

High Profile E-Commerce Intellectual Property Cases

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I. Napster Decision

District Court Injunction Issued by Marilyn Hall Patel, Ninth Circuit District Court,
July 26, 2000

- Napster preliminary enjoined from “engaging in or facilitating others in copying, downloading, uploading, transmitting, or distributing plaintiff’s copyrighted musical compositions and sound recordings.”

Background of Case

- Motion Pictures Expert Group developed a standard file format for storage of audio recordings and digital format called mpeg-3 (MP3).
- Digital MP3 files are created by “ripping” and audio compact disks directly to a computer hard drive in compressed format.
- Compressed MP3 files can then be transmitted rapidly over the Internet.

Peer to Peer File Sharing

- Napster facilitates transmission of MP3 files by peer to peer file sharing.
 - 1) Makes MP3 music files stored on individual computer hard drives available for copying by other Napster users.
 - 2) Allows searching for MP3 music files stored on other users’ computers.

- 3) Facilitates transfer of exact copies of the contents of other users' MP3 files from one computer to another via the Internet.

Listing of Files

- User downloads Napster's MusicShare software from Napster.
- MusicShare searches user's library of MP3 files.
- Names of the MP3 files are uploaded to Napster server while content of MP3 files resides on user's hard drive.

Napster's Library

- Napster stores the names of the MP3 files in a searchable library.
- MP3 files are associated with a user's name and Internet address.
- Users logging onto Napster's server can search the names of the MP3 files in Napster's server.

Napster's Search Function

- Napster maintains a search engine to allow users to search the names of MP3 files for users that are currently logged onto Napster.
- Napster provides hot list function that keeps a record of MP3 files for users that have previously logged onto the system.

Transfer of Files

- Napster obtains the Internet address of the requesting user and the host user.
- Napster provides the host user's Internet address to the requesting user.
- The requesting user computer connects to the host user and downloads a copy of the contents of the MP3 file as a "peer to peer" transfer.
- Contents of the MP3 file are never transferred to Napster servers.

Standard for Preliminary Injunctive Relief

- Plaintiff must demonstrate either 1) a combination of probable success on the merits and the possibility of irreparable harm, or 2) that serious questions are raised and the balance of hardships tip in its favor.
- Sliding scale in which the required degree of irreparable harm increases as probability of success decreases.

Prima Facie Case of Copyright Infringement

- Must show ownership.
- Must demonstrate infringement of at least one exclusive right granted to the copyright holder under 17 USC Section 106.

Contributory Infringement

- Must have direct infringement in order to have contributory infringement.
- Plaintiff must show direct infringement by Napster users to prove contributory infringement by Napster.

Fair Use (Defense to Direct Infringement) of Napster Users

- Three fair uses alleged by Napster:
 - 1) Sampling – temporary copy of work before purchasing.
 - 2) Space shifting – merely obtaining a work already owned by the user in a different format.
 - 3) Permissive distribution of the recordings by artists.

Fair Use Factors

- Purpose and character of the use.
- Nature of the copyrighted work.
- Amount and substantiality of the portion used in relation to work as a whole.
- The effect of use upon the potential market for the work or the value of the work.

Ninth Circuit Appeals Court Holding

- Agreed with District Court Judge Marilyn Hall Patel that Napster users are not fair users.

Purpose and Character of Use

- Transformation
 - Does the work replace the original creation or add a further purpose or different character?
 - Downloading a MP3 file does not transform the copyrighted work.
 - Fair use is not normally found where an original work is merely transmitted in a different medium.
 - This element also requires a determination as to whether infringing use is commercial or non-commercial – but not dispositive of issue.
 - Distributing a file to an anonymous requester is not personal use.
 - Napster users obtain MP3 files for free which they would normally have to buy.
 - Direct economic benefit is not required to demonstrate commercial use.
- Nature of the Work
 - Creative works have greater copyright protection than fact-based works.
 - Musical compositions and sound recordings are creative by nature.
 - This weighs against the finding of fair use.
- Portion Used
 - “While wholesale copying does not preclude fair use per se, copying an entire work militates against the finding of fair use.”
- Effective Result on Market
 - “Fair use doctrine, when properly applied, is limited to copying by others which does not materially impair the marketability of the work which is copied.”
 - The Court found that Napster harmed the market and that it reduced audio CD sales among college students. Evidence provided by a survey.

Fair Use Defense Based on Specific Uses by Napster

- Sampling – Napster contended that MP3 files were downloaded to sample the music by the user to decide whether to purchase the recording.
 - The Court found that previous sampling limited to 30 to 60 second samples.
 - District Court found that the market for audio CDs was adversely affected by Napster’s service.
 - The Court found that even if the sampling was done for a non-commercial use, the market was affected as the use of the Napster service became more widespread.
- Space shifting – Napster maintains that its users engaged in space shifting and space shifting is fair use.
 - Napster cited the Diamond case in which a portable MP3 player allowed a user to copy files and take the player with the user to portably play the files.
 - Napster also cited the Sony “time shifting” case. VCR recorders sold by Sony were used by users to record shows that were later viewed by the user.
 - The Court found in both cases that these were personal uses and that the information was not made “available to millions of other individuals.”

Contributory Infringement under Copyright Law

- “One, with knowledge of the infringing activity, induces, causes or materially contributes to the infringing conduct of another, may be held liable as a contributory infringer.”

Knowledge

- Contributory liability requires that the secondary infringer know or have reason to know of direct infringement.
- The District Court found that Napster had both actual and constructive knowledge that its users engaged in copying copyrighted music.
- Napster’s actual, specific knowledge of direct infringement distinguishes the Napster situation from the holding in Sony Corp. v. Universal Studios 464 US 417 (1984).

Sony Decision

- US Supreme Court refused to hold the manufacturer and retailers of video tape recorders liable for contributory infringement despite evidence that such machines could be and were used for copying copyrighted television shows.
- The Sony Court declined to impute the requisite level of knowledge where the defendants made and sold equipment capable of both infringing and substantial non-infringing uses.
- Similar to the “Staple Article of Commerce Doctrine” and from patent law.

Appeals Court Modification of District Court Ruling

- Appeals Court indicated that they were bound to follow the ruling and Sony did not impute the requisite level of knowledge to Napster merely because peer to peer file-sharing technology may be used to infringe plaintiff’s copyrights.
- Rejected argument that merely supplying the means to accomplish an infringing activity leads to imposition of liability.
- Substantial evidence provided that Napster knew or had reason to know that its users infringed the plaintiff’s copyrights.
- The record supported a finding:
 - that Napster had actual knowledge that specific infringing material was available on its system;
 - that Napster could block access to the system by suppliers of infringing material;
 - that Napster failed to remove the material.
- Court stated that if a computer system operator learns of specific infringing material available on his or her system and fails to purge such material from the system, the operator knows and contributes to direct infringement.
- The Appeals Court also held that absent any specific information which identifies infringing activity, a computer system operator cannot be liable for contributory infringement merely because the structure of the system allows for the exchange of copyrighted material.

Consider Following Examples

- Manufacturer of a copying machine
- Manufacturer of pens and pencils
- Manufacturer of ink jet cartridges
- Manufacturer of computers and servers used for Internet connection

Vicarious Liability

- Extends beyond employer/employee relationship.
- Defendant has the right and ability to supervise infringing activity (policing).
- Defendant has a direct financial interest in such activities.

Policing

- The reserved right to police must be exercised to its full extent.
- Turning a blind eye to detectable acts of infringement for the sake of profit gives rise to liability.
- Fonovisa case: Operators of swap meets held vicariously liable because operators knew that vendors at swap meets were selling counterfeit recordings. Failure of swap meet owners to police.
- Failure to police the conduct of the primary infringer leads to imposition of vicarious liability for copyright infringement.
- The Court held that Napster's failure to police its system knowing that copyright infringement was occurring by its users, combined with the showing that Napster financially benefited from continuing availability of infringing files on its system leads to an imposition of vicarious liability.

Digital Millennium Copyright Act

- Safe harbor for Internet service providers – Napster failed to show that it qualified as an ISP under the DMCA.

Affirmative Defenses

- Napster claimed that the plaintiff waved its right to enforce its copyrights and provided an implied license since the plaintiff knowingly provided the technology (MP3) for copying and distributing files over the Internet.
- The Court rejected these affirmative defenses.
- The Court also rejected Napster's affirmative defense of misuse that the plaintiff tried to control non-copyrighted works in addition to its copyrighted works.

Restatement of Court's Ruling

- Contributory infringement may potentially be imposed only to the extent that Napster:
 - 1) Receives reasonable knowledge of specific infringing files with copyrighted musical compositions and sound recordings.
 - 2) Knows or should know that such files are available on the Napster system.
 - 3) Fails to act to prevent viral distribution of the works.
- The mere existence of Napster system without actual knowledge and Napster's demonstrated failure to remove the offending material is insufficient to impose contributory liability.

Napster Seeking Help from Congress

- Recording Industry Association of America sent Napster a list of 135,000 songs.

II. E-Commerce Patents

E-commerce patents protect a way of doing business on-line.

- Business method patents are a type of e-commerce patent.
- There has been a tremendous growth in the filing of e-commerce patents.
 - 1995 – 105 e-commerce patents issued.
 - 2001 – tens of thousands of e-commerce patents issued.
 - Priceline.com secure protection on “name your price business model”.
 - SiteSound.com – holds a basic patent on selling music through digital downloads.

- There's been a backlash by the on-line community to IP protection for on-line methods of doing business.

What is the purpose of a patent?

- Article I, Section 8 – “Promote the progress of science and useful arts by securing for limited times to authors and inventors the inclusive right to the respective writings and discoveries.”

Incentive for Creation and Disclosure

- Encourages dissemination of information and commercialization.
- Allow the Patentee to exploit his or her intellectual property through licensing.

Requirements for Patenting

- New
- Useful
- Non-obvious
- Statutory subject matter
 - Does not protect
 - 1) abstract ideas
 - 2) scientific truths (mathematical expression)
 - 3) laws of nature
 - 4) abstract intellectual concepts

III. State Street Bank v. Signature Financial

Invention

- Computer running on software program.
- Makes mutual fund asset allocation.

State Street Bank decision made the public aware of business method patents.

- Started frenzy of Internet patents.

Facts of State Street Bank

- Hub and spoke structure
- Mutual funds – spokes
- Hub – pooled assets in investment portfolio organized as a partnership.
- Partnership of hub gives tax advantages.
- Economies of scale realized in reducing administrator costs of the mutual fund partnership.
- Signature attempted to negotiate a license with State Street and the licensing talks brought down.
- Signature filed a declaratory judgment action.
 - Basis of action was failure to claim statutory subject matter.
- District Court granted motion for summary judgment.

Court of Appeals for the Federal Circuit Decision in State Street Bank

- Mathematical algorithms
 - Not patentable subject matter to the extent that they are merely abstract ideas.
 - Mathematical algorithms are an abstract idea until reduced to some type of practical application.
 - Disembodied concept versus useful, concrete and tangible result

Judicially-Created Business Method Exceptions

- Court put “ill-conceived exception to rest.”
- Business methods are subject to the same legal requirements as other methods.
- Lower court justified business method exception by saying it would “foreclose any computer implemented accounting structure to manage this type of account.”
- CAFC reply
 - If the claims are too broad, then find prior art to cover them.
 - This has nothing to do with statutory subject matter.
- Use the standard rejections of novelty and non-obviousness.

- Business method patents are just like any other methods.

Arguments of Those Opposed to Business Method Patents

- A revolution in patent law was occurring while Congress was fiddling with Monica and Bill.
- Business method patents may affect the business of every company.
- New marketing schemes, advertising, etc.
- Exercise extreme caution when starting a new business venture, especially a business method that is carried out over the Internet.
- Examples of business methods that may have been able to receive protection in the past.
 - Music videos
 - Shock jock radio
 - Frequent flier points program
 - Trading stamps program
 - In-flight shopping

Arguments of Those Supporting Business Method Patents

- Various articles in the press have focused too much attention on business methods not being per se unpatentable.
- CAFC explained that business methods are no different from other methods and that they should be subject to the same legal requirements, i.e. novelty, non-obviousness, statutory subject matter.
- Judge Rich of the CAFC explained that business method exceptions were never invoked by the CCPA or the CAFC.
- US Patent and Trademark Office removed the business method exception in 1996 as a reason for rejection.
 - Treated like any other method.

No Lifeboat Needed

- Use the same protections that are used against other methods.
- Business method patents should meet the statutory definition of patentability.
- Same outcry was heard when software deemed patentable.
- Focus should be on prior art and ability to examine these applications.
- New prior user rights law provides protection.

A revolution has not occurred in patent law.

- Law of the court for over 4 decades
- Last 10 years
 - 2000 patents issued
 - Health care insurance
 - Airline reservation systems
 - Inventory management
 - Accounting
 - Other areas

There is no clear line of demarcation between business method patents and other methods

- No clear reason for not allowing business method patents.

IV. Amazon.com v. Barnesandnoble.com

- One click ordering
- Prior art did not show such a system

Operation of Amazon System

- Amazon's web server saves purchaser information including identification of the purchaser, payment information, and shipment information, which is usually provided from a previous order.
- Web server then assigns an identifier to the purchaser and sends the identifier to the purchaser's computer for storage.

- The next time the purchaser requests information about an item, the identifier is sent to the web server.
- When the web server supplies the item information back to the purchaser, the one click ordering function is enabled.

Evidence of Non-obviousness

- Dr. John Lockwood, inventor of the “WebBasket” system, admitted that it never occurred to him to modify the “WebBasket” program to enable single action ordering despite his testimony that such a modification would be easy to implement.
- An expert from Columbia Business School testified that the one click system was a major innovation in on-line retailing that allows for purchasing without disrupting the customer shopping experience.
- Copying of the invention by Barnes & Noble.com and others is additional evidence of non-obviousness.
- Customers were found to be timid regarding ordering on-line.
- The one click process, which was hugely successful, took away the fear of ordering.
- One click maximized the likelihood of completing purchases.
- Commercial success of the invention and failure of others to solve the problem addressed by the patented invention and the fact that the invention has become the industry standard is compelling, objective evidence of the non-obviousness of the claimed invention.

V. Conclusion

Intellectual property has been effectively used to protect e-commerce inventions and copyrights.

E-commerce intellectual property is an important new area of law to which companies should pay careful attention.