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A review of developments in Intellectual Property Law

Supreme Court Maintains Licensing Status Quo in *Kimble v. Marvel Entertainment, LLC*.



By Kevin E. Noonan, Ph.D.

A bedrock principle of U.S. patent law is that the patent grant comprises a *quid pro quo*. In exchange for a limited term of exclusivity (presently, twenty years from the

earliest filing date), the patented invention is placed in the public domain when the patent expires. While this principle is both simple and fundamental (and patent expiry is expressly contained in the statute, codified at 35 U.S.C. § 154), it finds its most controversial application in a Supreme Court case from 50 years ago, *Brulotte v. Thys Co.*¹ *Brulotte* stands for the rule that a patentee cannot receive royalties for activities falling within the scope of the patent claims once the patent has expired. Roundly criticized on economics grounds since it was handed down, the Court refused to walk back the *Brulotte* rule in a case decided at the end of the past term, *Kimble v. Marvel Entertainment, LLC*.²

The facts of the case do not provide any equities to the licensee, Marvel. The issue arose regarding Kimble's U.S. Patent No. 5,072,856 for a toy that simulated the web-shooting devices used by the fictional Spiderman.³ As any child or pop culture fan knows, Marvel is the purveyor of all things Spiderman, owning the rights to the character, comic books, movies, and ancillary merchandise. Kimble attempted to license his invention to Marvel, but they chose to copy the invention, bringing their own version of the toy to market.⁴ The parties settled Kimble's resulting patent infringement lawsuit on terms wherein Marvel purchased the patent for a lump sum (approximately \$500,000) plus a 3% royalty.⁵ The settlement contained no limit on this royalty obligation with regard to patent expiry.⁶ According to the opinion, the parties were apparently unaware of the *Brulotte* rule that precluded Kimble from receiving royalties after the '856 patent expired, but (once purportedly apprised of the existence of the rule) Marvel brought a declaratory judgment

action against paying post-expiry royalties, in which it prevailed.⁷

The Court affirmed Marvel's victory in an opinion by Justice Kagan, joined by Justices Scalia, Kennedy, Ginsberg, Breyer, and Sotomayor; Justice Alito dissented, joined by the Chief Justice and Justice Thomas. While the opinion acknowledged that the *Brulotte* rule had been the subject of judicial and scholarly criticism,⁸ the majority refused to overrule it. The reason is *stare decisis*, the majority stating that "[i]n crafting the patent laws, Congress struck a balance between fostering innovation and ensuring public access to discoveries."⁹ The opinion justifies letting the *Brulotte* rule stand because "[t]his Court has carefully guarded that cut-off date, just as it has the patent laws' subject-matter limits" based on the public interest.¹⁰ This is reflected in other examples of its precedent consistent with *Brulotte*, including situations where it has prevented, *inter alia*, parties from agreeing not to challenge a patent.¹¹

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The majority found the statutory basis for the *Brulotte* rule in the patent term provisions of § 154, which limits the duration within which the patentee can exercise the right to exclude. Thereafter, the patent *quid pro quo* demands that the invention is freely available to the public. The Court recognized that “[t]he *Brulotte* rule, like others making contract provisions unenforceable, prevents some parties from entering into deals they desire” and that royalty plans like the one in *Brulotte* (and here) can have advantages including “draw[ing] out payments over time and t[ying] those payments, in each month or year covered, to a product’s commercial success.”¹² The majority also recognized the traditional justification for extending the term for paying royalties, that “[a] more extended payment period, coupled (as it presumably would be) with a lower rate, may bring the price the patent holder seeks within the range of a cash-strapped licensee,” the opinion analogizing the situation with purchasing a consumer product on an installment plan.¹³ Alternatively, “such an extended term may better allocate the risks and rewards associated with commercializing inventions — most notably, when years of development work stand between licensing a patent and bringing a product to market.”¹⁴

Nevertheless, the majority believes that the statutory term is sufficiently important to require patentees and their licensees to “find ways around *Brulotte*” using other means.¹⁵ These include deferred payments on royalties earned during the patent term,¹⁶ or extending royalties until the last-to-expire of a patent portfolio. Also permitted would be licensing non-patent rights — such as “know-how” or trade secrets (no matter how closely tied to the patent). “Finally and most broadly, *Brulotte* poses no bar to business arrangements other than royalties — all kinds of joint ventures, for example — that enable parties to share the risks and rewards of commercializing an invention,” according to the opinion.¹⁷

The majority rejected Kimble’s argument that these situations should be subjected to a “case-by-case,” “rule of reason” approach.¹⁸ This is where the Court most directly resorts to *stare decisis* principles, stating that “[o]verruling precedent is never a small matter.”¹⁹ The benefits of not overruling *Brulotte* (or any other decision) include that “it promotes the evenhanded, predictable, and

consistent development of legal principles, fosters reliance on judicial decisions, and contributes to the actual and perceived integrity of the judicial process.”²⁰ But in doing so, the Court adopted Justice Brandeis’ view that “it is usually “more important that the applicable rule of law be settled than that it be settled right.”²¹

The opinion also states that “[a]ccordingly, an argument that we got something wrong — even a good argument to that effect — cannot by itself justify scrapping settled precedent.”²² Rather the majority believes that “[t]o reverse

While nothing has changed with this opinion, it is well to remember this reassertion of the *Brulotte* rule when crafting licensing agreements. Indeed, creativity rules.

course, we require as well what we have termed a ‘special justification’ — over and above the belief ‘that the precedent was wrongly decided.’”²³

The majority opinion also states that *stare decisis* is more important when the Court interprets a statute because the party can “take their objections across the street” and have Congress change the law.²⁴ In this case, the majority perceives that Congress has declined this opportunity repeatedly (“long congressional acquiescence”), citing the implementing statutes for the GATT/TRIPS agreements as well as specific bills introduced (but never enacted) aimed at changing the law to abrogate the *Brulotte* rule.²⁵

Other reasons contained in the majority opinion for refusing to overrule *Brulotte* include the special characteristics of cases at the nexus between property law and contract law, where the majority believe *stare decisis* principles to be “at their acme” because such precedents are used by parties when “ordering their affairs.”²⁶ This reasoning harkens back to the sentiment that the Court should not

upset settled expectations: “[s]o long as we see a reasonable possibility that parties have structured their business transactions in light of *Brulotte*, we have one more reason to let it stand.”²⁷ In addition, the majority believes that *Brulotte* remains consistent with other precedent supporting “bright line” patent term expiry and that the rule (according to the majority) remains “workable” in practice, particularly when compared with antitrust law.

The opinion acknowledges the scholarly consensus that post-expiration royalties can have pro-competitive effects.²⁸ But in their view this is a patent case, not an antitrust case (where the Court has been more flexible due to the dynamic nature of antitrust law), and the public interest trumps these considerations: “[s]o in deciding whether post-expiration royalties comport with patent law, *Brulotte* did not undertake to assess that practice’s likely competitive effects. Instead, it applied a categorical principle that all patents, and all benefits from them, must end when their terms expire.”²⁹ And, “[s]o if Kimble thinks patent law’s insistence on unrestricted access to formerly patented inventions leaves too little room for pro-competitive post-expiration royalties, then Congress, not this Court, is his proper audience.”³⁰

Appeals to innovation, the “wellspring of patent policy,” and the rule’s harm to innovation provided no help: “[n]either Kimble nor his amici have offered any empirical evidence connecting *Brulotte* to decreased innovation; they essentially ask us to take their word for the problem. And the United States, which acts as both a licensor and a licensee of patented inventions while also implementing patent policy, vigorously disputes that *Brulotte* has caused any ‘significant real-world economic harm.’”³¹

Justice Alito disagreed, characterizing *Brulotte* as “a clear case of judicial overreach” and saying that in his view the rule was based not on patent law but on antitrust principles that have been “debunked.”³² Regarding the rationale for the majority opinion, Justice Alito writes that “[o]ur traditional approach to *stare decisis* does not require us to retain *Brulotte*’s *per se* rule. *Brulotte*’s holding had no basis in the law. Its reasoning has been thoroughly disproved. It poses economic barriers that stifle innovation. And it unsettles contractual expectations.”³³

While nothing has changed with this opinion, it is well to remember this reassertion

of the *Brulotte* rule when crafting licensing agreements. Indeed, creativity rules. In those instances where the licensee requires time to bring the claimed invention to market or the invention requires so much development time that the royalty term may be insufficient for a license to make economic sense, non-royalty terms such as milestone payments or other lump sum payments can be included. Other avenues include having royalty payments tied to know-how or trade secrets, both of which met (albeit hypothetically) with the Court's approval. Payments tied to market success can also be included. While this shifts some of the risk to the patentee (who in many instances has little or no control over whether the licensee will have market success), licenses can include provisions where lack of success terminates the license or converts an exclusive license to a non-exclusive one. Such provisions reduce (but do not eliminate) some of the risk attendant on exclusive licensing even in those situations where an exclusive license is required to justify the costs of bringing a patented article to market. These are just a few of the ways licenses can be structured to avoid the negative consequences of the *Brulotte*

rule. They remain necessary because this Court seems unwilling to reconsider its reliance on categorical rules involving licensing, and there is no indication that this attitude will change.

Endnotes

- 1 379 U.S. 29 (1964).
- 2 No. 13-720, slip op. at 1 (Jun. 22, 2015).
- 3 *Id.*
- 4 *Id.* at 2.
- 5 *Id.*
- 6 *Id.*
- 7 *Id.*
- 8 *Id.* at 3 (citing *Scheiber v. Dolby Labs., Inc.*, 293 F. 3d 1014, 1017–1018 (7th Cir. 2002) (Posner, J.) and Ayres & Klemperer, *Limiting Patentees' Market Power Without Reducing Innovation Incentives: The Perverse Benefits of Uncertainty and Non-Injunctive Remedies*, 97 MICH. L. REV. 985, 1027 (1999)).
- 9 *Id.*
- 10 *Id.*
- 11 *Id.* at 4 (citing *Scott Paper Co. v. Marcalus Mfg. Co.*, 326 U.S. 249 (1945); *Edward Katzinger Co. v. Chicago Metallic Mfg. Co.*, 329 U.S. 394, 400–401 (1947) and *Lear, Inc. v. Adkins*, 395 U.S. 653, 668–675 (1969)).
- 12 *Id.* at 5.
- 13 *Id.*
- 14 *Id.*
- 15 *Id.* at 6.
- 16 *Id.* at 6 (citing *Zenith Radio Corp. v. Hazeltine Research, Inc.*, 395 U.S. 100, 136 (1969)).
- 17 *Id.*
- 18 *Id.* at 7.
- 19 *Id.*
- 20 *Id.* (citing *Payne v. Tennessee*, 501 U.S. 808, 827–828 (1991)).
- 21 *Id.* (citing *Burnet v. Coronado Oil & Gas Co.*, 285 U.S. 393, 406 (1932) (which besides being contrary to the Court's role in actually trying to interpret the laws to effectuate congressional intent, it also must be noted that Justice Brandeis's statement was made in a dissent and thus not the basis for the *Burnet* decision)).
- 22 *Id.* at 8.
- 23 *Id.* (citing *Halliburton Co. v. Erica P. John Fund, Inc.*, No. 13-317, slip op. at 4 (2014)).
- 24 *Id.* (citing *Patterson v. McLean Credit Union*, 491 U.S. 164, 172–173 (1989)).
- 25 *Id.* at 8-9.
- 26 *Id.* at 9.
- 27 *Id.* at 10.
- 28 *Id.* at 13.
- 29 *Id.* at 15.
- 30 *Id.* at 16.

- 31 *Id.* at 17 (citing the government's amicus brief).
- 32 *Id.* at 1 (Alito, J., dissenting).
- 33 *Id.* at 6.

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Amgen v. Sandoz—Did the Federal Circuit Just Doom the New Biosimilar Approval Pathway?

By Andrew W. Williams, Ph.D.
and Ann C. Palma

Congress passed the Biologics Price Competition and Innovation Act (“BPCIA”) in 2009 in an effort to bring biosimilar drug products to market.¹ The goal was for the BPCIA to mimic for biologic drugs the Hatch-Waxman statute for small molecules, including both an abbreviated drug approval process and a mechanism to address any potential patent challenges during the approval process.² Nevertheless, due at least in part to the increased complexity in manufacturing and patent protection of biosimilars (as compared to small molecules), unique provisions were necessary for the BPCIA. Interpretation of these unique provisions, however, has proven to be equally complex. In the highly fractured *Amgen v. Sandoz* decision, the Federal Circuit, in part, concluded that the BPCIA patent resolution procedure was not mandatory, leaving open the distinct possibility that no biosimilar applicant will ever use the new biosimilar approval pathway.

Sandoz was the First Biosimilar Applicant to Test the Language of the BPCIA

The dispute between the parties in *Amgen v. Sandoz* began in July 2014 when Sandoz, a division of Novartis, filed an application under the BPCIA with the Food and Drug Administration (“FDA”) for a biosimilar known under the brand name ZARXIO™.³ The drug is a biosimilar form of the protein filgrastim that is sold by Amgen under the brand name NEUPOGEN®.⁴ The FDA ultimately approved the biosimilar application on March 6, 2015 for the same indications as Amgen’s NEUPOGEN®, specifically for treating cancer patients.⁵

Sandoz’ decision to avail itself of the first part of the BPCIA afforded it several advantages, including a reduction in the time and cost required to obtain approval for its drug. Following acceptance of its biosimilar application, however, Sandoz intentionally chose not to comply with the disclosure provisions of the BPCIA, reasoning that Congress intended these provisions to be optional.⁶ Namely, Sandoz

opted not to timely disclose a copy of the application it submitted to the FDA and other related information to Amgen after receiving notice of its acceptance by the FDA.⁷

Sandoz maintained that these disclosure provisions of the BPCIA are optional due to the existence of a remedy for the reference product sponsor (in this case, Amgen) should the biosimilar applicant choose not to comply with the disclosure provisions.⁸ Sandoz also noted that it chose not to provide Amgen with a copy of the application because it did not want

More broadly, if a biosimilar applicant chooses not to disclose its application and related documents, or sits out the patent dance, the reference product sponsor will likely have no insight as to which of its patents cover the biosimilar product.

to share its BPCIA application or manufacturing process with a future competitor.⁹

In response to Sandoz’ non-compliance, Amgen filed suit in the Northern District of California requesting, among other things, an injunction preventing Sandoz from marketing its biosimilar product.¹⁰ Importantly, Amgen alleged that Sandoz infringed U.S. Patent No. 6,162,427 (directed to the use of G-CSF in combination with a chemotherapeutic agent), but reserved the right to assert additional patents based on information obtained in discovery.¹¹ On March 19, 2015, Judge Seeborg of the Northern District of California denied Amgen’s motion for a preliminary injunction, paving the way for review by the Federal Circuit.¹²

The BPCIA Provisions at Issue

In a decision on July 21, 2015, the Federal Circuit interpreted two sections of the statute, accompanied by two dissenting opinions (at least in part).¹³ Judge Newman joined Judge Lourie writing for the court with regard to whether the provision requiring “Notice of Commercial Marketing” had to occur after the FDA approved (or licensed) the biosimilar drug product -- it does. But, Judge Chen joined Judge Lourie with regard to whether the aBLA (abbreviated biologics license application) disclosure and patent exchange provisions are mandatory -- they are not. With regard to this last point, the court determined that, in isolation, “shall” normally means “shall,” but in the context of this provision of the BPCIA, “shall” does not mean “must.”

This latter provision has been referred to as the “patent dance,” and can be found at 42 U.S.C. § 262(l)(2). Specifically, no later than 20 days after a biosimilar application is accepted for review, the biosimilar applicant:

- (A) *shall* provide to the reference product sponsor a copy of the application submitted to the Secretary under subsection (k), and such other information that describes the process or processes used to manufacture the biological product that is the subject of such application;
- and (B) *may* provide to the reference product sponsor additional information requested by or on behalf of the reference product sponsor.¹⁴

The statute limits the recipients of this information to at least one outside counsel and one in-house counsel that do not engage, formally or informally, in patent prosecution relevant to the reference product.¹⁵

Important in the outcome, the statute provides the reference product sponsor with an optional remedy should the biosimilar applicant fail to comply with § 262(l)(2). Namely, 42 U.S.C. § 262(l)(9)(C) provides that:

If a subsection (k) applicant fails to provide the application and information required under paragraph (2)(A), the reference product

sponsor, but not the subsection (k) applicant, may bring an action under section 2201 of title 28 for a declaration of infringement, validity, or enforceability of any patent that claims the biological product or a use of the biological product.

The Court ultimately held that when the “shall” provision in paragraph (l)(2)(A) is read in isolation, the biosimilar applicant would be required to comply with the disclosure provisions. The Court went on to hold, however, that when a biosimilar applicant fails to comply with the disclosure requirement, the statute expressly provides a remedy to address the precise path that Sandoz chose.¹⁶ Thus, failure to disclose is not a violation of the BPCIA.

Did Congress Intend the Disclosure and Exchange Provisions to be Mandatory?

An important question remains whether Congress meant this pathway to be optional. Amgen stressed that the language of the BPCIA indicates the intent of Congress that the disclosure provisions of the BPCIA be mandatory, evidenced *inter alia* by the fact that when Congress intended optional provisions, it recited them in the statute.

For example, Congress used the term “shall” as opposed to “may” in paragraph (2) with respect to the disclosure of the application, which suggests that section (A) is mandatory while section (B) is optional. Indeed, “shall” is generally interpreted in statutes as meaning mandatory:

Use of “shall” and “may” in statutes also mirrors common usage; ordinarily “shall” is mandatory and “may” is permissive. These words must be read in their broader statutory context, however, the issue often being whether the statutory directive itself is mandatory or permissive. Use of both words in the same provision can underscore their different meanings, and often the context will confirm that the ordinary meaning of one or the other was intended. Occasionally, however, context will trump ordinary meaning.¹⁷

Congress further clarified its intent in §

262(l)(1) when it defined that the application shall be provided to persons that do not engage in patent prosecution as is “required to be produced pursuant to paragraph (2).”

It is likely that Congress included these provisions as mandatory because without knowledge of the nature of the biosimilar drug and the methods for manufacturing it, the reference product sponsor must essentially guess which patents it should assert. This could result in premature generic competition without any avenue to prevent it. Clearly, Congress attempted to minimize the risks associated with disclosing confidential information regarding the manufacturing process by limiting disclosure to individuals not engaged in patent prosecution relevant to the reference product.

Biosimilar Applicants May Choose to Sit This Dance Out

In light of Congress’ apparent intent to render the disclosure provisions mandatory for biosimilar applicants taking advantage of the abbreviated approval process, it is curious that Congress failed to include a provision linking the two. Indeed, it is easy to imagine a process where final FDA approval of the biosimilar drug would be contingent on the outcome of the patent resolution pathway. But unlike the Hatch-Waxman statute, the BPCIA does not contain such a correlation.

As Amgen has discovered, biosimilar applicants may not be sufficiently deterred for failing to comply with the disclosure requirement. A favorable outcome for Sandoz could have a major economic impact. Neupogen® is a \$1.2-1.4 billion dollar per year product for Amgen. Indeed, on September 4th Sandoz entered the biosimilars market with its Zarxio™ product priced at a 15% discount over Amgen’s Neupogen® price; Amgen can be expected to reduce the cost of the drug by an equivalent amount once Sandoz’ biosimilar is accepted by physicians. Of course, this damage may be tempered somewhat because Zarxio™ does not have “interchangeability” status. As a result, physicians would be required to specifically prescribe the biosimilar, which they may be hesitant to do for patients already on Neupogen®. Such may not always be the case, however, for other biosimilar applicants.

More broadly, if a biosimilar applicant chooses not to disclose its application and related documents, or sits out the patent dance, the reference product sponsor will likely have

no insight as to which of its patents cover the biosimilar product. If this uncertainty is not resolved prior to approval, or the 180-day notice period, it may be unable to assert its patents in federal court before the launch of the biosimilar drug. Further, district courts may be reticent to grant injunctions because of the “assumption” that infringement has not occurred. With the deck stacked against the original biologic license holder, this case raises a real concern that no biosimilar applicant will ever choose to comply with the disclosure provisions of the BPCIA.

Endnotes

- 1 See 42 U.S.C. § 262(k), (l).
- 2 *Id.*
- 3 Amgen Inc. v. Sandoz Inc., Case No. 14-cv-04741, 2015 WL 1264756, *3 (N.D. Cal. Mar. 19, 2015).
- 4 U.S. Food and Drug Administration, FDA approves first bio-similar product Zarxio, FDA.GOV, (March 6, 2015), <http://www.fda.gov/NewsEvents/Newsroom/PressAnnouncements/ucm436648.htm>.
- 5 *Id.*
- 6 Amgen, 2015 WL 1264756 at *5-6.
- 7 *Id.* at *5.
- 8 *Id.* at *5-6; Non-Confidential Brief for Defendant-Appellee at 30, Amgen Inc. v. Sandoz Inc., Appeal No. 2015-1499 (Fed. Cir. 2015), ECF No. 73.
- 9 Non-Confidential Brief for Defendant-Appellee at 13, Amgen Inc. v. Sandoz Inc., Appeal No. 2015-1499 (Fed. Cir. 2015), ECF No. 73.
- 10 Complaint, Amgen Inc. v. Sandoz Inc., Case No. 14-cv-04741 (N.D. Cal. 2015), ECF No. 1; Amgen, 2015 WL 1264756 at *4.
- 11 Complaint, Amgen Inc. v. Sandoz Inc., Case No. 14-cv-04741 (N.D. Cal. 2015), ECF No. 1.
- 12 Amgen, 2015 WL 1264756 at *10-11.
- 13 Amgen Inc. v. Sandoz Inc., No. 2015-1499, 2015 WL 4430108 (Fed. Cir. 2015).
- 14 42 U.S.C. § 262(l)(2) (emphasis added).
- 15 42 U.S.C. § 262(l)(1)(B)(ii).
- 16 Amgen, 2015 WL 4430108.
- 17 *Statutory Interpretation: General Principles and Recent Trends*, Congressional Research Service Report for Congress, August 31, 2008 (internal citations omitted).

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New York v. Aleynikov: New York State's Penal Code (Like Federal Criminal Law) Does Not Cover Electronic Reproduction of Source Code

By Joshua R. Rich

In 2009, Sergey Aleynikov was a computer programmer employed by Goldman Sachs to write high-frequency trading code. He accepted an offer to join a new Chicago-based company, Teza Technologies. Before he left Goldman Sachs, however, he sent portions of Goldman's high frequency trading code to a German server for his own future use. After Goldman found out, it went to the FBI; Aleynikov was then arrested on a flight home from a visit to Chicago. With that arrest began a circuitous journey through the U.S. legal system, governed by two different sovereigns and under two different legal regimes – neither one of which was ultimately found to cover his actions.

Federal Prosecution of Aleynikov under the Economic Espionage Act and the National Stolen Property Act

Aleynikov was first tried¹ in the U.S. District Court for the Southern District of New York on charges of violating the Federal Economic Espionage Act of 1996 ("EEA")² and the National Stolen Property Act ("NSPA").³ At that time, the EEA's trade secret misappropriation section provided:

Whoever, with intent to convert a trade secret, that is related to or included in a product that is produced for or placed in interstate or foreign commerce, to the economic benefit of anyone other than the owner thereof, and intending or knowing that the offense will, injure any owner of that trade secret, knowingly . . . without authorization . . . downloads, uploads, . . . transmits, . . . or conveys such information . . . [would be guilty of a criminal offense punishable by up to ten years in jail].⁴

The parties disputed the application of the EEA to Aleynikov's behavior, Aleynikov's intent

in uploading the code to the German server, and the importance of the uploaded code. Ultimately, however, the jury found Aleynikov guilty under the EEA and NSPA.

The U.S. Court of Appeals for the Second Circuit interpreted the EEA and the NSPA more narrowly than the trial court. It stressed that the EEA had been adopted as a response to the Supreme Court's decision that the relevant

Sergey Aleynikov is in the remarkable position of having been tried twice for the same acts, having two juries find him guilty, but having been absolved by two different courts.

section of the NSPA (18 U.S.C. § 2314) did not apply to purely intangible property, as found in *Dowling v. United States*, 473 U.S. 207 (1985).⁵ It then considered the differences in language between the economic espionage provision of the EEA (18 U.S.C. § 1831) and the trade secrets provision (18 U.S.C. § 1832). The former did not require that the information be "related to or included in a product that is produced for or placed in interstate or foreign commerce," while the latter did.⁶ Given the statutory language, the Second Circuit found that Goldman's code was intended to remain confidential (and not be related to any product placed in interstate commerce).⁷ It therefore overturned Aleynikov's Federal conviction.

Remarkably, the Second Circuit's decision in the Federal *Aleynikov* case subsequently led to a change in the EEA. Although it cannot apply to the *Aleynikov* case (under both the Constitution's *ex post facto* clause and double jeopardy case law), § 1832 was amended to

apply to any trade secret "that is related to a product or service used in or intended for use in interstate or foreign commerce."⁸ Thus, in future cases, misappropriation of computer code that is intended to remain confidential, but used in relation to a service performed in interstate commerce, will be an offense under the EEA.

State Prosecution of Aleynikov for Unlawful Use of Secret Scientific Material and Unlawful Duplication of Computer Related Material

After sitting in prison for over a year awaiting resolution of the Federal claims against him, Sergey Aleynikov thought he was no longer in jeopardy when the Second Circuit issued its opinion absolving him of criminal liability. Not true. Rather than returning Aleynikov's computer, other evidence, and passport, the U.S. Attorney's Office turned it all over to the New York County (Manhattan) DA's office. Ultimately, that evidence was ruled to be illegally transferred and inadmissible as evidence against Aleynikov. The DA's office nonetheless decided to prosecute Aleynikov.

The state court prosecution proceeded on three counts under two statutes: two counts of Unlawful Use of Secret Scientific Material (N.Y. Pen. L. § 165.07) and one count of Unlawful Duplication of Computer Related Material (N.Y. Pen. L. § 156.30).⁹ The former statute provides:

A person is guilty of unlawful use of secret scientific material when, with intent to appropriate to himself or another the use of secret scientific material, and having no right to do so . . . , he makes a tangible reproduction or representation of such secret scientific material by means of writing, photographing, drawing, mechanically or electronically reproducing or recording such secret scientific material.¹⁰

The latter statute provides:

A person is guilty of unlawful duplication of computer related [material] . . . when having no right to do so, he or she copies, reproduces or duplicates in any manner: 1. any computer data or computer program and thereby intentionally and wrongfully deprives or appropriates from an owner thereof an economic value or benefit in excess of [\$2,500].¹¹

Aleynikov challenged his state indictment on numerous grounds, ranging from double jeopardy, to the high-frequency trading code not being “secret scientific material,” to not having made a “tangible reproduction or representation,” and to not having deprived Goldman of the value of the code. The trial court judge rejected those arguments and allowed the case to go forward to trial.

At trial in April 2015, Aleynikov argued that he had committed no crime, based both on his own lack of culpable intent and the technical language of the relevant statutes. The jury returned with a split verdict: guilty on one count of Unlawful Use of Secret Scientific Material, hung on the other count of Unlawful Use of Secret Scientific Material, and not guilty of Unlawful Duplication of Computer Related Material. After the jury verdict, Aleynikov renewed his motion to dismiss both counts of Unlawful Use of Secret Scientific Material; the trial court granted the renewed motion in a carefully reasoned 72-page decision issued on July 6, 2015.¹²

The trial court’s dismissal of the two counts of Unlawful Use of Secret Scientific Material rested on two separate grounds. First, the court found that the prosecution had not proved that Aleynikov had made “a tangible reproduction or representation of [any] secret scientific material.” Second, the court found that the prosecution had not proved that Aleynikov had the “intent to appropriate to himself or another the use of secret scientific material.” In both cases, the trial court’s decision was not based on a lack of evidence; rather, the trial court found that the act of making a copy of computer code was improper but could not violate the statute for either reason.

The trial court began its consideration of the renewed motion to dismiss with a review of the origins of the statute. The law was intended to be a counterpart to a larceny

statute (N.Y. Pen. L. § 155.30(3)) that makes it a felony to “steal property” which consists of “secret scientific material.”¹³ The difference between the two statutes was the physical act proscribed: in the case of the unlawful use statute, it was making a tangible reproduction or representation of scientific material; in the case of the larceny statute, it was taking the scientific material itself.¹⁴ For example, the unlawful use statute would be violated by writing down the synthetic steps for making a product, whereas the larceny statute would be violated by stealing the product itself. In both cases, a violation required the accused to have the same intent to steal.¹⁵ Both statutes grew out of a theft of trade secrets from the Lederle Laboratory Division of the American Cyanamid Company in which employees had taken confidential records and microorganisms used in the synthesis of antibiotics and steroids from Lederle and turned them over to be sold to other drug companies.¹⁶

The first key question confronting the trial court was what would constitute a “tangible” reproduction or representation because Aleynikov had made only a virtual copy of the disputed code; he had not printed it or otherwise copied it down. The trial court turned first to the dictionary for a definition of “tangible.” Black’s Law Dictionary (which the court found representative of dictionaries generally) had three definitions: “1. Having or possessing physical form; corporeal. 2. Capable of being touched and seen; perceptible to the touch; capable of being possessed or realized. 3. Capable of being understood by the mind.”¹⁷

In resolving which definition of “tangible” would apply, the court turned to four sources: canons of statutory construction, decisions under the EEA (based on the prior *Aleynikov* prosecution), New York state decisions construing similar statutes, and the Rule of Lenity.

The most important canon of construction for the trial court was the principle that every word in a statute must have a meaning and was assumed to have been inserted for a purpose.¹⁸ The statute would not have been violated if a representation or reproduction had been imaginary or incomprehensible because there would be no economic value to appropriate, so tangible had to mean something other than merely real or comprehensible. The DA first argued that tangible meant that the reproduction or representation itself need not be tangible, only that it be able to be physically reproduced or

represented.¹⁹ Alternatively, the DA argued that the term “tangible” was intended to distinguish memories.²⁰ The court found the first option would still render the word superfluous in the statute, and the second defied common sense.²¹ Further, the DA’s attempts at construction violated a second canon of construction, which was that statutes are to be construed according to their meaning at the time of enactment.²² When the statute was enacted in 1967, even the computer-related media that were available (like fax machines or photocopiers) yielded tangible, paper copies of original documents. Thus, the court found that a physical definition of “tangible” was required.

Second, the distinction between a virtual copy of computer code and a “tangible” physical copy was also starkly shown in Federal jurisprudence under the EEA. After Aleynikov had been absolved of criminal liability by the Second Circuit, another defendant, Samarth Agrawal, argued that his conviction should also be reversed.²³ But Agrawal, unlike Aleynikov, had printed out code from his employer’s high-frequency trading system on paper. As the Second Circuit found, “[t]his makes all the difference.”²⁴ In addition, earlier in the state *Aleynikov* case, a different justice of the New York Supreme Court had suggested that the misappropriated source code was “intangible property” in contrasting the *Agrawal* case.²⁵

Third, the court considered other criminal cases in which the nature of computer data was considered. New York’s child pornography statute required possession of illicit images; the New York Court of Appeals found that merely viewing, without knowledge that the images would be stored in a computer’s cache, did not satisfy that requirement.²⁶ The court relied heavily on that decision’s reasoning, as well as other cases in which computer data had been characterized as “intangible items,” to support a finding that computer data would not be a “tangible reproduction or representation.”²⁷

Finally, the court considered the Rule of Lenity. In addition to all of the evidence that suggested that the term “tangible” did not apply, the Rule counsels that “[i]f two constructions of a criminal statute are plausible, the one more favorable to the defendant should be adopted.”²⁸ Thus, the court found that virtual computer code could not support a finding that Aleynikov made a “tangible reproduction or representation” and the conviction had to be overturned.

(continued on page 10)

Comparison of Design Patent and Trade Dress Protection in Light of the Federal Circuit's Decision in *Apple v. Samsung*

By Sydney R. Kokjohn and Eddie Obissi

In a decision authored by Chief Judge Sharon Prost, the Federal Circuit held that while design patents covering product configurations – that is, “a product feature or a combination or arrangement of features”¹ – can protect functional aspects of a design, trade dresses cannot. The case, *Apple v. Samsung*,² evaluated Samsung’s appeal of a jury verdict that awarded Apple nearly one billion dollars in lost profits associated with the iPhone®. While the Federal Circuit upheld the jury verdict in regards to infringement of two utility patents, more noteworthy is its discussion and holding regarding the design patents and trade dresses at issue. In its opinion, the Federal Circuit drew a distinct line between design patent and trade dress protection, finding that the former appropriately protected the product configurations at issue, while the latter did not.

Design patent and trade dress law do not serve the same purpose, nor do they offer the same kind of protection. Design patents are meant to serve the purpose of “promot[ing] the decorative arts,” and “improving the appearance of articles of manufacture.”³ Conversely, “the purpose of trade dress protection is to secure the owner of the trade dress the goodwill of his business and to protect the ability of consumers to distinguish among competing producers.”⁴ Further, design patents only offer protection for a fifteen-year term, while trade dress protection is potentially indefinite. Requirements for a finding of infringement also differ subtly but importantly between the two areas of law.⁵ Under both design patent and trade dress law, consumer confusion between the protected and infringing product is considered during the infringement analysis. Design patents protect “non-functional aspects of an ornamental design,”⁶ however, only trade dress law explicitly excludes the protection of functional features. Thus, despite their seemingly disparate ends and means of enforcing those ends, design patents and trade dresses often cover similar material. In *Apple v. Samsung*, the

Federal Circuit clarified the role of functionality in each scheme and which protection properly incorporates product configurations.

In the case at hand, the Federal Circuit evaluated trade dresses and design patents that generally related to features of the iPhone®,

The Federal Circuit's decision displays the power that design patents possess and draws an important distinction between trade dress and design patent protection. Namely, trade dress protection is not applicable to product configurations where the elements are functional in any respect, even if they simply improve the usability of the product.

including the shape of the device, the screen, the borders, the bezel, and the icons found on the display. Applying Ninth Circuit precedent, the Federal Circuit found that the trade dresses in dispute protected functional aspects of the device, and thus the jury verdict of trade dress dilution was inappropriate. As an initial matter, the court emphasized that trademark law, which may grant perpetual protection, should not be used to monopolize the use of functional features of a design,⁷ and that

product configuration trade dresses are rarely valid. In declaring the trade dresses functional, the court focused on the utilitarian benefits offered by their features. Significantly, the court implied that features that increase ease of use constitute a utilitarian advantage that weighs towards functionality.⁸ Further, Samsung presented undisputed evidence that suggested the “usability function” of every aspect of the alleged trade dresses, including the rounded corners, the rectangular shape, the flat clear screen, the bezel, and the icons. Though Apple attempted to argue that the trade dresses simply were directed to the beauty of its design, the court corrected, stating that “Apple pursued both ‘beauty’ and functionality in the design of the iPhone.”⁹ In summary, Apple was not able to produce substantial evidence to support a jury finding in its favor, and thus the Federal Circuit reversed the district court’s denial of Samsung’s motion for judgment as a matter of law that the trade dresses were functional and thus not protectable.

In disputing the jury verdict of design patent infringement, Samsung presented two main arguments. First, Samsung argued that its products and the asserted design patents were similar only insofar as the patents covered functional elements, and that such elements should have been removed from the infringement analysis. Second, Samsung asserted that Apple had not presented any evidence of actual deception of consumers, and that the district court had inappropriately treated its analysis of the prior art in determining that Samsung’s products infringed the asserted design patents.

The court rejected Samsung’s first argument that “the district court should have excluded elements that are dictated by their functional purpose, or cover the structural aspects of the article.”¹⁰ To make this point, Samsung relied on two Federal Circuit cases, *Richardson v. Stanley Works*,¹¹ and *Lee v. Dayton-Hudson*.¹² However, the court did not agree with Samsung’s characterization of those cases. Instead, the court noted that

“the language ‘dictated by their functional purpose’ in *Richardson* was only a description of the facts there; it did not establish a rule to eliminate entire elements from the claim scope as Samsung argues.”¹³ Further, *Lee* “did not specify a rule, as Samsung represents, to eliminate [structural] elements from the claim scope of a valid patent in analyzing infringement.”¹⁴ In rejecting Samsung’s plea to exclude functional elements of Apple’s design from the claim scope, the court implied that the sole reason for distinguishing nonfunctional and functional aspects of a patented design is to consider only the “ornamental aspects” of those functional elements during the infringement analysis.¹⁵ Thus, while the court did not confirm or deny that Samsung’s products only included functional aspects of the asserted design patents, such an observation would have been moot. The court held that the design patents were valid and Samsung’s products included the elements of the asserted claims. Thus, the design patents were infringed and Samsung was liable for the associated damages.

The court dismissed Samsung’s second argument even more quickly. Samsung had argued that *Gorham Co. v. White*¹⁶ and *Egyptian Goddess, Inc. v. Swisa, Inc.*¹⁷ dictated that a design patent is infringed if an ordinary observer would have been deceived by the competing product and that copying features that are distinct from the prior art weighs in favor of a finding of actual deception. Samsung argued that the jury instructions should have reflected this precedent. According to Samsung, however, “portions in the infringement instruction . . . made the jury consider a lack of actual deception irrelevant and led the jury to disregard the prior art.”¹⁸ Again, the Federal Circuit disagreed. Judge Prost wrote, “[w]e conclude instead that the jury instruction simply clarified that actual deception was not required, which is an accurate reflection of the analysis in *Gorham*,”¹⁹ and “the jury instruction expressly required that each juror ‘must’ consider the prior art admitted at trial.”²⁰ Accordingly, Samsung failed to meet its burden of proving that the jury instructions did not fairly and correctly cover the substance of the applicable law.

The Federal Circuit next upheld the lost profits damages awarded to Apple in the jury verdict. In rejecting Samsung’s arguments in favor of an “apportionment” requirement, the court invoked 35 U.S.C. § 289, which explicitly

provides that one who infringes a design patent “shall be liable to the owner to the extent of his total profit.”²¹ Thus, the court found that there had been no legal error in the jury instruction on design patent damages.

The Federal Circuit’s decision displays the power that design patents possess and draws an important distinction between trade dress and design patent protection. Namely, trade dress protection is not applicable to product configurations where the elements are functional in any respect, even if they simply improve the usability of the product. Design patents, on the other hand, are more loosely bound by functional aspects. The Federal Circuit’s decision to exclude apportionment requirements from the damages calculation of design patent lost profits likewise makes them a powerful form of protection for product configuration designs. Thus, design patents offer superior protection of product configurations than do trade dresses.

It is still unclear how applicable this decision is to cases outside the scope of product configuration designs. The Federal Circuit was quick to point out the limited enforceability of trade dresses that purport to protect product configurations, and set a low bar for functionality in such cases. Meanwhile, valid design patents protecting product configurations are likely to enjoy enforceability, regardless of the inherent functionality provided by their various elements.

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McDonnell Boehnen Hulbert & Berghoff LLP has been favorably ranked among top law firms in the 2015 edition of *IAM Patent 1000 – The World’s Leading Patent Practitioners*. Published by Intellectual Asset Management (IAM) magazine, *IAM Patent 1000* is a unique guide that identifies the top patent practitioners in key jurisdictions around the globe. MBHB is recognized in the 2015 edition of *IAM Patent 1000* as follows:

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Endnotes

- 1 Duraco Products, Inc. v. Joy Plastic Enterprises, Ltd., 40 F.3d 1431, 1434 (3d Cir. 1994).
- 2 Apple Inc. v. Samsung Elec. Co., Ltd., 786 F.3d 983 (Fed. Cir. 2015).
- 3 Hueter v. Compco Corp., 179 F.2d 416, 417 (7th Cir. 1950).
- 4 Fair Wind Sailing, Inc. v. Dempster, 764 F.3d 303, 308 (3d Cir. 2014).
- 5 See Sears, Roebuck & Co. v. Talge, 140 F.2d 395, 395-396 (8th Cir. 1944) (Discussing a typical test for design patent infringement.); see also Fair Wind Sailing, Inc. v. Dempster, 764 F.3d at 309 (Discussing a typical test for trade dress infringement.).
- 6 See Amini Innovation Corp. v. Anthony California, Inc., 439 F.3d 1365, 1371 (Fed. Cir. 2006).
- 7 See *Apple*, 786 F.3d at 991.
- 8 See *id.* at 993.
- 9 *Id.* at 994.
- 10 *Id.* at 998.
- 11 *Richardson v. Stanley Works, Inc.*, 597 F.3d 1288, 1294 (Fed. Cir. 2010).
- 12 *Lee v. Dayton-Hudson Corp.*, 838 F.2d 1186, 1188 (Fed. Cir. 1988).
- 13 *Apple*, 786 F.3d at 998.
- 14 *Id.* at 999.
- 15 See *id.* at 998 Citing *OddzOn Prods., Inc. v. Just Toys, Inc.*, 122 F.3d 1396, 1405 (Fed. Cir. 1997) The court declared that “[w]here a design contains both functional and nonfunctional elements, the scope of the claim must be construed in order to identify the non-functional aspects of the design as shown in the patent.” But in distinguishing *Richardson*, the court noted that “the claim construction in *Richardson* did not exclude [functional] components in their entirety. Rather, the claim construction included the ornamental aspects of those components. . . .”
- 16 *Gorham Co. v. White*, 81 U.S. 511, 528, 14 Wall. 511, 20 L.Ed. 731 (1872).
- 17 *Egyptian Goddess, Inc. v. Swisa, Inc.*, 543 F.3d 665, 678 (Fed. Cir. 2008).
- 18 *Apple*, 786 F.3d at 1000.
- 19 *Id.*
- 20 *Id.*
- 21 *Id.* at 1001-02.

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Similarly, the court found that Aleynikov could not have had an “intent to appropriate the use” of the high-frequency trading code. Under the New York Penal Law:

To “appropriate” property of another to oneself or a third person means (a) to exercise control over it, or to aid a third person to exercise control over it, permanently or for so extended a period or under such circumstances as to acquire the major portion of its economic value or benefit, or (b) to dispose of the property for the benefit of oneself or a third person.²⁹

The former definition applies to the Unlawful Use of Secret Scientific Material statute, the latter definition to the larceny statute. Thus, there were two questions that the court had to answer. First, what does “the major portion of [property’s] economic value or benefit” mean? And second, can it be defined independently from the rightful owner’s retained value or is it a zero-sum definition?

Based on dictionary definitions and the context of the statute, the court found that “the major portion” would have to be the majority of the value.³⁰ Importantly, the definitional statute of “appropriate” uses the definite article, indicating that there can be only one major portion.³¹ And a Federal district court considering the same question came to the same result, rejecting arguments that “the major portion” could be a significant, but minority, portion.³²

The court also found that appropriation would have to be a “zero-sum game,” where a defendant would not only obtain benefits but also deprive the rightful owner of the same benefits. To the extent that such a result was not compelled by the relative definition of “the major portion,” it was supported by case law on larceny and the Rule of Lenity.³³ Because Aleynikov had not taken most of the value of the code from Goldman (and no evidence was introduced that supported a valuation of the code, its value to Aleynikov, or its remaining value to Goldman), his conviction could not stand.

Finally, despite the outcome of the *Aleynikov* case itself, the court noted that efforts were underway in the New York legislature to plug the holes into which the conviction had fallen.³⁴ While those updates to the law would not rescue Aleynikov’s conviction, they would have the same effect as the amendments of the EEA in punishing later misdeeds.

Despite the court’s careful decision and

the steps already being taken to fix the statute, the prosecution chose to appeal the court’s dismissal of Aleynikov’s conviction. On July 24, 2015, it filed a notice of appeal. Thus, an appellate panel will consider whether conduct like Aleynikov’s could violate the Unlawful Use of Secret Scientific Material statute.

Conclusion

Sergey Aleynikov is in the remarkable position of having been tried twice for the same acts, having two juries find him guilty, but having been absolved by two different courts. He also has been the driving force between an amendment to a Federal statute and, most likely, his absolution will be the cause for an update of state laws as well. However, his situation goes to show how poor a fit current criminal statutes are to the fast-moving virtual world. That is one of the reasons that numerous parties have sought a Federal trade secrets law, which would allow private parties to bring civil suits to enforce their rights. Such a law, the Defend Trade Secrets Act of 2015, has been introduced in Congress and may prove to be the best tool for combatting acts like Aleynikov’s.

Endnotes

- 1 United States v. Aleynikov, 737 F. Supp. 2d 173, 177, 185 (S.D.N.Y. 2010). Aleynikov was also indicted on a charge of unauthorized computer access in violation of the Computer Fraud and Abuse Act (“CFAA”), 18 U.S.C. § 1030(a)(2)(C), but that charge was dismissed by the trial court. *Id.* at 190–94.
- 2 Economic Espionage Act of 1996, Pub. L. No. 104-294, §§ 1831–39, October 11, 1996, 110 Stat. 3488.
- 3 18 U.S.C. §§ 2311–15 (2006).
- 4 Economic Espionage Act of 1996 § 1832.
- 5 United States v. Aleynikov, 676 F.3d 77, 82-83 (2d Cir. 2012).
- 6 *Id.* at 79.
- 7 *Id.* at 82.
- 8 Pub. L. 112–236, § 2, Dec. 28, 2012, 126 Stat. 1627.
- 9 People v. Aleynikov, No. 04447/12, slip. op. 1 (N.Y. Sup. Ct. July 6, 2015). The Manhattan DA’s office offered Aleynikov a plea bargain: if he pled guilty to one of the counts, they would agree to drop the other charges and seek no time beyond the one year he had already served awaiting trial on the Federal charges. Aleynikov rejected the plea deal.
- 10 N.Y. Pen. L. § 165.07.
- 11 N.Y. Pen. L. § 156.30.
- 12 People v. Aleynikov, slip. op. at 72.
- 13 *Id.* at 26–27.
- 14 *Id.* at p. 27.
- 15 *Id.*
- 16 *Id.* at p. 28.
- 17 *Id.* at p. 29.
- 18 *Id.* at p. 32.
- 19 *Id.*
- 20 *Id.* at p. 33.
- 21 *Id.*
- 22 *Id.* at p. 35.
- 23 United States v. Agrawal, 726 F.3d 235 (2d Cir. 2013).
- 24 *Id.* at 252.
- 25 People v. Aleynikov, slip. op. at p. 38–40.
- 26 *Id.* at 40 (citing People v. Kent, 19 N.Y.3d 290 (2012)).
- 27 *Id.* at 41–44.
- 28 *Id.* at 44 (quoting People v. Golb, 23 N.Y.3d 455, 468 (2014)).
- 29 N.Y. Pen. L. § 155.00(4).
- 30 People v. Aleynikov, slip. op. at 49.
- 31 *Id.*
- 32 *Id.* at p. 50 (quoting Perfect Curve Inc. v. Hat World Inc., 988 F. Supp. 2d 38, 60–61 (D. Mass. 2013)).
- 33 *Id.* at 51–57.
- 34 *Id.* at 69–72.

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