Novartis Vaccines & Diagnostics, Inc. v. Hoffinan-La Roche Inc. (Novartis I)*, 597 F. Supp. 2d 706, 711 (E.D. Tex. 2009).

<sup>194</sup> *See Vasudevan Software, Inc. v. Int'l. Bus. Mach. Corp.*, No. 2:09-CV-105-TJW, 2009 WL 3784371, \*2–3 (E.D. Tex. Nov. 10, 2009) (indicating that evidence was localized in transferee forum); *Fifth Generation Computer Corp. v. Int'l. Bus. Mach. Corp.*, No. 9:08-CV-205, 2009 WL 398783, at \*4 (E.D. Tex. Feb. 17, 2009).

<sup>195</sup> *J2 Global*, 2009 WL 440525, at \*3; *Invitrogen Corp. v. Gen. Elec. Co.*, No. 6:08-CV-113, 2009 WL 331889, at \*3 (E.D. Tex. Feb. 9, 2009).

<sup>196</sup> *Motiva*, 2009 WL 1882836, at \*3; *Sanofi-Aventis Deutschland GmbH v. Genentech, Inc. (Sanofi I)*, 607 F. Supp. 2d 769, 776 (E.D. Tex. 2009).

case, the court accounted for evidence not specified where said evidence was located in or near the Eastern District.<sup>197</sup> Third, despite *TS Tech*,<sup>198</sup> the district continued to argue that modern technology renders this factor unimportant and neutral.<sup>199</sup> In May 2009, the Federal Circuit restated that this factor cannot be rendered superfluous on technological grounds.<sup>200</sup> The district has since agreed.<sup>201</sup>

## 2. Private Factor 2: Availability of Compulsory Process

This factor weighs the power of the transferor and transferee forums to subpoena witnesses, forcing them to attend trial and discovery proceedings.<sup>202</sup> If the transferee forum is closer to the witnesses, it will have greater subpoena power and this should weigh in favor of transfer.<sup>203</sup> Yet even in such cases, the Eastern District frequently finds this factor neutral. The district argues that this factor only weighs in favor of transfer when the transferee forum had “absolute subpoena power,” meaning that the transferee forum had subpoena power over *all* witnesses.<sup>204</sup> In the Eastern District’s analysis, if the transferee forum had subpoena power over most witnesses or more witnesses than the Eastern District, this factor—at best—slightly favored transfer.<sup>205</sup> The district’s remaining analysis resem-

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<sup>197</sup> *Centre One v. Vonage Holding Corp.*, No. 6:08-CV-467, 2009 WL 2461003, at \*6 (E.D. Tex. Aug. 10, 2009).

<sup>198</sup> *In re TS Tech. USA Corp.*, 551 F.3d 1315, 1321 (Fed. Cir. 2008).

<sup>199</sup> *Odom v. Microsoft Corp.*, 596 F. Supp. 2d 995, 1000 (E.D. Tex. 2009) (decided in January and holding that relevant evidence included source code, which is stored electronically); *Jackson v. Intel Corp.*, No. 2:08-CV-154, 2009 WL 749305, at \*2 (E.D. Tex. Mar. 19, 2009) (“[D]efendants have identified no documents or evidence located in Illinois that cannot be produced electronically or easily transported to Marshall.”); *Sanofi I*, 607 F. Supp. 2d at 777 (decided in March 2009); *J2 Global*, 2009 WL 440525, at \*2.

<sup>200</sup> *In re Genentech, Inc.*, 566 F.3d 1338, 1345–46 (Fed. Cir. 2009).

<sup>201</sup> *Centre One*, 2009 WL 2461003, at \*5 (decided in August); *Acceleron, LLC v. Egenera, Inc.*, 634 F. Supp. 2d 758, 765 (E.D. Tex. 2009) (decided in June); *Motiva*, 2009 WL 1882836, at \*3 (“[C]ourts have analyzed this factor in light of the fiction that voluminous documents must be transported from their physical location (supposing that electronically stored documents are, in fact, physical) to the trial venue.”); *Aloft Media, LLC v. Yahoo!, Inc.*, No. 6:08-CV-509, 2009 WL 1650480, at \*2 (E.D. Tex. June 10, 2009) (decided in June); *Aten Int’l. Co. v. Emine Tech. Co.*, 261 F.R.D. 112, 123–24 (E.D. Tex. 2009) (decided in June); *Fujitsu Ltd. v. Tellabs, Inc.*, 639 F. Supp. 2d 761, 767 (E.D. Tex. 2009) (decided in June).

<sup>202</sup> See Fed. R. Civ. P. 45(b)(2), (c)(3).

<sup>203</sup> See *In re Genentech*, 566 F.3d at 1345 (reversing *Sanofi I*).

<sup>204</sup> *Acceleron*, 634 F. Supp. 2d at 765.

<sup>205</sup> *Deep Nines, Inc. v. McAfee, Inc.*, No. 9:09-CV-89, 2009 WL 3784372, at \*4 (E.D. Tex. Nov. 10, 2009); *Mondis Tech. Ltd. v. Top Victory Elec. (Taiwan) Co.*, No. 2:08-CV-478 (TJW), 2009 WL



bles the reasoning discussed under the sources of proof factor. The court looks to the number of witnesses on each side, but has found this factor to be neutral where the witnesses are dispersed geographically.<sup>206</sup> Further, this factor is found neutral if the court concludes that none of the witnesses outside the district are unwilling to attend trial in the Eastern District<sup>207</sup> or that deposition testimony could be videotaped.<sup>208</sup>

### 3. Private Factor 3: Cost and Convenience of Attendance

The Eastern District's analysis of this factor shifted in response to a Federal Circuit case, *In re Genentech*.<sup>209</sup> *TS Tech* enforced the Fifth Circuit's "100-mile rule" whereby inconvenience increases proportionally with the distance a witness must travel in excess of 100 miles.<sup>210</sup> After *TS Tech*, the Eastern District followed the 100-mile rule,<sup>211</sup> but used it to argue *against* transfer in applicable cases. First, where some witnesses were foreign, the court added up distances to argue that foreign witnesses would have had to travel farther if the transferee forum is in California.<sup>212</sup> Second, in cases where witnesses resided on both U.S. coasts, the court added up distances to find that its "central location" reduced travel for witnesses on both coasts.<sup>213</sup> Third, in cases where the witnesses were dispersed, the Eastern Dis-

3460276, at \*4 (E.D. Tex. Oct. 23, 2009); *Emanuel v. SPX Corp./OTC Tools Div.*, No. 6:09-CV-220, 2009 WL 3063322, at \*6 (E.D. Tex. Sept. 21, 2009); *Aten*, 261 F.R.D. at 124 .

<sup>206</sup> *ICHL, LLC v. NEC Corp. of Am.*, Nos. 5:08-CV-65, 5:08-CV-175, 5:08-CV-177, 2009 WL 1748573, at \*9 (E.D. Tex. June 19, 2009) (creating dispersion in this case by arguing that relevant witnesses should encompass more parties than what defendant proposed and the inclusion of this larger set of relevant witnesses created dispersion of the superset); *Konami Digital Entm't Co. v. Harmonix Music Sys., Inc.*, No. 6:08-CV-286, 2009 WL 781134, at \*6 (E.D. Tex. Mar. 23, 2009).

<sup>207</sup> *Centre One v. Vonage Holding Corp.*, No. 6:08-CV-467, 2009 WL 2461003, at \*6 (E.D. Tex. Aug. 10, 2009); *Odom v. Microsoft Corp.*, 596 F. Supp. 2d 995, 1002 (E.D. Tex. 2009); *Sanofi-Aventis Deutschland GMBH v. Genentech, Inc. (Sanofi I)*, 607 F. Supp. 2d 769, 777-78 (E.D. Tex. 2009).

<sup>208</sup> *J2 Global Comm., Inc. v. Protus IP Solutions, Inc.*, Nos. 6:08-CV-211, 6:08-CV-262, 6:08-CV-263, 2009 WL 440525, at \*5 (E.D. Tex. Feb. 20, 2009); *Invitrogen Corp. v. Gen. Elec. Co.*, No. 6:08-CV-113, 2009 WL 331889, at \*3 (E.D. Tex. Feb. 9, 2009); *Sanofi I*, 607 F. Supp. 2d at 777-78.

<sup>209</sup> 566 F.3d 1338 (Fed. Cir. 2009).

<sup>210</sup> *In re TS Tech. USA Corp.*, 551 F.3d 1315, 1321-22 (Fed. Cir. 2008).

<sup>211</sup> *Acceleron, LLC v. Egenera, Inc.*, 634 F. Supp. 2d 758, 766 (E.D. Tex. 2009); *Deep Nines, Inc. v. McAfee, Inc.*, No. 9:09-CV-89, 2009 WL 3784372, at \*4 (E.D. Tex. Nov. 10, 2009); *Motiva LLC v. Nintendo Co.*, No. 6:08-CV-429, 2009 WL 1882836, at \*5 (E.D. Tex. June 30, 2009).

<sup>212</sup> *E.g.*, *J2 Global*, 2009 WL 440525, at \*4.

<sup>213</sup> *MHL Tek, LLC v. Nissan Motor Co.*, No. 2:07-CV-289, 2009 WL 440627, at \*4 (E.D. Tex. Feb. 23, 2009); *Novartis Vaccines & Diagnostics, Inc. v. Hoffman-La Roche Inc. (Novartis I)*, 597 F.

strict generalized the centralized location approach and added distances to show that it was no less convenient than the proposed transferee forum.<sup>214</sup>

*Genentech* overruled the first and second practices.<sup>215</sup> The Eastern District has since agreed that the 100-mile rule is not rigidly applicable to foreign witnesses<sup>216</sup> and the centralized location test is not good law.<sup>217</sup> Very recent Federal Circuit cases also militate against the third practice.<sup>218</sup> Finally, the Eastern District has found that in cases where the transferee forum was the Northern District of California (San Francisco, Silicon Valley) or the Southern District of New York (Manhattan), the costs of hotels, parking, meals and other expenses attendant to litigation would have been higher there as compared to divisions in the Eastern District, thus disfavoring transfer.<sup>219</sup>

#### 4. Private Factor 4: All Other Practical Problems (Judicial Economy)

As the name suggests, this factor is a catchall for all other private considerations. For example, transfer may raise issues concerning judicial economy and the

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Supp. 2d 706, 713–14 (E.D. Tex. 2009); see also Elizabeth Durham, *Will All Roads Still Lead to the Eastern District of Texas? Transfer Practice After Volkswagen and TS Tech*, 21 No. 7 INTELL. PROP. & TECH. L.J. 12, 12 (2009).

<sup>214</sup> Compare *ICHL, LLC v. NEC Corp. of Am.*, Nos. 5:08-CV-65, 5:08-CV-175, 5:08-CV-177, 2009 WL 1748573, at \*11–12 (E.D. Tex. June 19, 2009) (denying transfer because witnesses dispersed in Los Angeles, Texas, Illinois, New Jersey, and defendants had worldwide operations); with *PartsRiver, Inc. v. Shopzilla, Inc.*, No. 2:07-CV-440, 2009 WL 279110, at \*2 (E.D. Tex. Jan. 30, 2009) (granting transfer where parties are in Washington and Northern California); *Odom v. Microsoft Corp.*, 596 F. Supp. 2d 995, 1002 (E.D. Tex. 2009) (granting transfer where parties in Oregon and Washington); and *Vasudevan Software, Inc. v. Int'l. Bus. Mach. Corp.*, No. 2:09-CV-105-TJW, 2009 WL 3784371, at \*2 (E.D. Tex. Nov. 10, 2009) (granting transfer where witnesses localized around Northern California).

<sup>215</sup> *In re Genentech, Inc.*, 566 F.3d 1338, 1344 (Fed. Cir. 2009).

<sup>216</sup> *Acceleron*, 634 F. Supp. 2d at 767; *Mondis Tech. Ltd. v. Top Victory Elec. (Taiwan) Co.*, No. 2:08-CV-478 (TJW), 2009 WL 3460276, at \*2 (E.D. Tex. Oct. 23, 2009); *Novartis Vaccines & Diagnostics, Inc. v. Bayer Healthcare LLC (Novartis II)*, No. 2:08-CV-068 (TJW), 2009 WL 3157455, at \*3 (E.D. Tex. Sept. 28, 2009).

<sup>217</sup> *Mondis*, 2009 WL 3460276, at \*2; *Aloft Media, LLC v. Yahoo!, Inc.*, No. 6:08-CV-509, 2009 WL 1650480, at \*2 (E.D. Tex. June 10, 2009).

<sup>218</sup> *In re Hoffman-La Roche, Inc.*, 587 F.3d 1333, 1336 (Fed. Cir. 2009); *In re Nintendo Co.*, 589 F.3d 1194 (Fed. Cir. 2009).

<sup>219</sup> *Sanofi-Aventis Deutschland GmbH v. Genentech, Inc. (Sanofi I)*, 607 F. Supp. 2d 769, 778 (E.D. Tex. 2009) (stating that San Francisco is more expensive than Lufkin); *Sanofi-Aventis Deutschland v. Novo Nordisk, Inc. (Sanofi II)*, 614 F. Supp. 2d 772, 779 (E.D. Tex. 2009) (stating that New York is more expensive than Lufkin).

“possibility of delay and prejudice.”<sup>220</sup> The Eastern District favors transfer where the defendant first-filed a declaratory judgment action in the transferee forum.<sup>221</sup> Transfer is also favored when a pending action in the transferee forum concerning the same or substantially similar patents has progressed further in litigation than in the Eastern District.<sup>222</sup>

Judicial economy considerations can also militate against transfer. Where a pending action in the proposed transferee forum concerns the same or substantially similar patents and the Eastern District action has progressed further, transfer is disfavored.<sup>223</sup> Where a declaratory action filed in the proposed transferee forum is then transferred to the Eastern District, transfer back to the transferee forum is disfavored.<sup>224</sup> Transfer is also disfavored where the Eastern District has encountered the same parties or substantially similar patents in past cases.<sup>225</sup> In *Sanofi I*, the Eastern District found that this factor disfavored transfer for two reasons. First, the defendant in the current action had previously been a plaintiff in the Eastern District in an unrelated case.<sup>226</sup> Second, it was unclear whether the transferee forum had personal jurisdiction over the plaintiff.<sup>227</sup> The Federal Circuit in *Genentech* reversed *Sanofi I*, finding these two considerations irrelevant.<sup>228</sup>

#### 5. Public Factor 1: Administrative Difficulties (Court Congestion)

This factor compares disposition speeds and judicial caseloads of the forums. Pre-*TS Tech*, the district commonly concluded that the Eastern District’s faster time-to-trial disfavored transfer to the slower transferee forum.<sup>229</sup> The Eastern Dis-

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<sup>220</sup> *Mondis*, 2009 WL 3460276, at \*4.

<sup>221</sup> *Sanofi II*, 614 F. Supp. 2d at 779–81.

<sup>222</sup> *Fujitsu Ltd. v. Tellabs, Inc.*, 639 F. Supp. 2d 761, 768 (E.D. Tex. 2009).

<sup>223</sup> *Deep Nines, Inc. v. McAfee, Inc.*, No. 9:09-CV-89, 2009 WL 3784372, at \*5 (E.D. Tex. Nov. 10, 2009); *J2 Global Comm., Inc. v. Protus IP Solutions, Inc.*, 2009 WL 440525, at \*6 (E.D. Tex. Feb. 20, 2009) (indicating transferee district had stayed a pending related action).

<sup>224</sup> *MHL Tek, LLC v. Nissan Motor Co.*, No. 2:07-CV-289, 2009 WL 440627, at \*7 (E.D. Tex. Feb. 23, 2009).

<sup>225</sup> *Jackson v. Intel Corp.*, No. 2:08-CV-154, 2009 WL 749305, at \*4 (E.D. Tex. Mar. 19, 2009).

<sup>226</sup> *Sanofi-Aventis Deutschland GmbH v. Genentech, Inc. (Sanofi I)*, 607 F. Supp. 2d 769, 778–79 (E.D. Tex. 2009).

<sup>227</sup> *Id.*

<sup>228</sup> *In re Genentech, Inc.*, 566 F.3d 1338, 1346 (Fed. Cir. 2009).

<sup>229</sup> *E.g., Network-1 Sec. Solutions, Inc. v. D-Link Corp.*, 433 F. Supp. 2d 795, 800–01 (E.D. Tex. 2006).

trict has since followed the Federal Circuit's lead<sup>230</sup> and now presumes this factor to be "speculative" in many cases.<sup>231</sup> In other applicable cases, the court found this factor neutral because the difference in time-to-trial is negligible.<sup>232</sup> The court has also required the plaintiff to present data showing that the transferee forum is slower in patent cases specifically.<sup>233</sup> Data for all civil cases generally is insufficient.<sup>234</sup>

Post-*TS Tech*, the Eastern District in some instances has still found that the relatively greater speed of the Eastern District's rocket docket disfavors transfer.<sup>235</sup> The court has also used the speculative nature of this factor to disregard a defendant's data showing that the Eastern District is slower or more congested.<sup>236</sup> For example, while the transferee district had a faster termination time, the Eastern District had a faster time-to-trial for the cases that reached trial.<sup>237</sup> Hence, this factor was inconclusive.<sup>238</sup> The court also disagreed that its heavy patent caseload created

<sup>230</sup> *In re Genentech*, 566 F.3d at 1347.

<sup>231</sup> *Versata Software Inc. v. Internet Brands, Inc.*, No. 2:08-CV-313, 2009 WL 3161370, at \*4 (E.D. Tex. Sept. 30, 2009); *Orinda Intell. Prop. USA, Inc. v. Sony Corp.*, No. 2:08-CV-323, 2009 WL 3261932, at \*3 (E.D. Tex. Sept. 29, 2009); *ICHL, LLC v. NEC Corp. of Am.*, Nos. 5:08-CV-65, 5:08-CV-175, 5:08-CV-177, 2009 WL 1748573, at \*12 (E.D. Tex. June 19, 2009).

<sup>232</sup> *Emanuel v. SPX Corp./OTC Tools Div.*, No. 6:09-CV-220, 2009 WL 3063322, at \*8-9 (E.D. Tex. Sept. 21, 2009) (indicating difference in median disposition time is negligible where Eastern District takes 9.7 months and transferee district takes 10.4 months); *Invitrogen Corp. v. Gen. Elec. Co.*, No. 6:08-CV-113, 2009 WL 331889, at \*4 (E.D. Tex. Feb. 9, 2009); *Novartis Vaccines & Diagnostics, Inc. v. Hoffman-La Roche Inc. (Novartis I)*, 597 F. Supp. 2d 706, 714 (E.D. Tex. 2009).

<sup>233</sup> *Odom v. Microsoft Corp.*, 596 F. Supp. 2d 995, 1003 (E.D. Tex. 2009).

<sup>234</sup> *Id.*

<sup>235</sup> *Acceleron, LLC v. Egenera, Inc.*, 634 F. Supp. 2d 758, 767 (E.D. Tex. 2009); *Deep Nines, Inc. v. McAfee, Inc.*, No. 9:09-CV-89, 2009 WL 3784372, at \*5 (E.D. Tex. Nov. 10, 2009); *Centre One v. Vonage Holding Corp.*, No. 6:08-CV-467, 2009 WL 2461003, at \*7 (E.D. Tex. Aug. 10, 2009); *Konami Digital Entm't Co. v. Harmonix Music Sys., Inc.*, No. 6:08-CV-286, 2009 WL 781134, at \*8 (E.D. Tex. Mar. 23, 2009); *Sanofi-Aventis Deutschland v. Novo Nordisk, Inc. (Sanofi II)*, 614 F. Supp. 2d 772, 781 (E.D. Tex. 2009); *Aten Int'l. Co. v. Emine Tech. Co.*, 261 F.R.D. 112, 125 (E.D. Tex. 2009) ("parties' evidence relates that the median time to trial is 21.3 months in the Central District of California and 18 months in the Eastern District of Texas. Therefore, this factor weighs slightly against transfer").

<sup>236</sup> *Sanofi-Aventis Deutschland GMBH v. Genentech, Inc. (Sanofi I)*, 607 F. Supp. 2d 769, 780 (E.D. Tex. 2009).

<sup>237</sup> *Id.*

<sup>238</sup> *Id.*

congestion that slowed down its docket,<sup>239</sup> though the district's slowdown since its 2007 peak might suggest otherwise.<sup>240</sup>

#### 6. Public Factor 2: Local Interest

The Eastern District has acknowledged *TS Tech*'s holding that it cannot claim a localized interest on the sole ground that nationwide infringing activity also occurred in the district.<sup>241</sup> However, the court has perhaps attempted to minimize the gist of *TS Tech*. The court has found this factor disfavors transfer so long as any party resides in Texas, even if a large number of parties are incorporated elsewhere.<sup>242</sup> This factor has been found neutral when the defendant resides in the proposed transferee forum<sup>243</sup> or when more infringing uses or sales occurred in the transferee forum.<sup>244</sup>

#### 7. Public Factors 3 and 4: Familiarity with Law and Conflicts of Law

Familiarity with governing law is usually neutral and rarely argued by the parties since the governing law is federal patent law. Federal district courts presumptively have equal familiarity.<sup>245</sup> This factor disfavors transfer in instances

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<sup>239</sup> *Motiva LLC v. Nintendo Co.*, No. 6:08-CV-429, 2009 WL 1882836, at \*5 (E.D. Tex. June 30, 2009).

<sup>240</sup> See *supra* Tables 1 and 3 in Part II.B.1. Figure 1 shows that the number of patent cases filed has dropped from 368 in 2007 to 240 in 2009. Table 2 shows that the current median-to-trial time is over two years, up from less than a year circa 2004–2006.

<sup>241</sup> *Novartis Vaccines & Diagnostics, Inc. v. Bayer Healthcare LLC (Novartis II)*, No. 2:08-CV-068 (TJW), 2009 WL 3157455, at \*4 (E.D. Tex. Sept. 28, 2009); *J2 Global Comm., Inc. v. Protus IP Solutions, Inc.*, Nos. 6:08-CV-211, 6:08-CV-262, 6:08-CV-263, 2009 WL 440525, at \*7 (E.D. Tex. Feb. 20, 2009); *Odom v. Microsoft Corp.*, 596 F. Supp. 2d 995, 1003 (E.D. Tex. 2009).

<sup>242</sup> See *Acceleron, LLC v. Egenera, Inc.*, 634 F. Supp. 2d 758, 768 (E.D. Tex. 2009); *Centre One v. Vonage Holding Corp.*, No. 6:08-CV-467, 2009 WL 2461003, at \*8 (E.D. Tex. Aug. 10, 2009) (weighing against transfer where businesses had operations in Texas, despite being incorporated in Delaware).

<sup>243</sup> See *Deep Nines, Inc. v. McAfee, Inc.*, No. 9:09-CV-89, 2009 WL 3784372, at \*5 (E.D. Tex. Nov. 10, 2009) (holding that other considerations show the transferee forums no more convenient); *Aloft Media, LLC v. Yahoo!, Inc.*, No. 6:08-CV-509, 2009 WL 1650480, at \*7 (E.D. Tex. June 10, 2009).

<sup>244</sup> *Invitrogen Corp. v. Gen. Elec. Co.*, No. 6:08-CV-113, 2009 WL 331889, at \*4 (E.D. Tex. Feb. 9, 2009); see generally *Konami Digital Entm't Co. v. Harmonix Music Sys., Inc.*, No. 6:08-CV-286, 2009 WL 781134, at \*8–9 (E.D. Tex. Mar. 23, 2009).

<sup>245</sup> *Acceleron*, 634 F. Supp. 2d at 768; *Aten Int'l. Co. v. Emine Tech. Co.*, 261 F.R.D. 112, 126 (E.D. Tex. 2009); *Novartis II*, 2009 WL 3157455, at \*5; *Emanuel v. SPX Corp./OTC Tools Div.*, No.

where the Eastern District has confronted the same or similar parties and patents.<sup>246</sup> Conversely, transfer is favored where the transferee forum has prior experience with the patents and parties.<sup>247</sup> Transfer is also favored where the case involves state law claims and the transferee forum is in that state.<sup>248</sup> The “conflicts of law” factor is usually neutral and is rarely argued.<sup>249</sup>

## V. The Federal Circuit Responds: *Genentech*, *Hoffman*, *Nintendo*

In 2009, the Federal Circuit reversed the district’s denials of § 1404(a) transfer in three cases. The Federal Circuit’s reversals discouraged the Eastern District of Texas’ interpretation and application of *TS Tech* and reinforced its precedent. A discussion of the three cases follows.

### A. *In re Genentech*: No Centralized Location Test

*Genentech* reversed *Sanofi I*.<sup>250</sup> The plaintiff, Sanofi, was a German corporation. The defendants, Genentech, Inc. and Biogen, Inc., had respective places of business in San Francisco and San Diego and sought transfer to the Northern District of California.<sup>251</sup> District Judge Clark denied the defendants’ motion primarily on grounds that the parties, witnesses, and evidence were dispersed geographically.<sup>252</sup> The plaintiff’s witnesses and records were located in Germany and Swit-

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6:09-CV-220, 2009 WL 3063322, at \*9 (E.D. Tex. Sept. 21, 2009); *Konami*, 2009 WL 781134, at \*9; *Invitrogen*, 2009 WL 331889, at \*5; *Odom*, 596 F. Supp. 2d at 1003–04.

<sup>246</sup> *Deep Nines*, 2009 WL 3784372, at \*6.

<sup>247</sup> *Jackson v. Intel Corp.*, No. 2:08-CV-154, 2009 WL 749305, at \*4 (E.D. Tex. Mar. 19, 2009) (“Defendant represents to the Court that over the course of twelve years, from 1994 through 2006, [plaintiff] litigated with more than 75 parties over the [disputed patent] in the Northern District of Illinois, his home district.”).

<sup>248</sup> *Odom*, 596 F. Supp. 2d at 1004; *see also* *Mediostream, Inc. v. Microsoft Corp.*, No. 2:08-CV-3690, 2009 WL 3161380, at \*5 (E.D. Tex. Sept. 30, 2009) (indicating plaintiff’s decision to drop its California state law claims rendered this factor neutral; had plaintiff kept the claim, this would have favored transfer); *but see* *Mondis Tech. Ltd. v. Top Victory Elec. (Taiwan) Co.*, No. 2:08-CV-478 (TJW), 2009 WL 3460276, at \*4 (E.D. Tex. Oct. 23, 2009) (holding that the existence of a simple ancillary California contract claim does not make this factor favor transfer).

<sup>249</sup> *Acceleron*, 634 F. Supp. 2d at 768; *Aten*, 261 F.R.D. at 126; *Emanuel*, 2009 WL 3063322, at \*9; *Konami*, 2009 WL 781134, at \*9.

<sup>250</sup> *See In re Genentech, Inc.*, 566 F.3d 1338, 1340 (Fed. Cir. 2009) (overturning the prior order denying motion to transfer).

<sup>251</sup> *Id.* at 1340–41.

<sup>252</sup> *Sanofi-Aventis Deutschland GMBH v. Genentech, Inc. (Sanofi I)*, 607 F. Supp. 2d 769, 776–78 (E.D. Tex. 2009).

zerland. Under a rigid application of the 100-mile rule, the cost of attendance and transportation would have been higher for European witnesses if trial were held in California.<sup>253</sup> Potential witnesses and evidence included “individuals . . . in eleven different countries and nineteen different states.”<sup>254</sup> The court concluded that the Eastern District of Texas was “centrally located” for all the parties.<sup>255</sup>

The Federal Circuit ruled that that Eastern District misapplied the “central location” test, and held that the test is only applicable where some witnesses actually resided in the plaintiff’s choice of forum.<sup>256</sup> Here, zero witnesses resided in the Eastern District.<sup>257</sup> Accordingly, the district could not qualify as a central location.<sup>258</sup> The court held that favoring transfer does not require that transfer is more convenient for *all* witnesses, but only that, on balance, transfer is more convenient.<sup>259</sup> In addition, the 100-mile rule does not apply rigidly for foreign witnesses since they must travel large distances for any U.S. venue.<sup>260</sup> The “bulk” of evidence in patent cases is presumed to reside with the defendant.<sup>261</sup> Thus, transfer to a district nearer to the defendant’s residence makes access to sources of proof more convenient.<sup>262</sup>

The Federal Circuit reversed other trial findings. The defendants are not required to show that the witnesses they identify are “key witnesses.”<sup>263</sup> The possibility that the Northern District lacked personal jurisdiction over the *plaintiff* was irrelevant because whether the case could have been brought there depends only on whether the transferee forum had personal jurisdiction over the defendants.<sup>264</sup>

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<sup>253</sup> *Id.* at 778.

<sup>254</sup> *Id.* at 777–78.

<sup>255</sup> *Id.*

<sup>256</sup> *In re Genentech*, 566 F.3d at 1344.

<sup>257</sup> *Id.*

<sup>258</sup> *Id.*

<sup>259</sup> *Id.* at 1345.

<sup>260</sup> *Id.* at 1344.

<sup>261</sup> *Id.* at 1345.

<sup>262</sup> *In re Genentech, Inc.*, 566 F.3d 1338, 1345–46 (Fed. Cir. 2009).

<sup>263</sup> *Id.* at 1343–44.

<sup>264</sup> *Id.* at 1346.

Transfer analysis is “case-by-case.”<sup>265</sup> That the defendant, Genentech, had previously been a plaintiff in the Eastern District was irrelevant to whether *this* trial in the Eastern District was convenient for Genentech.<sup>266</sup> While the Eastern District had faster time-to-trial, this factor was speculative.<sup>267</sup> Circuit Judge Linn’s thoroughness in addressing each finding by the Eastern District intimates that the “abuse of discretion” standard of review is likely now a fiction in reviewing § 1404(a) cases.

Interestingly, the Eastern District’s transfer grant rate dropped after *Genentech*—from 45.5 percent (5 of 11) to 31.0 percent (9 of 29).<sup>268</sup> While *Genentech* cut off particular avenues of discretion previously available (e.g., not applying the 100-mile rule rigidly for foreigners; congestion is often speculative), the Eastern District found other ways to deny venue transfer requests. In the latter half of 2009, the district consistently denied transfer on grounds that the parties were dispersed geographically.<sup>269</sup> The Federal Circuit addressed this practice in late 2009.

#### B. *Hoffman* and *Nintendo*: No Dispersed Location Test

Decided on December 2, 2009, *In re Hoffman-La Roche Inc.*<sup>270</sup> reversed the Eastern District’s denial of transfer in *Novartis I.*<sup>271</sup> The plaintiff, Novartis, resided in California. The defendants resided in Switzerland and Michigan.<sup>272</sup> The patent concerned a pharmaceutical drug whose development occurred in multiple jurisdictions. The Federal Circuit identified eighteen potential non-party witnesses and seven party witnesses residing in several jurisdictions.<sup>273</sup> The defendants sought transfer to the Eastern District of North Carolina where much of its research and development activity took place.

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<sup>265</sup> *Id.*

<sup>266</sup> *Id.*

<sup>267</sup> *Id.* at 1347.

<sup>268</sup> Information is based on my Westlaw survey. See *supra* Table 4a in Part VI.A.

<sup>269</sup> See *supra* notes 189–191 and accompanying text.

<sup>270</sup> 587 F.3d 1333 (Fed. Cir. 2009).

<sup>271</sup> *Id.* at 1338.

<sup>272</sup> *Id.* at 1335.

<sup>273</sup> *Id.* (“[T]he parties identified eighteen potential non-party witnesses: four from North Carolina, five from California, three from Maryland, one from Missouri, two from Alabama, two from Europe, and one, Dr. Nancy Chang, from Houston, Texas. The parties also identified seven potential party witnesses: three from North Carolina, three from New Jersey, and one from Colorado”).



District Judge Folsom denied the motion on the grounds that the evidence and witnesses were dispersed geographically.<sup>274</sup> No evidence or witnesses were in the Eastern District of Texas. However, because this was a “nationwide” suit, Judge Folsom disfavored transfer because the Eastern District of Texas was no less convenient than the North Carolina court.<sup>275</sup> Judge Folsom also found that while the North Carolina court had subpoena power over some witnesses, it did not have “absolute subpoena power.”<sup>276</sup> Hence, the compulsory process factor did not favor transfer.<sup>277</sup> Finally, because the infringing sales occurred nationwide, the transferee had no *greater* local interest in this dispute.<sup>278</sup> In conclusion, none of the factors favored transfer.<sup>279</sup>

The Federal Circuit rejected trial findings on nearly every factor. In his opinion, Circuit Judge Garjasa asserted: “[T]here appears to be no connection between this case and the Eastern District of Texas.”<sup>280</sup> On sources of proof, the majority of evidence relevant to the infringement claim was in North Carolina. Judge Garjasa also reprimanded the plaintiff for transporting 75,000 pages of documents from its headquarters in California to the Eastern District of Texas in anticipation of litigation, calling it a “fiction . . . created to manipulate the propriety of venue.”<sup>281</sup> On compulsory process, absolute subpoena power is not required for courts to favor transfer.<sup>282</sup> Compulsory process favored transfer because the North Carolina court had subpoena power over four non-party witnesses, while the Eastern District of Texas court had subpoena power over none.<sup>283</sup> North Carolina had a greater localized interest in the matter since the case questioned the work and reputation of sev-

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<sup>274</sup> *Novartis Vaccines & Diagnostics, Inc. v. Hoffman-La Roche Inc.* (Novartis I), 597 F. Supp. 2d 706, 711–14 (E.D. Tex. 2009).

<sup>275</sup> *Id.* at 712–14.

<sup>276</sup> *Id.*

<sup>277</sup> *Id.* at 712–13.

<sup>278</sup> *Id.* at 714.

<sup>279</sup> *Id.* at 716.

<sup>280</sup> *In re Hoffman-La Roche, Inc.*, 587 F.3d 1333, 1336, 1338 (Fed. Cir. 2009).

<sup>281</sup> *Id.* at 1336–37.

<sup>282</sup> *Id.*

<sup>283</sup> *Id.* at 1336.

eral scientists residing there.<sup>284</sup> Finally, the North Carolina court had a lighter patent docket.<sup>285</sup> Thus, the congestion factor favored transfer.<sup>286</sup>

The Federal Circuit displayed similar analysis in *In re Nintendo Co.*,<sup>287</sup> decided on December 17, 2009, reversing the Eastern District's denial of a motion to transfer venue in *Motiva*.<sup>288</sup> The plaintiff, Motiva, resided in Ohio. The defendants sought transfer to the Western District of Washington where one defendant resided.<sup>289</sup> The Eastern District's opinion in *Motiva* summarizes its approach:

In those cases [*Genentech* and *TS Tech*], it was undisputed that the vast majority of identified documents and witnesses were located in and around the transferee court. Here, while Defendants rely heavily on the fact that there are no documents and witnesses located in Texas, they ultimately fail to meet their burden-proof that this case is clearly more conveniently tried in the Western District of Washington.<sup>290</sup>

The Federal Circuit rejected the Eastern District's view that denial of transfer was proper for a patent case bearing no relation to the Eastern District.<sup>291</sup> Geographic dispersion is not sufficient to counteract the fact that none of the witnesses or documents were located in Texas.<sup>292</sup> Moreover, Circuit Judge Rader's opinion disapproved the district's speculation that some evidence may be located at the defendants' satellite offices in California and New York.<sup>293</sup> Judge Rader asserted that the district court's hypothesis that evidence would come from disparate locations was based on questionable reasoning, already rejected in *Genentech*.<sup>294</sup> Part VI of this article discusses these recent developments and assesses the future implications

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<sup>284</sup> *Id.*

<sup>285</sup> *Id.*

<sup>286</sup> *In re Hoffman-La Roche, Inc.*, 587 F.3d 1333, 1336 (Fed. Cir. 2009).

<sup>287</sup> *In re Nintendo Co.*, 589 F.3d 1194 (Fed. Cir. 2009).

<sup>288</sup> *Id.* at 1201.

<sup>289</sup> *Id.* at 1196–97.

<sup>290</sup> *Motiva LLC v. Nintendo Co.*, No. 6:08-CV-429, 2009 WL 1882836, at \*6 (E.D. Tex. June 30, 2009).

<sup>291</sup> *See Nintendo*, 589 F.3d at 1199 (holding that although four Japanese witnesses would be inconvenienced, the remaining witnesses benefitted from transfer).

<sup>292</sup> *See id.* at 1198–1200.

<sup>293</sup> *Id.* at 1199.

<sup>294</sup> *Id.*

for the Eastern District of Texas, forum shopping in patent cases, and the NPE business model.

## VI. Implications of New Venue Law on Non-Practicing Entities

After being reversed four times by the Federal Circuit in 2009, the Eastern District of Texas should seemingly grant transfer motions more frequently. This section seeks to answer two questions. First, what is the likely future for the Eastern District and forum shopping in patent cases? Second, what are the resulting implications for the NPE business model?

### A. The End of the Eastern District and Forum Shopping?

The Federal Circuit ended 2008 with *TS Tech* in which it departed from its history of affirming the transfer rulings of the Eastern District of Texas. In *TS Tech*, the Federal Circuit held that when the transferee forum is more convenient, the case should be transferred.<sup>295</sup> In 2009, the Federal Circuit pushed further in *Genentech*, holding that the district could not deny transfer on grounds that the district was centrally located.<sup>296</sup> The Federal Circuit ended 2009 with *Hoffman* and *Nintendo*, which make even clearer that the Eastern District cannot prevent the transfer of patent cases that bear no connection to the district.<sup>297</sup>

The Eastern District could continue denying transfer motions at current rates, but there is a strong likelihood of continuing reversals. Defendants, aware of *TS Tech* and its progeny, are likely to appeal any § 1404(a) denials.<sup>298</sup> In form, the Federal Circuit may recite the “abuse of discretion” standard, however, in substance, the Federal Circuit has given the Eastern District zero deference to its transfer rulings. If necessary, it appears the Federal Circuit will reverse the Eastern District’s denials one-by-one. The inevitability of eventual transfer will likely become apparent to potential patentee-plaintiffs, who will then file their infringement claims elsewhere.

The Eastern District’s disposition of *SMDK Corp. v. Creative Labs, Inc.* at the end of 2009 indicates a possible change of direction.<sup>299</sup> The plaintiff’s principal

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<sup>295</sup> See *supra* Part III; *In re TS Tech.*, 551 F.3d at 1319.

<sup>296</sup> See *supra* Part V.A.

<sup>297</sup> See *supra* Part V.B.

<sup>298</sup> 28 U.S.C. § 1404(a) (1996).

<sup>299</sup> No. 2:08-CV-26, 2009 WL 5246368, at \*1 (E.D. Tex. Dec. 11, 2009); *but see* *Novartis Vaccines & Diagnostics, Inc. v. Wyeth*, No. 2-08-CV-00067TJW-CE, 2010 WL 1374806, at \*2–3, 5 (E.D.

place of business was in Florida. The defendants resided in far-flung places like California, New York, Arkansas, Indiana, and Japan.<sup>300</sup> Judge Folsom noted that transfer to the Northern District of California may inconvenience some defendants, none of whom objected to the motion to transfer venue, but would be more convenient for the majority of defendants.<sup>301</sup> Further, the case had no connection to the Eastern District. Citing *Hoffman*, Judge Folsom granted transfer.<sup>302</sup>

On the other hand, three 2010 denials of motions to transfer venue create new reason for doubt that the transfer rates will increase in the Eastern District.<sup>303</sup> The three cases are distinguishable from the cases that the Federal Circuit overruled in that the plaintiffs in each case resided in Texas.<sup>304</sup> However, the Eastern District continues to underplay connections to the transferee forum, while overplaying any connections of the plaintiffs to the district.<sup>305</sup> The district disregarded the *Nintendo* and *Genentech* presumption that the majority of evidence and factual connections in patent cases is presumed to be located where the defendant resides.<sup>306</sup>

What may be more troubling about these cases is that, by focusing on the residence of the plaintiffs, they may inadvertently hint at a self-remedy for the plaintiffs. The plaintiffs can create shell subsidiaries or offices in the Eastern District to cheat any venue and § 1404(a) rules.<sup>307</sup> NPEs in particular could resort to

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Tex. Mar. 31, 2010) (denying transfer of venue, finding the Eastern District to be more centrally located than the Northern District of California and that access to sources of proof is an unimportant factor because most of the documents were not located in either venue); *Realtime Data, LLC v. Morgan Stanley*, Nos. 6:09CV326-LED-JDL, 6:09CV327-LED-JDL, 6:09CV333-LED-JDL, 2010 WL 1064474, at \*1 (E.D. Tex. Mar. 18, 2010) (denying motion to transfer venue from the Eastern District of Texas to the Southern District of New York).

<sup>300</sup> *SMDK*, 2009 WL 524636, at \*1.

<sup>301</sup> *Id.*

<sup>302</sup> *Id.*

<sup>303</sup> See *eTool Dev., Inc. v. Nat'l Semiconductor Corp.*, No. 2-08-CV-196-TJW, 2010 WL 1000790, at \*1 (E.D. Tex. Mar. 15, 2010); *MedIdea, LLC v. Zimmer Holdings, Inc.*, No. 2-09-CV-258-TJW, 2010 WL 796738, at \*1 (E.D. Tex. Mar. 8, 2010); *Personal Audio, LLC v. Apple, Inc.*, No. 9:09-CV-111, 2010 WL 582540, at \*1 (E.D. Tex. Feb. 11, 2010).

<sup>304</sup> See *eTool*, 2010 WL 1000790, at \*1; *MedIdea*, 2010 WL 796738, at \*1; *Personal Audio*, 2010 WL 582540, at \*1.

<sup>305</sup> See generally *MedIdea*, 2010 WL 796738, at \*2-4; *Personal Audio*, 2010 WL 582540, at \*3-7.

<sup>306</sup> *In re Genentech, Inc.*, 566 F.3d 1338, 1345 (Fed. Cir. 2009); *In re Nintendo Co.*, 589 F.3d 1194, 1199 (Fed. Cir. 2009).

<sup>307</sup> Kory D. Christensen, *Recent Developments in the Patent Reform Movement: Potential Benefits and Unintended Consequences*, in UNDERSTANDING PATENT REFORM IMPLICATIONS: LEADING

this strategy.<sup>308</sup> NPEs have no development or manufacturing operations and few employees.<sup>309</sup> Holding only intangible property rights and some attesting documents, NPEs could easily incorporate in Texas or set up a small office in the Eastern District. Given how central litigation is to the NPE business model, it is not duplicitous to call the Eastern District their principal place of business for venue purposes. However, the Federal Circuit would easily see through this form of fabricated venue.<sup>310</sup> The Federal Circuit would likely respond by modifying § 1404(a) analysis to minimize the weight of the plaintiff's location in the analysis. The court might adopt a presumption in favor of transfer if the defendant resides in the transferee forum.

Congress' proposed Patent Reform Act of 2009 went further by proposing a modification of § 1400(b), the patent venue provision.<sup>311</sup> The amendment would have barred parties from "manufacturing" venue by assignment or incorporation.<sup>312</sup> Venue would be proper only where (a) the defendant is incorporated; (b) the defendant has its principal place of business; (c) where the defendant is permanently located and has committed substantial acts of infringement; or (d) where the plaintiff resides if the plaintiff is a nonprofit or individual inventor.<sup>313</sup> The changes would overrule *VE Holding* by precluding NPEs from filing where they reside since NPEs are for-profit and not inventors.<sup>314</sup> The House bill called for similar amendments to § 1400(b). Under H.R. 1260, venue is proper only in districts where the defendant has significant operations, with exceptions for plaintiffs who are nonprofits, academic institutions, or individual "natural person" inventors.<sup>315</sup>

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LAWYERS ON DEFINING KEY ISSUES, INTERPRETING CURRENT PROPOSED LEGISLATION, AND PROJECTING FUTURE DEVELOPMENTS 1, 8 (2009), 2009 WL 535243.

<sup>308</sup> Personal Audio LLC, MedIdea LLC, and eTool Development are likely NPEs. *See generally* Ipeg, *Texas Forum Shopping—Europe has its Share as Well*, (Mar. 13, 2010), <http://www.ipeg.eu/blog/?p=1011>.

<sup>309</sup> *See supra*, Part I.

<sup>310</sup> *Cf. In re Hoffman-La Roche, Inc.*, 587 F.3d 1333, 1336–38 (Fed. Cir. 2009) (stating that plaintiff cannot alter value analysis by transporting documents to the Eastern District in anticipation of litigation).

<sup>311</sup> 28 U.S.C. § 1400(b) (2006); Patent Reform Act of 2009, S. 515, 111th Cong. § 8 (2009).

<sup>312</sup> *See id.*

<sup>313</sup> *Id.*

<sup>314</sup> *See supra* Part II.B.

<sup>315</sup> H.R. 1260, 111th Cong., § 10 (2009).

The Patent Reform Act of 2009 has not passed, but efforts have continued with the Patent Reform Act of 2009.<sup>316</sup> At present, the Senate bill keeps § 1400(b) as is, but adds § 1400(c).<sup>317</sup> Subsection (c) in effect codifies the *TS Tech* line of cases, requiring transfer upon a showing that the transferee forum is clearly more convenient than the current forum.<sup>318</sup> The provision is vague and the bill leaves § 1400(b) and *VE Holding* intact. However, as work on the bill advances, its measures could revert to resemble the stricter proposals found in the bill as introduced. Even if Congress' efforts fail, the Federal Circuit will assuredly take action. The Federal Circuit may revise its transfer analysis to weigh the defendant's location more heavily. Alternatively, the court may reverse *VE Holding*, reinterpreting current § 1400(b) to define patent venue in a manner similar to the original bill's amended § 1400(b). Either way, the Eastern District of Texas phenomenon will end. Forum shopping in patent cases more generally will end because Federal Circuit law applies across all jurisdictions.

#### B. The End of the Non-Practicing Entity?

Without the ability to forum shop, the NPEs will likely wither, but not die. Litigation is central to the NPE business model.<sup>319</sup> That does not imply that NPEs always bring frivolous claims.<sup>320</sup> While NPEs have made great use of the Eastern District, a substantial share of their litigation still arises in other forums.<sup>321</sup> NPEs with valid patents and meritorious infringement claims will continue to prevail. However, litigating in forums with slower dockets and less favorable conditions will lower expected returns. NPEs will face higher litigation costs because discovery and trials take longer. Defendants will be more inclined to litigate rather than settle and to litigate using scorched earth tactics that the Eastern District barred. NPEs will also face less favorable findings from judges and juries.

Unfortunately for NPEs, changing transfer and venue rules are only part of broader judicial and legislative movements discussed below.

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<sup>316</sup> Patent Reform Act of 2009, S. 515, 111th Cong. § 8 (2009). Although the Act has not passed the full Senate yet, it was voted out of committee as amended on April 2, 2009. See The Library of Congress, <http://thomas.loc.gov/cgi-bin/bdquery/z?d111:S.515>: (last visited Sept. 16, 2010) (detailing the Patent Reform Act and noting its passage through committee).

<sup>317</sup> *Id.*

<sup>318</sup> *Id.*

<sup>319</sup> See *supra* Part I.

<sup>320</sup> See Hosie, *supra* note 64, at 79.

<sup>321</sup> See *supra* Table 1 in Part II.B.1.

### 1. Judicial Developments

The following patent law cases reduce the efficacy of litigation as part of the NPE business model:

- Permanent Injunctions: The prospect of permanent injunctions often forces patent defendants to concede to large licensing fees.<sup>322</sup> After *eBay Inc. v. MercExchange, L.L.C.*, permanent injunctions are no longer awarded as a matter of course upon finding the defendant liable for infringement.<sup>323</sup> Justice Kennedy's concurrence argued that injunctive remedies would not serve the "public interest" when the plaintiff is an NPE.<sup>324</sup>
- Obviousness Standards: *KSR Int'l Co. v. Teleflex Inc.* adopts a more flexible test for obviousness, rejecting the prior "teaching, suggestion, motivation" (TSM) test.<sup>325</sup> The new obviousness standard makes it easier for the defendants to challenge the validity of the plaintiff's patent on obviousness grounds.<sup>326</sup>
- Declaratory Judgment Actions: *MedImmune, Inc. v. Genentech, Inc.* permits a licensee of a patent to file a declaratory judgment action alleging non-infringement or invalidity of licensor's patent, without terminating the license.<sup>327</sup> *SanDisk Corp. v. STMicroelectronics, Inc.* lowers the threshold for when declaratory judgment actions can be granted.<sup>328</sup> When an intended licensee rejects the license offer, this creates standing for a declaratory action.<sup>329</sup> These two cases expand the circumstances under which a potential defendant can preemptively file a declaratory judgment action alleging non-infringement or invalidity of an NPE's patent.

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<sup>322</sup> See *supra* Part II.A.1.

<sup>323</sup> 547 U.S. 388, 394 (2006).

<sup>324</sup> See *id.* at 396–97.

<sup>325</sup> 550 U.S. 398, 407, 415, 417 (2007).

<sup>326</sup> See Klein, *supra* note 19, at 314; McCurdy, *supra* note 11.

<sup>327</sup> 549 U.S. 118, 137 (2007).

<sup>328</sup> 480 F.3d 1372, 1382–83 (Fed. Cir. 2007).

<sup>329</sup> See *id.*

## 2. Congressional Reform Proposals

As far back as 2005, Congressional reform efforts recognized the impact of NPEs.<sup>330</sup> For example, some proposals would change the methods of calculating damage remedies, with the intent of reducing damage awards.<sup>331</sup> Because NPEs do not commercialize their patents, their damage remedy is a reasonable royalty, rather than lost profits.<sup>332</sup> A reasonable royalty is determined by considering the licensing fee the parties would agree to under a “hypothetical bargain.”<sup>333</sup> However, courts have not settled on any consistent and precise methods of determining royalties from a “hypothetical bargain” and recent Federal Circuit cases indicate the law on reasonable royalties in patent cases is in a state of flux.<sup>334</sup>

Complicating matters, NPEs usually hold patents covering only a component of a defendant’s infringing product.<sup>335</sup> However, courts increasingly have adopted the “entire market analysis” rule. Formally applied, this rule gives NPEs a royalty based on the proceeds of all sales of the entire infringing product, although the NPE’s patent may only cover a minor component.<sup>336</sup> Realizing that a strict application of the rule overcompensates in such cases, the Federal Circuit has modified the rule by using a multiplier.<sup>337</sup> The NPE will receive a royalty equaling a royalty

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<sup>330</sup> See Anna Mayergoyz, Note, *Lessons from Europe on How to Tame U.S. Patent Trolls*, 42 CORNELL INT’L L.J. 241, 253–54 (2009); McDonough, *supra* note 16, at 195–96 (noting that in 2005 (before *eBay*), Congress considered implementing legislation denying injunctions specifically for NPE-plaintiffs).

<sup>331</sup> Patent Reform Act of 2009, S. 515, 111th Cong. § 4 (2009); H.R. 1260, 111th Cong. § 5 (2009); Watanabe, *supra* note 63, at 477; Jonathan W. Parthum & Phillip J.C. Signore, *Patent Reform: The Debate Continues into 2010*, 997 PRAC. L. INST., PAT., COPYRIGHTS, TRADEMARKS, & LITERARY PROP. COURSE HANDBOOK SERIES 355, 361–63 (2010); Shrestha, *supra* note 12, at 136–37; Posting of Dennis Crouch to Patently-O, Patent Reform Act of 2009, <http://www.patentlyo.com/patent/2009/03/patent-reform-act-of-2009.html> (Mar. 3, 2009).

<sup>332</sup> See Ted Sichelman, *Commercializing Patents*, 62 STAN. L. REV. 341, 405 (2010).

<sup>333</sup> *Rite-Hite Corp. v. Kelley Co.*, 56 F.3d 1538, 1554 (Fed. Cir. 1995).

<sup>334</sup> See *e.g.*, *Lucent Techs., Inc. v. Gateway, Inc.*, 580 F.3d 1301, 1324–26, 1332–33, 1335 (Fed. Cir. 2009), cert denied, *Microsoft Corp. v. Lucent Techs., Inc.*, 130 S.Ct. 3324 (2010).

<sup>335</sup> See *supra* Part II.A.1.

<sup>336</sup> Brian J. Love, Note, *Patentee Overcompensation and the Entire Market Value Rule*, 60 STAN. L. REV. 263, 269–71 (2007).

<sup>337</sup> *Id.* at 272–79; Posting of Amy Landers to Patently-O, 2007: Patent Reform: Proposed Amendments on Damages, [http://www.patentlyo.com/patent/2007/04/2007\\_patent\\_ref.html](http://www.patentlyo.com/patent/2007/04/2007_patent_ref.html) (April 27, 2007); *e.g.*, *Lucent*, 580 F.3d at 1336, 1338–39. While the Federal Circuit held that the “entire market analysis” rule did not apply in this case, they also argued the rule can be applied liberally—the patented component need not be the “basis for customer demand” if the multiplier is suf-



base—total proceeds from sales of the entire product—times a multiplier representing the court’s estimation of the patent’s value as a fraction of the overall product.<sup>338</sup>

The Patent Reform Act of 2009 seeks to further reduce royalty rewards by tying damages to the patent’s “specific contribution over the prior art.”<sup>339</sup> For guidance, courts may consider the price of licensing a “similar noninfringing substitute in the relevant market.”<sup>340</sup> “In some cases, this could push damages to zero if the non-infringing substitute is in the public domain.”<sup>341</sup> The most recent version of the Senate bill rejects this proposal, perhaps in response to criticism that it raises uncertainty and judicial costs.<sup>342</sup> The current version of the bill gives courts and juries more discretion, while emphasizing sound methodology in computing damages and requiring documentation thereof, perhaps looking to courts of appeal to resolve any errant award amounts.<sup>343</sup> In any case, reform measures and the Federal Circuit’s recent rulings will likely reduce damage awards. This will lower the expected return of litigation for NPEs.

The bill also provides for post-grant review of patents by the patent appeals board.<sup>344</sup> Relative to litigation, post-grant review provides a more expedient and economical means for alleged infringers to challenge the validity of patents.<sup>345</sup>

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ciently small. Chief Judge Michel notes that defendants probably would not object to entire market analysis if the multiplier was 0.1 percent rather than 8 percent.

<sup>338</sup> See, e.g., *Lucent*, 580 F.3d at 1336 (indicating that the court applied an 8 percent rate, but notes this percentage can be adjusted at the court’s discretion).

<sup>339</sup> Patent Reform Act of 2009, S. 515, 111th Cong. § 4; H.R. 1260, 111th Cong. § 5; Shrestha, *supra* note 12, at 136–37; Crouch, *supra* note 330.

<sup>340</sup> S. 515 § 4(c)(1)(B); H.R. 1260 § 5(c)(1)(B); Crouch, *supra* note 330.

<sup>341</sup> Crouch, *supra* note 331.

<sup>342</sup> See, e.g., S. 515, § 4; Mark v. Campagna, *Understanding Patent Reforms in the Context of Litigation*, in UNDERSTANDING PATENT REFORM IMPLICATIONS: LEADING LAWYERS ON DEFINING KEY ISSUES, INTERPRETING CURRENT PROPOSED LEGISLATION, AND PROJECTING FUTURE DEVELOPMENTS 1, 8 (2009), 2009 WL 535235; Watanabe, *supra* note 63, at 476–77.

<sup>343</sup> S. 515 § 4 (“The court shall identify the methodologies and factors that are relevant to the determination of damages, and the court or jury, shall consider only those methodologies and factors relevant to making such determination.”); Posting of Stephan Albainy-Jeini to Patently-O, Patent Reform Act of 2010: A Substitute S. 515, <http://www.patentlyo.com/patent/2010/03/patent-reform-act-of-2010-an-overview.html> (Mar. 8, 2010).

<sup>344</sup> Parthum & Signore, *supra* note 331, at 369–70.

<sup>345</sup> *Id.*; Campagna, *supra* note 342, at 5.

NPEs are often accused of holding patents of questionable validity.<sup>346</sup> If NPEs hold invalid patents, these proposals would harm NPEs by facilitating invalidity determinations of their holdings. Even if NPEs hold valid patents, post-grant review would still reduce a defendant's costs.

### 3. *Leave it to the Courts*

If recent patent reform efforts are any indication, Congress' current efforts are not likely to pass in the near future.<sup>347</sup> The Patent Reform Act of 2009, arguably Congress' strongest rebuke of NPEs yet, has still not passed. This hold-up is partly attributable to opposition from small inventors and their proponents.<sup>348</sup> Opponents view the bill as a money grab by America's largest corporations.<sup>349</sup> The bill effectively lowers infringement penalties on large corporations by reducing litigation costs, the likelihood of liability, and the severity of remedies.<sup>350</sup> The proposed change to § 1400(b), for example, is not intended to combat NPEs, but to guarantee home field advantage for large corporate defendants in patent suits. In addition, the bills' harsh measures overreacted to the NPEs by being over-inclusive, punishing small businesses along with NPEs.<sup>351</sup>

The passage of the Patent Reform Act would probably not significantly affect NPEs. If the bill does not pass, the judiciary will continue to combat the perceived abuses of the system by NPEs, from forum shopping to excessive licensing fees. If the bill does pass, the Senate's current version does little other than expand judicial discretion.<sup>352</sup> The current bill's pullback reflects the difficulty in identifying NPEs.<sup>353</sup> The 2010 bill's tenor is to have the judiciary decide whether a plaintiff is an NPE and adjust their analysis accordingly.

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<sup>346</sup> See *supra* Part II.A.2 and accompanying text.

<sup>347</sup> Christopher A. Cotropia, *The Individual Inventor Motif in the Age of the Patent Troll*, 12 YALE J.L. & TECH. 52, 65 (2009).

<sup>348</sup> See, e.g., Parthum & Signore, *supra* note 331, at 364; Watanabe, *supra* note 63, at 475.

<sup>349</sup> *Id.*

<sup>350</sup> Cotropia, *supra* note 347, at 68; see Parthum & Signore, *supra* note 331, at 363–64.

<sup>351</sup> Cotropia, *supra* note 347, at 68.

<sup>352</sup> E.g., in the current version of S. 515, § 8, no amendments are made to the patent venue provision, § 1400, except to add a subsection (c) that allows transfer of venue when the court finds the transferee forum is "more convenient." See *supra* Part VI.A. Consider also, current S. 515, § 4, which does not limit damages or specify how to compute them. Instead, the provision leaves it to the district court. See *supra* Part VI.B.2.

<sup>353</sup> See Cotropia, *supra* note 347, at 63–64.

Past holdings of the Federal Circuit and the Supreme Court indicate that NPEs face a gradual decline towards extinction. While never expressly identifying parties as “NPEs” or “patent trolls,” the courts have steadily reduced their usefulness to NPEs.<sup>354</sup> The Federal Circuit’s 2009 skirmishes with the Eastern District of Texas are representative of the Federal Circuit’s attack on NPEs. Discouraging forum shopping was part of a larger effort to reduce the leverage that patent litigation provides NPEs.

## VII. Conclusion

Over the past decade, the meteoric rises of NPEs and the Eastern District of Texas as a venue for patent litigation have gone hand in hand. The Eastern District has served as a second home for NPEs, providing a launching point for infringement suits that are central to the NPEs’ business model. The Federal Circuit’s decision in *TS Tech*, easing the requirements for § 1404(a) transfer of venue in patent cases, was seen by many to mark the end of the Eastern District as a haven for patent litigants. Instead, the Eastern District proved remarkably resilient, sparking a series of reversals from the Federal Circuit in 2009 concerning the requirements for transfer of venue. The appellate authority of the Federal Circuit ultimately prevails. As a result, the Eastern District of Texas phenomenon will end. Combined with the broader judicial and legislative movements, the *TS Tech* line of cases may also signal the decline of NPEs.

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<sup>354</sup> A Westlaw search for the term “patent troll” or “non-practicing entity” in all federal cases reveals 14 results, all from district courts. The earliest mention of the term “patent troll” is in 2007.



# Unrepresentative Randomization: An Empirical Study of Judging Panels of USPTO Appeals to the CAFC

Thomas Froats\*

- Introduction..... 80
- I. Background..... 82
  - A. Appeals from the USPTO..... 82
  - B. Randomization of Judges to Appeals ..... 83
  - C. Judges of the Federal Circuit..... 85
    - 1. Current Judges..... 85
    - 2. Senior Judges ..... 87
    - 3. Visiting Judges ..... 87
- II. Description of the Study ..... 88
  - A. Parameters of the Study..... 88
  - B. Data Collected ..... 89
  - C. Limitations..... 90
- III. Results of the Study..... 90
  - A. Overall Study of Judging Panels ..... 92
    - 1. Judging Panels..... 92
    - 2. Opinion Authors ..... 94
  - B. Study of Judge Statistics by Ruling ..... 96
  - C. Study of Judge Statistics by Issue..... 99
    - 1. Patentable Subject Matter Under 35 U.S.C. § 101 ..... 101
    - 2. Anticipation Under 35 U.S.C. § 102 ..... 102
    - 3. Nonobviousness Under 35 U.S.C. § 103..... 103

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4. Adequacy of the Specification Under 35 U.S.C. § 112..... 104

5. Interferences Under 35 U.S.C. § 135 ..... 104

6. Conclusions Regarding Issue Statistics..... 104

D. Study of Judge Statistics for Precedential Cases ..... 105

E. Other Interesting Trends Revealed by the Study ..... 107

IV. Rolling Appointment System..... 108

Conclusion..... 110

**Introduction**

When Congress created the United States Court of Appeals for the Federal Circuit (Federal Circuit), it saw fit to codify how the judging panel should be composed.<sup>1</sup> One goal was “to ensure that all of the judges sit on a representative cross section of the cases heard” by the court.<sup>2</sup> In furtherance of this goal, the Federal Circuit adopted Rule 47.2(b) seeking to maintain the “representative cross-section [of judges across] the fields of law within the jurisdiction of the court.”<sup>3</sup>

The clerk’s office of the Federal Circuit runs a computer program that randomly generates three-judge panels.<sup>4</sup> Then, the list of panels is merged with the list of cases before the Federal Circuit.<sup>5</sup> Theoretically, based on these procedures, every judge would sit on the same number of panels in a particular field of law in a given term. This is important because some studies suggest that specific judges in the Federal Circuit influence the outcome of particular patent cases.<sup>6</sup> Therefore, if the representative cross-section requirement is not sufficiently upheld, that is, if a select number of judges sit on panels that render more decisions in a particular area of law than the rest, then it could result in those judges having a significantly stronger influence over that area of law.

There is a need for an empirical study that looks at patent appeals from the United States Patent and Trademark Office (USPTO) to determine if there is a truly

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<sup>1</sup> 28 U.S.C. § 46(b) (2006).

<sup>2</sup> *Id.*

<sup>3</sup> FED. CIR. R. 47.2(b).

<sup>4</sup> FED. CIR. INTERNAL OPERATING P. 3.

<sup>5</sup> *Id.*

<sup>6</sup> See Lee Petherbridge, *Patent Law Uniformity?*, 22 HARV. J.L. & TECH. 421, 440 (2009) (noting that the content of opinions is judge dependent).

representative cross-section of judges involved in those decisions. Such a study would provide valuable information to patent prosecutors, those in appellate practice before the Federal Circuit, and those who analyze the current Rule 47 process employed by the Federal Circuit.

This article provides such a study. It examines all patent appeals from the USPTO's Board of Patent Appeals and Interferences (BPAI) over a five-year period, from 2005 through 2009. The study includes all prosecutions, coming both directly and indirectly<sup>7</sup> from the BPAI, and interference proceedings that are directly<sup>8</sup> and indirectly appealed. Patent prosecution appeals represent only a portion of patent cases heard by the Federal Circuit.<sup>9</sup> However, because the nature of patent prosecution is so different from infringement litigation, and because infringement can never occur without the underlying patent, it is important to view patent prosecution in its own light and as its own field of law.

Based on this study, this article concludes that there is a need for a revised system for assigning judges and cases to panels in order to achieve a truly representative cross-section of judges in the Federal Circuit participating in a particular field of law. Under the current system, there is great disparity in the number of direct patent appeals from the BPAI participated in by each judge.<sup>10</sup> This disparity shows a lack of a representative cross-section in the supposedly random system employed by the Federal Circuit.

This article comes to these conclusions in the following manner. First, Part I provides background on how the cases included in the study reached the Federal Circuit and were assigned to judges, along with a brief review of the backgrounds of some Federal Circuit judges. Part II describes the empirical study, including its parameters and limitations. Part III reports the findings of the study, highlighting trends and interesting statistics revealed by the data. Part IV suggests a new system that could alleviate the problems revealed by the empirical study. The conclusion

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<sup>7</sup> 35 U.S.C. § 145 (2006).

<sup>8</sup> *Id.* at § 146.

<sup>9</sup> In fiscal year 2009 (October 2008–September 2009), there were 398 patent infringement appeals to the Federal Circuit from U.S. District Courts. United States Court of Appeals for the Federal Circuit, The Court, Statistics, Caseload, Patent Infringement, <http://www.cafc.uscourts.gov/images/stories/the-court/statistics/PatentFilingsHistorical2000-2009.pdf> (last visited Aug. 8, 2010). However, appeals to the Federal Circuit come from a variety of sources. United States Court of Appeals for the Federal Circuit, The Court, Statistics, Caseload, By Category, <http://www.cafc.uscourts.gov/images/stories/the-court/statistics/ChartFilings09.pdf> (last visited Aug. 27, 2010).

<sup>10</sup> See *infra* Part III.A.1.

reiterates the most significant findings from the study and the finer points of the suggested revisions.

## I. Background

### A. Appeals from the USPTO

If, in the process of applying for a patent, the applicant is dissatisfied with a final rejection by the patent examiner, he or she may appeal that decision to the BPAI.<sup>11</sup> If the applicant is still not satisfied after the appeal to the BPAI, the applicant has two paths of review. The first is to appeal the decision directly to the Federal Circuit.<sup>12</sup> The other is to file a civil action in the United States District Court for the District of Columbia against the Director of the USPTO.<sup>13</sup> If the applicant appeals from this district court proceeding, the case will also likely find its way to the Federal Circuit because of the Federal Circuit's exclusive jurisdiction over patent cases.<sup>14</sup>

Occasionally in the process of prosecution, the applicant will enter into an interference proceeding.<sup>15</sup> Interference proceedings take place in the BPAI, whose decision amounts to a final judgment as far as the USPTO is concerned.<sup>16</sup> If the applicant is unhappy with the decision of the BPAI, he or she has two paths similar to that of the traditional applicant. The first is to file an appeal directly to the Federal Circuit. The other is to file a civil suit in any district court against the adverse party in the interference, assuming jurisdiction exists under civil procedure rules.<sup>17</sup> Any appeals from these civil actions will also make their way to the Federal Circuit due to its aforementioned exclusive appellate jurisdiction over patent cases.<sup>18</sup>

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<sup>11</sup> 35 U.S.C. § 134(a) (2006).

<sup>12</sup> *Id.* at § 141.

<sup>13</sup> *Id.* at § 145.

<sup>14</sup> 28 U.S.C. § 1295(a)(1) (2006).

<sup>15</sup> See 35 U.S.C. § 135(a) (2006) (stating that an interference occurs "[w]henver an application is made for a patent which, in the opinion of the Director, would interfere with any pending application, or with any unexpired patent").

<sup>16</sup> *Id.*

<sup>17</sup> *Id.* at § 146.

<sup>18</sup> 28 U.S.C. § 1295(a)(1) (2006).



### B. Randomization of Judges to Appeals

In 1982, the ninety-seventh Congress passed the Federal Courts Improvement Act (the Act), which created the Federal Circuit.<sup>19</sup> One of the provisions of the Act amended 28 U.S.C. § 46(b) to add, *inter alia*, that “[t]he United States Court of Appeals for the Federal Circuit shall determine by rule a procedure for the rotation of judges from panel to panel to ensure that all of the judges sit on a representative cross section of the cases heard . . . .”<sup>20</sup> The Federal Circuit’s rules reflect this amendment.<sup>21</sup>

The passage of the Act mandated a large number of requirements for the panels assigned to cases. For one, the Act ensures that a judging panel has as many active Federal Circuit judges as possible.<sup>22</sup> There was concern among Congress that judges on senior status were playing too heavy a role in the decisions of the various appellate courts, a concern that also applied to judges sitting by designation.<sup>23</sup> However, the reasons set out by Congress for the Act do not specifically indicate why they added the representative cross-section requirement.<sup>24</sup> Thus, it is hard to discern the reason Congress required the Federal Circuit maintain this representative cross-section among judges while not imposing this requirement on other circuit courts.

Regardless of the motive behind the requirement, the Federal Circuit includes the language in its rules. The system that the Federal Circuit uses, which if in accordance with the law would result in a representative cross-section, is one of randomization. The Federal Circuit’s Internal Operating Procedures (IOP) mandate that a computer program randomly assign three-judge panels.<sup>25</sup> Then, a computer program merges its list of ready cases with the panels of judges, subject to the rep-

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<sup>19</sup> Federal Courts Improvement Act of 1982, Pub. L. No. 97-164, 96 Stat. 25 (1982).

<sup>20</sup> *Id.* at § 103(b)(3).

<sup>21</sup> FED. CIR. R. 47.2(b).

<sup>22</sup> See S. REP. NO. 97-275, at 25–27 (1981), *reprinted in* 1982 U.S.C.C.A.N. 11, 36 (noting that the changes from the Act “would provide greater stability and predictability in the law being applied in any given area”).

<sup>23</sup> *Id.* at 25–26, *reprinted in* 1982 U.S.C.C.A.N. 11, 36 (stating that less than a majority of active judges on a panel “may contribute to instability in circuit law”).

<sup>24</sup> See generally *id.* (outlining the reasons for the Act and not specifying why the representative cross-section was added).

<sup>25</sup> FED. CIR. INTERNAL OPERATING P. 3.

representative cross-section requirement.<sup>26</sup> Based on this method, as stated in the IOP, the randomization system utilized by the Federal Circuit should result in any particular field of law having a reasonably even spread of judges assigned to the panels of the cases in that field.<sup>27</sup>

It is possible that the representative cross-section requirement intended to operate so that each judge heard a representative spread of cases for each particular field of law, as opposed to each field of law being heard by a spread of judges. Because of the lack of information in the legislative history of the requirement, it is hard to determine the aim Congress had in mind when adopting this language. However, while this study primarily addresses the spread of judges among patent prosecution and interference appeal panels, the information revealed can also be applicable to each specific judge personally hearing a representative cross-section of cases for each field of law.

Some legal scholars have scrutinized the randomization system, and suggest that it creates a political imbalance because of the inherent leanings by judges, doctrinal or otherwise.<sup>28</sup> These scholars suggest that panels should be specifically chosen so that there is adequate representation of all political leanings.<sup>29</sup> Other scholars find that a randomized system for the assignment of judges and adjudication of cases is more beneficial than any assignment system.<sup>30</sup>

This article, being an empirical study, does not make any suggestions as to the negatives or positives of the current system, but instead looks at how effective the current randomization system is in achieving a representative cross-section. However, it is important to note that both sides of the debate on the effectiveness of the current randomization system generally assume that it achieves randomization to the point that every judge on a court has heard the same exact number of cases in

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<sup>26</sup> *Id.*

<sup>27</sup> *Id.*

<sup>28</sup> Emerson H. Tiller & Frank B. Cross, *A Modest Proposal for Improving American Justice*, 99 COLUM. L. REV. 215, 215–17 (1999).

<sup>29</sup> *Id.* at 232.

<sup>30</sup> See Adam M. Samaha, *Randomization in Adjudication*, 51 WM. & MARY L. REV. 1, 6–7 (2009) (defending the randomization system applied to both assignment of judges as well as the adjudication aspect of cases).

each field of law.<sup>31</sup> It is against this assumption that this article evaluates the effectiveness of the current system.

### C. Judges of the Federal Circuit

The Federal Circuit, when there are no vacant positions, has twelve judges in active service.<sup>32</sup> Judge Schall, on October 5, 2009, and Judge Mayer, on June 30, 2010, both assumed senior status and their positions remain unfilled.<sup>33</sup> Additionally, Chief Judge Michel retired on May 31, 2010.<sup>34</sup> This has resulted in three vacancies on the Federal Circuit so that there are currently only nine active judges.<sup>35</sup> In addition to the active judges, there are presently six senior judges serving the Federal Circuit.<sup>36</sup> Apart from these fifteen judges, judges from other circuit and district courts sometimes sit by designation.<sup>37</sup>

#### 1. Current Judges

Currently, there are eight circuit judges on the Federal Circuit and one chief judge.<sup>38</sup> The judges of the Federal Circuit are different from those of the other circuit courts and the district courts because of the special jurisdiction of the Federal

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<sup>31</sup> See generally *id.* at 9, 23 (stating that a statistically random process “refers to a process that affords equal probability to all outcomes within a given set” and “[r]andom assignment across a sufficient number of cases should equalize unaccounted for variables”); Tiller & Cross, *supra* note 28, at 217–18 (noting that one of the primary reasons for the current assignment system is that “the procedure ‘ensures an equitable distribution of the caseload’ among members of the court”).

<sup>32</sup> 28 U.S.C. § 44(a) (2006).

<sup>33</sup> United States Court of Appeals for the Federal Circuit, The Court, Judges, [http://www.cafc.uscourts.gov/index.php?option=com\\_content&view=article&id=132&Itemid=24](http://www.cafc.uscourts.gov/index.php?option=com_content&view=article&id=132&Itemid=24) (last visited Aug. 8, 2010) [hereinafter Judicial Biographies].

<sup>34</sup> United States Court of Appeals for the Federal Circuit, Announcements, [http://www.cafc.uscourts.gov/index.php?option=com\\_content&view=article&id=3:chief-judge-michel-will-retire-on-may-31-2010-&catid=18:2010&Itemid=50](http://www.cafc.uscourts.gov/index.php?option=com_content&view=article&id=3:chief-judge-michel-will-retire-on-may-31-2010-&catid=18:2010&Itemid=50) (last visited Aug. 16, 2010) [hereinafter Chief Judge Michel Retirement Announcement].

<sup>35</sup> Judicial Biographies, *supra* note 33.

<sup>36</sup> *Id.*; see also *infra* Part I.C.2 (defining a senior judge and their responsibilities in relation to active judges).

<sup>37</sup> Designation is the common term for the practice described in 28 U.S.C. § 291(b) (2006).

<sup>38</sup> Judicial Biographies, *supra* note 33.

Circuit. As such, scholars sometimes examine the backgrounds of judges that sit on the Federal Circuit.<sup>39</sup>

Prior to the appointment of noted scholar and professor Kimberly Moore to the bench, four of the judges serving on the Federal Circuit had technical backgrounds.<sup>40</sup> Judge Moore was appointed in 2006 and has an extensive technical background, making her the fifth judge with such a background on the court.<sup>41</sup> The other judges with technical backgrounds are Judges Newman and Lourie, who each hold a Ph.D. in Chemistry, and Judges Gajarsa and Linn.<sup>42</sup> In addition to these five judges with technical backgrounds, current Chief Judge Rader has significant experience in the field of patent law, being a former full-time patent professor and a co-author of one of the most widely used casebooks in the field.<sup>43</sup> On March 10, 2010, President Obama nominated Kathleen O'Malley to fill a vacant seat on the Federal Circuit.<sup>44</sup> O'Malley, similar to current Chief Judge Rader, does not have a technical background, but has extensive experience with patent cases in addition to being an adjunct professor of patent litigation.<sup>45</sup> Although this article focuses on the assignment of cases to judges without regard to the backgrounds of the judges, this information may prove interesting to Federal Circuit watchers and assorted scholars. While the ratio of judges having technical backgrounds to those without could result in some appeals having a panel full of judges without such a background, a majority of the law clerks to the judges have technical backgrounds.<sup>46</sup>

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<sup>39</sup> See Kimberly A. Moore, *Are District Court Judges Equipped to Resolve Patent Cases?*, 12 FED. CIR. B.J. 1, 15 n.70 (2002) (quoting Matt Krantz, *Computer & Technology Patent Suits Try Patience of High-Tech Companies*, INVESTOR'S BUS. DAILY, Dec. 9, 1996, at A6) ("The U.S. Court of Appeals for the Federal Circuit in Washington, D.C., is known as the Supreme Court of Patents. It's manned by three judges with both legal and scientific training.").

<sup>40</sup> *Id.* at 15.

<sup>41</sup> Judicial Biographies, *supra* note 33.

<sup>42</sup> Brenda Simon, *The Underrepresentation of Women on the Court of Appeals for the Federal Circuit*, 16 WIS. WOMEN'S L.J. 113, 117 (2001).

<sup>43</sup> Judicial Biographies, *supra* note 33.

<sup>44</sup> The White House, President Obama's Judicial Nominations, <http://www.whitehouse.gov/the-press-office/president-obama-nominates-raymond-lohier-jr-united-states-court-appeals-second-circ> (last visited Mar. 29, 2010).

<sup>45</sup> *Id.*

<sup>46</sup> See Jonathan Ringel, *Federal Circuit's Scientific Method: Coveted Judicial Clerkships Draw Pool of Candidates with Technical Backgrounds to Match the Court's Docket*, LEGAL TIMES, Nov. 6, 2000, at 1 (noting that twenty-five of thirty-six law clerks from the Federal Circuit had a science or engineering background).

## 2. Senior Judges

Following their changes to senior status, Judge Schall and Judge Mayer became the fifth and sixth senior judges serving on the Federal Circuit.<sup>47</sup> After a judge retires, he or she may move to senior status indefinitely, provided he or she receives certification every year by the Chief Judge.<sup>48</sup> Retired judges on senior status, known as senior judges, can be assigned to active duty by the Chief Judge and perform any duties that they are willing and able to undertake.<sup>49</sup>

Senior judges have a reduced caseload in comparison to their active counterparts.<sup>50</sup> Another difference between active and senior judges is the number of law clerks that each judge can employ: an active judge can have up to four, whereas a senior judge can only employ one clerk.<sup>51</sup> Senior status is so similar to active status on the Federal Circuit that the court's rules allow for a panel to be composed of a majority of senior judges.<sup>52</sup>

## 3. Visiting Judges

The laws allow for circuit judges from other circuit courts to serve on the Federal Circuit from time to time.<sup>53</sup> The Federal Circuit welcomes these judges, known as visiting judges, as valuable benefits to the court.<sup>54</sup> Visiting judges have

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<sup>47</sup> Judicial Biographies, *supra* note 33. Unlike Judges Schall and Mayer, when Chief Judge Michel retired on May 31, 2010, he did not move to senior status, instead he retired completely from the federal judiciary. Chief Judge Michel Retirement Announcement, *supra* note 34.

<sup>48</sup> 28 U.S.C. § 371 (2006). The requirements for the certification of a senior judge are contained in subsection (e).

<sup>49</sup> 28 U.S.C. § 294 (2006).

<sup>50</sup> *See infra* Part III.A.1 (showing that the number of panels senior judges sit on is significantly lower than for active judges).

<sup>51</sup> United States Court of Appeals for the Federal Circuit, The Court, Court Jurisdiction, [http://www.cafc.uscourts.gov/index.php?option=com\\_content&view=article&id=144&Itemid=27](http://www.cafc.uscourts.gov/index.php?option=com_content&view=article&id=144&Itemid=27) (last visited Aug. 8, 2010).

<sup>52</sup> FED. CIR. R. 47.2(a).

<sup>53</sup> 28 U.S.C. § 291(a) (2006).

<sup>54</sup> FED. CIR. INTERNAL OPERATING PROC. 6 ("Visiting judges provide a welcome aid in the work of the court. Their favorable impression is carried throughout the nation. Their contribution of varied viewpoints, experiences, ideas, and information from throughout the judicial system is invaluable."), available at <http://www.cafc.uscourts.gov/images/stories/rules-of-practice/IOP.pdf>.

all of the same rights and duties as an active judge on the Federal Circuit during their visits.<sup>55</sup>

During the five-year period of the study, twelve visiting judges sat on panels that heard BPAI appeals.<sup>56</sup> A visiting judge sat on a panel in fourteen BPAI decisions, and in two of those decisions, a visiting judge delivered the opinion of the court.<sup>57</sup> It is notable that both visiting judges who wrote opinions came from districts where patent litigation has become popular.<sup>58</sup>

## II. Description of the Study

In order to fill the need for more information on how the Federal Circuit assigns panels to appeals from the BPAI, a study of these appeals was performed. The basic goal of this study was to capture all appeals that start in the BPAI and make their way, directly or indirectly, to the Federal Circuit. This data revealed interesting trends as well as shed light onto how effective the system of assigning cases upholds the representative cross-section requirement of 28 U.S.C. § 46(b).

### A. Parameters of the Study

This study contains a defined population of decisions of the Federal Circuit issued over a five-year period, from January 1, 2005 through December 31, 2009.<sup>59</sup>

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<sup>55</sup> 28 U.S.C. § 296 (2006).

<sup>56</sup> See *infra* Part III.A.1

<sup>57</sup> Judge Richard G. Stearns of the District Court for the District of Massachusetts delivered the opinion in *In re Alonso*, 545 F.3d 1015 (Fed. Cir. 2008). Judge T. John Ward of the District Court for the Eastern District of Texas delivered the opinion in *In re Stauffer*, 290 F. App'x 327 (Fed. Cir. 2008).

<sup>58</sup> See Kimberly A. Moore, *Forum Shopping in Patent Cases: Does Geographic Choice Affect Innovation?*, 79 N.C. L. REV. 889, 917 (2001) (noting that plaintiffs may have chosen Massachusetts as a forum due to its plaintiff winning rates, though the actual win rates for plaintiffs in Massachusetts do not support that reasoning); see also Yan Leychikis, *Of Fire Ants and Claim Construction: An Empirical Study of the Meteoric Rise of the Eastern District of Texas as a Preeminent Forum for Patent Litigation*, 9 YALE J.L. & TECH. 193, 195–96 (2007) (looking into the significant increase in cases brought into the Eastern District of Texas due to plaintiff success).

<sup>59</sup> The study's results are on file with the author. The cases were obtained either directly through the database of the Federal Circuit, available at <http://www.ca9c.uscourts.gov/dailylog.html>; or by searching LexisNexis's Federal Circuit database over the five-year period for cases appealed from the Board of Patent Appeals and Interferences. Searches performed included searching for "Doll," "Dudas," or "Kappos" as a party to a suit in the Federal Circuit, searching for mention of the "Board of Patent Appeals and Interferences," searching for mention of the "United States Patent and Trademark Office," and searching for "In re" as a party to suits to encompass most actions that arise from the BPAI. Additionally, searches were performed to locate references to 28 U.S.C. §§ 145 and 146 in Federal Circuit cases.

Only decisions resulting from appeals either directly through the BPAI, or indirectly through patent prosecution civil action, as noted previously, are included.<sup>60</sup> This population includes all decisions regardless of the outcome or whether the Federal Circuit ever reached the merits of the case.

The study comprises all cases where the Federal Circuit delivered an opinion, including Rule 36 cases that allow the Federal Circuit to affirm without writing a discussion of the case, giving an explanation, or providing any text at all in the opinion.<sup>61</sup> The study also includes both precedential and nonprecedential opinions. A nonprecedential opinion is provided when more than a simple affirmance is necessary, but the holding does not significantly add to the body of law.<sup>62</sup>

In addition, the study does not give additional weight to decisions that encompass multiple cases in a single opinion.<sup>63</sup> For instance, opinions or affirmances containing multiple cases only count as one decision for the purposes of this study. Conversely, cases reheard with the same panel are counted each time. Because the Federal Circuit has discretion as to how decisions are rendered, the author felt it was appropriate to count appeals in a similar fashion.

#### B. Data Collected

For each decision in the population, the following data was collected from the Federal Circuit's opinion:

- (1) case name, docket number, and date of decision;
- (2) whether the Federal Circuit affirmed, reversed, or vacated the decision of the BPAI or lower court;

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<sup>60</sup> 35 U.S.C §§ 145, 146. Patent cases appealed to the Federal Circuit from district courts that were related to infringement or other matters, e.g., evidence law or procedure law, were not included in the study.

<sup>61</sup> See Beth Zeitlin Shaw, Note, *Please Ignore this Case: An Empirical Study of Nonprecedential Opinions in the Federal Circuit*, 12 GEO. MASON L. REV. 1013, 1015 (2004) (noting that Rule 36 allows the Federal Circuit to affirm without opinion when "the court determines an opinion would have no precedential value, and any of five other conditions exist").

<sup>62</sup> FED. CIR. R. 32.1(b).

<sup>63</sup> It is up to the discretion of the Federal Circuit to combine multiple cases in a single appeal. See *In re Barnett*, 253 F. App'x 18 (Fed. Cir. 2007), for an example of the court merging three cases into a single decision. See also *Goldberg v. Bass*, 284 F. App'x 809 (Fed. Cir. 2008), and *Goldberg v. Bass*, 284 F. App'x 810 (Fed. Cir. 2008), for an example of the Federal Circuit issuing multiple decisions for a related case.

- (3) the issue(s) presented in the case, if the opinion listed the issues;<sup>64</sup>
- (4) whether the opinion was precedential or nonprecedential;
- (5) the judges who sat on the panel for the case; and
- (6) the judge who authored the opinion of the court for non-Rule 36 cases, and the judges, if any, who authored additional opinions in the case.

### C. Limitations

The notable limitation of this study pertains to its predictive power. Although an empirical study such as this one can describe and make assumptions on what happened over the five-year period, these are merely predictions.<sup>65</sup> There are sometimes extenuating circumstances that cannot be seen in the words of the opinions and through data in a study that may account for changes in the usual practices of the court. This includes circumstances such as recusal, where judges must disqualify themselves because of worries of impartiality.<sup>66</sup> Additionally, there may be instances where a judge is unavailable for a panel because of illness, emergency, or assignment to another court by designation, which also could lead to attenuation in the results. Therefore, this study does not attempt to make predictions on the reasons behind the results, but instead analyzes the results for trends and evaluates the randomization system. Any information the study may provide for prediction outside the five-year period, particularly towards the future practices of the Federal Circuit, should be taken with caution. Thus, this study attempts to minimize any assumptions about the meaning, past or future, of the empirical data.

The study's main goal is to provide a clearer picture of judging panels that hear non-infringement patent cases. Any inferences made regarding the success or failure of the current randomization system in upholding the statutory requirements are based on the data available.

### III. Results of the Study

Using the data set defined in Part II, this study tests the effectiveness of the current randomization system of the Federal Circuit in achieving the representative

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<sup>64</sup> In Rule 36 affirmances, no issue is given, but if the opinion were a reexamination appeal it would be noted in the opinion and counted as a reexamination for purposes of the study.

<sup>65</sup> See Christopher A. Cotropia, *Nonobviousness and the Federal Circuit: An Empirical Analysis of Recent Case Law*, 82 NOTRE DAME L. REV. 911, 929 (2007) (noting that studies inherently possess limitations which prohibit true accuracy when predicting the past or the future).

<sup>66</sup> 28 U.S.C. § 455 (2006).



cross-section requirement set out in both the federal law and the court's rules.<sup>67</sup> The results are analyzed in four ways, with the latter three comprising focused subsets of the first. First, the overall statistics for all appeals coming from the BPAI are analyzed with respect to the judges on the panels. This analysis notes the judges on the panels for each decision, without regard to the nature of the decision, including Rule 36 affirmances, interferences, as well as the typical<sup>68</sup> appeals that reach the Federal Circuit from the BPAI. The overall study aims to capture all of the opinions from the Federal Circuit that originated as patent appeals from the USPTO.

The second analysis looks at the judging panels for the three different rulings the Federal Circuit may issue: affirming, reversing, or vacating the appealed holding. While this analysis does not speak directly to the effectiveness of the randomization system, it may provide valuable insight to both sides in the debate about judges playing extra-influential roles in Federal Circuit jurisprudence.<sup>69</sup>

The third analysis reviews the judging panels for appeals relating to issues most commonly seen by the Federal Circuit. The issues include anticipation inquiries,<sup>70</sup> obviousness inquiries,<sup>71</sup> patentable subject matter,<sup>72</sup> adequacy of the specification,<sup>73</sup> and interferences.<sup>74</sup> This focus may provide additional insight to the debate over the influential roles certain Federal Circuit judges may have if it reveals that the system leads to a handful of judges in particular changing the law on a specific topic.

The final analysis focuses on the precedential decisions issued by the Federal Circuit. Because precedential opinions have a large influence on the body of law, something lacking in their non-precedential counterparts, it is important to see if the randomization system is effective specifically as to precedential opinions. While it

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<sup>67</sup> The federal law relating to randomization can be found in 28 U.S.C. § 46(b) (2006), and the Federal Circuit's rule can be found in FED. CIR. R. 47.2(b).

<sup>68</sup> For a list of "typical" issues, see *infra* Part III.C.

<sup>69</sup> Cf. Petherbridge, *supra* note 6, at 427–28 (noting that Federal Circuit judges may have more individual freedom in deciding cases).

<sup>70</sup> 35 U.S.C. § 102 (2006).

<sup>71</sup> *Id.* at § 103.

<sup>72</sup> *Id.* at § 101.

<sup>73</sup> *Id.* at § 112.

<sup>74</sup> *Id.* at § 135.

may be difficult or even impossible to determine prior to the assignment of judging panels if a case will become precedential or not, a look into the results of the current system may help identify any possible harms.

In addition to the aforementioned analyses, the article also examines various trends and points of interest revealed during the course of the study. These trends, not visible when viewing the overall results, may be of interest to scholars in the area.

#### A. Overall Study of Judging Panels

This look at the overall results of the judging panels for every decision in the study is instructive on the effectiveness of the randomization system in achieving the representative cross-section requirement. First, comparison between judges is made based on the percentage of panels that each judge served. Then, a comparison is made based on the statistics of authors of opinions.

##### 1. Judging Panels

In the five-year period encompassed by the overall study, a total of 110 decisions were issued by the Federal Circuit on appeals from the USPTO.<sup>75</sup> Only one of these decisions featured a panel of more than three judges, as it was a rehearing *en banc*.<sup>76</sup> Judge Moore was only available for eighty-four cases due to confirmation on September 5, 2006.<sup>77</sup> Since Senior Judge Cleverger assumed senior status on February 1, 2006,<sup>78</sup> he was an active judge during the decisions of only 17 of the 110 cases. Senior Judge Schall assumed senior status on October 5, 2009, and thus, was a senior judge during only the last nine decisions of the study.<sup>79</sup> While Senior Judge Mayer and former Chief Judge Michel did recently retire,<sup>80</sup> both were active

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<sup>75</sup> The cases along with the study's results are on file with the author. See *supra* note 59 (detailing how the searches for cases were performed).

<sup>76</sup> *In re Bilski*, 545 F.3d 943, 949 (Fed. Cir. 2008) (en banc), *aff'd sub nom*, *Bilski v. Kappos*, 130 S. Ct. 3218 (2010).

<sup>77</sup> United States Senate, U.S. Senate Roll Call Votes 109th Congress – 2nd Session, [http://senate.gov/legislative/LIS/roll\\_call\\_lists/roll\\_call\\_vote\\_cfm.cfm?congress=109&session=2&vote=00231](http://senate.gov/legislative/LIS/roll_call_lists/roll_call_vote_cfm.cfm?congress=109&session=2&vote=00231) (last visited Aug. 27, 2010). The percentages reported for Judge Moore reflects this total number of eighty-four cases.

<sup>78</sup> Judicial Biographies, *supra* note 33.

<sup>79</sup> *Id.*

<sup>80</sup> See United States Court of Appeals for the Federal Circuit, Announcements, [http://www.cafc.uscourts.gov/index.php?option=com\\_content&view=article&id=205:circuit-judge-haldane-robert-mayer-assumed-senior-status-on-june-30-2010-&catid=18:2010&Itemid=50](http://www.cafc.uscourts.gov/index.php?option=com_content&view=article&id=205:circuit-judge-haldane-robert-mayer-assumed-senior-status-on-june-30-2010-&catid=18:2010&Itemid=50)

during the decisions of all cases included in the study. As a result of the number of decisions they were active for, Senior Judge Clevenger is represented as a senior judge in the study, and Senior Judge Schall, Senior Judge Mayer, and former Chief Judge Michel are represented as active judges.

Table 1. Judge Panel Statistics in Appeals from BPAI Decisions

Judge	Panels	Case %
Judge Prost	32	29.1%
Judge Mayer	31	28.2%
Judge Rader	29	26.4%
Judge Newman	28	25.5%
Judge Bryson	27	24.5%
Chief Judge Michel	26	23.6%
Judge Linn	26	23.6%
Judge Gajarsa	21	19.1%
Judge Lourie	20	18.2%
Judge Moore <sup>81</sup>	15	17.9%
Judge Schall	19	17.3%
Judge Dyk	19	17.3%
Visiting Judges	14	12.7%
Senior Judge Friedman	10	9.1%
Senior Judge Clevenger	8	7.3%
Senior Judge Archer	7	6.4%
Senior Judge Plager	6	5.5%

Table 1 depicts the number of panels that each judge sat on during the five-year period of this study. The data shows the difference in BPAI patent appeal load. Judges Mayer and Prost each heard more than thirty BPAI patent appeals during the period, while four of the other judges each sat on only twenty or fewer panels during the same time. This leads to an interesting difference in the percentages, as shown in the table. Judge Prost participated in 29.1% of the BPAI patent

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(last visited Aug. 8, 2010) (noting that Senior Judge Mayer did not move to senior status until June 30, 2010); Chief Judge Michel Retirement Announcement, *supra* note 35 (noting that Chief Judge Michel retired on May 31, 2010).

<sup>81</sup> Percentages for Judge Moore are based on a total possible caseload of eighty-four cases.



appeals that reached the Federal Circuit, while Judges Schall and Dyk each only participated in 17.3%.

Such a large difference in the number of BPAI patent appeals heard calls into question not only the success of the current randomization system, but also whether it is meeting the statutory requirements that it must uphold. A computer that randomly builds panels and then randomly assigns them to cases is assumed to achieve a somewhat even spread of cases among each judge on the Federal Circuit.<sup>82</sup> Because the number of cases heard by judges varies by up to 160%, it suggests that the current system may not achieve an even spread. The aforementioned representative cross-section requirement<sup>83</sup> may not be met based on what is shown in Table 1.

It is hardly representative of the Federal Circuit when the three busiest judges hear over thirty more cases than the three judges with the lightest BPAI patent appeal caseload. Even if the requirement were read as requiring each judge to have a representative spread of cases from each field of law, Table 1 still casts suspicion on the current system's success in meeting that interpretation. The randomization system should theoretically assign a similar number of cases to every judge on the Federal Circuit.

The current randomization system appears to lead to a distribution of cases that does not meet the intended requirements of the representative cross-section rule. However, the author does not wish to jump to the conclusion that this has an influential effect on the Federal Circuit. The fourth analysis, looking at precedential opinions, will better show if the uneven spread of judges leads to a few judges having a stronger influence on the Federal Circuit than other judges, but the overall study cannot confidently raise inferences regarding anything other than potentially the success or failure of the current randomization system.

## 2. *Opinion Authors*

In the five-year period of the study, the Federal Circuit published fifty-eight majority opinions.<sup>84</sup> In addition to these, there were nine partial<sup>85</sup> or full dissents.<sup>86</sup>

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<sup>82</sup> Cf. Tiller & Cross, *supra* note 28, at 216–17 (noting that randomization should help ensure an equitable distribution).

<sup>83</sup> 28 U.S.C. § 46(b) (2006).

<sup>84</sup> The cases along with the study's results are on file with the author. See *supra* note 59 (detailing how the searches for cases were performed).

<sup>85</sup> A partial dissent here is one where the judge dissents in part and concurs in part.



Table 2. Authored Opinion Statistics in Appeals from BPAI Decisions

Judge	Majority Opinions	% of All Opinions	% of Panels	Dissents	Dissent %
Judge Newman	10	17.2%	52.6%	3	33.3%
Judge Prost	8	13.8%	42.1%	1	11.1%
Chief Judge Michel	6	10.3%	33.3%	0	0%
Judge Gajarsa	6	10.3%	42.9%	0	0%
Judge Lourie	6	10.3%	54.5%	0	0%
Judge Linn	5	8.6%	38.5%	0	0%
Judge Rader	4	6.9%	26.7%	3	33.3%
Judge Bryson	4	6.9%	40.0%	0	0%
Judge Dyk	3	5.2%	25.0%	0	0%
Judge Moore <sup>87</sup>	3	5.2%	30.0%	1	11.1%
Visiting Judges	2	3.4%	33.3%	0	0%
Judge Mayer	1	1.7%	7.1%	1	11.1%
Judge Schall	0	0%	0%	0	0%

Table 2 shows the statistics for the authored opinions during the five-year period encompassed by the study. The table appears to be consistent with Table 1, in that judges who hear more appeals tend to write more of the opinions. The fourth column, labeled “% of Panels,” shows how many opinions that the respective judge authored based on the number of panels they served where an opinion was actually published. This data possibly shows that the judges with a technical background may tend to author more opinions than those that do not.<sup>88</sup> However, it is hard to reach such a conclusion without viewing the cases individually to see, in decisions

<sup>86</sup> *Hyatt v. Doll*, 576 F.3d 1246, 1279 (Fed. Cir. 2009) (Moore, J., dissenting), *vacated*, 366 F. App’x 170 (Fed. Cir. 2010); *Chapman v. Casner*, 315 F. App’x 294, 298 (Fed. Cir. 2009) (Rader, J., dissenting); *In re Bilski*, 545 F.3d 943, 976, 998, 1011 (Fed. Cir. 2008) (Newman, J., Mayer, J., and Rader, J., dissenting), *aff’d sub nom. Bilski v. Kappos*, 130 S. Ct. 3218 (2010); *In re Basell Poliolefine Italia S.P.A.*, 547 F.3d 1371, 1379 (Fed. Cir. 2008) (Newman, J., dissenting); *In re Buszard*, 504 F.3d 1364, 1368 (Fed. Cir. 2007) (Prost, J., dissenting); *In re Fisher*, 421 F.3d 1365, 1379 (Fed. Cir. 2005) (Rader, J., dissenting); *In re Sibia Neurosciences*, 156 F. App’x 314, 316 (Fed. Cir. 2005) (Newman, J., dissenting).

<sup>87</sup> Percentages for Judge Moore are based on the eighty-four cases in which she was available to participate following her nomination and confirmation.

<sup>88</sup> See *supra* Part I.C.1 for information on which judges have technical backgrounds.



where an opinion was warranted, what percentage of those opinions were assigned to a judge with a technical background if one was on the panel. For instance, some panels may have no judges with a technical background, while other panels may feature three such judges.

Furthermore, the statistics in Table 2 reveal something else worth noting. Of the nine dissents written in the five-year period, either a judge with a technical background or one with extensive knowledge of patents wrote seven of them.<sup>89</sup> Further, in six of those seven dissents, a judge with a technical background dissented from an opinion authored by a judge without a technical background.<sup>90</sup> In five of those instances, the majority opinion was authored by former Chief Judge Michel<sup>91</sup> who, as the most senior member of the court, assigned the opinion authorship for every panel where he was in the majority.<sup>92</sup> This may also account for the large number of opinions by Judge Newman, who is second in seniority behind the former Chief Judge.

#### B. Study of Judge Statistics by Ruling

Of the 110 cases encompassed by the study, the Federal Circuit affirmed ninety-two, or 83.6%. Of the remaining cases, the Federal Circuit reversed ten and vacated the remaining eight. Because she joined the Federal Circuit after the start date of the study, Judge Moore was only available for the panel of seventy of the affirmed, eight of the reversed, and six of the vacated cases.

Table 3. Judging Panel Statistics by Ruling for Appeals from BPAI Decisions

Judge	Affirmed		Reversed		Vacated	
	Cases	Case	Cases	Case	Cases	Case
Judge Prost	26	28.3%	5	50.0%	2	25.0%
Judge Mayer	27	29.3%	4	40.0%	1	12.5%
Judge Rader	23	25.0%	4	40.0%	2	25.0%

<sup>89</sup> *Hyatt*, 576 F.3d at 1279; *Chapman*, 315 F. App'x at 298; *In re Bilski*, 545 F.3d at 976, 1011; *In re Fisher*, 421 F.3d at 1379; *In re Sibia Neurosciences*, 156 F. App'x at 316.

<sup>90</sup> *Hyatt*, 576 F.3d at 1279; *Chapman*, 315 F. App'x at 298; *In re Bilski*, 545 F.3d at 976, 1011; *In re Fisher*, 421 F.3d at 1379.

<sup>91</sup> *Hyatt*, 576 F.3d at 1279; *In re Bilski*, 545 F.3d at 976, 998, 1011; *In re Fisher*, 421 F.3d at 1379.

<sup>92</sup> FED. CIR. INTERNAL OPERATING P. 8 ("The presiding judge assigns the authoring responsibility for each case at the end of each day's sitting or at the end of a session. If the panel is divided, the authoring role is assigned to a member of the majority. If the presiding judge dissents, assignment will be made by the senior active member of the majority.")



Judge Newman	20	21.7%	5	50.0%	3	37.5%
Judge Bryson	27	29.3%	1	10.0%	0	0%
Chief Judge Michel	22	23.9%	3	30.0%	1	12.5%
Judge Linn	23	25.0%	0	0%	3	37.5%
Judge Gajarsa	17	18.5%	0	0%	4	50.0%
Judge Lourie	18	19.6%	1	10.0%	1	12.5%
Judge Moore <sup>93</sup>	12	17.1%	0	0%	3	50.0%
Judge Schall	18	19.6%	0	0%	1	12.5%
Judge Dyk	15	16.3%	3	30.0%	1	12.5%
Visiting Judges	14	15.2%	0	0%	0	0%
Senior Judge Friedman	7	7.6%	3	30.0%	0	0%
Senior Judge Clevenger	8	8.7%	0	0%	0	0%
Senior Judge Archer	4	4.3%	1	10.0%	2	25.0%
Senior Judge Plager	6	6.5%	0	0%	0	0%

Table 3 shows statistics for the panels on which each judge served. While the results cannot directly speak to the effectiveness of the randomization system or its meeting the statutory requirements, the data shows a few trends that may be of interest to Federal Circuit observers.

There were eight cases during the five-year study period where the Federal Circuit vacated the appealed ruling.<sup>94</sup> With three judges on each of the panels,<sup>95</sup> there were twenty-four occasions for a judge to serve. The study showed that judges with technical backgrounds or extensive patent knowledge or experience<sup>96</sup> filled sixteen of those twenty-four possible seats, or 66.7%. Based on this percentage, theoretically every time the Federal Circuit vacates a ruling, a majority of the

<sup>93</sup> Judge Moore's percentages reflect the seventy affirmed, eight reversed, and six vacated cases for which she was available to serve as a member of the panel.

<sup>94</sup> *In re Lister*, 583 F.3d 1307 (Fed. Cir. 2009); *Takeda Pharm. Co. v. Doll*, 561 F.3d 1372 (Fed. Cir. 2009); *In re Reuning*, 276 F. App'x 983 (Fed. Cir. 2008); *In re Sullivan*, 498 F.3d 1345 (Fed. Cir. 2007); *Henkel Corp. v. Procter & Gamble Co.*, 485 F.3d 1370 (Fed. Cir. 2007); *In re Hays*, 210 F. App'x 995 (Fed. Cir. 2006); *In re Kumar*, 418 F.3d 1361 (Fed. Cir. 2005); *Capon v. Eshhar*, 418 F.3d 1349 (Fed. Cir. 2005).

<sup>95</sup> See 28 U.S.C. § 46(b) (2006) ("In each circuit the court may authorize the hearing and determination of cases and controversies by separate panels, each consisting of three judges . . .").

<sup>96</sup> Judges Newman, Lourie, Linn, Gajarsa, Moore, and Rader fit this definition. See *supra* Part I.C.1 (discussing the backgrounds of Federal Circuit judges).



panel has a technical background. This inference, based on the overall statistic, mostly holds true as looking into the eight cases, six had panels with two or more judges with such a background, and one such judge authored one of the remaining two opinions. It would appear, based on these results, that a panel containing a majority of judges with a technical background is much more likely to vacate a ruling than one without a majority. However, based on the small number of rulings, such a conclusion cannot properly be drawn.

Furthermore, the results of the study concerning reversals also cast suspicion on any such inference made by the vacation statistics. Over the study period, there were ten reversals by the Federal Circuit.<sup>97</sup> For these ten reversals, judges with a technical background filled only one third of the seats. Furthermore, in only three of the ten cases did a majority of the judges on the bench have technical backgrounds.<sup>98</sup>

Additionally, regarding non-affirmances,<sup>99</sup> Judge Newman authored the opinion for all five of the reversals where she was a participant.<sup>100</sup> Four of the five opinions published as precedential.<sup>101</sup> Judge Newman also wrote two of the three opinions where panels she served on vacated the lower court's holding.<sup>102</sup> Both of these opinions published as precedential. In total, Judge Newman authored the

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<sup>97</sup> *In re Skvorecz*, 580 F.3d 1262 (Fed. Cir. 2009); *In re McNeil-PPC, Inc.*, 574 F.3d 1393 (Fed. Cir. 2009); *In re Reiffin Family Trust*, 340 F. App'x 651 (Fed. Cir. 2009); *In re Wheeler*, 304 F. App'x 867 (Fed. Cir. 2008); *In re Buszard*, 504 F.3d 1364 (Fed. Cir. 2007); *In re Comiskey*, 499 F.3d 1365 (Fed. Cir. 2007), *opinion withdrawn and superseded on rehearing en banc*, 89 U.S.P.Q.2d 1641 (Fed. Cir. 2009), *opinion revised and superseded*, 554 F.3d 967 (Fed. Cir. 2009); *Frazer v. Schlegel*, 498 F.3d 1283 (Fed. Cir. 2007); *Brand v. Miller*, 487 F.3d 862 (Fed. Cir. 2007); *In re Scroggie*, 170 F. App'x 132 (Fed. Cir. 2006); *Brown v. Barbacid*, 436 F.3d 1376 (Fed. Cir. 2006).

<sup>98</sup> *In re Wheeler*, 304 F. App'x at 867 (Newman, J., and Lourie, J., on the panel); *Frazer*, 498 F.3d at 1283 (Newman, J., Rader, J., on the panel); *Brown*, 436 F.3d at 1376 (Newman, J., and Rader, J., on the panel).

<sup>99</sup> Non-affirmances here refer to cases where the lower holding was either vacated or reversed.

<sup>100</sup> *In re Skvorecz*, 580 F.3d at 1262; *In re Wheeler*, 304 F. App'x at 867; *In re Buszard*, 504 F.3d at 1364; *Frazer*, 498 F.3d at 1283; *Brown*, 436 F.3d at 1376.

<sup>101</sup> An opinion is precedential if it is determined to add significantly to the body of law. See FED. CIR. R. 32.1(b) (noting that a non-precedential opinion is an opinion that the issuing panel has determined does not significantly add to the body of law). The precedential opinions here were: *In re Skvorecz*, 580 F.3d at 1262, *In re Buszard*, 504 F.3d at 1364, *Frazer*, 498 F.3d at 1283, and *Brown*, 436 F.3d at 1376.

<sup>102</sup> *In re Kumar*, 418 F.3d 1361 (Fed. Cir. 2005); *Capon v. Eshhar*, 418 F.3d 1349 (Fed. Cir. 2005).



opinion for seven of the eighteen non-affirmances, or 38.9%.<sup>103</sup> As mentioned previously, however, on many of the panels that Judge Newman participated, she was the presiding judge and had the authority to assign authoring responsibilities.<sup>104</sup>

The author does not wish to infer that any judge in particular may be more or less inclined than the rest to vacate or reverse the BPAI. However, if a judge is inclined to not affirm the USPTO and the current system results in that judge sitting on 20% more panels than his or her colleagues, it may result in that particular judge exerting more influence than their colleagues in this field of law.

### C. Study of Judge Statistics by Issue

There are several common issues central to the cases brought up on appeal to the Federal Circuit from the BPAI. The current system of randomization used by the Federal Circuit aims at achieving a representative cross-section for a particular field of law. This requirement is more than likely referring to a broad field of law, such as patent prosecution generally, and likely not intended to reach specific issues such as proper enablement in a patent specification.<sup>105</sup> The author contends that patent prosecution itself is a broad field of law distinguished from patent litigation. Regardless of the scope of the requirement, looking at the results of the current system concerning judges that hear particular issues may shed light on the effectiveness of the system and provide valuable information to patent prosecutors concerning judges that shape certain areas of patent prosecution practice.<sup>106</sup>

Five issues in particular are central to most appeals to the Federal Circuit arising from the USPTO: patentable subject matter, anticipation, nonobviousness, adequacy of specification, and interference.<sup>107</sup> Statutes ground each of these issues,

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<sup>103</sup> *In re Skvorecz*, 580 F.3d at 1262; *In re Wheeler*, 304 F. App'x at 867; *In re Buszard*, 504 F.3d at 1364; *Frazier*, 498 F.3d at 1283; *Brown*, 436 F.3d at 1376; *In re Kumar*, 418 F.3d at 1361; *Capon*, 418 F.3d at 1349. In one case where Judge Newman did not author the opinion that the panel on which she sat vacated a ruling, the opinion was authored by Judge Lourie, a colleague who also has a technical background. Judge Gajarsa, a former patent examiner, was the third judge on the panel. *In re Sullivan*, 498 F.3d 1345 (Fed. Cir. 2007).

<sup>104</sup> See FED. CIR. INTERNAL OPERATING P. 8 (discussing who assigns the writing of opinions).

<sup>105</sup> See Elizabeth I. Rogers, *The Phoenix Precedents: The Unexpected Rebirth of Regional Circuit Jurisdiction over Patent Appeals and the Need for a Considered Congressional Response*, 16 HARV. J.L. & TECH. 411, 468 (2003) (noting that the representative cross-section requirement "ensur[es] that all the judges sit on a representative sampling of all the cases heard").

<sup>106</sup> Detailed information of all of the study's cases are on file with the author and available upon request. See *supra* note 59 (detailing how the searches for cases were performed).

<sup>107</sup> 35 U.S.C. § 101–03, 112, 135 (2006); JANICE MUELLER, PATENT LAW 39–40, 45–47 (3d ed. 2009).

with guidance provided by the Federal Circuit and Supreme Court, as well as by the USPTO in the form of the Manual of Patent Examining Procedure.<sup>108</sup> Of the 110 cases encompassed by the study, seventy-five correspond to one of the five main issues, and in some instances, the same case raised more than one of these main issues. When a case raised multiple issues, it counted once for each individual issue.<sup>109</sup> The remaining cases were Rule 36 opinions where the court did not provide the information necessary to determine the issue raised.

Figure 1. Appeal Breakdown by Issue Presented

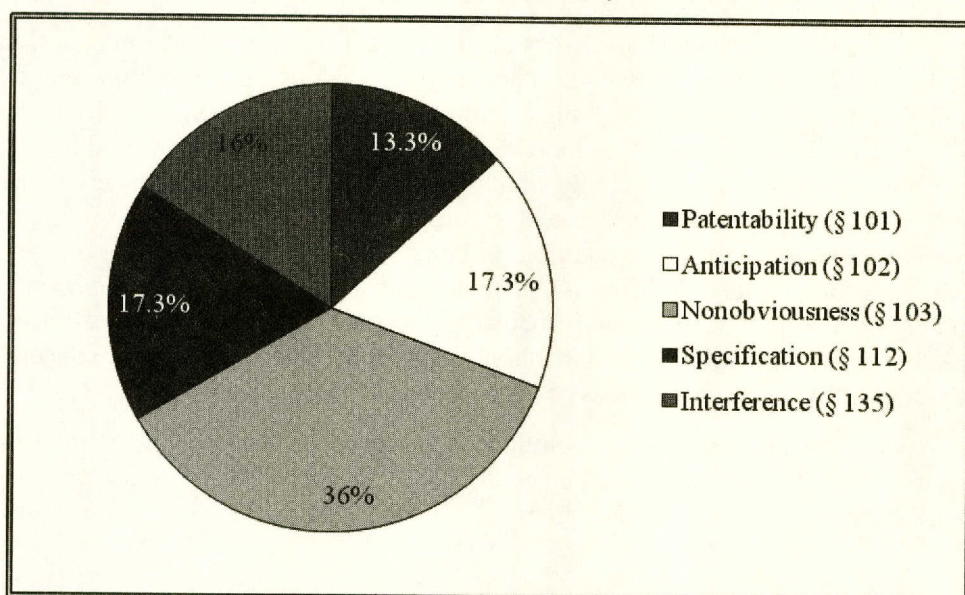


Figure 1 depicts the proportions of each particular issue in relation to the other common issues raised on appeal. The percentages provided in the figure correspond to the percentages for that issue based on all seventy-five cases encompassed

<sup>108</sup> U.S. PATENT AND TRADEMARK OFFICE, MANUAL OF PATENT EXAMINING PROCEDURE (8th ed., rev. 2010); MUELLER, *supra* note 107, at 35–40.

<sup>109</sup> The author counted cases in this fashion because each time an issue is brought up in a case it may be just as important as any other issue in the same case, and therefore should be weighed accordingly.



in the study. Appeals for nonobviousness occurred more often than any other issue, and the other four issues occurred with approximately the same frequency.

### 1. Patentable Subject Matter Under 35 U.S.C. § 101

During the period encompassed in the study, there were ten cases with opinions where patentable subject matter was an issue central to the case.<sup>110</sup> Among all of the individual issues, § 101, patentability, had the most even spread of judges on the panels. Every non-senior judge sat on at least two panels, with the majority of the judges participating in three cases. Only three of the twelve judges heard more than three cases, and those that did hear more than three cases were not authors of significantly more opinions than other judges. If the results of the study with regard to appeals under § 101 are representative of the whole study, it would appear that the current system of randomization was highly effective. However, in light of the overall study, this particular subset of cases is not very representative.

One notable trend seen in cases arising under this section is that more cases where § 101 is an issue were appealed to the Federal Circuit recently than in the early years of the study. In the author's opinion, this trend could be due to both the Federal Circuit's decision in *In re Bilski*,<sup>111</sup> as well as the Supreme Court's granting of the petition for certiorari in the case.<sup>112</sup> Prior to that decision, there were only four cases involving § 101 in forty months,<sup>113</sup> barely one decision a year. Since the Federal Circuit's *Bilski* decision, there have been five appeals to the Federal Circuit in fourteen months,<sup>114</sup> nearly a 360% increase in appeals regarding the USPTO's § 101 determination. While there has been an increase in appeals in general during the fourteen-month period, this increase does not necessarily account

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<sup>110</sup> *In re Fallaux*, 564 F.3d 1313 (Fed. Cir. 2009); *Takeda Pharm. Co. v. Doll*, 561 F.3d 1372 (Fed. Cir. 2009); *In re Ferguson*, 558 F.3d 1359 (Fed. Cir. 2009); *In re Basell Poliolefine Italia S.P.A.*, 547 F.3d 1371 (Fed. Cir. 2008); *In re Bilski*, 545 F.3d 943 (Fed. Cir. 2008), *aff'd sub nom.*, *Bilski v. Kappos*, 130 S. Ct. 3218 (2010); *In re Speas*, 273 F. App'x 945 (Fed. Cir. 2008); *In re Comiskey*, 499 F.3d 1365 (Fed. Cir. 2007); *In re Nuijten*, 500 F.3d 1346 (Fed. Cir. 2007); *In re Fisher*, 421 F.3d 1365 (Fed. Cir. 2005); *In re Fujimara*, 130 F. App'x 465 (Fed. Cir. 2005).

<sup>111</sup> *In re Bilski*, 545 F.3d 943, 949 (Fed. Cir. 2008) (en banc), *aff'd sub nom.*, *Bilski v. Kappos*, 130 S. Ct. 3218 (2010).

<sup>112</sup> *Bilski v. Doll*, 129 S. Ct. 2735 (2009).

<sup>113</sup> *In re Speas*, 273 F. App'x 945 (Fed. Cir. 2008); *In re Nuijten*, 500 F.3d 1346 (Fed. Cir. 2007); *In re Fisher*, 421 F.3d 1365 (Fed. Cir. 2005); *In re Fujimara*, 130 F. App'x 465 (Fed. Cir. 2005).

<sup>114</sup> *In re Fallaux*, 564 F.3d 1313 (Fed. Cir. 2009); *Takeda Pharm. Co. v. Doll*, 561 F.3d 1372 (Fed. Cir. 2009); *In re Ferguson*, 558 F.3d 1359 (Fed. Cir. 2009); *In re Basell Poliolefine Italia S.P.A.*, 547 F.3d 1371 (Fed. Cir. 2008); *In re Comiskey*, 499 F.3d 1365 (Fed. Cir. 2007).

for the significant increase in patentable subject matter appeals during that same period.

## 2. Anticipation Under 35 U.S.C. § 102

During the five-year period of the study, there were thirteen cases where anticipation was one of the issues central to the appeal.<sup>115</sup> Of these thirteen cases, six of them had Judge Newman on their panel,<sup>116</sup> while three of the other non-senior judges heard only one anticipation appeal.<sup>117</sup> With Judge Newman on 46.2% of the panels where anticipation was raised and several other judges hearing less than 10% of those same type of cases, this subset of cases is more representative of the results of the overall study.<sup>118</sup>

There are two interesting trends from the results of the study with regard to the anticipation subset. First, Judge Newman authored the opinion for five of the six anticipation cases where she was on the panel.<sup>119</sup> Those opinions represent 50% of the cases where there was an author given for the opinion of the court.<sup>120</sup> While authorship may not speak to any influence Judge Newman had on shaping the law with regard to anticipation, it shows that if Judge Newman had something to say about § 102, patent law practitioners should definitely listen.

The other interesting trend revealed when looking at this subset of the study concerns reversals and vacatur. Of the thirteen § 102 cases from the five-year period where the court published opinions, three of them were reversed<sup>121</sup> and two of

<sup>115</sup> Detailed information of all of the study's cases are on file with the author and available upon request. See *supra* note 59 (detailing how the searches for cases were performed).

<sup>116</sup> *In re Skvorecz*, 580 F.3d 1262 (Fed. Cir. 2009); *In re Guess*, 347 F. App'x 558 (Fed. Cir. 2009); *In re Wheeler*, 304 F. App'x 867 (Fed. Cir. 2008); *In re Buszard*, 504 F.3d 1364 (Fed. Cir. 2007); *In re Margolin*, 244 F. App'x 329 (Fed. Cir. 2007); *In re Johnston*, 435 F.3d 1381 (Fed. Cir. 2006).

<sup>117</sup> *In re Lister*, 583 F.3d 1307 (Fed. Cir. 2009) (Linn, J., on panel and Prost, J., authoring); *In re Margolin*, 244 F. App'x 329 (Fed. Cir. 2007) (Schall, J., on panel and Newman, J., authoring); *In re Hays*, 210 F. App'x 995 (Fed. Cir. 2006) (Rader, J., on panel and Moore, J., authoring).

<sup>118</sup> See *supra* Table 1.

<sup>119</sup> *In re Skvorecz*, 580 F.3d 1262 (Fed. Cir. 2009); *In re Wheeler*, 304 F. App'x 867 (Fed. Cir. 2008); *In re Buszard*, 504 F.3d 1364 (Fed. Cir. 2007); *In re Margolin*, 244 F. App'x 329 (Fed. Cir. 2007); *In re Johnston*, 435 F.3d 1381 (Fed. Cir. 2006).

<sup>120</sup> Rule 36 affirmances, by their nature, do not have an author. Additionally, per curiam decisions by the court also do not provide an author for the opinion.

<sup>121</sup> *In re Skvorecz*, 580 F.3d 1262 (Fed. Cir. 2009); *In re Wheeler*, 304 F. App'x 867 (Fed. Cir. 2008); *In re Buszard*, 504 F.3d 1364 (Fed. Cir. 2007).

them were vacated.<sup>122</sup> For issues other than anticipation, affirmation rates were considerably higher.

### 3. *Nonobviousness Under 35 U.S.C. § 103*

During the study period, there were twenty-seven cases where the nonobviousness requirement of § 103 was an issue on appeal.<sup>123</sup> This number represents more than twice as many appeals as the other issues, which makes sense given that the nonobviousness requirement is one of the most important requirements in patent law.<sup>124</sup> Since there are more cases involving this issue than other issues, the variance among judge percentages more closely resembles the variances seen in the overall study. Both former Chief Judge Michel and Judge Prost were on the panel for ten, or 37%, of the twenty-seven cases.<sup>125</sup> Current Chief Judge Rader and Judge Dyk were both on seven of the panels.<sup>126</sup> These four judges heard more cases than the other eight non-senior judges combined. Two judges with technical backgrounds, Judges Moore and Gajarsa, were only on one<sup>127</sup> and two panels,<sup>128</sup> respectively.

Judge Prost's participation is notable regarding the statistics of this particular subset. Judge Prost, a decorated labor relations specialist,<sup>129</sup> authored the opinion for six of the ten nonobviousness appeals that she heard.<sup>130</sup> These opinions represent over 25% of the authored opinions for nonobviousness cases. Additionally, in a number of the decisions where Judge Prost authored the opinion, she sat on

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<sup>122</sup> *In re Lister*, 583 F.3d 1307 (Fed. Cir. 2009); *In re Hays*, 210 F. App'x 995 (Fed. Cir. 2006).

<sup>123</sup> The cases along with the study's results are on file with the author. *See supra* note 59 (detailing how the searches for cases were performed).

<sup>124</sup> *See Cotropria*, *supra* note 65, at 915 (noting the importance of nonobviousness).

<sup>125</sup> The cases along with the study's results are on file with the author. *See supra* note 59 (detailing how the searches for cases were performed).

<sup>126</sup> The cases along with the study's results are on file with the author. *See supra* note 59 (detailing how the searches for cases were performed).

<sup>127</sup> *In re Gleave*, 560 F.3d 1331 (Fed. Cir. 2009).

<sup>128</sup> *In re Baggett*, 326 F. App'x 569 (Fed. Cir. 2009); *In re Sullivan*, 498 F.3d 1345 (Fed. Cir. 2007).

<sup>129</sup> *Judicial Biographies*, *supra* note 33.

<sup>130</sup> The cases along with the study's results are on file with the author. *See supra* note 59 (detailing how the searches for cases were performed).

a panel with judges who had technical backgrounds.<sup>131</sup> While some may believe that judges with technical backgrounds are better suited to serve in patent cases, it appears that the judges on the Federal Circuit do not feel that one's background affects their ability to apply the law in patent prosecution cases.<sup>132</sup>

#### 4. Adequacy of the Specification Under 35 U.S.C. § 112

During the period of the study, thirteen cases were brought up on appeal from the USPTO involving the requirements of § 112.<sup>133</sup> Three of the non-senior judges—Judges Mayer, Bryson, and former Chief Judge Michel—held fifteen seats on the panels for the cases, while the nine other non-senior judges only appeared sixteen times. This statistic provides additional support for the assertion that the current system does not result in an even spread of judges, as three of the twelve judges, only 25% of the possible number of concurrently active judges, sat on the panel for 50% of cases. Judge Lourie, one of the judges with a technical background, never sat on a panel for any of the § 112 appeals during the study.

#### 5. Interferences Under 35 U.S.C. § 135

The last basis for appeal from the USPTO reviewed by this study is interferences. Interference appeals accounted for twelve of the appeals to the Federal Circuit during the period of the study.<sup>134</sup> This subset shows a reasonably even distribution of judge participation compared to most of the other issues. Every judge, with the exception of one senior judge, sat on at least one panel, with most judges sitting on two or three panels. Additionally, authorship for the nine published opinions for interference appeals was distributed among seven of the judges.

#### 6. Conclusions Regarding Issue Statistics

Breaking down the statistics of the study by the main issues generally raised on appeal to the Federal Circuit shows a few interesting trends and casts doubt on the effectiveness of the current randomization system used to assign judges to pa-

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<sup>131</sup> E.g., *In re Gleave*, 560 F.3d 1331 (Fed. Cir. 2009) (Moore, J., on the panel); *Chapman v. Casner*, 315 F. App'x 294 (Fed. Cir. 2009) (Rader, J., and Lourie, J., on the panel); *In re Reuning*, 276 F. App'x 983 (Fed. Cir. 2008) (Linn, J., on the panel).

<sup>132</sup> See Moore, *supra* note 39, at 15 (discussing technical backgrounds and judges on the Federal Circuit).

<sup>133</sup> The cases along with the study's results are on file with the author. See *supra* note 59 (detailing how the searches for cases were performed).

<sup>134</sup> The cases along with the study's results are on file with the author. See *supra* note 59 (detailing how the searches for cases were performed).

nels. As mentioned previously, a select few judges participated in the majority of the panels for two of the issues—nonobviousness and adequacy of the specification. With respect to the particular field of law mandate of the Federal Circuit's rules, the data raises concerns regardless of the breadth read into the requirement. If the Federal Circuit considers all of patent prosecution to be a particular field of law, then there is no representative cross-section since the number of panels each judge is on varies significantly. If the requirement is read to apply to more specific issues, each their own field of law, the system is still ineffective.

For three of the five issues, there was a significant variance in the number of panels among the judges. For the remaining two issues, although the statistics were closer, there was still room for improvement to achieve an even spread. Regardless of the reading of the representative cross-section requirement, the study shows that the system does not properly achieve its goals. If the intention of the requirement is to make sure each of the issues has a representative cross-section of judges, the current system falls short. For example, Judge Dyk, who is on the lowest percentage of panels in the overall study, sits on more nonobviousness appeals than nine of his colleagues. Alternatively, if the intention of the requirement is to ensure that each judge hears a representative cross-section of issues, the system also fails to meet its goal. Judge Moore was on the panel for only one nonobviousness case and on ten panels for the other four issues. This statistic means that Judge Moore's caseload featured only 9% nonobviousness cases, when the overall study revealed that nonobviousness was an issue in 36% of cases with identified issues. Thus, with respect to this field of law, Judge Moore was not sitting on a representative cross-section of cases.

#### D. Study of Judge Statistics for Precedential Cases

Of the 110 cases encompassed in the study, the Federal Circuit published as precedential only thirty-nine, or 35.5% of the cases. Federal Circuit observers who are concerned with the influence of particular judges of the court would find this subset the most important, as precedential opinions influence the future direction of the law and the USPTO.<sup>135</sup> Of these thirty-nine cases, Judge Moore was only a member of the Federal Circuit for twenty-nine of them.

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<sup>135</sup> This is because precedential opinions may significantly affect the body of law, unlike their non-precedential predecessors. See FED. CIR. R. 32.1(b) ("An opinion or order which is designated as nonprecedential is one determined by the panel issuing it as not adding significantly to the body of law.").



Table 4. Judging Panel Statistics of Precedential Appeals from BPAI Decisions

Judge	Panels	Case %	Opinions	%
Judge Moore <sup>136</sup>	9	31.0%	2	6.9%
Judge Newman	12	30.8%	7	17.9%
Judge Michel	11	28.2%	4	10.3%
Judge Gajarsa	11	28.2%	5	12.8%
Judge Prost	11	28.2%	3	7.7%
Judge Rader	10	25.6%	4	10.3%
Judge Linn	10	25.6%	4	10.3%
Judge Dyk	9	23.1%	3	7.7%
Judge Mayer	9	23.1%	1	2.6%
Judge Bryson	7	17.9%	1	2.6%
Judge Schall	6	15.4%	0	0%
Judge Lourie	5	12.8%	3	7.7%
Visiting Judges	3	7.7%	1	2.6%
Senior Judge Friedman	4	10.3%	0	0%
Senior Judge Archer	4	10.3%	0	0%
Senior Judge Plager	1	2.6%	0	0%
Senior Judge Clevenger	0	0%	0	0%

Table 4 depicts the statistics for each individual judge based on how many panels they sat on where the authored opinion was precedential. While the number of panels only changes by one or two from judge to judge, the overall picture and the percentages are telling. Judge Moore, the newest member of the bench, has been on 31% of the panels for precedential cases since joining the Federal Circuit. Meanwhile, Judge Lourie has only participated in 12.8% of such cases.

The second set of data in Table 4 depicts how many precedential opinions a particular judge authored, along with what percentage of all precedential opinions it represents. The study revealed that Judge Newman authored 17.9% of all precedential opinions, which is more than any other judge currently sitting on the Federal Circuit.

<sup>136</sup> The percentages for Judge Moore reflect her availability to serve on a panel for only twenty-nine of the cases in which a precedential opinion was issued.



The author does not make any inference as to the meaning of the results of this subset of data. While it is possible that judges who sit on the panel for more precedential cases than others might eventually have a greater influence on the law, it is not possible to conclude that any particular judge has greater influence than another based on the results of this study, or that any system for assigning cases could lead to that. The purpose of this empirical study is merely to show trends and point out the ineffectiveness of the current system in meeting its statutory requirements. Many additional factors that go beyond the scope of this study could contribute to deciding who authors an opinion. Without taking into account these factors, it is incredibly difficult to draw any inference from this subset about the influence of any particular judge on the Federal Circuit.

It is not practical or necessarily possible for a court to look at its future cases and determine if they will yield precedential decisions. However, this does not mean that a more effective system of assigning judges to panels will not yield a more “representative” assignment of judges to precedential cases. Moreover, while it may be impractical to achieve a truly random assignment of judges to precedential cases, achieving such an assignment for all of the cases presented to the Federal Circuit for any particular field of law is possible. It is with the foregoing in mind that the author conducted this study.

#### E. Other Interesting Trends Revealed by the Study

In addition to the statistics provided in Part III, the study indicates several other points that may be of interest to patent prosecutors, litigators, scholars, and Federal Circuit observers. First, the study revealed that there has been a significant increase in the appearance of senior judges on the panels for appeals arising from the USPTO. The number of Federal Circuit decisions encompassed in this study increased from twenty in 2008 to thirty-eight in 2009, almost doubling.<sup>137</sup> Over this same period, the Federal Circuit saw a considerable increase in participation by its senior judges. Senior Judge Clevenger sat in on three cases in 2009 after not participating in any of these appeals since February of 2006. Senior Judge Plager also returned to the bench for five cases in 2009, following no appearances since June of 2005. Almost half of all of the panels where senior judges participated took place in 2009.

In addition to the increase in senior judges, there has also been an increase in visiting judge participation. From 2005 to 2008, there were four visiting judges on

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<sup>137</sup> The cases along with the study’s results are on file with the author. *See supra* note 59 (detailing how the searches for cases were performed).

fifty-two total cases. For the last two years of the study, in fifty-eight cases, there were ten panels with visiting judges, two of which had the visiting judge author the opinion. As mentioned earlier,<sup>138</sup> this increase could be a move by the Federal Circuit to provide an information exchange with district courts in patent litigation hotbeds around the country by having their judges sit in on appeals at the Federal Circuit.

Lastly, the number of pro se appellants in the Federal Circuit has increased in recent years. During the period of the study, there were only eight instances where an applicant filed an appeal acting pro se. Of these eight appeals, five of them took place in 2009. Despite the increase in pro se appellants, however, during the five-year period of the study the Federal Circuit ruled in favor of the USPTO in every case with a pro se appellant.

#### IV. Rolling Appointment System

The current system of assigning judges to panels and assigning cases has proven ineffective to achieve its statutory goals. While there is an assumption by many that random assignment by a computer will lead to an even distribution of judges among cases, the Federal Circuit's current system has failed to achieve an even distribution, at least with respect to patent prosecution. Because the Federal Circuit created a rule in hope of achieving such a distribution,<sup>139</sup> the author suggests a possible rolling appointment system to achieve this goal.

The problem with the current system is that it uses a completely random system to assign judges and cases to panels.<sup>140</sup> The system does not take into account the fluctuations in quantity of cases during different times or the subject matter of a particular case. For example, there may be sixty cases heard in April, and then only thirty cases heard in May. Additionally, only five of the cases in April might be patent-related cases, whereas twenty of the thirty in May could be patent-related. A system that assigns cases randomly without any other variables can skew the assignments so that judges may not receive a representative cross-section of a particular field of law. This flaw is where the current system suffers.

A rolling appointment system will constantly update based on its progress. For example, in the first week of April there are twenty-four cases, six involving

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<sup>138</sup> See *supra* Part I.C.3 (noting that the two visiting judges who authored opinions were from districts that have become hotbeds for patent litigation).

<sup>139</sup> See FED. CIR. R. 47.2(b) (discussing the requirement).

<sup>140</sup> See FED. CIR. INTERNAL OPERATING P. 3 (discussing the system).

patents and eighteen involving other subject matter. Panel A consists of three judges and hears twelve cases, including all six patent cases. Panel B consists of three other judges and hears the remaining twelve cases, none involving patents. During the first week of May, there are eighteen new cases, where twelve are patent related. Under a rolling appointment system, assignment of panels would consider the statistics of the previous month. Both panels would be assigned to nine cases each so that every judge hears an even number of cases. However, panel B's nine cases would all be patent cases, with the other three patent cases heard by panel A. Therefore, after two months, both panels have heard twenty-one cases, including nine patent cases.

The benefits of a rolling system are that the system would achieve both the statutory requirement of a representative cross-section and the Federal Circuit's requirement that the cross-section is across each particular field of law. By adjusting the method of case assignment with every new assignment, the Federal Circuit can more easily maintain the spread of judges.

The problem with such a system is that it requires the Federal Circuit to look into every case prior to assigning it. Unlike the Supreme Court, which has discretion in selecting cases, the Federal Circuit must review every case appealed from certain administrative agencies or the district courts.<sup>141</sup> This lack of discretion means that every case would need examination prior to assignment to determine its particular field of law. The amount of time and resources this would require is dependent on how narrowly or broadly the court reads the particular field of law requirement. The broader the requirement, the easier it would be to assign a case to a particular field. If, for example, patents comprised one single field of law, it would be very easy to look at the appeal and see that a patent was involved and assign it to the patent field of law. Thus, it would not take a great deal of resources to assign cases with a rolling appointment system. Another potential problem with the system is that some cases may involve multiple fields of law, especially if the fields are determined narrowly. While this problem may present additional difficulty in assigning cases, the difficulty is relatively low, especially considering the overall benefits of the system.

A rolling appointment system, while a significant change to how the court would work if adopted, would be a benefit. It would uphold the statutory requirements for the assignment system. Additionally, if case assignments under the system guaranteed that each judge would sit on an equal number of panels, concerns

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<sup>141</sup> See 28 U.S.C. § 1295 (2006) (discussing the Federal Circuit's jurisdiction); see also 35 U.S.C. § 141 (2006) (discussing appeals to the Federal Circuit from the BPAI).

about improper influence by particular judges would lessen. The system would also readily compensate for times when judges are away from the Federal Circuit and unable to hear cases, as the next rounds of assignments would reflect that they had served on fewer panels than their fellow judges. Overall, the benefits of such a system would outweigh the detriments and lead to the Federal Circuit properly achieving its requirement of a representative cross-section among the particular fields of law. It could also benefit other courts if tailored to meet those courts' specific needs.

### **Conclusion**

This study provides much needed insight into the Federal Circuit's assignment of judging panels to patent prosecution appeals. The overall study and the highlighted subsets of results provide several interesting findings. Several of these findings are as follows:

- (1) the number of panels any one active judge sat on ranged from as high as 29.1% to as low as 17.3%;
- (2) for cases where the specification or nonobviousness was an issue central to the appeal, three or four judges sat on as many cases as the remaining non-senior judges combined; and
- (3) in anticipation cases, the number of panels a judge sat on varied from 46.2% to 7.7%.

The results cast doubt on the effectiveness of the current system in achieving the required representative cross-section for a particular field of law. The study's results suggest that the system currently used by the Federal Circuit, where a computer randomly assigns judges, leads to some judges sitting on more panels than others and thus, an unbalanced system.

The study suggests that a new system is needed in order for the court to meet the representative cross-section requirement. A rolling appointment system might cure the problems of the current system and would require a minimal increase in resources. Such a system would achieve what the current system fails to: an even spread of judges assigned to cases to give a representative cross-section among cases for a particular field of law.

# Pull Too Hard and the Rope May Break: On the Secondary Liability of Technology Providers for Copyright Infringement

Lital Helman\*

I. Introduction.....	112
II. The Standard for Secondary Liability of Technology Providers.....	114
A. The Doctrines of Secondary Liability and Their Application to Technologies.....	114
1. Contributory Infringement.....	115
2. Vicarious Liability.....	116
3. Application of the Secondary Liability Rule to Technology Providers.....	117
B. Secondary Liability of Technology Providers in Court and Congress....	119
1. The Creation of a De Jure Safe Harbor for Technologies in <i>Sony</i> ....	119
2. The Development of a De Facto Open-Ended Standard in Courts ...	124
3. The Role of Congress in Crafting an Open-Ended Standard.....	131
III. The Ineffectiveness of the Open-Ended Secondary Liability Standard.....	137
A. The Dichotomous Reaction of the Market to the Law.....	137
1. The Risk-Minimizing Path and the Cost of Overcompliance.....	138
2. Legal Escapism and the Futility of Efforts to Reduce Digital Infringement.....	148
B. The Ineffectiveness of the Open-Ended Secondary Liability Standard ..	155

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1. Cost Effectiveness .....	155
2. Deep Pocket Defendants.....	158
3. Secondary Infringers as Gatekeepers.....	161
IV. Conclusion .....	166

## I. Introduction

The digital age marks a turning point in the world of copyright, allowing for the creation of infinite identical copies of digital content by anyone, autonomously and free of charge.

The fact that copyright owners strive to fight the widespread copying and distribution of copyrighted works is not surprising, yet the degree to which their fight is carried out is quite striking. As a strategic decision, the fight is conducted not only against copyright infringers themselves, but also against the providers of various types of technologies that make such infringements possible. Technology providers of different sorts, ranging from creators of file-sharing services<sup>1</sup> and Internet Service Providers (ISPs),<sup>2</sup> to developers of decryption programs<sup>3</sup> and search engines,<sup>4</sup> have been sued or have faced criminal charges.<sup>5</sup> The common thread among these lawsuits is that the defendants themselves have not engaged in any copyright infringement. Rather, infringing conduct of others—users of the defendants' technology—is the basis of the claims.

This article focuses on the standard of secondary liability for technology providers under copyright law. Drawing on existing literature, it shows that contrary to the conventional understanding of the law as granting a safe harbor for technologies, courts have created a *de facto* open-ended liability standard. It then argues that the strict and unpredictable nature of that open-ended standard prevents effective

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<sup>1</sup> See *infra* Part II.B.

<sup>2</sup> See, e.g., *Religious Tech. Ctr. v. Netcom On-Line Commc'n Servs., Inc.*, 907 F. Supp. 1361 (N.D. Cal. 1995).

<sup>3</sup> See, e.g., *Universal City Studios, Inc. v. Corley*, 273 F.3d 429 (2d Cir. 2001); *321 Studios v. Metro-Goldwyn-Mayer Studios, Inc.*, 307 F. Supp. 2d 1085 (N.D. Cal. 2004); *RealNetworks, Inc. v. Streambox, Inc.*, No. 2:99CV022070, 2000 WL 127311 (W.D. Wash. Jan. 20, 2000).

<sup>4</sup> See, e.g., *Kelly v. Arriba Soft Corp.*, 336 F.3d 811 (9th Cir. 2003).

<sup>5</sup> See, e.g., *United States v. Elcom Ltd.*, 203 F. Supp. 2d 1111 (N.D. Cal. 2002).

tive direction of market behavior and harms the effectiveness of secondary liability as an enforcement measure in this regard.

The de facto standard for secondary liability of technology providers diverges from the standard that the Supreme Court and Congress declared de jure. *Sony v. Universal*, the 1984 principal Supreme Court precedent in this field, set the standard that a technology capable of substantial noninfringing use is shielded from secondary liability.<sup>6</sup> However, *Sony* itself is vague and indecisive. Moreover, while outwardly upholding *Sony*, subsequent moves in courts and in Congress have cut back on its protection—to the extent that not a single case or statute actually shields any technology based on the *Sony* safe harbor.<sup>7</sup> The Digital Millennium Copyright Act (DMCA),<sup>8</sup> which was designed to provide safe harbors for various scenarios, has also proven inapplicable to contemporary technologies and contexts.

With the law becoming increasingly complicated and unpredictable, the market developed a dual, polarized reaction. One path, which I term the *risk-minimizing route*, is typically taken by established and “deep pocket” companies. The risk-minimizing route is epitomized by over-protectiveness of copyrights, often at the expense of users’ interests. The second path, which I term the *legal escapism route*, prevails among peer-to-peer networks. This route is best characterized as continuing the unauthorized transmission of copyrighted works, while employing various measures to avoid the legal consequences that may stem from this behavior.

The implication of this dichotomous market behavior on the effectiveness of secondary liability is critical. Secondary liability of technology providers is designed to promote effective and efficient copyright enforcement through three main objectives.<sup>9</sup> First, it provides a cost-effective litigation mechanism compared to the alternative path of suing countless direct infringers. Second, it attempts to generate adequate compensation for plaintiffs via the deep pockets of technology companies. Third, it positions technology providers as gatekeepers that can hinder infringement by a copyright-friendly design and utilize their service fees to both distribute revenues to copyright owners and discourage infringement. However, the open-ended

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<sup>6</sup> *Sony Corp. of Am. v. Universal City Studios, Inc.*, 464 U.S. 417, 442 (1984).

<sup>7</sup> See *infra* Part II.B.1. The one case that shielded a technology based on the *Sony* standard was invalidated by Congress later on. *Id.*

<sup>8</sup> DIGITAL MILLENNIUM COPYRIGHT ACT, 17 U.S.C. §§ 1201–05 (2006).

<sup>9</sup> See *infra* Part III.B for a discussion of these objectives.

standard has been destructive to its own purpose, and has rendered these objectives unfulfilled. Instead of effective enforcement, the law results in market substitution. Infringement simply shifts from one platform to another, becoming more sophisticated and evasive.

To be clear, I am not suggesting that the copyright enforcement crisis is due entirely to the vagueness of the secondary liability regime. Much of the enforcement hardship is obviously the result of the high demand for free copyrighted works, which encourages the creation of platforms to consume copyrighted works for free. Yet, the ambiguity of the secondary liability standard has its own unique contribution to this crisis: it did not leave a clear safe zone for companies where they know they can function without being excessively attentive to copyright owners' interests and at the same time operate in a legal manner.<sup>10</sup>

Part II focuses on the descriptive-analytic aspect of the argument, exploring the law of secondary liability and elucidating the development of a de-facto open-ended standard. Part III addresses the development of the open-ended standard normatively, and analyzes the ineffectiveness of the open-ended standard for secondary liability. Part III first expands on the dichotomous market of copyright-affected technologies. Second, it demonstrates that this standard is at odds with the objectives of a secondary liability regime. The article concludes that the law must abandon the open-ended standard in favor of restoring a clear, coherent regime, which will be able to effectively direct behavior of technology providers and users in the digital age.

## II. The Standard for Secondary Liability of Technology Providers

### A. The Doctrines of Secondary Liability and Their Application to Technologies

Two long-standing doctrines hold a person liable for copyright infringement committed by another: contributory infringement and vicarious liability.<sup>11</sup> These doctrines stem from tort common law.<sup>12</sup> However, these doctrines have largely di-

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<sup>10</sup> See *infra* Part III.

<sup>11</sup> See, e.g., ROBERT A. GORMAN & JANE C. GINSBURG, COPYRIGHT: CASES AND MATERIALS 752–68 (5th ed. 1999) (discussing individual, vicarious, and contributory liability). Also note that some commentators view the inducement theory as a third, independent secondary liability doctrine. See *infra* note 125 and accompanying text.

<sup>12</sup> See, e.g., *Ted Browne Music Co. v. Fowler*, 290 F. 751, 754 (2d Cir. 1923) (“Courts have long recognized that infringement of a copyright is a tort.”); *Lawrence v. Dana*, 15 F. Cas. 26, 61 (C.C.D. Mass. 1869) (“[W]hoever invades [copyright] . . . commits a tort.”); GORMAN &



verged from their tort law source, developing unique rules and terminology.<sup>13</sup>

### 1. *Contributory Infringement*

Contributory infringement arises when a person, knowingly and materially, contributes to an infringing act of another person. As stated in the seminal case of *Gershwin*,<sup>14</sup> a defendant may be held contributorily liable if “with knowledge of the infringing activity, [she] induces, causes or materially contributes to the infringing conduct of another.”<sup>15</sup> The Supreme Court recognized contributory infringement as far back as 1908 and 1911,<sup>16</sup> and the doctrine became firmly established in the 1970s.<sup>17</sup>

The doctrine of contributory infringement extended over the years with the interpretation of “knowledge” extending to include both actual and constructive knowledge.<sup>18</sup> Furthermore, the Ninth Circuit recently concluded that merely pro-

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GINSBURG, *supra* note 11, at 782 (“It must always be remembered that copyright infringement is in the nature of a tort.”).

<sup>13</sup> Vicarious liability in tort law, for example, is a general name for indirect liability, RESTATEMENT (THIRD) OF TORTS: APPOINTMENT OF LIABILITY § 13 (2000), and similarly, “contributory” in tort law usually refers to negligence of the plaintiff, which contributed to her own harm, RESTATEMENT (SECOND) OF TORTS § 463 (1965). See Charles W. Adams, *Indirect Infringement from a Tort Law Perspective*, 42 U. RICH. L. REV. 635, 637 n.8 (2008) (arguing that courts should refer to tort law principles when analyzing secondary liability of intellectual property, and conform to them in the absence of persuasive counter reasons).

<sup>14</sup> *Gershwin Publ’g Corp. v. Columbia Artists Mgmt.*, 443 F.2d 1159 (2d Cir. 1971).

<sup>15</sup> *Id.* at 1162.

<sup>16</sup> See *Scribner v. Straus*, 210 U.S. 352 (1908); *Kalem Co. v. Harper Bros.*, 222 U.S. 55, 62–63 (1911).

<sup>17</sup> See, e.g., *Fonovisa, Inc. v. Cherry Auction, Inc.*, 76 F.3d 259, 264 (9th Cir. 1996) (discussing the origins of contributory infringement in tort law); *Cable/Home Commc’n Corp. v. Network Prods., Inc.*, 902 F.2d 829, 845 (11th Cir. 1990) (providing a background and a test for contributory infringement); *Religious Tech. Ctr. v. Netcom On-Line Commc’n Servs., Inc.*, 907 F. Supp. 1361, 1373 (N.D. Cal. 1995) (describing contributory infringement); *Demetriades v. Kaufmann*, 690 F. Supp. 289, 293 (S.D.N.Y. 1988) (laying out the elements of contributory infringement); see also Peter S. Menell & David Nimmer, *Legal Realism in Action: Indirect Copyright Liability’s Continuing Tort Framework and Sony’s De Facto Demise*, 55 UCLA L. REV. 143, 153 (2007) (“[T]he law of indirect copyright liability was firmly established by the 1970’s.”).

<sup>18</sup> This interpretation was based on *Gershwin*’s reading of previous cases, and the application of this reading later on. See *Ellison v. Robertson*, 357 F.3d 1072, 1076 (9th Cir. 2004); *Casella v. Morris*, 820 F.2d 362, 365 (11th Cir. 1987); *Gershwin*, 443 F.2d at 1162–63.

viding online services might satisfy the “material contribution” prong of the doctrine.<sup>19</sup> In fact, the precise boundaries of the doctrine remain opaque to this day.<sup>20</sup>

## 2. Vicarious Liability

Vicarious liability originated in the contexts of employment and independent contracting based on the general agency theory of respondeat superior.<sup>21</sup> In the seminal case of *Shapiro*,<sup>22</sup> however, vicarious liability extended to all cases in which a person has both a direct financial interest in the infringement and the “right and ability to supervise [it].”<sup>23</sup>

A substantial expansion of the doctrine occurred over the last two decades, through the attenuation of the “direct financial interest” requirement. Viewed as a major keystone in this context, *Fonovisa* held that swap meet organizers had a “direct financial benefit” from the sales of infringing material that occurred in the swap meet even though their fee was not in any way tied to the sale revenues.<sup>24</sup> More recently, in *Napster*<sup>25</sup> the court posited that this requirement was fulfilled even though the defendant earned no profit, since such profit was likely in the future.<sup>26</sup>

Many cases invoking vicarious liability and contributory infringement tend to use confusingly similar reasoning and rhetoric. This obscures the differences between the two doctrines.<sup>27</sup> The danger in this confusion is not merely semantic.

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<sup>19</sup> *Ellison*, 357 F.3d at 1077.

<sup>20</sup> See Sverker K. Högberg, Note, *The Search for Intent-Based Doctrines of Secondary Liability in Copyright Law*, 106 COLUM. L. REV. 909, 919–21 (2006).

<sup>21</sup> *Perfect 10, Inc. v. Visa Int’l Serv. Ass’n*, 494 F.3d 788, 802 (9th Cir. 2007); *Fonovisa*, 76 F.3d at 261–62.

<sup>22</sup> *Shapiro, Bernstein & Co., Inc. v. H.L. Green Co., Inc.*, 316 F.2d 304 (2d Cir. 1963).

<sup>23</sup> *Id.* at 307; see *Metro-Goldwyn-Mayer Studios, Inc. v. Grokster, Ltd.*, 545 U.S. 913, 930 (2005) (noting that vicarious liability “allows imposition of liability when the defendant profits directly from the infringement and has a right and ability to supervise the direct infringers”).

<sup>24</sup> *Fonovisa*, 76 F.3d at 263–64; see B. Kolsun & J. Bayer, *Indirect Infringement and Counterfeiting: Remedies Available Against Those Who Knowingly Rent to Counterfeiters*, 16 CARDOZO ARTS & ENT. L.J. 383, 409–10 (1998) (discussing the holding in *Fonovisa*).

<sup>25</sup> *A & M Records, Inc. v. Napster, Inc.*, 239 F.3d 1004 (9th Cir. 2001).

<sup>26</sup> *Id.* at 1023 (“Napster’s future revenue is directly dependent upon ‘increases in userbase.’”).

<sup>27</sup> See Douglas Lichtman & William Landes, *Indirect Liability for Copyright Infringement: An Economic Perspective*, 16 HARV. J.L. & TECH. 395, 404 (“[Napster’s] analysis seems to blur the line between the requirement under contributory infringement that a culpable party have knowledge of

The fear is that lawmakers will bypass the phase of proving all the elements of a particular doctrine, and will subject defendants to liability based on some assortment of standards from these doctrines, thus subjecting a broader class of activities to liability than originally intended.<sup>28</sup>

### 3. *Application of the Secondary Liability Rule to Technology Providers*

Contributory infringement and vicarious liability are the basic paradigms for secondary liability law.<sup>29</sup> The secondary liability standards pertaining to technology providers stem from contributory infringement and vicarious liability. Interestingly, though, the cases that originally shaped these doctrines concerned *people* or *businesses* that were in some way involved in the infringing activities of a fellow person, not *technologies* that were later used for infringement.<sup>30</sup>

This is not to say that the concept of protecting content by controlling dissemination technology is novel in any way. In fact, it is older than the idea of copyright itself. For decades, prior to the establishment of the copyright regime in England, protection for the content industry was provided by granting the Stationers' Company of London control over the printing press—the only available dissemination technology at that time.<sup>31</sup> Perhaps unsurprisingly, this control was often utilized to promote the stationers' own agenda at the cost of free flow of information

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the direct infringement and the requirement under vicarious liability that a culpable party have control over the specific infringer.”)

<sup>28</sup> *Id.*; see *Grokster*, 545 U.S. at 930 (“One infringes contributorily by intentionally inducing or encouraging direct infringement.”). Note that this interpretation omits the prongs of material contribution, causation, or knowledge.

<sup>29</sup> However, note that some view inducement theory as an independent source of liability. See, e.g., Adams, *supra* note 13, at 649 (noting that “if a manufacturer or distributor intentionally induces another to infringe a trademark . . . [they are] contributorily responsible for any harm done as a result of the deceit” (citing *Inwood Labs., Inc. v. Ives Lab., Inc.*, 456 U.S. 844, 853–54 (1982)); Rebecca Giblin, *A Bit Liable? A Guide to Navigating the U.S. Secondary Liability Patchwork*, 25 SANTA CLARA COMPUTER & HIGH TECH. L.J. 7, 39–44 (discussing the application of vicarious liability to copyright law) (2008).

<sup>30</sup> See Elizabeth Miles, Note, *In re Aimster & MGM, Inc. v. Grokster, Ltd.: Peer-to-Peer and the Sony Doctrine*, 19 BERKELEY TECH. L.J. 21, 23 (2004) (“*Sony* was the first and remains the only Supreme Court decision to apply secondary liability to technology . . .”).

<sup>31</sup> See JOE B. RICHARDSON, *THE LAW OF COPYRIGHT* 5–14 (1913) (discussing the Stationer’s Company); see also Edward Lee, *Freedom of the Press 2.0*, 42 GA. L. REV. 309, 309 (2008) (noting that the “[s]tationers . . . ran the printing presses in England with the Crown’s backing”).

and free speech.<sup>32</sup> It was not until the 1710 Statute of Anne, which is the origin of the copyright regime in the United States as well, that the focus shifted to *use*, as distinct from *dissemination* of content.<sup>33</sup>

However, as technology progressed, infringement became increasingly widespread through technological tools, and this paradigm began to crack. As once articulated by Hon. Lewis A. Kaplan:

There was a time when copyright infringement could be dealt with quite adequately by focusing on the infringing act. . . . In principle, the digital world is very different. . . . Every recipient is capable not only of decrypting and perfectly copying plaintiffs' copyrighted DVDs, but also of retransmitting perfect copies. . . . The process potentially is exponential rather than linear.<sup>34</sup>

Consequently, the law sought to stop infringement at its root, and secondary liability, which developed outside the technological context, appeared to be an appropriate vehicle to hold technology providers liable for the misuse of their technology by its users.<sup>35</sup>

In fact, the secondary liability doctrines may have different implications when applied to technology providers. Technology, particularly digital technology, is disseminated to an unlimited and indefinite number of users globally.<sup>36</sup> Moreover, while in the early cases, the infringement occurred *during* the contractual (or other) relationship between the direct and the secondary infringers, infringement in the technological realm often occurs long after this relationship has ended.<sup>37</sup> These implications change the way copyright law applies to secondary infringers: the technology design now must incorporate copyright considerations *ex-ante*.

Moreover, while holding a *person* secondarily liable limits only the specific infringing activity at question, holding a *technology* secondarily liable precludes

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<sup>32</sup> See *Lasercomb Am., Inc. v. Reynolds*, 911 F.2d 970, 974 (4th Cir. 1990) (noting the Stationers' role in the "censorship of Protestant materials").

<sup>33</sup> See Statute of Anne, 1710, 8 Anne, c. 19 (Eng.).

<sup>34</sup> *Universal City Studios, Inc. v. Reimerdes*, 111 F. Supp. 2d 294, 331–32 (S.D.N.Y. 2000).

<sup>35</sup> See Miles, *supra* note 30, at 23. ("Sony was the first . . . Supreme Court decision to apply secondary liability to technology—the capabilities of machines rather than the conduct of people.")

<sup>36</sup> Martin F. Halstead, *The Regulated Become the Regulators—Problems and Pitfalls in the New World of Digital Copyright Legislation*, 38 TULSA L. REV. 195, 210 (2002).

<sup>37</sup> See, e.g., *infra* Part II.B.2 (discussing *Grokster* and the underlying technology at issue).

this technology altogether—its infringing and noninfringing functions alike.<sup>38</sup> This represents not only an immediate risk to the specific technology at issue, but also a chilling effect on innovation in general. Indeed, potential innovators may be discouraged from creating a technology that could eventually be precluded.<sup>39</sup> Thus, when applied to technologies, the positioning of the doctrines of secondary liability is not in their natural sphere to direct behavior in a certain set of circumstances, but rather regulating technology design in general.<sup>40</sup>

## B. Secondary Liability of Technology Providers in Court and Congress

### 1. *The Creation of a De Jure Safe Harbor for Technologies in Sony*

The application of the secondary liability doctrines to technologies first occurred in 1984 with *Sony v. Universal*.<sup>41</sup> The case concerned Sony's Betamax videocassette recorder (VCR), which was the first compact, affordable videotape recorder on the market.<sup>42</sup> The Betamax was enthusiastically welcomed among consumers, yet its greeting among other groups was not as favorably passionate.<sup>43</sup> Before long, Universal Studios and Walt Disney Productions, copyright owners of numerous television shows, commenced a lawsuit against Sony alleging direct and contributory infringement.<sup>44</sup> The basis of the contributory infringement claim was

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<sup>38</sup> See Lichtman & Landes, *supra* note 27, at 397 (“The benefits in terms of increased copyright enforcement come at too high a cost in terms of possible interference with the sale of a legitimate product.”).

<sup>39</sup> See, e.g., Matthew Fagin et al., *Beyond Napster: Using Antitrust Law to Advance and Enhance Online Music Distribution*, 8 B.U. J. SCI. & TECH. L. 451, 500 (2002) (“Innovation in the technologies of distribution will decline markedly if potential new innovators are chilled by a threat of legal action or believe they will not be able to attain access to works for their networks.”); Mark Lemley & R. Anthony Reese, *Reducing Digital Copyright Infringement Without Restricting Innovation*, 56 STAN. L. REV. 1345, 1388 (2004) (“Over and above the direct restrictions on innovation, the threat of lawsuits or criminal prosecutions against innovators is likely to deter a significant amount of innovation, some of which would unquestionably have been legal.”).

<sup>40</sup> See Tim Wu, *The Copyright Paradox*, 2005 SUP. CT. REV. 229, 231 (2006) (“How comfortable are we with the federal courts . . . using the copyright code to set market-entry policy for new technologies at all?”).

<sup>41</sup> *Sony Corp. of Am. v. Universal City Studios, Inc.*, 464 U.S. 417 (1984).

<sup>42</sup> *Id.* at 457 (describing the “introduction of the home videotape recorder (VTR) upon the market”).

<sup>43</sup> *Sony*, 464 U.S. at 421–22.

alleged infringing activities conducted by the VCR users, including building archives of programs for repeated viewing.<sup>45</sup>

The district court rejected the lawsuit on both its direct and contributory infringement claims.<sup>46</sup> The court concluded there was no showing of commercial harm to the studios and that private noncommercial copying was generally not prohibited, or at the very least constituted fair use and was nearly impossible to enforce.<sup>47</sup>

This conclusion likely appeared outrageous to copyright holders, who appealed the decision.<sup>48</sup> Meeting their expectations at least somewhat, the Ninth Circuit reversed the District Court's ruling with regards to contributory liability, recognizing a possible cumulative effect of the VCR to diminish potential markets.<sup>49</sup> However, the Ninth Circuit did not disturb the District Court decision that Sony conducted no direct infringement.<sup>50</sup>

Sony subsequently filed a petition for a writ of certiorari to the Supreme Court, challenging the holding regarding its contributory infringement. After granting the certiorari,<sup>51</sup> and following re-argument two years later, the Court, by a 5-4 vote, reversed the Ninth Circuit's ruling and held that Sony was not subject to contributory infringement.<sup>52</sup> The decision was based on a standard borrowed from patent law, where a producer of a technology that is capable of "substantial noninfringing use" is shielded from contributory liability.<sup>53</sup> The Court found that beyond the fact that various producers consented to the recording of their programs, the

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<sup>44</sup> The lawsuit was filed against Sony Corp., the Sony Corp. of America, Sony's advertising agency, VCR retailers, and a private VCR owner who was included in order to prove direct infringement. *Universal City Studios, Inc. v. Sony Corp. of Am.*, 480 F. Supp. 429, 432 (C.D. Cal. 1979).

<sup>45</sup> *Id.* at 451.

<sup>46</sup> *Id.* at 469.

<sup>47</sup> *Id.* at 442, 456.

<sup>48</sup> *Id.* at 431.

<sup>49</sup> *Universal City Studios, Inc. v. Sony Corp. of Am.*, 659 F.2d 963, 974 (9th Cir. 1982).

<sup>50</sup> *See id.* at 974-76 (imposing liability on Sony under the contributory infringement theory only).

<sup>51</sup> *Sony Corp. of Am. v. Universal City Studios, Inc.*, 102 S. Ct. 2926 (1982).

<sup>52</sup> *Sony Corp. of Am. v. Universal City Studios, Inc.*, 464 U.S. 417, 421 (1984).

<sup>53</sup> *Sony*, 464 U.S. at 434-36 (citing 35 U.S.C. § 271(c) (2006), which shields sellers of "a staple article or commodity of commerce suitable for substantial noninfringing use" from liability for contributory infringement of a patent).

regular use of the VCR was time-shifting—namely, recording a program in order to watch it once at a later time.<sup>54</sup> Time-shifting, the Court opined, is fair use, and the VCR is therefore protected as a product that is capable of substantial noninfringing use.<sup>55</sup>

The dissenting opinion, by Justice Blackmun, suggested that the standard for a dual-use technology should be based on its actual, not potential, use and on the possibility of new potential markets that opened as a result of the new technology.<sup>56</sup> Thus, a technology provider would be held contributorily liable if it could not show substantial *actual* noninfringing use of its technology or if the plaintiffs demonstrate they have been deprived of the ability to exploit a new market. Justice Blackmun further disagreed that the actual use of the VCR was definitively, in quantitative terms, substantially noninfringing.<sup>57</sup>

At first glance, the immediate effect of the *Sony* standard, also known as *Sony's* Staple Article of Commerce Doctrine, was the creation of a safe harbor for technologies that are capable of significant noninfringing use.<sup>58</sup> Among most scholars, this standard was widely viewed as a victory for technology and consumers and as the “Magna Carta” of the technology age.<sup>59</sup> At the same time, however, the *Sony* decision attracted criticism, not so much for its conclusion as for the analysis that led to it.

One point that drew significant criticism was the Court’s reliance on a patent law standard, based on a “historic kinship” between the laws of patents and copy-

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<sup>54</sup> *Sony*, 464 U.S. at 456.

<sup>55</sup> *Id.* at 454–56.

<sup>56</sup> *See id.* at 491–93 (Blackmun, J., dissenting).

<sup>57</sup> *Id.* (calling for remand to allow the district court to issue findings on “the percentage of legal versus illegal home-use recording”).

<sup>58</sup> Pamela Samuelson, *The Generativity of Sony v. Universal: The Intellectual Property Legacy of Justice Stevens*, 74 *FORDHAM L. REV.* 1831, 1850 (2006) (“The most obvious and most commercially significant legacy of Sony is the safe harbor it established for technologies having or capable of having substantial non-infringing uses.”).

<sup>59</sup> Jessica Litman, *The Sony Paradox*, 55 *CASE W. RES. L. REV.* 917, 951 (2005). Among copyright lawyers and the copyright bar, and clearly the—Motion Picture Industry, the decision was, however, objectionable. *See* Jessica Litman, *The Story of Sony v. Universal Studios: Mary Poppins Meets the Boston Strangler*, in *INTELLECTUAL PROPERTY STORIES* 358, 382–83 (Jane C. Ginsburg & Rochelle Cooper Dreifuss eds., 2006).

rights.<sup>60</sup> Scholars argued that this reliance was not even necessary. The same outcome could have been reached based on the consent of various producers to the recording of their works, on the determination that time-shifting is fair use, and on the absence of proof of commercial harm to the plaintiffs.<sup>61</sup> Reliance on the Staple Article of Commerce Doctrine, scholars argue, overlooks critical differences between the laws of patents and copyrights including their objectives,<sup>62</sup> their statutory history,<sup>63</sup> and the industry-wide effect this doctrine may have on each body of law.<sup>64</sup>

Other scholars have criticized *Sony* for loosely using legal terms to the extent that the precise scope of the doctrine remains opaque, and its applicability problematic. The murky phrase “substantial noninfringing use,” (defined simply as “commercially significant”),<sup>65</sup> and the ill-defined fair use doctrine have made the safe harbor weak. Similarly, the interchangeable use of the phrases “contributory liability” and “vicarious liability” throughout the decision<sup>66</sup> led to confusion in applying the *Sony* doctrine to vicarious liability.

As a result of this vagueness, the Seventh Circuit interpreted *Sony* as applicable to both contributory and vicarious liability, while the Ninth Circuit viewed it as limited to contributory liability.<sup>67</sup> This confusion renewed in the *Grokster* decision,

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<sup>60</sup> *Sony*, 464 U.S. at 439.

<sup>61</sup> See Adams, *supra* note 13, at 668 (“Had the Court relied on general tort law instead of the patent statute, it would have reached the same result . . .”).

<sup>62</sup> Peter S. Menell, *Indirect Copyright Liability: A Re-examination of Sony’s Staple Article of Commerce Doctrine* 1 (U.C. Berkeley Pub. Law & Legal Research Working Paper Series, Paper No. 682051, 2005), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=682051](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=682051) (“Whereas patent law seeks to promote technological innovation . . . copyright law seeks to promote cultural and social progress, manifesting a more cautious stance toward technological dissemination, particularly where a technology threatens widespread piracy of expressive works.”).

<sup>63</sup> Remarkably, the Staple Article of Commerce Doctrine was not incorporated from the Patent Act into the 1976 Copyright Act, implying a willful omission of this doctrine. See Adams, *supra* note 13, at 668 (“[T]here is no evidence of any legislative intent for applying the patent statute to copyright law.”).

<sup>64</sup> Menell, *supra* note 62, at 10.

<sup>65</sup> *Sony*, 464 U.S. at 442.

<sup>66</sup> See, e.g., *id.* at 435 (“[V]icarious liability is imposed in virtually all areas of the law, and the concept of contributory infringement is merely a species of the broader problem of identifying the circumstances in which it is just to hold one individual accountable for the actions of another.”).

<sup>67</sup> Compare *In re Aimster Copyright Litig.*, 334 F.3d 643, 654 (7th Cir. 2003) (“[T]he Court . . . treat[ed] vicarious and contributory infringement interchangeably [and] held that *Sony* was not a vicarious infringer either.” (citations omitted)), and *Lemley & Reese*, *supra* note 39, at 1356



where the Supreme Court again used these doctrines interchangeably.<sup>68</sup> Therefore, *Sony*, supposedly creating a safe harbor, may have actually sowed the seeds of confusion reflected in the area of copyright secondary liability to this day.<sup>69</sup>

The internal dynamic of the *Sony* Court's decision-making process may have contributed to this result. Initially, only four Justices voted to grant *Sony* a writ of certiorari.<sup>70</sup> Justice Blackmun was among them and, as his dissent implies, sought to *affirm* and reinforce the Ninth Circuit's ruling.<sup>71</sup> As commentators have observed, however, this strategy proved to be risky. Although originally five justices preferred to leave the Ninth Circuit decision intact, in the discussion process Justice O'Connor crossed the line to the other side of the divide.<sup>72</sup> Justice Blackmun's draft, originally written as the majority opinion, became the dissent, while Justice Stevens' dissent became the majority opinion.<sup>73</sup> It is not surprising that such a process would require a compromise, the natural casualty of which can be clarity of the legal rule.<sup>74</sup>

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("[T]he opinion strongly suggested that its analysis applied to secondary liability for copyright infringement generally and . . . would bar using . . . vicarious liability doctrine."), *with Metro-Goldwyn-Mayer Studios, Inc. v. Grokster Ltd.*, 380 F.3d 1154, 1164 (9th Cir. 2004) ("*Sony-Betamax* 'has no application to . . . vicarious copyright infringement' because the issue of vicarious liability was 'not before the Supreme Court' in that case." (quoting *A & M Records, Inc. v. Napster Inc.*, 239 F.3d 1004, 1022 (9th Cir. 2001))), and *Napster*, 239 F.3d at 1022–23 ("[W]hen the Sony Court used the term 'vicarious liability,' it did so broadly and outside of a technical analysis of the doctrine of vicarious copyright infringement.").

<sup>68</sup> See *Metro-Goldwyn-Mayer Studios, Inc. v. Grokster, Ltd.*, 545 U.S. 913, 930 (2005) (treating contributory and vicarious liability together).

<sup>69</sup> See, e.g., Menell & Nimmer, *supra* note 17, at 156 ("In reaching its *Sony* decision, the Supreme Court turned not to tort law but to patent law. That resolution has produced unnecessary distortion in copyright doctrine.").

<sup>70</sup> Jonathan Band & Andrew J. McLaughlin, *The Marshall Papers: A Peek Behind the Scenes at the Making of Sony v. Universal*, 17 COLUM.-VLA J.L. & ARTS 427, 432 (1993).

<sup>71</sup> *Id.*

<sup>72</sup> *Id.* at 446–47.

<sup>73</sup> *Id.* at 448–50.

<sup>74</sup> For example, Justice Stevens's opinion was initially based, not on the doctrine of fair use, but on the theory that private copying is noninfringing. Ultimately, it was amended, *inter alia*, to incorporate the compromise offered by Justice White and to accommodate Justice O'Connor's position. *Id.* at 429, 439–47; see Randal C. Picker, *Rewinding Sony: The Evolving Product, Phoning Home and the Duty of Ongoing Design*, 55 CASE W. RES. L. REV. 749, 752 (2005) ("The internal history

The vagueness of the *Sony* standard rendered it both difficult to follow and easy to manipulate.<sup>75</sup> This may have contributed to the trend of subsequent legal measures to assert consistently the *Sony* rule while simultaneously applying different standards and leaning on factors other than the capability of a technology for substantial noninfringing use, as shown below.

## 2. *The Development of a De Facto Open-Ended Standard in Courts*

In a recent research, Peter Menell and David Nimmer demonstrate that courts consistently sidestepped the application of *Sony*.<sup>76</sup> They note the Fifth Circuit's *Vault* decision,<sup>77</sup> effectively reversed by Congress,<sup>78</sup> and the two lower courts' *Grokster* decisions,<sup>79</sup> reversed by the Supreme Court,<sup>80</sup> as the only cases that adopted *Sony* as a valid safe harbor.<sup>81</sup> In all other secondary liability cases that succeeded *Sony*, its safe harbor was always declared but never actually applied.<sup>82</sup> Indeed, not only did following *Sony* involve too high a risk for copyright owners, but also it was rather easy to avoid, considering that *Sony* itself was quite ambiguous.<sup>83</sup>

For instance, a court distinguished *Sony* in a case that involved an *operator* of technology, as distinct from its *manufacturer*.<sup>84</sup> Similarly, a court distinguished *Sony* in a case where the provider had *intended* that the product would be used for

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of the *Sony* opinion makes concrete the fundamental ambivalence that the Court faded—and that we still face—about the right way to frame the test in this situation.”)

<sup>75</sup> See Menell & Nimmer, *supra* note 17, at 177–88 (discussing recent secondary liability cases).

<sup>76</sup> *Id.*

<sup>77</sup> *Vault Corp. v. Quaid Software Ltd.*, 847 F.2d 255 (5th Cir. 1988).

<sup>78</sup> The *Vault* court ruled for a provider of decryption software for lockout of copied diskettes, as the software could potentially be used for substantial noninfringing purposes. *Id.* at 262. However, the DMCA now forbids providing unauthorized decryption methods, rendering this case obsolete. Menell & Nimmer, *supra* note 17, at 174.

<sup>79</sup> *Metro-Goldwyn-Mayer Studios, Inc. v. Grokster Ltd.*, 380 F.3d 1154 (9th Cir. 2004); *Metro-Goldwyn-Mayer Studios, Inc. v. Grokster, Ltd.*, 259 F. Supp. 2d 1029 (C.D. Cal. 2003).

<sup>80</sup> *Metro-Goldwyn-Mayer Studios, Inc. v. Grokster, Ltd.*, 545 U.S. 913, 927, 940 (2005).

<sup>81</sup> See Menell & Nimmer, *supra* note 17, at 184–85.

<sup>82</sup> *Id.* at 173–88 (cataloging secondary liability cases from 1987–2000 and post-2000).

<sup>83</sup> *Id.*

<sup>84</sup> *RCA Records v. All-Fast Sys., Inc.*, 594 F. Supp. 335 (S.D.N.Y. 1984).

infringement<sup>85</sup>—even though *Sony* never concerned itself with the provider's intent. In other cases, a court considered the *Sony* doctrine inapplicable based on the actual use of the product in question, although *Sony* itself eschewed an examination of an actual use of a product in favor of a focus on the product's capability.<sup>86</sup> Thus, case by case, bit by bit, the de facto and the de jure standards for secondary liability diverged, to the point where the *Sony* doctrine has evolved to merely a starting point for discussion from which the final conclusion is likely to differ.

Courts' responses to the rise of peer-to-peer technology<sup>87</sup> at the turn of the third millennium intensified this trend further converting *Sony*'s doctrine to an intangible anchor that was too lenient to apply to peer-to-peer technologies. At times, courts have found secondary liability to be not merely an important tool to assist in copyright enforcement in the peer-to-peer realm but rather *the exclusive* way to impede infringement.<sup>88</sup> The Ninth Circuit's decision in *Napster*,<sup>89</sup> the Seventh Circuit's decision in *Aimster*,<sup>90</sup> and above all the Supreme Court's decision in *Grokster*<sup>91</sup> typify this trend.

In *Napster*, music copyright owners sued the pioneer file-sharing service for disseminating a software program predominately used to exchange copyrighted music files.<sup>92</sup> *Napster*'s site never hosted any copyrighted content itself. It indexed files that were residing on users' hard drives and provided the software that enabled

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<sup>85</sup> *Cable/Home Commc'n Corp. v. Network Prods., Inc.*, 902 F.2d 829, 846 (11th Cir. 1990).

<sup>86</sup> *A & M Records, Inc. v. Abdallah*, 948 F. Supp. 1449, 1456–57 (C.D. Cal. 1996); *see also* *Matthew Bender & Co. v. West Publ'g Co.*, 158 F.3d 693 (2nd Cir. 1998) (providing refuge to the declaratory plaintiff based on the *actual* noninfringing uses of the product and not on its potential use).

<sup>87</sup> Peer-to-peer technology uses a distributed architecture in which computers communicate directly with each other, not through central servers. *Metro-Goldwyn-Mayer Studios, Inc. v. Grokster, Ltd.*, 545 U.S. 913, 919–20 (2005).

<sup>88</sup> *See Grokster*, 545 U.S. at 929–30 (“When a widely shared service or product is used to commit infringement, it may be *impossible* to enforce rights in the protected work effectively against all direct infringers, the *only* practical alternative being to go against the distributor of the copying device for secondary liability . . . .” (emphasis added)).

<sup>89</sup> *A & M Records, Inc. v. Napster Inc.*, 239 F.3d 1004 (9th Cir. 2001).

<sup>90</sup> *In re Aimster Copyright Litig.*, 334 F.3d 643 (7th Cir. 2003).

<sup>91</sup> *Grokster*, 545 U.S. 913.

<sup>92</sup> *A & M Records, Inc. v. Napster Inc.*, 114 F. Supp. 2d 896, 900, 902–03 (N.D. Cal. 2000).

their copying and sharing.<sup>93</sup> Thus, the plaintiffs raised no claim of direct infringement against Napster, but rather sued for contributory and vicarious liability.<sup>94</sup> In its defense, Napster argued for the application of the *Sony* safe harbor.<sup>95</sup> Along the same lines as Sony's defense in that case, Napster emphasized its capability for substantial noninfringing use, namely, transfer of non-copyrighted files, authorized transfers, and promotion of new artists.<sup>96</sup> The district court rejected the argument, focusing on the *actual* infringing uses of Napster.<sup>97</sup>

The Ninth Circuit, on appeal, affirmed the preliminary injunction, yet departed from the district court's reasoning.<sup>98</sup> The court reinterpreted *Sony* narrowly in two aspects. First, it created a distinction between services and technologies, and posited that in the former, *Sony* merely precluded contributory liability based on constructive knowledge.<sup>99</sup> Thus, the court found that the plaintiffs would likely prevail on the contributory infringement claim. Second, the court ruled that *Sony* is inapplicable in the context of vicarious liability, and accordingly found that success was likely on the vicarious liability claim as well.<sup>100</sup>

Looking back, *Sony itself* may have not have escaped secondary liability under that strict reading of the *Sony* standard.<sup>101</sup> Looking ahead, in order to increase copyright enforcement, the *Napster* case substantially reduced the *Sony* safe harbor, precluding its application to services and to cases of vicarious liability.<sup>102</sup>

The *Sony* safe harbor was eroded further in the *Aimster*<sup>103</sup> case. *Aimster* was a file-sharing service, which operated in Instant Messaging frameworks, essentially

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<sup>93</sup> See *id.* at 905–08 (describing Napster's technology).

<sup>94</sup> *Id.* at 900.

<sup>95</sup> *Id.* at 900–01.

<sup>96</sup> Napster's "New Artist" function allowed new artists to post a page in return for allowing users to share their music. *Id.* at 907.

<sup>97</sup> *Id.* at 912.

<sup>98</sup> *A & M Records, Inc. v. Napster, Inc.*, 239 F.3d 1004, 1021, 1029 (9th Cir. 2001).

<sup>99</sup> *Napster*, 239 F.3d at 1020 (quoting *Sony Corp. of Am. v. Universal City Studios, Inc.*, 464 U.S. 417, 442 (1984)).

<sup>100</sup> See *id.* at 1020–23.

<sup>101</sup> Lemley & Reese, *supra* note 39, 1357–58.

<sup>102</sup> *Napster*, 239 F.3d at 1020–23.

<sup>103</sup> See *In re Aimster Copyright Litig.*, 334 F.3d 643 (7th Cir. 2003).

allowing simultaneous users of chat rooms to swap files.<sup>104</sup> Following the *Napster* decision, Aimster filed for declaratory relief of its legality, and the Recording Industry Association of America (RIAA), together with various record companies and copyright owners, filed a countersuit for contributory and vicarious infringement.<sup>105</sup>

Akin to *Napster*, Aimster argued, *inter alia*, for the application of *Sony*; and akin to *Napster*, this argument was rejected. The district court distinguished *Sony* on two grounds: first, on the lack of substantial *actual* noninfringing use;<sup>106</sup> second, on the distinction between a discrete product and an ongoing service.<sup>107</sup> Noticeably, this analysis does not correspond to *Sony*'s de jure standard, which is based on the capability of a technology of noninfringing use. It resembles two other familiar lines of analysis: that of *Napster* and that of the *Sony* dissent.<sup>108</sup>

The Seventh Circuit, on appeal, affirmed the judgment, though on a different basis.<sup>109</sup> The court rejected Aimster's argument that it was unable to identify infringing conduct due to the encryption built into its code, viewing the encryption as "[w]illful blindness."<sup>110</sup> Furthermore, the Seventh Circuit held that an ongoing service would be entitled to the *Sony* safe harbor only if no alternative design for the service was available at a reasonable cost.<sup>111</sup> This requirement originates in the general tort law of secondary liability, but the *Sony* majority did not adopt it, though it was offered in the dissent.<sup>112</sup>

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<sup>104</sup> *Id.* at 645.

<sup>105</sup> *Id.* at 645–46.

<sup>106</sup> *In re Aimster Copyright Litig.*, 252 F. Supp. 2d 634, 653 (N.D. Ill. 2002).

<sup>107</sup> *Id.*

<sup>108</sup> In *Napster*, the court created the distinction between a product and a service. See *supra* note 99 and accompanying text. In *Sony*'s dissent, the actual use of the technology was examined. See *supra* notes 56–57 and accompanying text.

<sup>109</sup> *In re Aimster Copyright Litig.*, 334 F.3d 643, 656 (7th Cir. 2003).

<sup>110</sup> *Id.* at 650–51.

<sup>111</sup> *Id.* at 653.

<sup>112</sup> See *Sony Corp. of Am. v. Universal City Studios, Inc.*, 464 U.S. 417, 494 (1984) (“Even were an appropriate remedy not available at this time, the Court should not misconstrue copyright holders’ rights in a manner that prevents enforcement of them when, through development of better techniques, an appropriate remedy becomes available.”).

*Aimster*, like *Napster* before, created obstacles that go beyond *Sony*. Each of these opinions chipped away at *Sony*'s doctrine from a different angle, and it has become impossible for future innovators to piece a comprehensive standard together. For example, *Napster* interpreted *Sony* as granting lesser protection to services than to products, while *Aimster* applied *Sony* equally to both.<sup>113</sup> On the other hand, *Aimster* applied the requirement to reduce the harm to plaintiffs and the willful blindness theories, while *Napster* imposed no such constraints.<sup>114</sup> Future innovators, however, cannot predict a future lawsuit's jurisdiction and so must be aware of the different standards. The *Sony* standard has become even vaguer, with varying definitions and fluid boundaries.

In 2005, the Supreme Court handed down its unanimous decision in *Grokster*.<sup>115</sup> While *Grokster* could have cleared up the aura of ambiguity, it instead reinforced the transition of the law to an open-ended, unpredictable standard, driving legal uncertainty to a higher level.

In *Grokster*, the defendants' distribution of free file-sharing software led to a secondary liability suit by music and movie copyright owners.<sup>116</sup> However, unlike their predecessors, the defendants *Grokster* and *Streamcast* utilized no central servers whatsoever, and their sites did not index file names.<sup>117</sup> Rather, their sole contact with the user was at the point of downloading the software.<sup>118</sup> Accordingly, in the district court and in the Ninth Circuit, the defendants were granted summary judgment based on the *Sony* safe harbor.<sup>119</sup>

The Supreme Court, however, vacated the Ninth Circuit's judgment.<sup>120</sup> Though outwardly upholding *Sony*, the Court was reluctant to apply it to the crux of

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<sup>113</sup> *Aimster*, 334 F.3d at 648–49; see also Jonathan Zittrain, *A History of Online Gatekeeping*, 19 HARV. J.L. & TECH. 253, 278 (2006) (discussing how the Ninth Circuit was careful in how it described *Napster*).

<sup>114</sup> Compare *Aimster*, 334 F.3d at 650, with *A & M Records, Inc. v. Napster Inc.*, 114 F. Supp. 2d 896 (N.D. Cal. 2000). It is possible, however, to view the *Napster* requirement of filtering technology as a requirement to reduce the harm to plaintiffs.

<sup>115</sup> *Metro-Goldwyn-Mayer Studios, Inc. v. Grokster, Ltd.*, 545 U.S. 913 (2005).

<sup>116</sup> *Id.* at 919–21.

<sup>117</sup> *Id.* at 921–22.

<sup>118</sup> *Id.*

<sup>119</sup> *Id.* at 927.

<sup>120</sup> *Id.* at 943.

the matter because of the egregious conduct of the defendants.<sup>121</sup> Such conduct included advertisements comparing the service to the illegal Napster and showing availability of copyrighted works, internal materials indicating intent to allow copyright infringement, advertisement revenue dependency (a model based on large volume of users), and absence of any filtering mechanism.<sup>122</sup> Tying these factors together, the court concluded that they amounted to *inducement* of copyright infringement, and denied the defendants the application of the *Sony* doctrine.<sup>123</sup>

Not only did *Grokster* not help to clarify the law that preceded it, it is also open to various interpretations itself. While one view holds that inducement liability is a subspecies of contributory liability,<sup>124</sup> another view sees it as a third, independent doctrine alongside contributory and vicarious liability.<sup>125</sup> Further, the status of products *actually* used for infringement remains unclear. Under one interpretation of *Grokster*, intention that the product will be used for infringement may suffice for liability to attach.<sup>126</sup> A narrower interpretation finds that active steps to encourage infringement are required to establish liability in addition to the provider's intent.<sup>127</sup>

Commentators are likewise divided over the interrelation between *Sony* and *Grokster*. On the surface, the immediate effect of *Grokster* was the creation of an exception to *Sony* in cases where the provider induces infringement.<sup>128</sup> However,

<sup>121</sup> Metro-Goldwyn-Mayer Studios, Inc. v. Grokster, Ltd., 545 U.S. 913, 936–40 (2005).

<sup>122</sup> *Id.* at 939–40.

<sup>123</sup> *Id.* at 940.

<sup>124</sup> See, e.g., Perfect 10, Inc. v. Amazon.com, Inc., 487 F.3d 701, 726 (9th Cir. 2007) (“Liability . . . may be predicated on actively encouraging (or inducing) infringement . . . or on distributing a product distributees use to infringe . . .”).

<sup>125</sup> See, e.g., Adams, *supra* note 13, at 636 (“Copyright law has three separate doctrines for third-party liability: vicarious infringement; contributory infringement; and inducing infringement.”); Giblin, *supra* note 29, at 15 (“[I]nducement liability is the newest addition to the secondary liability toolkit.”).

<sup>126</sup> Jane C. Ginsburg & Sam Ricketson, *Inducers and Authorisers: A Comparison of the US Supreme Court's Grokster Decision and the Australian Federal Court's KaZaA Ruling*, 11 MEDIA & ARTS L. REV. 2, 5 (2006), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=888928](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=888928).

<sup>127</sup> See Wu, *supra* note 40, at 246–47.

<sup>128</sup> Metro-Goldwyn-Mayer Studios Inc. v. Grokster, Ltd., 545 U.S. 913, 934–35 (2005); see Jane Ginsburg, *Separating the Sony Sheep from the Grokster Goats: Reckoning the Future Business Plans of Copyright-Defendant Technology Entrepreneurs*, 50 ARIZ. L. REV. 577, 583 (2008) (“So-

the facts of the cases undermine that supposedly obvious reading. Indeed, the Court in *Sony* could have concluded that the defendant engaged in inducement had it found such a discovery relevant.<sup>129</sup> As Justice Blackmun pointed out in his dissent, Sony openly sponsored advertisements calling for the recording of programs and the creation of private video libraries for multiple viewing.<sup>130</sup> Nonetheless, the important factor in *Sony* was not the manufacturer's intent, but rather the character of the product itself.<sup>131</sup>

Perhaps the single most blatant deviation of *Grokster* from *Sony* is the shift of focus from the capabilities of the technology to its actual use. Justice Breyer concluded that *Sony* does not apply to technologies actually used "almost exclusively" for infringing purposes,<sup>132</sup> and Justice Ginsburg precluded technologies that have "overwhelming use" for infringement.<sup>133</sup> Although this deviates from the *Sony* doctrine as it is widely understood,<sup>134</sup> *Sony* itself did discuss the actual use of the VCR as well, concluding that it was primarily time-shifting, and thus fair use.<sup>135</sup> This left some doubt about whether *Sony* itself really applied the rule it announced regarding merely *potential* uses. Whatever the case may be, *Grokster* has a vital role in re-carving the boundaries of the *Sony* doctrine and crafting an open-ended liability standard.

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ny standard does not even come into play when the defendant is 'actively inducing' copyright infringement."). The court in *Arista Records LLC v. Lime Group LLC*, No. 06 Civ. 5936(KMW), 2010 WL 2291485 (S.D.N.Y. May 25, 2010), implemented this view. The court granted summary judgment to the plaintiffs against the file-sharing service LimeWire based on inducement theory, while positing as to contributory liability, that it "cannot determine, as a matter of law, whether LimeWire is capable of substantial noninfringing uses." *Id.* at 15, 21.

<sup>129</sup> See Litman, *supra* note 59, at 360–61.

<sup>130</sup> *Sony Corp. of Am. v. Universal City Studios, Inc.*, 464 U.S. 417, 459 (1984) (Blackmun, J., dissenting).

<sup>131</sup> See *id.* at 442 (ruling that in order to be protected from secondary liability, a product "need[s] merely [to] be capable of substantial noninfringing uses").

<sup>132</sup> *Grokster*, 545 U.S. at 957 (Breyer, J., concurring); but see *id.* at 944 (J. Ginsburg, concurring) ("Sony, as I read it, contains no clear, near-exclusivity test. Nor have Courts of Appeals unanimously recognized Justice Breyer's clear rule.").

<sup>133</sup> *Id.* at 947 (Ginsburg, J., concurring). Justice Ginsburg further rejected the relevance of equivalent technologies, thus placing significantly less focus on *potential* uses, which can be derived from studying similar products. See *id.* at 948.

<sup>134</sup> See *supra* note 58 for more on how *Sony* is widely understood.

<sup>135</sup> *Sony Corp. of Am. v. Universal City Studios, Inc.*, 464 U.S. 417, 454–55 (1984).



The open-ended nature of the secondary liability standard renders it difficult, if not impossible, to predict the results of future cases or even the theories upon which they would be decided.<sup>136</sup> Interestingly, both the courts and Congress (as shown below) not only avoided explicitly challenging *Sony*, but also outwardly emphasized its importance as a safe harbor that assures innovation is not hindered by the copyright laws.<sup>137</sup> At the same time, the *Sony safe harbor* never has been fully applied or clearly defined, and subsequent measures added qualifications eroding it and reshaping its boundaries. The net result of the judiciary process is a de facto open-ended standard for secondary liability, as each case and act developed a theory of its own regarding the meaning of the *Sony* doctrine.

### 3. *The Role of Congress in Crafting an Open-Ended Standard*

While the secondary liability standard is principally judge-made, Congress has also extensively regulated it. The mosaic of acts and regulations, the formation of the legislation (often a compromise between different industry players),<sup>138</sup> and the fact that the legislation only partially corresponds to the judicial standards add to the complexity and uncertainty that characterizes the law.

Indirect liability found its way into legislation by implication when Congress amended the 1976 Copyright Act to apply liability not only to actual infringers but also to those who *authorize* infringement.<sup>139</sup> Legislative history shows that Congress designed this addition specifically to acknowledge contributory infringement.<sup>140</sup> It further reveals that the Judiciary Committee considered and rejected a proposition to abandon vicarious liability, effectively sustaining the case law on

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<sup>136</sup> For example, in the case of *Warner Bros. v. SeeqPod*, record labels argued before a district court in California that the defendant, which facilitates music search for streaming, is not merely a search engine, but rather “an unlawful music service that directly engages in, encourages, and facilitates the mass infringement of . . . copyrighted works.” Complaint for Direct, Contributory, and Vicarious Copyright Infringement, Inducement of Copyright Infringement, Misappropriation and Unfair Competition at 16–17, *Warner Bros. Records, Inc. v. SeeqPod, Inc.*, No. 08 CV 00335 (C.D. Cal. Jan. 18, 2008), 2007 WL 4837988.

<sup>137</sup> See *infra* Part II.B.3.

<sup>138</sup> See Jessica Litman, *The Politics of Intellectual Property*, 27 *CARDOZO ARTS & ENT. L.J.* 313, 314–15 (2009) (discussing the various players involved in the drafting of copyright legislation).

<sup>139</sup> 17 U.S.C. § 106 (2006).

<sup>140</sup> See H.R. REP. NO. 94-1476, at 61 (1976), *reprinted in* 1976 U.S.C.C.A.N. 5674 (stating that the insertion was designed “to avoid any questions as to the liability of contributory infringers”).

this topic as well.<sup>141</sup> Notably, however, the Committee, caught in the paradigm of the traditional model of ballroom or night club, did not envision the technology provider model, which poses different challenges for copyright secondary liability as elaborated above.<sup>142</sup>

Driven by interest groups from both sides, Congress' involvement in crafting rules pertaining to technologies increased following the *Sony* decision.<sup>143</sup> The congressional acts that accompanied the rise of the Internet have adopted a rather copyright-protective approach that restricted innovation more than *Sony's* de jure standard requires.<sup>144</sup>

A congressional attempt to create a safe harbor regime for the liability of technology providers occurred in 1998 with the enactment of the DMCA.<sup>145</sup> However, not only is the DMCA disharmonious with *Sony*, further weakening its power as a safe harbor, it has also been proved ineffective in offering reliable safe harbors to contemporary technologies that emerged after its enactment.

The DMCA was the result of a study by the Clinton administration and consists in part of a compromise between copyright owners and ISPs, which have become a susceptible target for copyright lawsuits.<sup>146</sup> In essence, the DMCA encompasses dual functions, both affecting technology providers considerably. The first

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<sup>141</sup> See H.R. REP. NO. 94-1476, at 159–60. (“The committee has considered and rejected an amendment to this section intended to exempt the proprietors of an establishment, such as a ballroom or night club, from liability for copyright infringement committed by an independent contractor, such as an orchestra leader. . . . The committee has decided that no justification exists for changing existing law, and causing a significant erosion of the public performance right.”).

<sup>142</sup> See *supra* Part II.B.2.

<sup>143</sup> See Joseph P. Liu, *Regulatory Copyright*, 83 N.C. L. REV. 87, 88–89 (2004) (arguing that as a general matter, copyright law increased the use of legislative, detailed, industry-specific regulations).

<sup>144</sup> See, e.g., Audio Home Recording Act of 1992, Pub. L. No. 102-563, § 2, 106 Stat. 4237, 4240 (1992) (codified at 17 USC §§ 1001–10 (2006)). Aiming to strike a balance between the competing interests, the Audio Home Recording Act (AHRA) entitled copyright owners (and performers) to royalties for every sale of a digital audio technologies (DAT) device in return for limited rights for users to create first-generation, noncommercial copies for personal use. *Id.* Importation, manufacture or distribution of DAT devices that allowed second-generation copies was outlawed. *Id.* This departs from the *Sony* rule, as the outlawed devices are capable of potentially substantial noninfringing uses, including, for example, recording of noninfringing content.

<sup>145</sup> Digital Millennium Copyright Act, Pub. L. No. 105-304, 112 Stat. 2860 (1998) (codified in scattered sections of Title 17 of the United States Code).

<sup>146</sup> See Niva Elkin-Koren, *Making Technology Visible: Liability of Internet Service Providers for Peer-to-Peer Traffic*, 9 N.Y.U. J. LEGIS. & PUB. POL'Y 15, 26 (2006) (discussing the exemptions for ISPs).

is what is now § 1201 of the Copyright Act, which sets the “anti-circumvention rule” of devices that copyright owners install to protect their materials.<sup>147</sup> Section 1201 has drawn vast criticism, to the extent that only five years after its enactment officials stated that it would have probably been impossible to enact it at that time.<sup>148</sup> The second is now § 512, and sets the “notice and takedown rule,” which protects services from liability, direct or derivative, for monetary damages if they expeditiously block access to infringing materials.<sup>149</sup>

Section 1201 bans the circumvention of technological measures that control access to digital files, the paradigmatically Digital Right Management (DRM) devices.<sup>150</sup> It further forbids the manufacturing of any device designed, used, or marketed primarily to support circumvention or has only limited legal purposes.<sup>151</sup> This definition of illegality evidently covers technologies that are capable of substantial noninfringing uses (if they are capable of such use yet designed primarily for circumvention purposes), and are thus lawful under *Sony*. As articulated by Lemley and Reese, “[t]he DMCA’s anticircumvention provisions expressly rejected the ‘substantial noninfringing use’ test in favor of one much more generous to copyright owners.”<sup>152</sup>

<sup>147</sup> 17 U.S.C. § 1201 (2006).

<sup>148</sup> See Marybeth Peters, *Brace Memorial Lecture: Copyright Enters the Public Domain*, 51 J. COPYRIGHT SOC’Y U.S.A. 701, 711 (2004) (“[I]t would be impossible to enact the DMCA today.”). The core critique of the DMCA is rooted in the view that it expands copyright’s control beyond the Copyright Act. See Glynn S. Lunney, Jr., *The Death of Copyright: Digital Technology, Private Copying, and the Digital Millennium Copyright Act*, 87 VA. L. REV. 813, 814 (2001) (“COPYRIGHT is dead. The Digital Millennium Copyright Act (‘DMCA’) has killed it.”); Neil W. Netanel, *Locating Copyright within the First Amendment Skein*, 54 STAN. L. REV. 1, 75 (2001) (“The ‘paracopyright’ provided for under the DMCA expands content provider control over content significantly beyond that which has traditionally [been] obtained under the Copyright Act.”); but see June M. Besek, *Anti-Circumvention Laws and Copyright: A Report from the Kernochan Center for Law, Media and the Arts*, 27 COLUM. J.L. & ARTS 385, 390 (2004) (emphasizing that the DMCA “includes a ‘safety valve’—in addition to several exemptions set out in the law, the Copyright Office can create new exemptions through its rulemaking proceeding”).

<sup>149</sup> 17 U.S.C. § 512 (2006).

<sup>150</sup> *Id.* at § 1201(a).

<sup>151</sup> *Id.* at § 1201(a)(2).

<sup>152</sup> Lemley & Reese, *supra* note 39, at 1390. Interestingly, Congress expressed the view that *Sony* has been preserved in the DMCA. See, e.g., 144 CONG. REC. H10621 (1998) (statement of Rep. Klug) (“I’m very pleased that the conferees have meaningfully clarified that the *Sony* decision remains valid law.”).

The DMCA's second function, now § 512, offers safe harbors to shield Online Service Providers (OSPs) from liability for copyright infringement.<sup>153</sup> These harbors may apply to some technology providers, but certainly not to all of them.<sup>154</sup> Eligibility for the safe harbors is limited to providers who qualify as OSPs<sup>155</sup> and who meet the following criteria: first, they must apply a policy of termination of repeat infringers; and second, they must apply standard technical measures that protect copyrighted works.<sup>156</sup> If the providers meet these prerequisites, four safe harbors apply, each subject to specific conditions as well.<sup>157</sup> The first harbor, in 17 U.S.C. § 512(a), protects services that are mere conduits for digital transmissions. The second harbor, in 17 U.S.C. § 512(b), shields against liability for temporarily storing online material. A third harbor, 17 U.S.C. § 512(c), applies to services that store data at the direction of a user, such as sites that store users' websites. Finally, the fourth harbor, in 17 U.S.C. § 512(d), protects "information location tools," such as search engines. Notably, the *Sony* safe harbor, for services that are capable of noninfringing use, is absent from this list of DMCA safe harbors though it preceded the legislation by more than a decade.

Enacted in 1998, the DMCA preceded the peer-to-peer revolution as well as other important technological advances of the new millennium. This fact alone is a source of confusion in its application to contemporary technologies. For example, the law often excludes current technologies, like many peer-to-peer applications, from the DMCA safe harbors either because they do not qualify as OSPs, or because their conduct does not fall under any of the four categories to which safe harbors apply.<sup>158</sup> That exclusion, however, does not reflect a deliberate decision, but rather the obvious lack of predictive powers.

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<sup>153</sup> 17 U.S.C. § 512 (2006).

<sup>154</sup> See Lemley & Reese, *supra* note 39, at 1369 ("Some innovators will likely not meet this definition and therefore not be eligible for the safe harbors at all."); but see Jonathon J. Darrow & Gerald R. Ferrera, *Social Networking Web Sites and the DMCA: A Safe-Harbor from Copyright Infringement Liability or the Perfect Storm?*, 6 NW. J. TECH. & INTELL. PROP. 1, 13 (2007) ("Courts have consistently applied a broad definition to the term 'service provider' to bring within the definition a wide range of entities, including, Aimster, eBay, and Amazon.").

<sup>155</sup> See 17 U.S.C. § 512(k)(1) (2006) (defining "service provider"); see also *ALS Scan, Inc. v. Remark Cmtys., Inc.*, 239 F.3d 619, 623 (4th Cir. 2001) (noting that the DMCA defines "service provider" broadly).

<sup>156</sup> 17 U.S.C. § 512(i) (2006).

<sup>157</sup> *Id.* at § 512.

<sup>158</sup> See Lemley & Reese, *supra* note 39, at 1369–72 (discussing eligibility for safe harbors). Other legislation that was aimed to regulate technologies in a very specific way suffered a similar fate.

Congress was called upon to intervene after the peer-to-peer revolution as well, initiating new acts, though most of them did not directly influence secondary liability.<sup>159</sup> Following the district court's *Grokster* decision, Congress attempted to legislate "inducement infringement," and to impose liability on technologies that can be viewed as encouraging copyright infringement.<sup>160</sup> The Computer and Communications Industry Association and the Consumer Electronics Association opposed these efforts and this bill is still in the pipeline of Congress.<sup>161</sup>

The above legislative acts, as well as other statutes, which directly or indirectly influence technology providers' liability, are only partially harmonious with the judicial standards pertaining to secondary liability.<sup>162</sup> Thus, for example, the AHRA<sup>163</sup> is divorced from the *Sony* rule, as many of the devices outlawed in the former are certainly capable of substantial noninfringing uses. Similarly uncertain is the relationship between judicial standards for secondary liability and the DMCA, codified at both § 512 and § 1201. While § 1201 virtually ignores *Sony*, it remains unclear whether compliance with § 512 shields technology providers from

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*See, e.g.,* Wu, *supra* note 40, at 231 n.7 (arguing that the AHRA has also been highly irrelevant as a whole).

<sup>159</sup> *See, e.g.,* No Electronic Theft (NET) Act, Pub. L. No. 105-147, § 2(b), 111 Stat. 2678, 2678 (1997) (codified as amended at 17 U.S.C. § 506 (2006)).

<sup>160</sup> *See* A Bill to Amend Chapter 5 of Title 17, U.S.C., Relating to Inducing Infringement of Copyright Act of 2004, S.2560, 108th Cong. (2d Sess. 2004).

<sup>161</sup> *See* The Library of Congress, <http://thomas.loc.gov/cgi-bin/bdquery/z?d108:s.02560>: (last visited Sept. 15, 2010) (giving a summary and the status of S.2560, discussed in *supra* note 160); *see also* Hannibal Travis, *The Future According to Google: Technology Policy from the Standpoint of America's Fastest-Growing Technology Company*, 11 YALE J.L. & TECH. 209, 212 (2009) (noting that Google joined the Computer and Communications Industry Association and the Consumer Electronics Association in opposing S.2560). For a review of bills concerning DRM in the 108th Congress, some of which have direct influence on the status of OSPs, *see* Declan McCullagh & Milana Homs, *Leave DRM Alone: A Survey of Legislative Proposals Relating to Digital Rights Management Technology and Their Problems*, 2005 MICH. ST. L. REV. 317, 319-20 (2005).

<sup>162</sup> *See, e.g.,* 1984 Record Rental Amendment of 1984, Pub. L. No. 98-450, § 2(2), 98 Stat. 1727, 1727 (1984) (codified at 17 U.S.C. §109(b) (2006)) (prohibiting the rental of sound recordings). This law was extended to software half a dozen years later in Computer Software Rental Amendment Act of 1990, Pub. L. No. 101-650, § 802, 104 Stat. 5089, 5134 (1990) (codified as amended at 17 U.S.C. § 109(b)), but attempts to extend it to motion pictures were unsuccessful. *See* Menell & Nimmer, *supra* note 17, at 157-60 (discussing the attempts to extend the law).

<sup>163</sup> Audio Home Recording Act of 1992, Pub. L. No. 102-563, § 2, 106 Stat. 4237, 4240 (1992) (codified at 17 USC §§ 1001-10 (2006)).

liability stemming from the *Napster*, *Aimster*, and *Grokster* theories.<sup>164</sup> While technology companies claim that DMCA compliance entirely shields them from liability, copyright owners often view the judicial standards as a parallel, alternative basis for litigation.<sup>165</sup>

The case law is not settled in this regard. In California, *Columbia Pictures Industries et al v. Fung* held on summary judgment that technologies that induce copyright infringement are, categorically, not eligible for the DMCA safe harbor.<sup>166</sup> In *Viacom International Inc. v. YouTube, Inc.*, a New York district court granted summary judgment for YouTube, holding that it complies with the notice and take-down mechanism of the DMCA,<sup>167</sup> and is immune from liability.<sup>168</sup> While it remains to be seen how the case fares on appeal, the case distinguished *Grokster* as irrelevant to a case where defendants are entitled to DMCA protections.<sup>169</sup>

To be sure, there is nothing problematic per se about Congress making changes to the law after the *Sony* decision, especially when *Sony* itself implied that Congress may reconsider the balance the court sets.<sup>170</sup> Yet the fact that Congress has made these changes while outwardly upholding *Sony*, yet in fact deviating from its path, is what gives rise to possible confusion and to the distorted market described below.

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<sup>164</sup> See Ginsburg, *supra* note 128, at 590–602 (discussing application of the safe harbor provisions to service providers).

<sup>165</sup> See, e.g., *Columbia Pictures Indus., Inc. v. Fung*, No. CV 06-5578 SVW(JCx), 2009 WL 6355911, at \*18 (C.D. Cal. Dec. 21, 2009) (noting that no DMCA safe harbor is available when an alleged infringer is guilty of inducement); *Viacom Int'l Inc. v. YouTube, Inc.*, Nos. 07 Civ. 2103(LLS), 07 Civ. 3582(LLS), 2010 WL 2532404, at \*14 (S.D.N.Y. June 23, 2010) (rejecting the plaintiffs', including Viacom, argument that by merely complying with the DMCA, the defendant (YouTube) takes too minor a role in participating in copyright enforcement).

<sup>166</sup> *Columbia Pictures*, 2009 WL 6355911, at \*18. The court held that “[i]n many ways, the Digital Millennium Copyright Act is simply a restatement of the legal standards establishing secondary copyright infringement . . . The two sets of rules do not entirely overlap, but this framework is helpful for understanding the Act’s statutory text and structure.” *Id.* at \*15 (citing *A & M Records, Inc. v. Napster, Inc.* 239 F.3d 1004, 1025 (9th Cir. 2001)).

<sup>167</sup> See 17 U.S.C. § 512 (2006).

<sup>168</sup> *Viacom Int'l Inc. v. YouTube, Inc.*, Nos. 07 Civ. 2103(LLS), 07 Civ. 3582(LLS), 2010 WL 2532404, at \*14 (S.D.N.Y. June 23, 2010).

<sup>169</sup> See *id.* at \*11 (maintaining that the *Grokster* decision, along with others, was of “little application” to the case at bar).

<sup>170</sup> See *Sony Corp. of Am. v. Universal City Studios, Inc.*, at 464 U.S. 417, 456 (“It may well be that Congress will take a fresh look at this new technology, just as it so often has examined other innovations in the past. But it is not our job to apply laws that have not yet been written.”).

The net result of the law is an open-ended liability rule, which entails no clear boundaries for liability. Both judges and legislatures have diminished *Sony*, the de jure primary safe harbor. The law has become a collage of standards whose applications are uncertain and to a large part, circuit-specific. As analyzed below, from the point of view of market players, this open-endedness translates into uncertainty and creates a distorted reaction to the law that places copyright enforcement—the very goal of secondary liability—at critical risk.

### III. The Ineffectiveness of the Open-Ended Secondary Liability Standard

#### A. The Dichotomous Reaction of the Market to the Law

The shift from a supposedly safe harbor regime to an open-ended standard had a twofold effect. First, it expanded the scope of liability to reflect lawmakers' attempts to strengthen copyright enforcement. Second, it added a dimension of vagueness to secondary liability law and made it a patchwork of standards, arrangements, and specific laws—partially parallel, partially congruent to each other. Thus, the big promise of the *Sony* rule—to render innovators immune from liability based on circumstances that are not under their control—became the first casualty of the new legal environment.

In the marketplace, innovators developed two alternative reactions to this reality. The first was to behave over-protectively: obtain a license from copyright owners even if legally unnecessary and take down content uploaded by users even if its infringing nature was uncertain or unlikely.<sup>171</sup> The second course of action, principally taken in the peer-to-peer arena, was to routinely continue the unauthorized use of copyrighted materials while making it complicated or costly to identify the operation and take legal action against it—usually by means of decentralizing, encoding, and shifting operations abroad.

While the first path points to the distortion of the traditional balance between copyright owners and users, the second sheds light on the ineffectiveness of this standard in coping with digital infringement via alterative platforms, such as peer-to-peer networks. As analyzed below, this polarized effect renders the goals of secondary liability unfulfilled.

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<sup>171</sup> See *infra* Part II.A.1.

### 1. *The Risk-Minimizing Path and the Cost of Overcompliance*

Conventional wisdom says that uncertainty tends to induce actors into being overly cautious.<sup>172</sup> When the scope of legal risk is not clear, even risk-neutral actors tend to overcomply by avoiding actions that may draw them into court.

James Gibson persuasively describes the chronicle of overcompliance in copyright-based industries and its influence towards an accretive expansion of copyright entitlements.<sup>173</sup> According to Gibson's analysis, the ambiguity of copyright law, together with the high penalties it entails, motivates rational players to license content from copyright owners even if—as a matter of law—they are entitled to use the content without a license.<sup>174</sup> This repetitive behavior has created a market practice that influences successive legal analyses to view the uses covered by licenses as if actually covered by the positive copyright law.<sup>175</sup>

Although Gibson focuses on direct liability and on the market of derivative works, his analysis is applicable in the context of secondary liability of technology providers. Imagine an entrepreneur who reasonably fears that her content-neutral technology will actually be used, *inter alia*, for infringing purposes. Creating the technology requires a vast investment of money, time, and energy for several years. The process may be accompanied by risk-averse investors whose principal incentive is to return their investment and who also possess some decision-making power over the project.<sup>176</sup> The entrepreneur's lawyer advises her that a successful second-

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<sup>172</sup> See Richard Craswell & John E. Calfee, *Deterrence and Uncertain Legal Standards*, 2 J.L. ECON. & ORG. 279, 286 (1986) (“[I]f uncertainty is centered around the optimal value . . . small amounts of uncertainty will always lead to overcompliance . . . .”); see also Tom Baker, Alon Harel & Tamar Kugler, *The Virtues of Uncertainty in Law: An Experimental Approach*, 89 IOWA L. REV. 443, 444–49 (2004) (finding that uncertainty increases deterrence but viewing it as a positive outcome in tort law and criminal law).

<sup>173</sup> See James Gibson, *Risk Aversion and Rights Accretion in Intellectual Property Law*, 116 YALE L.J. 882, 887–906 (2007) (detailing how a feedback loop has caused overcompliance with copyright laws); see also Matthew Africa, Comment, *The Misuse of Licensing Evidence in Fair Use Analysis: New Technologies, New Markets, and the Courts*, 88 CAL. L. REV. 1145, 1172 (2000) (“Fear of liability causes users to obtain licenses for borderline uses rather than risk the cost of a lawsuit. This licensing can, in turn, create a market that can be held against subsequent users to disprove the fairness of use.”).

<sup>174</sup> Gibson, *supra* note 173, at 887.

<sup>175</sup> *Id.* at 887–906; Africa, *supra* note 173, at 1172.

<sup>176</sup> Banks are traditionally risk-averse, while venture capitalists are generally not. David Rosenberg, *Venture Capital Limited Partnerships: A Study in Freedom of Contract*, 2002 COLUM. BUS. L. REV. 363, 364 (2002) (“Banks, the traditional institutions from which businesses receive needed funding, are, comparatively speaking, reluctant to take big risks . . . Venture capitalists, on the other hand, are drawn to risky propositions. . . .”).



ary infringement lawsuit may lead to injunction<sup>177</sup>—the ultimate end of the entire project. The lawyer will be less certain of the likelihood of success of such a lawsuit,<sup>178</sup> but this does not matter that much. Litigation itself may terminally delay the project and substantially increase its cost.<sup>179</sup> In such a scenario, the entrepreneur may well prefer to err on the side of over-compliance by licensing content from copyright owners, or otherwise create a stake for them in the project in order to avoid litigation.

The likelihood of an actor behaving over-cautiously is a function of various conditions. First is the probability that the technology actually will be used for infringing uses, and that such uses will be detected. A higher probability increases both the chances of litigation and the innovator's inclination to over-comply. Second, high upfront costs of the project may push innovators towards a risk-minimizing course. Indeed, high sunk-costs, i.e., resources that providers already incurred and cannot recover, will discourage the innovator from risking the project, and spur her to appease potential copyright-owner plaintiffs beforehand. Perhaps most significantly, innovators who have deep pockets are much more likely to adopt a risk-minimizing approach, as they are more likely to face a lawsuit and be found liable.<sup>180</sup>

A number of factors intensify this behavior in copyright-intense markets. First and foremost, litigation in the technological realm may have extremely devastating consequences for defendants. The implications of a successful copyright lawsuit can be completely destructive to a project,<sup>181</sup> drastically increasing the risk

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<sup>177</sup> See 17 U.S.C. § 502 (2006) (detailing injunctions as an available remedy).

<sup>178</sup> See *supra* Part II for a discussion of the legal uncertainty surrounding this issue.

<sup>179</sup> See Margaret C. McHugh & William T. Gallagher, *Strategic Considerations in U.S. Copyright Litigation*, FINDLAW, 2003, <http://library.findlaw.com/2003/Nov/11/133141.html> (discussing copyright litigation costs and potential remedies such as injunctions).

<sup>180</sup> Courts are often, explicitly or implicitly, sympathetic to a deep pockets theory, choosing to place the costs of a victim's loss in the hands of the entity best capable of bearing it. *Cf.*, RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* § 6.8 204–05 (5th ed. 1998) (noting that employers are incentivized to reduce liability by controlling employees behavior).

<sup>181</sup> Most importantly, a successful copyright lawsuit can lead to an injunction. See 17 U.S.C. § 502 (2006) (detailing injunctions as an available remedy). Monetarily, copyright remedies include actual damages, statutory damages of up to \$150,000 per work infringed, disgorgement of profits, costs, and attorney's fees. See 17 U.S.C. §§ 504–05 (2006).

litigation presents.<sup>182</sup> Moreover, even if such a lawsuit eventually proves to be unsuccessful, in the competitive and rapidly changing technological market, a delay in launching a project may prove to be an insurmountable barrier to the project.

Second, dominant market figures are often simultaneously present on both sides of the divide. Sony, for example, is a giant technology company, and yet—through its subsidiaries—it is also deeply involved as a copyright owner in the music and film industries.<sup>183</sup> Similarly, technology companies are often interested in the expansion of the copyright scope that protects their software<sup>184</sup> and are not enthusiastic about promoting policies that would protect technologies if these technologies may ultimately put their products at risk.<sup>185</sup> This phenomenon reinforces the inclination of such companies to be overly cautious, fearing harm to themselves if they help trim down copyright in favor of technology.

Finally, this process is self-perpetuating. It is well established that in the absence of clear legal norms, market players tend to interpret a legal standard using market norms and behavioral regularities.<sup>186</sup> Thus, the more technologies behave over-protectively of copyright law, the more likely it is that other companies will follow suit.

Examples supporting the above analysis of over-compliance abound. Players in copyright-based industries—especially those who have deep pockets, whose products are prone to infringement, and who incur considerable upfront costs—dominantly pursue a risk-minimizing track. In recent decades, this strategy has often come into play through profit-sharing models between technology providers

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<sup>182</sup> See *supra* Part II for a discussion of the legal uncertainty surrounding this issue.

<sup>183</sup> Sony Music Entertainment (formerly, Sony BMG Music Entertainment) is one of the “big four” record labels, and Sony Pictures Entertainment, Inc. (SPE) is Sony’s motion picture unit. Bill Lamb, Top 4 Major Pop Record Labels, ABOUT.COM, <http://top40.about.com/od/popmusic101/tp/majorlabels.htm> (last visited Sept. 15, 2010). One explanation for Sony’s decision to settle an early 1990’s case was its expansion into the music business, which made it sensitive to the interests of the music industry. See Menell & Nimmer, *supra* note 17, at 190 (noting that one explanation for Sony not continuing the suit was that Sony had “diversified into the film and music industries”).

<sup>184</sup> Software is protected as literary work. See 17 U.S.C. § 101 (2006).

<sup>185</sup> Technology companies often rigorously and strategically protect the copyright in their software products. See, e.g., Apple, Inc. v. Psystar Corp., 673 F. Supp. 2d 931 (N.D. Cal. 2009).

<sup>186</sup> See Yuval Feldman & Alon Harel, *Social Norms, Self-Interest and Ambiguity of Legal Norms: An Experimental Analysis of the Rule vs. Standard Dilemma*, 4 REV. L. & ECON. 81, 89 (2008) (“In the absence of information concerning the result dictated by legal norms with respect to a particular situation, people would seek cheap and available sources of information [such as social norms].”).

and copyright owners, that exceed the legal requirements. Thus, prior to launching technologies whose use is expected to involve copyrighted works, technology companies have entered deals with copyright owners in order to minimize the risk of secondary liability litigation. Further, they employed mechanisms to filter out copyrighted works.

In 1999, TiVo involved Hollywood in its digital video recorder (DVR) project from the very beginning, by raising capital from and splitting commercial revenues with them.<sup>187</sup> This path was pursued although the regular uses of the DVR have probably been time-shifting (or perhaps space-shifting) and thus may be fair use.<sup>188</sup> At the very least, the DVR most likely would have been found legitimate under *Sony*, as it was at least capable of substantial noninfringing use such as time-shifting. However, TiVo preferred to go hand-in-hand with Hollywood and not risk litigation.<sup>189</sup> This case is especially interesting because the market provides us with a control group: TiVo's competitor, ReplayTV. ReplayTV pursued a different path; it did not negotiate a license from Hollywood, and included applications such as commercial-skipping and content-sharing.<sup>190</sup> The foreseeable lawsuit against ReplayTV was not long in coming,<sup>191</sup> and ReplayTV, which based its defense on *Sony*,

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<sup>187</sup> See Menell & Nimmer, *supra* note 17, at 194 ("TiVo took the . . . conciliatory path, raising investment capital from key content industry players early in its development."); Ashley Dunn, *TiVo Woos TV's Big Players With Its Set-Top Box*, L.A. TIMES, July 28, 1999, at C1, available at <http://articles.latimes.com/1999/jul/28/business/fi-60201>.

<sup>188</sup> The status of space shifting as fair use is often taken from an analogy to time-shifting. There is, however, no ruling deciding whether space shifting is indeed fair use. See David O. Carson, *Making the Making Available Right Available 22nd Annual Horace S. Manges Lecture, February 3, 2009*, 33 COLUM. J.L. & ARTS 135, 138 (2010) ("There are no reported cases deciding whether space shifting is fair use . . ."); but see *In re Aimster Copyright Litig.*, 334 F.3d 643, 652 (7th Cir. 2003) ("Someone might own a popular-music CD that he was particularly fond of, but he had not downloaded it into his computer and now he finds himself out of town but with his laptop and he wants to listen to the CD, so he uses Aimster's service to download a copy. This might be a fair use rather than a copyright infringement, by analogy to the time-shifting approved as fair use in the *Sony* case.").

<sup>189</sup> See Menell & Nimmer, *supra* note 17, at 194 ("TiVo took the more conciliatory path, raising investment capital from key content industry players early in its development."); see also Jacob Carroll, Note, *Digital Recording Devices: How Far Can Copyright Law Be Stretched?*, 2001 UCLA J.L. & TECH. NOTES 4, 4 (2001) (noting that TiVo responded to a lawsuit regarding a capability that would eliminate revenues for entertainment companies with "we have looked at these capabilities—they are not hard to implement, but we have decided there is no reason to antagonize media companies in this way").

<sup>190</sup> Carroll, *supra* note 189, at 4.

<sup>191</sup> Menell & Nimmer, *supra* note 17, at 194; Carroll, *supra* note 189, at 4.

fatefully went bankrupt during the proceeding—in large part due to lawsuit expenses.<sup>192</sup> Indeed, the risk that TiVo’s risk-minimizing path prevented was not the loss in court, but rather the litigation itself, which proved destructive in the case of its competitor, ReplayTV.

More recently, Apple, *reasonably* assuming that consumers would likely use its iPod for unauthorized copying,<sup>193</sup> faced a similar dilemma. Apple could have sought shelter behind *Sony* to claim that a substantial, perhaps even the primary function of the iPod is space-shifting and thus noninfringing.<sup>194</sup> Instead, Apple splits the revenue pie with record labels and media giants. While not sharing the revenues from the device itself, Apple operates the iTunes music store, which it claims generates minimal revenue for Apple,<sup>195</sup> and avoids litigation over the legality of the music player itself.<sup>196</sup> This co-operation has led to further collaboration between Apple and the big record companies, who are now launching *Cock-*

<sup>192</sup> See Litman, *supra* note 59, at 952 (“SonicBlue [the second defendant in the Replay litigation, L.H.] . . . was unable to survive the motion picture industry’s suit against its ReplayTV.”).

<sup>193</sup> See Darrow & Ferrera, *supra* note 154, at 26 (“[A]t \$0.99 per song, it would cost nearly \$20,000 to fill the iPod to capacity, which is more than fifty times the cost of the iPod itself.”); see also *Universal Chief May Badger Jobs for Ipod Royalties*, APPLEINSIDER, Nov. 28, 2006, [http://www.appleinsider.com/articles/06/11/28/universal\\_chief\\_may\\_badger\\_jobs\\_for\\_ipod\\_royalties.html](http://www.appleinsider.com/articles/06/11/28/universal_chief_may_badger_jobs_for_ipod_royalties.html) (quoting Universal CEO Doug Morris: “[t]hese devices are just repositories for stolen music and they all know it”).

<sup>194</sup> Even the RIAA, though never admitting that copying music for personal use is fair use, asserts that “[r]ecord companies have never objected to someone making a copy of a CD for their own personal use.” RIAA, <http://riaa.com/faq.php> (last visited July 7, 2010).

<sup>195</sup> It is common wisdom that the iTunes Store has operated around break even since it was launched. See David Kusek, *New Artist Model*, FUTURE OF MUSIC, Oct. 21, 2007, <http://www.futureofmusicbook.com/2007/10/new-artist-model/> (asserting that “[t]he value of recorded music is plummeting and not even Apple can make money off of it”). However, a recent estimate by Pacific Crest Securities analyst Andy Hargreaves that Apple has managed to reduce transaction fees with credit card companies and thereby has begun to generate some profit from the iTunes store. Katie Marsal, *iTunes Store a Greater Cash Crop than Apple Implies?*, APPLEINSIDER (Apr. 23, 2007), [http://www.appleinsider.com/articles/07/04/23/itunes\\_store\\_a\\_greater\\_cash\\_crop\\_than\\_apple\\_implies.html](http://www.appleinsider.com/articles/07/04/23/itunes_store_a_greater_cash_crop_than_apple_implies.html).

<sup>196</sup> Kusek, *supra* note 196 (stating that iTunes “has just kept Apple out of court with the labels”). The observation that Apple’s interest lies in the hardware devices much more than in the iTunes store is strengthened by Apple’s strategy to block access of other devices to iTunes—a move that decreases the traffic to the iTunes store, but increases the appeal of its devices over competing ones. See, e.g., Jenna Wortham, *Rivalry Between Apple and Palm Intensifies*, N.Y. TIMES, Aug. 4, 2009, at B6, available at [http://www.nytimes.com/2009/08/04/technology/companies/04palm.html?\\_r=1](http://www.nytimes.com/2009/08/04/technology/companies/04palm.html?_r=1).

*tail*—a mutual project that will add interactive features to the albums sold on iTunes.<sup>197</sup>

MySpace agreed to a comparable deal in 2008, spinning out its MySpace Music service as an independent joint venture in partnership with three of the “big 4” record labels.<sup>198</sup> The fourth, EMI Group, is expected to join the venture at a later time.<sup>199</sup> MySpace was a harder nut to crack—the prospect of a hypothetical lawsuit did not pull it into a risk-minimizing path.<sup>200</sup> An actual secondary copyright infringement lawsuit that Universal filed against MySpace in 2006, and was settled and dropped during the transaction talks, pushed the deal forward.<sup>201</sup>

Likewise, YouTube reportedly reached deals with leading copyright holders that provide for sharing of advertising revenues.<sup>202</sup> Google has further developed a filtering mechanism for YouTube to screen out copyrighted works, despite YouTube’s own view that liability would have been negated had the issue actually come to court, as YouTube is covered under § 512.<sup>203</sup>

Alternatively, and perhaps more regretfully from a societal point of view, other technologies preferred to completely abandon their intended projects rather than

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<sup>197</sup> *Apple, Labels Stir up Deluxe, Digital Cocktail*, PC MAGAZINE, Aug. 2, 2009, <http://www.pcmag.com/article2/0,2817,2351088,00.asp>.

<sup>198</sup> Brad Stone & Jeff Leeds, *MySpace and Record Companies Create Music Site*, N.Y. TIMES, Apr. 3, 2008, <http://www.nytimes.com/2008/04/03/technology/03cnd-myspace.html>.

<sup>199</sup> *Id.*

<sup>200</sup> It has further been assumed that a smaller video-sharing site, Bolt, was pressured to settle a copyright infringement lawsuit in order to put additional pressure on other defendants, including MySpace and YouTube, to settle. See Matthew Belloni, *Video-Sharing Site Settles With Universal Music*, ALLBUSINESS, Feb. 12, 2007, available at <http://www.allbusiness.com/services/legal-services/4468199-1.html>.

<sup>201</sup> See Verdict, Agreement, and Settlement, UMG Recordings, Inc. v. MySpace, Inc., No. CV 06-07361 AHM (AJWx) (C.D. Cal. Apr. 4, 2008), 2008 WL 2071593 (noting the settlement).

<sup>202</sup> See Complaint for Declaratory and Injunctive Relief and Damages at 5, Viacom Int’l Inc. v. YouTube, Inc., No. 1:07-CV-2103 (S.D.N.Y. Mar. 13, 2007), 2007 WL 775611 (“Google has reportedly issued substantial equity and entered into expensive licenses with certain providers of copyrighted content”); Saul Hansell, *YouTube’s Video Poker; A Bet That Media Companies Will Want to Share Ad Revenue*, N.Y. TIMES, Sept. 30, 2006, [http://www.nytimes.com/2006/09/30/business/30tube.html?ref=saul\\_hansell](http://www.nytimes.com/2006/09/30/business/30tube.html?ref=saul_hansell) (discussing the Warner Music-YouTube deal).

<sup>203</sup> Defendant’s Answer and Demand for Jury Trial at 1, Viacom Int’l Inc. v. YouTube, Inc., No. 1:07-CV-02103 (S.D.N.Y. Aug. 30, 2007), 2007 WL 172564.

risk litigation. The lawsuits against RecordTV<sup>204</sup> and Scour,<sup>205</sup> for example, pulled the plug on these initiatives,<sup>206</sup> fulfilling scholars' gloomy predictions of a chilling effect on innovation.<sup>207</sup>

An additional variant of the risk-minimizing behavior is the alignment of various services' policies towards user-generated content with the interests of copyright owners. The fear of litigation drove services to err on the side of over-protection, religiously applying the DMCA take-down policy, and taking down any user-generated content accused of being infringing.<sup>208</sup> Even the 40th anniversary video of my in-laws was taken down from YouTube because of the music played in its background. Services diligently cut off users who receive multiple claims.<sup>209</sup> Indeed, services take all the measures required to be certain to fall under the DMCA safe harbors. Such a policy has generally been implemented by "[e]very Internet company in the United States that deals with content of third-party users—companies such as Amazon, AOL, CNN, eBay, Facebook, Google, MySpace, YouTube, and numerous startups aspiring to become just as successful."<sup>210</sup> As Edward Lee has observed, "it would be foolish, if not a breach of corporate fiduciary duty, for any such company not to do so."<sup>211</sup>

The DMCA notice and take down mechanism is vulnerable to manipulation. Manifestly, in 2009, Warner Music Group strategically amplified DMCA notices—even on obvious fair-use materials following a licensing quarrel with YouTube.<sup>212</sup>

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<sup>204</sup> Complaint, Metro-Goldwyn-Mayer Studios Inc. v. RecordTV.com, No. 00-06443 (C.D. Cal. June 15, 2000), 2000 WL 35449007.

<sup>205</sup> Complaint, Twentieth Century Fox Film Corp. v. Scour, Inc., No. 00-5335 (S.D.N.Y. July 20, 2000), 2000 WL 34016408.

<sup>206</sup> As Jessica Litman explains: "Litigation is expensive . . . and angry copyright owners have very deep pockets. RecordTV and Scour.com folded their tents rather than continue ruinous litigation." Litman, *supra* note 59, at 952.

<sup>207</sup> See sources cited *supra* note 39 and accompanying text.

<sup>208</sup> E.g., YouTube, Copyright Infringement Notification, [http://www.youtube.com/t/dmca\\_policy](http://www.youtube.com/t/dmca_policy) (last visited Aug. 30, 2010).

<sup>209</sup> See, e.g., YouTube, Copyright: Preventing Copyright Infringement on YouTube, <http://www.google.com/support/youtube/bin/answer.py?answer=55773&topic=10554> (last visited July 7, 2010) ("User accounts of repeat infringers are automatically terminated.")

<sup>210</sup> Edward Lee, *Decoding the DMCA Safe Harbors*, 32 COLUM. J.L. & ARTS 233, 233 (2009).

<sup>211</sup> *Id.* at 234.

<sup>212</sup> Greg Sandoval, *Youtube Users Caught in Warner Music Spat*, CNET NEWS, Jan. 27, 2009, [http://news.cnet.com/8301-1023\\_3-10150588-93.html](http://news.cnet.com/8301-1023_3-10150588-93.html). For additional bogus take-down notices, see *Online Policy Group v. Diebold, Inc.*, 337 F. Supp. 2d 1195, 1201–02 (N.D. Cal. 2004).

On another rather famous occasion, Universal Music Group demanded that YouTube take down a video of a dancing baby.<sup>213</sup> This time, the baby's mother, who uploaded the music, sued Universal and prevailed in the preliminary stages.<sup>214</sup> Most users, however, do not sue nor even protest the removal of their materials, and when they do sue they do not sue the service provider but rather the copyright owner who initiates the take-down notice. The asymmetric risk of litigation has structured a distorted incentive system for services to be more concerned with copyright infringement than with users' interests in legitimate use of copyrighted materials.

Moreover, it has become standard for services to develop, install and run filtering mechanisms of their own.<sup>215</sup> As a matter of law, however, copyright owners bear the responsibility to identify copyrighted materials that they want removed.<sup>216</sup> Indeed, there is no affirmative duty for services to take any filtering measures themselves, unless there is a "red flag",<sup>217</sup> and services are only obligated not to in-

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<sup>213</sup> *Lenz v. Universal Music Corp.*, 572 F. Supp. 2d 1150, 1151–52 (N.D. Cal. 2008).

<sup>214</sup> *Id.*

<sup>215</sup> *See, e.g.*, Principles for User Generated Content Services, <http://www.ugcprinciples.com/> (last visited Sept. 1, 2010) (detailing a set of "User Generated Content Principles" which result from a collaboration between copyright owners (including, among others, Disney, Sony, and Viacom) and services (including, among others, Microsoft and MySpace)). The UGC Principles obligate services to employ filtering mechanisms in order to curtail copyright infringement through their sites. *Id.* YouTube has done just that. *See* Miguel Helft, *YouTube Eases the Way to More Revenue*, N.Y. TIMES, Oct. 6, 2009, at B4, available at <http://www.nytimes.com/2009/10/07/technology/internet/07youtube.html> (noting that Google is able to identify copyrighted content soon after it is publicly available); Stacy D. Kramer, *Google Will Use Audible Magic Technology For Filtering: Report*, PAIDCONTENT.ORG, Feb. 23, 2007, <http://paidcontent.org/article/419-google-will-use-audible-magic-technology-for-filtering-report/> (reporting that Google acquired a company that develops filtering technology).

<sup>216</sup> 17 U.S.C. § 512 (2006); *see, e.g.*, *Perfect 10, Inc. v. CCBill LLC*, 488 F.3d 1102, 1113 (9th Cir. 2007) ("The DMCA notification procedures place the burden of policing copyright infringement—identifying the potentially infringing material and adequately documenting infringement—squarely on the owners of the copyright.").

<sup>217</sup> The standard for finding a red flag can be quite high. *See Perfect 10, Inc. v. CCBill, LLC*, at 13–14 (holding that content including the phrases "stolen" or "illegal" are not necessarily red flags as they may just "be an attempt to increase [the content's] salacious appeal").

terfere with copyright owners' efforts to identify or block the access to their works.<sup>218</sup>

Over-cautiousness to copyright protection may often be unfavorable. Filtering mechanisms bear the risk of jeopardizing fair use, since filters cannot accurately distinguish copyright infringement from legitimate uses of copyrighted material for fair use purposes.<sup>219</sup> In addition, transactions between copyright owners and technology companies, though probably brilliant from a risk-analysis perspective, entail negative externalities and may be detrimental from a broad-spectrum point of view. While transactions in the free market are thought to promote efficiency, this is not the case with transactions that stem from legal uncertainty and are entered into simply because the parties cannot reasonably assess the risk of litigation or identify the cases in which liability does not arise. In fact, such transactions may distort otherwise efficient market behaviors.<sup>220</sup>

The straightforward risk pertaining to these transactions is their implications on those who are not invited to the negotiation table in the first place. Specifically, the incentives to over-protect copyrights, both by over-licensing and by undue management of user-generated material, carry sizable costs to the interests of end-users. First, paid services are likely to raise their service price to reflect the cost of the license they acquire from copyright owners. Such a price hike may place access-barriers and result in a suboptimal number of users.<sup>221</sup> Setting an entry point for users via secondary liability copyright liability is undesired for both users and copyright owners. For users, the centrality of digital services as platforms for social and cultural involvement renders exclusion from them severely harmful. For copyright owners, the further this exclusion goes, the more appealing and morally accepted alternative, illegal services appear.<sup>222</sup>

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<sup>218</sup> See 17 U.S.C. § 512(i) (2006) (noting that to be eligible for safe harbor protections, an entity must not interfere with "technical measures that are used by copyright owners to identify or protect copyrighted works").

<sup>219</sup> See, e.g., Electronic Frontier Foundation, *Fair Use Principles for User Generated Video Content*, <http://www EFF.org/issues/ip-and-free-speech/fair-use-principles-usergen> (last visited Sept. 1, 2010) (noting that many pieces of user generated content may fall under a category of fair use and that filtering mechanisms should take certain "precautions . . . to ensure that fair uses are not mistakenly caught in them").

<sup>220</sup> See Gibson, *supra* note 173, at 932 ("A licensing culture that results from risk aversion on the part of the licensee and invites strategic holdout on the part of the licensor is unlikely to promote overall social welfare . . .").

<sup>221</sup> Assaf Hamdani, *Gatekeeper Liability*, 77 S. CAL. L. REV. 53, 88 (2003).

<sup>222</sup> See *infra* Part III.B.



Furthermore, with regards to the second variant of the risk-minimizing path, commentators have already warned against the impediment of free speech and creativity under the limits of copyright law resulting from the censorship on speech that incorporates copyrighted works.<sup>223</sup> Expanding censorship beyond the defined limits of the law is not desired.<sup>224</sup> The more speech-enabler companies are motivated to censor excessively users' speech, the greater the harm to free speech becomes. Yet, the open-ended standard for secondary liability provides the very incentive for companies to do just that, even when censorship is not required by pure copyright law.

An additional, often overlooked implication of these transactions is their influence on the balance of power within copyright-based industries. Deals involving leading technology companies empower those who are parties to such deals (typically industry giants) over other industry players (usually indie labels, small, independent studios, and authors themselves).<sup>225</sup> By overemphasizing the interests of the already influential players, such deals reinforce the current power structure in copyright-based industries, often to the detriment of authors and other less fortunate groups.

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<sup>223</sup> See, e.g., Yochai Benkler, *Free as the Air to Common Use: First Amendment Constraints on Enclosure of the Public Domain*, 74 N.Y.U. L. REV. 354, 358 (1999) (warning that enclosure of the public domain would convert free speech into a negative liberty); Robert C. Denicola, *Copyright and Free Speech: Constitutional Limitations on the Protection of Expression*, 67 CAL. L. REV. 283, 285 (1979) (noting that even though direct censorship of free speech through copyright has ceased, there is still tension between the two); Melville B. Nimmer, *Does Copyright Abridge the First Amendment Guarantee of Free Speech and Press?*, 17 UCLA L. REV. 1180, 1181 (1970) (recognizing the paradox between the first amendment's prohibition of laws abridging free speech and the enactment of the Copyright Act that seems to do just that); see generally, Jack M. Balkin, *The Future of Free Expression in a Digital Age*, 36 PEPP. L. REV. 427 (predicting that free speech and innovation policy will meld together and eventually be viewed as part of a larger picture of knowledge and information policy).

<sup>224</sup> See *supra* note 227 for examples.

<sup>225</sup> See, e.g., Stone, *supra* note 198 and accompanying text. Understandably, stakeholders who have not been invited to the negotiation table, such as book-illustrators in the Google Books project are quite worried. See John Mark Ockerbloom, *The Google Books Settlement: A Symposium, and a Call for Library Action*, EVERYBODY'S LIBRARIES, Mar. 18, 2009, available at <http://everybodyslibraries.com/2009/03/18/the-google-books-settlement-a-symposium-and-a-call-for-library-action/>. Note, however, that the plaintiffs in the Google Books case argued for direct infringement, stemming from Google's copying of the books and not from secondary infringement. Class Action Complaint at 1, *Author's Guild v. Google, Inc.*, No. 05-CV-8136 (S.D.N.Y. Sept. 20, 2005).

The music industry provides a typical example of the detrimental nature of these transactions to artists. As is gradually becoming apparent, standard record contracts grant musicians extremely unfavorable conditions.<sup>226</sup> While internet technologies have been viewed as an “escape route” for musicians from these contracts and from relying on record labels, by opening up alternatives for distribution,<sup>227</sup> transactions between leading technologies and record labels spur musicians to stay under these detrimental contracts, thus reinforcing the traditional balance of power within the music industry against the artists themselves.

Perhaps unsurprisingly, the more expensive, restrictive, and displeasing that authorized services become, the more lucrative the option to engage in illegal services appears to users. As shown below, to the frustration of copyright owners, there is no shortage in such services. Therefore, paradoxically, the increasing grip of copyright owners on technology markets also becomes the driving force for the unauthorized markets that they attempt to stifle.

## *2. Legal Escapism and the Futility of Efforts to Reduce Digital Infringement*

As described above, the enhanced liability for secondary infringement, combined with considerable legal uncertainty, drove companies to avoid projects that involve unauthorized use of copyrighted material, even when, in pure legal terms, such avoidance is unnecessary. Other market players took the opposite route. Most

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<sup>226</sup> See Lital Helman, *When Your Recording Agency Turns into an Agency Problem: The True Nature of the Peer-to-Peer Debate*, 50 IDEA 49, 93–101 (discussing the nature of the standard framework of recording contracts).

<sup>227</sup> From a *New York Times* article that ran during the summer of 2000: “In the none-too-distant future, techno-visionaries declare, musicians will not need record labels[.] Instead, they will market and sell recordings directly to fans over the Internet. Even the labels that manage to hang on to their artists will find their sales eviscerated by piracy.” Alex Berenson & Matt Richtel, *Heartbreakers, Dream Makers: Despite Digital Upstarts, Big Labels Still Rule the Music Industry*, N.Y. TIMES, June 25, 2000, at B11, available at <http://www.nytimes.com/2000/06/25/business/heartbreakers-dream-makers-despite-digital-upstarts-big-labels-still-rule-music.html>. A well-known example of the fulfillment of the Internet expectations is Radiohead’s self-released “In Rainbows” album, which was made available for download on their website in 2007 under a “pay what you can” model. Posting of Ernesto to TorrentFreak, *RIAA ‘Protects’ Radiohead’s In Rainbows*, TORRENTFREAK (Aug. 1, 2010), <http://torrentfreak.com/riaa-protects-radioheads-in-rainbows-100801/>. Thus far, the album has sold more than each of their previous albums. *Id.*; see Memorandum from Mary Madden, Research Special, Pew Internet and Am. Life Project, and Lee Rainie, Pew Internet Project Dir., *Pew Internet and Am. Life Project, Music and Video Downloading Moves Beyond P2P 8–9* (Mar. 2005), available at <http://www.pewinternet.org/Reports/2005/Music-and-Video-Downloading.aspx> (pointing to other platforms utilized by users for online and offline copying).

dominantly, driven by the enormous demand in the market, file-sharing services continue their unauthorized activities while adopting sophisticated measures to avoid potential legal consequences. Although peer-to-peer file-sharing is emblematic of this trend, other services, such as file hosting, blogs, and Internet sites, pursue this path as well.<sup>228</sup>

If one's source of information is the annual reports of the International Federation of the Phonographic Industry (IFPI) or the RIAA, she may have the impression that the fight against peer-to-peer services may have actually borne fruit. Indeed, after the issuing of the *Grokster* decision, courts and copyright owners compelled various file-sharing services, including BearShare, eDonkey, and SoulSeek to meet the demands of copyright owners, to settle for high dollar amounts, and ultimately to cease their operations.<sup>229</sup> Building on that claimed success against peer-to-peer services, copyright owners pushed for the creation of "legit" (i.e., RIAA-MPAA-authorized)<sup>230</sup> file-sharing services based on a pay-per-download system instead of a free scheme. A number of services, including iMesh, BearShare, and—most remarkably—Napster, transformed into smaller-scale legit operations following secondary liability lawsuits.<sup>231</sup> Other networks, such as FurthurNet, proactively acquired copyright owners' authorization without first being sued.<sup>232</sup>

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<sup>228</sup> See Madden & Rainie, *supra* note 227 at 8–9 (noting that while surveys show the percentage of peer-to-peer users are decreasing, "17% cited other music or movie-related websites, such as on-line magazines, artist homepages[,] or review sites" as places they now turn to).

<sup>229</sup> See Dale Dietrich, *EDonkey Settles for \$30M and Shuts Down after Adverse Ruling*, iMEDIa LAW BLOG, Sept. 12, 2006, <http://daledietrich.com/imedia/edonkey-settles-for-30m-and-shuts-down-after-adverse-ruling/>.

<sup>230</sup> The MPAA is the Motion Pictures Association of America, the advocate of the American motion picture, home video, and television industries.

<sup>231</sup> See William E. Lee, *Cable Modem Service and the First Amendment: Adventures in a "Doctrinal Wasteland,"* 16 HARV. J.L. & TECH. 125, 131 (2002) (noting that Napster is "now a shadow of its former self following a suit enjoining Napster from downloading, uploading, transmitting, or distributing unlicensed copyrighted sound recordings"); Geoff Duncan, *iMesh's BearShare 6.0 Goes Legit*, DIGITAL TRENDS, Aug. 17, 2006, <http://www.digitaltrends.com/computing/imeshs-bearshare-60-goes-legit/> (describing BearShare's attempt to launch a lawful service); Niall McKay, *Peer-to-Peer Goes Legit*, WIRED, Nov. 3, 2005, <http://www.wired.com/entertainment/music/news/2005/11/69457> (describing how iMesh moved from illegal file-sharing to a lawful business).

<sup>232</sup> See, e.g., Furthur Network Features Page, <http://www.furthurnet.org/about/features.html> (last visited July 5, 2010) (noting that FurthurNet implements strict filtering protocols that limit distribu-

Indeed, at present, only two large unauthorized peer-to-peer services remain operating in the United States: LimeWire and BitTorrent. A recent court case has declared the former illegal.<sup>233</sup> As to the latter, copyright owners worldwide are fighting BitTorrent trackers<sup>234</sup> that are being used for infringement.<sup>235</sup> At first blush, it may appear that the open-ended secondary liability standard has achieved the desired effect of strengthening digital copyright enforcement.

A deeper examination reveals, however, a diametrically opposed reality. Apparently, though efforts to combat it have consistently continued, the file-sharing phenomenon has not only persisted but has significantly proliferated. Indisputably, the number of users in peer-to-peer networks steadily and substantially increased, concurrent with the expansion of the secondary liability rule.<sup>236</sup>

This is not to say that the nature of file-sharing has not been affected by the open-ended secondary liability rule. It has in fact, been tremendously affected. The impact, however, did not follow the path that copyright owners and lawmakers delineated for it. Instead of stifling the incentive for creation of file-sharing services, the law incentivized such service providers to transform in order to keep operating despite the enhanced liability. The transformation has taken two main forms: functionally, systems have incorporated liability-escaping features into the technology itself; structurally, much of the operation has shifted to small, short-lived com-

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tion to the recordings of musicians who permit it); *see also* Mark F. Schultz, *Fear and Norms and Rock & Roll: What Jambands Can Teach Us About Persuading People to Obey Copyright Law*, 21 BERKELEY TECH. L.J. 651, 681–82 (2006) (noting jambands' and their fans' various proactive efforts to voluntarily comply with intellectual property rules).

<sup>233</sup> Complaint for Federal Copyright Infringement, Common Law Copyright Infringement and Unfair Competition, *Arista Records LLC v. Lime Wire LLC*, 532 F. Supp. 2d 556 (S.D.N.Y. 2007) (No. 06-CV-5936), 2006 WL 2582075.

<sup>234</sup> A BitTorrent tracker is a server that assists in the communication between peers using the BitTorrent protocol.

<sup>235</sup> *See, e.g.*, Editorial, *The Pirate Bay Ruling*, L.A. TIMES, Apr. 18, 2009, <http://www.latimes.com/news/opinion/editorials/la-ed-pirate18-2009apr18,0,3705805.story> (describing a Swedish lawsuit against BitTorrent tracker The Pirate Bay).

<sup>236</sup> *See, e.g.*, William S. Coats & Melissa Keyes, *Recent Developments in Vicarious Liability and Copyright Licensing for Music*, 915 PLI/PAT 257, 266 (2007) (“Even in the wake of the Supreme Court’s decision in *MGM Studios, Inc. v. Grokster, Ltd.*, peer-to-peer file-sharing networks continue to proliferate and acquire users.”); Koleman Strumpf & Felix Oberholzer-Gee, *The Effect of File Sharing on Record Sales: An Empirical Analysis*, 115 J. POL. ECON. 1, 2 (2007) (noting a 50% increase in monthly number of files shared compared to two years earlier).

panies or to overseas locations, still enabling access to an increasing volume of users globally.<sup>237</sup>

Functionally, file-sharing services have developed various liability-escaping channels. Some networks, such as BitTorrent, have decentralized their operations, thus complicating detection of infringement.<sup>238</sup> Others, such as DirectConnect, WASTE, and AllPeers, have created closed, encrypted peer-to-peer circles for groups of friends.<sup>239</sup> Other means are employed by technologies such as MUTE and Freenet, which transfer content through a number of intermediate points in order to obfuscate its source and protect users' anonymity.<sup>240</sup> Peer-to-peer users can further use programs such as Tor,<sup>241</sup> which protect anonymity of online activity by obscuring IP addresses.<sup>242</sup> Paradoxically, these modifications only complicated copyright enforcement on both direct and indirect infringers, the facilitation of which constituted the justification for indirect liability in the first place.<sup>243</sup>

These functional evolutions do not come without costs. Services have been led by legal considerations to adopt inferior functions—a phenomenon termed by Niva Elkin-Koren as the “dialectic relation between liability rules and design.”<sup>244</sup> An example of this pattern is Napster's abandonment of its search mechanism

<sup>237</sup> RIAA v. Verizon Internet Servs., Inc., 351 F.3d 1229, 1231 (D.C. Cir. 2003) (“[M]illions of people in the United States and around the world continue to share digital .mp3 files of copyrighted recordings using P2P computer programs . . . .”); Bryan H. Choi, *The Grokster Dead-End*, 19 HARV. J.L. & TECH. 393, 410 (2006) (“[I]llegal file-sharing has . . . continued at ever-increasing rates . . . .”); Jonathan Zittrain, *A History of Online Gatekeeping*, 19 HARV. J.L. & TECH. 253, 286 (2006) (“[U]nauthorized file sharing continued unabated, and indeed grew . . . .”).

<sup>238</sup> For a discussion about the legal implications of BitTorrent, see Coats & Keyes, *supra* note 236.

<sup>239</sup> RIAA v. The People: Five Years Later, ELECTRONIC FRONTIER FOUNDATION, <http://www.eff.org/wp/riaa-v-people-years-later> (last visited Aug. 10, 2010) [hereinafter *EFF 2008 Report*].

<sup>240</sup> MUTE: Simple, Anonymous File Sharing, <http://mute-net.sourceforge.net/> (last visited July 12, 2010); The Freenet Project, <http://freenetproject.org/> (last visited July 12, 2010).

<sup>241</sup> Torproject, <http://www.torproject.org/> (last visited July 12, 2010).

<sup>242</sup> See Posting of Ernesto to TorrentFreak, *5 Ways To Download Torrents Anonymously*, TORRENTFREAK (Aug. 19, 2010), <http://torrentfreak.com/5-ways-to-download-torrents-anonymously-100819/> (discussing privacy services allowing users to hide their identities online).

<sup>243</sup> See discussion *infra* Part III.B.

<sup>244</sup> Elkin-Koren, *supra* note 146, at 59; see Tim Wu, *When Code Isn't Law*, 89 VA. L. REV. 679, 717 (2003) (“The technical study of P2P design shows that designing a P2P filesharing network to avoid copyright requires important deviations from the optimal design for speed, control, and usability.”).

based on indexing songs, in favor of passing a search request throughout the network in current services.<sup>245</sup> Despite being significantly more efficient in time and resources, Napster's mechanism had the service itself more involved in the process, and therefore more vulnerable to liability. Newer networks have abandoned this mechanism.

The second impact the law has had on the file-sharing market, as mentioned above, is structural. Here, the file-sharing market has undergone a process of relocation overseas<sup>246</sup> and is shifting to operating through small, thinly-resourced companies.<sup>247</sup> This shift should not come as a surprise. Developing unfiltered peer-to-peer software is well within the capabilities of small offshore companies, or even within the capabilities of individual hobbyist programmers. As noted in a report by the Electronic Frontier Foundation (EFF), "After all, a college student was able to create Napster in mere months, and BitTorrent was largely the handiwork of one unemployed software developer working in his spare time."<sup>248</sup> The open source code—basis of many of these services—renders it rather common to see a service shut down and a new-but-old one emerge soon thereafter.<sup>249</sup> Such moves place only minor barriers for users to access the services. They do, however, render any enforcement an unlikely dream.<sup>250</sup>

The reaction of the peer-to-peer community to the 2009 Swedish ruling against The Pirate Bay, the world's largest BitTorrent tracker at the time, reflects a prominent example of such a structural effect. The Swedish court held that The Pirate Bay was secondarily liable for the transfer of numerous copyrighted files be-

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<sup>245</sup> Elkin-Koren, *supra* note 146, at 20.

<sup>246</sup> The Swedish Pirate Bay is a good example. Editorial, *supra* note 235. Some countries may also further restrict the enforcement powers for copyright law. See, e.g., *Swiss Supreme Court Orders Company to Stop Snooping on Illegal File-Sharing Suspects*, CBONLINE, Sept. 8, 2010, [http://www.canadianbusiness.com/markets/market\\_news/article.jsp?content=D913Q6500](http://www.canadianbusiness.com/markets/market_news/article.jsp?content=D913Q6500).

<sup>247</sup> See, e.g., *EFF 2008 Report*, *supra* note 239 (describing "private P2P circles").

<sup>248</sup> *EFF 2008 Report*, *supra* note 239.

<sup>249</sup> Already at the end of the *Grokster* year, 2005, four of the five largest peer-to-peer communities (BitTorrent, eDoneky2000, Gnutella, and Ares Galaxy) were based upon open source code. Thomas Mennecke, *File-Sharing Winners and Losers of 2005*, SLYCK, Dec. 24, 2005, <http://www.slyck.com/news.php?story=1040>.

<sup>250</sup> See Todd Woody, *The Race to Kill Kazaa*, WIRED, Feb. 2003, <http://www.wired.com/wired/archive/11.02/kazaa.html> (illustrating sarcastically with regards to KaZaA, "[t]he servers are in Denmark. The software is in Estonia. The domain is registered Down Under, the corporation on a tiny island in the South Pacific. The users—60 million of them—are everywhere around the world. The next Napster? Think bigger. And pity the poor copyright cops trying to pull the plug").

tween its users.<sup>251</sup> Not only did The Pirate Bay itself refuse to cease its operation after the ruling,<sup>252</sup> but the ruling did not lead to any decrease in infringement industry-wide. Within the peer-to-peer community, the point of failure the lawsuit revealed was the centralized structure of the trackers' configuration, which led to excessive dependence on The Pirate Bay. From this point of view, the solution is to divide the task of free torrent traffic between a number of services already lining up to share The Pirate Bay's mission.<sup>253</sup> Moreover, BitTorrent methods that do not rely on trackers, such as DHT, PEX, and Magnet Links, are rampant and may prove to be the future.<sup>254</sup> Users can—and do—continue their actions nearly undisturbed. Law enforcement measures, on the other hand, are desperately disturbed by the further decentralization of the market, which renders enforcement extremely unlikely.

Even the “success stories” of copyright litigation and settlements have a different narrative within the peer-to-peer community. Although copyright owners view the formation of legit peer-to-peer services as a strategic success, web traffic analyzers indicate that the volume of activity is exceptionally low.<sup>255</sup> Likewise, it has been suggested that the eDonkey service was already dying when the RIAA “killed” it; and eMule and its variants began supplementing eDonkey by the time

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<sup>251</sup> Editorial, *The Pirate Bay Ruling*, L.A. TIMES, Apr. 18, 2009, available at <http://www.latimes.com/news/opinion/editorials/la-ed-pirate18-2009apr18,0,3705805.story>.

<sup>252</sup> Beverley Head, *IiNet Claims it Can't Block Pirate Bay*, ITWIRE, Nov. 5, 2009, <http://www.itwire.com/content/view/29097/53/>.

<sup>253</sup> See Rasmus Fleischer, Address at the Ars Electronica in Linz (Sept. 7, 2009) (transcript available at <http://copyriot.se/2009/09/08/ars-electronica-x-thank-you-for-the-5000-euro-we-will-have-to-waste-them-fast-piratbyrans-talk-in-linz/>) (“What will come after The Pirate Bay will not be one big ship, but something less centralized, harder to pin down by any legal system.”); see also Posting of Ernesto to TorrentFreak, *It's Time to Sink The Pirate Bay, and Replace It*, TORRENTFREAK (Sept. 13, 2009), <http://torrentfreak.com/its-time-to-sink-the-pirate-bay-and-replace-it-090913/> (reporting that The Pirate Bay will dissolve, but at least two new services have already emerged).

<sup>254</sup> Posting of Ernesto to TorrentFreak, *BitTorrents Future? DHT, PEX and Magnet Links Explained*, TORRENTFREAK (Nov. 20, 2009), <http://torrentfreak.com/bittorrents-future-dht-pex-and-magnet-links-explained-091120/>.

<sup>255</sup> E.g., Alexa The Web Information Company, *shareza.com*, <http://www.alexa.com/siteinfo/shareza.com> (last visited July 12, 2010) (showing a ranking of 464,839 based on web traffic); *Compete*, *bearshare.com* <http://siteanalytics.compete.com/bearshare.com/> (last visited July 12, 2010) (showing a compete ranking of 721); see also Posting of Ernesto to TorrentFreak, *Mininova Traffic Plummets After Going 'Legal'*, TORRENTFREAK (Dec. 5, 2009), <http://torrentfreak.com/mininova-traffic-plummets-after-going-legal-091205/> (noting that after Mininova removed over one million torrent files following a lawsuit, its traffic fell 66% in a matter of days).

the agreement with the RIAA was reached.<sup>256</sup> Thus the agreement had little, if any, practical effect. Moreover, various Internet sites still host free versions of BearShare and KaZaA, and though not actively maintained, their software is used to pirate music—perhaps at this very moment. Even Grokster, despite the legal commotion it created, was not perceived as a substantial loss to the peer-to-peer society.<sup>257</sup> Throughout its years of operation, Grokster was regarded as a second-rate service due to its extensive use of spyware and adware and it attracted fewer users than competing services. One commentator described the *Grokster* decision as finally taking “[t]his menace . . . out of its misery.”<sup>258</sup>

The development of file-sharing into a “shadow industry” does not benefit society. It drives good minds to the unproductive course of liability escapism, leads to an absence of responsible players from the field, and criminalizes otherwise law-abiding citizens,<sup>259</sup> all without any sign of improvement in coping with the enforcement crisis of digital infringement.<sup>260</sup>

The open-ended secondary liability standard discourages responsible and law-abiding players from autonomously creating technologies that may involve copyrighted content, while leaving the wrongdoers intact. In fact, this liability standard and the risk-minimizing front it created indirectly strengthened enforcement chal-

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<sup>256</sup> See e.g., Jordan Running, *Edonkey Shuts Down, Kills Installed Clients*, DOWNLOADSQUAD, Sept. 12, 2006, <http://www.downloadsquad.com/2006/09/12/edonkey-shuts-down-kills-installed-clients/> (“The eDonkey network itself, of course, is decentralized and will live on as long as people keep using it, and given the popularity of eMule and other alternative clients, its vitality does not seem in jeopardy.”); Alexandru Macovschi, *EDonkey Shuts Down*, Sept. 29, 2005, <http://news.softpedia.com/news/eDonkey-Shuts-Down-9528.shtml> (stating that MetaMachine’s management, influenced by *Grokster* and the warning received from the RIAA began closing down).

<sup>257</sup> Mennecke, *supra* note 249.

<sup>258</sup> *Id.*

<sup>259</sup> For the increasingly criminal nature of copyright law, see Geraldine Scott Moohr, *Defining Overcriminalization Through Cost-Benefit Analysis: The Example of Criminal Copyright Laws*, 54 AM. U. L. REV. 783, 787–805 (2005) (“[T]he possibility that costs of criminalizing personal-use infringement may outweigh its benefits serves as a signal to lawmakers that treating infringement as a crime may not be an effective way to protect the long-term interests of copyright holders or the public.”); Lanier Saperstein, Comment, *Copyrights, Criminal Sanctions and Economic Rents: Applying the Rent Seeking Model to the Criminal Law Formulation Process*, 87 J. CRIM. L. & CRIMINOLOGY 1470, 1471 (1997) (“Copyright law is making increased use of criminal sanctions to punish transgression.”).

<sup>260</sup> Clearly, a certain degree of enforcement hardships is inherent in the copyright regime due to the non-rivalrous nature of expressive content. Abraham Bell & Gideon Parchomovsky, *The Evolution of Private and Open Access Property*, 10 THEORETICAL INQUIRIES L. 77, 92–93 (2009). Moreover, technological developments have also adversely impacted copyright enforceability. *Id.*



lenges by driving technologies and users that resist over-compliance to hunt for alternatives, which they found in the legal escapism path. On the whole, this polarized market reaction is an anomaly that proves the law has failed in its main role: to adequately direct the conduct in the market.

### B. The Ineffectiveness of the Open-Ended Secondary Liability Standard

All told, the open-ended standard for secondary copyright liability has created a distorted online market for copyrighted works with costs reflected in the suboptimal level of enforcement on the one hand, and in the yielding of individuals' rights and other societal interests on the other. To complete the analysis from a normative standpoint, this Part examines the effects of the secondary liability standard on the realization of the goal of secondary liability—namely, to promote the effective and efficient enforcement of copyright law.

Secondary liability is perceived to be an effective enforcement vehicle for three main reasons. First, it can provide a more cost-effective mechanism for litigation in place of suing countless unknown direct infringers. Second, it can provide an effective compensation system for defendants through the deep pockets of secondary infringers. Third, it can utilize potential secondary infringers as gatekeepers against infringement by direct users. Gatekeepers can either modify their technology to impede infringement (e.g., by filtering out copyrighted content), or utilize the fee charged to users as a means to both compensate copyright owners and perhaps to deter infringement. In reality, however, the market reaction to the open-ended secondary liability standard doomed these objectives and the main goal of effective enforcement to failure.

#### 1. Cost Effectiveness

Probably the most straightforward advantage of a secondary liability rule is that a case against one secondary infringer is simply more cost-effective than a large number of cases against direct infringers.<sup>261</sup> Theoretically, one successful indirect suit renders suing numerous unidentified users unnecessary and kills an infi-

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<sup>261</sup> Richard J. Gilbert & Michael L. Katz, *When Good Value Chains Go Bad: The Economics of Indirect Liability for Copyright Infringement*, 52 HASTINGS L.J. 961, 962 (2001) (“[T]he social choice is between identifying direct infringers at large costs and taking actions against activities at other stages in the value chain at potentially smaller costs.”); Lemley & Reese, *supra* note 39, at 1349 (“The high volume of illegal uses, and the low return to suing any one individual, make it more cost-effective to aim litigation at targets as far up the chain as possible.”).

nite number of infringing birds with one stone.<sup>262</sup> To complete this argument, as analyzed below, the return on a secondary liability ruling assumedly exceeds the return on direct liability lawsuits, as secondary infringers often generate income from the infringement and are further believed to have deep pockets.

On the surface, this cost-effectiveness rationale appears applicable, perhaps even intensified, in the context of digital copyright infringement.<sup>263</sup> Identifying and prosecuting the large and increasing population of individual infringers may well appear cost-prohibitive.<sup>264</sup> Each of these lawsuits comprises two phases: the “John Doe,” or ex parte discovery phase intended to reveal the user’s identity; and the “named defendant” phase, where the actual suit commences against the individual whose identity was previously revealed.<sup>265</sup> Shifting to secondary infringement liability would simplify the process and render redundant this onerous two-phased litigation process.<sup>266</sup>

In fact, secondary liability litigation is likely to be more costly and time consuming than litigation against individuals, as the suit is more complex and the defendants are more likely to defend themselves in court.<sup>267</sup> While most cases against individuals settle before reaching a trial on the merits,<sup>268</sup> suits against technology

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<sup>262</sup> Randal C. Picker, *Copyright as Entry Policy: The Case of Digital Distribution*, 47 ANTITRUST BULL. 423, 442 (2002) (“Chasing individual consumers is time consuming and is a teaspoon solution to an ocean problem . . .”).

<sup>263</sup> See, e.g., *Metro-Goldwyn-Mayer Studios, Inc. v. Grokster, Ltd.*, 545 U.S. 913, 929–30 (2005) (“When a widely shared service or product is used to commit infringement, it may be *impossible* to enforce rights in the protected work effectively against all direct infringers, the *only* practical alternative being to go against the distributor of the copying device for secondary liability . . .” (emphasis added)).

<sup>264</sup> Lichtman & Landes, *supra* note 27, at 397 (“[T]he costs of tracking down that many [direct infringers], gathering evidence as to the specific activities of each, and then litigating that many separate lawsuits would likely make it uneconomical for [the copyright holder] to enforce its copyright.”).

<sup>265</sup> Ray Beckerman, *Large Recording Companies v. the Defenseless: Some Common Sense Solutions to the Challenges of the RIAA Litigations*, 47 JUDGES’ J. 20, 22 (2008).

<sup>266</sup> See Lemley & Reese, *supra* note 39, at 1376–77 (noting that “suing even a fraction of the end users could bankrupt the content industries”).

<sup>267</sup> Anthony Ciolli, *Lowering the Stakes: Toward a Model of Effective Copyright Dispute Resolution*, 110 W. VA. L. REV. 999, 1002 (2008).

<sup>268</sup> See Ray Beckerman, *How the RIAA Litigation Process Works*, RAY BECKERMAN PC, Apr. 9, 2008, <http://beckermanlegal.com/howriaa.htm>.

providers rarely settle early.<sup>269</sup> Moreover, as a result of the dynamics of the peer-to-peer market,<sup>270</sup> locating secondary infringers and litigating with them has become—as in the case of direct infringers—even more complicated and expensive. Such services, if at all registered in the United States, are innumerable, intentionally feeble and short-lived. These characteristics diminished the gap between the cost-effectiveness of direct and secondary liability litigation.

That said, the problem with applying the cost effectiveness argument to the online infringement context is not merely the doubtful cost-effectiveness of secondary liability lawsuits; rather, it is more fundamental. The validity of the cost-effectiveness argument depends on the assumption that a successful suit against a secondary infringer actually eliminates or at least substantially reduces the scope of direct infringements, and consequently, the need to pursue direct infringement suits against end-users. This rationale stands only if the framework of online infringement allowed, at least partially, for *substitution* of direct infringement litigation with secondary infringement litigation. In reality, secondary liability is not an alternative, but rather an additional procedure, and as noted above, a particularly complicated one. If that is the case, the cost-effectiveness of secondary liability of technology providers is practically undercut.

In fact, as shown above, such a substitution effect is blatantly absent in the context of digital infringement. The enhanced, open-ended secondary liability standard has not reduced the need to litigate direct infringement. Instead, the opposite has occurred. Despite the heavy hand on secondary infringers, the dimensions of digital infringement have grown exponentially since 2001, when copyright owners began litigating against providers of digital technologies.<sup>271</sup> This reality brought

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<sup>269</sup> See, e.g., Gary Gentile, *Details of Grokster Settlement Emerge*, LAW.COM, Nov. 9, 2005, <http://www.law.com/jsp/article.jsp?id=900005440761> (stating that *Grokster* settled only after the Supreme Court decision).

<sup>270</sup> See *supra* Part III.A.2.

<sup>271</sup> Although there is no consistency as to the rates of file-sharing or the ways in which to measure the rate of file-sharing, the consensus is that the number of file-sharers is ever-growing. See Stan J. Liebowitz, *File Sharing: Creative Destruction or Just Plain Destruction?*, 49 J. LAW & ECON. 1, 5 (2006) (“[T]he number of file sharers continued its upward trend within months of Napster’s shutdown.”); see also *id.* at 7–13 (summarizing data regarding rates of file-sharing). The *Grokster* year (2005) opened with 8.4 million calculable U.S. peer-to-peer users. By June of 2005, this number had grown to 8.9 million, and by the end of 2005 it reached 9.4 million, excluding BitTorrent users. Mennecke, *supra* note 249; see also Sudip Bhattacharjee et al., *Impact of Legal Threats on Online Music Sharing Activity: An Analysis of Music Industry Legal Actions*, 49 J. LAW & ECON. 91, 92–93 (2006) (noting the potential growth in file-sharing activity).

about the need to escalate not only the litigation campaign against secondary infringers but also the campaign against direct infringers themselves.<sup>272</sup> Secondary liability litigation therefore complements, and does not supersede, direct liability litigation.

Moreover, the number of secondary infringers has also increased over this period, and the services developed characteristics similar to those that made direct infringers unpalatable targets for litigation. Thus, as described above, the structural changes in the peer-to-peer industry led to the construction of scores of file-sharing services as a reaction to the destruction of fewer predecessors.<sup>273</sup> Today, these services are almost as numerous, evasive, and feeble as direct infringers, further undermining the case of cost-effectiveness in attaching open-ended secondary liability to technologies that are used for infringement.

The fact that infringement became more difficult via risk-minimizing might drive users to find alternative services in their pursuit of copyrighted works. This ironically strengthens the legal escapism route that the law seeks to defy. Thus, not only has the risk-minimizing route not enhanced the cost-effectiveness, it has also indirectly harmed it.

In sum, beyond the uncertainty of the relative efficiency of secondary liability litigation (in terms of actual litigation costs), the goal of cost-effectiveness appears demonstrably unfulfilled in the context of digital infringement. In fact, the growing number of direct infringers functions as a double-edged sword in the framework of this argument. Theoretically, the high—and growing—number of direct infringers provides a justification for viewing secondary liability as the cost-effective choice for litigation.<sup>274</sup> In reality, however, the fact that this number continues to grow—secondary liability litigation notwithstanding—is compelling evidence that the secondary liability standard has not promoted cost-effectiveness as a tangible outcome.

## 2. *Deep Pocket Defendants*

An additional, closely related objective to secondary liability is to place the burden of damages on defendants who are likely to have the ability to pay for

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<sup>272</sup> The music industry, which was the first to be threatened by file-sharing and thus led the fight against it, has filed more than thirty thousand lawsuits against file-sharers to date. *EFF 2008 Report*, *supra* note 239.

<sup>273</sup> See discussion *supra* Part III.A.2.

<sup>274</sup> See *supra* note 264 and accompanying text.

them.<sup>275</sup> If secondary infringers earn money from their activity, it seems fair to follow the monies that were received for their activity. Moreover, direct infringers are often judgment-proof—namely, they lack the resources to pay the damages for their own misconduct.<sup>276</sup> Therefore, going after direct infringers exclusively is likely to fail to compensate plaintiffs and to provide sufficient incentives for users to refrain from committing such misconduct.<sup>277</sup> To a large extent, this argument complements the rationale of cost-effectiveness: beside the high volume of direct infringement, it is the low return on direct infringement litigation that renders it more cost-effective to aim litigation at secondary infringers.<sup>278</sup>

This rationale assumes that secondary infringers have more resources than individual infringers, and therefore is only partially applicable to the framework of online infringement. The supra-compensatory nature of copyright remedies reduces the likelihood that individual defendants will be able to afford the full damages that plaintiffs are entitled to by law.<sup>279</sup> Indeed, although copyright law entitled copyright owners to statutory damages of up to \$150,000 per work infringed,<sup>280</sup> in reality, the majority of the direct infringement cases in the music industry settle for

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<sup>275</sup> See Lichtman & Landes, *supra* note 27, at 398–99 (noting the deep pockets rationale as a reason for vicarious liability).

<sup>276</sup> See Hamdani, *supra* note 221, at 65 (noting the theoretical importance of assuming that direct infringers are judgment-proof); see also Alfred C. Yen, *A Preliminary Economic Analysis of Napster: Internet Technology, Copyright Liability, and the Possibility Of Coasean Bargaining*, 26 DAYTON L. REV. 247, 252 (2001) (“Internet users may be difficult to identify or find, and their pocketbooks often are not deep enough to pay for monetary judgments.”).

<sup>277</sup> See Hamdani, *supra* note 221, at 65 (“Under this assumption, primary liability . . . would fail to prevent wrongdoers from committing misconduct.”); but see Matthew Sag, *Piracy: Twelve Year-Olds, Grandmothers, and Other Good Targets for the Recording Industry’s File Sharing Litigation*, 4 NW. J. TECH. & INTELL. PROP. 133, 134 (2006) (arguing that suing end users makes sense in a rational choice model).

<sup>278</sup> See Lemley & Reese, *supra* note 39, at 1349 (“The high volume of illegal uses, and the low return to suing any one individual, make it more cost-effective to aim litigation at targets as far as up the chain as possible.”).

<sup>279</sup> Cf. Hamdani, *supra* note 221, at 65 (asserting that the “wrongdoers are judgment proof . . . they will have no assets to pay the penalty or the damages for misconduct” and thus, in such situations, “primary liability . . . would fail to prevent wrongdoers from committing misconduct”).

<sup>280</sup> 17 U.S.C. § 504(c)(2) (2006).

amounts ranging from \$2,000 to \$5,000.<sup>281</sup> Larger verdicts may be impossible to collect.<sup>282</sup> In comparison, because copyright owners are not required to prove actual damages in order to recover money,<sup>283</sup> secondary infringement lawsuits and settlements have resulted in large amounts of compensation.<sup>284</sup>

The polarized market reaction that resulted from the open-ended secondary liability rule has had an adverse effect on the chances of extracting money from secondary infringers as well. In general, potential defendants who have deep pockets usually turn to a risk-minimizing track, leaving the litigation platform almost exclusively to small and financially limited entities.<sup>285</sup> However, the current structure of the peer-to-peer market creates a strong incentive for services to become even smaller and more financially incapable. The more the operation shifted to numerous small companies instead of a limited number of responsible, well-financed companies, the more implausible achieving adequate compensation through secondary liability litigation became. Yet, the law has incentivized services to pursue this path. This process renders the rationale of deep pockets increasingly less applicable to the digital infringement context.

Occasionally, the deep pocket rationale can be a valid ground for litigation and can support instigation of lawsuits such as *Viacom v. YouTube*,<sup>286</sup> as well as ter-

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<sup>281</sup> J. Cam Barker, Note, *Grossly Excessive Penalties in the Battle Against Illegal File-Sharing: The Troubling Effects of Aggregating Minimum Statutory Damages for Copyright Infringement*, 83 TEX. L. REV. 525, 528 n.19 (2004).

<sup>282</sup> See, e.g., Nate Anderson, *Thomas Verdict: Willful Infringement, \$1.92 Million Penalty*, ARSTECHNICA, June 18, 2009, <http://arstechnica.com/tech-policy/news/2009/06/jammie-thomas-retrial-verdict.ars> (noting the response of Jammie Thomas “that the recording industry would never collect [and stating,] ‘Good luck trying to get it from me. . . it’s like squeezing blood from a turnip,’” after her loss in the infamous copyright lawsuit over downloaded music, *Capitol Records Inc. v. Thomas*, 579 F. Supp. 2d 1210, 1228 (D. Minn. 2008)).

<sup>283</sup> 17 U.S.C. § 504(c)(1) (2006).

<sup>284</sup> The settlements with BearShare, Grokster, and similar services were estimated to be in the millions. How close these figures are to the actual sums received by copyright owners is unclear. On paper, judgments against individuals granted the plaintiffs high amounts as well, yet they could not be enforced. See, e.g., Mike Harvey, *Single-Mother Digital Pirate Jammie Thomas-Rasset Must Pay \$80,000 Per Song*, TIMES (London), June 19, 2009, [http://technology.timesonline.co.uk/tol/news/tech\\_and\\_web/article6534542.ece](http://technology.timesonline.co.uk/tol/news/tech_and_web/article6534542.ece) (describing a jury verdict awarding record companies \$1.92 million).

<sup>285</sup> See discussion *supra* Part III.A.

<sup>286</sup> See Complaint for Declaratory and Injunctive Relief and Damages at 1–2, *Viacom Int’l Inc. v. YouTube, Inc.*, No. 1:07-CV-2103 (S.D.N.Y. Mar. 13, 2007), 2007 WL 775611 (stating that “[e]ntrepreneurs have made fortunes providing the networks . . . YouTube is one such entity”). However, it should be noted that the court granted summary judgment for YouTube holding that it

tiary infringement litigation, such as suits against investors and credit card companies of secondary infringers, which indeed have deep pockets.<sup>287</sup> However, even in those cases, it is important to bear in mind the open-ended liability brought upon by the legal escapism dynamic in the peer-to-peer market, invalidating this rationale in that context. As the price of hardware and storage devices steadily declines, this scenario is not unimaginable in equivalent markets. For example, although Google, YouTube's parent company, is a deep pocket, and so the *Viacom v. YouTube* case makes sense in terms of this rationale, YouTube is not the only game in town. Yahoo! Video,<sup>288</sup> Revver,<sup>289</sup> and VMIX,<sup>290</sup> to name a few, allow users to upload, store, and distribute videos and embed them in other Web sites. The stricter the copyright policy Google adopts, the stronger the appeal of alternative video sites for users becomes. If over-litigation causes users and services to switch to litigation-safe channels to evade the law, copyright owners may find themselves once again facing a decentralized shadow market with no light of enforcement at the end of the tunnel.

### 3. Secondary Infringers as Gatekeepers

Perhaps the main appeal for technology providers' liability stems from the perceived function of technology providers as gatekeepers—controllers of passageways that are essential to engaging in infringement.<sup>291</sup> Imposing liability on technology providers for their users' infringement supposedly aligns their interests

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complies with DMCA notice and take down requirements. *Viacom Int'l Inc. v. YouTube, Inc.*, Nos. 07 Civ. 2103(LLS), 07 Civ. 3582(LLS), 2010 WL 2532404, at \*14 (S.D.N.Y. June 23, 2010).

<sup>287</sup> See, e.g., *In re Napster, Inc. Copyright Litig.*, 479 F.3d 1078, 1083 (9th Cir. 2007) (discussing suit filed against investors); *Perfect 10 v. Visa Int'l Serv. Ass'n*, No. C04-0371JW, 2004 WL 1773349, at \*1 (N.D. Cal. 2004) (noting the suit was filed against both Visa and Mastercard); see generally William S. Coats, Mark Weinstein & Eric R. Zimmerman, *Pre- and Post-Grokster Copyright Infringement Liability for Secondary and Tertiary Parties*, 877 PRACTICING L. INST. 323 (2006).

<sup>288</sup> Yahoo! Video Blog, About Yahoo! Video, <http://www.yvideoblog.com/blog/about/> (last visited Aug. 29, 2010).

<sup>289</sup> Revver, About Revver, <http://revver.com/about/> (last visited Aug. 29, 2010).

<sup>290</sup> VMIX, Video Sharing, Distribution and Syndication Software, <http://www.vmix.com/video-sharing.php> (last visited Aug. 29, 2010).

<sup>291</sup> See Reinier Kraakman, *Gatekeepers: The Anatomy of a Third-Party Enforcement Strategy*, 2 J.L. ECON. & ORG. 53, 54 (1986) (noting that the passageways are "usually a specialized good, service, or form of certification that is essential for [a] wrongdoing to succeed").

with those of copyright owners and encourages them to police their users' conduct.<sup>292</sup>

The first assumption within this framework is that providers can design their technologies to be more copyright-friendly. They can, for example, focus on technologies that do not potentially interfere with copyright. Alternatively, they can design the technologies in a manner that will allow tracking of users' conduct ex post (during or after use) or, even better, that will impede infringement ex ante, such as through filtering out copyrighted materials.<sup>293</sup>

The second assumption suggests that technology providers can serve as cost-spreading mechanisms as well as infringement barriers by raising their service fees to reflect the shifting of the risk of liability from users to the technology providers. Secondary liability would then be equivalent to imposing a tax on the use of the technology, which would redistribute income to copyright-owners.<sup>294</sup> Technology providers can further create a differential fee for users who are assumed to be prone to infringement (perhaps users who have infringed copyrights in the past), thus achieving both a just distribution of the "tax" and deterrence from misuse of the technology. Obviously, tailoring fees to each user's likelihood of infringement presents prospective costs,<sup>295</sup> and it is unclear what level of proof should be required to identify users as "risky." Some variables, such as age, may appear discriminatory, while deducing risk levels from take-down notices copyright owners

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<sup>292</sup> See Hamdani, *supra* note 2211, at 63–82 ("Gatekeepers can often take a variety of steps to prevent their clients from acting unlawfully."); Wu, *supra* note 40, at 247–48 (discussing the possibility of technologies to filter out infringing content); see also Lichtman & Landes, *supra* note 27, at 409 ("[T]hese parties . . . are typically in a good position to either prevent copyright infringement or pay for the harm it causes.").

<sup>293</sup> See Lichtman & Landes, *supra* note 27, at 398 ("In some cases it may be possible for the equipment maker . . . to redesign its product in a way that would eliminate or greatly reduce the level of infringement.").

<sup>294</sup> *Id.* at 405; see Louis Kaplow & Steven Shavell, *Why the Legal System is Less Efficient than the Income Tax in Redistributing Income*, 23 J. LEGAL STUD. 667, 667 (1994) (analyzing the proper role of distributional goals in designing liability regimes).

<sup>295</sup> In particular, there is an asymmetric benefit for users and services in using and providing digital services. With the exception of services that depend on infringement, risky users generate little utility for services and represent high costs. Therefore, services may be inclined to excessively purge risky users from their system, causing more costs than benefits. *Cf.*, *Criminal Law in Cyberspace*, 149 U. PA. L. REV. 1003, 1007–08 (2001) (raising a similar argument regarding ISP liability for cybercrime).



send may be too excessive to serve as a clear indication, given copyright owners' vested interests.<sup>296</sup>

As convincing as they may appear in theory, when these theoretical assumptions are tested in reality, the idyll collapses. Although risk-minimizing players are partially fulfilling gatekeeping functions—policing infringement and distributing wealth to copyright owners—the availability of the parallel legal escapism path renders all these efforts fruitless in the big picture. The main Achilles heel of the gatekeeping aspiration is the existence of alternative, “keeperless” gates for widespread infringement. The more decentralized the digital market is, the wider the breach in the dam becomes. Since lawmakers have generally applied an “ostrich policy” to the nature of the online market, they have failed to notice that instead of effective enforcement, the open-ended liability standard has generated, on the whole, an effect of market substitution.

The expectation that liability would affect the design of technologies has partially been fulfilled among risk-minimizing market players, but it gives an interesting twist on the legal escapism path. As demonstrated by the foregoing discussion, risk-minimizing players implemented copyright-friendly features in their businesses beyond the requirements of the law, such as filtering mechanisms.<sup>297</sup> In at least two cases, liability pushed providers to fully shun projects that affect copyright owners' interests.<sup>298</sup>

Conversely, in the legal escapism realm, efforts were directed toward creating mechanisms to avoid the law rather than to better comply with it. Thus, some entities have implemented migration, encryption, decentralization, and various other mechanisms to protect users' anonymity and to evade the law.<sup>299</sup> Thus, although liability has influenced the design and function of technologies throughout the market, and perhaps has set market-entry points for innovation, this influence took different forms between the two types of affected market players, leading not to the disappearance of infringement, but rather, to a shift of platforms for its execution.

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<sup>296</sup> See *supra* Part II.

<sup>297</sup> See *supra* Part III.A.

<sup>298</sup> See sources cited *supra* notes 39, 206 and accompanying text.

<sup>299</sup> See *supra* Part III.A.2.

The second gatekeeping function is only partially applicable, even to the risk-minimizing framework. No service I know of scrutinizes prospective clients to determine their 'risk-level' as to copyright compliance, or utilizes its service-fee to regulate users' compliance with copyright law. It is also difficult to observe an increase in overall fees in the absence of data regarding what the prices would have been were it not for liability. In this regard, many services have remained free. As a clear effect, however, services, ranging from social networks to hardware manufacturers to YouTube, have entered deals that redistribute wealth to copyright owners,<sup>300</sup> pointing to the applicability, though confined, of the distributive part of this rationale in the risk-minimizing framework.

In the legal escapism realm, neither function has been assumed. Consider the reaction of the peer-to-peer market to the attempt to apply at least the distributive element of this rationale to the file-sharing market. As discussed above,<sup>301</sup> in a number of out-of-court settlements, copyright owners have converted free file-sharing services to gatekeepers. These services, including iMesh, BearShare, and eDonkey, began to require registration, add content filtering mechanisms, and charge for sharing. Users, for the most part, have simply substituted the modified services for other ones, usually further decentralized services that offer identity-protection. Overall, the peer-to-peer market has not begun to play by the new rules. Infringement never ceased because services have neither allowed the tracking of users nor have they made them pay for file-sharing, as the technologies-as-gatekeepers theory suggests they should. Rather, they have transformed themselves and decentralized to allow the free model to continue undisturbed as much as possible.

This should not come as a surprise. The effectiveness of a gatekeeping policy depends on the gatekeeper's services being necessary for entering the market.<sup>302</sup> At the very least, the cost of entering the market without the gatekeeper's services must be high enough to keep users under the gatekeeper's control despite the costs staying under the gatekeeper entails. This is not the reality in the online infringement context. From a user's perspective, the cost of shifting from a gatekeeper-controlled platform to an alternative one is virtually zero. Alternative services are easy to locate and use, and users incur no considerable shifting costs in the process.

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<sup>300</sup> See *supra* Part III.A.1.

<sup>301</sup> See *supra* Part III.B.

<sup>302</sup> See Kraakman, *supra* note 292, at 77 (discussing the creation of gatekeepers in various markets)..

Overall, instead of effective enforcement, the secondary liability regime has led to market substitution as infringement shifted from risk-minimizing services to services of the legal escapism dominion. The more copyright-aware gatekeepers have become, the more appealing their alternatives appear to users. Today, if a movie is unobtainable on YouTube, it is likely available on eMule. If iTunes' price-scale or inventory is unsatisfactory, BitTorrent and various other platforms offer the full version of virtually every musical piece for free. If an e-book on Amazon comes protected by burdensome DRM, it is often available free of charge and free of DRM on RapidShare, a German file-hosting company based in Switzerland.<sup>303</sup> While unauthorized use of copyrighted materials has become difficult or risky through established companies, alternative routes still provide an easy, accessible, and morally accepted<sup>304</sup> haven for infringement. This market substitution explains the escalation of the infringement scale despite copyright owners' efforts to put gatekeepers in place.

This is not to say that, in principle, a secondary liability regime is harmful or unfeasible in the context of digital technologies. The dual path market behavior is not predestined and could have been avoided had the law provided a reasonably predictable standard, as *Sony* intended to establish. In order to encourage users to obtain services from controllable gatekeepers and discourage the creation of businesses built on the legal escapism model, a more predictable and less complex standard is crucial.<sup>305</sup> Had the law provided a clear standard, established companies would not have been spurred to over-comply at the expense of users' interests; services that almost categorically operate outside of the limits of the law could have found room within the limits of the law. Such a shift would have discouraged users from fleeing to paths that ultimately disregard the law and could have prevented the snowball of decentralization in the peer-to-peer industry. There is a crucial need for lawmakers to restore certainty and predictability in this realm and to provide clear guidelines to the innovators of today and to those of tomorrow.

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<sup>303</sup> RapidShare, <http://rapidshare.com/> (last visited July 12, 2010).

<sup>304</sup> See, e.g., Online Survey by Angus Reid Strategies, *File Sharing Has Become the "New Normal" for Most Online Canadians*, VISION CRITICAL, Mar. 13, 2009, <http://www.visioncritical.com/2009/03/file-sharing-has-become-the-new-normal-for-most-online-canadians> (finding that 45% of participants agreed "file sharers who download music and movies are regular Internet users doing what people should be able to do on the Internet," and only 3% agreed that "file-sharers are criminals who should be punished by law").

<sup>305</sup> See Kraakman, *supra* note 292, at 77 (noting the risk that gatekeeper liability will lead clients to waive the use of gatekeeper services).

#### **IV. Conclusion**

Much electronic ink has been spilled over portraying, mourning, or attempting to solve the crisis of copyright enforcement in the digital age. However, the attempt to strengthen enforcement by employing an open-ended standard on the secondary liability of technology providers has been a futile measure, which has resulted in a distorted market for copyright-affected technologies, a surrendering of individual rights, and has showed no sign of coping with the increasing rates of digital copyright infringement.

In reality, instead of enhanced enforcement, applying an open-ended standard for secondary liability of technology providers results in market substitution in which infringement only shifts from one platform to another.

An open-ended standard for third party liability may perhaps be effective in areas that comprise a confined group of players that are defined by territorial boundaries and few alternatives to effective gatekeepers. Technology in a globalized world does not have such characteristics. Therefore, there is a pressing need to re-think the standard for technologies in the secondary liability context and to restore a clear, predictable standard in order for the law to remain viable in an era of rapid technological changes.

# State Bar Section News



## Letter from the Chair

By Shannon W. Bates

The 2010-2011 activities are underway for the Intellectual Property Law Section of the State Bar of Texas, and we are excited about another great year. We have a strong Section with a wide variety of committees and dedicated volunteers, and I look forward to working with all of you to make it even better. Some of our goals for this year are to build and strengthen our committees, increase the level of participation by our 2000+ Section members, continue offering high quality CLE programs, enhance our Section website, and regularly publish helpful and informative newsletters.

One of the Section's core relationships is with the University of Texas School of Law and the *Texas Intellectual Property Law Journal*. The *Journal* is published three times each year and is one of the premier IP journals in the nation. We appreciate the hard work of the staff and students that put together this superb publication. Special thanks to James Sellers, who serves as chair of the IP Journal Committee.

This year, our Section will continue its award programs. For law students, the Section awards Women & Minority Scholarships and conducts an IP Law Writing Contest. The submissions for these awards are due in the Spring, and students should check our Section website at [www.texasbariplaw.org](http://www.texasbariplaw.org) for details. In addition, the Section also selects and honors the Outstanding Texas Inventor of the Year. All of these awards will be presented at the Annual Meeting in June 2011.

The Section is gearing up for the 24th Annual Intellectual Property Law Institute, which will be held in March 2011 in Dallas. The Course Director for this program will be our Section Vice Chair Scott Breedlove. Our Chair-Elect, Steve Malin, is the Course Director and coordinator of the Section's CLE program and events during the State Bar of Texas Annual Meeting to be held in San Antonio in

June 2011. In addition, our Section plans to co-sponsor an Advanced Patent Litigation program in July 2011.

This year, we plan to focus significant effort on improving and enhancing our website, which will be overseen by our Website Officer Van Lindberg. One of the best means of communicating to our members is through our Section newsletter, and our Newsletter Officer Kristin Jordan Harkins will lead that effort to bring you relevant articles covering current topics and practice points.

Committees are the foundation of our Section, and our committees include: Alternative Dispute Resolution, Antitrust, Copyright, Diversity Task Force, Electronic & Computer Law, Ethics and Unauthorized Practice, International Law, Inventors' Recognition, Litigation, Membership, Newsletter, Opinions, Patent Legislation/PTO Practice, Pro Bono Task Force, Public Relations, Section Website, Trademark Legislation/PTO Practice and Unfair Competition and Trade Secrets. We are also adding a brand new Women in IP Task Force this year, which you will hear more about as the steering committee sets out its goals and activities. The year is already underway and I encourage you to join some committees and get involved. You can find more information on the committees on our website at [www.texasbariplaw.org](http://www.texasbariplaw.org). Please contact any of the committee chairs or me to join a committee.

Finally, I would like to thank Craig Lundell for his contributions and hard work last year as the Chair of our Section. Craig remains active and involved as Immediate Past Chair, and we are thankful for his continued dedication and service to the Section.

On behalf of our Council, we look forward to an exciting and productive year. I hope you have an opportunity to join us at some of our Section's events, become active in our committees, and enjoy our Section's activities and publications throughout the year. Of course, if you have any ideas on what we can do this year to better serve our members, I encourage you to contact me or any of our other officers or Council members. Finally, for any students reading this column, I encourage you to get involved with our Section and participate in our award programs. We look forward to your future involvement in our Section and welcome any ideas you may have for us.

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