



FEATURE

Intellectual Property Economic Damages Principles

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Introduction

When a client suffers economic damages to its intellectual property (IP), whether patent, copyright, trademark or trade secret as result of a breach of contract or a tort, legal counsel will retain a damages expert, conduct discovery, negotiate a settlement, and litigate the dispute. Similarly legal counsel are also involved defending a client alleged to have caused the IP damages.

Once the economic damage analyst is selected, legal counsel will provide instructions to the analyst, assist with the due diligence process, review and rely on the analyst's damages report, defend the analyst at deposition and trial, and work with the analyst to rebut an opposing damages expert. Accordingly, legal counsel who practices in the IP discipline should be familiar with the basic principles of economic damages analysis.

This discussion summarizes the basics of what legal counsel needs to know about the damages analysis objective, the common types of damages measurements, and economic damages methods and procedures.

Damages Analysis Objective

The typical objective and purpose of the damages analysis is to measure the amount of economic damages suffered by the IP owner/operator due to the respondent's wrongful actions. Another component of the damages analysis objective is to estimate the amount of a judicial award that will make the IP owner/operator whole after experiencing the damages event. That is, the damages analysis concludes the analyst's recommendation to a finder of fact as to the amount of monetary compensation that will restore the IP owner/operator to its financial position before the impact of the respondent's wrongful actions.

The damages analysis objective and purpose statement often includes the following:

1. Definition of the damaged IP
2. Description of the IP ownership interest that was damaged
3. Summary description of the alleged damages event
4. Summary of the type of damages suffered by the owner/operator
5. Description of the alleged damages period (or the important damages dates)
6. The parties who may rely on the analysis conclusion

The analyst should expect that the damages report will be submitted as evidence in the litigation. The analyst should expect to offer expert testimony in support of the analysis and report, and the analyst should prepare the damages report in compliance with the expert report evidentiary requirements of the relevant jurisdiction. Legal counsel should instruct the analyst as to expert report and expert testimony requirements.

It is the analyst's responsibility to quantify the compensatory damages amount related to the respondent's wrongful action, not to explain what law the respondent violated that would make the respondent's actions wrongful. The damages analyst will typically receive a legal instruction to presume that the respondent's actions are illegal.

Continued, next page

Editor

Chris Curfman



Inside This Issue

FEATURE: Intellectual Property Economic Damages Principles
pg. 1

CIP Cup Golf Tournament
pg. 3

Patent Committee Report
pg. 9

Chair Elect's Report
pg. 11

H.R. 3261 Update
pg. 11

Intellectual Property Economic Damages Principles

Continued

It is typically not the analyst's responsibility to conclude if the respondent's actions caused the claimant's damages. That legal claim should be supported at trial by a causation expert. Only when the damages event is within the analyst's expertise (e.g., accounting fraud and misrepresentation) will the damages analyst also serve as the causation analyst.

The Damages Period

The IP economic damages analysis often encompasses an extended damages period because the owner/operator usually experiences the impact of the respondent's wrongful action over a period of time. Figure 1 illustrates the typical IP damages period timeline:

Figure 1



The respondent allegedly performs the first wrongful action (i.e. damages event). This wrongful action could be a breach of contract, breach of a duty, an intellectual property rights infringement, or some other type of tort. The respondent's actions are not typically limited to one day. Rather, the respondents may infringe on the owner/operator's IP for months or years after the initial damage event.

Once the owner/operator learns about the damages event, the claimant is responsible for mitigating the damages caused by the respondent's actions. Let's presume the claimant's counsel immediately contacts the respondent, demands that it cease the infringement actions, and the owner/operator contacted their customers about the infringing trademark, implements corrective advertising to avoid market confusion, or performs some other corrective action. Those activities would represent the first mitigation. The full mitigation date relates to the time when the claimant has mitigated the respondent's wrongful actions as much as possible. Such actions could include developing an entire advertising and promotion campaign to counteract the impact of the trademark infringement.

The current date is the date when the analyst issues the damages report. Typically the analyst calculates the IP damages as of either (1) the damages event date or (2) the trial date (or, at least, the expected trial date). If the analyst estimates the economic damages as of the damages event date, then all of the damages analyses will be based on projections and assumptions. In this manner, the damages event date estimate will have to be adjusted to the trial date by the application of a pre-trial interest rate. Alternatively, the analyst could estimate the amount of the damages that the owner/operator will incur up through the trial date and avoid adjusting for pre-trial interest.

The trial date is when the finder of fact hears the evidence with respect to the dispute. Hopefully, the finder of fact quickly reaches a conclusion with regard to damages after the presentation of the evidence. In that case, the trial date and the date of the damages award (if any) are reasonably close to each other.

The last day noted in the Figure 1 timeline is the end of damages date. This date represents the date at which the claimant no longer experiences any effects related to the respondent's wrongful actions. The claimant may continue to experience damages beyond the trial date and into the future. In that case, the analyst will have to estimate when the claimant will no longer experience damages, make appropriate adjustments to project the effects of the economic damages through the end of a damages date and adjust the damage calculation model accordingly.

Types of Damages Measurement

The various IP damages methods and procedures are typically grouped into the following categories:

1. Lost profits – primarily historical (pre-current date) lost profits
2. Economic damages – primarily expected future (post-current date) lost profits
3. Cost to restore the IP value
4. Reasonable royalty rate
5. Other

Continued, next page

Intellectual Property Economic Damages Principles

Continued

The analyst will decide which method is most appropriate for the subject analysis, based on (1) the quantity and quality of available data and (2) the facts and circumstances of the damages event. The analyst may consult with legal counsel with respect to the selection of the damages method. In some cases, certain methods may be allowable as a matter of legal statute, judicial precedent, or administrative ruling. In other cases certain methods may not be allowable. Legal counsel should provide instructions to the analyst as to the acceptable or unacceptable damages methods.

Lost Profits

This measurement calculates the lost profits incurred by the claimant as a result of the respondent's wrongful actions. Historical lost profits are measured from the first damages event date up through the analysis current date. Lost profits consider both (1) the actions of the claimant to mitigate the damages and (2) the actions of the respondent to mitigate the damages. Also, lost profits are typically measured on a comparative or incremental basis and typically measure the difference between:

1. The profits the claimant would have earned during the damages period if the respondent did not perform the wrongful act and
2. The profits the claimant actually earned during the damages period after the respondent performed the alleged wrongful act.

For purposes of a lost profits analysis, profits are typically measured on a contribution margin basis (and not on a GAAP net income basis). Lost profits are measured as:

1. Variable revenue minus
2. Variable costs

Continued, next page

Second Annual Charity IP Golf Tournament a Success

The 2nd annual IP Charity Golf Tournament was held on October 24 at the Alpharetta Athletic Club. It was a beautiful day and a wonderful time was had by all. Proceeds from the tournament benefited Georgia Lawyers for the Arts, the Public Interest Law Association, and the Intellectual Property Scholarship Fund at Georgia State University.

The day produced a number of winners, including a tie for low net foursome. Those honors are shared by the AT&T team (**Scott Frank, Chason Carroll,**

Jeff Keuster and Bret Bonzheim) and the team from Kilpatrick (**Richard Goldstrucker, Jay Bogan, Jon Blake and David Hanson**).

Low gross foursome was awarded to the team from IP Investments (**Bill Hartselle, Mike McLaughlin, Ryan Strong and Charlie Chamberlain**).

John Harrison was closest to the pin on the front nine, while the back nine honors went to **Art Gardner**. **David Hanson** and **Bret Bonzheim** each impressed the crowd with the longest drives on the front and back nine, respectively.



We're grateful for the support of these great sponsors:
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Intellectual Property Economic Damages Principles

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An allocation of the claimant's fixed costs (at any level of the income statement) is typically not considered in the lost profits measurement. This is because, by definition, fixed costs are fixed. The claimant will have to incur these fixed costs whether or not the damages event occurs.

Some analysts measure lost profits on a cash flow basis, instead of an income statement basis. These analysts consider such cash flow components as capital expenditures, depreciation and amortization expenses, and net working capital changes. Even so, analysts measure lost cash flow on a contribution margin basis.

Economic Damages Methods

The various damages methods usually consider the claimant's expected lost profits from the current date up to the end of the damages period. These measures typically include a projection of expected future lost profits. The difference in the measurement methods is primarily related to how these projections are made. Historical lost profits and projected economic damages should consider both (1) the actions of the claimant to mitigate the damages and (2) the actions of the respondent to mitigate the damages.

The three IP economic damages methods are:

1. The before and after method
2. The projection/"but for" method
3. The yardstick method

The objective of each method is to estimate the amount of lost profits related to the damages event from (1) the current (analysis) date through (2) the expected end of the damages period.

The Before and After Method

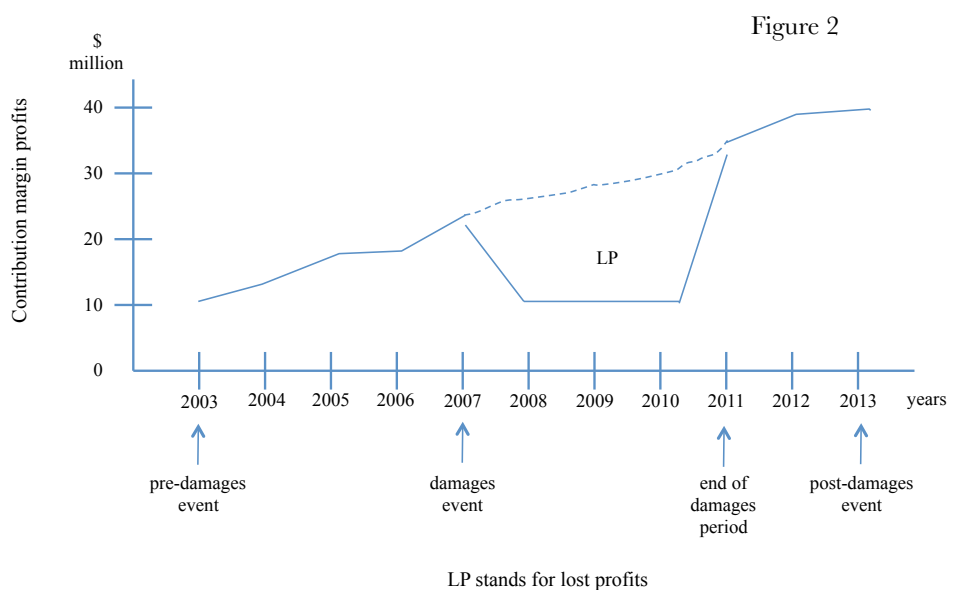
The before and after method is most applicable when the analyst has two sets of financial data available:

1. Claimant results of operations for several years prior to the damages event, and
2. Claimant results of operations for several years after the end of the damages period.

In this method, the analyst compares the "before" results of operations and the "after" results of operations and extrapolates the claimant results of operations "but for" the damages event. Figure 2 presents a simple illustration of this method.

Let's presume that Baker Company breached its contract with Able Company early in 2007. Even after its mitigation efforts, it took until 2011 for Able to replace the Baker contracts and to fully recover from the damages event. The solid line in Figure 2 indicates (1) Able Company's profitability trend for the several years prior to the Baker wrongful act (2) the actual Able profits for the 2007-2011 during the damages period (3) Able Company's profits for several years after it has recovered from the Baker contract breach.

The dotted line between 2007 and 2011 represents the analyst's projection of what the profits would have been "but for" the wrongful act. The interior area labeled LP represents the total lost profits that Able suffered as a result of the breach of contract.



This application of the before and after method presumes the current date does not occur until after 2013, the analyst is not retained, and the analyst does not prepare the damages report until after the end of the damages period. Most injured parties do not want to wait

Continued, next page

Intellectual Property Economic Damages Principles

Continued

until “all of the dust has settled” and the analyst has actual post-damages financial statements available. This method projects claimant economic damages based on an analysis of actual claimant restored profitability.

The Projection / “But For” Method

The projections method (a/k/a, the “but for” method) is commonly applied in IP damages analyses. Neither the analyst nor the injured party has to wait until the damages period is over and “normal” profit levels are restored before it exercises its legal rights against the respondent.

The principal component of this method is the projection of the claimant’s lost profits after the current date. This method can be used if the current date is soon after the damages date, and it can be used when there is little or no historical results of operations to use in the before and after method. Such a set of circumstances often occurs when the damage is suffered by a new business, a new product line, a new contract, or new IP.

Figure 3 presents a simple illustration of the projections method. Let’s assume the introduction of a relatively new product line for Charlie Company. The period of 2010 to 2011 represents the actual results of operations for the injured party. Next let’s assume that Delta Company implements the damages event at the start of 2011. The damages event is discovered immediately, and legal counsel retains an analyst to quantify the damages. The current date is also in the early part of 2011. The analyst will rely on a projection of Charlie Company’s results of operations without the impact of the damages event.

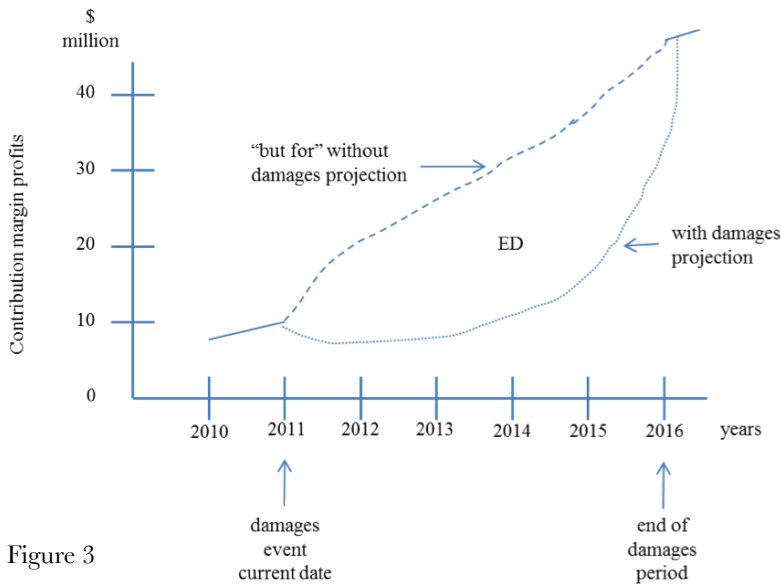


Figure 3

ED stands for economic damages

If the analyst does not prepare the projections, then the analyst should perform reasonable due diligence procedures before accepting the projections. Ideally, the analyst will have access to projections prepared prior to the damages event. These projections may have been prepared for business decision-making purposes, such as: company investment rationing, presentation to bankers, presentation to shareholders, etc.

Next the analyst will require a projection of the claimant’s results of operations considering the impact of the damages event. By definition, this projection has to be prepared after the damages event has occurred. This projection is illustrated by a dotted line in Figure 3. This dotted line starts at the damages event date and continues until the two projection lines intersect indicating the end of damages and the injured party has fully recovered from the damages event.

The analyst will also perform reasonable due diligence with respect to the “with damages” projection. There may not be much data available to confirm the “with damages” projection because Charlie did not expect—and did not

budget for—the wrongful act. The area inside the two lines on Figure 3 represents Charlie Company’s damages. The total amount of economic damages is labeled ED.

The Yardstick Method

The yardstick method also measures damages by reference to claimant financial projection. In the yardstick method, the basis for the injured company’s projection is an independent yardstick. A dependent variable that is difficult to project (i.e., claimant company results of operations) is related to an independent variable that is less difficult to project (e.g., a macroeconomic statistic or a demographic statistic).

First, the analyst identifies an independent variable that correlates to claimant company revenue or profits. Second, the analyst obtains independent projections of the independent variable (e.g., national residential construction, the money supply, the GNP growth rate, the population data, etc.). Third, the analyst uses this yardstick to project the claimant company results of operation without the impact of

Continued, next page

Intellectual Property Economic Damages Principles

Continued

the damages event. Fourth, the analyst obtains a projection of the claimant company results throughout the damages period. Fifth, the difference between the yardstick projection and the after-damages projection indicate the expected lost profits related to the damages event.

Figure 4 presents a simple illustration of the yardstick method. The analyst is asked to measure the economic damages to Echo Company as a result of the wrongful action of Foxtrot Company.

In this example, Echo manufactures a product that is marketed to retirees. For the 2003 through 2007 pre-damages period, there is a very strong correlation between the over-65 year old population and the sales of the product. Also, there is a very strong correlation between sales and profits. These three variables (i.e., consumer demographics, sales, and profit) are indicated by the solid lines on Figure 4.

At the beginning of 2007, Foxtrot performs a wrongful act against Echo. Legal counsel promptly retained an analyst to measure the economic damages. Echo management did not have any long-range financial projections prepared. However, the analyst was able to obtain from government sources a five-year demographic projection of the over 65-year old population.

With this yardstick projection, the analyst and management could project what sales and profits would have been if Echo had not been damaged. The analyst and management worked together to prepare a projection of expected company results of operations over the next four years. These projections encompass the expected impact of the wrongful act on the sales and profit. The four-year projection period is the expected damages period (i.e., the total time period between (1) the damages event and (2) the date when Echo will have fully recovered from the damages).

In Figure 4, the yardstick projections for sales and profits are indicated with the dotted lines. In this figure, the expected sales and profits after the impact of the damages are indicated with the dash lines. In the bottom of the figure, the interior of the intersection of the dotted lines and the dash line is indicated by the letters ED. This interior area represents the expected amount of economic damages that Echo suffered as a result of the wrongful action.

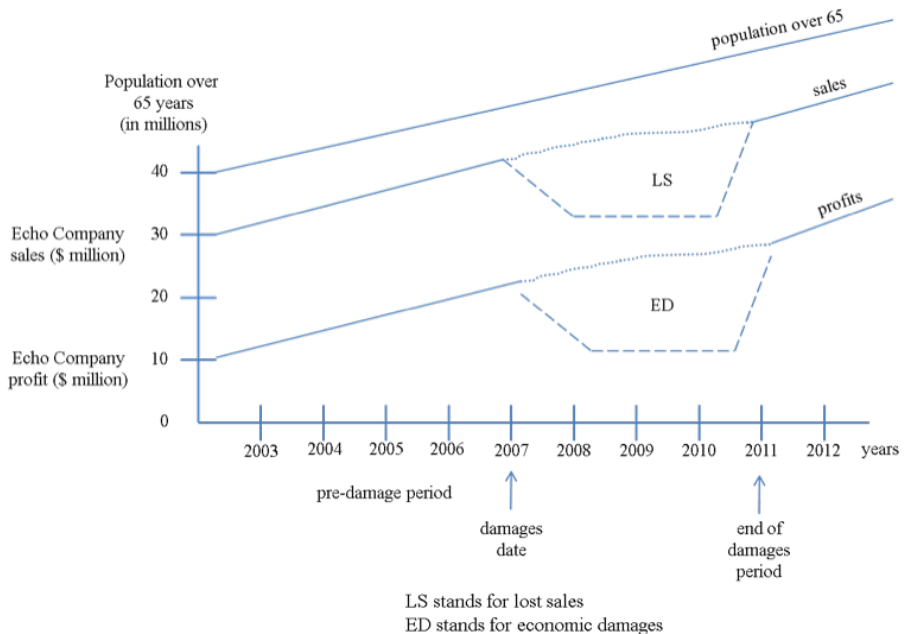
As with the other methods, the damages are measured as of the current date. This analysis considers the impact of all mitigation actions performed by both the claimant and the respondent.

Consistent with all damages measurement methods, lost profits relate to lost revenue. Lost revenue includes both (1) any decrease in unit volume and (2) any decrease in unit prices. The decrease in unit price is also known as price erosion. Lost revenue relates to both (1) lost sales directly related to the damages event and (2) lost sales indirectly (or consequentially) related to the damages event (e.g., the loss of follow-on sales of maintenance services or replacement/repair parts).

Cost to Restore Value

The cost to restore value method typically measures the difference in the IP value before the damages event and after the damages event. There are typically two cost components to the lost IP value (or the cost to restore the IP). The first component is the direct reduction in the IP value (direct cost to restore damaged IP value). The second component is the claimant's lost profits during the IP restoration period. This lost profits component is considered an opportunity cost, or as part of the cost to restore the owner/operator to its condition before the damages event occurred.

Figure 4



Intellectual Property Economic Damages Principles

Continued

Let's assume that retail mall owner Green agrees that franchise restaurant operator Henry will be the only restaurant on the mall property. Based on this contractual agreement, Henry rents the vacant restaurant building and opens the franchise operation. The franchise license includes the rights to use trademarks, trade dress, and trade secrets. After several years of operations, Henry estimates the value of his franchise agreement at \$10 million. Then, Green allows another (competitor) franchise restaurant operator to build a restaurant on the same mall property.

Next, let's presume that the new franchise restaurant draws revenue and profits from Henry. One year after the new restaurant opens, Henry sells his franchise agreement to another restaurant operator for \$7 million. Henry had a franchise with a \$10 million value before the damages event (i.e., the breach of contract), and now Henry has a franchise with a \$7 million value after the damages event (based on the arm's-length sale of the franchise). The direct reduction of IP value component of the cost to restore Henry to a pre-damages condition is \$3 million (i.e., \$10 million pre-damages value - \$7 million after damages value).

Finally, let's presume that Henry also experienced lost profits during the restoration period. The restoration (or partial restoration) event is the third-party sale of the Henry franchise. Henry expected to earn \$2 million in contribution margin during the last year. This expectation assumes no competition, and this expectation is based on the operating results of the Henry restaurant during the last few years. During the last year, with the restaurant competition, the Henry restaurant only earned \$1 million. Henry experienced lost profits (an opportunity cost) of \$1 million (i.e., \$2 million pre-damages profits - \$1 million after damages profit).

The damages experienced by Henry are summarized in Table 1:

Table 1	
Henry Franchise Restaurant	
Cost to Restore Damages Method	
	Damages
Cost to Restore IP Value	Amounts
Component I - direct cost to restore the damaged party IP (compensation required to restore the \$10 million franchise value)	\$3 million
Component II - indirect cost to restore - lost profits opportunity cost during the IP restoration period (\$1 million lost profits)	<u>1 million</u>
Total IP cost to restore	<u>\$4 million</u>

Reasonable Royalty Rate Method

This damages method estimates what a third party licensor would pay to a third party licensee for an arm's-length IP use license. This method does not apply to all types of IP damages. For example, it may not be applicable to many breach of contract (or of noncompete, nonsolicitation, nondisclosure, franchise, or other agreement) disputes. However, this method is particularly applicable to certain types of tort claims, such as an infringement, tortious interference, or other wrongful use of the IP.

This damages method models the scenario where the respondent unlawfully infringes or misappropriates a lawful licensed use of the IP. The principle and lawful method is (1) the licensee would be willing to pay a fair royalty rate for the inbound license of the IP and (2) the licensor would be willing to accept a fair royalty rate for the outbound license of the IP.

By infringing or otherwise misappropriating the IP, the respondent is preventing the owner/operator from receiving the fair royalty income on the hypothetical license. If the respondent paid the claimant this fair royalty income, the owner/operator would be compensated for the damages. In this method, the fair royalty rate is either applied to (1) the claimant's revenue or (2) the respondent's revenue. The royalty income based on the claimant's revenue measures lost income to the injured party. The royalty income based on the respondent's revenue measures the unjust enrichment to the injuring party.

Other Methods

This category includes two types of methods. First, there are statutory damages amounts for certain types of wrongful acts. For example, federal law provides for a statutory damages amount (that may be sought by the claimant) in the case of copyright infringement or trademark infringement. Second, sometimes the analyst may develop a de novo method based on the facts and

Continued, next page

Intellectual Property Economic Damages Principles

Continued

circumstances of the individual case. In such cases, the analyst believes that the case-specific damages method is more appropriate than the above-described damages methods.

Damages Considerations

First, with respect to historical lost profits, it is noteworthy that profitability is measured on a contribution margin basis. The analyst is only concerned with the claimant's financial fundamentals that changed as a result of the damages event.

Second, with regard to each method, the analyst should be able to explain a reasonable basis for the claimant's financial projections. Regardless of the method, the analyst should perform sufficient due diligence in order to become generally comfortable with the financial projections.

Third, related to the cost to restore value method, the analyst can use either the income approach, the cost approach, or the market approach to value the damaged IP. The measurement of the cost to restore (also called the cost to cure) does not mean the analyst must use the cost approach to value the damaged IP.

Fourth, with regard to the reasonable royalty rate method, the analyst can use a variety of generally accepted methods to estimate the royalty rate. The comparable uncontrolled transactions (CUT) method is the most common method. However, the analyst may also use the profit split method (or the residual profit split method). The analyst also could use the residual (or excess) profit margin method. Or, the comparable profit margin (CPM) method.

Fifth, with respect to other methods, the analyst should consider if the selected method (1) is reasonable for the circumstances and (2) measures the impact of the damages event (and not some other trend or phenomenon). In the case of a statutory method, the analyst should obtain guidance from legal counsel as to the application and amount of such damages.

The Damages Award is a Taxable Event

The award of compensatory (and punitive) damages is typically a taxable event to the damaged party. The claimant typically has to recognize taxable income related to the damages award. The objective of the damages analysis is to place the injured party in the same financial condition as before the damages event. If the claimant pays out a portion of the damages award as income tax expense, then the claimant is not in the same financial condition as before the damages event. The damages award should be sufficient to (1) cover the amount of actual damages and (2) pay the income tax liability on the actual damages. There are two procedures to adjust the actual damages amount to consider the claimant's income tax liability.

In the first procedure, the analyst projects all expected future lost income on a pre-tax basis. Then, using an after-tax discount rate the analyst calculates the present values of the pre-tax lost income. This calculation results in a damages award recommendation that includes both (1) the future lost profits and (2) the income tax liability on the judicial award.

In the second procedure, the analyst measures the amount of the claimant's actual damages, using any of the above-described methods. Then, the analyst calculates the income tax liability related to the judicial award of actual damages.

Finally, the analyst adds together these two calculated figures. The sum is the judicial award recommendation that will make the injured party "whole" after the damages event. Table 2 illustrates this second procedure.

Table 2				
Income Tax Adjustment				
Factor	Recommended Judicial Award Component			Amount
1.	Inured party IP actual damages (based on any damages measurement method)			\$10,000,000
2.	Income tax adjustment on compensatory damages (1 - assumed 35% tax rate)	÷		65%
3.	Recommended total judicial award			<u>\$15,385,000</u>

Continued, next page

Intellectual Property Economic Damages Principles

Continued

Table 3 illustrates how the injured party is restored to its pre-damages condition.

Table 3		
Reconciliation to Actual Economic Damages		
Factor	Actual Economic Damages Reconciliation	Amount
1.	Finder of fact orders the recommended award (i.e., taxable income to the claimant)	\$15,385,000
2.	Income tax expense related to the award (at the 35% tax rate)	5,385,000
3.	Reconciliation to actual economic damages	<u>\$10,000,000</u>

Summary and Conclusion

Legal counsel are often involved in IP disputes. These disputes could involve a breach of contract or a tort. These disputes typically involve a claim for IP economic damages. In these matters, legal counsel will select, work with, and examine an IP damages analyst. Accordingly, legal counsel should be familiar with the basic principles of economic damages analysis.

This discussion summarized the basic principles related to IP damages analysis, including the damages analysis purpose and objective, and generally accepted damages measurement methods. This discussion focused on IP damages analysis only. That is, this discussion did not consider pre-judgment interest or the present value of future lost profits. Therefore, this discussion did not describe the mathematics of IP damages analysis.

Patent Committee Report

The Patent Committee hosted a program on October 7, 2011, entitled, "What Your Client Needs to Know: Leahy-Smith America Invents Act." More than 50 people attended. We would like to thank our panelist **Bill Needle** (Ballard Spahr) and **Dr. Robert Hodges** (Pabst Patent Group) for their presentations. In addition, we would like to thank **Rivka Monheit** (Pabst Patent Group) for her assistance in organizing this presentation.

We are in the process of planning additional CLE events and we welcome members and suggestions for other CLEs or Patent Committee events.

If you would like to participate in the Patent Committee, please contact:

George Medlock (george.medlock@alston.com),
Rivka Monheit (rivka@pabstpatent.com), or
Susanne Hollinger (shollin@emory.edu).

Get Involved!

The IP Section is busy planning for an exciting year of educational programming and valuable networking and social events. We always welcome suggestions from Section members so please get in touch with any of the officers or committee chairs listed on the last page of this newsletter if you have any ideas to share!

Photos From the North American Entertainment, Sports and Intellectual Property Law Conference



Held November 9 - 13th at the Fiesta American Grand Los Cabos Golf & Spa Resort in Cabo San Lucas, Mexico, this Section-sponsored event combined the 23rd Annual Entertainment and Sports Law Conference and the 17th Annual Intellectual Property Law Institute.

More than 100 IP Section members and their guests attended. The conference offered up to 12 hours of CLE credit and a number of opportunities for networking and entertainment.



Chair-Elect's Report

Philip Burrus

Planning has begun for the 2012-2013 bar year, which begins on July 1, 2012. In planning for the next year, I want to hear from you. Specifically, I want to know what the Section can do to better serve you, the membership.

As you may recall, we conducted a survey in late 2010 to gauge the interests of the members. We received a lot of great suggestions from that survey. As an example, there was a suggestion for the section to work to increase the visibility of our members to Georgia industry. As a result of that suggestion, I plan to create a new outreach committee to work with

industry, local Chambers of Commerce, and business associations to increase awareness of the intellectual property bar in Georgia.

Our events have traditionally included lunch and learn events, an annual institute, and social events. However, the Section is continually evolving. I welcome ideas for new events, programs, or services. I also welcome the participation of those who want to help bring those ideas to life. If you have ideas, or if you want to participate in the Section, please let me know. My email is pburrus@burrusiplaw.com.

H.R. 3261 Stop Online Piracy Act

House Judiciary Committee Abruptly Delays Vote On Piracy

Tom Lundin, Jr.

On December 17, 2011, the U.S. House Judiciary Committee postponed a vote on the controversial Stop Online Piracy Act ("SOPA"), H.R. 3261.¹ The move came during the second day of a hearing to mark up and vote on the bill, during which a bipartisan group of representatives defeated multiple amendments offered by opponents of the legislation.² The hearing ended as the result of a motion by Rep. Jason Chaffetz (R-UT) seeking to postpone voting until the Committee could hear testimony from technical experts concerning provisions requiring Internet service providers ("ISPs") to alter the Internet's Domain Name System ("DNS") to block foreign web sites "dedicated" to copyright infringement, which critics say would create significant cybersecurity risks.³ The Committee later scheduled the hearings to resume on December 21, 2011.⁴

Purpose And Content

SOPA was introduced in the House on October 26, 2011 to "build on" the PRO IP Act of 2008 and as an analogue to the PROTECT IP Act currently before the Senate.⁵ SOPA seeks to combat "rogue" websites that enable or facilitate copyright infringement or traffic in counterfeit goods.⁶ The authors of SOPA assert that the bill is necessary to modernize criminal and civil statutes to "meet new IP enforcement challenges," including the inability of law enforcement to seek injunctive relief against websites on foreign top-level domains (TLDs).⁷

SOPA provides that the Attorney General may seek injunctive relief in an action against a "foreign infringing site," which is a "foreign Internet site" that would be subject to seizure or prosecution for criminal copyright

infringement or trafficking in counterfeit goods if it were a domestic Internet site.⁸ The bill defines a foreign Internet site as a site that is "U.S.-directed" and used by users in the United States, but excludes domestic sites.⁹

SOPA also would provide a right of private action to seek injunctive relief against an "Internet site dedicated to the theft of U.S. property," which is defined as a foreign Internet site, used by users in the United States, that either

(i) "is primarily designed or operated for the purpose of, has only limited purpose or use other than, or is marketed . . . primarily for use in offering goods or services [that constitute criminal copyright infringement or counterfeit goods]" or

(ii) the site is operated "with the object of promoting or has promoted [criminal copyright infringement] as shown by clear expression or other affirmative steps taken[.]"¹⁰

A private rights-holder must first provide a written notification identifying the accused site to payment network providers and Internet advertising services requiring those entities to forward the notification and suspend their services to the accused site unless the site's owner, operator, or domain name registrant a "counter notification" denying the violations. If a counter notification is provided or the payment network provider or Internet advertising service fails to suspend its

House Judiciary Committee Abruptly Delays Vote On Piracy

Continued

services in the absence of such a counter notification, the private plaintiff may commence suit against the accused site.¹¹

Whether commenced by the Attorney General or a private plaintiff, SOPA provides that an action may be brought *in rem*, that is, against the web site itself.¹² Further, the bill provides that order granting injunctive relief may be served on a variety of types of U.S. Internet companies, which are obligated to take steps to prevent access to or transactions with a foreign infringing site subject to such an order.

The Attorney General may serve a SOPA order on ISPs, Internet search engines, “payment network providers,” and Internet advertising services. Upon being served, an ISP would be required to take “the least burdensome, technically feasible, and reasonable means designed to prevent access” by U.S. users to the foreign infringing site.¹³ “[T]echnically feasible and commercially reasonable measures” would be required of (i) Internet search engines to prevent a hyperlink to a foreign infringing site from being served in response to a search query, (ii) payment network providers to prevent transactions between U.S. customers or accounts and a foreign infringing site, and (iii) Internet advertising services to prevent, and to cease providing or receiving compensation for, advertising relating to a foreign infringing site. A private plaintiff may serve a SOPA order on payment network providers and Internet advertising services, resulting in the same obligations.¹⁴

Other sections of SOPA expand the definition of criminal copyright infringement to include “streaming” of copyrighted works and expands the criminal offense of trafficking in inherently dangerous goods or services to include counterfeit drugs and military goods. SOPA also increases the penalties for a variety of violations of intellectual property rights.¹⁵

Supporters And Opponents

SOPA enjoys widespread support from organizations representing copyright holders, entertainment industry unions, trade associations, and the U.S. Chamber of Commerce.¹⁶ Opponents of the legislation include Internet companies such as AOL, eBay, Facebook, Google, LinkedIn, Mozilla, Twitter, Yahoo, and Zynga, as well as public interest groups like the Electronic Frontier Foundation and Reporters Without Borders, and law professors.¹⁷ Opponents have raised a number of critiques of the legislation, including those based on free speech or censorship, technical, and overbreadth concerns.

Legislators opposed to the bill have proposed more than 50 amendments, most addressing the bill’s provisions relating to DNS blocking. At the time that the Committee

adjourned, fourteen such amendments had been voted down and ten had been withdrawn for further consideration by Committee legal staff.¹⁸ Shortly before the December 15 hearing, Reps. Darrell Issa (R-CA) and Ron Wyden (D-OR) began promoting an alternative bill, the Online Protection and Enforcement of Digital Trade (“OPEN”) Act, which would put online infringement cases under the jurisdiction of the U.S. International Trade Commission and would not include DNS-blocking language.¹⁹

¹ Before the December 15, 2011 hearing, Judiciary Committee Chairman Rep. Lamar Smith (R-TX), introduced a manager’s amendment in the nature of a substitute bill to address concerns raised during public hearings held November 16, 2011. See 157 Cong. Rec. D1233-01, D1235, 2011 WL 5572828.

² See http://judiciary.house.gov/hearings/mark_12152011.html (last accessed December 17, 2011).

³ *Id.* The Judiciary Committee has made available webcast video of the December 15 and 16, 2011 hearings.

⁴ See, e.g., “House postpones action on Internet piracy bill,” Washington Post (December 16, 2011), http://www.washingtonpost.com/blogs/post-tech/post/house-postpones-action-on-internet-piracy-bill/2011/12/16/gIQA0DChxyO_blog.html (noting that the Judiciary Committee confirmed resumption of debate December 21); “Congress to Resume SOPA Hearings Next Week,” PC World (December 17, 2011), http://www.pcworld.com/article/246500/congress_to_resume_sopa_hearings_next_week.html (same).

⁵ See http://judiciary.house.gov/issues/issues_RogueWebsites.html (last accessed December 18, 2011). The PRO IP Act was enacted on October 13, 2008 as Public Law 110-403, 122 Stat 4256. The Senate PROTECT IP Act, S. 968, was introduced on May 12, 2011. It has been approved by the Senate Judiciary Committee, but is being held from a vote of the full Senate by Sen. Ron Wyden (D-OR). See <http://wyden.senate.gov/newsroom/press/release/?id=33a39533-1b25-437b-ad1d-9039b44cde92>.

⁶ Access to a page collecting materials on SOPA on the website of the Committee on the Judiciary is provided through a hyperlink entitled “Rogue Websites.” See, e.g., *supra*, note 4.

⁷ See, *supra*, note 1.

⁸ “Amendment In The Nature Of A Substitute To H.R. 3261 Offered By Mr. Smith Of Texas” (the “Manager’s Amendment”), Sec. 102(a) (<http://judiciary.house.gov/hearings/pdf/HR%203261%20Managers%20Amendment.pdf>). References to “criminal copyright infringement” and “trafficking in counterfeit goods” herein are by the author. The bill references violations of 18 U.S.C. § 2318-2320 and 17 U.S.C. § 1201, 1204.

⁹ *Id.*, Sec. 101(2)-(5), (8), (23), 102(a).

¹⁰ *Id.*, Sec. 103(a) (referencing violations of 17 U.S.C. § 501, 1201; 15 U.S.C. § 1116(d); and 18 U.S.C. § 2320).

¹¹ *Id.*; see also H.R. 3261, Stop Online Piracy Summary, <http://judiciary.house.gov/issues/Rouge%20Websites/Stop%20Online%20Piracy%20Summary.pdf> (last accessed December 16, 2011).

¹² Manager’s Amendment, Sec. 102(b)(2), 103(b)(2).

¹³ *Id.* Sec. 102(c).

¹⁴ *Id.* Sec. 103(c). In addition, before commencing suit against an accused foreign infringing website, a private plaintiff must provide notice to a payment network providers and Internet advertising services requesting that such entities suspend services to the foreign website.

¹⁵ *Id.* Sec. 201-203.

¹⁶ For example, supporters include the Copyright Alliance, National Association of Theatre Owners, Directors Guild of America, American Federation of Television and Radio Artists, Screen Actors Guild, International Alliance of Theatrical and Stage Employees, Motion Picture Association of America, American Federation of Musicians, International Brotherhood of Teamsters, National Association of Manufacturers, Pharmaceutical Research and Manufacturers of America, and Business Software Alliance.

¹⁷ “Google, Facebook, Zynga oppose new SOPA copyright bill,” CNet News (November 15, 2011), http://news.cnet.com/8301-31921_3-57325134-281/google-facebook-zynga-oppose-new-sopa-copyright-bill/.

¹⁸ See, *supra*, note 1.

¹⁹ “Issa on the OPEN Act’s strengths and weaknesses,” Washington Post (December 14, 2011), http://www.washingtonpost.com/blogs/post-tech/post/issa-on-the-open-acts-strengths-and-weaknesses/2011/12/13/gIQAaXJCuO_blog.html.

Upcoming Events

We're
finalizing dates
for the annual
IP Section
Spring Social
to be held
March/April
2012.

Invitations with
the specifics
will be emailed
soon.

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