

# Ipls P STATE BAR OF MICHIGAN PROCEEDINGS

## VidAngel Not Saved by the Family Movie Act

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### Introduction

The Ninth Circuit's decision in *Disney Enter. v. VidAngel, Inc.*<sup>1</sup> provides the first appellate interpretation and application of the Family Movie Act of 2005 ("FMA").<sup>2</sup> The FMA permits removing objectionable content from movies during home viewing. Several studios including Disney, Lucasfilm, and Warner Bros. sued a relatively unknown company, VidAngel, for copyright infringement. VidAngel offered a movie streaming service that enabled users to filter out objectionable content from films customers purchased. Accordingly, VidAngel argued that the FMA immunized its services from copyright infringement.<sup>3</sup> The Ninth Circuit disagreed.

To stream and filter a movie, VidAngel's users would purchase a DVD or Blu-ray disc from VidAngel priced at \$20.<sup>4</sup> Users chose from over 80 categories of "inappropriate" content to remove while they watched the movie. Users could opt to receive the movie on physical media such as DVD or Blu-ray, but in nearly all instances, VidAngel's users preferred to stream the movie via the Internet.<sup>5</sup> After the user watched the filtered movie, users could watch the film in perpetuity through the VidAngel service or "sell back" the movie to VidAngel at a price of \$19. Most users would automatically sell back the initial purchase, thus VidAngel marketed itself as a \$1 movie streaming service.<sup>6</sup>

The Ninth Circuit held that VidAngel circumvented the studios' protection measures (e.g., DVD or Blu-ray encryption) in violation of the Digital Millennium Copyright Act ("DMCA").<sup>7</sup> The Ninth Circuit held that VidAngel infringed the studios' exclusive rights to reproduce and to publicly perform their copyrighted works.<sup>8</sup> The Court held that VidAngel's FMA and fair use defenses were without merit.<sup>9</sup>

In response to the Ninth Circuit opinion, VidAngel discontinued its \$1 movie streaming service. In its place, VidAngel launched its "2017 service", a \$7.99 monthly subscription service. The 2017 service filters movies streamed via its users' accounts on other digital streaming services such as Amazon and Netflix.<sup>10</sup> VidAngel also sought crowdsource funding to support its petition for certiorari to the United States Supreme Court.<sup>11</sup> On August 31, 2017, VidAngel filed suit in Utah seeking a declaratory judgment against a new set of studios. The declaration sought an answer that VidAngel's 2017 service is legal and does not infringe copyrights.<sup>12</sup>

As discussed herein, the Ninth Circuit's rulings on the DMCA circumvention and the inapplicability of the FMA defense to VidAngel are consistent with the relevant statutory language and purpose. Had the Court ruled in VidAngel's favor, the Family Movie Act would create a giant loophole exception in copyright law. As the court explained, to benefit from the FMA's protections, the service must be

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# View from the Chair

Greetings from the IP Section's 44<sup>th</sup> Annual Intellectual Property Law Institute! By the time you read this, we will have kicked off the program and I will soon pass the gavel to Kendra Mattison, the incoming Chair for the IP Section.

We've had a great (extended) year – The IP Section's Annual Meeting occurs at our Annual IP Institute, which is typically held on Mackinac Island in July. Considering that we did not go to Mackinac this year and our Annual Meeting is just occurring in October, we've enjoyed an extended term working to produce networking and educational opportunities for the Section. Many thanks to the IP Section Council for putting up with me for 15 months!

In addition to the usual events this year, we had the pleasure of welcoming Damian Porcari as the new Director of the Midwest Regional Patent and Trademark Office. If you were not able to join us for the welcome luncheon at the Detroit Athletic Club on October 2, hopefully you are joining us at the IP Institute, where Director Porcari will again address our Section.

Please mark your calendars for the following events:

**Spring Seminar – Monday, March 18, 2019** – The Section will present its annual Spring Seminar at the Crown Plaza in Lansing. I shouldn't give too much away, but *The Slants* may be performing and their founding member, Simon Tam, presenting on the historic *Matal v. Tam* Supreme Court case, in which the Court unanimously affirmed the judgment of the Court of Appeals for the Federal Circuit that the Lanham Act's Disparagement Clause (prohibiting the registration of trademarks that may "disparage" persons, institutions, beliefs, or national symbols) violated the First Amendment.

**IP Law Institute – Thursday, July 18 - Saturday, July 20, 2019** – The Section will return to Mackinac Island in 2019. There is quite a lineup of prestigious speakers for the 2019 IP Institute. Hope to see you there.

Keep an eye out for registration forms or visit [www.icle.org/ip](http://www.icle.org/ip) for more information and to register.

Thanks again to the Council and I wish you well in 2019!



The October 2, 2018 luncheon for Director Porcari.

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provided solely for “private home viewing” and must result in “no fixed copy of the altered version of the motion picture.”<sup>13</sup> VidAngel’s digital filtered film model was unable to meet these statutory requirements.

The start of this legal battle began in July 2015, when VidAngel wrote to various movie studios describing their business model in detail and expressed a desire to work with them.<sup>14</sup> Specifically, VidAngel pleaded with the studios to have discussions if the studios felt VidAngel’s business model violated the Copyright Act or did not adequately protect the rights of copyright owners.<sup>15</sup> With no substantive response from any studios, VidAngel offered its movie streaming service in August 2015. On August 6, 2015, Disney opened a VidAngel account.<sup>16</sup>

After testing the VidAngel model for nearly a year and watching VidAngel’s significant growth,<sup>17</sup> Disney filed a lawsuit against VidAngel on June 9, 2016.<sup>18</sup> On August 22, 2016, the studios filed a Motion for Preliminary Injunction and the injunction was granted by the district court on December 12, 2016.<sup>19</sup> VidAngel filed motions to stay the preliminary injunction and while those motions were pending, continued to stream the studios’ copyrighted works.<sup>20</sup> After VidAngel was held in contempt for violating the preliminary injunction and the motions for stay of the preliminary injunction denied, VidAngel timely appealed to the Ninth Circuit.<sup>21</sup> The Ninth Circuit affirmed the district court opinion on August 24, 2017, bringing to close VidAngel’s streaming filter service after two years of operation.

## Copyright Violations

### Copyright Infringement Under Section 106

The first copyright statute was enacted in 1790 and has been amended periodically in subsequent years to adapt to as different technology becomes available.<sup>22</sup> With advances in digital technology, the need for the DMCA to protect digital reproduction and distribution of copyrighted works became apparent and was enacted in 1998.<sup>23</sup> The Copyright Act of 2005 codified the Family Movie Act, which was also meant to adapt to evolving works of authorship and technology.<sup>24</sup>

### The Right of Reproduction

Section 106(1) of the Copyright Act gives copyright owners the exclusive right to reproduce the copyrighted work in copies or phonorecords.<sup>25</sup> A copy is defined as any material object other than the original object where a work is fixed by any method now known or later developed, and from which the work can be reproduced directly or with aid of a machine.<sup>26</sup> The Ninth Circuit in *Mai Sys. Corp. v. Peak Comput.,*

*Inc.* held that transferring digital work from permanent storage to a computer’s Random-Access Memory (RAM storage) infringes the reproduction right.<sup>27</sup> An example is taking a physical DVD and removing the contents to save on a computer. The Ninth Circuit accepted the position that digitization or input of *any* copyrighted material, whether computer code or visual imagery, may support a finding of infringement even if it has a brief existence in a computer’s RAM.<sup>28</sup> Even if the digital copyrighted material is considered an intermediate copy, it can infringe the exclusive rights of copyright holders under section 106.<sup>29</sup>

VidAngel admitted that it did copy the studio’s copyrighted work on a computer system or third-party server.<sup>30</sup> However, VidAngel argued that these were only intermediate copies placed on the server during the process of streaming the movies.<sup>31</sup> VidAngel did not view these intermediate copies as unlawful because they could only be viewed by the consumer who lawfully purchased the original film.<sup>32</sup> The district court dismissed this argument, holding that intermediate copies are still “copies” as defined by the Act.<sup>33</sup> Because VidAngel’s secured server copy was viewed through the aid of VidAngel’s software, it thereby fell within the prohibited acts of section 106.<sup>34</sup>

Importantly, even the actual owner of a purchased DVD or Blu-ray does not obtain the right to make copies. An actual owner uploading a purchased DVD onto their personal computer is an act of reproduction that the first sale doctrine does not excuse.<sup>35</sup> Thus, absent another defense such as fair use, VidAngel’s copying of the movies as part of its streaming process infringed the exclusive right to reproduce the copyrighted works.

### The Right to Perform the Work Publicly

Section 106(4) of the Copyright Act gives the copyright owner of the motion picture or other audiovisual work, the right to perform the copyrighted work publicly.<sup>36</sup> “Perform” is defined as to play either directly or by means of any device the work in any sequence.<sup>37</sup> To perform publicly is defined as open to the public or any time a substantial number of persons outside of a normal circle of family or social acquaintances is gathered.<sup>38</sup> Public performance also includes transmission to the public by means of any device whether received in the same location or in separate places at the same or different times.<sup>39</sup> The concept of public performance covers the initial showing, but also any further rendition transmitted or communicated to the public.<sup>40</sup> In *Am. Broad. Co. v. Aereo, Inc.*, the Supreme Court held that transmitting a television program to multiple subscribers was a public performance.<sup>41</sup>

The studios claimed a violation of their public performance

rights even though the performances were transmitted privately for in-home viewing. The studios cited *On Command Video Corp. v. Columbia Pictures Indus.*, in which a hotel's electronic rental system infringed the public performance right by transmitting performances into the individual hotel rooms.<sup>42</sup> The holding in *On Command Video Corp.* relies on the relationship between the transmitter and the audience; when the relationship is commercial, it is a public performance regardless of where the viewing takes place.<sup>43</sup> In response, VidAngel cited *Aereo's* holding that the transmission of a copyrighted program is not made to the public when it is made to those who own the relevant product.<sup>44</sup> Therefore, the district court focused its determination of public performance based on who owned the transmitted copy of the film. The district court held that VidAngel customers were not lawful owners of the digital content streamed to them, even if they selected different filters of how they wished to view the film.<sup>45</sup> The commercial nature of the relationship of VidAngel and its customers infringed the public performance right of the studios.<sup>46</sup> The Ninth Circuit did not review whether the public performance right was violated because it held VidAngel was unlikely to succeed on the merits of its affirmative defenses.<sup>47</sup>

### *The Digital Millennium Copyright Act*

The DMCA has five main provisions and covers topics ranging from World Intellectual Property Organization (“WIPO”) treaties, “take down” provisions for online service providers, and boat hulls.<sup>48</sup> Relevant here are the DMCA's provisions regarding the Circumvention of Copyright Protection Systems.<sup>49</sup> The anticircumvention provision of § 1201 makes two important distinctions:

The first distinction is between technological controls that restrict access to a copyrighted work and technological controls designed to prevent violation of an exclusive right of the copyright owner. The second distinction is between individual acts of circumvention and the manufacture and distribution of technologies designed to circumvent technological protection measures.<sup>50</sup>

Section 1201(a)(1) pertains to circumventing access controls. Generally, users that have paid the required price for access to the work are free to circumvent technological controls that prevented the exercise of fair use.<sup>51</sup> Manufacturing or offering devices that circumvent violate § 1201(b).<sup>52</sup> Still, there are several different exemptions for circumvention activities including literary works in malfunctioning or obsolete formats, audiovisual works in university film or for the purpose of making clips for classroom use, and computer programs on mobile phones for the sole purpose of enabling interoperability with third-party software applications.<sup>53</sup> These various exemptions are declared by the Librarian of Congress in consultation with the Copyright Office and Department of Commerce every three years.<sup>54</sup>

Under the DMCA, circumvention is not always infringement.<sup>55</sup> The DMCA exempts from circumvention liability those authorized by a copyright owner to circumvent an access control measure.<sup>56</sup> The DMCA does not exempt those authorized by a copyright owner to merely access the work.<sup>57</sup> Thus, circumvention or decrypting an encrypted work does not necessarily infringe or facilitate infringement of a copyright.<sup>58</sup> A plaintiff alleging circumvention must prove a defendant's access was unauthorized.<sup>59</sup>

### *VidAngel*

VidAngel admitted it “rips” a film from its purchased DVD or Blu-ray disc to make a digital copy on its server.<sup>60</sup> VidAngel uploaded the decrypted files to its server.<sup>61</sup> The studios argued that VidAngel thus circumvented the technological protection measures (“TPMs”) present on the DVD and Blu-Ray discs in violation of the DMCA.<sup>62</sup> VidAngel conceded that the TPMs are encryption access controls that it circumvented, but argued that it was authorized to decrypt the TPMs because the original DVD or Blu-ray disc was an authorized purchase.<sup>63</sup> The Ninth Circuit did not support this position.

The Ninth Circuit held that an individual who buys a DVD has the authority of the copyright owner to *view* the DVD, not to circumvent encryption technology to view the DVD on a different platform.<sup>64</sup> The Ninth Circuit's review of the DMCA text held a defendant could be liable both for its circumvention of use and reproduction of that work despite coming from an originally authorized copy.<sup>65</sup> In fact, the court held, “virtually all piracy of movies originates in some way from a legitimate copy”.<sup>66</sup> Even though VidAngel had purchased a legitimate copy, its decryption of the CSS, AACs, and BD+ access controls without authorization was circumvention under the DMCA.<sup>67</sup> Moreover, VidAngel did not provide any support for their explicit or implicit authorization to circumvent encryption technology.<sup>68</sup>

### *The Family Movie Act of 2005*

#### *Background*

The FMA is a recent and obscure addition to the Copyright Act. The FMA was enacted in response to consumer desires to filter out objectionable content from films.<sup>69</sup> Filtering is the practice of selectively removing content – such as sex, violence, profane language, or advertising – from media content.<sup>70</sup> Common sense suggests that home viewers have the right to skip a sex scene or mute foul language in the privacy of their own home, but technology providers do not have the same rights to enable consumers ease when skipping or filtering.<sup>71</sup>

The Director's Guild of America (“DGA”) believes that filtering without the direct approval of the director undermines the film's artistic integrity by interfering with the story a director is trying to tell.<sup>72</sup> The Register of Copyrights, Marybeth

Peters, stated in the congressional hearings on the FMA, “It seems ... that if a person doesn’t want to watch such portions himself, there is a simple choice: don’t buy or rent the movie.”<sup>73</sup> Still, the market produces many films with very provocative content because those are the stories the directors wish to tell.<sup>74</sup> This produces very few “director’s cut” family-friendly films in the marketplace.<sup>75</sup>

The objectionable content filtered from films is not only foul language for impressionable children to hear. Content may be filtered for survivors of sexual assault or anyone wishing to avoid potentially distressing material.<sup>76</sup> Despite having a legitimate market need, there are very few viable home movie filtering options in the marketplace since most have been shut down by lawsuits from Hollywood studios and directors.<sup>77</sup>

The FMA sought to encourage filtering technologies by exempting from trademark and copyright infringement certain filtering of motion pictures for private home viewing and the creation of technology to facilitate filtering.<sup>78</sup> The FMA applies *only* to viewer-directed changes to the viewing experience, not to making or distributing altered physical copies of the motion picture.<sup>79</sup> Nonetheless, this exemption extends from performance for a private home viewing to legitimate pay-per-view or video-on-demand services.<sup>80</sup>

#### *Infringement Immunity*

The FMA is codified at 17 U.S.C. § 110(11) in a section titled Limitations on Exclusive Rights: Exception of Certain Performances and Displays.<sup>81</sup> The main text of the FMA at issue states:

Notwithstanding the provisions of section 106, the following are not infringements of copyright:

[...]

the making imperceptible, by or at the direction of a member of a private household, of limited portions of audio or video content of a motion picture, during a performance in or transmitted to that household for private home viewing, from an authorized copy of the motion picture, or the creation or provision of a computer program or other technology that enables such making imperceptible and that is designed and marketed to be used, at the direction of a member of a private household, for such making imperceptible, if no fixed copy of the altered version of the motion picture is created by such computer program or other technology.<sup>82</sup>

The language is narrow and specific to make a path for filtering technologies while balancing the interests and exclusive rights of copyright holders. The exemption from copyright liability is not intended to allow defeat of copyright protection.<sup>83</sup> In fact, the DMCA remains fully applicable even against those

who fall within the exemption of the FMA.<sup>84</sup> In the legislative history of the FMA, Senator Orrin Hatch of Utah clarified that the FMA should be narrowly construed to avoid impacting established doctrines of copyright law.<sup>85</sup> Senator Hatch pointed out ClearPlay Inc., as a company able to provide editing capabilities while avoiding copyright infringement.<sup>86</sup> ClearPlay’s DVD service uses a licensed in-home media player to decrypt and play films with encrypted time codes, in which the precise start and end times and categories of potentially offensive content (e.g., nudity, violence, profanity) are determined so that ClearPlay customers can fast-forward through or skip specific scenes while the film is playing directly from an authorized copy, without making any additional copies of the film.<sup>87</sup> ClearPlay also now provides a streaming service, using the same encrypted time codes. The streaming service uses an app that allows ClearPlay customers to fast-forward through or skip specific scenes from rentals and purchases made through Amazon.com.<sup>88</sup>

#### *The Ninth Circuit*

While the FMA had been interpreted by district courts, the Ninth Circuit’s VidAngel decision is the first appellate interaction with the FMA.<sup>89</sup> The Ninth Circuit focused on the textual distinction that VidAngel had created by suggesting that if filtering *begins* with an authorized copy, the subsequent filtered stream is also an authorized copy.<sup>90</sup> However, the text of the FMA stated the filtering must come *from* an authorized copy.<sup>91</sup> VidAngel’s intermediate copy placed on its server did begin with an authorized copy, but the intermediary copy was not authorized. Therefore, the filtered content by VidAngel was not an authorized copy.<sup>92</sup>

VidAngel argued that under the FMA if an authorized copy is purchased, any subsequent versions of the film that are not fixed are also authorized regardless of any circumvention.<sup>93</sup> The Ninth Circuit held that VidAngel’s interpretation of the FMA would create a massive loophole in copyright law. The Ninth Circuit felt it should identify the potential loophole, and to not allow such an interpretation, as doing so could undermine the very protections the FMA statute provides.<sup>94</sup>

The Ninth Circuit also took issue with VidAngel’s filtering options. VidAngel’s service provides over 80 categories of filtering including language, nudity or credits.<sup>95</sup> The customer was required to select at least one filter and, when VidAngel first launched, its service could filter only the film credits.<sup>96</sup> VidAngel later modified the service so that customers who initially chose to filter out only credits were required to select at least one additional filter.<sup>97</sup> Regardless, the Ninth Circuit focused only on the VidAngel service’s ability to filter out movie credits, noting that such filtering would severely erode the commercial value of the public performance in the digital context.<sup>98</sup> While the Ninth Circuit is technically correct, its position overlooks films with credits containing objection-

able content that viewers may wish to filter.<sup>99</sup> Therefore, there may be a legitimate content-oriented basis for filtering only a movie's credits.

## Fair Use

In response to Plaintiffs' complaint and preliminary injunction, VidAngel asserted the affirmative defense of fair use. The Copyright Act grants exclusive rights to authors of original works, but the fair use doctrine places limits to those rights.<sup>100</sup> To determine whether a particular use is fair, a court will consider the following factors: (1) The purpose and character of the use; (2) the nature of the copyrighted work; (3) the amount and substantiality of the portion used; and (4) the effect upon the market.<sup>101</sup> These factors are considered together and determined by a case-by-case analysis.<sup>102</sup> On appeal, VidAngel conceded that the district court properly found the second and third factors weighed against a finding of fair use.<sup>103</sup> VidAngel appealed only the first and fourth factors.<sup>104</sup>

### *Purpose and Character of the Use*

The first factor in the fair use analysis is, "the purpose and character of the use, including whether such use is of a commercial nature."<sup>105</sup> To determine the purpose and character of the use of the copyrighted material, courts look to whether the use is commercial or non-commercial and whether the use is transformative or non-transformative.<sup>106</sup> The more transformative the new work, the less significant the commercial purpose is in finding fair use.<sup>107</sup> The use is transformative if it adds something new with the purpose of altering the first expression.<sup>108</sup>

VidAngel argued that its use of filtering was transformative.<sup>109</sup> The court did not find that omitting objectionable portions of a film transformed the work.<sup>110</sup> The Ninth Circuit affirmed the district court's holding that removing objectionable content does not add something new or change the expression or message of the film.<sup>111</sup> The court went on to say, "Star Wars is still Star Wars, even without Princess Leia's bikini scene."<sup>112</sup>

The district court and the Ninth Circuit's holdings, that filtering is not transformative, is contrary to the Copyright Office's findings and stance of the DGA. In the hearings on the FMA, the Register of Copyrights, Marybeth Peters, said that filtering out an undesired scene, "alters a director's artistic vision".<sup>113</sup> In fact, a representative of the DGA said filtering undermined the film's artistic integrity and interfered with the story a director was telling.<sup>114</sup> When the movie studio Sony sought to release "clean" versions of its own films for airline use, several directors revolted.<sup>115</sup> Sony was able to achieve its result with a release of filtered versions of films, but *only* with director approval.<sup>116</sup>

Even if the district court had found filtering to be transformative, VidAngel admitted that its use was commercial.<sup>117</sup>

Commercial use is presumptively unfair, thus the concession made VidAngel's use presumptively unfair when determining the weight to give to this fair use factor.<sup>118</sup> The Ninth Circuit also noted that the FMA only exempts the removal of imperceptible limited portions of audio or video content of a motion picture.<sup>119</sup>

### *Effect of the Use Upon the Market*

The fourth and final fair use factor is the effect upon the potential market or value of the copyrighted work.<sup>120</sup> The analysis for this factor looks at the harm to the market of the original work and the market for derivative works.<sup>121</sup> VidAngel argued that its service's effect on the market favored its position because: (1) The studios benefit from VidAngel's service; and (2) VidAngel's service is space-shifting.

VidAngel said that its service benefited the studios because VidAngel paid for the original copy.<sup>122</sup> VidAngel did not believe it was creating a new or competing market with its service.<sup>123</sup> In an attempt to support its argument, VidAngel provided a customer survey that found the majority (51%) of VidAngel's customers would not view the studios' films without filtering.<sup>124</sup> This argument was unsuccessful in persuading the court that "most" of VidAngel's customers were people who would not have viewed the films in original form, thus increasing the studios' audience. The Ninth Circuit easily dismissed this argument by pointing out that the survey results meant that nearly half (49%) of VidAngel customers would still watch the same films regardless of filtering.<sup>125</sup> While some consumers would not watch the studio's films without VidAngel's service, it appears that many would continue to watch the films even without a filtering service.

The second argument for the market effect was space-shifting. Time-Shifting occurs when a videotape owner records a television show with a VCR for later viewing.<sup>126</sup> The VCR's current relative would be a DVR service or device that can record a television show for a homeowner to view later. A similar concept, space-shifting, occurs when an owner of data uses a device or website to store data in a different location to access it from various locations at any time.<sup>127</sup> An example of a space-shifting service is music purchased through iTunes, which allows the owner to access it from their computer, phone, or tablet. VidAngel argued that its service was space-shifting the copyrighted work already purchased by the customer.<sup>128</sup> The Ninth Circuit did not give this argument much weight, as it had already determined that VidAngel owned the intermediate copy of the film that is streamed to the customer.<sup>129</sup> The court stated that even if space-shifting was fair use, VidAngel's service was public and commercial.<sup>130</sup> The district court held that all four factors of fair use weighed in favor of the studios. The Ninth Circuit similarly found that the fair use factors all weighed in favor of the studios.

## The Future of Filtering Services

### *The Family Movie Act*

The Ninth Circuit's opinion, as the first appellate court interpreting the FMA, will be the primary legal reference source for future cases in which the FMA is implicated.<sup>131</sup> The Ninth Circuit applied the plain meaning rule and looked to the exact text of the FMA statute for its analysis. The plain meaning rule should increase consistency of statutory interpretation, but what is "plain" relies on the interpreter.<sup>132</sup> The appellate court acknowledged the legislative history but stated it did not need to rely on that history because its conclusion was based upon the philosophy that the FMA should not impact established doctrines of copyright.<sup>133</sup> In doing so, the Ninth Circuit does not support the legislative intent of the FMA. Congress intended to allow companies the ability to provide filtering services while retaining protections for copyright holders. The Ninth Circuit's opinion weighs heavily in favor of copyright holders and further restricts companies seeking to provide filtering services.<sup>134</sup> This favoring of copyright holders, despite congressional authority to permit filtering under the FMA, leaves the FMA restricted and makes future filtering increasingly more difficult.

### *VidAngel*

Despite its legal battles, VidAngel claims it is not finished yet.<sup>135</sup> VidAngel's original service has been shut down by the Ninth Circuit's affirmation of the preliminary injunction. In response, VidAngel stated it was prepared to take the case all the way to the United States Supreme Court and began crowdfunding for litigation.<sup>136 137</sup>

Scholars and commentators seem to agree that VidAngel violated the DMCA by its circumvention of the studios' technology on DVD and Blu-ray discs.<sup>138</sup> Because the FMA is still relatively young and this is the first instance an appellate court interpreted the statute, it is unlikely the Supreme Court would grant certiorari for this issue without a circuit split.<sup>139</sup> This is even further unlikely with the even more limited scope of the FMA interpretation made by the Ninth Circuit.

Even though this issue has been litigated, VidAngel filed a motion with the California District Court, requesting clarification of an injunction order.<sup>140</sup> In its motion, VidAngel sought an answer whether its 2017 service – filtering on top of accounts on other streaming services such as Netflix – violates the original Ninth Circuit order.<sup>141</sup> The California district court denied the motion holding VidAngel's request for a declaration regarding their 2017 service was inappropriate for a resolution in a motion to clarify.<sup>142</sup> The district court declined to issue any order regarding the 2017 service.

VidAngel also filed a federal complaint in Utah against 12 movie studios and entertainment companies.<sup>143</sup> These compa-

nies are affiliates of the studios in the Ninth Circuit case, but are not the same listed plaintiffs. VidAngel sought declaratory relief regarding its previous version of movie filtering, its 2017 service of movie filtering, and the FMA.<sup>144</sup> The lawsuit was dismissed on July 27, 2018 for lack of personal jurisdiction.<sup>145</sup>

### *The 2017 VidAngel Streaming Service*

In June 2017, while VidAngel awaited the Ninth Circuit decision, it launched its new 2017 service. The 2017 service is a \$7.99 monthly subscription that is selected as an add-on to customer's current digital streaming accounts.<sup>146</sup> This service only works with the customer's existing third-party digital streaming accounts, such as Amazon and Netflix, and cannot edit films from VidAngel's website. This allows for filtering films while movie studios continue profiting from streaming and licensing fees. This also maintains the movie studios' "windowing" market edge, allowing Studios to release their films through different distribution channels at different times and prices.<sup>147</sup>

If VidAngel's 2017 service is reviewed by a court, the issue will rest with the court's determination of whether a customer's purchased video stream (from services such as Amazon) is authorized to apply a third-party filter.<sup>148</sup> A court may analyze this by determining whether there was a right to modify the copyrighted work, or under the first sale doctrine. The issue is reminiscent of *Nintendo of America, Inc. v. Lewis Galoob Toys, Inc.*, where the court held that users had the right to modify copyrighted works (video games) for their own personal use.<sup>149</sup> In the *Nintendo of America* case, a modified game could only work as an add-on to the original copyrighted work and was unable to work independently. However, the modified game did not create a fixed copy.<sup>150</sup> Thus, a court applying *Nintendo of America* would be expected to focus on the manner in which VidAngel's 2017 service creates a fixed or intermediary copy, if it does so at all.

A court may also look to *Capitol Records v. ReDigi*, in which the company ReDigi tried to apply the first sale doctrine to the transfer of authorized copies of digital works.<sup>151</sup> ReDigi enabled its users to sell their digital music files to a third party by uploading the files to ReDigi.<sup>152</sup> The digital music file is transferred to the ReDigi remote server where the third party could access and download the files. After the transfer, the original file would be deleted from the seller's media storage location.<sup>153</sup> The court held that the digital music file moving from one computer to the ReDigi server means that a reproduction occurred.<sup>154</sup> The court rejected ReDigi's first sale defense, holding that the first sale doctrine was only a limitation on public distribution right, not the reproduction right.<sup>155</sup> ReDigi's model tried to create a digital equivalent of public distribution, but in the process it nevertheless created an infringing copy of the work just by the manner in which it

transferred the digital music file.<sup>156</sup> This opinion limited the application of the first sale doctrine to digital copies of music.<sup>157</sup> A court could apply *ReDigi* in the digital film context to limit the application of the first sale doctrine in all digital media formats. Thus, if a content-streaming company like Amazon purchases its digital copies of films from the copyright owners for use in its digital streaming service, a court applying *ReDigi* could hold that a filtered copy viewed by a customer is a transferred digital file. A court could find that the Amazon digital stream held on its server is then transferred to its customer in altered form according to filters, thereby creating a reproduction of the original work that is not exempted under the first sale doctrine. In other words, Amazon would be the original owner of a copy of the digital film and under *ReDigi*, not exempted to resell filtered digital copies to Amazon customers. Further, copyright holders increasingly license their digital works.<sup>158</sup> If Netflix or Amazon is a mere licensee, neither it nor its customers likely have any rights under the first sale doctrine.

The Ninth Circuit held that the FMA language that a filtered transmission of a film “from an authorized copy of the motion picture” does not mean “beginning from” or “indirectly from” an authorized copy.<sup>159</sup> According to the Ninth Circuit’s holding, the FMA language can only mean a filtered transmission itself must be “from” an authorized copy of the motion picture without the creation of any intermediary copy and without maintaining the original authorized copy for further distribution.<sup>160</sup> This argument could be applied to find that VidAngel’s 2017 service performs unauthorized copying, regardless of whether or not Netflix or Amazon or another streaming service is providing an authorized digital stream. For example, the authorization can be said to only apply to the digital stream uploaded to Netflix or Amazon by the copyright owner, and not to the filtered version the customer subsequently views. The Ninth Circuit’s interpretation of the FMA implies that a director himself must make these filtered approvals and filtering cannot be done by a consumer unless using the already permitted time coding technology of ClearPlay’s DVD filtering service. This interpretation would render the FMA ineffective at allowing any style of filtered streaming service that is different from ClearPlay’s time-coded DVD filtering service.

### Other Filtering Services

#### ClearPlay

Notably throughout the litigation against the studios were references to VidAngel’s competitor, ClearPlay Inc. ClearPlay was mentioned in discussions of the proposed FMA and the FMA was modeled, in part, after ClearPlay’s DVD filtering business model.<sup>161</sup> As mentioned above, ClearPlay sells a technology-assisted filtering device that uses video time codes

to allow customers to fast forward through specific scenes or mute specific audio on purchased DVD’s containing original (unfiltered) films.<sup>162</sup> This technology uses the time codes that are already integrated into a disc’s encrypted content and the ClearPlay device decrypts and play the content without making any additional copy.<sup>163</sup> ClearPlay submitted an *amicus curiae* brief in support of Plaintiffs/Appellees in the Ninth Circuit. Missing from ClearPlay’s *amicus curiae* brief was any reference to its pending litigation opposite VidAngel in Utah district court.<sup>164</sup>

A curiously-timed shutdown of ClearPlay’s streaming service was also not mentioned in ClearPlay’s *amicus curiae* brief. ClearPlay’s streaming service works as an add-on app to watched purchased or rented movies from Amazon.com.<sup>165</sup> The app using the same time coded technology as ClearPlay’s DVD service, to allow ClearPlay customers to fast-forward specific scenes or mute specific audio by selected those filters.<sup>166</sup> In February 2017, ClearPlay confirmed that their service no longer permitted streaming of new movies and had not done so since September of 2016.<sup>167</sup> ClearPlay’s streaming service resumed in approximately September of 2017.<sup>168</sup> Interestingly, the dates of the reported stop of service and the resumed streaming service generally correspond to key litigation dates for *Disney Enter. v. VidAngel, Inc.*<sup>169</sup>

As suggested by the temporary cessation in ClearPlay’s streaming service, ClearPlay’s filtering model could also be in trouble since the FMA did not mention digital streaming services at the time of its enactment.<sup>170</sup> Disney’s attorney Donald Verrilli said that the studios do not oppose filtering, only *illegal* filtering.<sup>171</sup> Verrilli said ClearPlay’s digital streaming model was within the parameters of the law.<sup>172</sup> VidAngel’s 2017 service now shares more similarities with ClearPlay’s streaming model as they both work as an add-on service that applies filters to a digital stream provided by a third-party service.<sup>173</sup> This add-on service by ClearPlay works exclusively with movies purchased or rented from Amazon.com.<sup>174</sup> Verrilli states that these services (*e.g.*, Amazon or another digital streaming service) “have actually done what they should’ve done and gotten a license for public performance rights.”<sup>175</sup> With this bold statement, it would be hard to argue from the studio’s perspective how ClearPlay’s service infringes without creating a contradiction.<sup>176</sup> It would similarly be difficult for studios to argue that VidAngel’s 2017 service infringes without contradicting themselves. Regardless, some consumers view ClearPlay’s streaming service inferior to VidAngel because it has more limitations in its filtering capabilities.<sup>177</sup>

#### Other Movie Filtering Options

Many other movie filtering companies have closed shop due to lawsuits. CleanFlix, CleanFlicks, and CleanFilms are just a few that customers are now without.<sup>178</sup> If customers

desire filtered movies without using ClearPlay, Sony does provide a few of its own films, in filtered form, for purchase through iTunes, VUDU, and FandangoNOW.<sup>179</sup> The company TVGuardian provides a foul language filter comparable to censoring applied to television.<sup>180</sup> This filter only applies to foul language and no other objectionable content. Parents Television Council urged Netflix to embrace and engage with filtering companies.<sup>181</sup> The filtering service options currently in place are limited and do not fulfill the full intent of the FMA to permit users to use filtering services.

### *The Family Movie Clarification Act*

Congress recently began its new approach to protect filtering services by introducing an Act to clarify and correct the Ninth Circuit's interpretation of the FMA.<sup>182</sup> On September 13, 2018, Representative Mia Love of Utah introduced the Family Movie Act Clarification Act of 2018 ("Clarification Act") to the House Committee on the Judiciary.<sup>183</sup> The Clarification Act would amend the FMA to make clear that the FMA protects streaming services, not just DVD player technology that was discussed during the original FMA congressional hearing.<sup>184</sup> The Clarification Act, as proposed, would explicitly include streaming services to permit filtering services and advocates of the Clarification Act believe it could do so without sacrificing studio revenue or violating the Copyright Act.<sup>185</sup> So long as this bill is able to pass, this would be a win for VidAngel and other filtering services.

### **Conclusion**

The Ninth Circuit found VidAngel's movie filtering service liable for copyright infringement. VidAngel used decryption technology to place an intermediary copy on its server, in violation of the DMCA. This holding would likely have been found by any other court, including the United States Supreme Court. This seemingly simple case opens the door to some underlying issues: Can a viable movie filtering service, other than the ClearPlay DVD filtering service, safely exist under the protections of the FMA? For the time being, ClearPlay's streaming and DVD service and VidAngel's 2017 streaming service appear temporarily safe. Nevertheless, given the long history of legal battles against movie filtering and the need for congressional intervention, it may only be a matter of time before another lawsuit commences and these services cease operation.<sup>186</sup> The Clarification Act would provide a safety-net for the filtering movie services against the threat of litigation.

As the FMA has been interpreted, it appears that ClearPlay's DVD service is the only legally compliant film filtering service model. Otherwise, if a company wanted to comply with the FMA, to be entirely safe they would first need an authorized filter copy, rather than starting from an authorized purchase of an original unfiltered film. This essentially gives

the power of filtering to movie studios and directors to determine what may be filtered or edited and takes away the purpose of the FMA, at least as it would pertain to streaming content. While benefiting from FMA protections could create a loophole in copyright law as suggested by the Ninth Circuit, it is not the role of the judiciary to identify and plug those loopholes.<sup>187</sup> Even if FMA created a loophole, it was authorized by Congress and therefore the responsibility of Congress to fill the hole or otherwise remedy the problem with the statute, such as with the Clarification Act.<sup>188</sup>

For a filtering company to withstand precedent set by the Ninth Circuit's interpretation of the FMA, the company may only stream authorized filtered copies. The Ninth Circuit's interpretation did not determine if the act of providing a filtering service as an add-on to already-purchased digital content is protected by the FMA or if the streaming filtering service infringes copyrights. To ensure no copyright infringement, a filtering company should receive consent from movie studios to perform any filtering actions. It is highly unlikely that a filtering company would receive permission given the studios' and directors' push back to filtering thus far. Movie studios should be embracing the market need for filtering services and work with companies in a way that benefits them and permits filtering beyond using only ClearPlay's physical DVD filtering service. There could be a way to permit quality legal digital streaming filtering but without the Clarification Act to secure it, this likely requires movie studios to consent for it to succeed. Without movie studio cooperation, it will be up to Congress to save digital streaming filtering (and VidAngel) through the Clarification Act. ?

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### **Endnotes**

- 1 *Disney Enter. v. VidAngel, Inc.*, 869 F.3d 848 (9th Cir. 2017).
- 2 17 USC § 110(11).
- 3 *Disney Enter.*, 869 F.3d at 865 n.17.
- 4 *Id.* at 853. The described service has been unavailable since the District Court granted Plaintiff's Motion for Preliminary Injunction on December 12, 2006.
- 5 Only 4 customers as of the date of the district court opinion had requested physical copies. Therefore, the district court did not review whether the physical model would constitute copyright infringement.
- 6 *Disney Enter.*, 869 F.3d at 854. Almost all VidAngel users would return the filtered film within five hours of the initial purchase. *Id.*

- 7 17 U.S.C. § 1201(a)(1)(A).
- 8 *Disney Enter.*, 869 F.3d at 864.
- 9 *Id.* at 857, 860.
- 10 See *Facts Concerning VidAngel's New Filtering Technology*, VIDANGEL, <http://blog.vidangel.com/wp-content/uploads/2017/06/Fact-Sheet-VidAngels-New-Technology.pdf> (last visited Oct. 1, 2018).
- 11 As of December 2016, VidAngel raised over \$10 million dollars for its legal fees from 7,500 donors. JD Alois, *VidAngel Just Crowdfunded \$10M Using Reg A+ & Now Court Orders Video Streaming Business to Shut Down*, CROWDFUND INSIDER (Dec. 13, 2016), <https://www.crowdfundinsider.com/2016/12/93666-vidangel-just-crowdfunded-10m-using-reg-now-court-orders-video-streaming-business-shut/>.
- 12 The Utah case was dismissed for lack of personal jurisdiction on July 27, 2018. *VidAngel, Inc. v. Sullivan Entm't Grp., Inc.*, No. 2:17-cv-00989-DN, 2018 WL 3611068 (D. Utah July 27, 2018). Other legal actions continued for VidAngel including a Chapter 11 bankruptcy filing and an appeal to the Ninth Circuit on claims that the studios violated unfair competition. See Neal Harmon, *VidAngel Uses Chapter 11 Protection to Pause Los Angeles Lawsuit to Reorganize Its Business around the New Streaming Model*, VIDANGEL (Oct. 18, 2017), [www.blog.vidangel.com/2017/10/18/vidangel-uses-chapter-11-protection-pause-los-angeles-lawsuit-reorganize-business-around-new-streaming-model/](http://www.blog.vidangel.com/2017/10/18/vidangel-uses-chapter-11-protection-pause-los-angeles-lawsuit-reorganize-business-around-new-streaming-model/). See *Disney Enters. v. VidAngel, Inc.*, 734 F. App'x 522 (9th Cir. 2018).
- 13 *Disney Enter.*, 869 F.3d at 857.
- 14 Brief for Appellant at 10, *Disney Enter. v. VidAngel, Inc.*, 869 F.3d 848 (9th Cir. 2017). VidAngel is the third movie filtering business model for CEO Neal Harmon. In his prior attempts, Harmon also sought permission from movie studios, but each time permission was withheld. *Id.* at 10-11.
- 15 *Id.*
- 16 *Id.*
- 17 JD Alois, *VidAngel Crowdfunded \$5 Million in Just 28 Hours Under Reg A+*, Crowdfund Insider (Dec. 4, 2016), <https://www.crowdfundinsider.com/2016/12/93321-vidangel-crowdfunded-5-million-just-28-hours-reg/>. From August 2015 to June 2016, VidAngel's sale transactions grew by over 1,800%. *Id.*
- 18 *Disney Enter. v. VidAngel, Inc.*, 224 F. Supp. 3d 957, 965 (C.D. Cal. 2016).
- 19 *Id.* at 963-64.
- 20 *Disney Enter.*, 869 F.3d at 855.
- 21 *Id.*
- 22 Julie E. Cohen, et al., *COPYRIGHT IN A GLOBAL INFORMATION ECONOMY* 864 (4th ed. 2015).
- 23 *Id.*
- 24 2 Nimmer on Copyright § 8.15.
- 25 17 U.S.C. § 106(1).
- 26 17 U.S.C. § 101.
- 27 *Mai Sys. Corp. v. Peak Comput., Inc.*, 991 F.2d 511, 518 (9th Cir. 1993).
- 28 *Disney Enter.*, 224 F. Supp. 3d at 969 (quoting *Tiffany Design, Inc. v. Reno-Tahoe Specialty, Inc.*, 55 F. Supp. 2d 113, 1121 (D. Nev. 1999)).
- 29 See e.g., *Sega Enter. v. Accolade, Inc.*, 977 F.2d 1510, 1519 (9th Cir. 1992). The court held that section 106 unambiguously proscribes intermediate copying. *Id.*
- 30 *Disney Enter.*, 224 F. Supp. 3d at 969.
- 31 *Id.*
- 32 *Id.* at 969-70.
- 33 *Id.* at 970. See also, *Sega Enter.*, 977 F.2d at 1519.
- 34 *Disney Enter.*, 224 F. Supp. 3d at 970.
- 35 R. Anthony Reese, *The First Sale Doctrine in the Era of Digital Networks*, 44 B.C. L. REV. 577, 612 (2003).
- 36 17 U.S.C. § 106(4).
- 37 17 U.S.C. § 101.
- 38 *Id.*
- 39 *Id.*
- 40 *Am. Broad. Co. v. Aereo, Inc.*, 134 S. Ct. 2498, 2506 (2014).
- 41 *Id.*
- 42 *On Command Video Corp. v. Columbia Pictures Indus.*, 777 F. Supp. 787 (N.D. Cal. 1991)
- 43 *Id.* at 788. See also, *Warner Bros. Entm't Inc. v. WTV Sys., Inc.*, 824 F. Supp. 2d. 1003 (C.D. Cal. 2011).
- 44 *Am. Broad. Co.*, 134 S. Ct. at 2510.
- 45 *Disney Enter.*, 224 F. Supp. 3d at 970-71.
- 46 *Id.* at 971.
- 47 *Disney Enter.*, 869 F.3d at 862 n. 13.
- 48 U.S. Copyright Office Summary (Dec. 1998), <https://www.copyright.gov/legislation/dmca.pdf>.
- 49 17 U.S.C. § 1201(a).
- 50 Julie E. Cohen, *supra* note 22, at 866.
- 51 *Id.*
- 52 *Id.*
- 53 *Id.* at 882.
- 54 *Id.* at 881.
- 55 *Chamberlain Grp., Inc. v. Skylink Techs, Inc.*, 381 F.3d 1178, 1192 (Fed. Cir. 2004).

- 56 17 U.S.C. § 1201(a)(3)(A).
- 57 *Id.*
- 58 17 U.S.C. § 1201(a).
- 59 *Chamberlain Grp., Inc.*, 381 F.3d at 1193.
- 60 *Disney Enter.*, 869 F.3d at 853. VidAngel used the software program AnyDVD HD to decrypt films. AnyDVD HD's parent company, RedFox, has been convicted overseas for trafficking in anti-circumvention technology by selling software that facilitates copyright violations. *Id.* at 853 n. 2.
- 61 *Id.* at 853.
- 62 *Id.* at 863-65. The TPMs VidAngel conceded to override are Content Scramble System and Advanced Access Content System. *Id.* at 853.
- 63 *Id.* at 863. VidAngel argued for the first time on appeal that TPMs on the studio's discs are use controls, not access controls and therefore, VidAngel cannot be liable for circumventing them. *Id.* at 864.
- 64 *Id.* at 863. (emphasis added).
- 65 *Id.*
- 66 *Id.* at 859.
- 67 *Id.* at 865.
- 68 *Id.*
- 69 *See, e.g.*, Matthew Faraci, *More Than Two Dozen Leaders Standing With VidAngel In Legal Battle With Disney While 30,000 Donors Contribute To Legal Defense Fund*, VidAngel (Sept. 20, 2016), <http://blog.vidangel.com/2016/09/20/more-than-two-dozen-leaders-standing-with-vidangel-in-legal-battle-with-disney-while-30000-donors-contribute-to-legal-defense-fund/>.
- 70 Brief for Appellant, *supra* note 14, at 1.
- 71 Marybeth Peters, *The Family Movie Act: Statement Of Marybeth Peters Register Of Copyrights Before The Subcommittee On Courts, The Internet And Intellectual Property Of The House Committee On The Judiciary*, UNITED STATES COPYRIGHT OFFICE (June 17, 2004), <https://www.copyright.gov/docs/regstat061704.html>.
- 72 Taylor Hackford, *Derivative Rights, Moral Rights, And Movie Filtering Technology: Hearing Before The Subcommittee On Courts, The Internet, And Intellectual Property Of The House Commission On The Judiciary*, Director's Guild of America (May 20, 2004), <https://www.gpo.gov/fdsys/pkg/CHRG-108hhrg93773/html/CHRG-108hhrg93773.htm>.
- 73 Marybeth Peters, *supra* note 71.
- 74 *See, e.g.*, Megan Christensen, *Viral Video Demonstrates Impact Of Swearing In Media On Families*, DESERET NEWS (Aug. 11, 2014), [www.deseretnews.com/article/865608554/Viral-video-demonstrates-impact-of-swearing-in-media-on-families.html](http://www.deseretnews.com/article/865608554/Viral-video-demonstrates-impact-of-swearing-in-media-on-families.html); Randy Olson, *A Look At Sex, Drugs, Violence, And Cursing In Film Over Time Through MPAA Ratings*, RANDAL S. OLSON (Jan. 12, 2014), <http://www.randalolson.com/2014/01/12/a-look-at-sex-drugs-violence-and-cursing-in-film-over-time-through-mpaa-ratings/>.
- 75 Marybeth Peters, *supra* note 71.
- 76 Ashley Cullins, *VidAngel Launches New Platform Amid Studio Legal Battle (Exclusive)*, HOLLYWOOD REPORTER (June 13, 2017), <http://www.hollywoodreporter.com/thr-esq/vidangel-launches-new-platform-studio-legal-battle-1013164>.
- 77 Brief for Appellant, *supra* note 14, at 9-10.
- 78 17 U.S.C. § 110.
- 79 2 Nimmer on Copyright § 8.15.
- 80 *Id.*
- 81 17 U.S.C. § 110.
- 82 17 U.S.C. § 110(11).
- 83 2 Nimmer on Copyright § 8.15.
- 84 *Id.*
- 85 *Disney Enter.*, 869 F.3d at 859.
- 86 *Id.* at 860.
- 87 *Id.* The ClearPlay device at the time the FMA was enacted was for physical DVDs only.
- 88 ClearPlay, *About Us*, CLEARPLAY.COM, <https://try.clearplay.com/what-is-clearplay/> (last visited Oct. 7, 2018).
- 89 *Disney Enter.*, 869 F.3d at 857.
- 90 *Id.*
- 91 *Id.*
- 92 *Id.*
- 93 *Id.* at 859.
- 94 *Id.* The Ninth Circuit did not accept the advice from Justice Scalia in his dissent in *Aereo*. Justice Scalia discusses the role of the judiciary by stating, "It is not the role of this Court to identify and plug loopholes. It is the role of good lawyers to identify and exploit them, and the role of Congress to eliminate them if it wishes." *Am. Broad. Co.*, 134 S. Ct. at 2517.
- 95 Brief for Appellant, *supra* note 14, at 12.
- 96 *Id.*
- 97 *Id.*
- 98 *Disney Enter.*, 869 F.3d at 859.
- 99 *See, e.g.*, *The Hangover* (2009). As the credits roll, the audience views photographs of the main characters' forgotten night including photos of male genitals. Wook Kim, *The Hangover*, TIME (Nov. 26, 2012), <http://entertainment.time.com/2012/11/27/after-the-end-10-memorable-end-credit-scenes/slide/the-hangover/>.
- 100 Julie E. Cohen, *supra* note 22, at 563.
- 101 17 U.S.C. § 107.

- 102 Campbell v. Acuff-Rose Music, Inc., 510 U.S. 569, 577-78 (1994).
- 103 *Disney Enter.*, 869 F.3d at 860.
- 104 *Id.*
- 105 17 U.S.C. § 107(1).
- 106 Alfred C. Yen and Joseph P. Liu, COPYRIGHT LAW ESSENTIAL CASES AND MATERIALS 385 (3rd ed. 2016).
- 107 *Campbell*, 510 U.S. at 579.
- 108 *Id.*
- 109 *Disney Enter.*, 869 F.3d at 861.
- 110 *Id.* See also, *Clean Flicks of Colo. v. Soderbergh*, 433 F. Supp. 2d. 1236, 1243 (D. Colo. 2006).
- 111 *Id.*
- 112 *Id.*
- 113 Marybeth Peters, *supra* note 71.
- 114 Taylor Hackford, *supra* note 72.
- 115 Andrew Zaleski, *YouTube's Orson Welles of Poop Wants to Sanitize Cinema*, WIRED (Sept. 6, 2017) <https://www.wired.com/story/youtubes-orson-welles-of-poop-wants-to-sanitize-cinema/>
- 116 *Id.* See also, Ashley Cullins, *supra* note 76.
- 117 *Disney Enter.*, 869 F.3d at 861.
- 118 *Id.* (citing *Leadsinger, Inc. v. BMG Music Publ'g*, 512 F.3d 522, 530 (9th Cir. 2008)).
- 119 *Id.*
- 120 17 U.S.C. § 107(4).
- 121 Alfred C. Yen, *supra* note 106, at 385. See also, *Campbell*, 510 U.S. at 590.
- 122 *Disney Enter.*, 224 F. Supp. 3d at 974.
- 123 *Id.*
- 124 Brief for Appellant, *supra* note 14, at 30.
- 125 *Disney Enter.*, 869 F.3d at 861.
- 126 Sony Corp. of Am. v. Universal City Studios, Inc., 464 U.S. 417, 423 (1984).
- 127 Michael J. Worth, *The Digital Double Standard for Internet Music Lockers: The DMCA's Feeble Attempt at Adapting to the Digital Universe*, 42 Sw. L. REV. 661, 679 (2013).
- 128 *Disney Enter.*, 869 F.3d at 862.
- 129 *Id.*
- 130 *Id.*
- 131 Stefanie A. Lindquist and Frank B. Cross, *Empirically Testing Dworkin's Chain Novel Theory: Studying the Path of Precedent*, 80 N.Y.U.L. REV. 1156, 1179 (2005).
- 132 Sydney Foster, *Should Courts Give Stare Decisis Effect to Statutory Interpretation Methodology?*, 96 GEO. L.J. 1863, 1883 n. 112.
- 133 *Disney Enter.*, 869 F.3d at 859.
- 134 See, e.g., Meaghan H. Kent, *Pendulum May Be Swinging Away From Fair Use*, LAW360 (Oct. 26, 2017).
- 135 Legal Entertainment, *VidAngel Loses Appeal; Content-Filtering Services Sees Trouble Ahead*, FORBES (Aug. 24, 2017), <https://www.forbes.com/sites/legalentertainment/2017/08/24/vidangel-loses-appeal-content-filtering-service-sees-trouble-ahead/#620527e340cc>.
- 136 Jeffrey Harmon, *9<sup>th</sup> Circuit Court Ruling Has No Impact on VidAngel's New System*, VIDANGEL (Aug. 24, 2017), <http://blog.vidangel.com/2017/08/24/9circuit-court-ruling-no-impact-vidangels-new-system/>.
- 137 VidAngel had 90 days from the entry of the Ninth Circuit order to file its petition for writ of certiorari to the Supreme Court, which lapsed on Friday, January 5, 2018. 28 U.S.C. § 2101.
- 138 *Id.*
- 139 *How The Court Works, Types Of Cases The Court Hears*, THE SUPREME COURT HISTORICAL SOCIETY, [www.supremecourthistory.org/htcw\\_casesthecourthears.html](http://www.supremecourthistory.org/htcw_casesthecourthears.html) (last visited Oct. 1, 2018).
- 140 *Disney Enter., Inc. v. VidAngel Inc.*, CV1604109ABPLAX, 2017 WL 6819882 (C.D. Cal. Oct. 5, 2017).
- 141 Art Raymond, *VidAngel Goes on Offense in Utah Following Setbacks in California Courts*, DESERET NEWS (Sept. 6, 2017), <https://www.deseretnews.com/article/865688242/VidAngel-goes-on-offense-in-Utah-following-setbacks-in-California-courts.html>.
- 142 *Id.*
- 143 *Id.*
- 144 Eriq Gardner, *VidAngel Seeks Salvation for Filtering Service in Utah Federal Court*, HOLLYWOOD REPORTER (Sept. 1, 2017), <http://www.hollywoodreporter.com/thr-esq/vidangel-seeks-salvation-filtering-service-utah-federal-court-1034581>.
- 145 *VidAngel*, No. 2:17-cv-00989-DN, 2018 WL 3611068, at \*1. VidAngel failed to make a *prima facie* showing of personal jurisdiction. *Id.* at \*3. VidAngel's creative arguments of lobbying activities, and business activities were not enough to overcome the personal jurisdiction requirement. *Id.*
- 146 Ashley Cullins, *supra* note 76.
- 147 *Disney Enter.*, 869 F.3d at 853.
- 148 See *Disney Enter.*, CV1604109ABPLAX, 2017 WL 6819882, at \*2.
- 149 *Nintendo of Am., Inc. v. Lewis Galoob Toys, Inc.*, 16 F.3d 1032 (9th Cir. 1994).
- 150 *Id.*

- 151 *Capitol Records, LLC v. ReDigi, Inc.*, 934 F. Supp. 2d 640 (S.D.N.Y. 2014).
- 152 *Id.* at 645.
- 153 *Id.*
- 154 *Id.* at 650.
- 155 *Id.* at 655.
- 156 *Id.*
- 157 *Id.*
- 158 *Id.*
- 159 *Disney Enter.*, 869 F.3d at 858.
- 160 *Id.* The Ninth Circuit analyzed the textual distinction between “beginning from”, “indirectly from”, and “from” by looking at the “postpositive modifier” or the words “positioned after multiple phrases or clauses” to hold that “from an authorized copy” modifies the preceding clauses. *Id.* (citing Antonin Scalia & Bryan Garner, *READING LAW: THE INTERPRETATION OF LEGAL TEXTS* 148-49 (2012)).
- 161 Brief of *Amicus Curiae* ClearPlay, Inc. Supporting Plaintiffs/Appellees, *Disney Enter. v. VidAngel, Inc.*, 869 F.3d 848 (9th Cir. 2017).
- 162 *Id.* at 3. This technology works on physical discs and on digital streams of films.
- 163 *Id.* at 3-4.
- 164 *VidAngel LLC v. ClearPlay Inc.*, No. 2:14-cv-160 DN, 2017 U.S. Dist. LEXIS 49877 (D. Utah Mar. 31, 2017). This case was filed by VidAngel seeking a declaratory judgment against ClearPlay that VidAngel is not infringing seven patents owned by ClearPlay and the ClearPlay patents are invalid. *Id.*
- 165 ClearPlay, *supra* note 88.
- 166 *Id.*
- 167 Herb Scribner, *ClearPlay Can No Longer Stream New Movies Through Google: Here's What That Means for VidAngel*, *DESERET NEWS* (Feb. 9, 2017), <https://www.deseretnews.com/article/865673008/ClearPlay-can-no-longer-stream-new-movies-through-Google-Heres-what-that-means-for-VidAngel.html>.
- 168 CLEARPLAY, <https://try.clearplay.com/home/> (last visited Sept. 8, 2017).
- 169 The California District Court's decision was signed December 12, 2016. Less than two months later, ClearPlay confirmed their streaming service was shut down. On August 24, 2017, the Ninth Circuit opinion was filed. It was approximately at this time that ClearPlay resumed its streaming service.
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# Patent Monetization during World War FRAND

By Michael Renaud, James Wodarski and Robert Moore

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*With the legal landscape surrounding SEPs shifting in many countries, it has never been more important to take a global view of patent assertion – but any cross-border litigation strategy needs careful consideration*

Former National Basketball Association star Jalen Rose popularised the expression “You never get what you deserve, only what you have the leverage to negotiate” – a statement that holds particularly true in the context of modern patent licensing. Where a patent holder could once expect others to pay reasonable royalties for practising innovations resulting from its R&D investment, many firms today will decline to pay anything at all unless the risk of not paying is undeniable and significant. The challenge facing patent owners is convincing prospective licensees that infringement is not efficient – that is, that the risk of failing to take out a licence outweighs the benefits of continuing without one.

Further complicating matters is the effect that globalization has had on patent portfolio management. For some time now, patent strategy has experienced a tug eastward, away from the United States. Once the undisputed worldwide leader in patent protection, the jurisdiction has become less hospitable to patent rights, just as other countries have become more attractive. In addition, global development has given rise to a new segment of potentially attractive targets without significant US exposure.

For these reasons, various global firms have reoriented their patent portfolios around the European Union – particularly Germany – and China, as these forums may offer more attractive venues for enforcement. As the United States transitions from deciding the bulk of patent-related issues to sharing its policy-making authority, many firms are likely to find their hard-wrought strategies for allocating IP resources upended, just as their time-tested strategies for licensing implementers have been.

These trends are particularly pronounced in the field of SEPs. Justice Birss’s 2017 UK ruling in *Unwired Planet v Huawei* ((2017) EWHC 711(Pat) and 1304 (Pat)) brought to the fore simmering disagreements between and within countries as to the implications of the so-called ‘FRAND commitment’ – the common obligation of a participant in standard-setting to offer implementers licences on terms that are fair, reasonable and non-discriminatory.

Jurisdictions have differed significantly in their definition of this obligation, which is never spelled out in an agreement

between a standard-setting organisation (SSO) and a participant. For several years, intransigent implementers have benefited from this inter-jurisdictional disagreement by forcing SEP owners to incur the high cost and risk of worldwide enforcement. Implementers are further emboldened by the belief that FRAND serves as a ‘get out of jail free’ card since a judicially-imposed FRAND royalty rate will rarely exceed a rate agreed on without litigation.

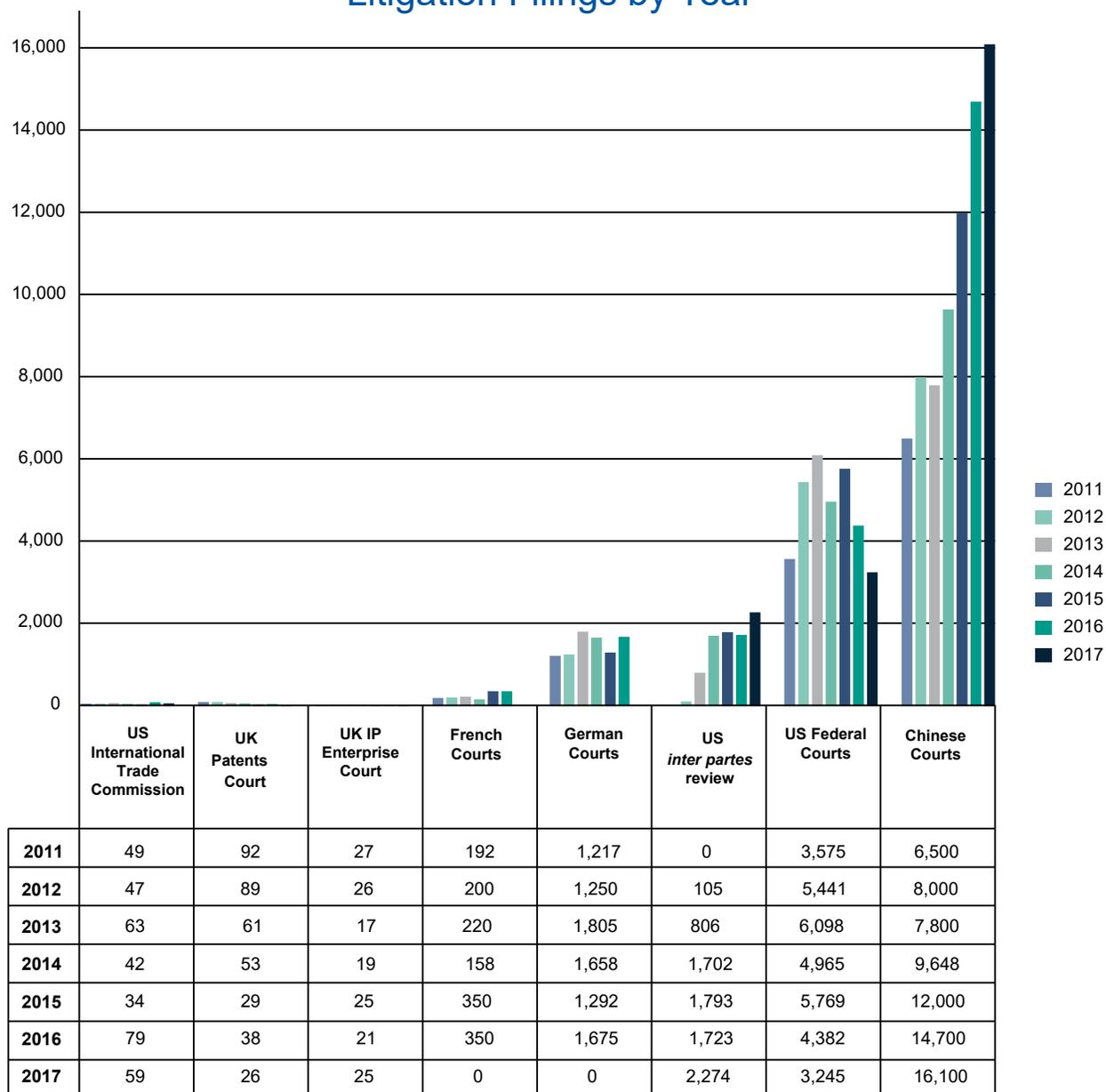
*Unwired Planet* raised the prospect that the United Kingdom could decide international FRAND disputes by itself, setting worldwide FRAND rates and penalising implementers that refuse to take a worldwide licence. Recent rulings have demonstrated that major jurisdictions are unwilling to defer to the judgment of others when it comes to defining FRAND. Nevertheless, the United States, the European Union, the United Kingdom and China are each vying with one another to impose their view of this commitment on the rest of the world.

For the monetization of significant portfolios, especially those containing SEPs, the foregoing trends call for a global perspective. The key to successful portfolio management is to maximize leverage against targets, given a finite budget. However, this is easier said than done, particularly given that single district enforcement against sophisticated targets is unlikely to yield sufficient leverage to deter efficient infringement.

At present, an enforcement strategy that focuses on the US International Trade Commission (ITC) and Germany – provided that both forums are available – remains the recommended approach for most portfolios against global targets. Coordinated enforcement in these two jurisdictions presents the most credible threat that a recalcitrant licensee’s infringing products will be excluded from significant markets. This in turn provides a compelling catalyst for the recalcitrant implementer to rethink its approach to taking a licence.

The ITC and Germany have also avoided many of the administrative and legal obstacles to enforcement that have arisen in recent years. However, this is subject to change as legal and market circumstances continue to evolve. Top patent strategists should monitor and predict developments worldwide, and allow these, as well as the nature of the portfolio and targets in question, to dictate strategy.

## Litigation Filings by Year



### Global Trends Point East

For years, the United States has dominated the world market for patent investment, offering the most robust IP protection and enforcement mechanisms of any country.

However, recent years have seen the United States's position as the world's leading IP venue begin to erode. It has been widely noted that US legislative and judicial reform has made patents generally harder to enforce – at least in the district courts – and, therefore, less valuable. At the same time, jurisdictions such as Germany and China have become more attractive for investment. The number of Chinese-filed patent enforcement actions has skyrocketed over the past five years, while the number of US filings has stagnated.

Underlying these trends are the shifting strengths and weaknesses of the three major jurisdictions.

### Strengths and Weaknesses

#### United States

The United States has traditionally been the leader in patent enforcement, albeit one that seems tempted to relinquish its mantle. The predictability of the US system – which boasts the most developed body of case law in the world – helps firms to understand the nature of the US patent rights that they may acquire or license. Further, as the world's largest economy, the United States is also the world's largest damages base for many technologies. The mechanisms for enforcement in the United States expand the ranks of those who can enforce.

## Whatever happened to the UPC?

One development that could affect patent strategy would be the establishment of the EU Unified Patent Court (UPC) as a viable enforcement venue. The UPC enforcement regime would begin upon ratification by 13 member states. Standing in the way are Brexit and a German constitutional challenge to ratification.

The United Kingdom ratified the UPC agreement in April 2018; however, the agreement limits participation in the UPC to EU member states only. Since the United Kingdom is set to depart the European Union on 29 March 2019, this calls into question whether it can remain a UPC participant under the present agreement. Adding to the uncertainty are various comments by UK officials that Brexit will signal an end to the UK acceptance of the jurisdiction of EU adjudicatory bodies over its own.

Even in ratifying the UPC agreement, the United Kingdom alluded to this stance, including in its announcement the statement: “The unique nature of the proposed court means that the United Kingdom’s future relationship with the UPC will be subject to negotiation with European partners as we leave the European Union.”

Upholding German ratification is a credible constitutional challenge brought by a local IP lawyer in 2017 and scheduled for hearing this year. The complaint argues, among other things, that adoption of the UPC would cede German sovereignty to an international body, triggering requirements that ratification pass the German legislature by super-majority and with a heightened quorum. The complaint also claims that, because an administrative panel would hold sway over whether UPC judges are reappointed, those judges may not be independent, as required under the German Constitution.

If the UPC is ratified by sufficient member states, it promises to draw significant consideration from patent strategists. The court’s territorial coverage, including almost all EU countries, would make it a compelling venue in several instances.

For monetisation programs seeking damages awards, the UPC would provide damages bases comparable to those in the United States. Further, in cases where obtaining an injunction in Germany

does not provide adequate leverage to drive a pan-European resolution (e.g., if the infringing activities are primarily in one of the member states that issue significant numbers of national patents, such as France or the United Kingdom, or if it is critical to enforce in member states not known for their robust patent enforcement mechanisms), the one-stop shop offered by the UPC would be preferable to parallel litigation in all relevant jurisdictions.

Access to proof could also drive certain monetisation programs to the UPC. Designed as a European compromise, the UPC incorporates the civil law tradition of Germany and France and the common law tradition of the United Kingdom, as well as some US influence.

When it comes to evidence rules, this compromise creates an interesting fusion of German-based, efficiency-oriented rules in regard to burden of proof and UK-based, truth-seeking disclosure obligations and expert involvement. Ultimately, the UPC would allow more aggressive fact finding than currently permitted under the German system, while avoiding some of the costlier aspects of UK disclosure.

These differences between the German and UK systems call into question whether an amalgam would be workable. However, in cases that require discovery to prove infringement, the UPC would be an attractive venue.

Not all patent holders will have the wherewithal and sophistication to enforce in the UPC, though. Intended to handle first-instance patent infringement proceedings in roughly 12 months, the court should look to European countries other than Germany, which provides such speedy enforcement only because proceedings are much less loaded with procedural options and intermediate steps.

The UPC intends to include significant discovery and motion practice in the compressed German timeframe, inevitably requiring a larger, talented team accustomed to adjudicating complex technical and legal matters in a truncated schedule. This in turn will elevate the cost of litigation – perhaps the biggest drawback of the UPC system.

Unlike many other jurisdictions, the United States awards fees only upon extraordinary circumstances. The rules of US civil proceedings also provide litigants with access to liberal discovery, enabling them to prove infringement by means other than inspection. Of course, US practice can be expensive, but in many cases patent holders can avoid bearing the

full risk of enforcement. Attorneys commonly take engagements on a contingency or partial contingency basis, and the prodigious US investment sector makes litigation financing available for enforcement.

However, for all its institutional advantages as a forum, the United States has increasingly ceded ground. Paramount

among the challenges to its position is the issue of enforceability. A compelling asset must run the gauntlet in many cases before it can be monetised. Since the America Invents Act 2011, district court enforcement will nearly always prompt petitions for *\*inter partes\** review, which has proved to be effective for defendants and petitioners both as a means of challenging validity and as grounds for staying infringement cases.

Over the past several years, case law has provided additional grounds for invalidity and thereby significantly reduced the value of certain sectors (*e.g.*, software patents). Even patent holders that prevail on validity and infringement in district courts have experienced difficulty in collecting damages – the Supreme Court’s *eBay* decision essentially eliminated the leverage of an automatic injunction while a series of appellate opinions constrained damages awards and increased the quantum of proof needed to support an award.

As an administrative agency charged with, among other things, protecting US industry by directing Customs to exclude articles that infringe US patents, the ITC has become – at least since *\*eBay\** – the US forum in which the enforcement of patent rights results in the most leverage. The availability of exclusionary relief, the speed of the remedy and insulation from *inter partes* reviews are all benefits that the ITC enjoys over the district courts.

Although efforts to reduce the ITC’s reach are ongoing, they have not yet diminished its utility. The ITC remains a compelling forum for the assertion of high-quality assets by firms with a well-thought-out execution strategy, first rate execution and the necessary profile to meet the ITC’s unique jurisdictional requirements.

### Germany

Germany is the established powerhouse of European patent enforcement, handling over 70% of all European patent infringement cases. Its success rests on the integrity of the German system and the economic strength of the country. On the structural side, the key advantages of the system are its efficiency, speed and competence – making German enforcement actions an affordable, robust and speedy option, with first-instance proceedings usually being terminated in under 12 months. Invalidity and infringement are handled by different courts, reducing the workload and costs of infringement actions. The court system is run by highly experienced panels of well-qualified judges – each panel handles approximately 120 cases per year. This not only improves the predictability of outcomes, but also generates a breadth of results that helps to shape expectations and practice throughout Europe and beyond. In addition, unlike US district courts, German courts have no discretion when issuing injunctions – patent infringement results in automated injunctions, excluding any balancing of interests.

German injunctions also carry weight beyond Germany’s borders due to the crucial importance of access to the German market. As such, German filings are a key tool for patent owners to motivate pan-European settlements.

The relative weaknesses of the German system are linked to its efficiency; means of discovery are contained, so that an infringer’s best defense is to prevent the leakage of technical information concerning the allegedly infringing product or service. In addition, damages awarded by German courts are modest compared to US standards; therefore, true monetary compensation typically happens outside court proceedings as part of a global or pan-European settlement, using the German injunction as a driving force.

### China

China’s progress in the global patent landscape has also been impressive. Just 15 years ago, the effectiveness of its IP enforcement system was hindered by protectionism. Now, with the rise of innovative Chinese global players such as Huawei and Haier, this has all changed. The most recent system upgrade was the establishment of three specialised IP courts in Beijing, Shanghai and Guangzhou in 2014. Their introduction served as a test for a nationwide roll-out of similar courts in the near future and further boosted patent enforcement activity in China.

A few years ago, the German government took on the challenge of fortifying China’s patent system. Today, that investment has resulted in a Chinese enforcement regime that vaguely resembles that of Germany – discovery is limited, while the costs of litigation (although growing) and the average time to trial remain approximately the same as in Germany.

Further similarities between the regimes include that Chinese actions handle infringement and validity in separate proceedings, and Chinese injunctions issue automatically for valid, infringed patents, affording great leverage against the large manufacturing sector – at least in theory. These features, along with the optics that China has cultivated as a rising IP power, have cemented the jurisdiction as a key component in most global portfolios. It has also increased the profile of Chinese patent judges, who are now regularly tapped to share their expertise with global audiences at international IP conferences.

Nonetheless, it is too early to determine whether China will evolve into a globally prioritized or dominant enforcement venue. It must first demonstrate that its enforcement mechanisms are available to all and against all. What is clear is that moving forward, China should be part of a patent holder’s enforcement strategy and, under certain conditions, may be crucial to a multi-jurisdictional execution strategy. However, Chinese patent holders should be aware that injunctions are often the only compelling leverage available to them. Typically, damages awarded by the courts will barely cover the legal fees invested, and speed and efficiency come at the cost

## Case study: \*Ericsson v TCL\*

Ericsson's ongoing effort to license its portfolio of 3G and 4G SEPs to handset firm TCL is a key example of the challenges facing SEP owners. For years, Ericsson has struck licences with implementers of these standards that reflect the depth and pedigree of its portfolio. But since TCL's licence to Ericsson's 2G portfolio lapsed in 2014, the parties have found themselves at loggerheads.

Ericsson pointed to its long history of licensing implementers and offered what it determined to be terms materially similar to those on which it licensed firms similarly situated to TCL. TCL took the position that Ericsson's longstanding approach was inconsistent with its obligations as a participant in standard-setting to offer implementers FRAND terms.

For Ericsson to maintain the viability of its licensing program and realize revenue from TCL practising its SEPs, the company had no choice but to mount a worldwide enforcement campaign – with all the accompanying cost and risk. Ericsson therefore brought suits against TCL in France, the United Kingdom, Brazil, Russia, Argentina, Germany and the US District Court of the Eastern District of Texas. TCL brought an action for declaratory judgment with regard to Ericsson's FRAND obligations in the US District Court of the Central District of California, which in 2015 granted TCL's application for an anti-suit injunction and stayed all other proceedings between the parties involving Ericsson's 2G, 3G and 4G SEP portfolios.

In 2017 the California matter proceeded to a bench trial, whereby TCL contended that a FRAND rate should be based on a top-down analysis, under which Ericsson would receive a fraction of the overall royalty stacks that implementers owed the SEP owners for the corresponding standard. Ericsson pointed to its longstanding and successful licensing program, identified comparable licences and reduced those licences to effective rates based on the units that the parties estimated at the time of the deal the licences would cover.

The court largely accepted TCL's proposal. Since Ericsson had failed to perform its own top-down analysis, the court generally relied on TCL's calculations. Ultimately, it found that a FRAND rate for the portfolio was significantly lower than Ericsson had demanded and that a release payment for TCL's past unlicensed sales, dating back to 2007, was approximately \$16.45 million. At the time of writing, the matter is on appeal.

The FRAND royalties calculated by the court stand in contrast to the \$75 million that a US District Court of the Eastern District of Texas jury awarded Ericsson in December 2017 for TCL's infringement of a patent not declared essential to any standard. In a May 2018 order, the judge found that TCL's decision to litigate the case adequately supported the jury's finding that the company's post-complaint infringement was willful, and enhanced the damages by \$25 million.

of access to discovery. Therefore, opportunities to prove infringement are limited, especially considering that all evidence must be produced in notarised form (as well as legalised form, if coming from abroad). These limits affect the kinds of assets that can realistically be asserted.

In addition, planning an enforcement program that provides adequate leverage against a target requires careful attention to the nature of the portfolio. Some classes of assets (*e.g.*, software patents) tend to fare better in certain jurisdictions. The need to obtain evidence of use to prove infringement can also suggest an approach that does not involve enforcement in some jurisdictions or that delays enforcement until after the assets have been enforced in a jurisdiction with more robust discovery.

### FRAND: Competing Definitions

Most SSOs – particularly those with global reach – require their members to identify essential patents (*i.e.*, patents necessarily infringed on implementation of a standard) and offer implementers a licence on FRAND terms. However, what this requirement entails is never made explicit. The underlying economic rationale is that the patent holder and the implementer

will mutually benefit from the licensing mechanism; therefore, they will be commercially motivated to negotiate efficiently and in good faith. However, that dynamic has been displaced.

Moreover, because SSOs often bring together SEPs with differing views on the monetary value of their intellectual property, they can rarely offer constructive guidance on the nature of the encumbrance. In the absence of a definition of 'FRAND,' the courts and administrative bodies have considered the twin policy objectives of the term: ensuring that licensing royalties do not impede the adoption of a standard, while also ensuring fair recompense and continued participation in standard-setting by holders of essential patents. The United States, Germany and China have each struck a different balance.

In the United States, interpretation of the encumbrance has lurched from concern over the fair apportionment of profits due to the technology being incorporated to concern over the potentially market-distortive effects. Early cases such as *Microsoft v Motorola* and *Innovatio* focused on the former and took stock of other licences or pool rates in the context of a modified *Georgia-Pacific* analysis, in order to adduce a reasonable rate given the FRAND context.

In contrast, the recent *TCL v Ericsson* ruling (which is currently on appeal) considered existing, comparable licences as probative of the non-discriminatory prong of the encumbrance, as well as the fair and reasonable prong. Under traditional *Georgia-Pacific* analysis, a licence is probative of a reasonable royalty insofar as it demonstrates the value that parties in an actual negotiation placed on the rights to be granted. Thus, the inquiry is the valuation placed on the rights at the time of the previous negotiation. In *TCL* the court deviated from this reasoning, holding that whether a rate was non-discriminatory depended on the *de facto* effective rate of existing, comparable licences, as borne out *post hoc* by actual sales data. Under the *TCL* formulation, an SEP owner that asks licensors for lump-sum payments bears the risk that sales of affected products will exceed expectations and drive down subsequent FRAND rates. Consideration of market-distortive effects in the derivation of a FRAND rate would bring the United States closer to the prevailing law in China and other Asian jurisdictions.

The ITC has approached the issue of FRAND encumbrances as a matter of institutional competence and contract law. A series of investigations beginning with *Certain 3G Mobile Handsets* determined that, because a FRAND encumbrance arose as a result of a contract (the agreement specifying the terms of the patent owner's membership in the relevant SSO), the FRAND defense was another form of contract defense – placing the burden of proof on the party claiming a breach of FRAND obligations. Setting a rate was outside the purview of the ITC; therefore, as far as the ITC was concerned, a respondent's FRAND defence will fail where the record shows that the complainant bargained in good faith.

The ITC's approach resembles the German courts' focus on the mechanical elements of a FRAND negotiation. In Germany, the courts have determined the steps that parties seeking an injunction on FRAND-encumbered assets must take prior to enforcement. These steps include articulating to prospective licensees the patent owner's basis for concluding that a given offer is consistent with FRAND – particularly, the basis for concluding that the offer is reasonable.

China and various other Asian jurisdictions agree that an offer must provide the basis for the FRAND position; however, until recently, they focused more on the non-discriminatory element of the encumbrance. Multiple antitrust enforcement proceedings against Qualcomm (China in 2015, and Taiwan and Korea in 2017) illustrated that the chief inquiry in deciding a FRAND rate is the impact on the relevant market (*i.e.*, that the rate does not advantage one market-participant licensee over another).

More recently, Chinese courts have fleshed out the mechanics of a FRAND negotiation. In a ruling affirmed on appeal with little discussion in April 2017, the Beijing IP Court issued an injunction against Sony for, among other things,

failing to negotiate reasonably with SEP holder IWNCOMM. Similarly, in January 2018 the Shenzhen Intermediate People's Court issued an injunction against implementer Samsung for repeated, unreasonable delays in its FRAND negotiations with SEP holder Huawei.

### The Global Race

The differing interpretations of FRAND advanced by the various countries generally benefit their constituent industries. For instance, China's renowned and powerful manufacturing sector boasts high volumes but, in many cases, low margins. It follows that the country would orient its understanding of the FRAND commitment on market distortion, as any discrepancy in royalty rates to Chinese competitors is magnified by the sector's high volumes and could materially affect the low margins. Given each country's interest in protecting its constituent industries, it is unsurprising that so many countries are jockeying to impose their definition of the term on the rest of the world.

Birss's ruling in *Unwired Planet* demonstrates this competition. The FRAND injunction that he created, combined with the prospect of worldwide adjudication in a single jurisdiction, has already begun to attract SEP enforcement to the United Kingdom. In April 2018 the UK court in *Conversant Wireless Licensing SARL v Huawei Technologies Co Ltd* (16 April 2018 [2017] EWHC 0000 (Pat)) held that the United Kingdom had jurisdiction to determine a global FRAND rate. With this developing line of cases, the United Kingdom is gradually emerging as a key venue for settling FRAND disputes.

China's efforts to steer the discussion have relied primarily on available remedies and market influence. The National Development and Reform Commission has stepped in multiple times to negotiate FRAND terms on behalf of Chinese industries such as handsets. Chinese courts have also issued two injunctions against implementers that refused to take FRAND licences – given the extent of manufacturing in China and the allure of the Chinese market, the threat of such an injunction carries real risk. As a result, SEP owners have begun to take note and incorporate Chinese enforcement into their strategies.

The United States remains vocal in defining FRAND thanks to the historic reliability of the US legal system. Through *Microsoft*, *Innovatio*, *TCL* and others, US district courts have developed a body of law that adds a measure of predictability to FRAND enforcement proceedings, particularly for SEPs relating to telecommunications standards.

US courts have also asserted their position by staying foreign FRAND actions with overlapping parties and issues. The Shenzhen Intermediate People's Court injunction against Samsung came amid ongoing US proceedings involving Huawei and Samsung. In April 2018 the US District Court for the Northern District of California – hearing the US matters between the parties – stayed the foreign counterparts, including

## Leading FRAND Rulings by Region

Region	Case	Court	Significance
United States	<i>Microsoft Corp v Motorola, Inc</i> (14-35393)	US District Court of Appeals for the Ninth Circuit	Applied modified <i>Georgia-Pacific</i> analysis to derive FRAND royalty rates.
	<i>Realtek Semiconductor Corporation v LSI Corporation and Agere Systems LLC</i> (Case C-12-3451-RMW)	US District Court of the Northern District of California, San Jose Division	The FRAND obligation rendered injunctions unavailable as a remedy.
	<i>In the Matter of Certain 3G Mobile Handsets and Components Thereof</i> (Inv 337-TA-613)	International Trade Commission	The party claiming that a FRAND obligation precludes or limits certain relief bears the burden of demonstrating that such an obligation exists, that the party is owed that obligation, and that the obligation was not met.
	<i>TCL Comm'n v Ericsson</i> ((SAV 14-341 JVS(DFMx) and CV 15-2370 JVS(DFMx))	US District Court of the Central District of California	Ericsson's offers were not FRAND; FRAND rates determined by top-down patent counting approach.
European Union	<i>Huawei Technologies Co Ltd v ZTE Corp</i> (Case C-170/13)	European Court of Justice (ECJ)	Prior to enforcement, a FRAND-encumbered patent holder must offer the target a licence on FRAND terms, providing the basis for the belief that the offer is FRAND.
	<i>Unwired Planet v Huawei</i> ([2017] EWHC 711 (Pat), 5 April 2017)	UK High Court of Justice (Patents)	The FRAND obligation contemplates global licences.
Asia	Chinese National Development and Reform Commission (NDRC)'s Investigation into Qualcomm, Inc.	NDRC	The Chinese government essentially negotiated FRAND terms on behalf of the Chinese handset market.
	<i>Xi'an IWN Comm v SonyMobile</i>	Beijing IP Court	First injunction granted in China for infringement of SEPs; injunction issued at request of Chinese company; injunction affirmed by Beijing Higher People's Court and Sony ordered to pay equivalent of \$1.3 million in damages and court fees of approximately \$12,000.
	<i>Huawei v Samsung</i>	Shenzhen Intermediate People's Court	Injunction granted against Samsung; Huawei did not violate its FRAND obligations; Samsung "maliciously delayed negotiations" and was thus the party at fault during negotiations; the court's "at fault" approach utilised guidelines similar to the ECJ's in <i>Huawei v ZTE</i> .

the injunction issued three months previously. Similarly, the US District Court for the Central District of California stayed worldwide proceedings between TCL and Ericsson while it determined FRAND rates for Ericsson's SEP portfolios.

For years, US courts have been able to ignore comity and the global nature of SEP enforcement thanks to the jurisdiction's market clout. While the US market for SEPs remains so significant, the courts can continue to stay foreign FRAND proceedings knowing that their decisions will be respected and

followed, despite conflicting with orders being issued by foreign courts with competent jurisdiction. However, it stands to reason that other fora will likely return the favour should the United States ever lose its market position.

### Uncertainty Begets Efficient Infringement

The patchwork of approaches to FRAND has complicated efforts to account for the encumbrance; implementers – particularly those based in China – have taken full advantage of

## Differences Between the Forums

	United States	US International Trade Commission (ITC)	Germany	China
Expense of litigation	In 2017 median patent litigation expenditures ranged from \$800,000 for cases with less than \$1 million at stake to \$4.9 million for cases with more than \$25 million at stake.	In 2017 median patent litigation expenditures ranged from \$530,000 for cases with less than \$1 million at stake to \$4.2 million for cases with more than \$25 million at stake.	Defeated party pays court costs and all attorneys' fees based on the amount in contention. In an infringement action, fees and costs awarded range from €40,000 for a case with €1 million at stake to €775,000 for a case with €30 million at stake. In a nullity action, fees and costs awarded range from nearly €32,000 for a case with €250,000 in contention to nearly €32,000 for a case with €2 million in contention.	Attorney's fees estimated for an invention patent are Rmb50,000 to Rmb500,000 at trial (patent court) and Rmb100,000 to Rmb800,000 at first appeal (high court).
Median time to outcome	Ruling in patentees favour of infringement – 26 months. Ruling against patentee of non-infringement – 31.4 months. Jury's verdict – 36.1 months. Judge's verdict after a bench trial – 41.9 months.	Earliest practicable time; usually 12-16 months, or within 18 months in more complicated cases.	Where no neutral expert is appointed by the court – nine-14 months.  Where a neutral expert is appointed by the court – 17-24 months.	First-instance patent infringement proceedings – six-12 months. Patent infringement proceedings with foreign elements involved – no time limit for a decision. Invalidation proceedings – six months to two years.
Patent owner rate of success	In recent cases that proceeded to judgment on the merits, patentees have succeeded at proving infringement at the following rates: <ul style="list-style-type: none"> <li>● 2008 – 35.9%</li> <li>● 2009 – 43%</li> <li>● 2010 – 40.7%</li> <li>● 2011 – 35.9%</li> <li>● 2012 – 37.4%</li> <li>● 2013 – 37.7%</li> <li>● 2014 – 33.8%</li> <li>● 2015 – 28.8%</li> <li>● 2016 – 24.1%</li> <li>● 2017 – 24.6%</li> </ul>	The percentage of investigations that terminated with an ITC-affirmed finding of infringement has varied from 19% in 2016 to 33% in 2017. The ITC issued a general exclusion order in 2.4% of investigations terminated in 2016 and 4.8% in 2017; a limited exclusion order in 21.4% of terminated investigations in 2016 and 30.9% in 2017; and cease and desist orders in 14.3% of terminated investigations in 2016 and 26.2% in 2017.	For 2007-2012 first-instance infringement proceedings – 66% (Dusseldorf Court).  For 2007-2012 first-instance nullity proceedings – 39% (Federal Patent Court).	Infringement proceedings in 2007-2013: <ul style="list-style-type: none"> <li>● Invention patents – 67.8%;</li> <li>● Utility models – 72.7%</li> <li>● Design patents – 86%</li> </ul> Invalidity proceedings in 2007-2013: <ul style="list-style-type: none"> <li>● Invention patents – 48%</li> <li>● Utility models – 44%</li> <li>● Design patents – 44%</li> </ul>
Venue laws	Venue is appropriate in the judicial district where the defendant resides or where infringing acts occurred and where the defendant has a regular and established place of business.	Single venue.	Jurisdiction exists wherever the infringing product is sold. The most common courts in patent infringement proceedings are Dusseldorf, Mannheim and Munich courts, which together hear around 900 cases a year. Approximately 250 nullity proceedings are also initiated each year.	Patent cases can be heard by 70 intermediate people's courts. In 2014 three IP courts (Beijing, Shanghai and Guangzhou) were founded.

this. The dispute between TCL and Ericsson began over half a decade ago and included complaints around the world. Had TCL struck a licence in 2014, when its last SEP licence with Ericsson lapsed, the rates likely would have been in line with those realised in other Ericsson licences. So far, TCL has paid no apparent price for forcing Ericsson to engage in four years of litigation. Indeed, Judge Selna expressly did not derive the FRAND royalty rates that he determined for Ericsson's portfolio from any of the company's existing licences (which, for the most part, exceeded the rate that he imposed by a considerable margin). In any event, there is no indication that Ericsson's significant investment of resources in pursuing TCL will result in a licence (see box-out: *Ericsson v TCL*).

Nokia and Interdigital have also embarked on worldwide SEP enforcement programs. Their victories have been somewhat pyrrhic – coming at the cost of significant delays in transacting, tremendous expense and a risk to their portfolios.

Even patent pools have had to account for the international disparities in FRAND approaches. VIA Licensing's advanced audio coding patent pool successfully licensed nearly the entire addressable market. However, in order to license Chinese firm Xiaomi, in 2017 VIA began to offer an alternative rate structure with discounted rates royalties for sales in China and other emerging markets. Although this achieved good results, the outcome rewarded the implementers' intransigence.

### A Global Enforcement Strategy

Although the global practice of patent monetization is evolving, it has not yet been upended. Single jurisdiction enforcement is no longer a sufficient response to efficient infringement and the impact of patent reform in the United States. Many firms will find that the best course of action remains a balanced approach, with the ITC and Germany providing natural fora for parallel enforcement proceedings and China offering a possible venue in the future.

The speed of ITC or German proceedings mitigates the risk of invalidity proceedings such as *inter partes* reviews or nullity actions. Further, the prospect of exclusionary relief can bring an implementer to the table to discuss international sales. For

SEP owners, the fact that these fora focus on formalistic requirements for FRAND negotiations, rather than determining a FRAND rate, restricts the opportunity for implementers to quibble over math.

Patent holders should explore how best to exert leverage in parallel proceedings. In many cases, the obvious strategy will be concurrent filings in the ITC and Germany. Coordinating timing, arguments and consistency of execution across jurisdictions is key to success. With the rigidity of the ITC's schedule and the speed of German court proceedings, cases can be staged to maximum effect and minimal cost.

A well-orchestrated filing schedule that prioritizes US litigation – with Unified Patent Court, German, and possibly even Chinese filings hitting the scene at the approximate time of the Markman hearing – places almost all worldwide revenue for the disputed articles in jeopardy. It would optimise leverage for reaching global settlement solutions, while allowing litigation costs to ramp up as additional leverage is brought to bear.

To facilitate the coordination of worldwide enforcement campaigns, patent holders around the globe have coalesced on two camps. Under the first approach, the enforcing firm has offices – and therefore expertise – in all major European jurisdictions (mainly Germany, the United Kingdom, France and the Netherlands), as well as optional offices in the United States and China. Under the second approach, the enforcing firm belongs to a confederation of firms in their respective jurisdictions – that is, a well-established, non-exclusive network of equally reputable foreign firms. Under both approaches, technical expertise is essential, as cases will likely require a seamless interaction between lawyers and litigators on the one hand and technical experts and patent attorneys on the other.

### The Most Effective Venues

Efficient infringement is central to any modern patent strategy. In a decreasingly US-centric patent landscape, firms should distribute their IP budgets between the United States, Germany and, in some cases, China – despite the discrepancies between these fora.

### Action plan:

SEP owners should plan a multi-jurisdictional enforcement program to license intransigent, worldwide implementers. Therefore, the following factors are worth considering:

- At present, a program based on enforcement in the ITC and Germany is the best bet for most patent owners.
- Patent owners should also analyze whether enforcement in China would complement US and EU enforcement activity.
- SEP holders should monitor UK developments in relation to FRAND injunctions – the United Kingdom may eventually offer SEP holders sufficient leverage to drive worldwide licensing without worldwide litigation.

For the majority of assets, the United States continues to offer the most enforcement advantages.

Following in its wake, China offers an attractive base and a government that is increasingly promoting strong IP rights – although Chinese courts are still perceived as favoring Chinese firms over foreign nationals. Nonetheless, recent decisions such as the Shenzhen injunction against Samsung demonstrate that, in certain circumstances and against the right party, China can be a potent forum – particularly as part of a larger coordinated approach. In these circumstances, China may even provide the most appropriate venue for a first salvo in enforcement.

Finally, Germany offers an attractive addressable market – albeit one that trails the United States and China – and a sophisticated enforcement regime willing to grant injunctions in cases of infringement. However, limited discovery affects the types of case that can prevail there.

Coverage in the three major jurisdictions is preferable, given that the upheaval in the worldwide market has yet to resolve.

During this period of transition, successful monetization against global firms will require an international approach and a steady hand. Firms should be aware of the various options for enforcement worldwide and their benefits. Top monetization teams must be skilled at staging and coordinating enforcement in multiple jurisdictions simultaneously and must have a global perspective and experience.

Ultimately, the ITC and Germany remain the preferred venues against leading global implementers, despite – or perhaps because of – ongoing changes in patent enforcement. The simplicity of and leverage from the injunctive remedies available in both jurisdictions can drive a licensing discussion on worldwide sales, and neither venue is as susceptible as, for example, US courts to developments that reduce the leverage of patent owners. <sup>1</sup>

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## Michigan Patent Pro Bono Project Serves Under-Resourced Inventors: Seeks to Expand Volunteer Attorney Panel

The Michigan Patent Pro Bono Project is a service project of the Intellectual Property Law Section. The goal of the Project is to address the unmet need for patent legal services in Michigan by matching low-income inventors and innovators with volunteer patent attorneys.

The Project was launched in 2015 with the support and assistance of the U.S. Patent and Trademark Office. Since that time, the Project has received requests for legal services from over 100 income-eligible clients and has successfully placed eligible cases with volunteer attorneys at corporations, law firms, and clinics in Michigan.

The Project coordinates its activities with USPTO-certified patent clinical programs at Wayne State University Law School and University of Detroit Mercy Law School. Landon IP, a division of CPA Global, has volunteered to provide pro bono patentability search reports to Project clients. Once a request for pro bono assistance with the filing of a non-provisional patent application has been approved by the Project and accepted by a participating volunteer attorney, the attorney can ask Landon IP to perform a patentability search on a pro bono basis.

Due to the number of clients seeking pro bono assistance, the Project is seeking patent practitioners to join the volunteer attorney panel. Volunteer attorneys must be registered to practice before the USPTO and be State Bar of Michigan members. Volunteers also must participate in an orientation/training session to introduce the volunteer to the Project operating procedures. The orientation may be viewed online. Volunteer attorneys joining the panel are not obligated to accept referrals. The Project Screening Committee reviews all clients matters and strives to place cases with attorneys with appropriate technical competence and experience.

Attorneys interested in joining the panel can access an application at <https://michbar.wufoo.com/forms/patent-pro-bono-attorney-registration/>. More information is available on the IPLS webpage, or by contacting David C. Berry at [dberry@brookskushman.com](mailto:dberry@brookskushman.com).

The Project is part on a nationwide network of pro bono programs providing services to inventors in all 50 states plus Puerto Rico. More information about the USPTO program is available at <https://www.uspto.gov/patents-getting-started/using-legal-services/pro-bono/patent-pro-bono-program>. <sup>1</sup>

# Where Are We Now: Evolution of PTO Ethics Opinions

By Michael E. McCabe, Jr.

*This is part two of a series. Part one of this series, “Are Your Firm’s Foreign Associate Practices Ethical?” ran in the last issue of IPLS Proceedings.*

Thirty years ago, the PTO issued (in 1987 and 1988) ethics opinions regarding very discrete questions concerning two aspects of ethics issues that arise when a U.S. practitioner communicates and services their clients by working through foreign agents and “client liaisons.”

Several significant developments have occurred since the PTO published its 1987 and 1988 Notices.

First, the USPTO changed its ethics rules. Today, USPTO practitioner conduct is governed by the USPTO Rules of Professional Conduct. The PTO’s current ethics rules include many provisions not found in the former Code of Professional Responsibility. And while some of the new rules are similar to the old rules, even those similar rules have differences in their language that could be significant.

Second, over the course of the past twenty years, there has been a proliferation of businesses that represent clients—typically sole inventors and small businesses—who seek to monetize their inventions. Those entities—vention “promoters”—contract with their clients to provide a combination of patent and non-patent services. For the patent services, the promoters contract with a USPTO registered patent agent or attorney to provide the services on the client’s behalf. Some of these invention “promotion” companies have turned out to be fraudulent enterprises that prey on an unsophisticated client base hungry for validation of their ideas and false promises of financial rewards. The USPTO has professionally disciplined patent practitioners who service their clients by working through these non-practitioner “middlemen.”

In June 2017, the USPTO published the *Mikhailova* decision. The public notice published as part of the USPTO Director’s Final Order in that matter provides a thorough discussion of how the OED/USPTO expect practitioners to operate when they are representing clients through “non-practitioner third parties.” While this guidance may have been written specifically with the invention promotion entity in mind, the *Mikhailova* decision does not state that it is limited to that particular arrangement.

According to *Mikhailova*, any legal services arrangement in which a USPTO practitioner interfaces with a “non-practitioner”

third-party on behalf of a client must pass muster under a veritable maze of different Rules of Professional Conduct. And yet the USPTO made a point to state that nothing in *Mikhailova* was meant to trump anything that was said in the 1987 or 1988 Notices.

## Practice Considerations for Firms Interfacing with Foreign Associates

While the USPTO sought to preserve the 1987 and 1988 OG Notices, as discussed in part one, those Notices failed to address many of the issues addressed in *Mikhailova*.

In light of both the old guidance (1987 and 1988 OG Notices) and the new guidance (*Mikhailova*), practitioners may want to consider whether or how their foreign associate practices are compliant.

## Has The Intermediary Given Informed Consent?

The OG Notices make clear that there must be an agreement between the foreign associate and the client whereby the client has “consented after full disclosure” to the representation. Said another way, if there is an agreement between the client and the intermediary or foreign associate, but the client has not given its “informed consent”, then the agreement does not satisfy the USPTO’s requirements.

Informed consent (or “consent after full disclosure”) is a defined term in the USPTO ethics rules. It means: “the practitioner has communicated adequate information and explanation about the material risks of and reasonably available alternatives to the client being represented by the practitioner.”

The ramifications for not complying with the USPTO’s “consent after full disclosure” requirement are unclear. One might see how the USPTO would take the position that an agreement between a foreign associate and their client that was formed without “consent after full disclosure” is not legally effective.

According to the 1987 Notice, “if there is, in fact, no agreement” (presumably meaning a legally effective agreement), then the U.S. practitioner is prohibited from “taking instructions from” or “relying on the instructions of” the for-

eign associate. Instead, “the registered practitioner must communicate to the client/patent applicant.”

U.S. practitioners are responsible for: (a) knowing whether or not their client has an appropriate “agreement” with the intermediary to represent the client for the purpose of communicating about the USPTO proceeding to the U.S. practitioner; and (b) assuring themselves that before entering into such an agreement, the client received information sufficient to satisfy the “informed consent” standards of the USPTO.

The right of a U.S. patent practitioner to communicate with a client through an intermediary is contingent upon the existence of a valid agreement. Consequently, it is imperative that U.S. counsel communicate with their foreign associates and similar intermediaries to ensure that the necessary agreements are in place, and adequate disclosures to the clients are made, before legal services are rendered to the referral source. U.S. counsel who remain willfully blind about such issues risk violating the USPTO’s ethics rules.

#### **Is There a Business Conflict with the Foreign Associate?**

USPTO Practitioners have a significant financial interest in continuing to receive referrals from their foreign associates. Some foreign associates may refer many different clients or matters to a practitioner. And a number of foreign associate-U.S. law firm relationships have lasted for decades and have generated millions of dollars in revenue for the practitioner. In addition, many foreign associates have an expectation that the U.S. counsel they choose to work with will refer IP work back to them when U.S. counsel has a client that wishes

to obtain patent or trademark protection in the foreign associate’s country.

This business arrangement raises a concern that a regulator at the USPTO would find that the personal interests of the practitioner in maintaining the foreign associate relationship create a conflict of interest. Pursuant to 37 C.F.R. § 11.107(a)(2), a practitioner “shall not” represent a client if there is “a significant risk that the representation of one or more clients will be materially limited by . . . a personal interest of the practitioner.”

Given the potentially lucrative and longstanding relationships that some IP firms have with the foreign associates, it is reasonable to conclude, as the USPTO observed in the *Mikhailova* case, that a business conflict of interest exists between the client and the practitioner “due to the practitioner’s personal financial interest in continuing to receive inventor referrals from the non-practitioner third party.”

This conflict can be waived, but only if the client gives “informed consent, confirmed in writing.” In the case of the foreign associate, such informed consent may require disclosure of the length and duration of the relationship, the numbers of cases that the foreign associate has referred to the practitioner, and reasonable alternatives available to the client—such as having the services provided by a practitioner that does not have a business relationship with the foreign associate.

Notably, this observation is not inconsistent with the USPTO’s 1987 and 1988 OG Notices. Neither of those OG Notices addresses the later-adopted conflicts of interest rules codified in 2013 in the USPTO’s Rules of Professional Conduct, including “personal interest” conflicts.



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## Does the Foreign Associate Referral Client Conflict with a Current or Former Client?

Apart from business conflicts, patent practitioners are subject to the usual conflicts rules that apply, including direct adversity conflicts with current clients. Those who receive referrals from foreign associates are not exempt from the conflict of interest rules.

The USPTO expects practitioners to conduct adequate conflict checks to ensure that they are not representing another client seeking the same, or a substantially similar variant, to another client's patent or application; the client is not "directly adverse" to another firm client; or the matter is not "substantially related" and adverse to a matter the U.S. practitioner worked on for a former client. As for the process of conflict checking itself, specifically subject matter conflicts, the OED expects IP law firms will conform to the standards set forth in *Maling v. Finnegan*, 473 Mass. 336 (2015) (admonishing IP firms to employ a "robust" conflict check procedure that includes checking for "subject matter conflicts").

As a matter of course, practitioners should determine if the referral is looking to target another company's product or process. The U.S. practitioner may be in the dark as to whether the client is looking to target a third party. It behooves U.S. counsel to communicate, either with the foreign associate or directly with the client, to identify potential targets of the client's application. This may help avoid a future conflict of interest or malpractice claim if in fact the U.S. counsel unwittingly prosecutes patent claims that are intended by the client to read on another company's product or process.

## Do You Know Your Client's Objectives?

Working through an intermediary does not absolve U.S. counsel of their obligations to know what are the client's objectives and how those objectives are to be accomplished. The request for legal services may make it clear what the client is seeking to accomplish. If the foreign associate referral states that it desires a design patent, for example, it may be useful for U.S. counsel to ensure that their client understands the different scope of protection afforded by design patents as compared to utility patents.

There are many opportunities during the course of a patent representation to communicate with the client, and even if it is permissible to communicate through a foreign associate, client communication is necessary. Some firms, for example, have prepared detailed checklists or letters communicating to the client on issues such as identifying the correct inventor, different types of patent protection available, and compliance with the USPTO's duty of disclosure. The U.S. firm should not assume that the foreign associate will com-

municate such matters on its own to the client. Indeed, the foreign associate has a right to assume that the local law firm (in this instance, the U.S. firm) will provide them with whatever information is required to conform with local law.

## Following Client "Instructions" Still Permissible – But is it Permitting UPL?

In *Mikhailova*, the USPTO repeated that its "guidance" was not intended to be inconsistent with the 1987 or 1988 OG Notices. And those Notices stated in relevant part that a practitioner may rely upon the instructions of the corporate liaison or the foreign agent as to the action to be taken in a proceeding before the Office.

What is unclear is whether the USPTO meant to say that it is okay for non-practitioners to engage in the unauthorized practice of law. Neither OG Notice addressed this issue of "following instructions" of unlicensed representatives in the context of constituting the unauthorized practice of law.

Moreover, in *Mikhailova*, the USPTO repeated its guidance that it is unethical for a USPTO patent practitioner to "assist a non-registered individual to practice before the Office in patent matters." See generally 37 C.F.R. § 11.505.

If the intermediary is drafting the substantive papers on behalf of the client with instructions for the U.S. counsel to just file the materials in the USPTO, it is not clear why that practice would not constitute aiding the unauthorized practice of law. After all, neither the intermediary (whether called a foreign associate, foreign agent, or client liaison) is no more authorized to practice U.S. patent law than any other non-lawyer. Indeed, even if such middlemen are authorized practitioners in their own country, absent additional licensing in the U.S., their status as foreign attorneys gives them no special right to practice U.S. law or to advise clients on substantive or procedural issues of U.S. law, including practice before the USPTO.

Even if "instructions" come from the client through the foreign associate, that does not give a free license for the U.S. counsel to blindly follow such instructions. Particularly in an area as complex as U.S. patent law, where entire cases can turn on the placement of a comma or the meaning of a single word, U.S. practitioners should not simply rubber stamp someone else's work product. The "I was just following orders" excuse is not a defense to a claim that a practitioner must act competently and exercise independent professional judgment. Neither of the OG Notices addresses the issue of whether a practitioner's reliance on legal instructions from an unlicensed individual is consistent with the practitioner's duty of competency.

## Are You Engaged in Unlawful Fee-Splitting with a Foreign Associate?

In *Mikhailova*, the USPTO warned that where a non-practitioner intermediary “regularly refers inventors to registered practitioners to provide the patent legal services purchased by inventors from the third party, practitioners may unwittingly violate the fee-sharing prohibition if the practitioner does not know the amount the inventor has paid to the third party for patent legal services.” This would occur, according to the USPTO, if the intermediary charged the client more for the practitioner’s legal services than the intermediary paid the practitioner for those services.

The USPTO further stated that “If the entire amount received by the third party for the practitioner’s compensation is not distributed to the practitioner and any undistributed compensation held by the third party is not returned to the inventor, then the practitioner has likely impermissibly shared fees with a non-practitioner”, in violation of 37 C.F.R. § 11.504(a).

The 1987 and 1988 OG Notices did not address the issue of fee-splitting. But according to the USPTO’s decision in *Mikhailova*, a practitioner has a duty of inquiry to both the intermediary and the client. Specifically as it relates to fees, the U.S. practitioner “is reasonably expected to question carefully the inventor and the referring non-practitioner third party about the amounts being charged to the inventor for the patent legal services to ensure the entire amount is remitted to the practitioner.”

In many cases, the U.S. counsel bills the foreign associate, and the foreign associate pays U.S. counsel’s bills. But do U.S. counsel routinely (or ever) actually check with the client to determine how much the foreign associate billed them, the ultimate client, for the U.S. counsel’s services? If the foreign associate “upcharges” the client for what the U.S. practitioner was actually paid, then that could raise an issue

of whether the U.S. firm was (perhaps unwittingly) engaged in fee-splitting.

The fee-splitting admonitions in the *Mikhailova* ruling are not inconsistent with either the 1987 or 1988 OG Notices. Neither of those Notices discusses the issue of fee-splitting. All those Notices state in relevant part that the practitioner may be paid by the intermediary for the practitioner’s services provided on behalf of the client. The OG Notices do not state that it is permissible for the foreign associate to upcharge the client for the U.S. practitioner’s legal fees and expenses and keep the difference between the amount received from the client and that paid to the practitioner.

## Conclusion

In the process of regulating attorneys who provide legal services for patent promoter intermediaries, the USPTO has made some fairly broad statements regarding how it expects practitioners to deliver patent and trademark legal services to clients working through non-practitioner third parties. The breadth of the language used by the USPTO could easily be read as applying to how U.S. counsel interface with foreign associates. Therefore, it may be short-sighted to assume that the USPTO’s recent discussion in *Mikhailova* is intended only to apply in the context of IP counsel working through invention promoters.

IP firms who regularly receive referrals from, and work through, foreign agents would be wise to consider these developments. In addition, the OG Notices from 1987 and 1988 impose specific requirements on practitioners who work through foreign associates and corporate liaisons. If your practice includes working with foreign associates, it may be prudent to evaluate whether any changes may be necessary to ensure that your firm is complying with the USPTO’s ethics rules. ?





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