



FENWICK & WEST LLP



Intellectual Property

2003 FALL BULLETIN

The Proposed Intellectual Property Protection Restoration Act of 2003

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It is common for States to obtain federal intellectual property rights such as patents and trademarks. At the same time, their status as sovereign entities insulates them from intellectual property claims that could be brought by others against them. Since the *Florida Prepaid* cases decided by the Supreme Court in 1999, lawmakers have attempted to address the intersection of State sovereignty and intellectual property rights in a way that is respectful to both States and IP owners. The most recent attempt at a solution is the Intellectual Property Protection Restoration Act of 2003 (IPRRA). The proposed legislation aims to encourage States to voluntarily waive their immunity to suits for IP infringement damages in exchange for maintaining the opportunity to recover damages from infringers of their IP.

The Eleventh Amendment explicitly provides that “the Judicial Power of the United States shall not be construed to extend to any suit . . . commenced or prosecuted against any one of the United States. . . .” The Supreme Court has explained that the Eleventh Amendment goes beyond restricting federal judicial jurisdiction and extends generally to the notion that each State is a sovereign entity and that as such, States cannot be made amenable to suits brought without their consent. However, the immunity of a State under the Eleventh Amendment is not absolute. States have the power to waive their immunity by consenting to suit. Also, the Fourteenth Amendment explicitly provides that “no State shall . . . deprive any person of life, liberty, or property, without due process of law.” That Amendment empowers Congress to enforce, through legislation, the protections provided therein, and thus abrogate State sovereign immunity in certain cases.

Cases construing U.S. patent law and the Lanham Act initially established that these statutes applied to States, but the Supreme Court held differently in *Atascadero State Hospital v. Scanlon*. From that point on, courts have held that the language in the intellectual property statutes was not sufficiently directed to States, and as a result, States are immune.

In order to address the resulting inequities, Congress passed the Patent Remedy Act in 1992 to “clarify that States . . . are subject to suit in Federal court by any person for infringement of patents. . . .” Similar acts likewise clarified the trademark and copyright statutes.

It took little time for the remedy acts to be put to the test. In 1994, College Savings Bank (CSB) brought a patent infringement action and a separate Lanham Act false advertising action against the Florida Prepaid Postsecondary Education Expenses Board. CSB owned

In This Bulletin

The Proposed Intellectual Property Protection Restoration Act of 2003	1
<i>Kelly v. Arriba Soft</i> : Search Engines, Web Crawlers and Copyright's Exclusive Right of Display	3
Quick Updates	5
Festo Revisited: Explaining Some New Exceptions to an Exception to the Standard Rule of Infringement	5
Domain Name Registrar Liable for Conversion	6
Protection of Trade Secrets – No Matter What?	6
Third Circuit Finds Broader Basis for Copyright Misuse	7

a patent, which it alleged was infringed by Florida Prepaid. CSB also alleged that Florida Prepaid made misstatements in its brochures and annual reports. Florida Prepaid moved to dismiss both actions on the grounds of sovereign immunity. As to the patent action, the district court and the Federal Circuit sided with CSB, which argued that Congress had properly exercised its enforcement authority pursuant to the Fourteenth Amendment. As to the false advertising action, the district court and the Federal Circuit both sided with Florida Prepaid, finding there to be neither property protectable under the Fourteenth Amendment nor a waiver of immunity.

In a bitterly divided 1999 decision, the Supreme Court held that Florida Prepaid was immune with respect to both actions. In the patent case, the Supreme Court accepted the fact that patents are property and therefore amenable to protection under the Fourteenth Amendment. However, the majority held that Congress is only empowered to abrogate a State's sovereign immunity to remedy a Fourteenth Amendment violation, and Congress had not in this case identified conduct transgressing the substantive provisions of the Fourteenth Amendment. In the Lanham case, the Supreme Court held that there is no protected property interest in the right to be free from a business competitor's false advertising or to be secure in one's business interests, and that there is no such doctrine as implied or constructive waiver of immunity.

In the wake of the *Florida Prepaid* decisions, there has been a significant amount of judicial, administrative and legislative activity. Many of these responses viewed the Supreme Court decisions with a critical eye. Senator Specter remarked in a floor statement that the *Florida Prepaid* decisions "leave us with an absurd and untenable state of affairs [where] States will enjoy an enormous advantage over their private sector competitors." Legislation to remedy the situation was introduced four months after *Florida Prepaid* by Senator Leahy. During a hearing on the legislation he stated that there is a "huge loophole in our federal intellectual property laws." The IPPRA builds on Senator Leahy's earlier proposals.

The IPPRA is structured around three provisions:

- *Intellectual Property Remedies Equalization.* The first provision is aimed at encouraging States to waive their sovereign immunity by providing incentives. The federal intellectual property statutes would be amended to prohibit any State from recovering damages for

infringement of its intellectual property rights unless it has waived its immunity from damages suits for infringing the intellectual property rights of others.

- *Clarification of Remedies Available for Statutory Violations by State Officers and Employees.* The second provision would make the full set of remedies under the federal IP statutes available against State officers or employees "in the same manner and to the same extent as such remedies are available in an action against a private individual under like circumstances." These remedies include monetary damages, declaratory and injunctive relief, destruction of infringing articles, costs and attorney fees.
- *Liability of States for Constitutional Violations Involving Intellectual Property.* The third provision is for limited abrogation of State sovereign immunity for constitutional violations involving intellectual property.

Supporters of the proposed legislation believe that this act is poised to succeed where previous attempted solutions have failed because it has been fashioned to be consistent with recent judicial opinions on State sovereignty issues. They point out that the incentive system is designed to avoid being unconstitutionally coercive by conditioning a "gift" from the federal government, that is, federal intellectual property protection enforceable by suits for damages, on a State's waiving immunity to such suits.

There is considerable disagreement in the intellectual property community as to the extent of the problem created by State sovereign immunity to damages for intellectual property infringement. The General Accounting Office (GAO) issued a report in 2001 that found "few accusations of intellectual property infringement" against State entities. Leslie Winner, testifying on behalf of the Association of American Universities and other organizations, noted that this study supports the conclusion that there is no evidence that public institutions of higher education abuse the intellectual property rights of others, or that these public institutions have changed course since *Florida Prepaid*. Opponents of the proposed legislation believe it provides an overly broad solution to a situation that arises in a mere handful of cases.

In contrast, the United States Patent and Trademark Office responded to the report by stating that the GAO "did not adequately qualify its conclusion that 'infringement accusations against states have been few.'" Other critics

of the study suggest reasons for the limited number of reported suits include the difficulty in obtaining an accurate count and the short amount of time that had passed since *Florida Prepaid*.

As a byproduct of the lack of agreement on the extent of State infringement of IP rights, some representatives of State institutions are concerned that the proposed legislation will harm State institutions without an adequate rationale. According to some commentators, State institutions do have cause to worry, because States may not be willing to waive their immunity to opt into this system. Even some supporters of the proposed act believe the incentives are not great enough to adequately induce States to waive immunity.

Because the potential exists for States to choose not to waive their immunity, one frequently noted problem of the proposed legislation is that a multitude of institutions are bound by the single decision of a State. For example, public universities are owners of intellectual property but cannot individually choose whether to waive their immunity. A related concern is that the benefits of the decision not to waive immunity are not evenly distributed with the burdens, in the eyes of some critics. For instance, the decision not to waive by a State is likely to decimate technology transfer programs run as partnerships between public universities and private industry because massive amounts of State-owned IP would lose almost all value.

With the IPPRA, lawmakers are attempting to balance several competing interests. They want legislation that respects intellectual property rights as well as State sovereignty. They want to provide incentives for voluntary waiver by States but do not want to cross the line from encouragement to coercion. Perhaps most significantly, lawmakers want legislation that treats States as special actors but does not provide them too many advantages over their market competitors. Congress has attempted to balance these issues in the past. Undoubtedly, the courts will have the final say as to whether the balance struck this time will stand.

Kelly v. Arriba Soft: Search Engines, Web Crawlers and Copyright's Exclusive Right of Display

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The Internet's appeal includes the ability to link to conceptually related materials with the click of a button, to share rich content including images and to make content widely, easily and inexpensively available. These features recently came under scrutiny in the Ninth Circuit case *Kelly v. Arriba Soft*, which raised various issues under copyright law's exclusive right of display and doctrine of fair use concerning Internet linking.

The defendant in this dispute, Ditto.com (formerly Arriba Soft), operated an image search engine. In response to a user's search terms, Ditto's product would return related low-resolution "thumbnail" images. By clicking on a thumbnail, a user could view a full-size version of the image, transmitted directly from the originating site. Ditto employed a web crawler, which traveled the web in search of images to populate its database. Ditto's web crawler copied the entire found image and then translated it into a thumbnail, discarding the full-size copy such that only the thumbnail was stored on Ditto's server. The search engine's presentation of the large-scale images changed as its product developed. From January to June 1999, a full-size image was displayed from its original source (for example, Kelly's website) within a window provided by Ditto, and surrounded by Ditto's own content. Ditto then changed its model; from June 1999 through August 2000, a full-size image, again provided by the originating website, appeared in a window by itself, in front of a window displaying the entire originating web page.

The Dispute

In early January 1999, plaintiff Leslie A. Kelly, a commercial photographer, discovered that Ditto's web crawler had copied approximately 35 of his images. Kelly sent a notice of infringement to Ditto that same month. Ditto responded by removing Kelly's thumbnail images from its database and placing Kelly's website on a list of sites not to crawl in the future. Nonetheless, Kelly filed a suit against Ditto in April 1999 alleging that, among other things, Ditto directly infringed the copyrights to Kelly's photographs. Both parties moved for summary judgment.

The District Court’s Ruling

Ditto conceded that Kelly owned the copyrights to his photographs and that its web crawler had copied said images into thumbnails. However, Ditto argued that its actions were permissible under the doctrine of fair use. Fair use provides that, in limited circumstances, a defendant may not be liable for infringing copyrights where the copying is socially valuable. In analyzing the issue, courts will consider four nonexclusive factors: the character of the use, the nature of the copyrighted work, the amount of the portion used in relation to the original and the effect of the use on the potential market for the copyrighted work.

The district court found that Ditto’s use was protected under the fair use doctrine. *See generally Kelly v. Arriba Soft*, 77 F. Supp. 2d 1116 (C.D. Cal. 1999). Its opinion focused on the first prong: the nature and character of the use. According to the district court, Ditto’s argument was supported by the fact that its use of Kelly’s images was transformative; Kelly used his images for artistic purposes while Ditto employed them in its database as a functional element. As they appeared through Ditto, Kelly’s images, along with millions of others in Ditto’s database, helped users to visually navigate and organize information on the web.

The Ninth Circuit’s First Ruling

Kelly appealed the district court’s decision in March 2000. The Ninth Circuit, rather than considering Ditto’s use of the thumbnail and full-size images under a single analysis as the district court had done, separated Ditto’s use of the thumbnails and the large-scale images into discrete inquiries. *See generally Kelly v. Arriba Soft*, 280 F.3d 934 (9th Cir. 2002). In so doing, it found that, although Ditto’s use of the thumbnails may be permissible under the doctrine of fair use, Ditto’s use of the large-scale images was not. Recall that Ditto’s incorporation of the large-scale images involved no reproduction from Kelly’s site. Rather, the appearance of those images, though facilitated by Ditto’s search engine, was caused by the transmission of the images by Kelly’s originating site. Here, the court reasoned, though there was no copying, Ditto’s “use” of Kelly’s full-size images implicated copyright’s right of public display.

Section 101 of the Copyright Act defines “public display” as “to transmit or otherwise communicate a . . . display of the work . . . to the public, by means of any device or process, whether the members of the public capable of receiving the . . . display receive it in the same place or in separate places and at the same time or at different times.” At first glance it

would appear that public display would require that a work be both transmitted and received.

No prior decision had definitively addressed whether the type of linking provided by Ditto violated a copyright owner’s exclusive right of display, so the Ninth Circuit applied decisions from other districts by analogy: *Playboy Enterprises v. Webbworld, Inc.*, 991 F.Supp. 543 (N.D. Texas 1997) and *Playboy Enterprises v. Russ Hardenburgh*, 982 F. Supp. 503 (N.D. Ohio 1997). In both of these cases, the lack of proof as to whether any of the images were actually received by third parties was held to be irrelevant to establishing infringement of copyright’s exclusive right to display. The issue, according to those courts, was simply whether defendants *actively* took steps to make the images available for display.

However, in those cases, defendants’ stored images were transmitted directly from defendants’ sites. In *Arriba Soft*, Ditto’s server stored only the thumbnail images, and Ditto’s use of those, according to both the district and the appellate courts, constituted fair use. Ditto only made the large-scale images available to those users who had (1) entered relevant query terms, and (2) opted to view one of the full-scale images from the group of thumbnails that were retrieved. Only if a user did both of these things would Ditto’s website have facilitated the display of Kelly’s photographs by Kelly’s website. Absent both steps, Kelly’s images remained un navigated. Thumbnail images, for the most part, remained on Ditto’s server for less than a month; thus it was unclear whether any third party ever accessed Kelly’s images through Ditto’s search engine.

The Ninth Circuit’s Substituted Ruling

In February 2002, Ditto filed a petition for rehearing. In its petition, Ditto asserted that the *Hardenburgh* and *Webbworld* cases were inapplicable to its facts, and also focused on portions of the prior appellate decision that suggested the court failed to understand the linking technology incorporated in Ditto’s search engine. For example, when describing the process by which the search engine allowed users to view underlying images, the court imprecisely described Ditto’s search engine as “importing” the images from Kelly’s site. In fact, Ditto’s interface employed a technology that sent content directly from the originating website to the user’s browser, bypassing Ditto’s web server completely.

In July 2003, the Ninth Circuit withdrew its first opinion and issued a substitute ruling, which rendered moot

Ditto's motion for rehearing. *See generally Kelly v. Arriba Soft*, 336 F.3d 811 (9th Cir. 2003). The substitute opinion affirmed that Ditto's thumbnail reproductions constituted fair use. It withdrew, however, its opinion as to the alleged infringement of the full-size images, explaining, “[t]he parties did not move for summary judgment as to copyright infringement of the full-sized images. Further [Ditto] had no opportunity to contest the *prima facie* case for infringement as to the full-sized images.”

Thus, at least in the Ninth Circuit, copyright issues pertaining to these types of linking appear to remain unresolved, and it is unlikely that such issues will be clarified in the immediate future, at least with regards to this dispute. Though the case has been remanded to the district court, Ditto has filed for bankruptcy, and a nonprecedential default judgment will likely be entered against it.

Future Implications of *Kelly v. Arriba Soft*

Against this backdrop of uncertainty, what lessons can be learned? The Ninth Circuit's first opinion generated controversy, in part, because it employed broad language causing some to question whether the ruling might reach beyond a defendant's use of the types of linking used by Ditto, and possibly even to regular hyperlinking commonly used by Internet websites. To show that a defendant infringed upon a copyright holder's exclusive right of display, the primary issues are whether the content has been transmitted and whether the receipt of that information by a third party is a required element. All linking operates by facilitating transmission from the content site. Thus, the lesson of the *Arriba Soft* dispute could be that either all linking methods will constitute *prima facie* infringement of copyright's exclusive right of display, or that none of them will. In either case, the Internet's future may depend on the application of copyright's fair use doctrine to determine the permissibility of linking with regard to the right of display.

Quick Updates

Festo Revisited: Explaining Some New Exceptions to an Exception to an Exception to the Standard Rule of Infringement

The Federal Circuit revisited the murky waters of prosecution history estoppel recently in yet another decision in *Festo Corp. v. Shoketsu Kinzoku Kogyo Kabushiki Co.*, Appeal No. 95-1066 (Fed. Cir. Sept. 26, 2003) (en banc).

The Supreme Court sent this case back for further consideration after rejecting the “absolute bar” rule favored by the Federal Circuit. The Supreme Court held that there is a presumption of surrender when a patentee makes a narrowing amendment to a claim for reasons related to patentability. However, the Supreme Court found that this presumption can be overcome by showing that at the time of the amendment, one skilled in the art could not reasonably be expected to have drafted a claim that would have literally encompassed the alleged equivalent. It remanded the case to the Federal Circuit to determine whether and how Festo could rebut the presumption.

First, the Federal Circuit made clear that it is the judge, and not the jury, who will decide the applicability of prosecution history estoppel, including the question of whether the patentee has overcome the presumption of surrender. This holding rests on the equitable nature of prosecution history estoppel. Thus, even though there may be underlying factual issues, the resolution of these issues is for the judge.

Second, the Federal Circuit considered each of the factors identified by the Supreme Court as relevant to rebuttal of the presumption of surrender and offered “general guidance” on these factors.

The first factor is whether the equivalents in question would have been *unforeseeable* to one of ordinary skill in the art at the time of the amendment. The Federal Circuit held that after-arising technology is never foreseeable, and that old technology is foreseeable if it was “known in the prior art of the field of the invention.” On this issue, extrinsic evidence and expert testimony is admissible. Accordingly, the Federal Circuit remanded the case to the district court so that Festo could submit evidence on this question. To successfully rebut the presumption, it would have to submit evidence showing that the accused equivalent was either (1) an after-arising technology; or (2) an old technology that was unknown in the prior art of the field of the invention.

The second factor is whether the rationale underlying the narrowing amendment bore no more than a *tangential relation* to the accused equivalents. Here, the Federal Circuit determined that an amendment made to avoid prior art that contains the equivalent in question is not tangential. Moreover, only the record of the prosecution history is relevant, and extrinsic evidence and expert testimony are only admissible to interpret that record. Because the prosecution history in *Festo* did not explain why the rationale for the amendment was tangential, and because no

other evidence was admissible, the Federal Circuit held that Festo could not satisfy the “tangential” criterion on remand to the district court.

The third factor is whether there was “*some other reason*” such that the patentee could not reasonably have been expected to have described the accused equivalents. The Federal Circuit construed this category narrowly and held further that only the record of the prosecution history is relevant. Since this record was silent, the Federal Circuit held further that Festo could not satisfy the “*some other reason*” criterion on remand.

Thus, after eight years on appeal, Festo returns to the district court with a very narrow mandate to show infringement under the doctrine of equivalents.

Domain Name Registrar Liable for Conversion

In a unanimous decision, the Ninth Circuit Court of Appeal ruled in *Kremen v. Cohen*, 337 F.3d 1024 (2003), that a domain registrar could be held liable under the theory of conversion for transferring a domain name without authorization.

In 1994, Gary Kremen claimed the sex.com domain for his company by registering the domain with Network Solutions, Inc (NSI), the defendant. Before Kremen could do anything with the domain, Gary Cohen sent NSI a letter, supposedly from Kremen’s company, Online Classified. The letter stated that Online Classified wanted the domain transferred to Cohen. NSI accepted the letter at face value, despite the oddity of receiving such a letter from Cohen, rather than Online Classified, and transferred the domain to Cohen. Kremen successfully sued Cohen, but soon found out that he could not enforce the judgment because Cohen had fled the country. Kremen then sued NSI under a number of theories, including breach of implied contract, breach of NSI’s registrar contract, conversion and conversion by bailee, claiming that NSI should be held liable for Cohen’s damages. The district court rejected each of these claims.

On appeal, the Ninth Circuit affirmed as to the first two claims, but reversed the third conversion claim (it did not address the last claim). Conversion is the crime of interfering with the ownership of another’s property without authorization or justification. In its earlier decision, the district court had held that domain names were not subject to conversion because domain names were intangibles that were not merged into a document as required by the *Restatement (Second) of Torts* § 242 (1945). The Ninth Circuit

reviewed the case law, but except for *Olchewski v. Hudson*, 87 Cal. App. 282 (1927) (holding laundry route not subject to conversion), it found no cases that had adopted the strict interpretation of the *Restatement* rule, which essentially requires the merged document to embody the property right before conversion of an intangible is allowed. Instead, it found that most other cases followed a looser interpretation of the rule. Therefore, while the court did not go so far as to eliminate the merger requirement entirely, it did reject *Olchewski* by stating that any document(s) sufficed for merger, as long as the document(s) had some connection with the intangible property, even if the document(s) were electronic and constantly updated. In this particular case, the court held that conversion was possible because the DNS database entries were sufficient to connect the plaintiff to the sex.com domain.

In reaching this decision, the Ninth Circuit also rejected the district court’s public policy arguments against holding a registrar strictly liable for conversion. The Ninth Circuit decided that there was nothing unfair about holding a registrar liable when the registrar had negligently transferred a domain without first checking with its owner.

Protection of Trade Secrets – No Matter What?

On August 25, 2003 came the long-awaited and closely watched decision from the Supreme Court of California in the *DVD Copy Control Association v. Bunner* case, 31 Cal. 4th 864. The court of appeal had held that a preliminary injunction restraining a website operator from further disclosing the DVD CCA’s alleged trade secrets violated the operator’s right to free speech under the United States Constitution and the California Constitution. The Supreme Court of California reversed. Although the court agreed that computer code is a protectable form of expression, it concluded that the preliminary injunction prohibiting the further dissemination of code in this case is a permissible, content-neutral restriction on such expression.

Specifically, the court held that the purpose of the injunction against the website operator is not to suppress the content of any communication but to protect the DVD CCA’s legitimate property interests under California trade secret law. The injunction furthers a significant governmental purpose behind the trade secret laws, namely, to promote and reward innovative activities and to maintain standards of commercial ethics. Content-neutral injunctions are subjected to a balancing test that weighs the governmental interest served against the degree to which the restriction burdens speech. The court concluded that the injunction at

issue burdens speech no more than is necessary to serve significant government interests in protecting trade secrets from misappropriation. It prohibits the disclosure of the DVD CCA's alleged trade secrets, which is the only way to preserve this fragile property interest. The fact that the injunction incidentally enjoins some speech in connection with the protection of this property interest is an acceptable burden under the First Amendment. The injunction also prohibits persons who know or have reason to know that the alleged trade secrets were acquired by improper means. This result too is permissible under the First Amendment; the recipient of the alleged trade secrets is merely being required to abide by standards of commercial ethics, which include not using information that he or she received with actual or constructive knowledge that it was stolen. The Supreme Court of California also held that in addition to satisfying the balancing test, the injunction at issue is not an invalid prior restraint on speech. The content-neutral injunction was issued as a result of Bunner's prior unlawful conduct, and not in advance of any speech by Bunner.

Third Circuit Finds Broader Basis for Copyright Misuse

The U.S. Court of Appeals for the Third Circuit has broadened the sweep of the copyright misuse doctrine by ruling that the suppression of criticism may also constitute misuse. *Video Pipeline v. Buena Vista Home Entertainment, Inc.*, 342 F.3d 191 (3rd Cir. 2003).

Video Pipeline was in the business of compiling movie trailers onto videotape for home video retailers to display in their stores. Video Pipeline had licensing arrangements with various entertainment companies, including Buena Vista ("Disney"). When Video Pipeline took its business to the web, it partnered with major online retailers such as Best Buy and Amazon.com to provide "streaming" trailers to prospective online home video purchasers.

When Disney objected to this use of the trailers, Video Pipeline discontinued this practice because it was not covered under the existing license agreement. Instead, Video Pipeline began constructing its own "video clips" and filed a complaint in federal court seeking a declaratory judgment that this particular use of Disney's copyrighted material constituted a "fair use." Video Pipeline also charged that Disney had misused its copyrights.

On appeal, the Third Circuit affirmed that the video clips did not constitute fair use. However, the appeals panel was more willing to explore Video Pipeline's arguments for the misuse defense.

The defense of misuse first appeared in patent law as a response to anticompetitive behavior. In *Morton Salt Co. v. G.S. Suppiger Co.*, 314 U.S. 488 (1942), the Supreme Court held that courts might refuse to enforce patent rights when they are used to suppress competition in unpatented products. Such anti-competitive licensing arrangements undermine the Constitutional purpose of patent protection — "to promote the Progress of Science and useful Arts." Since that time, the U.S. Courts of Appeal in the Fourth, Fifth, Seventh and Ninth Circuits have extended the doctrine to copyrights in the context of anticompetitive licensing arrangements.

The issue in *Video Pipeline*, however, was whether the suppression of criticism constituted misuse. Specifically, Disney licensees were expressly prohibited from displaying the trailers on websites that were critical of Disney or the motion picture industry. Video Pipeline argued that these restrictions were antithetical to the purposes of copyright protection and should be recognized as misuse.

The Third Circuit agreed with Video Pipeline's theory, stating that a key policy objective underlying copyright protection is encouraging the creation and dissemination of creative activity. The court acknowledged that "a copyright holder's attempt to restrict expression that is critical of it (or of its copyrighted good, or the industry in which it operates, etc.) may subvert [this objective]." Given the right set of circumstances, the court held that the misuse doctrine is equally applicable outside of the traditional, anticompetition context.

Nonetheless, the court could not conclude that Disney engaged in misuse because the restrictions at issue were not likely to significantly interfere with creative expression. Licensees were not prevented from expressing criticism on other websites or in other media. Consequently, there was no evidence that the public would find it more difficult to obtain criticism of Disney.

This ruling may have implications for software vendors that place blanket prohibitions on the publication of benchmarking tests or other information that might be critical of the copyrighted material.

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