

Costco v Omega – SCOTUS to Clarify First-sale Doctrine with Respect to Gray-market Sales

On April 19, 2010, the United States Supreme Court granted certiorari in *Costco Wholesale Corp. v. Omega, S.A.*, No. 08-1423, to decide whether the Copyright Act's first-sale doctrine, codified in 17 U.S.C. 109(a), applies to goods manufactured abroad that have been imported and sold in the United States without authorization from the copyright owner. The Supreme Court's

answer should provide some clarity to the Copyright Act's "lawfully made under this title" language, and will likely have a great impact on businesses such as eBay and Amazon.com, which thrive on gray- or secondary market goods, genuine goods purchased overseas and imported into the United States without right-owner's consent and frequently sold at discounted prices. *continued on page 2*

Morality in the Patent Courts: A Calamity of Conscience

A U.S. District Court recently held that patent claims directed to breast cancer-linked genes, and claims on methods for using the genes, are unpatentable subject matter and therefore invalid. *Association for Molecular Pathology v. United States Patent and Trademark Office*, 2010 U.S. Dist. LEXIS 35418, Sections IV.A, VIII et al. (SDNY April 5, 2010). We have discussed this case in our April 2010 Newsletter. The district court's holding has sparked lively debates in the patent community on the benefits and drawbacks of allowing patent monopolies on human genes.

The holder of the invalidated claims, Myriad Genetics, reportedly enjoyed rev-

enues of about \$200 million in 2008 alone for testing covered by these patent claims (Id. at Section III.D.2), and has, not surprisingly, announced it will appeal the district court's decision. Myriad's decision to appeal is also not surprising because the district court's holding seems unlikely to be upheld on appeal, as it attempts to overturn several decades of USPTO grants of gene patents and solid U.S. caselaw supporting the patenting of genes.

Why would a judge choose to buck the system this way, to engage in a holding so against precedent and so likely to be overturned in an appeals court? *continued on page 2*

Do Not Take Your Eye Off the Prototype

In late March, Mr. Gray Powell, an Apple computer engineer, inadvertently left what was a secret prototype Fourth Generation (4G) iPhone at a bar in Redwood City, California. R. Brian Hogan found the phone and ultimately sold it to a technology blog site called Gizmodo for \$5,000. Gizmodo's president Jason Chen was instrumental in inspecting, photographing and describing the iPhone 4G on the Gizmodo blog. There were no attempts to reverse engineer the phone, download or copy any programming code or break into systems. There were just some basic external and internal observations, photos and video that Gizmodo released on its blog.

When the story broke on the blog, Apple immediately sent Gizmodo a letter asking for its "device" back. Gizmodo promptly turned the phone over to Apple and it looked like the matter was over.

Shortly after returning the phone, Jason Chen was served with a search warrant at his home that authorized seizure of essentially all of Chen's computer and electronic equipment. The warrant was based on potential violations of various California penal statutes, including theft of trade secrets. Representatives from Apple branded the prototype as "invaluable," and stated that release of photos and

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Tiffany v eBay – The Appeal

In 2006, Tiffany & Company ("Tiffany") brought suit against eBay Inc. ("eBay"), alleging trademark infringement, trademark dilution, and false advertising. Tiffany claimed that eBay facilitated and advertised the sale of counterfeit Tiffany goods on its online auction website, however the district court held in 2008 that eBay was not liable under any of the alleged claims.

Tiffany appealed the decision, and in April 2010, the Second Circuit affirmed all counts but one, holding that eBay was not liable for contributory or direct trademark infringement or trademark dilution. The Second Circuit did, however, remand the false-advertising claim. The Court agreed that eBay's "Tiffany" advertisements were not per se false, as genuine Tiffany goods were available on the site, but was not convinced that the district court considered whether the ads were misleading. Advertising "Tiffany" jewelry may have implied that *all* Tiffany goods were indeed confirmed genuine, when the available merchandise was a mix of genuine and counterfeit product.

All other issues, though, were affirmed in favor of eBay. On the issue of contributory infringement, Tiffany alleged that eBay continued to make its marketplace services available to infringing sellers despite knowledge that counterfeit goods were being sold throughout its website. The Second Circuit disagreed, however, noting,

For contributory infringement liability to lie, a service provider must have more than a general knowledge or reason to know that its service is being used to sell counterfeit goods. Some contemporary knowledge of which particular listings are infringing or will infringe in the future is necessary.

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Gray Market (continued from page 1)

The case stems from sales by Costco of Omega watches back in 2004. Omega manufactures its watches, which bear a small engraved emblem protected by U.S. copyright, in Switzerland. The watches were sold by Omega to authorized foreign distributors under agreement to limit sales to certain territories outside the U.S., but were later re-sold via unidentified third parties to a gray-market importer who sold them to Costco. Costco then sold the watches in the United States, without authority from Omega, at prices which undercut Omega's U.S. retailers. Omega filed a lawsuit alleging the sales constituted copyright infringement and moved for summary judgment. Costco filed a cross-motion arguing that under the first-sale doctrine, Omega's initial foreign sale of the watches exhausted its right of distribution and precludes any claim of infringement with regard to subsequent sales. The District Court found in Costco's favor without explanation, and Omega appealed.

The Court of Appeals for the Ninth Circuit reversed the District Court's decision, holding that Section 109(a) serves as a defense only with regard to copies made and sold in the United States, and not to copies that were first made and sold abroad. Thus, the Court found the first-sale doctrine unavailable as a defense to Omega's claims. In doing so, the Court reconciled that relevant precedent does not invalidate such a finding. First, it found that such a ruling is still consistent with *Quality King Distrib., Inc. v. Lanza Res. Int'l., Inc.*, 523 U.S. 135 (1998), which held that infringement cannot occur where the owner of a copy "lawfully made under this title" imports and sells that copy without the authority of the copyright owner, by finding that the copies of the design on the watches sold by Costco were not "lawfully made under this title" due to the fact that they were first made and sold abroad and not in the United States. This was

something that *Quality King* did not have to touch on, as the copies at issue in that case were produced in the United States. The Court found that to find otherwise would be problematic because it would impermissibly extend the Copyright Act extraterritorially by characterizing the making of copies abroad—conduct occurring entirely outside of the United States. The Court also found that the exception to this rule created in *BMG Music v. Perez*, 952 F.2d 318 (9th Cir. 1991), which states that the first-sale doctrine can still apply to copies manufactured abroad, so long as an authorized first sale occurs in the United States, does not apply in this case, because the first sale in the United States was not authorized. Thus, the Ninth Circuit explained that to qualify as a "lawfully made copy" under Section 109(a), the copy must be made with the authorization of the copyright owner and be produced in the United States.

After the decision, Costco petitioned the Supreme Court for a writ of certiorari, and several amici curiae, including eBay, submitted briefs in support. The opponents argue that the Ninth Circuit decision is bad for commerce in general, and especially for domestic manufacturing because it provides an incentive for companies to manufacture their goods abroad, where they will find more generous copyright protection. Further, they argue that there is no support in the text or legislative history for limiting the first-sale doctrine to domestically-manufactured goods.

The Solicitor General, at the request of the Supreme Court, submitted a brief to represent the views of the United States, arguing that the writ should be denied. The brief recognized that there are indeed concerns that the decision could provide an incentive to produce abroad, but argued that there is no evidence of such severe consequences as of yet, and also that the *BMG* exception reduces this threat. Further, it found that the decision

re-affirmed Ninth Circuit precedent, was consistent with the consensus view of the leading commentators on Copyright law, such as Melville Nimmer, and did not conflict with any other decision of any Court of Appeals.

Regardless of the outcome, the Supreme Court's decision will impact any retailer, importer, or distributor who deals in goods manufactured abroad and brought to the United States without copyright owner's authorization. It is certain that the Court will attempt to strike a balance between protecting the copyright owner while also keeping in line with the other concern behind Copyright law—ensuring the monopoly provided the author is properly limited so as not to conflict with overriding public interests.

Morality (continued from page 1)

A lesson learned during early years of patent prosecution may hold the answer—rejections under one point of law may include elements of another. To overcome such rejections, one must frame arguments in the language of the rejection while addressing what is really bothering the Examiner.

The district court struck down the claims as unpatentable subject matter, but really seemed to perform a test balancing benefits and drawbacks of patenting genes. Facts of the case included testimony that women unable to pay Myriad's monopoly price went untested for gene mutations that would indicate whether they were at high risk for breast cancer; that Myriad sent cease-and-desist letters to physicians offering to perform genetic tests for their patients; and a discussion of the general impact of Myriad's patents on research on the patented genes. (Id. at Sections III.D-E). Possibly, the district court was swayed by moral arguments and so legitimized previously unpersuasive arguments on

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Morality (continued from page 2)

subject matter patentability to invalidate Myriad's gene patents.

Morality arguments in the patent field are best exemplified in the European Patent Office, where inventions may be denied patent protection if it is deemed contrary to morality. For instance, in 2008 the European Patent Office Board of Appeals held that claims directed to destroying human stem cells are immoral and therefore unpatentable subject matter. Claims directed to mammals genetically modified to develop cancer were limited to only mice, in view of suffering inflicted on animals by the invention. These holdings create controversy at the international patent level, in view of arguably complimentary and contrary treaty provisions, for instance in the WTO TRIPs Agreement. If upheld, the above district court decision will do the same.

The U.S. does things a little differently. We do not ask the USPTO to consider the morality of inventions when determining whether claims are patentable subject matter, but rather limit the use of patented

Prototype (continued from page 1)

information about the prototype would damage Apple since it would entice consumers to delay purchases of new iPhones until the 4G phone was launched. When served with the warrant, Chen had no option but to comply and his equipment was seized.

Mr. Chen has not been charged with any crime. Neither has Mr. Hogan, who found the iPhone 4G and sold it to Chen. The iPhone 4G has been returned to Apple and Apple has not initiated any civil proceedings against anyone regarding this matter. It even appears that the engineer who lost the phone in the first place remains employed by Apple.

However, this story continues to raise

or unpatented inventions with criminal and other laws. Certainly, morality considerations came into play when the Congress enacted 35 USC 287(c), indicating that patent claims directed to pure surgical methods of treating the human body are not enforceable against medical practitioners in U.S. courts (See our December 2009 Newsletter). Also, compulsory licensing and other laws are in effect to limit patent monopolies when necessary for public health reasons.

The district court judge, swayed by his conscience, appears to have indulged in judicial activism that will be, if upheld on appeal, a calamity to the U.S. patent and biotechnology systems. Patents on other chemicals will be vulnerable to invalidation on the same grounds; companies will move away from public disclosure to protect their inventions through other laws where possible (e.g. test data and trade secret laws); trends toward harmonization of international patent laws will be strained. Hopefully, our appeals courts will remember that subject matter patentability is not the proper place for a moral discussion on U.S. patents.

interesting legal questions and some lessons from an intellectual property perspective. Though Chen has not been charged with any crime yet, what could he possibly be charged with? He bought a phone. That phone was found by someone at a bar. If the phone was found, could not returning it to its owner make it a theft? Could Chen then have liability for buying stolen property or misappropriation of trade secrets? In addition, issues surround the search of Chen's house and seizure of his computer equipment. Beyond these criminal law and search and seizure issues, there are potential First Amendment issues involved in this case. Since Chen was acting as a reporter for the Gizmodo blog through all of this, the First Amendment and its protection of the

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Tiffany v eBay (continued from page 1)

To arrive at its conclusion, the Second Circuit applied the test for contributory infringement defined in the Supreme Court decision, *Inwood Labs v. Ives Labs* (1982), noting that eBay must have identified specific sellers engaging in infringing activity and then opted not to act for liability to stick. In this case, both Tiffany and the Court acknowledged eBay's prompt removal of counterfeit Tiffany listings within 24 hours of specific infringement notifications. Thus, *Inwood* supported eBay's position that, when notified of specific instances, it acts appropriately.

The Second Circuit also affirmed that eBay was not liable for trademark dilution of the TIFFANY mark, because eBay did not use the Tiffany trademark to refer to its own products or services. Likewise, the Court agreed that eBay did not directly infringe the TIFFANY trademark as eBay used the mark to "describe accurately that genuine goods [were] offered on its website."

When faced with Tiffany's complaint that brand owners should not be forced to police eBay's website every waking second of every day, the Court declined to bite, stating that its responsibility was to the law and facts at hand, not to designate trademark policemen.

Even though the Second Circuit seemed reluctant to assign trademark policing responsibility, it appears brand owners are still ultimately responsible for policing counterfeiting activity under this decision, even when that activity emanates from a single, very public source, in high volume. However, some responsibility may still befall the online merchants. As the district court revisits the false-advertising issue, online retailers may ultimately be forced to redefine advertising procedures for legitimately-branded goods when a possibility exists that some goods may be counterfeit.

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press is implicated and the government is very limited in what it can seize from the press relating to a story it is covering. Thus, the entire seizure may be improper and no evidence obtained could be used against Chen—when and if he is charged with anything.

Also, it appears that another alleged iPhone 4G prototype has surfaced in Vietnam. There, someone claims he purchased an iPhone 4G in the United States, for \$4,000, in connection with the purchase of an iPad and returned to Vietnam with both items. The phone then turned up in the hands of a Vietnamese technology blogger who, like Gizmodo, posted photos, videos and descriptions of the phone's exterior and interior. How this will play out in Vietnam is uncertain at this point in time.

Lost in all of this is the actual iPhone 4G at the root of the story and what protection it deserves as a prototype. When one

envisions a next generation product under development, like the iPhone 4G, one thinks trade secret. That is, new products are generally kept confidential during development and before release to the public. This is one of the tenets of trade secret law: the owner of a trade secret, which is something not generally known that gives the owner an advantage over competitors, must take affirmative steps to maintain its secrecy.

Here, the iPhone 4G was out in public for some reason, perhaps field testing. An item out in public will generally no longer be "secret." Once the phone left Apple's offices, was carried to a bar and was then left for lost, it may have transmuted into something no longer "secret." Further, once in public, readily visible aspects of an item are no longer "secret." Here, Gizmodo took photos and video of the iPhone 4G's exterior and interior components and offered observations and comments on same. Gizmodo did not try to reverse-engineer the phone, break

into its code or software, or otherwise delve into the programming that makes the iPhone 4G what it is. What Gizmodo did was reproduce what is readily visible on the exterior and interior of the item.

Based on this, though issues remain in this matter regarding theft, search and seizure, and First Amendment, the question as to whether there has been an infringement or theft of Intellectual Property rights likely going to be a minor element. However, this iPhone saga provides a powerful lesson nonetheless. Trade secret protection for prototypes will generally apply only where the items are cloaked in secrecy, even in public. If a company is going to field test prototype products and wants to maintain secrecy over them, it must take precautions to prevent the public at large from using, viewing or obtaining the prototype, and take steps to avoid letting the product fall into the hands of the public at large and the press.