Recent Decisions In The United States

A recurring feature
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SETTLEMENT AGREEMENT GRANTS IMPLIED SUBLICENSE TO CUSTOMERS OF LICENSEE

A settlement agreement granting an affirmative right to sell components for use in infringing devices will grant an implied sublicense to customers who purchase those components for the manufacture, use, and sale of infringing devices. In *Jacobs v. Nintendo of America, Inc.*, No 03-1297 (Fed. Cir. May 28, 2004), the United States Court of Appeals for the Federal Circuit held that the grant of such an implied sublicense barred a suit for patent infringement by a patentee against a component supplier's customer.

This case related to tilt sensitive video game controllers for which Jacobs held a patent. In a previous action, Jacobs sued several entitles including Analog Devices, Inc. ("Analog") for infringement of its patent. Specifically, Jacobs sued Analog for inducement and contributory infringement based on Analog's supply of tilt-sensitive components to the other defendants in that action.

The case between Jacobs and Analog was resolved by a settlement agreement. As part of that agreement Jacobs granted Analog a license to "take any actions…, which would, but for [the] license, constitute an infringement" of Jacob's patent. The agreement further stated that "the license granted hereunder includes the right to make, use, sell, import, and export" tilt-sensitive components for "use in tilt-sensitive control boxes." Finally, the agreement also included a covenant by Jacobs not to sue Analog for any violation of his patent.

In the present case, Jacobs sued Nintendo for patent infringement based on the sale of one of its video game systems. Nintendo asserted that it was entitled to practice the patent-in-suit because the tilt-sensitive components used in the accused Nintendo devices were supplied by Analog. The District Court held that Nintendo had an implied license under Jacobs's patent because of the agreement between Jacobs and Analog and therefore granted Nintendo's motion for summary judgment of noninfringement.

On appeal, the Federal Circuit affirmed the holding of the district court. The court stated that the agreement between Jacobs and Analog "makes sense only if it is understood to confer on Analog the right to make and sell [tilt-sensitive components] for use in tilt-sensitive control boxes that would otherwise infringe Jacob's rights."

The Federal Circuit held that this clause barred Jacobs from prohibiting Analog's customers from making, using, and selling control boxes with those components. In the court's view, to hold otherwise would run afoul of the basic contract principle that a party may not assign a right, receive consideration for it, and then take steps to render that right worthless.

Moreover, the Federal Circuit found that in light of the other provisions of the agreement, it would be incorrect to interpret the provision as granting only a bare license to Analog. Such an interpretation would ignore the language of the agreement that went beyond the creation of the license and granted the right to make and sell components for use in tilt-sensitive control boxes. It would also render the covenant not to sue redundant. Therefore, the Federal Circuit found that the agreement granted Analog's customers an implied sublicense to use Analog's components to make, use, and sell tilt-sensitive control boxes that infringe Jacobs's patent.

SETTLEMENT AGREEMENT DOES NOT RELEASE THIRD PARTY WHO ACQUIRES LICENSEE AFTER EXECUTION OF THE AGREEMENT

A settlement agreement releasing a licensee and its parents from claims of infringement will not provide a release to a third party who later becomes the licensee's parent. In *Unova, Inc. v. Acer Inc.*, No. 03-1244, (Fed. Cir. March 31, 2004), the United States Court of Appeals for the Federal Circuit held that a settlement agreement between Unova and Compaq did not provide a release to Hewlett-Packard after Hewlett-Packard purchased Compaq.

This case related to smart battery patents held by Unova. Prior to the present case, Unova and Compaq entered into a settlement agreement whereby Unova released Compaq and its "parents" from liability for infringement. The agreement further provided that Unova would not sue Compaq or its parents for infringement by any "Compaq Products" and granted a non-exclusive license to Compaq and its parents under the smart battery patents.

Almost a year after the agreement was signed, Hewlett-Packard purchased all of the stock of Compaq, thus be-

coming Compaq's parent. Subsequently, Unova sued Hewlett-Packard for patent infringement. Hewlett-Packard moved for summary judgment that the agreement between Unova and Compaq released Hewlett-Packard from liability for infringement of the smart battery patents. The District Court granted the motion, and Unova appealed.

The Federal Circuit held that the District Court erred in granting Hewlett-Packard's motion for summary judgment. The court held that under California contract law, a third party's rights under a release agreement are predicated upon the contracting parties' intent to benefit that third party. The Federal Circuit held that Unova and Compaq did not intend to release Hewlett-Packard from liability for infringement arising from events that occurred before it became Compaq's parent. According to the court, the agreement intended only to release Compaq and its parents as of the date the agreement was signed. Since Hewlett-Packard became Compaq's parent later, it was not covered by the release.

The Federal Circuit also noted that this interpretation was consistent with the other provisions of the agreement. Notably, the covenant not to sue and license provisions applied only to Compaq-branded products. The court noted that it would be unusual for the agreement to release Hewlett-Packard for past liability but reserve the right to sue Hewlett-Packard for identical acts of infringement that occurred after it became Compaq's parent. Therefore, the Federal Circuit reversed the decision of the District Court.

PATENTEE CANNOT RECOVER LOST PROFITS OF A SISTER CORPORATION IN A PATENT INFRINGEMENT ACTION

If a parent corporation creates two subsidiaries, one that holds its patent rights and one that makes the patented product, the patent-holding subsidiary will not be able to recover the lost profits of the manufacturing subsidiary. In *Poly-America, L.P. v. GSE Lining Technology, Inc.*, No. 04-1022, (Fed. Cir. September 14, 2004), the United States Court of Appeals for the Federal Circuit held that Poly-America was not entitled to lost-profits damages of its sister corporation despite the close relationship between the two companies.

This case involved patents relating to textured landfill liners owned by Poly-America. Poly-America sued GSE lining for patent infringement and a jury found in favor of Poly-America and awarded Poly-America a reasonable royalty and lost-profits. Poly-America did not actually manufacture the patented product. Rather, its sister corporation Poly-Flex did. Poly-Flex operated under a non-exclusive license under the patents and had granted Poly-America the right to collect damages on its behalf. Therefore, the lost profits awarded by the jury were based on the lost profits of Poly-Flex, not Poly-America.

The Federal Circuit held that Poly-America was not entitled to recover Poly-Flex's lost profits. The Court held that while Poly-America and Poly-Flex seem to share interests as two entities collaborating in the manufacture and sale of textured landfill liners, that relationship was not sufficient to permit Poly-America to claim Poly-Flex's lost profits. The Federal Circuit found that since their parent corporation set up the companies as separate corporate entities, it must take the benefits of that structure with the burdens. Therefore, even though Poly-America had the right to sue under its patents, it can only recover its own lost profits, not Poly-Flex's.

Moreover, the fact that Poly-Flex granted Poly-America its right to collect damages did not alter the decision. Since Poly-Flex was only a non-exclusive licensee, it could not sue for damages on its own. Therefore, Poly-Flex had no right to collect lost profits. Therefore, the Federal Circuit reversed the award of lost profits to Poly-America.

JAPANESE FTC FINDS MICROSOFT'S LICENSING POLICY IN VIOLATION OF ANTIMONOPOLY ACT

On July 13, 2004, the Japanese Fair Trade Commission ("JFTC") issued a recommendation to Microsoft concluding that certain provisions in Microsoft's Windows operating system ("OS") licenses violated the Antimonopoly Act. The contracts at issue were license agreements entered into with PC manufacturers who wished to place the Windows OS on their computers. The agreements required the PC manufacturers to agree not to sue Microsoft for any infringement of the PC manufacturer's patents by the Windows OS. The JFTC found that these non-assertion provisions unjustly restricted the business activities of the PC manufacturers.

The JFTC noted that Microsoft has a dominant position in the PC market and that it is extremely important to the PC manufacturers to obtain licenses to each new version of the Windows OS as it becomes available. The JFTC further noted that Microsoft has increasingly incorporated audio and visual functions ("AV function") into its Windows OS and that many PC manufacturers were also developing technologies and held patents relating to AV function. The commission found that when PC manufacturers objected to waiving their right to assert their AV function patents against Microsoft, Microsoft refused to alter the agreement, thereby forcing the PC manufacturers to accept the provision.

The JFTC found that this licensing practice restrained PC manufacturers from enforcing their patent rights. The JFTC further found that such a restraint might cause these manufacturers to lose their incentives to invent and develop technology related to AV function. Therefore, the commission found that Microsoft violated the Antimonopoly Act. The JFTC concluded by recommending that Microsoft remove all such provisions from its current agreements, and further agree not to include such provisions in future agreements.

In response, Microsoft has publicly decided to no longer include such provisions in its future agreements. Microsoft, however, rejected the JFTC's recommendation and instead chose to proceed with a hearing on its licenses. At present, this matter is still pending.

PATENTEE ENTITLED TO LOST PROFITS ON SALES OF UNPATENTED MATERIALS SOLD WITH A PATENTED DEVICE

A patentee may recover its lost profits from lost sales of unpatented materials it sells with a patented device if it can demonstrate a functional relationship between the device and materials. In *Juicy Whip, Inc. v. Orange Bang, Inc.*, No. 03-1609, (Fed. Cir. September 3, 2004), the United States Court of Appeals for the Federal Circuit held that Juicy Whip was entitled to present evidence on its lost profits on lost syrup sales due to Orange Bang's infringement of its beverage dispenser patent.

Before the district court, a jury found that Orange Bang had infringed Juicy Whip's beverage dispenser patent and awarded Juicy Whip compensatory damages. At trial, Juicy Whip sought to introduce evidence on its lost profits on syrup sales, but the district court denied Juicy Whip's motion because it did not believe the syrup and patented dispenser constituted a single functional unit.

The Federal Circuit found that the district court abused its discretion by not allowing Juicy Whip to present evidence of lost profits on syrup sales. The court held that the appropriate test for determining whether a patentee could recover lost profits on sales of unpatented materials was whether the unpatented materials have a functional relationship with the patented device. The Federal Circuit found that the syrup and beverage dispenser shared a functional relationship and were analogous to parts of a single assembly. Specifically, the syrup functioned together with the dispenser to provide a visual appearance that was central to the patent. Moreover, the fact that other syrups could be used with the dispenser did not alter this result. Therefore, the Federal Circuit vacated the jury's damage award and remanded for further proceedings on the issue.

SUPPLYING INSTRUCTIONS OR CORPORATE OVERSIGHT FROM THE UNITED STATES FOR PRODUCTS MADE OUTSIDE THE UNITED STATES DOES NOT CONSTITUTE INFRINGEMENT

A company that manufactures and sells an accused product entirely outside of the United States typically is not liable for patent infringement. However, the U.S. patent law also provides that someone who supplies a substantial portion of components of a patented invention from the United States for combination outside of the United States is liable for patent infringement in the United States. In *Pellegrini v. Analog Devices, Inc.*, No. 04-1054, (Fed. Cir. July 8, 2004), the United States Court of Appeals for the Federal Circuit held, on a case of first impression, that components that are manufactured outside the United States and never physically shipped to or from the United States, do not infringe a U.S. patent even if those components are designed within the United States and the instructions for their manufacture and disposition are transmitted from within the United States.

This case involved chips manufactured by Analog Devices outside of the United State that were never physically shipped to or from the United States. Analog Devices did, however, design the chips in the United States and provided the instructions for their manufacture from within the United States. Pellegrini asserted that Analog Devices was liable for infringement under section 271(f) of the U.S. patent laws. Section 271(f) provides liability for a company who supplies all or a substantial portion of the components of a patented invention from the United States for combination outside of the United States. The district court had granted Analog Devices motion for summary judgment that section 271(f) did not apply to its activities, and Pellegrini appealed.

The Federal Circuit held that section 271(f) did not apply to the activities of Analog Devices. According to the court, this section applies only when components of a patented invention are physically present in the United States and then sold or supplied outside of the United States for combination. Therefore, the fact that Analog Devices provides instructions from the United States does not create any liability for infringement since the components were not actually supplied in or from the United States.

Pellegrini pointed to the fact that the invoices shipped with all Analog Devices' products included a statement that the "commodities, technology, or software were exported from the United States." Pellegrini contended that even if the components were not actually shipped from the United States, the components should be deemed to have originated from the United States by virtue of this declaration. Analog Devices responded by stating that these statements were included out of an abundance of caution to comply with U.S. export laws. The Federal Circuit rejected Pellegrini's argument noting that Analog Devices' statements could not override the fact that no products were actually exported from the United States. Therefore, the Federal Circuit affirmed the decision of the district court granting Analog Devices' motion for summary judgment.