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INTELLECTUAL PROPERTY ISSUES IN E-COMMERCE

By: *Herbert J. Hammond*¹ & *Justin S. Cohen*²

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I. INTRODUCTION

Today's companies face an incredible array of intellectual property issues, particularly when conducting business online. Forrester Research expects U.S. e-commerce retail sales to grow by over 10% per year and reach \$278.9 billion in 2015.³ As e-commerce business increases and utilizes new technologies, e-commerce companies are likely to see a surge in IP issues and litigation. This Article discusses several of the more significant IP issues that an e-commerce company

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3. Sucharita Mulpuru et al., *US Online Retail Forecast, 2010 to 2015*, FORRESTER RESEARCHER (Feb. 28, 2011), http://www.forrester.com/rb/Research/us_online_retail_forecast%2C_2010_to_2015/q/id/58596/t/2?src=RSS_CustomFeed&cm_mmc=Forrester_-RSS_-Document_-23.

is likely to encounter and provides several strategies for dealing with such issues.

II. PATENT INFRINGEMENT

Every e-commerce company needs to understand patent infringement since e-commerce companies are often the target of patent infringement lawsuits. Anyone who owns a patent can sue for patent infringement. Under U.S. patent law, patent infringement includes the manufacture, use, importation, sale, or mere offer to sell a patented product.⁴ A patent owner can sue e-commerce companies that do nothing more than merely offer to sell another company's products.⁵ In the e-commerce world, patent infringement cases usually involve the sale or offer for sale of patented products on a company's website or some basic technology used by many e-commerce companies. For example, a patent infringement claim may involve the operation of the website, mobile applications, payment processing, etc.

A. *How Much Will This Lawsuit Cost Us?*

Generally, a patent infringement lawsuit is expensive and exposes a defendant to significant potential liability. Liability for infringement not only includes the patent owner's damages but can also include the patent owner's attorneys' fees and an injunction.⁶ Patent owners may, and often do, seek damages based on a "reasonable royalty,"⁷ which is a theoretical calculation of the amount that a licensee would be willing to pay through negotiations to license the patented technology. Even if a patent owner cannot show any damages, they are nonetheless entitled to a reasonable royalty.

Even if a case never goes to trial, patent infringement lawsuits are very expensive to litigate. Costs can range from just under \$500,000 through the end of discovery to over \$6 million through trial.⁸ Many patent infringement lawsuits are split into two trials—one to determine if a defendant infringes and a second trial to determine damages—thereby increasing the potential litigation expenses.

While there are many cost-saving defense strategies and potential cost sharing with co-defendants, even the weakest patent case still demands a great deal of time, money, and attention. In fact, Chief Judge Randall Rader of the U.S. Court of Appeals for the Federal Circuit

4. See 35 U.S.C.A. § 271 (West 2001 & Supp. 2011).

5. See *id.*

6. See 35 U.S.C. §§ 281, 283–85 (2006).

7. *Id.* § 284.

8. See *American Intellectual Property Law Association, Report of the Economic Survey*, INTELL. PROP. INS. SERVS. CORP., <http://www.patentinsurance.com/iprisk/aipia-survey/> (last visited Feb. 20, 2012) (providing further, additional statistics).

recently addressed the high costs of U.S. patent litigation.⁹ Judge Rader noted that IP lawsuits typically have disproportionately high discovery costs and noted one study that showed litigation costs for IP lawsuits are 60% higher than other cases.¹⁰ While most litigants are aware of the problem, there are few solutions currently in sight to cap the high cost of patent litigation.

B. *Where Can I Be Sued?*

Companies that do business over the Internet may be subject to lawsuits anywhere in the country. The patent venue rules governing where a party may be sued for infringement permit a suit to be filed in any federal district court in the country in which a defendant is “doing business.”¹¹ A party who sells products or provides services over the Internet probably does business or offers to do business, for federal jurisdiction purposes, in just about any state or district in the country.

Thus, a plaintiff can typically haul an e-commerce company into plaintiff-friendly jurisdictions, such as the U.S. District Court for the Eastern District of Texas. One survey showed that the Eastern District of Texas had the second-highest success rate for plaintiffs and the third-highest average damages awards in patent cases among all district courts in the United States, coupled with what is typically a short time to trial.¹²

The recent patent reform act¹³ places some limits on suing many accused infringers in one lawsuit when the accused infringers come from different industries and businesses but did not affect the ability for a patent owner to choose a friendly venue in which to file suit.¹⁴ Recently, instead of suing many defendants together, some plaintiffs have simply filed several lawsuits on the same day in the same court, grouping defendants by industry or business.

C. *What About Third Party Products or Services?*

When a company sells its own products online, the patent issues are virtually no different than they are in the brick-and-mortar world. But companies that sell someone else’s products over the Internet face some unique patent issues. Many of today’s Internet retailers of-

9. Chief Judge Randall R. Rader, U.S. Court of Appeals for the Federal Circuit, *The State of Patent Litigation*, at E.D. Texas Judicial Conference (Sept. 27, 2011), available at <http://www.patentlyo.com/files/raderstateofpatentlit.pdf>.

10. *Id.* at 7.

11. See 28 U.S.C. § 1391(f)(3) (2006).

12. CHRIS BARRY ET AL., *THE CONTINUED EVOLUTION OF PATENT DAMAGES LAW 21* (2010), available at <http://www.pwc.com/us/en/forensic-services/publications/assets/2010-patent-litigation-study.pdf>.

13. Leahy-Smith America Invents Act, Pub. L. No. 112-29, 125 Stat. 284 (2011) (codified as amended in scattered sections of 35 U.S.C.).

14. See 35 U.S.C.A. § 299(a)(1) (West, Westlaw through P.L. 112-86 (excluding P.L. 112-55, 112-56, 112-74, 112-78, and 112-81)).

fer hundreds, if not thousands, of products for sale that are made by someone else. In addition, many Internet retailers are not limited by warehouse or shelf space since many drop-ship their listed products.

Drop-shipping, which is now a common online business model, means that the retailer does not maintain an inventory of products but merely takes orders online from a customer and simply electronically transmits those orders and shipping information to a distributor (or manufacturer) that then ships the product directly to the customer. The retailer accepts payment, takes a commission on the sale of the product, and remits the balance of the payment to the distributor.

Some Internet retailers allow other companies to use their website to take orders and sell products, while others operate websites for other companies using their website resources in addition to operating their own. While a customer thinks he or she is ordering a product from Company X, he or she may be ordering that product from a website maintained by Company Y, which is hosting Company X's website or allowing Company X to use its website (e.g., Amazon hosted Borders.com's website for a time). There are variations of these models, of course, but the point is that online business models allow companies to offer to sell products that they do not physically have in their inventory.

Today's Internet retailers may list and sell products from a far wider variety of sources than ever before. But, such freedom comes with consequences. One such consequence is that the Internet makes it easy for a patent owner to find potential infringers selling a product or service and to target them in a lawsuit. Patent owners who traditionally sued only the manufacturer of such products are now targeting retailers, especially where the manufacturer is offshore or does not have the financial wherewithal to be responsible for its infringing acts. Suing a large Internet retailer for infringement is also a way to indirectly pressure the manufacturer of a potentially infringing product to stop making the product or to pay for a license.

Another consequence of such Internet business models is that the Internet retailer may have very little knowledge of or information about many of the products they sell. Many companies face similar problems even when the patent owner is targeting the company's technology. For example, many companies rely on third parties to provide the underlying technology accused of infringement. Examples include aspects of a company's website, database, payment processing system, order fulfillment, marketing, and information security.

By simply operating a website, regardless of what products or services it sells, a company can be liable for patent infringement. Nearly every major retailer selling products through its website has been sued

for patent infringement based on the operation of its website.¹⁵ These cases are potentially more serious than cases involving a particular product because losing may involve a large amount of damages and also the potentially catastrophic possibility that the court will issue an injunction shutting the website down.

When the accused product, service, or technology is provided by a third party, one of the first things a defendant should do is investigate whether the third party has an indemnification obligation. In such scenarios, indemnification plays an important role for the Internet retailer accused of patent infringement since it could obligate the third party to defend the Internet retailer. However, many indemnification clauses/agreements have notice provisions that require prompt notice. Thus, researching the issue in a timely manner and promptly requesting indemnification from the third party may be very important.

D. *What About Those False Patent Marking Lawsuits?*

Lawsuits alleging false patent marking have had a meteoric rise and fall. In 2010, there were over 500 false patent marking lawsuits filed by *qui tam* plaintiffs and over 350 such suits filed in the first half of 2011.¹⁶ Generally, these lawsuits were brought by private individuals and companies that focused primarily on suing companies for false marking.¹⁷

However, the law recently changed significantly reducing the threat of these false marking lawsuits. Under the new law, only the U.S. government or someone that can show a “competitive injury” may sue a company for false patent marking.¹⁸

False marking claims arise when a patent owner marks its products as patented when they are not or when it continues to mark products as patented after a patent has expired. False marking lawsuits could have been filed by anyone against a person or company that actually marked a product or simply advertised a product as patented or patent pending.¹⁹ Although on the books for decades, the law became incredibly popular after a 2009 court ruling that damages for false marking may be as high as \$500 for *each* falsely marked article.²⁰ The false marking lawsuit against Solo Cup for falsely marking billions of

15. *Online Retail Companies like Amazon Sued for Patent Infringement by SFA Systems*, ALL ABOUT PATENTS (Aug. 2, 2011, 7:02 AM), <http://patentsind.blogspot.com/2011/08/august-01-2011-sfa-systems-plaintiff.html>.

16. See DOCKET NAVIGATOR, CASES ALLEGING FALSE MARKING (Sept. 30, 2011), available at <http://www.grayonclaims.com/storage/False%20Marking%20Cases.pdf>.

17. See R. Mark McCareins & Peter Slawniak, *Current State of Patent False Marking Litigation*, 23 INTELL. PROP. & TECH. LAW J. 3, 3 (2011), available at http://www.winston.com/siteFiles/Publications/77318_eprint.pdf.

18. 35 U.S.C.A. § 292 (West, Westlaw through P.L. 112-86 (excluding P.L. 112-55, 112-56, 112-74, 112-78, and 112-81)).

19. See 35 U.S.C. § 292(a) (2006).

20. See *Pequignot v. Solo Cup Co.*, 608 F.3d 1356, 1365 (Fed. Cir. 2010).

disposable cup lids had potential liability of over \$5 trillion.²¹ Although unrealistic, even a small fraction of such damages could be devastating to a company.

While a company can still face a false patent marking claim, it is now far less likely. In addition, if a competitor sues for false marking and alleges a “competitive injury,” the damages are no longer up to \$500 per falsely marked item but merely “damages adequate to compensate for the injury.”²²

III. TRADEMARKS

E-Commerce companies face many of the same trademark issues as seen in the brick-and-mortar world. For example, issues arising from the use of confusingly similar marks for related goods and services are the same whether the products and services are advertised and sold online or through more traditional channels. However, today’s Internet and technologies have created some unique trademark issues for e-commerce companies, particularly for domain name disputes and trademark infringement claims based on the sale of counterfeit or even genuine trademarked products.

A. *Protecting Your Trademarks*

As with any business, an e-commerce company should protect its trademarks by registering them with the U.S. Patent and Trademark Office and implementing a comprehensive enforcement policy. Typically, a policing and enforcement policy will include educating employees about how the trademarks can be used internally and externally, requiring routine searches for third party use (e.g., use of a trademark watch service), and enforcing trademark rights against third parties.

B. *Domain Name Disputes*

Domain names have become just as important, if not more important, than a company’s trademark, especially in e-commerce. For example, many Internet retailers and other e-commerce companies typically select domain names reflecting their corporate name or trademarks. This makes it easy for consumers to find a company’s website (e.g., Amazon.com, Staples.com, Apple.com, and NewEgg.com are but a few examples). In the business world, the American Bar Association and the American Bankers Association can coexist perfectly well, and both can be known as the “ABA” because nobody will confuse these two organizations. But both cannot use “ABA.org” for their domain name. In the e-commerce world, when one company

21. *Id.* at 1359.

22. 35 U.S.C.A. § 292(b) (West, Westlaw through P.L. 112-86 (excluding P.L. 112-55, 112-56, 112-74, 112-78, and 112-81)).

selects a domain name similar to that of another entity's domain name, corporate name, or trademark, the resulting dispute will fall into one of two categories—either cybersquatting or a legitimate domain name dispute.

Cybersquatting occurs when someone looking to profit reserves domain names that incorporate another entity's trademark and then offers to sell the domain name back to the trademark owner. While blatant cybersquatting is less prevalent today than it was in the 1990s and early 2000s, it still occurs. One variation of cybersquatting is that parties may register domain names for commonly misspelled trademarks or add a geographic region to the trademark.

In 1999, the Federal Trademark Act was amended to permit trademark owners to sue to force the transfer of a domain name that was acquired in bad faith.²³ However, many cybersquatters who register such domain names do not live in the U.S. and are not subject to a U.S. court's jurisdiction. However, a less expensive and effective method of resolving domain name disputes is through a Uniform Domain Name Resolution Policy ("UDRP") proceeding. A UDRP proceeding is far less expensive than a lawsuit and most are resolved within a few months. But the only remedy available through a UDRP proceeding is the transfer or cancellation of a domain name registered in bad faith.²⁴

Generally, a party complaining about another party's registration of a domain name must prove that the registrant lacks any legitimate right in the domain name grounded in a trademark or corporate name and that the registrant used the domain name in bad faith. Thus, when legitimate business uses of a domain name are in conflict, the first party to register the domain name will usually be entitled to keep it, no matter how famous the latecomer's name or mark may be.

One problem companies may face when attempting to select and use a new trademark is that the domain name may already be registered. In such cases, when the company cannot claim prior rights, the domain name may be kept by the first to register the domain name. Thus, prompt registration of a domain name for a new company, product line, or even product is critical to preempt registration by cybersquatters and to avoid legitimate domain name conflicts. Movie studios, for example, will register domain names for films years in advance. The domain name *ConspiratorTheMovie.com* for the movie *The Conspirator* was registered in 2005 while the movie was not released until 2011.²⁵

23. Consolidated Appropriations Act, Pub. L. No. 106-113, sec. 3002, 113 Stat. 1501A-545, 546-48 (1999) (codified as amended at 15 U.S.C. § 1125 (2006)).

24. See *Uniform Domain Name Dispute Resolution Policy*, ICANN (Oct. 24, 1999), <http://www.icann.org/en/dndr/udrp/policy.htm>.

25. *WHOIS Results for conspiratorthemovie.com*, NETWORKSOLUTIONS.COM, <http://www.networksolutions.com/whois-search/conspiratorthemovie.com> (last visited

C. Counterfeit Goods

The sale of counterfeit consumer goods or “knockoffs” remains a serious problem for trademark owners. While there is much speculation about how many billions of dollars of counterfeit goods are sold worldwide each year, anti-counterfeiting industry experts appear to agree that the figure is likely in the billions.²⁶ Like legitimate forms of e-commerce, the sale of counterfeit goods has moved from the flea markets and back alleys to the Internet and companies like eBay and Craigslist. The trademark laws are aimed primarily at people who apply an infringing mark to goods or services sold in commerce. However, a person can still be held liable when they induce another to infringe a trademark or continue to supply a product to someone whom they know (or have reason to know) is engaging in trademark infringement.²⁷

Counterfeiters are notoriously difficult to catch—especially since many are overseas and doing business nearly anonymously over the Internet. So trademark owners have resorted to suing online auction sites for contributory trademark infringement. Tiffany, for example, sued eBay because eBay users were selling counterfeit Tiffany jewelry through eBay’s site.²⁸ Unfortunately for Tiffany, the Second Circuit confirmed that eBay was not liable for contributory trademark infringement.²⁹ The court found Tiffany’s general allegations of counterfeiting insufficient to prove that eBay continued to provide service to those users that eBay knew were selling counterfeit products.³⁰ Moreover, the court found that eBay had a vigorous program for monitoring piracy and fettering out counterfeit products.³¹ eBay’s policy also delisted anyone engaged in selling counterfeit products or trademark infringement.³²

Based on *Tiffany*, it appears unlikely that the more established Internet auctions or resellers can be held liable for trademark infringement when one of their customers is selling counterfeit merchandise. However, companies that operate online auctions or sell products from sources whose legitimacy may be suspect are potentially liable for contributory infringement, particularly when they take no action to police their own website and fail to respond to complaints of infringement by trademark owners.

Feb. 13, 2012); *The Conspirator*, CONSPIRATORTHEMOVIE.COM, <http://www.conspiratorthemovie.com> (last visited Feb. 13, 2012).

26. U.S. Gov’t Accountability Office, GAO-10-423, *Intellectual Property: Observations on Efforts to Quantify the Economic Effects of Counterfeit and Pirated Goods* 18–24 (2010), available at <http://www.gao.gov/new.items/d10423.pdf>.

27. See *Inwood Labs., Inc. v. Ives Labs., Inc.*, 456 U.S. 844, 854 (1982).

28. *Tiffany (NJ) Inc. v. eBay, Inc.*, 600 F.3d 93, 96 (2d Cir. 2010).

29. *Id.* at 109.

30. *Id.*

31. *Id.*

32. *Id.*

To avoid liability for contributory infringement, an online site has to exercise diligence in identifying piracy and eliminating infringement when it comes to their attention. A comprehensive policy and system for handling complaints from trademark owners is one step to avoid liability for contributory trademark infringement.

IV. COPYRIGHTS

E-commerce companies must also be aware of copyright infringement issues. The Internet has significantly increased the ability to engage in, and also to identify, copyright infringement. For example, merely displaying copyrighted material on a website can constitute copyright infringement if done without the copyright owner's permission.³³ E-commerce companies must ensure that they either own the copyrights or have a license for material displayed on their websites.

Like contributory trademark infringement, e-commerce companies can also be liable for contributory copyright infringement if they allow others to use their website to exchange infringing material. A person can be liable for contributory copyright infringement if he or she has the right and ability to supervise infringing activities or if he or she has a direct financial interest in the infringing activity, regardless of that person's knowledge of the specific infringing acts.³⁴ This presents particular challenges for companies like Facebook, YouTube, and other social networking sites that allow or assist users to post content on their websites.

In the notorious *Napster* case, the Ninth Circuit found that Napster was liable for contributory copyright infringement.³⁵ Napster facilitated peer-to-peer sharing of digital music by providing a central index of data about which users had what music files and provided the software for allowing the users to share the music files.³⁶ Following the decision, Napster was shut down.³⁷ Notably, Napster was found liable for contributory copyright infringement because it had actual knowledge of specific infringement within its system, it encouraged and assisted others in engaging in infringement, and it materially contributed to the infringing activity.³⁸

33. *Perfect 10, Inc. v. Amazon.com, Inc.*, 508 F.3d 1146, 1160 (9th Cir. 2007) (holding that proof of copyrighted photographic thumbnail images displayed to Google users was prima facie evidence of infringement).

34. *A&M Records, Inc. v. Napster, Inc.*, 239 F.3d 1004, 1022 (9th Cir. 2001) (quoting *Fonovisa, Inc. v. Cherry Auction, Inc.*, 76 F.3d 259, 262 (9th Cir. 1996)).

35. *Id.* at 1021.

36. *Id.* at 1011.

37. *Id.* at 1029.

38. *Id.* at 1021–22.

V. CONCLUSION

Every e-commerce company should have a basic understanding of the IP issues that they are likely to face, particularly as e-commerce business grows. Whether dealing with patent, trademark, or copyright issues, understanding the fundamentals may help avoid a lawsuit or reduce expense and exposure down the road.