STAY CURRENT
A Client Alert from Paul Hastings

PAUL HASTINGS

July 2011

Don’t Miss The Mark: Why Deal Makers Should Not Overlook Recent False Marking Statute Decisions

BY JAMES M. J. HERRIOTT & TODD M. SCHNEIDER

Patent holders frequently mark products by stamping “patented” or “protected by U.S. Patent No. ________” on the article in order to put potential infringers on notice that the product is patent protected. The Patent Marking Statute (35 U.S.C. § 287(a)) limits the damages a patent holder may recover to those stemming from acts of infringement which occurred after an infringer was given actual or constructive notice of infringement. Marking a patented article establishes such constructive notice.

The 2009 Federal Circuit Court case of *The Forest Group, Inc. v. Bon Tool Co.*, which interpreted the federal False Marking Statute to impose up to $500 in penalties per mismarked article, created a bit of a firestorm among patent counsel[1], and raised the importance of conducting patent false marking diligence as a part of a party’s standard intellectual property related diligence for a deal. With potentially huge verdicts imaginable, the *Forest Group* decision sparked into action numerous disgruntled competitors and so-called “false-marking trolls”—adventurous patent counsel acting independently.

Court decisions within the past few months appear to be reducing the potential false marking risks, and with it the need for deal counsels’ vigilance. Indeed, bills are working their way through the U.S. House of Representatives and Senate which would amend the False Marking Statute so only the federal government could prosecute violations.

However, the legal authority on this point is still in flux and M&A practitioners and deal makers should stay tuned for future developments—and be sure to perform their IP diligence carefully and review intellectual property representations and warranties with an eye towards potential false marking exposure. The results of such diligence, while likely not rising to the level of killing a deal (in the absence of fraud or other purposeful abuse), may give one party additional leverage during negotiations.

Background

Although marking a patented article can establish constructive notice of infringement, the False Marking Statute (35 U.S.C. § 292) prevents businesses from gaining an advantage by marking “unpatented articles.” In particular the False Marking Statute provides that marking any unpatented article or advertising in connection with any unpatented article, with the word “patent” or any word or number implying that the article is patented for the purpose of deceiving the public shall be fined not more than $500 for every such offense. The statute also contains a *qui tam* provision which permits private citizens to raise and prosecute claims under the statute, with any penalties recovered to be split evenly between the plaintiff and the United States government.[2]

The False Marking Statute has been law in one form or another since 1870 and has not been amended since 1994. But the *Forest Group* case drew heightened attention to the False Marking Statute and significantly raised the stakes for companies that mark their products. Since January 1, 2010, plaintiffs have filed at least 700 cases claiming false patent marking.[3] The court in *Forest Group* found that the statute's $500 penalty limit applied on a per-article basis. Previously courts had held that the penalty applied for each distinct decision to falsely mark.[4] The difference in the two standards can be immense. For example, under the *Forest Group* standard, if a company created a label design for a can of tuna that referenced an inapplicable patent, the company could be subject to up to a $500 fine for each can onto which the label was affixed. In contrast, under the pre-*Forest Group* standard, the company would be subject to a total maximum fine of $500, regardless of how many cans displayed the incorrect label.

In fact, courts have been reluctant to assess the full $500 per article potential fine and have frequently instead based the per-article damages on a percentage of the revenue earned by the defendant on each article, perhaps factoring in how egregious the courts find the particular violation.[5] The *Forest Group* court itself noted that, "[i]n the case of inexpensive mass-produced articles, a court has the discretion to determine that a fraction of a penny per article is a proper penalty.[6] However, the court's discretion to charge significantly higher penalties for mass-produced items will likely give defendants concern.

The possibility of large damages has attracted a variety of plaintiffs to file claims under the False Marking Statute. Although a number of cases have been brought by competitors who believe other businesses have intentionally mismarked products to gain a competitive advantage, many claims seem to be brought by patent counsel who may have discovered possible violations by searching public patent records and hunting for markings on easily accessible consumer products.[7] Many claims have targeted companies that have continued to mark patent numbers on products after once-applicable patent have expired.[8] This type of claim may be easier to discover than certain other types of violations. However, because the False Marking Statute only penalizes defendants who had the purpose of deceiving the public, plaintiffs may have difficulty showing that defendants purposefully left the markings on products after the once-applicable patents expired.

Recent Developments May Reduce False Marking Risks

A March 2011 decision by the U.S. Court of Appeals for the Federal Circuit appears to have begun easing the pressure for defendants in false marking suits. The *In re BP Lubricants USA, Inc.* ruling held that false marking claims must be pled with particularity under the heightened standards of Rule 9(b) of the Federal Rules of Civil Procedures.[9] This decision erects a barrier for plaintiffs who must allege that defendants *had the purpose of deceiving the public* when they falsely marked products. Previously, many plaintiffs had simply alleged in their initial complaints that defendants knew or should have known that their patents had expired, perhaps because of the apparent size or sophistication. Plaintiffs could then hope to find more evidence of intent through the discovery process. After *BP Lubricants*, a plaintiff may not reach discovery unless it can offer in its initial complaint some objective indication that the defendant was aware the patent had expired.

Defendants have received help in recent months from a couple other directions. At least two district courts have found that the False Marking Statute's *qui tam* provision, which permits private parties to prosecute violations, is unconstitutional.[10] It remains to be seen whether any other court, including, the U.S. Court of Appeals for the Federal Circuit, will follow this decision.[11] Additionally, in March 2011, the U.S. Senate passed the “Patent Reform Act of 2011” which would permit only the government and businesses who have suffered competitive harm from false marking to bring claims under the False Marking Statute.[12] The House of Representatives passed a similar bill in late June 2011, which will now return to the Senate for reconciliation.[13]

Precautions to Protect Against Potential False Marking Claims

In light of the risks stemming from false patent marking, even though apparently declining, deal makers should be aware of the impact false patent marking liability may have on their proposed transactions. Additionally, attorneys representing clients in the purchase or sale of a business should consider what steps to take to identify and minimize false marking claim liability, and, in the case of an acquirer, to use any such identification to its advantage. Venture capital firms and other potential acquirers can employ independent counsel to review the validity and significance of a target companies’ patents, and review whether the target company’s products are properly marked. For companies with a very large catalog of intellectual property, financial and time constraints may limit such a review to certain key products. The results of this review may be used as leverage during transaction negotiations or to reduce the purchase price of the target.

For companies preparing to be acquired or to sell their assets, they may wish to consider performing similar diligence. If a company discovers any incorrect markings, companies and their counsel should discuss what corrective actions should be taken. Once a false marking is discovered, the company has knowledge of the situation which could be used to allege that the company intended to deceive the public. Therefore immediate action may provide evidence that the company did not intend to deceive and may prevent or reduce potential liability.

M&A practitioners should also consider potential marking risks when negotiating intellectual property representations and warranties. Similarly, parties should pay close attention to how any applicable indemnification caps and baskets would cover their risks. Representation and warranty insurance may be available to minimize the risks associated with potentially problematic representations. Also, parties should keep in mind the five-year statute of limitations for false marking claims with respect to the survival of representations and warranties and the duration of any escrow arrangement.

Finally, companies that have the luxury of time and have not yet started down the road to a possible sale transaction may wish to consider reviewing its patent markings, and establishing or reviewing policies with respect to when they will redesign product molds or labels that bear patent markings. Taking remedial steps to correct any identified false markings prior to the beginning of a potential sale transaction may prove valuable in minimizing or completely eliminating patent false marking liability from the issues surrounding the deal.

✧ ✧ ✧

If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

Atlanta

Walter E. Jospin
1.404.815.2203
walterjospin@paulhastings.com

Los Angeles

Rob Carlson
1.213.683.6220
robcarlson@paulhastings.com

New York

Kevin Logue
1.212.318.6039
kevinlogue@paulhastings.com

Orange County

James M. Herriott
1.714.668.6252
jamesherriott@paulhastings.com

Peter J. Tennyson
1.714.668.6237
petertennyson@paulhastings.com

San Diego

Carl R. Sanchez
1.858.458.3030
carlsanchez@paulhastings.com

Todd M. Schneider
1.858.458.3057
toddschneider@paulhastings.com

Jane I. Song
1.858.458.3043
janesong@paulhastings.com

Deyan Spiridonov
1.858.458.3044
deyanspiridonov@paulhastings.com

---

[1] 590 F. 3d 1295 (Fed Cir. 2009).

[2] Under 28 U.S.C. § 2462, plaintiffs may not bring a suit under the False Marking Statute more than five years from the time the claim accrued (i.e. the time the product was falsely marked). *Seirus Innovative Accessories, Inc. v. Cabela's, Inc., 3-09-cv-00102 (S.D. Cal. April 20, 2010).*

[3] Based on data provided through docketnavigator.com and grayonclaims.com.

[4] See *Pequignot v. Solo Cup Co*., 646 F. Supp. 2d 790, 801 (E.D. Va. 2009) citing *London v. Everett H. Dunbar Corp.*, 179 F. 506, 508 (1st Cir. 1910) which interpreted an earlier but similar version of the False Marking Statute.

[5] See *King Tuna, Inc. v. Anova Food, Inc.*, 2011 WL 839378 (C.D. Cal.) and *Custom Designs of Nashville, Inc. v. Alsa Corporation*, 2010 WL 2991247 (M.D. Tenn.).

[6] *Forest Group* at 590 F.3d at 1304.

[7] For example, Matthew A. Pequignot, a Washington, D.C. attorney, was plaintiff in the *Solo Cup* case and brought another false marking claim against Gillette and its parent company Procter & Gamble. *Pequignot v. Gillette*, No. 1:08-cv-00049 (E.D. Va.). Additionally, in *Stauffer v. Brooks Brothers*, the court found that patent attorney Raymond E. Stauffer, who acted pro se, had standing to sue Brooks Brothers under the False Marking Statute even though he did not allege any personal loss from Brooks Brothers patent markings. 619 F.3d 1321 (N.Y. 2010). However, as discussed below, courts recently have questioned the constitutionality of the False Marking Statute's *qui tam* provision which permits private plaintiffs to prosecute false marking claims.

[8] See, for example, *Solo Cup* and *Brooks Brothers*.

[9] Misc. Docket No 960 (Fed. Cir. 2011).

[10] See *Unique Product Solutions, Ltd. v. Hy-Grade Valve, Inc.*, 765 F.Supp.2d 997 (N.D. Ohio 2011) and *Rogers v. Tristar Products, Inc.*, 2011 WL 2175716 (E.D.Pa.).

[11] See *United States ex rel FLFMC, LLC v. Wham-O, Inc.*, Case No. 2011-1067, in which questions regarding the constitutionality of the False Marking Statute were preserved for appeal.

[12] See Senate Bill S-23. http://www.govtrack.us/congress/bill.xpd?bill=s112-23.

[13] See House of Representatives Bill H.R.-1249: America Invents Act. http://www.govtrack.us/congress/bill.xpd?bill=h112-1249.