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INTELLECTUAL PROPERTY LITIGATION

Expert Analysis

At Circuit, Internet Broadcasters Victorious in Licensing Fee Case

By **Lewis R. Clayton**

My teenage daughter last year introduced me to Pandora Radio, which describes itself as a "personalized Internet radio and music discovery service." Pandora allows you to create unique "radio stations" for yourself by specifying favorite artists or songs.

Using its database, said to include more than 600,000 songs, Pandora creates playlists that have characteristics in common with the chosen songs. You can expect to hear a good deal of material from the artists you have picked, mixed in randomly with similar music from other performers and composers. And if you ask, Pandora's computer will tell you what characteristics it has identified in the music you chose—a question that can produce embarrassing answers.

In a closely watched case, the U.S. Court of Appeals for the Second Circuit became the first appellate court to consider the amount of royalties an "individualized internet radio station" must pay to the owners of copyrights in sound recordings. *Arista Records, LLC v. Launch Media Inc.*, 2009 WL 2568733 (Aug. 21, 2009).

Arista is a victory for these Internet broadcasters, ruling that they need pay no more than a statutory licensing fee set by the Copyright Royalty Board.

Background of Law

The *Arista* decision comes against the background of the unique treatment of sound recordings under the Copyright Act. Until 1971, there was no federal copyright protection at all for sound recordings. In that year, a limited copyright in the reproduction of sound recordings was enacted, giving copyright owners the right to prevent copying of recordings.

But this copyright did not—and still does not—extend to public performances of sound recordings, so that traditional radio stations do not pay royalties to owners of sound recording copyrights. That arrangement reflects the view that radio airplay helps to sell recordings and therefore benefits holders of sound recording copyrights.

In 1995, concerned that high-quality digital audio transmissions would allow consumers to copy music or pay for the transmission of specific songs, the record industry convinced Congress to amend the Copyright Act to create a performance right covering digital audio transmissions. Non-interactive services may obtain a statutory license by paying rates set by the Copyright Royalty Board. Interactive services, however, must pay for individual licenses for each song they broadcast.

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The central issue in *Arista* was whether LAUNCHcast—a webcasting service now owned by Yahoo! that apparently was similar to Pandora—was "interactive" and therefore unable to take advantage of the statutory royalty. (While the Second Circuit's opinion describes LAUNCHcast as an ongoing service, the Yahoo! music site indicates that it no longer offers "customized radio stations.")

The relevant part of §114(j)(7) of the Copyright Act defines an "interactive service" as "one that enables a member of the public to receive a transmission of a program specially created for the recipient, or on request, a transmission of a particular sound recording, whether or not part of a program, which is selected by or on behalf of the recipient." As LAUNCHcast did not allow requests for particular songs, the question was whether it transmitted a program "specially created" for a user.

Sufficient Control Issue

While noting that it "comes as no surprise" that "the district court, the parties and others have struggled" with the meaning of the phrase "specially created" program, the Second Circuit did not attempt to define it.

Instead, looking to the purpose of the statute—which it perceived to be to prevent further "significant decreases in record sales"—the circuit focused on the degree of "control" a user has over the service. If the user has sufficient control to "predict the songs she will hear, much as…if she owned the music herself and could play each song at will, she would have no need to purchase the music she wishes to hear."

The circuit found that LAUNCHcast was not interactive because it gave users "almost no ability to choose, let alone predict, which specific songs" will be selected for a playlist. Playlists were designated by use of an extremely complicated algorithm, based on user preferences for songs, artists and broadly defined genres.

The system limited the number of user-designated songs that could be included in a playlist, restricted the number of songs from individual artists or albums, and required that selections be played in random order. Users were not able to view unplayed songs or repeat previous selections.

Under *Arista*, "individualized internet radio stations" should not have difficulty designing systems that will avoid the requirement to pay individual royalties. And the *Arista* ruling may well play a part in a fierce ongoing debate about whether Congress should amend the Copyright Act to create a broad performance right for sound recordings, which would require traditional AM/FM radio broadcasters to pay royalties to a record industry that finds itself under increasing financial pressure.

Patents

Patent infringement complaints are commonly met with allegations of inequitable conduct, the argument that a patent is unenforceable because of

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the patentee's misconduct during prosecution.

In *Exergen Corp. v. Wal-Mart Stores Inc.*, 2009 WL 2366535 (Aug. 4, 2009), the U.S. Court of Appeals for the Federal Circuit reaffirmed that inequitable conduct claims must be pleaded with particularity as required by FRCP 9(b), and announced a stringent test to be met in order to satisfy that pleading standard.

Following "the lead of the Seventh Circuit in fraud cases," the Federal Circuit held that "in pleading inequitable conduct in patent cases, Rule 9(b) requires identification of the specific who, what, when, where and how of the material misrepresentation of omission committed before" the Patent and Trademark Office.

And while knowledge of falsity and intent to deceive may be alleged generally, the pleadings must "allege sufficient underlying facts from which a court may reasonably infer that a party acted with the requisite state of mind."

Applying that standard, the Federal Circuit found insufficient a pleading alleging that a patentee had failed to disclose relevant prior art references to the patent office and made false statements during patent prosecution. The pleading failed to identify the specific individuals who "both knew of the material information and deliberately withheld or misrepresented it." Nor did the pleading specify the particular information in the prior art that was relevant to individual patent claims.

Section 271(f) of the Patent Act provides that a U.S. patent is infringed where a party supplies "in or from the United States" (a) "all or a substantial portion of the components of a patented invention" in order to actively induce the combination of those components outside the United States in a way that would infringe the patent; or (b) a component specially made to practice the invention, with the intention that the component be used outside the United States in a way that would infringe.

The statute was passed to overrule a 1972 U.S. Supreme Court opinion that found that shipping unassembled parts of a patented machine for assembly abroad was not infringement of a U.S. patent. In *Cardiac Pacemakers Inc. v. St. Jude Medical Inc.*, 2009 WL 2516346 (Aug. 19, 2009), the Federal Circuit, acting en banc, held that this statute does not apply to create infringement liability for patents covering methods, as opposed to those covering a tangible product or apparatus.

The Federal Circuit emphasized that the statute speaks of "supplying" "components." The "components" of a method patent are "the steps that comprise the method," and the statutory reference to "supply" "impl[ies] the transfer of a tangible object." Therefore, the intangible "steps" of a method patent cannot be "supplied" as the statute requires.

The en banc circuit overruled the decision in *Union Carbide Chemicals & Plastics Tech. Corp. v. Shell Oil Co.*, 425 F.3d 1366 (Fed. Cir. 2005), which held that the statute applied to method claims. A dissenting judge complained that the majority ruling "reopens, for process inventions, the loophole that was plugged by §271(f) for all patented inventions."

Copyright

Salinger v. Colting, 2009 WL 1916354 (S.D.N.Y. July 1, 2009), held that "60 Years Later: Coming Through the Rye"—a novel about a grown-up version of the central character from J.D. Salinger's iconic novel "The Catcher in the Rye"—was an infringement of Salinger's copyright.

Rejecting defendants' fair use arguments, the court held that "60 Years Later" merely rehashed themes from "Catcher" and was therefore neither a parody nor a transformative use of Salinger's novel.

The court found that the real purpose of "60 Years Later" was to satisfy the appetite among Salinger fans for a sequel to "Catcher" and noted that defendants had described the former work in this way before Salinger filed suit.

The court also rejected defendants' argument that "60 Years Later," which featured Salinger himself as a character, deserved fair use protection as a critique of the famously reclusive novelist's withdrawal from public life. The court also stressed that publication of "60 Years Later" would undermine the market for derivative works based on "Catcher" and that Salinger was entitled to have this market protected and to control the creation of derivative works, even though he had not chosen to exploit that market.

A fair use defense was upheld, however, in *Warren Publishing Co. v. Spurlock*, 2009 WL 2412542 (E.D. Pa. Aug. 4, 2009).

There, a retrospective book about illustrator Basil Gogos reproduced his illustrations from various magazine covers, including a number of covers in their entirety. The publisher of some of these magazines claimed copyright infringement.

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Sustaining fair use on summary judgment, the court found the defendant's use of the images to record and assess Gogos's artistic achievements was transformative when compared to the original magazine covers' purpose of catching the eye of potential readers. The court also found that the images in the retrospective constituted only a small portion of each magazine, rejecting plaintiff's argument that the magazine covers should each be viewed as a single work, not as part of the magazine as a whole.

Although the retrospective might have undermined the derivative market for plaintiff's copyrighted images, the court found, in contrast to the views expressed in *Salinger*, that the plaintiff's right to control this market was weakened because he had not taken steps to create derivative works.

Trademarks

Zino Davidoff SA v. CVS Corp., 571 F.3d 238 (2d Cir. 2009), found that removal of the unique production code, or "UPC," from the packaging of trademarked goods may constitute trademark infringement, even if the goods themselves are genuine.

The luxury goods company Davidoff sued CVS for selling allegedly counterfeit fragrances marked with Davidoff's "Cool Water" trademark. During the litigation, Davidoff discovered 16,600 items in CVS's inventory from which UPCs originally placed on bottles and packaging had been removed.

The Second Circuit affirmed a preliminary injunction barring sale of those items.

Davidoff submitted evidence that it placed UPCs on its products to make it easier to locate and recall faulty merchandise and to identify counterfeits.

The circuit held that, even if the goods were genuine, removing the codes "interfered with the trademark holder's ability to control quality," unreasonably risking "injury to the reputation of the mark."

It also held that removal of the codes made the products inferior, because consumers would notice that the packaging had been damaged: "consumers may regard a product whose packaging has been tampered as inferior and perhaps suspicious."

The typical preliminary injunction in a trademark case preserves the status quo, preventing further infringement of a plaintiff's marks.

When may a court go further, and issue a mandatory injunction, directing the recall of infringing products? In *Marlyn Nutraceuticals Inc. v. Mucos Pharma GmbH & Co.*, 571 F.3d 873 (9th Cir. 2009), following Third Circuit precedent, the Ninth Circuit held that such an injunction may be issued only where a trial court considers three factors in addition to those mandated by the traditional test for a preliminary injunction.

The additional factors are: defendant's "willful or intentional infringement" of the mark; whether "the risk of confusion to the public and injury to the trademark owner is greater than the burden of the recall to the defendant"; and whether there is "a substantial risk of danger to the public due to the defendant's infringing activity."

Where the infringing product causes a substantial risk of danger to the public, a recall "should" be ordered. As the district court did not consider these factors, the Ninth Circuit reversed and remanded an injunction directing defendant to recall allegedly infringing products and provide restitution to customers. Except where an infringing product threatens public health or safety, few trademark cases are likely to meet this test.