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## *the* DISPATCH

A NEWSLETTER TO CLIENTS AND FRIENDS | SPRING 2005

### UPCOMING PRESENTATIONS

**May 18, 2005 –– San Diego**
Julia Huston will moderate a discussion of US Trademark Litigation: Developments and Trends at the annual meeting of the International Trademark Association. www.inta.org

**June 10, 2005 –– Boston**
Bob Kann will speak at MCLE's 8th annual Intellectual Property Conference on Litigation and Settlement of Copyright and Trademark Disputes. www.mcle.org

## Open Source Gathers Steam in a Post-SCO World

WHEN THE SCO GROUP INC. SUED IBM for stealing its UNIX® code and dropping it into the Linux operating system, the open source software movement got an unexpected jolt of energy that is now propelling it to new heights.

SCO, which owns the rights to the UNIX operating system, gave IBM access to the UNIX source code as part of a joint effort to develop a 64-bit version of UNIX for the Intel x86 chipset. At the same time, IBM was making substantial contributions of source code to Linux, an open source UNIX clone. SCO accused IBM of systematically leaking UNIX code to its Linux development team. In March 2003, SCO sued IBM for $3 billion, alleging breach of contract and copyright infringement.

This legal action set off alarms throughout the software industry. If SCO was correct in its claims, could Linux be stopped dead in its tracks? Could every Linux user be liable for copyright infringement damages, and be made to pay license fees to SCO? The user community focused on the complete lack of infringement indemnity. There was nobody standing behind the integrity of the Linux code. After nearly two years of litigation, the presiding judge had this to say in a decision dated February 8, 2005:

> Viewed against the backdrop of SCO's plethora of public statements concerning IBM's and others' infringement of SCO's purported copyrights to the UNIX software, it is astonishing that SCO has not offered any competent evidence to create a disputed fact regarding whether IBM has infringed SCO's alleged copyrights through IBM's Linux activities.

In short, SCO's case is on life support. Because SCO has made a bet-the-company decision on this lawsuit, it will probably continue, but the outcome is not in doubt.

Meanwhile, the scare that this lawsuit gave the open source community generated several positive developments. First and foremost, the Open Source Development Laboratories (OSDL),

a global consortium dedicated to accelerating the adoption of Linux, has received substantial support from its members. The membership roster reads like a who's who of the corporate information technology world: IBM, Intel, Sun, Google, Cisco, EMC, Nokia, Mitsubishi, NEC, Hitachi and others. OSDL has hired Linus Torvalds, the creator of Linux, to continue his work coordinating the development of Linux; and it has established a $10M legal defense fund, available to Linux users sued by SCO.

Second, the user community has paid close attention to the SCO lawsuit, and the process by which source code is added to Linux and other open source products. After a long hard look, the business community has accelerated its adoption of open source software.

Third, the challenge posed by the SCO litigation has caused the open source community to review and improve its procedures for accepting code, reducing the risk of copyright infringement.

For practical purposes, then, we are in a post-SCO world. In that environment, the user community is interested in open source software because it is cheaper than proprietary software and because it frees them from being too tightly tied to one vendor. Software vendors, meanwhile, are developing not only software, but business models to succeed in selling software that is also available for free. Here are the basic models:

1. **Sell Service:** Why would anyone buy Red Hat Linux? Because Red Hat can and does offer good technical support, which may otherwise be hard to get.

2. **Dual Licensing:** Some companies are able to offer the same software under two different licenses: a free, open source license, and a relatively expensive, proprietary one. My SQL is a good example of this model. This approach is being copied by others.

3. **Sell Hardware:** Why is IBM promoting Linux? Because it sells hardware to run it.

If you are thinking about offering software on an open-source basis, you must carefully consider what

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license to use. If the license looks too much like a proprietary license, you will not generate enthusiasm (and software contributions) from the open source community, which has an ideological framework that must be addressed. If the license is too open, you may lose control of your product. Sun, Apple and Mozilla struggle with this issue.

In summary, the climate for open source software has never been better. Whether it suits your needs is an individual decision. If you would like us to review your situation, please call.

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*Tom Carey chairs our business group*

## A New Federal Circuit Decision Removes a Presumption

AN IMPORTANT RECENT DECISION of the Federal Circuit, the Knorr-Bremse case[1], removes a presumption but maintains the standard for enhanced damages. The result is that patent opinions are as important as ever.

Under applicable patent law[2], enhanced damages may be granted to a patent holder if the patent holder can show that the infringer acted "willfully." If the trier of fact finds that the infringer acted willfully, damages may be trebled by the court, and in exceptional cases, the court may award the patent holder attorney's fees. Until this decision, if an alleged infringer became aware of a patent and did not obtain or produce an opinion of counsel at trial, the trier of fact could make an adverse inference. This adverse inference often led to a finding of willfulness by the trier of fact. With the Knorr-Bremse case, the Federal Circuit has removed this adverse inference.

A simple reading of this holding might make one think that the need to obtain a written opinion of counsel has been reduced, if not removed. In reality, the circumstances of the case teach just the opposite. The Federal Circuit overruled only the presumption of an adverse inference. The court required that the

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trier of fact look to the totality of the circumstances to determine if the infringer acted willfully[3]. In order to pass the totality of the circumstances test, the infringer would need a sound reason to believe that the patent was not infringed or was invalid. Thus, once one becomes aware of a patent, any action or inaction that can be perceived by the jury as imprudent can result in a finding of willfulness. An effective opinion of counsel will provide a shield against a finding of willfulness, and therefore, reduce the risk of enhanced damages.

Competitive intelligence gathering will often cause a company to maintain collections of patents and raises questions about when an opinion of counsel should be obtained for a patent in the collection. Typically, engineers seek out information about competitors and uncover relevant patents. These patents end up in the engineers' files, are not presented to in-house counsel or management for consideration, and are only discovered once litigation has commenced. Obtaining a patent opinion at this juncture may be too late to do much good. If the fact finder finds the company's actions imprudent, enhanced damages will result.

On the other hand, a company may establish a program for systematically collecting patents discovered by company employees and for reviewing these patents by counsel. By including counsel in the evaluation process, the trier of fact is less likely to view the company's actions as willful. In most instances, a patent can be quickly evaluated by comparing the claims of the patent to the company's closest commercial product. If counsel finds that the patent needs further consideration, other actions, such as a review of the file history can be performed prior to seeking a written opinion. With relatively little expense when compared to an effective written opinion of counsel, a company can help to reduce its exposure to enhanced damages through systematically reviewing its known patents.

In conclusion, written opinions provide the greatest protection from a finding of willfulness and enhanced damages for a known patent. When a company obtains written opinions as part of a program that involves the systematic collection and evaluation of patents, the company may enjoy the best of both worlds: protection against willful infringement and competitive intelligence.

[1]Knorr-Bremse Systeme Fuer Nutzfahrzeuge GMBH, v. Dana Corporation and Haldex Brake Products Corporation and Haldex Brake Products AB.

[2]35 U.S.C. §284 ("the court may increase the damages up to three times the amount found or assessed") and 35 U.S.C. §285 ("the court in exceptional cases may award reasonable attorney fees to the prevailing party").

[3]Knorr-Bremse citing Gustafson, Inc. v. Intersystems Indus. Prods., Inc. 897 F2d 508, 510 (Fed. Cir. 1990).

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## What's This Case Worth?

*An Introduction to Decision Tree Risk Analysis*

Your client, a small innovator with growing revenues believes a competitor is infringing the client's patent. What is the range of litigation outcomes? What is the likelihood of positive outcomes? What is the cost of litigation relative to the likelihood of a significant damages award or settlement?

Or you have been retained to advise a successful technology company which has suffered a damages judgment involving a software development project. Should it appeal or seek a settlement?

Or your client has sued a competitor for a false advertising in violation of the Lanham Act. The defendant has offered to settle. What is a good counter offer?

Or your client is seeking to terminate a business relationship.  The adverse "partner" says it will withdraw from the business if your client will pay a half a million dollars.  Should your client pay for this resolution or sue to expel the partner?
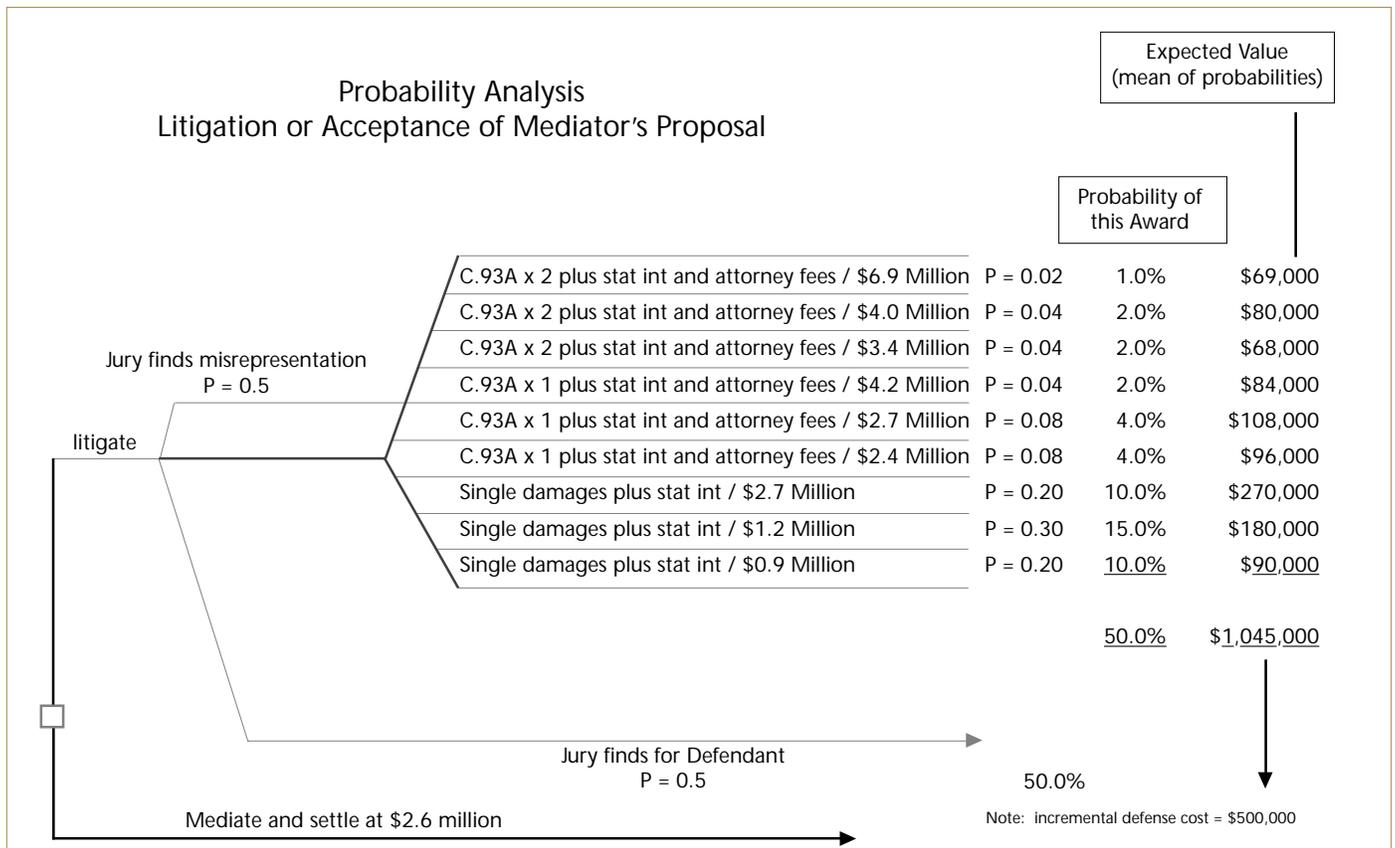
Lawyers deal with these questions every day and routinely evaluate complex disputes for clients.  But how do we communicate our evaluations and advice effectively?  Simply setting out alternatives, pros and cons, and then offering a preferred strategy does not communicate the basis for the advice or the relative merits of competing options and outcomes.  Increasingly, lawyers are turning to decision tree or risk analysis, a widely used, systematic approach to identifying, quantifying, and evaluating alternative courses of action and outcomes.

Decision tree analysis permits systematic identification and probability based comparison, and evaluation of alternative courses of action and their value or cost.  It is not a substitute for a lawyer's critical analysis, assessment, and evaluation; rather, it is a transparent, systematic adjunct.  Fundamentally,

decision tree analysis allows clients to join the process and to assess courses of action and alternative outcomes with the lawyer.  In short, the decision tree initiates an iterative and collaborative process.

A recent example from our practice illustrates the utility of the decision tree process.  The client has sued a vendor for misrepresentation, breach of a software development agreement, and deceptive business practices with an opportunity to press for multiple damages and attorney fees.  Now, after a year of motion practice and discovery, a mediator has recommended a settlement of $2.6 Million.  Our analysis, which is illustrated in the decision tree graphic, begins with systematic identification of every available course of action and all realistic outcomes.  Each independent course of action under the client's control has a numeric value of one.  Here, the client's independently controlled courses of action are to continue to litigate or to accept a mediator's proposal.

Next, we identify every potential outcome within each independent course of action and assign a probability to that outcome.  In the case of the settlement



**Probability Analysis**
**Litigation or Acceptance of Mediator's Proposal**

| | Probability of this Award | Expected Value (mean of probabilities) |
|---|---|---|
| C.93A x 2 plus stat int and attorney fees / $6.9 Million   P = 0.02 | 1.0% | $69,000 |
| C.93A x 2 plus stat int and attorney fees / $4.0 Million   P = 0.04 | 2.0% | $80,000 |
| C.93A x 2 plus stat int and attorney fees / $3.4 Million   P = 0.04 | 2.0% | $68,000 |
| C.93A x 1 plus stat int and attorney fees / $4.2 Million   P = 0.04 | 2.0% | $84,000 |
| C.93A x 1 plus stat int and attorney fees / $2.7 Million   P = 0.08 | 4.0% | $108,000 |
| C.93A x 1 plus stat int and attorney fees / $2.4 Million   P = 0.08 | 4.0% | $96,000 |
| Single damages plus stat int / $2.7 Million   P = 0.20 | 10.0% | $270,000 |
| Single damages plus stat int / $1.2 Million   P = 0.30 | 15.0% | $180,000 |
| Single damages plus stat int / $0.9 Million   P = 0.20 | 10.0% | $90,000 |
| | 50.0% | $1,045,000 |

Jury finds misrepresentation
P = 0.5

litigate

Jury finds for Defendant
P = 0.5                                    50.0%

Mediate and settle at $2.6 million

Note:  incremental defense cost = $500,000

option in our example, only one option has been proposed: settlement at $2.6 million. So, the probability of this outcome, if settlement is accepted, remains at P=1. In the case of the litigation option, there are multiple outcomes; here, counsel must apply expert judgment to assess the probability of each identified outcome. Note that the sum of the probabilities of all outcomes must equal the probability of the decision tree branch from which outcomes flow, here P=0.5.

If monetary values are then assigned to each probability outcome, the decision tree can readily calculate the probability and relative value of each outcome. From this, the decision tree demonstrates that the probability of a litigated recovery of more than $2.6 million is just 21% (the sum of all outcomes above $2.6 million). Moreover, the Expected Value or mean outcome of litigation if the case were litigated 100 times is just over $1 million (the sum of the dollar values of all of the probability values with damages awards).

Armed with this information, both lawyer and client are able to evaluate the value and probability of each outcome, compare the value and probability or more or less likely outcomes, assess the value of the mediator's proposal, and consider the prudence of seeking a higher settlement or judgment. In the example, of course, the mediator's proposal at $2.6 million seems likely to carry the day.

A best practices approach to decision tree analysis is for collaborative use of this analytical process throughout a litigation engagement. Analysis conducted to determine whether or not to initiate litigation will be very different from that after preliminary discovery and from that at expert discovery or at the time of settlement discussions. As the parties discover facts, evaluate theories, consider costs, and assess witnesses, different options, outcomes, and probability assessments will necessarily apply. Each decision tree will be more rigorous and will contribute to better informed decisions on issues of settlement, trial, or appeal.

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## European Trademark Protection Is Now Cheaper And Simpler

Registering trademarks in the European Union is now considerably simpler and cheaper for U.S. trademark owners.

On October 1, 2004, the European Community became a member of the Madrid Protocol, the treaty establishing an international system for trademark registration. U.S. trademark owners can now apply for Community Trademark ("CTM") protection using the Madrid Protocol, a procedure that is less expensive than filing a CTM application and that can, in some circumstances, be accomplished without involving a European lawyer.

The United States signed onto the Madrid Protocol on November 2, 2003. *See The Dispatch* (Winter 2003). Since then, U.S. trademark owners have been able to obtain international registrations that can cover over 50 countries (including all of the current EU countries), simply by filing a single application with the United States Patent and Trademark Office. Until now, however, a major drawback of the Madrid Protocol system has been its failure to provide protection under the CTM system. A single CTM registration provides protection throughout 25 EU countries.

Beginning October 1, this major drawback disappeared. The accession of the European Community to the Madrid Protocol now allows U.S. trademark applicants to obtain CTM coverage by filing an international application through the USPTO. Not every U.S. trademark owner may choose to use the Madrid Protocol system as a means of obtaining CTM protection. Using the Madrid Protocol system has some drawbacks, which must be weighed against its benefits. But any trademark owner who needs trademark protection in Europe should certainly consider the option of filing an international application under the Madrid Protocol system.

For more information about the Madrid Protocol, Community Trademarks, and foreign trademark protection, contact a member of our Trademark Practice Group.

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