

## Warranting Rightful Claims

Karen E. Sandrik

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### Repository Citation

Karen E. Sandrik, *Warranting Rightful Claims*, 72 La. L. Rev. (2012)  
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## Warranting Rightful Claims

Karen E. Sandrik\*

### ABSTRACT

*Damage awards for patent infringement have sky-rocketed and sparked significant debate in recent years. A part of this patent damage debate focuses on non-practicing entities, or so-called “patent trolls.” A patent troll is a patent owner that demands a royalty based on patented technology yet does not actually use the technology to provide an end product or service. Their strategy is simple: create nuisance and inflict fear. Patent trolls employ this strategy against the buyers of goods that use or practice the patented technology. Increasingly, buyers are availing themselves of the “warranty against infringement” (“WAI”) in sales contracts under the Uniform Commercial Code when sued by patent owners for alleged patent infringement. The WAI provides a guarantee that goods bought or sold in a given transaction are free from a “rightful” third-party infringement claim when delivered. A party protected by the WAI can receive an indemnity of sorts from the other party for costs and damages associated with expensive and high-risk patent infringement suits.*

*Under the current definition of rightful, the mere threat of litigation is sufficient to trigger protection under the WAI. As damage awards for patent actions continue to fall consistently in the million-dollar-plus range, and patent trolls target dozens of companies at one time, this low threshold for determining when a rightful claim exists opens the door for litigious, and perhaps abusive, conduct on the state level. Scholars have overlooked the significance of the WAI because of the unique blend of two areas of law: intellectual property and commercial law. This Article corrects this oversight. It argues that courts should adopt a new framework for determining when a rightful claim has been made against a buyer or seller, therefore providing the buyer or seller protection under the WAI.*

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## INTRODUCTION

Damage awards for patent infringement have sky-rocketed and sparked significant debate in recent years.<sup>1</sup> Although Congress

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1. See PRICEWATERHOUSECOOPERS, 2010 PATENT LITIGATION STUDY: THE CONTINUED EVOLUTION OF PATENT DAMAGES LAW 8 (2010), available at <http://www.pwc.com/us/en/forensic-services/publications/assets/2010-patent-litigation-study.pdf> [hereinafter PWC PATENT LITIGATION STUDY] (highlighting two awards of over \$1.5 billion); Barnaby J. Feder, *Boston Scientific Loses Patent Suit But*

recently passed the America Invents Act (“Act”), the Act fails to address these increasingly-high damage awards.<sup>2</sup> A part of this patent damage debate focuses on the non-practicing entity (NPE), or so-called “patent troll.”<sup>3</sup> “A favorite villain,” the patent troll is a patent owner that demands a royalty based on patented technology yet does not actually use the technology to provide an end product or service.<sup>4</sup> This lack of personal investment enables the troll to be less risk-averse than patent owners who rely on using the technology and, therefore, more likely to take risks in alleging patent infringement.<sup>5</sup> Patent trolls are known for aggressive and opportunistic behavior.<sup>6</sup> Their strategy is simple: create nuisance and inflict fear. A common response upon receiving a cease-and-desist letter from a patent troll is to pay the nuisance, the troll, to go away; this is accomplished through a license-based settlement. One of the most famous patent licensing campaigns resulted in a

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*Plans to Appeal*, N.Y. TIMES, Feb. 13, 2008 at C10, (discussing Dr. Bruce Saffran’s \$431 million win against Boston Scientific). Scholars have also played a part in this debate. See e.g., John M. Golden, *Principles for Patent Remedies*, 88 TEX. L. REV. 505 (2010); David W. Opderbeck, *Patent Damages Reform and the Shape of Patent Law*, 89 B.U. L. REV. 127 (2009); Thomas F. Cotter, *Patent Holdup, Patent Remedies and Antitrust Responses*, 34 J. CORP. L. 1151 (2009).

2. See U.S. HOUSE OF REPRESENTATIVES, COMM. ON THE JUDICIARY, AMERICA INVENTS ACT OF 2011, available at [http://judiciary.house.gov/issues/issues\\_patentreformact2011.html](http://judiciary.house.gov/issues/issues_patentreformact2011.html).

3. See John M. Golden, Commentary, “Patent Trolls” and Patent Remedies, 85 TEX. L. REV. 2111, 2112 (2007); see also John R. Allison, Mark A. Lemley & Joshua Walker, *Extreme Value of Trolls on Top? The Characteristics of the Most-Litigated Patents*, 158 U. PA. L. REV. 1 (2009).

4. Golden, *supra* note 3, at 2112 (trolls charge a “price for authorizing the work of others”); see also Mark A. Lemley & Carl Shapiro, *Patent Holdup and Royalty Stacking*, 85 TEX. L. REV. 1991, 2009 (2007) (“Defining a patent troll has proven a tricky business, but that does not mean the problem does not exist.”).

5. See Christopher A. Harkins, *Fending Off Paper Patents and Patent Trolls: A Novel “Cold Fusion” Defense Because Changing Times Demand It*, 17 ALB. L.J. SCI. & TECH. 407, 443 (2007) (finding patent troll will more likely “roll the dice and ‘game’ the patent system”).

6. “Patent troll” was apparently coined after “patent extortionist” invoked an action for libel. Golden, *supra* note 3, at 2112 n.7. Another account states the term “patent troll” was first used by Peter Detkin of Intel Corporation to describe small companies suing Intel for patent infringement and achieving “nuisance-value settlements.” Steve Seidenberg, *Troll Control: The Supreme Court’s eBay Decision Sets Back Pesky ‘Patent Trolls’ or American Innovation Depending Upon Which Side You Are On*, 92 A.B.A. J. 50 (2006).

patent owner receiving \$1.5 billion in licensing fees for patents that were ultimately deemed invalid and unenforceable.<sup>7</sup>

In the shadows of the controversy surrounding high damage awards, aggressive patent trolls, and patent reform proposals, defendants in patent infringement actions are seeking indemnification-type protection under contractual provisions and sales warranties.<sup>8</sup> Increasingly, buyers of goods using patented technology are availing themselves of the “warranty against infringement” (WAI) provided by the Uniform Commercial Code (UCC) when sued by patent owners for alleged patent infringement.<sup>9</sup> The WAI provides a guarantee that goods bought or sold in a given transaction are free from a *rightful* third-party infringement claim when delivered.<sup>10</sup> The party protected by the WAI can receive an indemnity of sorts from the other party for costs and damages associated with defending an infringement suit.<sup>11</sup>

For example, suppose Big-MP3 Co. (“Big”), a widget designer and manufacturer, buys one-fourth of the microchips it uses in these widgets from Sal’s Supply Co. (“Sal’s”). Big spends roughly one million dollars purchasing these microchips and incorporating them into the widgets. A year after buying and incorporating these microchips, Big receives a cease-and-desist letter from TP-Chip (“TP”), an unknown third party. TP asserts that the microchips used in Big’s widgets infringe patented technology that it owns. TP demands that Big either stop using the microchips and pay it damages for infringement up to that point, or enter a license

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7. The infamous “Lemelson suits” are discussed in Part I.B and illustrate the type of abuse that states should seek to avoid by adopting the proposed framework for enforcing the WAI.

8. “Indemnification-type” is used here because these actions are not strictly limited to indemnification or cover of litigation–settlement costs; consequential damages may be recoverable, as well. *See infra* Part I.

9. *See* U.C.C. § 2-312(3) (2002). The WAI also provides a cause of action for a seller when a buyer gives the seller “specifications” for the goods that it wants manufactured. *See id.* Further, the WAI covers claims of trademark and copyright infringement. *See id.*; *see also* Dolari Fabrics, Inc. v. Limited, Inc., 662 F. Supp. 1347, 1358 (S.D.N.Y. 1987) (stating WAI protects against patent, trademark, and copyright claims). This Article focuses on third-party claims of patent infringement, but it will address trademark and copyright claims in Part IV.

10. *See* U.C.C. § 2-312(3) (2002). Note the definition of goods as defined by U.C.C. § 2-105(1) (2011) does not include intellectual or intangible property. The goods being sold here are physical, tangible goods thereby placing the sale under the jurisdiction of the UCC; yet, it is the fact that these goods also potentially infringe an intellectual property right that invokes the WAI’s protection.

11. This indemnity can be for copyright, trademark, or patent infringement. *See infra* Part I.

agreement with it so that Big may continue using its current microchips without risk of suit. If Big refuses both options, TP threatens to file a patent infringement suit.

What should Big do? Should Big risk expensive litigation and a potentially devastating damage award or hope that TP is bluffing and will not file suit? Or should Big just settle and avoid the expense and risk of patent litigation? Either way, the WAI may entitle Big to damages against Sal's if a court finds that TP has or had (if settled) a *rightful* claim against Big. Of course, Big would also need to demonstrate that the allegedly infringing microchips were in fact the ones that Sal's sold to Big. Before Big makes a decision about which option to take, Big will want to know what it means to have a rightful claim under the WAI. Without a rightful claim, Sal's will not have breached the WAI, and Big will not be able to recover from Sal's.

Unfortunately, there is little guidance as to the meaning of a rightful claim under the WAI. No definition of rightful exists in the UCC, and scholars have overlooked this area for two simple reasons. First, prior to the late 1990s, courts faced few WAI claims, and, therefore, the WAI drew little attention from scholars and practitioners. Second, the WAI is a unique hybrid of two different areas of law: intellectual property and commercial law. Patent scholars focus on issues that arise under patent law, and patent law is almost exclusively dealt with on the federal level.<sup>12</sup> Conversely, commercial law scholars primarily focus on issues arising under state law. Also, they may be unlikely to consider the WAI because of its specific focus on intellectual property law, an area of law with which few commercial law scholars concern themselves. Due to this lack of guidance from the statute itself and little attention from scholars, courts have struggled to reach consistent results when faced with WAI claims.

For example, a federal court declined to define what a rightful claim is, yet the court did explain a plaintiff's "subjective belief and representation" that a third party's claim against it is rightful is insufficient.<sup>13</sup> Instead, the federal court explained that courts should determine whether a claim is rightful by "comparing the scope of the patents at issue with the allegedly infringing

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12. Section 1338 of Title 28 of the United States Code vests *exclusive* original jurisdiction with the district courts "of any civil action arising under any Act of Congress relating to patents . . ." 28 U.S.C. § 1338(a) (2006). Section 1295(a) grants the Federal Circuit Court of Appeals exclusive jurisdiction over appeals from a district court "if the jurisdiction of that court was based, in whole or in part, on section 1388 of this title." 28 U.S.C. § 1295(a)(1) (2006).

13. 84 Lumber Co. v. MRK Techs., Ltd., 145 F. Supp. 2d 675, 680 (W.D. Pa. 2001).

products.”<sup>14</sup> Under this standard, a federal court will analyze the merits of TP’s infringement claim before shifting the costs of a settlement or patent infringement suit from Big to Sal’s. By contrast, a state court recently stated that a rightful claim is a “nonfrivolous claim of infringement that has any significant and adverse effect, through the prospect of litigation or otherwise, on the buyer’s ability to make use of the purchased goods.”<sup>15</sup> This prospect of litigation may come in the form of a cease-and-desist letter.<sup>16</sup> In other words, this state court held that if a buyer or seller believes the third-party claim against it is rightful, and it voluntarily stops using the allegedly infringing goods upon receipt of a cease-and-desist letter, then it is entitled to damages under a WAI claim. Following this precedent, a state court will engage in little analysis of the merit of TP’s infringement suit, as well as engage in little analysis of whether Big should reasonably believe that TP has a rightful infringement claim against it.

Under the state court’s broad definition of rightful, the threat of litigation may be enough to trigger protection under the WAI. As damage awards for patent actions continue consistently to fall in the million-dollar-plus range, this low threshold for determining when a rightful claim has been made (thereby invoking the WAI) is opening the door for new abuses on the state level. A company in Big’s position has little incentive to determine if it really does infringe a third party’s patent. A company needs only to receive a cease-and-desist letter, purchase a license from the third party or stop using the allegedly infringing goods and pay past damages, and then sue the seller of the goods to recover these expenditures.<sup>17</sup>

Suppose, as often happens, TP sends a cease-and-desist letter not only to Big, but also to dozens of companies that use microchips in their end products. Further, suppose TP’s sole business purpose is to enforce and collect royalty payments based on its microchip patent portfolio. TP is a patent troll. What is troubling here is that TP’s patent may not in fact cover the specific

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14. *Id.* For a more detailed discussion, see *infra* Part II.

15. *Pac. Sunwear of Cal. Inc. v. Olaes Enters., Inc.*, 84 Cal. Rptr. 3d 182, 194 (Cal. Ct. App. 2008). For a more detailed discussion, see *infra* Part II.

16. *Id.*; see also Paul E. McGowan, *Strategies for Indemnification under the U.C.C. Against Claims of Patent Infringement*, 21 INTELL. PROP. LIT. 6 (2010).

17. While Big will incur transactional costs in bringing a suit against Sal’s, this cost is avoidable only if Sal’s agrees to pay TP directly. Very few sellers will admit this liability upfront to a buyer, let alone to a third party who will then target the seller, as well. My proposed framework does, however, encourage more upfront collaboration between buyers and sellers. This collaboration will also encourage buyers to be more thorough and to bargain harder with third parties when they know what a seller may not be able to cover.

microchips used by Big or Big may have a meritorious defense. Yet TP is betting here that Big, as well as many of the other targeted companies, will not evaluate the merits of the infringement claim and the strength of the asserted patent. TP hopes that Big will simply fear the cost of defending a patent suit and the risk of a high damage award and decide to meet TP's licensing demands.

So, why do we have this type of warranty on the state level, despite the fact that patent law is usually under the exclusive jurisdiction of federal courts?<sup>18</sup> How do we define rightful claim so that patent trolls are discouraged from initiating near-frivolous infringement actions and that buyers like Big have incentives to investigate the merit of the infringement claim before being fully reimbursed for expenses by the warrantor? These questions drive this project and are magnified by the reality that just one expensive suit for patent infringement may cause a company to close its doors.

This Article argues that courts should adopt a more rigorous standard for determining when a third party has made a rightful claim against a buyer, thereby entitling a buyer like Big to receive damages from its seller under the WAI. This stricter standard of rightful will provoke buyers to take more time when evaluating the value and strength of the third-party claim against them, and it will deter opportunistic patent troll behavior. A deeper problem exists with the WAI. A warranty is a risk-allocation device that places the risk on the party in the best position to manage it.<sup>19</sup> This risk-bearing party is said to have superior information, a premise upon which much of warranty law is based.<sup>20</sup> The WAI then assumes asymmetrical or imperfect information between buyer and seller, yet this may be unrealistic in the patent context.

This Article proposes a framework that attempts to correct this fundamental problem with the WAI. This framework interprets rightful more narrowly and gives courts a method for conducting intellectual-property-specific analyses. In short, a third-party claim should be deemed rightful only if it would have a reasonable likelihood of success on the merits at trial. If the buyer settles the infringement claim with the third party and then looks to the seller

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18. See 28 U.S.C. § 1295(a) (2006) (vesting the Federal Circuit Court of Appeals with exclusive jurisdiction over appeals from a district court "if the jurisdiction of that court was based, in whole or in part, on section 1338 of this title"). Section 1338, in turn, vests *exclusive* original jurisdiction with the district courts "of any civil action arising under any Act of Congress relating to patents . . ." 28 U.S.C. § 1338(a) (2006).

19. For a more thorough discussion, see *infra* Part III.

20. See *infra* Part III.

to recover its costs, it should further demonstrate that it acted in good faith, as defined by the UCC, in entering the settlement. This requires the buyer to demonstrate he or she was honest and that the process used in negotiating the settlement terms was objectively reasonable. When there is both a significant amount of money and highly sophisticated technology at issue, a court should presume the third party had a rightful claim. Yet, in these instances the buyer must still demonstrate that it acted in good faith in reaching the terms of the settlement with the third party. This standard is similar to the traditional preliminary-injunction standard that both state and federal courts use in civil litigation. Because of this experience with the standard and the balancing that is required, courts will already have the tools and much of the know-how to properly implement this framework.

This Article proceeds in four parts. Part I will discuss the WAI and highlight what happens when a patent troll targets numerous companies, specifically buyers of patented technology (like Big) instead of the manufacturers who are closer to the technology (like Sal's). Further, Part I discusses the consequences of the buyer "playing" with the seller's money. Part II analyzes recent cases where courts were faced with defining rightful as used in the WAI. Part II also illustrates the competing definitions of rightful and tracks the current trend which requires little of the plaintiff, in this case Big, the buyer.

Next, Part III discusses three separate theoretical justifications of warranty law and demonstrates how the unifying thread of these justifications—informational asymmetry between the parties—may not always exist with the WAI. Part III then argues that the current justifications of warranty law are too general to provide a realistic response for shifting liability to the seller under the WAI. Part IV proposes a new framework for courts for determining whether a rightful claim exists. The proposed framework will promote a realistic symmetry between the buyer and seller and protect companies from opportunistic patent trolls.

## I. WARRANTY OF TITLE AND AGAINST INFRINGEMENT

### A. *The Warranty Against Infringement*

The WAI is an implied warranty that "rides with" a contract for a sale of goods under the UCC.<sup>21</sup> In general, an implied warranty is

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21. Section 2-312 of the UCC is entitled the "Warranty of Title and Against Infringement; Buyer's Obligation Against Infringement." This section has three subsections. The first subsection, the warranty of title, states: "(a) the title

a guarantee that is read into the contract even though the contract itself does not explicitly contain such a provision.<sup>22</sup> The WAI is a default term, meaning parties are free to contract around it. The WAI states:

Unless otherwise agreed a seller who is a merchant regularly dealing in goods of the kind warrants that the goods shall be delivered free of the rightful claim of any third person by way of infringement or the like but a buyer who furnishes specifications to the seller must hold the seller harmless against any such claim which arises out of compliance with the specifications.<sup>23</sup>

Unless specifically disclaimed, the WAI attaches to every sale of goods regardless of the parties' implicit understanding, and guarantees that there is no "cloud" on the goods transferred in the form of a potential third-party patent, trademark, or copyright infringement suit.<sup>24</sup> Unique to the WAI is that the guarantee runs not only from seller to buyer, but also from buyer to seller.<sup>25</sup> The WAI requires the buyer to "hold the seller harmless" when it gives design instructions to the seller.<sup>26</sup> For example, if a lighting company (buyer) gives detailed instructions to an insulation manufacturer (seller) for a particular type of insulated part it needs, and then a third party sues the manufacturer for patent infringement based on these custom-designed parts, the lighting company is responsible under the WAI to pay any costs the

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conveyed shall be good, and its transfer rightful; and (b) the goods shall be delivered free from any security interest or other lien or encumbrance of which the buyer at the time of contracting has no knowledge." The second subsection describes how parties may disclaim this section. The third subsection, the WAI, is the focus of this Article.

22. ROBERT COOTER & THOMAS ULEN, *LAW & ECONOMICS* 297 n.9 (6th ed. 2012) (explaining that most states "impute[] a 'warranty of fitness,' which is a guarantee that the court reads into the contract, even though the actual contract did not explicitly contain such a guarantee.").

23. U.C.C. § 2-312(3) (2002).

24. While Official Comment 3 of § 2-312 (2002) only states that patent and trademark infringement claims are covered here, courts have extended § 2-312 to include copyright infringement claims as well. *See e.g.*, *Dolari Fabrics, Inc. v. Limited, Inc.*, 662 F. Supp. 1347, 1358 (S.D.N.Y. 1987). ("The broad language . . . applies to claim[s] of copyright infringement although the Official Comment explicitly refers only to 'claims of infringement of a patent or trademark by a third party.'"). It is unclear whether other intellectual property rights, such as misappropriation of trade secrets or violations of data privacy rights, may be covered by § 2-312.

25. *See* U.C.C. § 2-312(3) (2002).

26. *Id.*

manufacturer incurs in defending itself against the third party.<sup>27</sup> This has been coined the “customization exception.”<sup>28</sup> For purposes of clarity in this Article, the *buyer* is the default party bringing the breach of WAI claim.<sup>29</sup> This is the most common use of the WAI.<sup>30</sup>

Although the WAI is a promise made by a seller that its goods do not infringe a third party’s patent, trademark, or copyright, it is not a promise insuring against *any* claim of infringement.<sup>31</sup> Rather, the WAI provides relief only for rightful third-party claims. To establish a breach of the WAI, “a party must show the seller was a merchant regularly dealing in the goods of the kind, the goods were subject to a rightful infringement claim of any third party upon delivery, the buyer did not furnish specifications to the seller, and the parties did not form another agreement.”<sup>32</sup>

Courts began facing how to determine whether a third party had made a rightful claim relatively recently.<sup>33</sup> The statute itself provides little guidance, so courts have turned to treatises, scholarly articles, early cases involving the warranty of title, and the traditional methods of statutory interpretation for direction.<sup>34</sup>

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27. See *Cover v. Hydramatic Packing Co.*, 83 F.3d 1390, 1391–92 (Fed. Cir. 1996).

28. See e.g., *Phoenix Solutions, Inc. v. Sony Elects. Inc.*, 637 F. Supp. 2d 683, 698 (N.D. Cal. 2009).

29. Yet, as demonstrated with the lighting company and insulation manufacturer, the burden may switch to the buyer anytime it gives “specifications” to the seller.

30. See *infra* Part II for illustrative cases.

31. The UCC defines a merchant as a “person who deals in goods of the kind or otherwise by his occupation holds himself out as having knowledge or skill peculiar to the practices or goods involved in the transaction or . . . who by his occupation holds himself out as having such knowledge or skill.” § 2-104 (2011). This definition captures manufacturers, retailers, and wholesalers, even with the extra layer requiring a merchant to be one that deals “regularly” with the particular goods being sold. See McGowan, *supra* note 16, at 6.

32. *Phoenix Solutions*, 637 F. Supp. 2d at 693 (emphasis added) (citing 84 *Lumber Co. v. MRK Techs., Ltd.*, 145 F. Supp. 2d 675, 687–79 (W.D. Pa. 2001)). The U.C.C only requires notification to the seller of a breach of the WAI within a reasonable time if “the buyer is *sued* as a result of such a breach.” U.C.C. § 2-607(3)(b) (2002) (emphasis added). Because of the high settlement rates in patent litigation as well as the lack of incentives on buyers to not settle quickly, both discussed *infra*, the seller is most often unlikely to have the opportunity to ascertain the rightfulness of the claim and the reasonableness of the settlement terms.

33. See *Cover v. Hydramatic Packing Co.*, 83 F.3d 1390, 1391–92 (Fed. Cir. 1996).

34. See *Pac. Sunwear of Cal. Inc. v. Olaes Enters., Inc.*, 84 Cal. Rptr. 3d 182, 189-192 (Cal. Ct. App. 2008) (using case law, treatises, law review articles, and policy arguments as extrinsic aids used to properly define “rightful claim”).

Thus, courts have fashioned varying standards for determining what rightful entails, making it difficult for buyers and sellers to anticipate the full effects of the WAI. The uncertainty over the application of the WAI also undermines one of the main purposes of the UCC—to create uniform standards for parties across the nation.<sup>35</sup>

When faced with defining what constitutes a rightful claim giving rise to a WAI action, courts initially recognized a need for a comparison of the third party's patented technology and the allegedly infringing good.<sup>36</sup> A court using this standard needs to analyze the merit of the infringement claim in deciding whether it was a rightful claim invoking WAI liability.<sup>37</sup> Recently, courts have broadened this standard. For example, a state court found a rightful claim is any nonfrivolous claim that causes the buyer to voluntarily give up use of the goods.<sup>38</sup> Accordingly, a WAI claim may be established by as little as a cease-and-desist letter.<sup>39</sup>

This recent standard for determining whether a rightful claim has been made is troubling not only because patent trolls often threaten litigation, but also because it demonstrates that courts are unprepared to evaluate WAI claims in light of the relevant underlying infringement claim. Parties accused of patent infringement often want to continue using the allegedly infringing goods. The patent holder and potentially infringing party most often negotiate a price for continued use of the patented technology.<sup>40</sup> This negotiation results in a licensing settlement.<sup>41</sup> This settlement is reached in a familiar pattern: a patent-holding company sends a letter to a potential infringer proposing a "discussion" of its patent portfolio and inviting it to participate in its licensing program.<sup>42</sup> Even if the buyer voluntarily gives up its use of the goods or purchases a right to continue using the goods, it is not using its own money. Instead, the buyer under the current

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35. See generally Larry T. Garvin, *Uncertainty and Error in the Law of Sales: The Article Two Statute of Limitations*, 83 B.U. L. REV. 345, 345–49 (2003) (highlighting the purpose of the UCC to promote certainty but noting that it has provoked much litigation).

36. See *84 Lumber Co.*, 145 F. Supp. 2d at 680. For a more detailed discussion, see *infra* Part IV.

37. *84 Lumber Co.*, 145 F. Supp. 2d at 680.

38. *Pacific Sunwear*, 84 Cal. Rptr. 3d at 194. For a more detailed discussion, see *infra* Part IV.

39. See *Pacific Sunwear*, 84 Cal. Rptr. 3d at 194.

40. Ranganath Sudarshan, *Nuisance-Value Patent Suits: An Economic Model and Proposal*, 25 SANTA CLARA COMPUTER & HIGH TECH. L.J. 159, 160 (2008).

41. See *id.*

42. See *id.*

interpretation of rightful is in essence using the seller's money.<sup>43</sup> As soon as the buyer settles with the third party, it turns around and holds the seller financially responsible under the WAI.

The potential damages under the WAI may include settlement costs and traditional warranty damages, including losses occurring "in the ordinary course of events from the seller's breach . . . ."<sup>44</sup> If any incidental and consequential damages occur because of the seller's breach, the court may award those damages as well.<sup>45</sup> If the buyer does not settle and the third party wins at trial, the damage award in the patent infringement suit will be added to the buyer's claim under the WAI.<sup>46</sup>

### *B. The First Problem: Big Money and Uncertainty*

As illustrated above, the vast majority of patent infringement suits do not make it to trial. The high costs of litigation, in which discovery alone is estimated at \$1.25 million for a case with \$1 million-plus at stake, and the risk of an exorbitant judgment motivates parties toward an early settlement.<sup>47</sup> Most often this settlement results in a licensing transaction, whereby the alleged infringer essentially pays the patent holder for the right not to be sued for infringement.<sup>48</sup> These licensing transactions have been

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43. An odd dichotomy is created here: The buyer argues to the third party that it has not infringed, and then argues to the seller that it has likely infringed. This type of two-hat approach is inherent in the WAI, and although perhaps unsettling, courts have not appeared to be concerned.

44. U.C.C. § 2-714(1) (2002).

45. See U.C.C. § 2-714(3) (2002). The specific damages formula is "the difference at the time and place of acceptance between the value of the goods accepted and the value they would have had if they had been as warranted, unless special circumstances show proximate damages of a different amount." U.C.C. § 2-714(2) (2002). Although there is some debate whether § 2-714, the damages provision applied to warranties of quality breaches, should also apply to warranties of title breaches, Professor Lord sees "no reason on principle why a different rule should govern the measure of damages for a breach of the warranty of title." RICHARD A. LORD, WILLISTON ON CONTRACTS §66:54 (4th ed. 2007). Professor Lord then states that the UCC provides no separate measure of damages for the warranties of title and that we should accordingly conclude that the general remedy is sufficient for all warranties. See *id.*

46. For example, if a patent infringement suit results in an infringement verdict, these damages easily run in the millions. See PWC PATENT LITIGATION STUDY, *supra* note 1, at 7.

47. Harkins, *supra* note 5, at 435 (listing average costs of discovery in 2005 as \$350 thousand, \$1.25 million, and \$3 million for patent cases where \$1 million, \$1 million-plus, and \$25 million-plus are at stake, respectively).

48. A license in the intellectual property context is often described as a "mere covenant not to sue." RAYMOND T. NIMMER, LICENSING OF INTELLECTUAL PROPERTY AND OTHER INFORMATION ASSETS 12 (2d ed. 2007).

such an enormous financial success for patent owners that a new company structure has emerged—the “non-practicing entity” (NPE).<sup>49</sup> In less favorable terms, an aggressive NPE is known as a “patent troll.”<sup>50</sup> NPEs gather and administer patents that individuals or companies assign to them.

These “fiendish figures”<sup>51</sup> use their patent portfolios to wage a licensing campaign against any possible infringer in the hopes that such parties will simply get rid of the nuisance by buying a license to “use” the patented technology.<sup>52</sup> NPEs currently average damage awards three times greater than practicing entities.<sup>53</sup> The reason may be simply that NPEs are less risk-averse than practicing entities. If a practicing entity goes to trial and not only loses its infringement case but also has its patent invalidated, the result is devastating.<sup>54</sup> The practicing entity, the one with a personal investment in the patented technology, just lost its ability to enforce the patent. The patent troll does not have this deterrent. For the troll, a patent invalidation simply means the troll moves on to enforcing another patent in its portfolio.<sup>55</sup> Accordingly, a patent troll is much more likely to “roll the dice and ‘game’ the patent system in court.”<sup>56</sup> Some say NPEs are choosing stronger patents to litigate in certain jurisdictions with a reputation of producing big damage awards.<sup>57</sup>

An example of an infamous NPE may be helpful to ground the discussion. The late Jerome Lemelson has been called everything from “the most prolific inventor of our time”<sup>58</sup> and “an honest and

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49. These entities are also sometimes more broadly referred to as “patent-holding” entities or companies.

50. “Patent troll” was apparently coined after “patent extortionist” invoked an action for libel. Golden, *supra* note 3, at 2112 n.7. Another account states the term “patent troll” was first used by Peter Detkin of Intel Corporation to describe small companies suing Intel for patent infringement for “nuisance-value settlements.” Steve Seidenberg, *Troll Control: The Supreme Court’s eBay Decision Sets Back Pesky ‘Patent Trolls’ or American Innovation Depending Upon Which Side You Are On*, 92 A.B.A. J. 50, 51, 53 (2006).

51. Harkins, *supra* note 5, at 410–11 (drawing the imagery of Scandinavian folklore of trolls who lived under bridges that they had not actually built yet still prevented passersby from crossing if they did not pay a toll).

52. *See id.*

53. *See* PWC PATENT LITIGATION STUDY, *supra* note 1, at 7–8.

54. Patents are commonly challenged on validity grounds under obviousness, lack of enablement, and anticipation. 35 U.S.C. §§ 102, 103, 112.

55. *See* Harkins, *supra* note 5, at 443.

56. *Id.*

57. *See* PWC LITIGATION STUDY, *supra* note 1, at 10.

58. Myrna Oliver, *Jerome Lemelson; Inventor Held 500 Patents*, L.A. TIMES, Oct. 3, 1997, available at <http://www.inventionconvention.com/Americasinventor/dec97issue/section16.html#Friday>.

courageous man”<sup>59</sup> to “one of the great frauds of the 20th century.”<sup>60</sup> Lemelson and a team of attorneys, notably including Gerald Hosier, pulled off the most significant “legalized extortion,”<sup>61</sup> collecting an estimated \$1.5 billion dollars in licensing fees for patents that were ultimately invalidated.<sup>62</sup>

In the 1950s, Lemelson filed patent applications for an early “machine vision and bar code scanner.”<sup>63</sup> One early patent application was 150 pages and claimed a robot that could perform tasks such as riveting, welding, transporting, and playing the role of quality control inspector due to a built-in camera.<sup>64</sup> This patent application took nine years to get through the Patent and Trademark Office (PTO), resulted in 16 new patents, and had continuation applications tacked on throughout Lemelson’s lifetime. Prior to 1995, a patent term was 17 years from the date of issuance.<sup>65</sup> This date of issuance was the key to Lemelson’s licensing success. He would “file a ‘continuation in part’ application[,] which added additional drawings and text to the applications, in order to extend the time.”<sup>66</sup> Two specific characteristics of many of Lemelson’s patents (numbering in the hundreds) are noteworthy: They were “paper patents” as well as “submarine patents.”

A paper patent describes an invention that the inventor has never commercially used.<sup>67</sup> Often, this signifies that the inventor is a theorist and not a practitioner. Lemelson’s patents fit this

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59. Don Costar, *A Special Tribute to Jerome Lemelson*, AMERICA’S INVENTOR ONLINE EDITION, Dec. 1997, <http://www.inventionconvention.com/americasinventor/dec97issue/section16.html#Friday>.

60. *An Inventor’s Fight for Recognition — and Riches: Was Lemelson a Great American Innovator or a Fraud? Debate Rages On*, ASSOCIATED PRESS, Aug. 22, 2005, available at [http://www.msnbc.msn.com/id/9022361/ns/us\\_news-life/](http://www.msnbc.msn.com/id/9022361/ns/us_news-life/) [hereinafter ASSOCIATED PRESS].

61. Mike Masnick, *Lemelson’s Legacy: Great Inventor Or Patent Hoarder?*, TECHDIRT (Aug. 22, 2005, 2:18 AM), <http://www.techdirt.com/articles/20050822/0217213.shtml>.

62. See ASSOCIATED PRESS, *supra* note 60.

63. *Id.*

64. *Id.*

65. See 35 U.S.C. § 154(a); 35 U.S.C. § 271(a). A patent term is now twenty years.

66. *The Symbol/Cognex-Lemelson Patent Battle*, GROKLAW (Aug. 22, 2005, 11:05 AM), <http://www.groklaw.net/articlebasic.php?story=20050822040508297> [hereinafter *Patent Battle*].

67. See *Am. Cyanamid Co. v. Hercules Inc.*, 260 F. Supp. 368, 374 (D. Del. 1966) (describing a paper patent as one that has not been “commercially exploited”); *United Specialties Co. v. Industrial Wire Cloth Prods. Corp.*, 86 F. Supp. 37, 39 (E.D. Mich. 1949) (describing a paper patent as that which has not been put to “commercial use”).

description. He had no lab or manufacturing plant—he never built most of the technology that earned him his \$1.5 billion empire. He did not practice his patents. Although paper patents may be viewed as the stepchildren of patents, the PTO requires only that an applicant demonstrate conception and reduction to practice, and reduction to practice requires no prototype or representation that the applicant has actually used the invention.<sup>68</sup> Rather, the required reduction to practice may be constructive. So long as the patent's written description "enable[s] any person skilled in the art . . . to make and use" the invention, it may pass muster.<sup>69</sup>

A submarine patent, no longer at issue because of the 1995 changes to patent law, was a patent that remained pending in the PTO for years until, ultimately, the technology captured in the patent comes into widespread commercial use.<sup>70</sup> The pending application would then be published, dated back to the time of filing, and the patentee would have the power to collect heavy royalties and licensing fees from all the companies that now use this technology.<sup>71</sup> Lemelson's machine vision technology (bar code scanner) was a submarine patent. He filed the patent application in 1956, and by the time the patent was finally approved in 1989 similar bar code technology was widely used by Japanese, European, and American companies. Lemelson collected hundreds of millions of dollars in licensing fees for his submarine patent.<sup>72</sup>

The Lemelson suits demonstrated an extreme licensing strategy that many NPEs emulate today.<sup>73</sup> Although this level of monetary success may never be reached again due to the unique nature of Lemelson's submarine patents and the broad use of the technology at issue, the strategy is still viable. Hosier, Lemelson's main attorney and strategist, focused his efforts on corporations with

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68. In the United States, actual invention may be reduction to practice. U.S. PATENT & TRADEMARK OFFICE, U.S. DEP'T OF COMMERCE, MANUAL OF PATENT EXAMINER PROCEDURE § 2138.04–.05 (8th ed., 2d rev. 2010) [hereinafter MPEP]. Generally, the first inventor to conceive the invention and, either actually or constructively, ultimately reduce it to practice is credited with the earlier dated patent application. *But see* 35 U.S.C. § 102(g); MPEP § 2138.06 (requiring reasonable diligence on the part of the first conceiver (but second reducer) from just prior to the first reducer's entrance into the field to the first conceiver's reduction to practice for the first conceiver to be entitled to a patent).

69. *See* 35 U.S.C. § 112 (1) (2006).

70. W. Samuel Niere & Robert E. Krebs, *Prosecution Laches: Lemelson Bar Code and Machine Vision Patents Held Unenforceable*, INTELL. PROP. & TRADE J., Spring 2004, at 12.

71. *Id.*

72. *Patent Battle*, *supra* note 66.

73. Oliver, *supra* note 58.

deep pockets, the customers of the manufacturers, and had one simple premise for getting them to pay: fear.<sup>74</sup> As he stated, “This business is not based on what’s right or what’s wrong . . . . It’s based on fear. Nobody would pay you for a patent unless they feared that the consequences of not paying you vastly exceed the consequences of paying.”<sup>75</sup> These fear tactics were successful. No company would take the risk of an infringement suit. Almost every company chose to participate in the licensing program instead of challenging the validity of Lemelson’s patents or infringement claims.

Lemelson died in 1997 believing his patents were safe and enforceable.<sup>76</sup> After already receiving hundreds of millions of dollars in licensing fees, Hosier and the Lemelson Medical, Education & Research Foundation, LP (Lemelson Foundation) continued the licensing campaign, suing more than 400 companies in 1999.<sup>77</sup> Again, his enforcement strategy was simple: Lemelson sued any company that developed a product that one of his patents may have covered in some way.<sup>78</sup> Companies again started to buy into the licensing program out of fear, even though people in the industry recognized that the bar code scanner was likely not enabled (meaning that the patent would likely be declared invalid and unenforceable for failing to meet patentability requirements).<sup>79</sup> Simply, an ordinary person skilled in the art could not read the claims and written description and then build a bar code scanner—at least one that would recognize “a bar code from a piece of tree bark.”<sup>80</sup>

Cognex Corporation, a leading manufacturer of bar code scanning systems, and Symbol Technologies, Inc., a leading producer of bar code scanning devices, had a line of customers that were demanding indemnification and damages, presumably

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74. *Patent Battle*, *supra* note 66.

75. *Id.* Although this statement makes it hard to be compassionate for Lemelson, he spent his life battling the big companies and fighting for what he thought was his. He set up a not-for-profit organization to give back to his community and to individual inventors like himself, and he gave generously. *See Costar*, *supra* note 59.

76. *See id.*

77. *See id.*

78. Susan Hansen, *Breaking the (Bar) Code*, IP LAW & BUSINESS, March 2004, available at [http://www.ropesgray.com/files/Publication/0a7ad1bd-23b8-4659-bfe5-a172b34a980d/Presentation/PublicationAttachment/2c66e5f3-c656-4244-aa26-21bc3d93c2/Breaking\\_the\\_Bar\\_Code.pdf](http://www.ropesgray.com/files/Publication/0a7ad1bd-23b8-4659-bfe5-a172b34a980d/Presentation/PublicationAttachment/2c66e5f3-c656-4244-aa26-21bc3d93c2/Breaking_the_Bar_Code.pdf).

79. *See id.* For a thorough discussion of patent validity, see MERGES ET AL., *infra* note 211.

80. Hansen, *supra* note 78.

through both individual contracts and the WAI.<sup>81</sup> Because Cognex and Symbol were never personally targeted, they filed a declaratory judgment action against the Lemelson Foundation challenging the machine vision and bar code patents on the grounds of noninfringement, validity, and enforceability.<sup>82</sup> Both Cognex and Symbol “literally couldn’t afford to settle or lose.”<sup>83</sup> In the end, a federal district court decided in favor of Cognex and Symbol, ruling the asserted patents were invalid and unenforceable, and that Cognex and Symbol did not infringe.<sup>84</sup>

Hosier had been defeated, but not before scores of companies paid over \$1.5 billion to “license” Lemelson’s technology—technology based on patents that likely should have never been valid or enforceable.<sup>85</sup> The Lemelson suits show the value of challenging dubious infringement assertions as well as the ability of weak patents to withstand decades of threatened litigation. This is precisely the type of company, the true user of the patented technology, the framework proposed in this Article will encourage to challenge weak patents.

Patent trolls and other aggressive patent holders will sue any company that appears to be using the claimed technology. This pattern of aggressive licensing campaigns is traditionally seen on the federal level under the Patent Act as demonstrated by the Lemelson suits. The problem is exacerbated by the increased use of the WAI and the low threshold to establish a rightful claim. Protected by the WAI, infringement defendants (buyers) have stronger incentives to settle a claim than to defend themselves against possibly frivolous suits. Because the WAI continues to be used more frequently in commercial transactions and courts have broadened the definition of rightful claim, patent trolls will continue seizing the opportunity to target even more companies. Accordingly, this sort of licensing campaign may spread to the

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81. A notable example is *84 Lumber Co. v. MRK, Techs., Ltd.*, 145 F. Supp. 2d 675 (W.D. Pa. 2001), a case discussed in Part II.

82. *Patent Battle*, *supra* note 66.

83. *Id.*

84. *Symbol Techs., Inc. v. Lemelson Med., Educ. & Research Found.*, 301 F. Supp. 2d 1147, 1167 (D. Nev. 2004), *aff’d*, 422 F.3d 1378 (Fed. Cir. 2005). Specifically, the court found the patents “unenforceable under the equitable doctrine of prosecution laches; that the asserted patent claims as construed by the Court [were] not infringed by Symbol or Cognex because use of the accused products [did] not satisfy one or more of the limitations of each and every asserted claim; and that the claims [were] invalid for lack of written description and enablement . . .” *Id.*

85. Likely in response to criticism of the companies licensing weak patents, Hosier stated, “These were eyes-open deals . . . . You pay your money and you take your chances.” Hansen, *supra* note 78.

state level. This is precisely why we should care whether a claim is rightful.

*C. The Second Problem: Buyer Playing with Seller's Money*

The problem of patent trolls sending hundreds of cease-and-desist letters and waiting for licensing royalties to roll in is troubling because of the WAI's currently low standard for what constitutes a rightful claim entitled to protection. In order to recover under the WAI, a buyer needs only to be threatened with an infringement suit. The threat of litigation brings with it the risk of suffering damages through the loss of the goods or a forced payment to continue using the goods sold to it by a seller. Instead of exposing its business to the substantial risk posed by protracted litigation over the validity or potential infringement of a patent, the buyer will settle with the threatening third party and proceed directly against the seller to recover the licensing fees it pays resulting from a settlement.

For the patent system to work as intended, a party is expected to put forth maximum effort in determining a patent infringement claim's weaknesses. Parties responsible for paying their own infringement damages or licensing fees will work to defend themselves in court or at least to drive down potential licensing fees. A company protected by the WAI lacks the incentives necessary to defend itself against an infringement claim. A low threshold for establishing that a third party has a rightful claim, thereby entitling a party to WAI damages, worsens the problem. Sellers forced to pay WAI claims believe, of course, that the amount paid to appease the patentee is unreasonable.<sup>86</sup> To prevent patent trolls from adding unjustified costs to the productive commercial use of technology, parties like Cognex and Symbol need to take a stand and challenge the validity and enforceability of the asserted patent(s). Only after the type of overreaching demonstrated in the Lemelson suits, in which manufacturers must either challenge or go out of business, are sellers willing to risk patent litigation.

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86. See, e.g., *Acushnet Co. v. G.I. Joe's, Inc.*, No. CV05-764-HU, 2006 WL 2729555, at \*5-6 (D. Or. Sept. 22, 2006) (finding a genuine issue of fact existed regarding whether the \$25,000 settlement between buyer and third party was unreasonable based on seller's argument that the damages of an infringement suit would likely have been \$2,500 under the Lanham Act).

## II. CONTRASTING DEFINITIONS OF RIGHTFUL

Recall that the WAI states that “a merchant regularly dealing in goods of the kind warrants that the goods shall be delivered free of the *rightful claim* of any third person by way of infringement . . . .”<sup>87</sup> Importantly, there is no definition of *rightful* in the UCC and the statutory language itself gives little insight as to how it should be construed by the judiciary.<sup>88</sup> That said, there are some clear parameters. For starters, *rightful* does not mean “valid.”

The National Conference of Commissioners on Uniform State Laws and the American Law Institute originally proposed the following language for when the WAI is triggered: “any *rightful claim* of any third person by way of infringement or otherwise unless the circumstances at the time of contracting place the risk of such claim upon the buyer.”<sup>89</sup> After the publication of this definition, various bar groups were invited to offer testimony and written memoranda on the proposed draft of the UCC. The New York Patent Law Association (NYPLA) wanted the WAI to protect against “valid claims.”<sup>90</sup> The NYPLA argued for the term “valid” to be used because it believed *rightful* was not only too ambiguous but also that “patents, trademarks and copyrights are presumably valid and therefore practically any colorable claim under them could be a *rightful claim*.”<sup>91</sup> The NYPLA further argued that a standard of eviction, either actual or constructive, should be adopted.<sup>92</sup> Thus, a buyer would be required to prove “he or she had been precluded from using the purchased goods as a prerequisite to a warranty claim.”<sup>93</sup>

Despite strong support for the NYPLA’s proposed change, the UCC drafters rejected the recommendation.<sup>94</sup> Comment 4 to the WAI states that the case law requiring eviction is not adopted and, moreover, that “‘eviction’ is not a necessary condition to the buyer’s remedy since the buyer’s remedy arises immediately upon receipt of notice of infringement . . . .”<sup>95</sup> After the defeat of the

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87. U.C.C. § 2-312(3) (2002) (emphasis added).

88. William F. Dundine, Jr., *Warranties Against Infringement Under the Uniform Commercial Code*, 36 N.Y. St. B.J. 214, 214 (1964).

89. *Id.* at 217.

90. *Id.*

91. *Id.*

92. *Id.*

93. *Pac. Sunwear of Cal., Inc. v. Olaes Enters., Inc.*, 84 Cal. Rptr. 3d 182, 188 n.3 (Cal. Ct. App. 2008).

94. Dundine, *supra* note 88, at 218.

95. U.C.C. § 2-312 cmt. 4 (2002).

proposed “valid claim” language, many questions remain unanswered for NYPLA supporters, such as:

Must the claim be one which is ultimately vindicated by a judgment of validity and infringement, or need it only be one which reasonable men would agree is rightful? Would it include a colorable claim which reasonable businessmen would settle rather than fight? Whose responsibility is it and what are the criteria to test whether the claim is “rightful”?<sup>96</sup>

The judiciary continues struggling to answer these questions, and despite the expressed desire for “national uniformity in the area of commercial law,”<sup>97</sup> the answers vary from one jurisdiction to another.

#### A. *The Early Definitions Created by Federal Courts*

Although earlier courts applied the WAI, there was practically no discussion of what constituted a rightful claim before the 1996 Federal Circuit case *Cover v. Hydramatic Packing Corporation*.<sup>98</sup> The plaintiff–patentee Cover sued Sea Gull for direct infringement and Hydramatic for contributory infringement based on U.S. Patent No. 4,605,992 (‘992 patent).<sup>99</sup> The ‘992 patent’s claims describe “a lighting fixture system having a batt [fabric] of thermal insulation to protect the wiring from heat produced by a bulb.”<sup>100</sup> Hydramatic was an insulation products manufacturer that built its products to its customers’ specifications.<sup>101</sup> Sea Gull, a lighting fixture manufacturer, hired Hydramatic to create specific insulation parts

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96. Dundine, *supra* note 88, at 219.

97. See *Pure Country Weavers, Inc. v. Bristar, Inc.*, 410 F. Supp. 2d 439, 447 (W.D.N.C. 2006).

98. *Cover v. Hydramatic Packing Corp.*, 83 F.3d 1390 (Fed. Cir. 1996).

99. Direct infringement occurs when anyone “makes, uses, offers to sell, or sells any patented invention, within the United States . . . .” 35 U.S.C. § 271(a) (2006) (including “import[ing] into the United States any patented invention” within the class of acts that constitute direct infringement). Direct infringement of a patented invention is a necessary condition for the imposition of contributory infringement. 17 AM. JUR. 2D *Patents* § 784 (2010). Additionally, contributory infringement requires an “offer[] to sell . . . within the United States . . . a component of a patented invention . . . or a material or apparatus for use in practicing a patented process” when the offering or selling person knows that such component or apparatus is “especially made or especially adapted for use in an infringement of such patent.” 35 U.S.C. § 271(c) (2006). Specifically exempted from this class of components or apparatuses are “staple” goods which are “suitable for substantial noninfringing use.” *Id.*

100. *Cover*, 83 F.3d at 1391.

101. *Id.*

for its light fixtures. Hydramatic purchased these parts from Pacor, the exclusive licensee of Cover's '992 patent.<sup>102</sup> Hydramatic settled with third-party patentee Cover for \$175,000<sup>103</sup> and then filed a cross-claim against Sea Gull seeking to recover that settlement amount under the WAI.<sup>104</sup> Sea Gull settled with Cover, but Hydramatic's cross-claim went to trial.<sup>105</sup>

Although the Federal Circuit did not ultimately need to define rightful claim,<sup>106</sup> it did find that there does not need to be an absolute finding of patent infringement for a rightful claim to exist.<sup>107</sup> The Federal Circuit reasoned that to require such a high burden would "eschew settlement and . . . force[] [parties] to go to trial to discern whether a 'rightful claim' exists under federal patent law."<sup>108</sup>

In 2001 a Pennsylvania district court looked more closely at what a rightful claim might be in *84 Lumber Co. v. MRK Technologies, Ltd.*<sup>109</sup> Plaintiff 84 Lumber purchased hand-held laser devices to use in its bar code scanning system from defendants.<sup>110</sup> Shortly after making this purchase from defendants, 84 Lumber found itself among 400 companies sued by Hosier and the Lemelson Foundation (together, "Lemelson") for infringing the bar code scanning patent.<sup>111</sup> Next, 84 Lumber settled with Lemelson for \$40,000 and then sued the defendant manufacturers in state court for breach of the WAI.<sup>112</sup> Defendants filed a timely removal to the federal district court, and the court ordered briefs and heard argument on whether the litigation was in the correct forum.<sup>113</sup> In these briefs and oral arguments, a dispute between the parties arose regarding the definition of rightful claim.

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102. *Id.* at 1391–92.

103. *See id.*

104. *Id.*

105. *Id.* at 1392.

106. This case involved a preemption issue, namely whether the marking statute, 35 U.S.C. 287(a), preempted the WAI. *Id.* *See also* 35 U.S.C. § 287(a) (2010) (stating that a patentee's or licensee's "failure to . . . mark" the patented article in accordance with the statutory requirements precludes damages "except on proof that the infringer was notified of the infringement and continued to infringe thereafter").

107. *Cover*, 83 F.3d at 1394.

108. *Id.*

109. *84 Lumber Co. v. MRK Techs., Ltd.*, 145 F. Supp. 2d 675 (W.D. Pa. 2001).

110. *Id.* at 676.

111. *Id.* at 676–77.

112. *Id.* at 677.

113. *Id.*

Plaintiff 84 Lumber argued that a rightful claim does not require a determination of actual liability to the third party, rather, that a reasonable belief that the third party would be successful in its action is sufficient.<sup>114</sup> The defendants argued that a rightful claim is “a just or legally established claim,” and, therefore, 84 Lumber did not have a valid breach of warranty claim.<sup>115</sup> The district court determined that “[i]f claims of patent infringement are seen as marks on a continuum, whatever a ‘rightful claim’ is would fall somewhere between purely frivolous claims, at one end, and claims where liability has been proven, at the other.”<sup>116</sup> Thus, the district court disagreed with the plaintiff’s reasonable-belief definition, reasoning that this personal belief is really a “subjective belief and representation” that the third party would likely win.<sup>117</sup> Subjective belief and representation is insufficient to impose liability on the defendants, yet the court also disagreed with the defendants’ argument that the claim must be “legally established.”<sup>118</sup>

Overall, the *84 Lumber* court found that the determination of whether a third party made a rightful claim, entitling the accused infringer to recover any losses under the WAI, should be addressed by “comparing the scope of the patents at issue with the allegedly infringing products.”<sup>119</sup> Although the federal court offered no guidance on how to make this comparison, it did recognize the need for a patent-specific analysis. It lit the path for future courts faced with delimiting rightful, yet state courts have failed to follow it. Instead, state courts have set a new standard in the opposite direction. They perform little, if any, analysis comparing the asserted patent with the allegedly infringing good before determining whether the third-party infringement claim is rightful and deserving of WAI protection.

### *B. The Recent Definitions Created by State Courts*

In 2007, a New Jersey court was the first state court to be faced with determining the boundaries of a rightful claim under the WAI.<sup>120</sup> The *Sun Coast Merchandise Corp. v. Myron Corp.*

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114. *Id.* at 679.

115. *Id.*

116. *Id.* at 680.

117. *Id.*

118. *See id.*

119. *Id.*

120. *Sun Coast Merch. Corp. v. Myron Corp.*, 922 A.2d 782 (N.J. Super. Ct. App. Div. 2007). The WAI had arisen in other cases, yet the definition of rightful was not at issue.

opinion commences the quick departure from the patent-specific analysis adopted in *84 Lumber*. The dispute in *Sun Coast* began when the third-party patentee sued the seller manufacturer (Sun Coast) for patent infringement of a flip-top calculator.<sup>121</sup> Because of the patent infringement suit against Sun Coast, Myron, the buyer, refused to pay for the calculators and other products ordered and received from Sun Coast.<sup>122</sup> Myron withheld payment because it was concerned that the patentee would sue Myron for infringement for its use of Sun Coast's calculators.<sup>123</sup> Further, Sun Coast allegedly implied that it had a licensing agreement with the patentee that would allow Myron to use the technology if it contributed a per-item royalty fee.<sup>124</sup> In fact, no such royalty fee arrangement between Sun Coast and the patentee existed. So, when Sun Coast sued Myron for a contractual breach, Myron counter-claimed for a WAI breach because, it claimed, Sun Coast could not deliver the product free from a rightful claim for infringement.<sup>125</sup>

The court began its discussion by noting the difficulty in determining when a third-party claim develops into a WAI action.<sup>126</sup> It then highlighted that the WAI's statutory language protects only rightful claims.<sup>127</sup> New Jersey state courts had not faced this issue before, and so the *Sun Coast* court looked to an earlier New Jersey opinion that had determined the warranty of title's scope.<sup>128</sup> This earlier case involved an allegedly stolen truck.<sup>129</sup> There, the court found that a "mere casting of a substantial shadow" over the title of the truck was sufficient to show a breach of the warranty of good title.<sup>130</sup> The *Sun Coast* court adopted this substantial standard, finding it appropriately suited for the WAI's rightful claim requirement.<sup>131</sup> Consistent with prior analyses, the court stated that a showing of validity and patent infringement is unnecessary—"only that [the patentee's] claim had

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121. See *Sun Coast*, 922 A.2d at 786.

122. See *id.* at 790.

123. *Id.* at 786. In fact, the patentee informed Myron to "be careful" because it would be "suing all those who violated its patent." *Id.*

124. See *id.*

125. See *id.* There were other claims involved, such as negligent misrepresentation and fraud, but none that are important to this Article.

126. *Id.* at 795.

127. *Id.*

128. The warranty of title is like the WAI in that there is strict liability for any "cloud" on the title. See *supra* Part I and accompanying notes.

129. *Sun Coast*, 922 A.2d at 795.

130. *Id.* (emphasis omitted) (quoting *American Container Corp. v. Hanley Trucking Corp.*, 268 A.2d 313, 331 (N.J. Ch. 1970)).

131. *Id.*

sufficient substance to unduly disturb [defendant's] ownership and disposition of the goods in question."<sup>132</sup>

The *Sun Coast* court cited *84 Lumber* in its discussion of the rightful claim issue, ultimately defining a rightful claim as one "of a substantial nature that is reasonably likely to subject the buyer to litigation, and has a significant and adverse effect on the buyer's ability to make use of the goods in question."<sup>133</sup> Implicit in this definition is that no actual litigation is necessary for a party to invoke the WAI's protection. The patentee never sued Myron. *Sun Coast*'s definition excludes the patent-specific language used in *84 Lumber*—"comparing the scope of the patents at issue with the allegedly infringing products"<sup>134</sup> although, in determining whether the third-party claim will likely expose a buyer to litigation, a court must address the claim's merit. This departure from the patent-specific language led later courts to stray further from the path set by *84 Lumber*.

Shortly after the *Sun Coast* opinion, a California state court found that the standard set in *Sun Coast* was unclear and that a substantial claim was more than the WAI required.<sup>135</sup> In *Pacific Sunwear of California, Inc. v. Olaes Enterprises, Inc.*, the California court found that "'substantial nature' should be understood to mean a nonfrivolous claim."<sup>136</sup> Only claims "devoid of merit" are excluded."<sup>137</sup> The court also clarified that in California, at least, actual litigation is unnecessary. The mere possibility of litigation may be sufficient.<sup>138</sup> Under this broader

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132. *Id.* at 797.

133. *Id.*

134. *84 Lumber Co. v. MRK Techs., Ltd.*, 145 F. Supp. 2d 675, 680 (W.D. Pa. 2001).

135. *Pac. Sunwear of Cal., Inc. v. Olaes Enters., Inc.*, 84 Cal. Rptr. 3d 182, 194 (Cal. Ct. App. 2008).

136. *Id.* (citations omitted) (quoting *Sun Coast*, 922 A.2d at 797). The *Pacific Sunwear* court also explained that it chose "nonfrivolous" over *Sun Coast*'s "substantial nature" test because "'nonfrivolous' is a term that can be readily applied to the evaluation of legal claims and is thus more conducive to concrete application." *Id.* (citing CAL. CIV. PROC. CODE § 128.5(b)(2) (defining "'frivolous' in the context of attorney or party sanctions to mean, inter alia, 'totally and completely without merit'")). This case involved a trademark dispute; a later federal district court in California stated that there is no reason to construe the WAI differently for a trademark than a patent case. *See Phoenix Solutions, Inc. v. Sony Elecs., Inc.*, 637 F. Supp. 2d 683, 697 (N.D. Cal. 2009).

137. *Pacific Sunwear*, 84 Cal. Rptr. 3d at 193 (finding "the warranty against rightful claims applies to all claims of infringement that have any significant and adverse effect on the buyer's ability to make use of the purchased goods, excepting only frivolous claims that are completely devoid of merit").

138. *See id.* at 194 ("[T]he existence of litigation is neither necessary nor, in itself, sufficient to establish that a claim is 'rightful.' A claim of infringement

interpretation of rightful, a buyer can maintain a WAI claim even if it voluntarily stops using its goods and gives up ownership of its goods upon receiving a patent holder's threat of an infringement suit.<sup>139</sup> Although the court only gives an example of a buyer who decides to stop using the goods, this standard presumably includes a buyer's decision to pay a licensing fee to settle the potential infringement suit.<sup>140</sup> Because a patent is presumed valid,<sup>141</sup> a nonfrivolous standard means little. As demonstrated by the Lemelson suits, targeting a company that has developed a product that "in some way [might] resemble" the patented technology is not frivolous or sanctionable.<sup>142</sup>

A California federal district court recently adopted this low threshold standard of rightful claim in *Phoenix Solutions, Inc. v. Sony Electronics, Inc.*<sup>143</sup> There the court held that Sony had met its burden of showing a rightful claim was made against it because the third-party infringement claim had a "significant and adverse effect on Sony's ability to make use of [the goods]."<sup>144</sup> Overall, state courts have curtailed the early standard for determining whether a third party asserted a rightful claim—one that required a comparison of the allegedly infringing goods to the patent claims' scope. Under the more recent standard, courts hardly analyze the third-party patent holder's infringement claim. Instead, courts focus on whether the threat of litigation had an adverse effect on the buyer's use of the purchased goods (e.g., purchase of a license). This is the type of "subjective" belief that *84 Lumber* found insufficient. Under the current regime, patent trolls are free to continue their aggressive behavior, and buyers can respond with others' money. The potential for abuse should not cause lawmakers or courts to discard the WAI entirely. Instead, potential for abuse

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may be rightful under section 2312(3) whether or not it is ultimately pursued in litigation.").

139. *Id.*

140. *See generally* Golden, *supra* note 3, at 2124 (stating the "overwhelming majority of patent disputes are resolved out of court"); Lemley & Shapiro, *supra* note 4, at 1992 (finding many patent disputes are resolved by licensing arrangements instead of litigation).

141. *See* 35 U.S.C. § 282 (2006) ("A patent shall be presumed valid.").

142. Hansen, *supra* note 78.

143. *Phoenix Solutions, Inc. v. Sony Elecs., Inc.*, 637 F. Supp. 2d 683 (N.D. Cal. 2009).

144. *Id.* at 697. In adopting the *Pacific Sunwear* court's definition, the California district court noted that it did not matter whether the underlying third-party claim is a trademark claim, as was the case in *Pacific Sunwear*. *See id.* "[T]here is no reason to construe section 2312(3) of the California [Commercial] Code any differently for patent cases." *Id.*

should spark motivation to look at the theoretical underpinnings of warranty law, examine why the UCC shifts liability to the seller under the WAI, and determine if these justifications are still applicable in today's technologically-driven economy.

### III. THEORETICAL JUSTIFICATIONS OF WARRANTY LAW

Calls for patent reform have included arguments that “patent damages are not properly tied to economic function of patents.”<sup>145</sup> Similarly, the incentives for parties arising from the WAI's current enforcement are not “properly tied” to the WAI's intended purpose and economic function. This problem may be linked in part to the low threshold for determining a rightful claim. Yet, the problem is caused by a deeper, more fundamental problem with the WAI. The theoretical justifications of warranty law do not distinguish the WAI from other warranties despite its unique focus on intellectual property. This approach creates an unrealistic and over-generalized response to the unique demands of the intellectual property infringement claims invoking WAI protection.

#### A. Theories of Warranty Law

Contracts involve risks, and warranties are risk-allocating devices. Warranty law attempts to provide uniform and predictable mechanisms by assigning risk to one party to the underlying contract.<sup>146</sup> The WAI's purpose is seemingly straightforward: create a default rule that places the risk of infringement on the party in the best position to manage it. This approach protects the buyer's good-faith expectations,<sup>147</sup> because the buyer is generally viewed as the party with the least information and least ability to assess risk. A party expects to purchase goods, not a lawsuit.

Under the WAI, where a merchant is one that regularly deals in the goods sold, this risk allocation may seem reasonable. Some scholars opine that the burden of anticipating and defending

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145. Opperbeck, *supra* note 1, at 187 (stating that patent reformers are correct in their “intuition” that patent damages and the economic function of patents are at odds). Recall that the WAI may also run from the buyer to seller if the buyer gives the seller design specifications for the goods it wants manufactured. U.C.C. § 2-312(3) (2002).

146. CLAYTON P. GILLETTE & STEVEN D. WALT, SALES LAW: DOMESTIC AND INTERNATIONAL 317 (2d ed. 2009).

147. *See* Pure Country Weavers, Inc. v. Bristar, Inc., 410 F. Supp. 2d 439, 449 (W.D.N.C. 2006) (describing warranty of title as “regulat[ing] the relationship between buyers and sellers . . . in order to protect the good-faith expectations of buyers”).

infringement claims is most judiciously born by the seller who generally has superior knowledge as to the potential existence of any such claims. In this instance, the WAI works to create a stronger incentive for the seller to put in effort to discover and prevent any potential infringement claims prior to sale.<sup>148</sup> The WAI is premised, therefore, in substantial part on theories of asymmetric information.

Theories of asymmetric or imperfect information posit that sellers, because of their position in the market as repeat players with ownership and oversight of the goods involved, will have more information than buyers about the quality or title of the goods.<sup>149</sup> Literature on economic informational asymmetries explains that market failure may occur when there “is an imbalance of information between parties to an exchange, one so severe that an exchange is impeded.”<sup>150</sup> These asymmetries can be corrected by actions in the law against those that fail to disclose certain information or misrepresent information.<sup>151</sup> In cases where there is a concern about a party’s willingness to give up its superior bargaining power, the government may step in and mandate certain disclosures.<sup>152</sup>

These informational imperfections or asymmetries may also be corrected by warranties. Under warranty law there is no mandatory disclosure. Instead, certain implicit guarantees are given; namely, that the goods sold will either perform the ordinary intended use of those goods<sup>153</sup> or a use for a particular purpose that is specifically expressed.<sup>154</sup> Another implicit guarantee is that the party selling the goods has full rights and title to the goods and that no third party will claim otherwise.<sup>155</sup> The purpose of these implied warranties is to place an incentive to disclose important information on the party who is in the best position to know the quality and title of the goods.<sup>156</sup> This disclosure of information helps to avoid, insure, or at least minimize risks of loss and the harm caused by the sale of goods.<sup>157</sup>

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148. *Pac. Sunwear of Cal., Inc. v. Olaes Enter., Inc.*, 84 Cal. Rptr. 3d 182, 190 (Cal. Ct. App. 2008).

149. GILLETTE & WALT, *supra* note 146, at 317.

150. COOTER & ULEN, *supra* note 22, at 46.

151. *Id.*

152. *Id.* at 46–47. An example of a mandatory disclosure is when a party sells a home and must disclose any termite infestation. *Id.*

153. *See* U.C.C. § 2-314 (2002).

154. *See* U.C.C. § 2-315 (2002).

155. *See* U.C.C. § 2-312 (2002).

156. GILLETTE & WALT, *supra* note 146, at 358–59.

157. *Id.* at 359.

Avoiding harms and insuring against the risk of loss also justifies the use of strict liability to enforce warranty law. Although the buyer must prove a causal relationship between the warranty breach and injury suffered,<sup>158</sup> holding a party strictly liable for breach of a warranty is defended on the grounds that “the seller, as an enterprise, is in the best position to bear and distribute losses through market insurance, self-insurance, or pricing.”<sup>159</sup> Whether the seller tried its best to manufacture quality goods or sell a car with clean title is irrelevant. If the seller fails to meet the standards of the implied warranty of merchantability or warranty of title, it will be liable for its breach.<sup>160</sup> Good faith is not a defense<sup>161</sup> because strict liability theories of warranty law are not premised on culpability, but rather comparative advantage.<sup>162</sup> Strict liability “allocates losses to merchant sellers not because they are wrongdoers, but because they have a comparative advantage as against their buyers at reducing or insuring against a risk of nonconformity in the goods sold.”<sup>163</sup> This allocation of risk places the incentive on the party in the best position to produce the most efficient result.<sup>164</sup>

Representational theories likewise focus on problems of asymmetrical information between parties.<sup>165</sup> For example, under the implied warranty of merchantability, “the goods are, at the very least, described in the agreement and sold at some price in a

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158. *Id.* This causal relationship is implicit in § 2-714(2)’s measure of buyer’s damages for breach. *See* U.C.C. § 2-714(2) (2002) (measuring buyer’s damages as “the difference at . . . acceptance between the value of the goods accepted and the value [the goods] would have had if they had been as warranted . . .”).

159. Richard E. Speidel, *Warranty Theory, Economic Loss, and the Privity Requirement: Once More Into the Void*, 67 B.U. L. REV. 9, 21 (1987).

160. And, remember, although the party with the most information is usually the seller, the WAI contemplates that the buyer may be in the superior position when it gives the seller designs and specifications to create its own custom goods.

161. “Good faith is not a defense to a claim for breach of the warranty of title, nor is the seller’s lack of knowledge of the title defect.” LORD, WILLISTON ON CONTRACTS, *supra* note 45, § 52:65.

162. GILLETTE & WALT, *supra* note 146, at 317.

163. *Id.*

164. *See* COOTER & ULEN, *supra* note 22, at 3–4. Efficiency can generally be defined as fulfilling the condition that “it is not possible to produce the same amount of output using a lower-cost combination of inputs . . .” *Id.* at 17. Specific to the warranty context, efficiency mandates placing the costs of breaching the WAI on the party most capable of reducing the risk and severity of infringement (here, the reduction of risk and severity of liability can be seen as the output) at the lowest cost.

165. *See* Speidel, *supra* note 159, at 14.

context where the relevant community's expectations of ordinary use can be determined."<sup>166</sup> The implied warranty of merchantability "has a strong representational component," and no proof of reliance on the representation is needed due to the implied nature of the promise.<sup>167</sup> Similarly, the WAI has a representational component based on reasonable interpretations of sales contracts. Simply, if a widget is purchased, the seller is implicitly representing it owns the widget. The seller is representing in the sale to its buyer that no other party has rights to or in the widget.

Whether couched as economic, strict liability, or representational theories, warranty law is commonly understood as a risk-allocation device.<sup>168</sup> Warranty law places the risk of loss on the parties who are in the best position to avoid or at least minimize the risk.<sup>169</sup> Although this structure generally makes sense, when applied to the specialized field of intellectual property, it fails to provide the same justifications upon which much of warranty law is based.

### *B. The Breakdown*

Because the WAI gets lumped together in the literature with warranties of quality and title, it is likewise defended on notions of informational asymmetries. So like warranties of quality, the WAI is seen as a tool to induce parties to act in a certain way. In particular, the WAI places the burden on the seller to take action to avoid potential loss or increased costs due to third-party infringement suits.<sup>170</sup> Yet the WAI is often applied "to situations where it is sheer imagination to presume that the seller has knowledge of his title superior to that of the buyer."<sup>171</sup> In those situations, the problem of asymmetrical information between parties is greatly reduced.

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167. *Id.*

168. GILLETTE & WALT, *supra* note 146, at 317.

169. *See id.*

170. Recall that the current standard of the WAI requires a buyer to have a "rightful claim" against it by a third party before it has the ability to claim damages from the seller. Likewise, the WAI imposes a duty on buyers to hold sellers harmless when the buyer provides the specifications for the goods to be manufactured, and the third party has a "rightful claim" against the seller. *See* U.C.C. § 2-312(3) (2002).

171. Dundine, *supra* note 88, at 215.

For example, assume Dr. Smith obtains a process patent for growing a crystal semiconductor that is used to produce blue light emitting diodes (LEDs). This patented technology is widely used in consumer electronic products, most notably Blu-ray players. Dr. Smith is a theorist and does not manufacture or sell any products that use his patented technology. Before Dr. Smith's patent expires, he launches a cease-and-desist licensing campaign targeting all major producers of consumer electronics. Dr. Smith believes he put in significant time and effort in discovering this crystal-growing process first and wants others who use the same process or a substantially similar process to pay him royalties.<sup>172</sup> Dr. Smith's attorney sends letters to all the major Blu-ray technology users, such as Sanyo, Mitsubishi, Motorola, and Sony. None of these buyers have ever heard of Dr. Smith or his patent because Dr. Smith is a unnoticed theorist who does not attend industry trade conferences or have relationships with any of the big technology companies. Even though these companies may doubt the patent's validity or the merit of Dr. Smith's infringement claim, they all succumb and participate in the licensing program. Simply, the risk of stalling an entire line of production, recalling products, and losing market position is too much. Within just a few years of building his license portfolio, Dr. Smith obtains over \$30 million dollars for a dubious patent.

Upon reaching a license-based settlement, the buyers that purchased the crystal semiconductors allegedly created using Dr. Smith's patented process have a WAI action against their supply manufacturers.<sup>173</sup> Because the buyers all received a threat of litigation and were adversely affected when they paid into Dr. Smith's licensing program, under current interpretations of rightful, they will have a WAI claim against the manufacturers. These manufacturers have likewise never heard of Dr. Smith or his patented process and, moreover, insist they have been using the same or the substantially similar crystal-growing process years before Dr. Smith received his patent. There is no informational asymmetry problem here, and yet, the WAI is supposed to correct assumed asymmetries by placing an incentive on the seller to avoid these patent infringement suits.

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172. The same-or-substantially-different language is from the doctrine of equivalents, which "allows the patentees to claim those insubstantial alterations that were not captured in drafting the original patent claim but which could be created through trivial changes." *Festo Corp. v. Shoketsu Kinzoku Kogyo Kabushiki Co., Ltd.*, 535 U.S. 722, 733 (2002).

173. This assumes the parties did not contract around the WAI.

The manufacturers in this situation must bear the entire burden of aggressive patent trolls like Dr. Smith. Further, these manufacturers are often given no meaningful opportunity to participate in the settlement process between the third-party patentee and the buyer. Even though a buyer must give notice to its seller, it is only obligated to do so when a third party sues.<sup>174</sup> In many instances the buyer is never sued, just threatened with suit. Further, the manufacturer may never have an opportunity to be involved in the settlement process because of other reasons. For example, in the semiconductor and software industries, companies often “aggregate hundreds or thousands of different components to make an integrated product.”<sup>175</sup> Further complicating matters, these different components are often patented by many different inventors.<sup>176</sup> How does Sony know which seller is responsible for an allegedly infringing component? Conversely, how does a seller know if it is his component that caused the threat of litigation? With a more rigorous definition of the WAI, both buyer and seller would carry the burden of gathering information and paying aggressive patent trolls. The buyer would have an incentive to evaluate the merits of the infringement claim before quickly agreeing to participate in a licensing program. The seller would have an incentive to support its buyers and help decide whether the infringement allegation has merit in the face of potential WAI liability.

These licensing campaigns that threaten costly infringement suits are a daily struggle for many corporate legal departments.<sup>177</sup> Patent law is vulnerable to this problem for several reasons, with the most noteworthy reason that patent law is a strict liability tort.<sup>178</sup> “Patent infringement is a strict liability tort in the sense that a defendant may be liable without having had any notice, prior to the filing of an infringement action, that her conduct was infringing.”<sup>179</sup> Unlike copyright law, which grants a defense based on independent discovery,<sup>180</sup> patent law provides no good-faith

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174. See § U.C.C. 2-607 (2002) (requiring notification to the seller of a breach of the WAI within a reasonable time if “the buyer is *sued* as a result of such a breach”) (emphasis added).

175. Mark A. Lemley, *Ignoring Patents*, 2008 MICH. ST. L. REV. 19, 19 (2008) (stating also that in the past 20 years, more than 2.5 million U.S. patents have been issued).

176. *Id.* at 19–20.

177. See Sudarshan, *supra* note 40, at 160 (stating that “nuisance-value patent suits are a daily fact of life for most corporate legal departments”).

178. *Jurgens v. CBK, Ltd.*, 80 F.3d 1566, 1570 n.2 (Fed. Cir. 1996)

179. Roger D. Blair & Thomas F. Cotter, *Strict Liability and Its Alternatives in Patent Law*, 17 BERKELEY TECH. L.J. 799, 800 (2002).

180. *Id.* at 801 n.7.

defense to an infringement claim.<sup>181</sup> Thus, defendants have no defense based on unintentional or inadvertent infringement.<sup>182</sup>

Most troubling here is that parties like Lemelson and Dr. Smith are garnering exorbitant licensing fees on infringement claims that are dubious at best. Correcting informational asymmetries between the parties, a main purpose of warranty law as applied generally to the WAI, is not always a realistic response given the factual circumstances. Sellers in many instances have no more information about potential infringement suits than their buyers, and so they possess no greater information than buyers that would enable them to avoid or minimize risk.<sup>183</sup> With over 2.5 million U.S. patents issued in the last 20 years and numerous patents covering extremely similar technology, it is unrealistic to have this expectation of sellers.<sup>184</sup>

The unifying theoretical thread of warranty law does not properly apply to the WAI. As a consequence of the misfit, patent trolls like Lemelson and Dr. Smith are not discouraged from engaging in overly aggressive and opportunistic behavior. With the low threshold for determining what a rightful claim is under the WAI, patent trolls can send targeted letters to buyers, counting on them to fear a costly patent infringement suit and therefore to decide to participate in licensing programs.<sup>185</sup> Patent trolls understand that buyers like Sony are more likely than manufacturers to enter license-based settlements because of their higher financial risk. The tendency to settle is bolstered by the fact that buyers are not as familiar as manufacturers are with the intricacies of the numerous components that comprise their products.

My proposed framework for determining when a third party makes a rightful claim, thereby triggering protection for the accused buyer under the WAI, will help states decrease current and future problems with the WAI. If buyers are encouraged to take a closer look at the infringement claim asserted by opportunistic patent holders in the cease-and-desist letters and to actively seek the involvement of the potential manufacturers and responsible parties for a breach of the WAI, patent trolls would be forced to support and defend their massive licensing campaigns. The resulting incentive for buyers to require a more rigorous

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181. *Id.* at 800–01.

182. *Id.*

183. Of course, this is not always the case, and when it is not, the same concern about holding the seller responsible for something it could not have prevented any better than the buyer does not exist.

184. See Lemley, *supra* note 175, at 19.

185. Sudarshan, *supra* note 40, at 160.

determination of the third-party claim will help spread the burdens of the liability-shifting WAI on both the seller and buyer, force buyers to internalize more of the ultimate costs of settlement, and deter patent trolls from targeting more buyers.

#### IV. A “UNIFORM” FRAMEWORK

Parties overwhelmingly resolve patent disputes out of court.<sup>186</sup> Because licensing terms are “negotiated in the shadow of litigation,”<sup>187</sup> we must analyze how patent law and commercial law affect parties when they are bargaining for the terms of their settlements. The interaction between patent law and commercial law is a relatively new issue. Federal courts have encountered aggressive and litigious behavior from patent holders for years, yet state courts have been shielded from the demands and intricacies of patents because of the federal courts’ exclusive jurisdiction over patent law.<sup>188</sup> Although this exclusivity means state courts will never decide patent infringement suits, state courts will sort out the resulting WAI disputes between buyer and seller. As scholars have noted, there is an increasing awareness of intellectual property implications in commercial transactions.<sup>189</sup> There is also now a recognition in practice that the WAI may function as a mechanism to recover losses for clients.<sup>190</sup> For the first time, the door is opening on the state level to the leftovers of aggressive patent troll behavior, and the sometimes-mismatched information between the buyer and seller further complicates the use of the WAI.

The easy solution here may seem to simply have the buyer and seller contract around the WAI. Although this solution may seem straightforward, it will work only if both parties agree to the

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186. Golden, *supra* note 3, at 2124.

187. Lemley & Shapiro, *supra* note 4, at 1992 (“[S]ince far more patents are licensed or settled than litigated to judgment, the primary economic effect of rules governing patent litigation arises through the effect of those rules on the licensing terms that are negotiated in the shadow of litigation.”).

188. See 28 U.S.C. § 1295(a) (2006) (vesting the Federal Circuit Court of Appeals with exclusive jurisdiction over appeals from a district court “if the jurisdiction of that court was based, in whole or in part, on section 1338 of this title”). Section 1338, in turn, vests *exclusive* original jurisdiction with the district courts “of any civil action arising under any Act of Congress relating to patents. . . .” 28 U.S.C. § 1338(a) (2006).

189. Scholars noted an increase in the amount of commercial transactions involving intellectual property in the mid-1990s. See PETER A. ALCES & HAROLD F. SEE, *THE COMMERCIAL LAW OF INTELLECTUAL PROPERTY* xxix, (1994); Robert P. Merges, *Intellectual Property and the Costs of Commercial Exchange: A Review Essay*, 93 MICH. L. REV. 1570, 1572 (1994).

190. See, e.g., McGowan, *supra* note 16, at 6.

explicit removal of the WAI in their transaction. In many instances, this may be impossible. The buyer often has more bargaining power than the seller due to its deep pockets; therefore, it may be able to demand that the WAI apply to the transaction. Accordingly, this solution is not only unrealistic in many transactions, but it may also be undesirable because it can result in a nervous buyer demanding a more secure WAI-type provision from sellers.<sup>191</sup> This negotiation around the default rule will also increase transaction costs. Parties will need to separately draft their own WAI, or otherwise draft a no-WAI provision. In this sense, implied warranties are beneficial because they avoid extra transaction costs and also instill some level of uniformity and expectation management for parties across the nation.

This Article proposes a better solution than striking the WAI from every sales contract. Instead, courts should adopt a new framework for determining what constitutes a rightful claim. Because courts are altering this structure with almost every case, this new framework is both a practical and implementable solution to a problem that is only going to get bigger with time. Put simply, a rightful claim should be one that has a reasonable likelihood of success on the merits. This means that a third party must have a claim against a buyer that will, or would if it went to trial, be reasonably expected to succeed on the merits at trial before the buyer is entitled to damages under the WAI from the seller.<sup>192</sup> This is similar to courts' initial interpretations of rightful, but this Article also offers a structured analysis for making this determination.<sup>193</sup> The analysis for determining the reasonable likelihood of success on the merits of the third-party's claim must be tailored to the specific intellectual-property-infringement claim asserted: patent, trademark, or copyright.

Courts have been conducting this type of tailored analysis for decades regarding preliminary injunction motions in civil litigation. State courts should look to how federal courts conduct these intellectual-property-specific analyses when they examine the first factor parties must demonstrate for a preliminary injunction: likelihood of success on the merits. Accordingly, when a buyer brings a breach of a WAI action because of a third-party-patentee infringement claim against it, the state court should mimic

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191. *See, e.g.*, *Chere Amie, Inc. v. Windstar Apparel, Inc.*, 01 Civ. 0040 (WHP), 2003 U.S. Dist. LEXIS 15261, at \*1 (S.D.N.Y. 2003) (Kohl's had Windstar agree to an "any claim" indemnification provision, eventually costing Windstar \$2,216,554 in attorney's fees and recall costs).

192. Of course, the parties will be switched if the buyer gives specifications to the seller for custom-made goods.

193. *See supra* Part II.A.

how federal courts handle the first factor of a preliminary-injunction motion for a patent infringement suit. This analysis focuses on the meaning and scope of the claims of the asserted patents.<sup>194</sup> It involves claim construction, although notably at an early stage in a patent infringement suit. After interpreting the claims of the patent, at least on a preliminary level, courts use this interpretation and compare it to the allegedly infringing good that the seller sold to the buyer.<sup>195</sup> Further, and consistent with transactions under the UCC, all settlement agreements must be entered into with good faith. This is of particular importance when liability is easily established and the buyer has little to no bargaining power. Good faith should be analyzed by looking at the process a party uses to decide how much it is willing to pay for a right not to be sued by the third-party patentee.

One exception exists to this proposed structure when a presumption of a rightful claim should inure to the buyer. Claims that receive this presumption are ones where the realistic value of the infringement suit is so high that the risk of going to trial leads the reasonable businessman to settle despite potential weaknesses in the infringement claim. These claims must also involve highly sophisticated technology to fit into this exception. Although this Article does not specifically delineate what is and what is not highly sophisticated technology or what balance of money and sophistication is needed because of the unique aspects in each situation, in many instances in practice this may be a relatively easy determination. Technology, for example, that involves introducing particular combinations of dopants with chemical elements in vats at extreme temperatures in order to grow layers of semiconductor crystals,<sup>196</sup> is much more sophisticated and high-risk in terms of dollar values than the technology and presumably money involved in flip top calculators or sheets of insulation.<sup>197</sup> Noteworthy here is that the settlement amount still must be analyzed with a standard of good faith that focuses on the process taken in reaching the terms of the settlement—i.e., the amount paid to obtain a license.

The following subparts discuss the preliminary-injunction motion's underpinnings and the type of analysis a federal court

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194. See, e.g., *Abbott Labs. v. Sandoz, Inc.*, 544 F.3d 1341, 1358 (Fed. Cir. 2008).

195. See *id.* at 1358–61.

196. See *Rothschild v. Cree, Inc.*, 711 F. Supp. 2d 173, 176–79 (D. Mass. 2010).

197. See *Sun Coast Merch. Corp. v. Myron Corp.*, 922 A.2d 782, 785–87 (N.J. Super. Ct. App. Div. 2007); *Cover v. Hydramatic Parking Co.*, 86 F.3d 1390, 1391 (Fed. Cir. 1996).

performs when deciding patent infringement claims. There is also a short discussion on both WAI infringement claims involving trademarks and copyrights because these analyses vary from that of patent infringement claims. Although the troubling issue of aggressive NPEs does not often arise with trademarks or copyrights, the issue of a buyer “playing” with a seller’s money does. This Article will then illustrate how these intellectual-property-tailored analyses will provide relief for the aggrieved buyer and also encourage it to be diligent and thorough with the settlement process. This in turn will provide a new level of deterrence for the aggressive licensing campaigns that patent trolls employ.

#### *A. Preliminary Injunctions: Reasonable Likelihood of Success*

The purpose of the preliminary injunction is to preserve the status quo of the parties and to halt any further actions that may cause damage to the plaintiff.<sup>198</sup> Thus, this motion is filed early in litigation.<sup>199</sup> Generally, a plaintiff must prove four factors to have a preliminary injunction granted:<sup>200</sup> “[(1)] that he is likely to succeed on the merits, [(2)] that he is likely to suffer irreparable harm in the absence of preliminary relief, [(3)] that the balance of equities tips in his favor, and [(4)] that an injunction is in the public interest.”<sup>201</sup>

Similar to a buyer not needing to establish a “valid” claim under the WAI, a party defending a preliminary injunction need not show actual invalidity or noninfringement of the patent. Rather, at the preliminary injunction stages the vulnerability of the patent is the focus, with the patent’s validity and/or noninfringement saved for

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198. See *Abbott Labs*, 544 F.3d at 1345 (quoting *Univ. of Tex. v. Camenisch*, 45 U.S. 390 (1981)).

199. See, e.g., *Abbott Labs. v. Andrx Pharms. Inc.*, 452 F.3d 1331, 1339 (Fed. Cir. 2006), *aff’d sub nom*, *Abbott Labs v. Sandoz Inc.*, 544 F.3d 1341 (Fed. Cir. 2008).

200. While there are several modifiers used by courts other than reasonable, such as “some” or “substantial,” commentators agree that this is merely a distinction without a difference. See *Titan Tire Corp. v. Case New Holland, Inc.*, 566 F.3d 1372, 1376 (Fed. Cir. 2009) (“We note in passing that some cases state the first factor as requiring a ‘reasonable’ likelihood of success on the merits. It is not clear whether the addition of ‘reasonable’ adds anything substantive to the test, but in any event, for our purposes the Supreme Court’s current statement of the test is the definitive one.”) (footnotes omitted). See also *Abbott Labs*, 452 F.3d at 1332 (requiring “some likelihood of success on the merits”); *Sanofi, S.A. v. Med-Tech Veterinarian Prods., Inc.*, 565 F. Supp. 931, 935 (D.N.J.) (requiring “reasonable probability of eventual success in the litigation”).

201. *Winter v. NRDC, Inc.*, 555 U.S. 7, 20 (2008).

trial.<sup>202</sup> Courts balance these four factors and allow for variations within the facts as well as the law involved. Here, the focus is solely on the first factor—likelihood of success on the merits—and how courts conduct this analysis regarding patents, trademarks, and copyrights.

### 1. Patent

For a patent preliminary injunction, a federal court compares the scope of the asserted patent with the allegedly infringing conduct.<sup>203</sup> This comparison requires courts to interpret the meaning of the claims of the patent. This process is most often termed “claim construction.”<sup>204</sup> The scope and the meaning of a patent are “indeterminate until interpreted by a court.”<sup>205</sup> The federal district court will interpret, or “construct,” the claims that makeup a patent and decide where the “metes and bounds” of the patent lie.<sup>206</sup> During claim construction, the district court looks first to the intrinsic evidence, including the patent claims, specification, and prosecution history.<sup>207</sup> If needed, as is common, the court will then look to extrinsic evidence for guidance, such as dictionaries, cases where courts have construed the same or similar terms contained in the patent at issue, published literature, and

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202. *Abbott Labs*, 544 F.3d at 1363. Similarly, “[t]he correct standard is not whether a substantial question has been raised, but whether the patentee is likely to succeed on the merits . . . [t]o hold that a defendant may defeat a preliminary injunction by raising a ‘substantial question’ that may render the patent ‘vulnerable’ would conflict with Supreme Court precedent and with the precedent of every regional circuit.” *Id.* at 1364–65.

203. Note that this is the type of analysis the *84 Lumber* court stated should be performed when determining whether a “rightful claim” has been made by a third party—a comparison of the “scope of the patents at issue with the allegedly infringing products.” *84 Lumber Co. v. MRK Techs., Ltd.*, 145 F. Supp. 2d 675, 680 (D. Pa. 2001).

204. See Thomas Chen, *Patent Claim Construction: An Appeal for Chevron Deference*, 94 VA. L. REV. 1165, 1169 (2008) (discussing that a patent infringement analysis first requires a construction of the patent claims and then a comparison of the claims to the allegedly infringing conduct).

205. OPDERBECK, *supra* note 1, at 159 n.226.

206. See *id.*; see also Dan L. Burk & Mark A. Lemley, *Fence Posts or Sign Posts? Rethinking Patent Claim Construction*, 157 U. PA. L. REV. 1743, 1744 (2009) (“In modern American patent doctrine, we define what the patentee owns . . . by what she *claimed*. Courts and commentators regularly analogize patent claims as akin to the ‘metes and bounds’ of a real property deed, defining the outer boundaries . . . conferred on the patentee.”) (emphasis added) (footnotes omitted).

207. Chen, *supra* note 204, at 1173.

expert testimony.<sup>208</sup> Claim construction is reserved for a judge, not a jury.<sup>209</sup>

Preliminary claim construction has a significant impact on the likelihood of success factor of the preliminary injunction motion even though the court still has three more factors to consider. For a preliminary injunction the patent holder must also show that “it will likely prove [the defendant’s] infringement, and that it will likely withstand challenges, if any, to the validity of the patent.”<sup>210</sup> This analysis considers the presumption of validity inherent in a patent, and if the patent holder moves for a preliminary injunction and the defendant fails to challenge validity,<sup>211</sup> then the “very existence of the patent with its concomitant presumption of validity satisfies the patentee’s burden of showing a likelihood of success on the validity issue.”<sup>212</sup>

An example of this type of likelihood analysis paired with a claim construction is demonstrated in *Abbott Laboratories v. Sandoz, Inc.*<sup>213</sup> Plaintiff patentee, Abbott Laboratories, brought an action for patent infringement against its competitor Defendant, Sandoz, based on its patents relating to extended release formulations of the antibiotic drug clarithromycin.<sup>214</sup> To prevent any actual damage, because Sandoz had not yet started to market or sell its version of the extended release clarithromycin, Abbott Labs moved for a preliminary injunction. On the infringement

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208. *Id.*

209. *See* *Markman v. Westview Instruments, Inc.*, 517 U.S. 370, 372 (1996) (“[C]onstruction of a patent, including terms of art within its claim, is exclusively within the province of the court.”); *Finisar Corp. v. DirectTV Group, Inc.*, 523 F.3d 1323, 1328 (2008).

210. *Titan Tire Corp. v. Case New Holland, Inc.*, 566 F.3d 1372, 1376 (Fed. Cir. 2009).

211. A defendant may challenge the validity of a patent on the grounds of patentability requirements, such as nonobviousness and enablement as well as inequitable conduct before the PTO. ROBERT PATRICK MERGES & JOHN FITZGERALD DUFFY, *PATENT LAW AND POLICY: CASES AND MATERIALS* (3d ed. 2002)

212. *Titan Tire Corp.*, 566 F.3d at 1377. Also, the court will view the “matter in light of the burdens and presumptions that will inhere at trial.” *Id.* at 1376. Accordingly, the patentee need not, at this stage, prove invalidity by clear and convincing evidence. Instead, the patentee must show only that through the evidence available at this early stage that there is a reasonable chance that he will succeed at trial. *Id.* Importantly, here, validity is not at issue. The WAI has not been extended to validity, presumably because of the actual language of the statute itself limiting itself to “infringement.” Consequently, the only question for the court to evaluate in the WAI context is whether the third-party’s infringement claim will likely hold at trial.

213. *Abbott Labs. v. Sandoz, Inc.* 544 F.3d 1341 (Fed. Cir. 2008).

214. *Id.* at 1343.

portion of the motion,<sup>215</sup> the Federal Circuit stated that the infringement issue could be substantially resolved by the claim construction of one phrase: “pharmaceutically acceptable polymer.”<sup>216</sup> This term of art is found in the written specification of the patent at issue, which lists only water-soluble hydrophilic polymers. Accordingly, if the term was construed strictly to include only the polymers named in the specification, then there could be no literal infringement because Sandoz’s generic version of clarithromycin used none of the identified polymers.<sup>217</sup> If the court decided that other, unnamed pharmaceutically acceptable polymers were covered by the construction of “pharmaceutically acceptable polymer,” then literal infringement would be likely.<sup>218</sup> Consequently, Sandoz argued to limit the construction to those named polymers—water-soluble hydrophilic polymers.<sup>219</sup>

In briefing of how the term should be construed, parties often identify other instances when the term has been defined in meaning and scope. “Pharmaceutically acceptable polymer” had been discussed in previous litigations, and twice in the Federal Circuit.<sup>220</sup> The Federal Circuit here agreed with the district court on “the fact that some methacrylic acid copolymers are water-insoluble does not require limiting ‘pharmaceutically acceptable polymer’ to the named polymers.”<sup>221</sup> Overall, and after similar claim constructions of “matrix” and an analysis of the difference between “polymer” and “excipient” were conducted, the Federal Circuit affirmed the district court’s ruling that Abbott Laboratories had demonstrated a reasonable likelihood of proving infringement at trial.<sup>222</sup>

While this type of analysis to determine whether a rightful claim exists may seem burdensome, this is precisely what a patent attorney is trained to do. Charts are created, words are defined, and

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215. Defendant Sandoz objected to the preliminary injunction motion by also challenging the validity of the patent. I will not discuss this here as it is not relevant to what a court would be faced with in a WAI action. Only infringement is at issue under the WAI.

216. *Abbott Labs*, 544 F.3d at 1358.

217. *Id.*

218. *Id.*

219. *Id.* at 1359. Sandoz’s drug contains water-insoluble polymers. Because infringement requires that every claim limitation is present in the allegedly infringing product, companies often try to design around the patent. Here, that may have been the case, and, if so, plaintiff Abbot Labs did a good job of ferreting out the argument that the polymers identified were merely examples of the type that could be used, instead of an exhaustive list.

220. *See id.* at 1358.

221. *Id.* at 1359.

222. *Id.* at 1361.

comparisons are made.<sup>223</sup> Because a patent holder must prove, for a literal infringement claim, that every single element of a claim is infringed by the product, defining the boundaries of the patent and the alleged infringing product often gives the parties insight into whether infringement is likely. Because of this insight, claim construction is considered “outcome determinative” and “often the first and last step in patent disputes.”<sup>224</sup>

## 2. Trademark & Copyright

The first factor of preliminary injunctions—whether there is a likelihood of success on the merits—is also context-specific for trademark and copyright infringement claims. For trademark infringement,

the plaintiff’s probability of success on the merits depends on the strength of its trademark infringement claim, which in turn requires a showing that the plaintiff’s “mark was used in commerce by the defendant without the registrant’s consent and that the unauthorized use was likely to deceive, cause confusion, or result in mistake.”<sup>225</sup>

The party moving for a preliminary injunction in a trademark infringement case must initially demonstrate that it was the first to use the mark in commerce. The plaintiff must demonstrate that “(1) its case has some likelihood of success on the merits; (2) that no adequate remedy at law exists; and (3) it will suffer irreparable harm if the injunction is not granted.”<sup>226</sup>

This determination may be simple when the facts show, for example, a holdout licensee’s near-exact imitation or clearly unlawful use of a mark.<sup>227</sup> In other cases this determination requires a more in-depth look at the nature and use of the similar trademarks. The question for the court acting as factfinder in these cases is one of proximity. The court will employ some or all of the

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223. Depending on the technology involved, these comparison–contrast charts may be completed in just a few days, or if a more in-depth analysis is needed (either because the technology is highly sophisticated or the value of the patented technology so substantial), a few weeks.

224. Chen, *supra* note 204, at 1169.

225. *Mont. Prof'l Sports, L.L.C. v. Leisure Sports Mgmt., Inc.*, 422 F. Supp. 2d 1271, 1277 (M.D. Fla. 2006) (quoting *McDonald's Corp. v. Robertson*, 147 F.3d 1301, 1307 (11th Cir. 1998)).

226. *Ty, Inc. v. Jones Group, Inc.*, 237 F.3d 891, 895 (7th Cir. 2001). Although various circuits have slightly different wording of these factors and different requirements, this is not important for this limited preliminary injunction discussion.

227. 35 AM. JUR. 3D *Proof of Facts* § 5 (1996).

following factors: the strength of the trademark, the degree of similarity between the two trademarks, the proximity of the products in the marketplace, the likelihood that the prior owner will move into the junior user's market, instances of actual consumer confusion, the degree of the junior user's good faith in adopting its trademark, and, finally, the sophistication of the purchasers.<sup>228</sup> When two products are competing in the same market, a simple side-by-side comparison is insufficient. Rather, an analysis "focusing on actual market conditions and the type of confusion alleged" is required.<sup>229</sup>

An example of this analysis in the preliminary injunction context is *Ty, Inc. v. Jones Group, Inc.*<sup>230</sup> This trademark infringement suit involved the plush toys under the trademark name "Beanie Babies." Ty began selling the plush toys in 1993, and they quickly became a smashing success—selling over one billion Beanie Babies by the time of the trial.<sup>231</sup> The Jones Group, a NASCAR licensee, began manufacturing and selling bean-filled replicas of NASCAR racing cars in 1998—named Beanie Racers.<sup>232</sup> After an unsuccessful cease-and-desist letter, Ty filed suit and shortly thereafter moved for a preliminary injunction against Jones that would prohibit it from selling any more of its Beanie Racers until the suit's outcome determined the parties' respective rights.<sup>233</sup>

Keeping the focus on the first factor, likelihood of success on the merits at trial, the Seventh Circuit began its analysis by determining whether consumers would likely be confused as to the origin or source of the Beanie Racers. The seven factors listed to aid in this determination are very similar to the traditional *Polaroid* factors,<sup>234</sup> yet the court utilized the following factors the most:

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228. *Polaroid Corp. v. Polarad Elecs. Corp.*, 287 F.2d 492, 495 (2d Cir. 1961).

229. *Louis Vuitton Malletier v. Dooney & Bourke, Inc.*, 454 F.3d 108, 112 (2d Cir. 2006).

230. *Ty*, 237 F.3d at 891.

231. *Id.* at 895.

232. *Id.*

233. *Id.*

234. The Seventh Circuit uses the following seven factors to determine whether a likelihood of confusion to a consumer exists: "(1) the similarity of the marks in appearance and suggestion; (2) the similarity of the products; (3) the area and manner of concurrent use; (4) the degree of care likely to be used by consumers; (5) the strength of the plaintiff's mark; (6) whether any actual confusion exists; and (7) the defendant's intent to palm off its goods as those of the plaintiffs." *Id.* at 897 (citing *Helene Curtis Indus., Inc. v. Church & Dwight Co., Inc.*, 560 F.2d 1325, 1330 (7th Cir. 1977)).

similarity of the marks and products, and the area and concurrent use of the products.<sup>235</sup>

Regarding similarity of the marks, the court noted that the confusion between the two marks “Beanie Babies” and “Beanie Racers” was in the word “Beanie.”<sup>236</sup> The court did find that the tags on the plush toys were distinctive—consumers would likely notice the difference in a side-by-side comparison.<sup>237</sup> Yet, the court was not convinced that consumers would recognize the different sources if the two toys were not side-by-side.<sup>238</sup> The court affirmed the lower court’s finding that “Beanie” was a “salient aspect of Ty’s product”<sup>239</sup> and that the other features on the tags were diminished because of that aspect. Likewise, the similarity of the products themselves weighed in Ty’s favor because both products are made from velvet boa-type fabric, are eight to nine inches long, and are filled with pellet-like materials.<sup>240</sup> Concerning the area and manner of concurrent use, the court found must determine “whether ‘there is a relationship in use, promotion, distribution, or sales between the goods or services of the parties.’”<sup>241</sup>

The evidence showed that both parties sold their plush toys to specialty-gift shops, that the toys were likely sold in the same spot in the most stores, that the parties advertised in many of the same magazines, and yet also that the target audiences were likely at a bit of odds (with younger females being the target audience of “Beanie Babies” and the NASCAR fan base historically consisting of men, not women or children).<sup>242</sup> Although not all the factors weighed in Ty’s favor, the Seventh Circuit still upheld the magistrate judge’s opinion that Ty demonstrated “some likelihood of succeeding on the merits.”<sup>243</sup> After considering the other factors,

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235. See generally *id.* at 898–901 (discussing the similarity of marks, similarity of products, and the area and manner of concurrent use in the majority of the opinion on whether plaintiff had shown a likelihood of success at trial). More commonly, similarity of the marks, intent of the defendant, and evidence of actual confusion are the three most important factors. *Id.* at 898 (citing *G. Heileman Brewing Co., Inc. v. Anheuser-Busch, Inc.*, 873 F.2d 985, 999 (7th Cir. 1989)). Yet as this case shows, this is a very case-specific, fact-intensive analysis, and sometimes other factors are more important because of unique facts.

236. See *id.* at 898.

237. *Id.* at 899.

238. *Id.*

239. *Id.*

240. *Id.*

241. *Id.* at 900 (quoting *Forum Corp. of N. Am. v. Forum, Ltd.*, 903 F.2d 434, 442 (7th Cir. 1990)).

242. See *id.* at 900–01.

243. *Id.* at 902.

such as the balancing of harms, the Seventh Circuit affirmed the grant of the preliminary injunction to Ty.<sup>244</sup>

The preliminary injunction factors in a copyright infringement suit are similar to those of patent and trademark infringement, requiring the plaintiff to demonstrate a likelihood of success on the merits, which will then create a presumption of irreparable harm, or a “fair chance of success on the merits” with the relative-hardships factor weighing strongly in the movant’s favor.<sup>245</sup> Specific to copyright infringement, the plaintiff must first show that it has registered its work with the U.S. Copyright Office and then prove that the alleged infringer has copied original elements of the work.<sup>246</sup> The actual-copying requirement is often broken down into two separate inquiries. “First, the copyright holder must show that, as a factual matter, the putative infringer copied the protected work. Second, the holder must show that the copying was so egregious as to render the allegedly infringing and infringed works substantially similar.”<sup>247</sup> Actual copying is best demonstrated by proving the alleged infringer had access to the original work and that direct copying was not only plausible, but that there is substantial similarity when the two expressions are compared. When the works are “so alike that the later (unprotected) work can fairly be regarded as appropriating the original expression of the earlier (protected) work[,]” the court will deem the works substantially similar.<sup>248</sup>

Accordingly, for the first step in a motion for a preliminary injunction in a copyright infringement suit, the movant must demonstrate to the court that it has a registered copyright. Second, the movant must show that it has either a probability or fair chance of success on the merits. This is accomplished by arguing that actual, unauthorized copying has occurred.<sup>249</sup> This copying of original elements will show that the unauthorized copying created two substantially similar works.

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244. *Id.* at 903–04.

245. *Jacobsen v. Katzer*, 535 F.3d 1373, 1378 (Fed. Cir. 2008).

246. *Id.* Note here that a copyright is not invalid without a registration, though it must be registered before litigation regarding the copyright can commence.

247. *Coquico, Inc. v. Rodriguez-Miranda*, 562 F.3d 62, 66 (1st Cir. 2009) (citations omitted).

248. *Id.* at 67.

249. The most used route is to show likelihood of success, so that the presumption of irreparable harm attaches and the motion granted. *See Jacobsen*, 535 F.3d at 1378–79.

*B. The Standard Applied*

We know from Part II that a rightful claim should “fall somewhere between purely frivolous claims, at one end, and claims where liability has been proven, at the other.”<sup>250</sup> We also know that state courts have recently broadened the definition of rightful, finding that a rightful claim is any nonfrivolous, third-party claim that causes some voluntarily adverse affect.<sup>251</sup> This may be proven by as little as a cease-and-desist letter.<sup>252</sup> This broad interpretation and lack of structured analysis fails to provide the right incentives for both buyers and third parties. To change these incentives, yet retain the benefits of the WAI for buyers, I propose that courts adopt a new and more rigorous framework for determining when a rightful claim has been made by a third party. This new framework with accompanying analysis will create a unified understanding of the WAI, thereby enabling parties to better manage expectations.

*1. Reasonable Likelihood of Success*

The question courts analyze when encountering a WAI claim under this new framework is whether the third-party infringement claim is (or was) reasonably likely to succeed on the merits at trial. A court should ensure that any settlement entered into with a third party was made in good faith as the UCC requires. This framework requires an intellectual-property-specific analysis. Because both federal courts (with patent, trademark, and copyright infringement claims) and state courts (with trademark infringement claims) perform this type of intellectual-property-specific analysis in preliminary injunction motions, state courts should use these established analyses as guidance.

For third-party patent infringement claims, the analysis aims to determine the scope of the patent claims, and then to determine whether the allegedly infringing product or process falls within those limitations.<sup>253</sup> The first step upon receiving a cease-and-desist letter is to have patent counsel look at the asserted patent and compare it with the client’s good(s). This early form of claim construction is most often manifested in claim charts, which will

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250. 84 Lumber Co. v. MRK Techs., Ltd., 145 F. Supp. 2d 675, 680 (W.D. Pa. 2001).

251. See *supra* Part II.B.

252. See *supra* Part II.B.

253. This patent and product comparison is also key for those complex products requiring the buyer to determine which seller, if any, may be responsible for the third-party infringement claim.

break down each claim of the patent and even further break down that claim into the various limitations given in the particular claim. These claim charts may be developed to the depth required by the potential value of the patent, and are useful for any number of responses to the cease-and-desist letter. The claim charts will ultimately determine, along with the particular level of risk a company is willing to bear, what response may be warranted. For example, an attorney may send a letter back to the patent holder identifying particular limitations of the patent that are not existent in the allegedly infringing product or process, or conversely, make a phone call to the patent holder to set up a meeting to discuss licensing options.<sup>254</sup>

This informal claim construction will roughly identify the strength of the infringement action. If the buyer decides to settle, these claim charts will be the foundation of a claim construction brief to the court in a WAI action. The court assessing the viability of the WAI action will go through the same claim construction analysis that federal courts do with patent preliminary injunction motions. The claim construction will not be akin to a Markman hearing—the final claim construction in a patent infringement suit<sup>255</sup>—instead, a more shallow analysis of the technology at issue will be conducted. If the patent infringement suit has a reasonable likelihood of success on the merits, determined by comparing the construed claims to the allegedly infringing good, then the court may award relief under the WAI. Although the WAI may still result in seemingly unfair results for sellers that were unaware their manufactured goods potentially infringed a patent, it nevertheless provides a fairer and more judicious process for all parties involved in the WAI.<sup>256</sup>

This stricter standard for determining when a rightful claim is made will still protect buyers under the WAI from meritorious infringement actions, and it will discourage the massive, impersonal, and overly aggressive licensing-campaign suits that are targeting easy settlements. No longer will a buyer have the right to settle without assessing whether the claim against it is likely to succeed. Instead, the buyer has the burden to prove it should be accorded relief from the seller.

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254. Another common answer is that the patent is likely invalid based on obviousness or nonenablement. If the buyer chooses to not settle based on these grounds, even though it may likely infringe, a seller is not responsible for the cost or outcome of this defense to a patent infringement suit. Simply, the WAI only covers assertions of noninfringement, not challenges to a patent.

255. See *Markman v. Westview Instruments, Inc.*, 517 U.S. 370, 372 (1996).

256. This is also consistent with the representational theories of warranty law. See *supra* Part III.

For a third-party trademark or copyright infringement claim, the process is a bit simpler. The trademark infringement analysis turns on whether the junior user's mark will confuse consumers. This analysis is highly factual and involves a court evaluating any number of the traditional *Polaroid* factors (for example, the similarity of the marks and products sold by the companies, and intent of the junior user). This analysis is performed exactly like that in the preliminary injunction process and will therefore be familiar territory for a state or federal court determining whether a rightful claim of trademark infringement was brought against a buyer.

For a third-party copyright infringement claim, the first step in determining whether the third party made a rightful claim against a buyer is verifying that the asserted copyright is registered with the U.S. Copyright Office. Second, the court must determine whether the seller copied original elements of the third-party's registered copyright. Recall that a *valid* claim is not the standard here. Instead, the standard is that the claim is reasonably likely to succeed on the merits. Factual determinations, such as a former employee or competitor's exposure to source code, will help substantiate a copyright infringement claim. If the works are substantially similar, the reasonable-likelihood-of-success hurdle may be met without a huge endeavor into the origins and creation of the source code.

Overall, this more rigorous standard for determining when a claim is rightful is in line with current case law as well as the initial parameters set with the WAI. No determination that there is in fact infringement is necessary or that a valid third-party claim exists. Rather, the only determination necessary is whether there is a reasonable likelihood that the third party would (or would have if it settled) succeed on its infringement claim at trial.

## 2. *Settled with Good Faith*

Further, when faced with a WAI claim where a settlement has already been entered by the buyer and third party, and, therefore, the buyer is suing the seller to recover its losses, the court should ensure that any settlement agreement was entered in good faith. Under the UCC, good faith for sales transactions requires "honesty in fact and the observance of reasonable commercial standards of fair dealing."<sup>257</sup> The first part, honesty in fact, is "often referred to as the subjective component of good faith," while the second part, reasonable commercial standards, "is referred to as the objective

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257. U.C.C. § 1-201(20) (2010).

component of good faith.”<sup>258</sup> This “subjective” part of the good-faith obligation has been referred to as the businessperson who may be “empty of head but good of heart.”<sup>259</sup> Under this first part, a party must show that it had an “honest belief in the legitimacy of the transaction.”<sup>260</sup> This honesty requirement differs from the reasonable or objective standard where a party must not only have been honest in its transaction and conduct, but also knowledgeable in its specific trade with behavior typical to those in its field.<sup>261</sup> A party may meet this requirement by demonstrating to the court the legitimacy of its actions and reasonableness of the settlement. This can be analyzed by looking at the terms of the settlement, namely the amount of licensing fees in comparison to the strength of the infringement claim and value of the patented technology.

This good-faith requirement is especially important in cases where infringement liability is easily provable. This occurs more frequently in trademark and copyright, where actual copying or use of a registered trademark or—copyright or counterfeiting of goods is easily determinable. In these cases, the infringing buyer has little to no bargaining power for settlement negotiations. Conceivably, the buyer will be upset with the seller for selling them goods so obviously in violation of another’s rights. Because of this, good faith is necessary to show the reasonableness of the settlement.

A recent example of this is Apple reportedly paying at least \$1 million to settle a trademark infringement suit against it for using the term “iAds.”<sup>262</sup> This trademark, “iAds,” was first used in 2006 by an online ad agency based in Los Angeles, Innovate Media, who then received two trademark registrations for the mark in October 2008.<sup>263</sup> Steve Jobs announced (on behalf of Apple on April 8, 2010) the new “iAds” program; Innovate Media sued just one month later. Reportedly, the two companies settled quietly in July.<sup>264</sup> Having deep pockets to go after and clear infringement of a registered trademark, it was in Apple’s best interests to settle quickly with Innovate Media. If Apple had licensed another to use this “iAds” trademark and had, therefore, been liable for any

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258. *United Energy Distributions, Inc. v. Conocophillips Co.*, 66 U.C.C. Rep. Serv. 2d 997 (D.S.C. 2008).

259. Boris Kozolchik, *Preparatory Reading Materials*, 27 ARIZ. J. INT’L & COMP. L. 349, 373–74 (2010).

260. Donald R. Cassling, *Banking Briefs*, 127 BANK. L.J. 476, 481 (2010).

261. Kozolchik, *supra* note 259, at 374.

262. Greg Sandoval, *Did Apple Pay Big Bucks in iAd Settlement?*, CNET NEWS (Nov. 1, 2010 10:18 AM), [http://news.cnet.com/8301-13579\\_3-20021361-37.html](http://news.cnet.com/8301-13579_3-20021361-37.html).

263. *Id.*

264. *Id.*

resulting losses from an infringement claim, the buyer would need to demonstrate, if challenged by Apple, that the settlement amount was reasonable.

Like with the body of preliminary injunction law, employing the well-established doctrine of good faith under the UCC gives courts parameters and existing law to look to for guidance. A case where this would have been helpful is *Acushnet Co. v. G.I. Joe's, Inc.*<sup>265</sup> This case involved G.I. Joe's, a golf ball seller, who purchased "Titleist" golf balls from Cam Golf.<sup>266</sup> Acushnet is the actual manufacturer of the "Titleist" golf ball and sued G.I. Joe's for infringement after it had discovered G.I. Joe's was selling counterfeits.<sup>267</sup> G.I. Joe's first discovered that the golf balls it bought from Cam Golf were counterfeits when a customer complained about the laminate on the balls coming off after just one round of golf.<sup>268</sup> G.I. Joe's quickly pulled its remaining stock of the "Titleist" golf balls, but not before another customer of G.I. Joe's had complained to Acushnet.<sup>269</sup> Acushnet promptly sued based on the Lanham Act against G.I. Joe's, who then filed a third-party complaint against Cam Golf for breaching the WAI.<sup>270</sup>

Subsequently, Acushnet and G.I. Joe's settled for \$25,000. G.I. Joe's also incurred \$19,350 in attorney's fees defending against Acushnet.<sup>271</sup> G.I. Joe's then sought damages from Cam Golf pursuant to Oregon's equivalent of the WAI, and Cam Golf argued that the settlement was unreasonable.<sup>272</sup> G.I. Joe's asked the district court for "the difference at the time and place of acceptance between the value of the goods accepted and the value they would have had if they had been as warranted . . . [as well as] consequential damages."<sup>273</sup> The consequential damages would cover the settlement as well as attorney's fees.

The district court had very little guidance on how to determine whether the settlement was reasonable and whether the settlement should be assessed under the Lanham Act or the WAI. Because these issues were before the court on a summary judgment motion, the court simply found that material issues of fact were present and denied the motion of G.I. Joe's. Instead of floundering for what

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265. *Acushnet Co. v. G.I. Joe's, Inc.*, No. CV05-764-HU, 2006 WL 2729555 at \*1 (D. Or. Sept. 22, 2006).

266. *Id.*

267. *Id.*

268. *Id.* at \*2.

269. *Id.*

270. *Id.*

271. *Id.*

272. *Id.* at \*3.

273. *Id.*

law to apply, a similarly situated court should follow my proposed framework.

First, the court should determine whether the third-party's claim had a reasonable likelihood of success on the merits. In the case above, establishing that the golf balls were counterfeit and that the golf balls came from the accused seller would accomplish this goal. Second, the court should determine whether the buyer settled in good faith. This determination is made by analyzing the process used in reaching the buyer's financial obligations under the settlement with the third party. Would a knowledgeable party make a similar decision based on the value of the goods and potential liability under the Lanham Act for trademark infringement? If so, then the court can rest assured that the buyer has established a rightful claim under the WAI and that the damages the buyer is requesting from the seller is reasonable (in this case, costs and fees associated with the settlement).

### *3. The Exception: Money and Sophistication*

A predictable situation may arise justifying an exception to the reasonably-likely-to-succeed standard. This is where the potential liability is substantial and the technology is highly sophisticated, making it difficult to determine the merit of the infringement claim. If both these requirements are met, the buyer should receive a presumption that it has a rightful claim, therefore shifting the burden to the defendant-seller to show otherwise. The seller may succeed in meeting this burden if it shows that the buyer did not enter settle in good faith. For example, if the seller could demonstrate that other similarly situated parties reasonably knowledgeable in the same industry would have settled for significantly less than the buyer did, then it has made a case that the buyer was not in good faith in entering the licensing settlement. Therefore, the buyer would not receive the amount of damages requested, but only the damages that would have been reasonable in a similar situation as demonstrated by the experts that the defendant called.

A recent example of a high-dollar, sophisticated technology case is Boston Scientific's reported settlement with Johnson & Johnson for an astounding \$1.725 billion.<sup>274</sup> This settlement concerned patents describing coronary stents, and it is the second high-dollar settlement Boston Scientific has reached with Johnson

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274. Barry Meier, *Boston Scientific to Pay \$1.7 Billion to Settle Patent Suits*, N.Y. TIMES, Feb. 1, 2010, available at <http://www.nytimes.com/2010/02/02/business/02device.html>.

& Johnson.<sup>275</sup> The first settlement was for \$716.3 million to the Cordis division of Johnson & Johnson just months earlier.<sup>276</sup> Although these settlements are on the extreme end of the spectrum, parties frequently reach high dollar settlements, and this remains true even when the infringement claim may not be as strong as others. When the potential losses are extreme, a more conservative approach is preferred.

Like the coronary stents above, these cases involve complicated technology that is difficult to assess at an early stage. In fact, in these cases, the parties are expected to go all the way to the Markman hearing (the final claim construction in a patent litigation trial where experts opine on the potential infringement) before having an honest understanding of whether infringement has occurred.

#### CONCLUSION

Overall, courts need to tighten their standard for determining when a rightful claim has been made, thereby entitling a party to relief under the WAI. I argue here that courts should adopt a new and more rigorous framework that is accompanied with an intellectual-property-specific analysis. A party asserting a breach of the WAI action must demonstrate that the infringement claim against it had a reasonable likelihood of success on the merits. Further, this party must show that if it settled with the third party it did so in good faith. Establishing this new standard will cut down on two troubling aspects of the current standard. One, it motivates the party accused of infringing to play the settlement game with more internalized notions of the consequences and outcomes of its actions. Two, patent trolls and other aggressive patentees will be deterred in their licensing campaigns when the buyers they sue no longer make a quick, under-reasoned decision to buy a license. Instead, these aggressive, often abusive parties will be forced to defend their infringement claims.

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275. *Id.*

276. *Id.*