Strategic Licensing in the New Economy

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Charles R. Neuenschwander, President, International Patent Licensing Company, Dallas, TX 75240. International Patent Licensing Company is a patent licensing firm specializing in patents that are being infringed through the manufacture or sale of products by companies that are not licensed. Services include using engineers and people with patent knowledge to evaluate patent portfolios and develop documented proof of infringement by third parties. Other services include licensing program management and the negotiation of patent license and financial agreements.

I. ABSTRACT

What should your intellectual property concerns be in the "New" Economy? Besides providing a brief practical tutorial on legal intellectual property rights that concern you and your enterprise, this paper shall discuss how your intellectual property can become profitable. Learn how to make wise decisions concerning what to patent, as well as how to make patenting more affordable by speeding up the application process. Also learn how you can make intellectual property pay off by weighing the pros and cons

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Dear Subscribers;

In this issue of *Corporate Counsel's Licensing Letter,* we are pleased to include three concise and informative articles discussing licensing issues. The first, by Dennis Fernandez of Fernandez & Associates LLP, and Charles R. Neuenschwander of International Patent Licensing Company, discusses taking a strategic approach in the licensing of intellectual property. The second, by Benjamin Hershkowitz and Robert D. Carroll of Goodwin Procter LLP, sets out ten steps to ensure software licensing compliance. The third, by Duncan Curley and Lisa M. Ferri of McDermott Will & Emery LLP, discusses gray market goods. We would like to thank these authors and their firms for allowing us to share their articles with our readers.

Very truly yours,
Jeanne D. Wertz
Senior Attorney Editor

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of business acquisition, litigation, and strategic licensing. Learn how to create a licensing strategy that enhances your existing business plan. Finally, this article will show you how to get the most out of your license agreement.

II. MAKING IP PROFITABLE

Intellectual Property, collectively defined as patents, trademarks, copyrights, maskworks, and trade secrets, is an important asset to any company in the new economy. IP can add value to your business through acquisition, litigation, or licensing. However, to maximize your profits, it is crucial to make wise, informed decisions concerning IP management. This paper will step through the various aspects of IP management, and at every turn will propose guidelines to increase your return.

Although this paper will focus primarily on patents, many of the strategies disclosed are also applicable to other types of intellectual property.

III. DEVELOPING YOUR PATENT PORTFOLIO

A. General Patent Strategy for the New Economy

In today's economy, possessing a strategic patent portfolio is more important than ever. However, it is increasingly important to make intelligent choices when developing your portfolio. Opt for quality rather than quantity—holding a few key patents will be incredibly useful from a strategic standpoint. To this end, it is beneficial to make wise decisions concerning which patents to pursue. Furthermore, expediting the patenting process will make patenting more affordable.

B. Deciding Whether to Patent

Today, smart companies apply for patents for three reasons. The first is to exclude others from using its technology to compete against it in the marketplace. The second is to use as a bargaining chip in cross-licensing situations, either in a proactive manner or as a response to charges of infringement by others. The final reason is to increase the companies profits through royalties paid by others. If none of these justifications are valid, applying for a patent is a waste of money and engineering/management time.

In evaluating a prospective patent, the following questions may help determine the value of the patent:

— Is there demand? If the invention represents a significant breakthrough, such as dramatically decreased manufacturing cost or significantly improved performance, a patent covering the invention will be extremely valuable.

— Is it likely that others are developing in the same technical area and could potentially exclude your participation through judicious patenting of their own? If so, you have little choice but to patent as quickly as possible.

— Is the invention fully developed? If not, the cost of implementation may be unclear, or innovative developments may not yet be discovered. If there is little chance that a competitor will file a similar patent application, it is prudent to wait until all aspects of the invention are fully understood.

— Are there available alternatives? If alternatives exist, the invention must offer benefits that offset the cost of pursing a patent.

— Is demand limited? If so, how big is the niche? If the market for the invention is small, or the invention is related to an obsolescent technology or standard, the cost of patenting must be weighted against the potential profits.

— Can the invention be maintained as proprietary? If related inventions are already known, can claims be made which are narrow enough to be patentable, but still protect the invention? Does someone else own technology that is needed for the product?

C. Expediting the Patent Process

In order to lessen the cost of patent prosecution, several steps can be taken to simplify and expedite the process. Furthermore, because the duration of a patent is 20 years from the filing date, shortening the time between filing and issue extends the useful life of the patent; this extended lifetime translates to increased revenue from the licensing or sale of the patent.

Several strategies should be employed in order to minimize the time to issue. Firstly, provisional patent applications should be avoided unless absolutely necessary (for example, if the competition is working on a similar project or if the details of the invention need to be publicly disclosed). With a provisional application, you are able to lock in a early filing date, however, the USPTO does not review the provisional until it is converted to a non-provisional. Since inventors have a year to activate, they often wait until the end of the one-year period to activate and thus, adding a year to the prosecution of the patent. Furthermore, the inventor should submit Invention Disclosure Statements to the US Patent and Trademark Office. These IDSs should contain all relevant information, including sources for ideas, articles regarding similar technologies, competitive ideas from other companies, or any previous technologies that the invention builds upon. Submitting this information to the USPTO will expedite the Examiner's search and response, which in turn will expedite the issue of the patent. In many cases, a patent may also be submitted with a Petition to Make Special, which will make the application high-priority within the USPTO. It should be noted, however, that this Petition should be submitted concurrently with the application, as submitting the Petition later may actually slow down the patenting process.

Furthermore, there are several steps that can be taken in drafting the application to minimize the communication between the Applicant and the USPTO. The specification should be comprehensive; this also gives you greater flexibility to add claims at a later date. The claims section should include both narrow and broad claims, and none of the claims should be so broad that it encompasses prior art. Furthermore, the drawings that are initially submitted should be the drawings that will be published; this saves the time of submitting first informal, then formal drawings.

In addition, ensuring that responses to Office Actions are filed promptly within the statutory period will eliminate unnecessary fees.

IV. STRATEGIC LICENSING

A. How Licensing Can Add Value to Your Business

Licensing technology may provide a low-risk way to capitalize on your intellectual property assets. Due to the high cost of manufacture and the comparatively small investment of a licensing program, many of the risks that a company would otherwise face in exploiting its intellectual property are transferred to the licensee. Depending upon the exclusivity of the license, there are varying degrees of risk involved for the licensee and licensor; however, an effective license strategy will minimize risk for both parties. Before a company considers licensing out its technology, however, it should consider whether other ways of taking advantage of its property, such as joint ventures and strategic alliances with other companies, would better compliment its economic position. Once licensing is decided upon, the nature of the company as well as the particular property it wishes to utilize should be carefully considered before deciding the architecture of the license.

B. Alternatives to Licensing

In deciding how to most profitably mobilize intellectual property, a company should consider a wide range of options.

— New Venture—If the product and the supporting business-structure exist in the company, though the risks are high, beginning a new venture of developing, marketing, and selling a product provides an opportunity for the highest reward for the intellectual property.

— Acquisition—Buying a new company is less risky than beginning a New Venture because much of the costly development has been completed and the infrastructure for a successful production line is in place.

— Strategic Alliance—If two companies share mutual interests, it may behoove both to consider forming an alliance that would enable profit-sharing. Through an alliance, firms may either use each other's manufacturing skills to take complete advantage of a market, or one company may agree to market and sell products manufactured by another company.

— Joint Venture—When two companies have more than a few ideas in common, they may wish to consider forming a third company as a joint venture. If the skills and resources of the participants are particularly complimentary and both sides are willing to diplomatically deal with the risks, rewards and operation of the company, then this is certainly an appealing option.

C. The Benefits of Licensing

By licensing out its technology, a company may generate income from unused portions of its intellectual property. In addition to making this potential energy kinetic, licenses enable a company to exploit other markets by allowing the licensee to apply the existing technology to a different market. When an invention is useful to several industries, licensing can prove profitable to both the licensor and the potential licensee as experts in separate fields.

Licensing out is not only a good way for a company to enable its invention to reap the benefits of other industries but also a way to capitalize on the potential of foreign markets. Licensing to firms for production and distribution to different populations can enable a company to further profit from its technology while protecting itself from the overhead required to participate in foreign markets.

Licensing out offers the additional benefit of allowing the licensee to advertise itself better as well as to make improvements (which can give the licensee varying degrees of liberty, thereby making the license more desirable) upon the invention.

In today's environment, enforcement of intellectual property rights has become common. Companies actively mine their patents and analyze activities in the marketplace to determine if any of their patented technology is being used by others. In major markets, the royalty value may be quite large. If infringement is found, a company can determine whether to attempt to license the infringer or immediately file a lawsuit, an action that can be quite expensive.

Before licensing in technology, a company should ask itself whether the invention is something it can develop in-house and, if so, whether the time and cost involved are worth the expected return and whether or not it can do this in a manner not to infringe on any one else's patents. When looking at potential technology to license in, the company should carefully consider whether the property in question fulfills its production and marketing needs.

The terms of the license are the most important aspect for the future licensee, and he must look carefully at these terms, negotiating with the licensor until issues such as long-term profitability/room for growth as well as royalties are resolved to suit both parties. The final consideration for a company to make in acquiring intellectual property through licensing in is whether the licensor is capable of fulfilling its obligations to the licensee financially and otherwise and whether, if additional support may be required later on, the licensor will have sufficient resources to further enable the licensee's production.

D. Questions to Consider When Licensing

Does the Strategy Fit?—When considering a licensing strategy, a company should look closely at how the licensing program will fit into the overall business plan of the company. The most ideal strategy should not only compliment but enhance a company's product line while providing an even more attractive position for the company *vis-a-vis* the market in which it participates. One way of ensuring that interference in this market is minimized is to only license to other markets or for use in foreign economies. Another good piece of advice is to use particularly stringent terms of licensing agreements when dealing with competitors. Additionally, if a company is attempting to license a technology that has been standardized, then it may be wise for it to decide not to compete with its licensees by avoiding the manufacture and sale of products in the markets where it knows it has licensed technology. Making a market or territory restriction in the licensing terms may prove beneficial to both parties as well.

Can Cross-licensing be Used?—When the prospective licensee owns intellectual property of interest to the licensor, cross-licensing is a relatively low-risk way of enabling both parties to exchange intellectual property. When such extensive intellectual property portfolios are involved in an agreement as with large corporations, cross-licensing becomes particularly attractive as rights to intellectual property may be exchanged while no royalty payments are involved or a balancing payment is worked out. However, in this scenario, terms regarding ownership of improvements on the cross-licensed technology needs to be clearly stated in the agreement.

Does the Licensee have the Appropriate Resources?—Ensuring that the licensee has the revenue to carry the product program through is essential for the licensor. After investing the time and money that it takes to sell a license, a licensor must expect the investment in the licensee to be a sound and profitable one that will matriculate as many royalties as possible from the intellectual property.

E. Determining the Financial Value of a License

At its heart, the value of a license is based on the impact to the licensee should it not be able to use the patented technology. The licensee must determine the implications of avoiding the markets requiring the technology; the cost of finding a non-infringing substitute for said technology or the cost and likelihood of defeating all the patents in litigation. Having said that and particularly in a friendly technology licensing situation where there is no concurrent infringement, some practical issues should be addressed when setting the value of a license.

Both parties should feel that the financial terms of the agreement suit them. The licensor should not expect to earn royalties in excess of the value it can expect a given technology to add to the product of the licensee. Another aspect of a license agreement that can prove prohibitive is the requirement of large initial payments especially of potential licensees who are particularly small and do not have sufficient cash flow to make such a great investment right off the bat.

Are Additional Licenses Required?—The licensor should attempt to foresee any additional licenses that the product of a licensee may require for manufacture. At this point, detecting the benefit of the licensor's particular technology to the product of the licensee is particularly essential in determining the royalty shares of the multiple licensors. Furthermore, both parties should make a careful analysis of all the licensing costs involved, as the total cost of the licenses may drive the retail price of the product up out of the market.

V. TERMS OF THE LICENSE AGREEMENT

A. Long-term vs. Short-term Agreements

In a long-term license, the up-front payment is usually relatively small, and the subsequent royalty payments form the bulk of the financial compensation. Such an agreement is usually mutually beneficial if the licensee is a small, cash-poor company. The attendant risk to use of a running royalty versus a larger up-front payment, however, is the chance the licensee may encounter financial difficulties or strategic alternatives leading to a premature exit from the market.

In a short-term license, the bulk of the payment is made in a larger up-front payment. In the most extreme case, this license may consist of one lump payment to cover past infringement. Such a license is suitable with an uncooperative or infringing licensee. This type of agreement is also useful when the licensing company wishes to liquidize its assets.

B. Exclusive vs. Non-Exclusive Agreements

Whenever possible, the parties should attempt to engage in a non-exclusive license. This provides benefits for both the licensor and the licensee. Firstly, there is less risk involved for both parties; the licensor is not dependent on the success of one product, and the lower licensing fee minimizes the risk of the venture for the licensee. In addition, the licensor retains more control over the product. Furthermore, the reduced royalty fees reduce the cost of the product, which can increase the market share. Lastly, licensing to several companies increases the likelihood that improvements on the technology will be made; these improvements can benefit the licensor and all the licensees.

If the licensee desires an exclusive license, the licensor should ensure that several criteria are met. Firstly, the licensor must consider whether an exclusive license is the best way to exploit the potential of the technology. In addition, substantial research should be conducted into both the technology and the licensee to ensure that the resulting product will be clearly superior to its competitors and will be able to garner a large market share. Finally, the licensor must be persuaded that the licensee has the marketing and production resources to make the product successful, and that the licensee is willing to commit these resources. The licensor may also wish to consider limited period exclusivity.

C. Improvements on the Technology

Both parties should carefully consider the proprietary rights of improvements made to the technology during the license term. It is beneficial to the licensor to gain rights to any improvements made by the licensee. Likewise, it is beneficial to the licensee to gain rights to any improvements made by the licensor. Furthermore, if the license is non-exclusive, the licensee may also be able to incorporate improvements made by other licensees. The rights to improvements may be included free of charge with the license, or the license agreement may stipulate a payment to be made by either party in return for intellectual property rights for the improvements.

D. Sublicensing

Unless the agreement specifically states otherwise, the licensee is allowed to sublet to other parties. The licensing party should be aware that it may lose direct control over the technology if the licensee sublicenses the intellectual property. If sublicensing is allowed, the terms and conditions should be explicitly stated in the agreement.

VI. CONCLUSION

A sound Intellectual Property portfolio can prove your company's most essential asset. Knowing how to craft valuable patents for your ideas as well as how to exercise the intellectual property you may already have is critical to maximizing your company's profit.

10 Simple Steps to Ensure Software Licensing Compliance*

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One area where companies can easily get into trouble is having unlicensed software on company computers. Computer software is protected under the U.S. Copyright Act. The Copyright Act provides for strict liability for possessing or using unlicensed software, meaning that your company may be liable for having unlicensed software, even if management does not know about the software or intend to use it. Additional penalties for intentional infringement also exist. The Copyright Act allows for the recovery of damages between $750 and $30,000 per copy of unlicensed software (with damages that may be reduced below that range for innocent infringement and enhanced above that range in the case of willful infringement). Liability for copies of unlicensed software could add up quickly to a large amount if your company were sued when it was not in full compliance. A typical office computer will have a substantial number of computer software programs, including for example, operating system, e-mail, word processor, spreadsheet, document management, virus protection, graphics, etc. If even one program per computer is unlicensed the liability can be tremendous. Here are 10 simple steps to ensure that your software licensing is compliant and up to date.

1. Direct all software purchases through a central purchasing or information technology department.

Directing all software purchasing through a central purchasing department, or through your company's information technology department, will simplify the tasks of controlling software purchases and installation, maintaining records of licensing and installation, and ensuring that unused or outdated software is deleted. Central purchasing has the added advantage of maintaining all of the licenses for the software at a single location and making sure that software is purchased only through proper channels.

2. Implement a streamlined method whereby business units or departments may rapidly get requests for necessary software approved and filled by a central purchasing department.

In order to get all business units or departments to channel their software purchasing through a central department, it is helpful to implement a simple method whereby different departments may request software purchases and installation and have those requests answered quickly. By providing a mechanism for a prompt response to a software request, it is less likely that an employee will simply go out and "acquire" software outside.

3. Buy software from an authorized software reseller.

Using a software reseller which is authorized by the company that produced the software ensures that the software is genuine and that the producer will recognize the license provided by the reseller. Most software companies provide lists of authorized resellers on their websites.

4. Keep detailed records of all purchases and license agreements in your central purchasing or information technology department.

If your company is sued for copyright infringement or presented with a demand for a software audit by a software producer, or one of the two main software industry associations that represent software producers, the Business Software Alliance (BSA) and the Software & Information Industry Association (SIIA), having detailed records will be key to your response. These organizations, when conducting a software audit on behalf of their members, often require a detailed listing of both the number of software installations and proof of the number of licenses. It is therefore important to keep detailed records concerning all software purchases, installations and deletions, as well as the licenses for any software purchased.

5. Run self-audit software regularly on all of your computers, including laptops that may only be connected to the network periodically.

There are a number of software self-audit tools available that your company can use to create a report on all copies of software presently installed on company computers. This software will allow routine checking to ensure compliance and avoid even innocent infringement. Descriptions of the tools and links to the websites of the providers of self-audit tools are available on the BSA and SIIA websites, http://www.bsa.org and http://www.siia.net.

6. Include a policy statement in your employment manual concerning software piracy, and discuss that policy with all new employees.

It is good practice to include in your employee manual a policy statement on software that: (i) states that it is the company's policy to use only licensed software and to observe all the terms and conditions of those licenses; (ii) states that downloading or using unlicensed software may lead to civil or criminal liability and/or disciplinary action by the company; and (iii) sets forth the proper procedure for requesting the installation of any software on a company computer.

7. Delete all older versions of software when a new version is installed.

When software is upgraded, older versions may inadvertently be left on computers. As any copy of software, even of an older version, is considered an installation requiring another license, any older version of an application should be deleted at the time the new version is installed.

8. Delete all beta software after the authorized time period for testing expires.

All software that is used by the company during a beta testing period or other time-limited period should be destroyed after the expiration of that period.

9. Consider locking down all computers to require administrative permission to install software.

The most secure way to ensure that no employee other than a member of the information technology department can install software on a company computer is to require an administrator password to install any software.

10. Send a member of your information technology department to attend a training course on software license management.

The SIIA sponsors a course for software managers aimed at teaching the skills necessary to manage software licensing issues, which it calls the Certified Software Manager course. Information is available at http://www.siia.net.

Software Licensing Case

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In *Wall Data, Inc. v. Los Angeles County Sheriff's Department,* 447 F.3d 769 (9th Cir. 2006), the sheriff's department bought 3,663 licenses for a software program from Wall Data. To facilitate faster installation of the software, and to ensure that the software was installed on the computers where it was needed, the Department used "hard disk imaging," a process that involved "simultaneously copying the entire contents of a single 'master' hard drive containing the … software applications onto the hard drives of other computers." *Wall Data, Inc. v. Los Angeles Co. Sheriff's Dept.*, 447 F.3d at 774. This resulted in the software being loaded onto 6,007 computers. The Department then configured the computers so that the number of computers that could assess the software was equal to the number of licenses that it had purchased. Wall Data contended that this arrangement constituted copyright infringement and the Department contended, among other things, that its actions fell under the "fair use" defense found in 17 U.S.C.A. § 107.

The district court granted summary judgment in favor of Wall Data on the issue of the Department's fair use defense, finding that the Department was not entitled to that defense. After a trial on the issues of copyright infringement and if any other defenses precluded the infringement claim, a jury found the Department liable for copyright infringement. The Department appealed, asserting that the district court erred in, among other things, granting summary judgment on the fair use defense.

The appellate court stated that fair use is determined by balancing four factors:

> (1) the purpose and character of the use, including whether such use is of a commercial nature or is for nonprofit educational purposes; (2) the nature of the copyrighted work; (3) the amount and substantiality of the portion used in relation to the copyrighted work as a whole; and (4) the effect of the use upon the potential market for or value of the copyrighted work.

Wall Data, Inc. v. Los Angeles Co. Sheriff's Dept., 447 F.3d at 777, 778. The appellate court found that all four factors weighed against a finding of fair use.

Under the first factor, the court looked at whether the Department's use of the work was transformative or just replaced the original work and if it was commercial. Because the Department made exact copies of the original work and used them for the exact same purposes as the originals, it was not transformative. The use was also commercial because the extra copies were made to save the expense of obtaining licensed copies for the extra computers. Under the second factor, the court determined that the nature of the work was such that it represented a significant investment of time and money because it was developed over several years at a multi-million dollar cost. Under the third factor, the court considered that the Department copied the complete software program and used it for the same purpose for which the original licenses were purchased. Under the fourth factor, the court examined the market for the work and determined that " 'widespread use' of hard drive imaging in excess of one's licenses could seriously impact the market for Wall Data's product." *Wall Data, Inc. v. Los Angeles Co. Sheriff's Dept.*, 447 F.3d at 781, 782. The court stated that

> [t]he Sheriff's Department could have bargained for the flexibility it desired, but it did not. Whenever a user puts copyrighted software to uses beyond the uses it bargained for, it affects the legitimate market for the product. Thus, although hard drive imaging might be an efficient and effective way to install computer software, we conclude that "unrestricted and widespread conduct of the sort engaged in by the defendant" would nonetheless lead to over-use of the software.

Wall Data, Inc. v. Los Angeles Co. Sheriff's Dept., 447 F.3d at 781. Thus, the appellate court affirmed the district court's grant of summary judgment in favor of Wall Data on the issue of the Department's fair use defense.

Trademark Rights versus Gray Market Drug Imports*

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The prescriptions drug market is changing. The disparity of prescription drug prices among countries, along with a growing concern about the availability of affordable medicine, has catalyzed the sale of lower-priced drugs outside the authorized distribution channels of branded drug companies. These gray market goods, also known as parallel imports, are goods produced under intellectual property rights held by the owner (or its licensee) for legitimate sale in one market that are then diverted and distributed in a second market without the authorization of the intellectual property rights owner.

The legality and status of these imports varies among jurisdictions. For example, within the European Union parallel imports are prima facie lawful among EU member states. In the United States, federal law and U.S. Food and Drug Administration (FDA) regulations prohibit gray market imports. However, legislation is currently pending that may allow importation from certain overseas markets.[1] Regardless, gray market imports of pharmaceutical products are estimated at more than $1 billion per year in the United States and $7 billion within the European Union with sales expected to increase exponentially around the globe in the coming years.[2] With the advent of the internet, not only do drug wholesalers and distributors traffic in gray market drugs with impunity, but individuals easily purchase low-cost drugs across borders devoid of any regulatory controls.

With the likely growth of gray market imports in the future, what can intellectual property owners do to control distribution of their products and enforce their valuable rights?

I. The U.S. Position

The U.S. trademark statute, the Lanham Act, may offer protection as it prohibits the unauthorized sale of goods bearing a registered trademark where there is a likelihood of confusion, mistake or deception of purchasers.[3] While the plain language of the statute does not bar importation of genuine goods, it will preclude unauthorized importation of goods bearing a registered trademark where there is some "material difference" between the foreign gray goods and the authorized domestic goods (*see Gamut Trading Co. v. International Trade Comm'n*).[4] The law concerning what constitutes a "material" difference has evolved over recent years to the benefit of intellectual property holders. Under the recent *SKF USA Inc. v. International Trade Commission*[5] decision, the material differences test has expanded to include non-physical differences between genuine and gray market goods—a significant gain for intellectual property owners in combating unauthorized importation and sale of gray market goods.

II. The Law of "Material Differences"

The purpose of the material difference test is to determine whether the importation of the gray market goods will likely injure the trademark owner's goodwill. There is no need to protect the consumer against confusion when the imported goods are identical to the goods of the trademark holder. However, where the foreign goods have materially different characteristics, consumers will likely be confused as to the quality and nature of the product bearing the mark, which will in turn erode the goodwill achieved by the U.S. source (*see Iberia Foods Corp. v. Rolando Romero, Jr.*).[6] Generally, courts apply a low threshold of materiality, requiring no more than a showing that consumers would likely consider the differences between the foreign and U.S. products to be significant. As consumer preferences are diverse, no definitive list of types of material differences can be compiled, but courts have found differences in quality, composition, packaging and price to be material. In essence, any difference likely to affect a consumer's perceptions of the desirability of the trademarked goods may qualify. For instance, in *Société des Produits Nestlé v. Casa Helvetia, Inc.*[7] the court held that the owner of the U.S. trademark PERUGINA could prevent the importation of PERUGINA chocolate licensed for sale only in Venezuela, as the Venezuelan chocolate differed in a number of ways, including quality control, composition, packaging and price. Similarly, in *Martin's Herend Imports, Inc. v. Diamond & Gem Trading USA*[8] the court found the U.S. trademark holder could prevent the importation of authentic Hungarian HEREND porcelain that varied in color, pattern or shape from the HEREND porcelain made for sale in the United States.

In applying the material difference test, courts have not limited the inquiry to solely physical differences. Rather, trademark owners have successfully asserted that differences in the written materials or labeling accompanying the product are "material." In *Original Appalachian Artworks v. Granada Electronics*,[9] the court granted an injunction to the U.S. owner of the CABBAGE PATCH trademark against importation of CABBAGE PATCH dolls made and sold abroad under license from the U.S. owner because they were sold with Spanish-language instructions and adoption papers. In *Gamut* the Federal Circuit went one step further and upheld a U.S. International Trade Commission (ITC) decision excluding Kubota tractors intended for the Japanese market from importation into the United States. In addition to structural differences and the lack of English-language manuals, the court cited lack of service and maintenance as a material difference. The *Gamut* court relied upon decisions in which the trademarked goods had physical and non-physical characteristics associated with them, such as *Osawa v. B&H Photo*.[10] In *Osawa,* the court halted importation of cameras produced outside the United States that had foreign language manuals and were not covered by the service warranty provided to purchasers of U.S.-authorized cameras. Similarly, the court in *Fender Musical Instruments Corp. v. Unlimited Music Center, Inc.*[11] prohibited importation of Japanese guitars that were structurally different and lacked certain services and warranties offered by U.S.-authorized dealers.

III. SKF USA Inc v. International Trade Commission

With the recent case of *SKF USA v. International Trade Commission,* the U.S. Courts of Appeals for the Federal Circuit faced an issue of first impression—in order to establish trademark infringement by gray market goods, must the differences between the goods be physical in nature? The court held no, thereby expanding the "material difference" test to the benefit of intellectual property owners. In *SKF* a manufacturer of ball-bearings sold in both U.S. and foreign markets filed suit in the ITC claiming trademark infringement because the imported ball bearings were "materially different" from those authorized for sale in the United States. Although the U.S. and foreign ball bearings were physically identical, the U.S. bearings came with certain service and technical support, including a "help" hotline for customers. The defendants argued that material differences must be physically manifested in the product or its packaging: the test "compares products, not sellers or the services they offer." The Federal Circuit rejected this argument and stated the lack of technical support for the foreign bearings was a "material difference" under the law. The court reasoned "trademarked goods originating from the trademark owner may have nonphysical characteristics associated with them, including services, such that similar goods lacking those associated characteristics may be believed by consumers to have originated from the trademark owner and, lacking such traits may mislead the consumer and damage the owner's goodwill."

According to the court, the *SKF* decision simply makes explicit what was implicit in *Gamut*—material differences need not be physical in order to establish trademark infringement in gray market cases. However, the Federal Circuit also affirmed the ITC's determination that "all or substantially all" of the U.S. ball bearings must be accompanied by the post-sale services to show the foreign ball bearings were materially different. Because the evidence in *SKF* established that 12.6 percent of the U.S.-produced bearings were sold without technical services, SKF did not prevail in blocking the importation of the gray market ball bearings.

IV. Material Differences in Gray Market Medicines

Currently the Lanham Act is the intellectual property owner's most useful defense. A number of recent cases involving veterinary medicines demonstrate that the Lanham Act can be used successfully to block the importation of gray market drug products. In *Novartis Animal Health US v. LM Connelly & Sons*,[12] the manufacturer of veterinary drug products sold under a number of trademarks in the United States and abroad brought suit against an Australian drug distributor and internet company for selling pet medicines made for the Australian market to U.S. consumers. Relying upon the Lanham Act, Novartis claimed the sale of the trademarked Australian goods would likely cause consumer confusion as the goods were materially different from the U.S. version. For instance, the labeling and package inserts did not contain information mandated by the FDA, such as the requirement that the drug be dispensed only by a licensed veterinarian. In addition a number of the Australian drugs had different formulations, some of which were not approved for use in the United States. The Australian package inserts contained different dosage instructions that relied upon metric unit weights of animals rather than pounds, and emergency customer assistance information valid only in Australia.

On the basis of these differences, the district court granted Novartis Animal Health's motion for a preliminary injunction finding that U.S. consumers would likely be confused and that Novartis would suffer irreparable harm. Similarly, on the basis of the reasoning in Novartis Animal Health, a number of courts have enjoined the sale of gray market medications in the United States—most often over the internet (*e.g., Novartis Animal Health U.S., Inc. v. Abbeyvet Export Ltd.*;[13] *Novartis Animal Health U.S., Inc. v. Bianjade Enterprises Pty Ltd.*;[14] and *Bayer Corp. v. Custom School Frames, LLC*[15]).

V. The European Position

In Europe the situation, and hence the strategy for control of gray market goods, is more complicated. The lawfulness of gray imports within the European Union is governed by provisions in the EC Treaty concerned with the "free movement" of goods.[16] These rules mean that once companies have placed a product on the market within the European Union, no restrictions can be imposed on the movement of product from one EU country to another EU country. This rule forms an important bedrock of European Community law.[17]

The institutions of the European Community (such as the European Commission) supervise the law relating to the free movement of goods. In practical terms, the European Commission is often suspicious of brand owners' attempts to prevent parallel imports. Some attempts to control gray imports through written contracts with member-state distributors have been met with investigations and fines under European competition (antitrust) laws.[18] Therefore, it is always advisable to adopt a cautious approach to any new distribution arrangements in Europe and to check carefully and in advance the legal and regulatory issues involved.

However, there is a specific carve-out for trademark rights in the rules relating to the free movement of goods.[19] A proprietor of a national trademark within a Member State may assert rights against goods that have been repackaged by a parallel importer and to which the trademark has been re-applied without the trademark owner's permission. Nonetheless, if a trademark proprietor wishes to exercise rights in this way, it must do so for legitimate reasons connected with the protection of the mark. Put another way, the exercise of trademark rights against a parallel importer must not be an artificial (or disguised) attempt to prevent trade between European Member States. If trademark rights are used solely to frustrate parallel trade and not for reasons related to harm caused to a registered trademark, the exercise of those rights may constitute a disguised restriction on trade, which is not allowed under the rules relating to the free movement of goods.

European case law has evolved in a similar fashion to the United States. In recent years the boundaries of what is permissible under trademark law against gray imports have expanded. This is particularly true in the field of pharmaceutical products, where language issues (for example, on drug information leaflets) and differing Member State prescription systems in the EU have necessitated special treatment.

The lawfulness of a number of practices adopted by parallel importers of pharmaceutical products has been (and continues to be) litigated in the European courts. One such practice is to "over sticker" boxes of tablets bearing a registered trademark with the name of the parallel importer, with the original writing and the trademark left visible. Another practice is to repackage the drugs completely in boxes designed by the gray market trader on which the trademark has been reproduced. Yet another practice is simply to "re-box" without the trademark and just use the generic name of the product on the new box.

As in the United States, repackaging that leads to an impairment of the goods and/or damage to the reputation of the trademark may provoke claims of trademark infringement.[20] However, the precise boundaries of the law remain unclear, and questions such as the extent to which a parallel importer can physically alter the original packaging of a drug product (for example, by over stickering) have still not been conclusively resolved in Europe.

It is possible to discern the following rules from the cases:[21]

— The overriding principle is that a trademark proprietor may rely on its trademark rights to prevent the repackaging of pharmaceutical products, unless the exercise of those rights contributes to artificial partitioning of markets among EU countries.

— The repackaging must not affect the original condition of the product.

— The name of the manufacturer and the name of the importer must be clearly stated on the packaging.

— The repackaging must not damage the reputation of the trademark, *i.e.,* the presentation of the product must not be untidy or of poor quality.

— A parallel importer must give prior notice to the brand owner of an intention to import repackaged product and provide samples, although the precise timeframe for doing this has not been determined.

However, replacement packaging of pharmaceuticals is permissible if it is "objectively necessary" to effectively access the target market; for example, re-boxing is permissible in order to overcome strong consumer resistance to over-stickered boxes bearing foreign language wording. Recent cases have sought to clarify the circumstances in which a gray market trader may maintain repackaging is "necessary." In the case of *Upjohn*,[22] the European Court of Justice decided that repackaging merely to secure a commercial advantage in the market was not a "necessity" in accordance with the rules. In the more recent case of *Boehringer*,[23] the UK Court of Appeal referred a number of questions on the meaning of "necessity" to the European Court of Justice for clarification, and the court's decision is expected later this year.[24]

VI. Combating Gray Market Drug Products

A number of avenues exist for trademark owners to challenge the importation of gray market pharmaceutical products, but the key is to properly register and maintain trademarks. In order to successfully implement the "material differences" test in the United States, pharmaceutical companies must adopt clear distinctions in the labeling and packaging of products intended for non-U.S. markets. If possible, manufacturing drugs intended for international distribution with different specifications is advisable as any difference in composition has been found to be a material difference. Non-physical differences, such as quality inspection procedures or the availability of after-sale assistance or service, like a customer "hotline," will also support a finding of trademark infringement by the gray market goods in the United States. Further, in light of the *SKF* decision, a trademark holder can preclude gray market goods that are "materially different" from the U.S. goods only where the different characteristics are evident with "all or substantially all" the U.S. goods.

ENDNOTES

1. The Prescription Drug Marketing Act , Pub. L. No. 100-293, codified at 21 U.S.C.A. § 381 (1988) prohibits importation of drugs by any entity other than the original manufacturer. Legislation such as the Pharmaceutical Market Access and Drug Safety Act, S.334 and H.R. 700, introduced in Congress in 2005 would allow for importation of approved prescription drugs.
2. "IMS Reports 11.5 Percent Dollar Growth in '03 U.S. Prescription Sales" IMS Health, February 17, 2004, see http://www.imshealth.com; "European Pharmaceutical Industry Determined to Address Parallel Trade of Medicines After Today's European Court of Justice Ruling" EFPIA, May 31, 2005, see http://www.efpia.org; "The Global Parallel Trade Outlook 2001-2006" Reuters Business Insights 2001.
3. Section 32 of the Lanham Act, 15 U.S.C.A. § 1114 bars the use of any "reproduction, counterfeit, copy or colorable imitation" of a federally registered mark, and § 43, 15 U.S.C.A. § 1125, prohibits the use of any false designation of origin likely to cause consumer confusion.
4. 200 F.3d 775 (Fed. Cir. 1999).
5. 423 F.3d 1037 (Fed. Cir. 2005).
6. 150 F.3d 298, 303 (3d Cir. 1998).
7. 982 F.2d 633 (1st Cir. 1992).

8. 112 F.3d 1296 (5th Cir. 1997).
9. 816 F.2d 68 (2d Cir. 1987).
10. 589 F. Supp. 1163 (S.D.N.Y. 1984).
11. 35 U.S.P.Q.2d 1053 (D. Conn. 1995).
12. 2005 U.S. Dist. LEXIS 18062, 75 U.S.P.Q. 2d 1513 (S.D.N.Y. 2005).
13. 75 U.S.P.Q.2d 1958 (S.D.N.Y. 2005).
14. Docket No. 04-CIV-533 (MBM) (S.D.N.Y. July 30, 2004).
15. 258 F. Supp. 2d 503 (E.D. La. 2003).
16. Articles 28-30.
17. It should be noted that where drug products have been placed on the market outside the European Union, the rules relating to the free movement of goods do not apply.
18. See for example case C-277/87 *Sandoz v. Commissioner* [1990] ECR I-45.
19. In article 30.
20. Case 102/77 *Hoffmann-LaRoche v. Centrafarm* [1978] ECR 1139.
21. In particular, the European Court of Justice gave a detailed ruling in case C-143/00 *Boehringer Ingelheim, Glaxo Group and Others v. Swingward Ltd. and Dowelhurst Ltd.* [2002] ECR I-3759.
22. Case C-379/97 *Pharmacia and Upjohn v. Paranova* [1999] ECR I-6927.
23. Boehringer Ingelheim, Glaxo Group and Others v. Swingwarad Ltd. and Dowelhurst Ltd. [2004] EWCA Civ. 757 (CA).
24. The questions that were referred to the European Court of Justice were published in the Official Journal of the European Communities on 6 November 2004 C 273/11-12.

Gray Market Goods Cases

Publisher's Editorial Staff

One case that raised both international and intellectual property concerns was *American Circuit Breaker Corp. v. Oregon Breakers Inc.*, 406 F.3d 577 (9th Cir. 2005). As noted by the court, "[f]ew subjects have generated more ink and consternation in the trademark arena in recent years than the topic of parallel imports/gray market goods." *American Circuit Breaker Corp.,* 406 F.3d at 578. Here, the court ruled in favor of the defendants and held that no trademark violation had occurred.

The court defined a gray market good or parallel import as a foreign-manufactured product that bears a valid U.S. trademark, but that is imported into the United States without the U.S. trademark holder's consent. *See, e.g., Kmart Corp. v. Cartier, Inc.,* 486 U.S. 281 (1988). In the early 1900s, Congress provided U.S. trademark holders a remedy under the Tariff Act against importation of genuine goods bearing U.S. trademarks. But federal law has not "quell[ed] the confusion and uncertainty, especially regarding the relationship between infringement claims under the Lanham Act and claims under the Tariff Act." *American Circuit Breaker Corp.,* 406 F.3d at 578.

This case involved the sale of circuit breakers imported into the United States from Canada under the STAB-LOK trademark. American Circuit Breaker Corporation (ACBC) holds the STAB-LOK trademark in the United States, while Schneider Canada holds the STAB-LOK trademark in Canada. Federal Pioneer Ltd. (Pioneer), a subsidiary of Schneider Canada, manufactures the circuit breakers both for itself and for ACBC. The two sets of circuit breakers are identical, except that ACBC's circuit breakers are black, while Pioneer's breakers are — coincidentally — gray. The dispute arose when Oregon Breakers, Inc. bought the gray circuit breakers from a Canadian third-party supplier and sold them in the United States without ACBC's permission. The district court dismissed ACBC's claims against Oregon Breakers for trademark infringement and unfair competition. ACBC appealed and the circuit court affirmed.

Prior to 1993, ACBC manufactured black STAB-LOK circuit breakers for the U.S. market at its plant in North Carolina, while Pioneer manufactured the gray STAB-LOK circuit breakers for the Canadian market. Following an intellectual property dispute in the early 1990s, ACBC entered into an agreement with Pioneer and Schneider Canada. Part of the dispute centered on Pioneer's claim that it had acquired rights to market the STAB-LOK mark in the United States and Canada.

Under the settlement agreement, Pioneer agreed to manufacture black STAB-LOK circuit breakers for ACBC for sale in the United States, and ACBC agreed to purchase guaranteed minimums from Pioneer. Meanwhile, Pioneer continued to manufacture gray STAB-LOK circuit breakers for sale in Canada, but the agreement prohibited Pioneer from selling the gray STAB-LOK circuit breakers in the United States for the term of the agreement. The agreement also provided that ACBC would assign its rights in the STAB-LOK mark to Pioneer at the conclusion of the agreement. The effect of the agreement was that "ACBC's exclusivity of those trademark rights came about through the deal it struck with Pioneer, a Canadian company." *American Circuit Breaker Corp.*, 406 F.3d at 579. The court summarized the situation as follows:

> In sum, this case involves a U.S. trademark owner which contracts with a foreign, but historically affiliated, manufacturer that owns the identical trademark in the foreign jurisdiction. The foreign trademark owner legitimately manufactures goods for both markets, which goods are identical except for color. A third party then imports identical goods manufactured under the foreign trademark into the United States, in competition with the U.S. trademark owner's products.

American Circuit Breaker Corp., 406 F.3d at 580.

ACBC sued Oregon Breakers for trademark infringement and unfair competition. Citing the Supreme Court's landmark decision in *A. Bourjois & Co. v. Katzel,* 260 U.S. 689 (1923), in which the Court adopted the principle of territoriality of trademarks and rejected the universality rule, the circuit court held that the fact that this was a gray market case did not "drive the solution." On the contrary, what was at issue was whether there was a likelihood of confusion as to the source under the principles of the Lanham Act. The circuit court held that there was not a likelihood of confusion and, thus, affirmed the lower court's decision in favor of the defendants.

As its name applies, the universality rule provides trademark protection whenever the product is sold. Conversely, the Supreme Court's territoriality principle provides that a trademark has a separate legal existence in each country in which the product is sold, and that the trademark receives the protection that is afforded to trademarks by the laws of each country.

To resolve a Lanham Act dispute, the courts typically apply a nine-factor likelihood of confusion test to determine the strength of the trademark and the degree of care that customers are likely to exercise. Those factors, however, did not apply because of the parties' stipulations. The circuit court concluded that there was "no material issue of fact with respect to infringement, that ACBC failed to establish infringement, and, consequently, the dismissal of claims was appropriate." *American Circuit Breaker Corp.,* 406 F.3d at 585.

The primary stipulation between ACBC and Oregon Breakers that resolved the case was that consumers purchasing the circuit breakers from Oregon Breakers were getting exactly the same circuit breakers, both in specification and quality, as they would have purchased from ACBC. In other words, the goods were identical (except for color) and genuine. In the court's words, "[r]ather than being confused, customers who purchase the gray STAB-LOK circuit breakers from Oregon Breakers get exactly what they expect." *American Circuit Breaker Corp.,* 406 F.3d at 585. Since there was no material fact as to infringement, ACBC's claims of trademark infringement and unfair competition were without merit.

In *Bourdeau Brothers, Inc. v. International Trade Commission,* 444 F.3d 1317 (Fed. Cir. 2006) the federal appeals court found that trademarked goods made in the United States solely for sale in foreign markets may violate trademark law if imported back into the United States for sale in the United States. Intervenor Deere & Company alleged that the appellants violated federal trademark law by importing and selling certain used Deere forage harvesters that were manufactured in the United States solely for sale in Europe. Deere asserted that the European versions of the harvester were materially different from those manufactured for sale in the United States. The International Trade Commission (ITC) investigated the allegations and the administrative law judge (ALJ) found that the appellants' importing of the used European version of the Deere harvesters violated 19 U.S.C.A. § 1337, and the ITC issued a general exclusion order covering the infringing harvesters, and cease and desist orders against the appellants and others. The appellants filed a notice of appeal.

The court began its analysis with a discussion of the applicable statute provision and "gray market goods."

> Section 1337(a)(1)(c) forbids "[t]he importation into the United States, the sale for importation, or the sale within the United States after importation by the owner, importer, or consignee, of articles that infringe a valid and enforceable United States trademark registered under the Trademark Act of 1946." Thus, section 1337 grants the ITC the power to prevent the importation of goods that, if sold in the United States, would violate one of the provisions of the federal trademark statute, the Lanham Act.

Bourdeau Brothers, Inc., 444 F.3d at 1320.

Gray market goods were defined by the court as "products that were produced by the owner of the United States trademark or with its consent, but not authorized for sale in the United States. [Citation omitted by editor.]" *Bourdeau Brothers, Inc.,* 444 F.3d at 1320. The court stated that the idea behind preventing the importation of gray market goods is that

> the public associates a trademark with goods having certain characteristics. To the extent that foreign goods bearing a trademark have different characteristics than those trademarked goods authorized for sale in the United States, the public is likely to become confused or deceived as to which characteristics are properly associated with the trademark, thereby possibly eroding the goodwill of the trademark holder in the United States. ... The basic question in gray market cases 'is not whether the mark was validly affixed" to the goods, "but whether there are differences between the foreign and domestic product and if so whether the differences are material. [Citations omitted by editor.]

Bourdeau Brothers, Inc., 444 F.3d at 1320-21.

To be "material" the differences need only be such that consumers would be likely to consider them significant when buying the product. However, the plaintiff in such a case must show that "all or substantially all of its sales are accompanied by the asserted material difference in order to show that its goods are materially different." *Bourdeau Brothers, Inc.,* 444 F.3d at 1321.

The court agreed with the ITC and held that

> the importation and sale of a trademarked good of domestic manufacture, produced solely for sale abroad and not authorized by the owner of the trademark for sale in the United States, may violate section 1337 if the imported good is materially different from all or substantially all of those goods bearing the same trademark that are authorized for sale in the United States.

Bourdeau Brothers, Inc., 444 F.3d at 1323.

In this case, the ALJ properly determined that there were a number of differences that customers in the United States would consider significant between the European and domestic versions of the harvesters at issue, including differences in the lighting functions and configurations, the warning labels and safety decals, hitch mechanisms, operator manuals, and product service programs. However, the appeals court determined that

> Deere did not establish that all or substantially all of its sales were accompanied by these asserted material differences. That is, Deere did not establish that all or substantially all of its sales in the United States were of North American forage harvesters.

Bourdeau Brothers, Inc., 444 F.3d at 1325. Because Deere has the burden of showing "that all or substantially all of the sales [in the United States] were materially different from the alleged gray market goods," the court remanded the case to the ITC to determine this issue. *Bourdeau Brothers, Inc.,* 444 F.3d at 1327.

See also SKF USA Inc. v. International Trade Commission, 423 F.3d 1307 (Fed. Cir. 2005) where the Federal Circuit held that the required "material difference" between authorized goods and gray market goods did not have to be physical differences. The differences could be, for example, the existence and extent of post-sale services or warranties. The court also affirmed that whatever the material difference was between the authorized and gray market goods, that difference had to be present in or accompany substantially all of the authorized goods in the United States.

In *Bose Corp. v. Silonsonnic Corp.,* 413 F. Supp. 2d 339 (S.D.N.Y. 2006), Bose, a maker of home entertainment sound systems and its European affiliates, sought a preliminary injunction against the defendants to prevent them from reselling Bose products on Web sites or by telephone, and to prevent them from using Bose's copyrighted or trademarked material in their advertisements. The defendants were reselling Bose sound systems that were manufactured specifically for the American market to customers in the European market. Bose asserted that there were significant differences in the sound systems made specifically for the European versus the American market such as voltage specifications, tuner increments, antenna connections, owner manual languages, television adaptors, and warranty length, among others. Because of these differences, Bose alleged that the sale of products made for the American market in Europe would dilute and/or damage Bose's reputation and goodwill in the European market because while the products defendants sold were not inferior per se, when sold to Europeans, it resulted in an "sub-optimal audio-visual experience … depriving those purchasers of the complete benefits of the European-market products." *Bose Corp.,* 413 F. Supp. 2d at 343.

The court agreed with Bose concerning defendants' sale of American-market products in Europe, stating that

> Bose has a legitimate interest in keeping inferior goods passed off as optimal-performing Bose products out of the European market; doing so insures that the value of Bose's highly respected trademarks are not diluted or damaged. "One of the most valuable and important protections afforded by the Lanham Act is the right to control the quality of the goods manufactured and sold under the holder's trademark." *El Greco Leather Prod. Co. v. Shoe World,* 806 F.2d 392, 395 (2d Cir. 1986).

Bose Corp., 413 F. Supp. 2d at 343.

Defendants asserted that Bose did not take measures to ensure that American-market products did not reach the European market. The court disagreed, finding that Bose took several measures to ensure that American-market products were sold in America, and that European-market products were sold in Europe. Therefore, the court found that Bose had shown a "clear and substantial likelihood of success on the merits … satisfying the test for the issuance of a preliminary injunction." *Bose Corp.,* 413 F. Supp. 2d at 345.

Bose also wanted the injunction to include the sales of American-market products in America, however, the court found that the only argument asserted by Bose for this injunction, that the sound systems sold by the defendants would not be covered by the Bose warranty, was disputable, a question that was "a fair ground for litigation" and so, Bose was not entitled to a preliminary injunction on that issue.

Finally, Bose sought an injunction against the defendants to prevent them from using Bose's copyrighted and trademarked materials in the defendants' advertisements of Bose products. The defendants admitted that in the past they had used such material, claiming that they had not known that such use was infringing, but that they no longer were using such materials. Thus, the court granted "a preliminary injunction enjoining Defendants from making unauthorized use of Bose's copyrights or trademarks, in any of their advertisements or otherwise." *Bose Corp.,* 413 F. Supp. 2d at 346.

Patent Cross-License Agreement Between Data Domain Inc. and Quantum Corporation

Editor's Note: The following form was obtained from the Electronic Data Gathering, Analysis, and Retrieval System (commonly known as EDGAR) which is maintained by the United States Securities and Exchange Commission (SEC) and is available on the Internet at www.sec.gov. This form was Exhibit 10.30 of Data Domain Inc.'s form S-1 filed with the SEC on March 30, 2007.

This Patent Cross-License Agreement ("Agreement") is made and effective as of the date of the last signature hereon ("Effective Date") by and between Data Domain, Inc., having a place of business at 2300 Central Expressway, Santa Clara, CA 95050, and Quantum Corporation, having a place of business at 1650 Technology Drive, Suite 700, San Jose, CA 95110.

RECITALS

WHEREAS, the parties to this Agreement each owns certain patents and patent applications, expects to file additional patent applications, and wishes to enter a cross-license agreement on the terms set forth herein;

NOW, THEREFORE, in consideration of the promises and the mutual covenants hereinafter contained and other good and valuable consideration, the sufficiency of which is hereby acknowledged, the parties hereto agree as follows:

Section 1—DEFINITIONS

As used in this Agreement, the following terms shall have the meanings indicated:

1.1 "DD" means Data Domain, Inc..

1.2 "Quantum" means Quantum Corporation and.

1.3 "Affiliate" of an entity means any other entity that, directly or indirectly, through one or more intermediates, is controlled by the first entity. For purposes of this definition and the definition of Related Company only, the term "control" means the possession of the power to direct or cause the direction of the management and policies of an entity through direct or indirect ownership of (or the contractual right to direct the voting of) more than fifty percent (50%) of the voting interest in the entity in question; provided, however, that if local law requires a minimum percentage of local ownership, control will be established by direct or indirect beneficial ownership of one hundred percent (100%) of the maximum ownership percentage that may, under such local law, be owned by foreign interests.

1.4 "Foundry Products" means and includes any product(s) which are either (i) designed by or for a third party without substantial input from one of the parties (or an Affiliate) hereto (the "Acting Party"), and manufactured, reproduced, sold, leased, licensed or otherwise transferred from the Acting Party to such third party or to customers of such third party; or (ii) designed, manufactured, reproduced, sold, leased, licensed or otherwise transferred through or by the Acting Party for the primary purpose of circumventing any Licensed Patents of the other party to this Agreement for the primary benefit of a third party that would otherwise have been viewed as the source of such product and would have required a license to the other party's Licensed Patents.

1.5 "Tape Technology" shall mean magnetic recording tape, tape cartridges, tape heads, tape drives, and tape libraries.

1.6 A party's "Licensed Patents" means each and every patent and patent application and all patents that ever issue therefrom, worldwide, that (a) claims or is entitled to claim a priority date of or prior to the Cut-Off Date; (b) is filed or owned or controlled at any time on or prior to the Cut-Off Date by such party and/or its respective Affiliates, or cites such a patent or patent application for priority; and (c) describes or claims (i) any aspect of data storage and/or data transmission, or (ii) any invention having any utility or application of, to or in data storage and/or data transmission (even if such utility or application of, to or in data storage and/or data transmission is not stated in the patent or patent application). Licensed Patents shall not include any claim of a patent or patent application to the extent it claims only Tape Technology or any method specifically for making Tape Technology. Notwithstanding the foregoing, if a patent right that would otherwise qualify as a party's Licensed Patent is subject to a running royalty payable to an unrelated third party as a result of such party's acquisition of such patent right, that patent right will nevertheless be excluded from that party's Licensed Patents unless the other party agrees to pay any such royalty resulting from its use or practice thereof for which it receives adequate documentation allowing it to calculate such royalty; each party will use reasonable efforts to promptly notify the other of any such patent rights and the applicable royalty terms related thereto.

1.7 A party's "Licensed Technology" means any method, device, or product or service excluding Tape Technology made, sold, leased, or used by or on behalf of either a party and/or its Affiliates in connection with any aspect of data storage and/or data transmission, the manufacture, production, use, sale or importation of which have infringed or, in the absence of this Agreement, would infringe any of the other party's Licensed Patets.

1.8 The "Consideration" means the one-time delivery of stock to Quantum in the amount set forth in Section 5.1.

1.9 The "Cut-Off Date" is January 1, 2012 or, if earlier, the date following an Acquisition of a party on which such party or its successor notifies the other party that no entirely new patent applications (e.g., not applications that claim or are entitled to claim priority from Licensed Patents) or patents issuing from such entirely new patent applications will become part of the licenses under this Agreement (which such party or its successor may do at any time).

1.10 An "Acquisition" of a party means a transaction resulting in a third party (a) having control (as defined in Section 1.3) of that party or (b) purchasing all or substantially all of that party's assets or business.

1.11 "Related Company" of an entity means any other entity that, directly or indirectly, through one or more intermediates, is controlled by, controls or is under common control with the first entity.

Section 2—MUTUAL LICENSE GRANTS

2.1 Effective upon delivery of the Consideration pursuant to Section 5.1, DD hereby grants (on behalf of itself and its Affiliates) to Quantum, and Quantum hereby accepts upon the terms and conditions specified herein, a non-exclusive, worldwide, personal license under DD's Licensed Patents, effective January 1, 2007, to make, have made, use, sell, offer for sale, and import Licensed Technology for the benefit of Quantum and/or for the benefit of any of Quantum's direct or indirect customers (including its distribution channel). This license (a) does not include any right to sublicense, except to its Affiliates while they remain Affiliates, and except as necessary for distribution and use of the Licensed Technology; (b) is non-transferable, except per the terms set forth in Section 6; and (c) does not include any right regarding Foundry Products. In addition, effective upon delivery of the Consideration pursuant to Section 5.1, DD covenants (for itself and its Affiliates) not to sue anyone under DD's Licensed Patents based in whole or in part on their past, current or future use, sale, offer for sale, importation, or exportation of Quantum's Licensed Technology covered by the above license or that would have been covered by the above license if such sale, offer for sale, importation, or exportation had occurred after such license became effective.

2.2 Effective upon delivery of the Consideration, pursuant to Section 5.1, Quantum hereby grants (on behalf of itself and its Affiliates) to DD, and DD hereby accepts upon the terms and conditions specified herein, a non- exclusive, worldwide, personal license under the Licensed Patents of Quantum, effective January 1, 2007, to make, have made, use, sell, offer for sale, and import Licensed Technology for the benefit of DD and/or for the benefit of any of DD's direct or indirect customers (including its distribution channel). This license (a) does not include any right to sublicense, except to its Affiliates while they remain Affiliates, and except as necessary for distribution and use of the Licensed Technology; (b) is non-transferable, except per the terms set forth in Section 6; and (c) does not include any right regarding Foundry Products. In addition, effective upon delivery of the Consideration pursuant to Section 5.1, Quantum covenants (for itself and its Affiliates) not to sue anyone under Quantum's Licensed Patents based in whole or in part on their past, current or future use, sale, offer for sale, importation, or exportation of DD's Licensed Technology covered by the above license or that would have been covered by the above license if such sale, offer for sale, importation, or exportation had occurred after such license became effective.

2.3 In the event that DD or any Affiliate assigns or transfers any ownership rights in DD's Licensed Patents (or rights to enforce such Licensed Patents), DD shall require as a condition of any such assignment that the assignee agree to be bound by the provisions of this Section with respect to DD's Licensed Patents. Any purported assignment or transfer of rights in derogation of the foregoing requirement shall be null and void.

2.4 In the event that Quantum or any Affiliate assigns or transfers any ownership rights in Quantum's Licensed Patents (or rights to enforce such Licensed Patents), Quantum shall require as a condition of any such assignment that the assignee agree to be bound by the provisions of this Section with respect to Quantum's Licensed Patents. Any purported assignment or transfer of rights in derogation of the foregoing requirement shall be null and void.

2.5 There are no implied licenses granted to Quantum or DD or any third party under this Agreement. Any such implied license is expressly rejected and disclaimed. This Section 2.5 is not intended to, and will not be deemed to, avoid the effect of patent exhaustion.

2.6 No other intellectual property rights are granted under this Agreement, including without limitation copyrights, trademarks and trade secrets.

Section 3—MARKING

3.1 To the extent that Quantum or its Affiliates produces any product that would infringe one or more of DD's Licensed Patents but for this Agreement, Quantum shall use commercially reasonable efforts to try to mark that product in a manner sufficient to preserve DD's and its Affiliates' rights under 35 U.S.C. § 287, upon DD's specific written request to Quantum to do so.

3.2 To the extent that DD or its Affiliates produces any product that would infringe one or more of Quantum's Licensed Patents but for this Agreement, DD shall use commercially reasonable efforts to try to mark that product in a manner sufficient to preserve Quantum's and its Affiliates' rights under 35 U.S.C. § 287, upon Quantum's specific written request to DD to do so.

Section 4—MUTUAL RELEASE

4.1 Subject to the terms of this Agreement and effective only upon delivery of the Consideration pursuant to Section 5.1, (a) DD (for itself and its Affiliates) hereby releases and forever discharges Quantum (and its Affiliates), and Quantum (for itself and its Affiliates) hereby releases and forever discharges DD (and its Affiliates), from any and all claims, liens, demands, causes of action, obligations, losses, damages, and liabilities, known or unknown, suspected or unsuspected, liquidated or unliquidated, fixed or contingent, anywhere in the world, that they (or their Affiliates) have or may have at any time for any past act or conduct of any kind prior to and including the Effective Date ("Claims") and (b) each party (for itself and its Affiliates) hereby releases and discharges any Claims to which the covenant not to sue of the last sentence of Sections 2.1 or 2.2 (as applicable) applies.

4.2 DD and Quantum (for themselves and their Affiliates) each expressly waives as to the other the provisions of Section 1542 of the California Civil Code, which reads as follows:

> A GENERAL RELEASE DOES NOT EXTEND TO CLAIMS WHICH THE CREDITOR DOES NOT KNOW OR SUSPECT TO EXIST IN HIS FAVOR AT THE TIME OF EXECUTING THE RELEASE WHICH IF KNOWN BY HIM MUST HAVE MATERIALLY AFFECTED HIS SETTLEMENT WITH THE DEBTOR.

Section 5—CONSIDERATION

5.1 Upon the execution of this Agreement, DD shall issue 390,000 shares of DD's Common Stock (the "Shares") to Quantum.

5.2 Quantum understands that the Shares will be characterized as "restricted securities" under the federal securities laws inasmuch as they are being acquired from DD in a transaction not involving a public offering and that under such laws and applicable regulations such securities may be resold without registration under the Securities Act of 1933, as amended (the "Act"), only in certain limited circumstances. In this connection, Quantum represents that it is familiar with SEC Rule 144, as presently in effect, and understands the resale limitations imposed thereby and by the Act.

5.3 Quantum believes it has received all the information it considers necessary or appropriate for deciding whether to acquire the Shares. Quantum acknowledges that it is able to fend for itself and has such knowledge and experience in financial or business matters that it is capable of evaluating the merits and risks of the investment in the Shares.

5.4 Quantum agrees not to make any disposition of all or any portion of the Shares unless and until: (a) there is then in effect a registration statement under the Act covering such proposed disposition and such disposition is made in accordance with such registration statement; or (b) Quantum shall have furnished DD with an opinion of counsel, reasonably satisfactory to DD, that such disposition will not require registration of the Shares under the Act. It is agreed that DD will not require opinions of counsel for transactions made pursuant to Rule 144 except in unusual circumstances.

5.5 It is understood that the certificates evidencing the Shares shall bear the following legend:

> "THESE SECURITIES HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED. THEY MAY NOT BE SOLD, OFFERED FOR SALE, PLEDGED OR HYPOTHECATED IN THE ABSENCE OF A REGISTRATION STATEMENT IN EFFECT WITH RESPECT TO THE SECURITIES UNDER SUCH ACT OR AN OPINION OF COUNSEL SATISFACTORY TO THE COMPANY THAT SUCH REGISTRATION IS NOT REQUIRED OR UNLESS SOLD PURSUANT TO RULE 144 OF SUCH ACT."

5.6 DD agrees to amend and restate its existing Investors' Rights Agreement, in the form attached hereto as Exhibit A (the "Amended Rights Agreement"), in order to provide Quantum with certain registration rights thereunder and to provide that (subject to the terms and conditions of the Amended Rights Agreement) the Shares issued to Quantum pursuant to Section 5.1 above shall be fully registrable and saleable in DD's initial underwritten public offering of its Common Stock ("IPO") and, to the extent so sold in such IPO, shall not be subject to any lock-up restrictions. Immediately upon execution of this Agreement, DD shall deliver an executed copy of the Amended Rights Agreement to Quantum, and Quantum shall sign the Amended Rights Agreement and become a party thereto.

5.7 DD represents and warrants that the Shares, when issued and delivered in accordance with the terms of this Agreement, will be duly and validly issued, fully paid and nonassessable, and will be free of restrictions on transfer other than restrictions on transfer under this Agreement, under the Amended Rights Agreement, and under applicable state and federal securities laws.

Section 6—CHANGE OF CONTROL

6.1 This Agreement and the rights and obligations herein may not be assigned by either party without the other party's written consent, except to a Permitted Assignee. A "Permitted Assignee" is an assignee that is a successor to all or substantially all of the assets or business or equity of a party. In the event of an assignment from a party to a Permitted Assignee, the Permitted Assignee shall have thirty (30) days to provide written notice to the other party that it has accepted the assignment of this Agreement, and shall be subject to its provisions in the place of the assigning party. Any purported assignment in derogation of the foregoing requirement shall be null and void.

6.2 If an Acquisition has occurred with respect to a party (whether or not this Agreement has been assigned) and that party (or its assignee) or any Related Company thereof sues the other party or any of its Affiliates for patent infringement (or sues a customer or distribution channel member of such other party or any of its Affiliates for patent infringement on account of a product or service provided directly or indirectly by such other party or any of its Affiliates) then the license (and covenant not to sue with respect to infringements occurring thereafter) granted herein to the party or assignee that is (or whose Related Company is) suing will terminate unless the suit is dismissed within 20 days of notice.

Section 7—CONFIDENTIALITY

7.1 The parties will issue a joint press release regarding this Agreement at a time, in a manner and with the content to be agreed. Either party may refer to or distribute copies of that press release at any time in the future.

7.2 Subject to the exceptions set forth in this Section, all terms of this Agreement are to be kept confidential. If disclosure of this Agreement, any of the terms hereof is required by applicable law, rule, or regulation, or is compelled by a court or governmental agency, authority, or body: (i) the parties shall apply reasonable efforts to use legitimate and legal means reasonably available to minimize the disclosure to third parties of the content of the Agreement, including without limitation seeking a confidential treatment request or protective order; (ii) the disclosing party shall inform the other party at least ten (10) business days in advance of the disclosure, or promptly upon becoming aware of such requirement, if less; and (iii) if legally possible the disclosing party shall give the other party a reasonable opportunity to review and comment upon the disclosure, and any request for confidential treatment or a protective order pertaining thereto, prior to making such disclosure. Each party may also disclose this Agreement on a confidential basis to its advisors and potential investors and acquirors.

Section 8—TERM

8.1 Except to the extent expressly otherwise provided in this Agreement, this Agreement (and the licenses granted herein) shall remain in force and effect until the date that the last claim of the Licensed Patents expires, or (if earlier), the date a final decree of invalidity of the last remaining Licensed Patent is entered from which no appeal or other judicial recourse can be, or is, taken.

Section 9—REPRESENTATIONS; DISCLAIMER; LIMITATION OF LIABILITY

9.1 Except as set forth herein, the parties make no express or implied warranty or representation with respect to the Licensed Patents, including without limitation any warranty or representation regarding the usefulness, merchantability, functional effectiveness, safety, performance or fitness for any particular use of any products or services covered by the licenses granted hereunder.

9.2 IN NO EVENT SHALL EITHER DD OR QUANTUM BE LIABLE FOR ANY INCIDENTAL, INDIRECT, SPECIAL OR CONSEQUENTIAL DAMAGES SUFFERED OR INCURRED IN CONNECTION WITH THIS AGREEMENT OR THE LICENSES GRANTED HEREUNDER.

9.3 DD and Quantum each represents and warrants: (a) that it has the full power to enter into this Agreement; and (b) that it has not entered into and shall not enter into any agreement with another party which is inconsistent or in conflict with this Agreement in any respect.

9.4 Other than the express warranties of this Section, there are no other warranties, express or implied or statutory.

Section 10—MISCELLANEOUS

10.1 Governing Law and Venue. This Agreement shall be interpreted, governed, construed, applied and enforced in accordance with the laws (without regard to principles of conflict of law matters) of the State of California. The United Nations Convention on Contracts for the International Sale of Goods does not apply to this Agreement.

10.2 Notice to Affiliates. Each party shall provide timely written notice of this Agreement to each of its present and future Affiliates and Related Companies.

10.3 Notice to Each Other. Any notice or request to a party to this Agreement that is required or permitted to be given in connection with this Agreement or the subject matter hereof shall be in writing and shall be deemed to have been sufficiently given when sent by registered air mail or overnight courier, postage or charges prepaid and addressed as follows:

If to DD:

Data Domain, Inc.
2300 Central Expressway
Santa Clara, CA 95050
Attn: Chief Financial Officer

If to Quantum:

Quantum Corporation
1650 Technology Dr., #700
San Jose, CA 95510
Attn: General Counsel
With copy to:
Attn: In-house Counsel

The date of receipt shall be deemed to be the date when such notice or request has been given. Any party may give written notice of a change of address; and after notice of such change has been received, any notice or request shall thereafter be given to such party as provided above at such changed address.

10.4 Severability/Invalidity. If any provision of this Agreement shall be held to be invalid, inoperative, illegal or unenforceable as applied to any particular case in any jurisdiction, such holding shall not have the effect of rendering the provision or provisions in question invalid, inoperative, illegal or unenforceable in any other jurisdiction or in any other case or of rendering any other provision in this Agreement as being invalid, inoperative, illegal or unenforceable. This Agreement shall be construed as if such invalid, inoperative, illegal or unenforceable provision had never been contained herein. The parties shall substitute for the defective provision a valid, operative and enforceable provision which most closely approximates the economic effect and intent of the defective provision.

10.5 No Construction Against Drafter. If an ambiguity or question of intent arises with respect to any provision of this Agreement, the Agreement will be construed as if drafted jointly by the parties and no presumption or burden of proof will arise favoring or disfavoring either party by virtue of authorship of any of the provisions of this Agreement.

10.6 Entire Understanding. This instrument contains the entire understanding and the entire and only agreement between the parties and supersedes all pre-existing agreements between them respecting its subject matter. Any representation, promise, or condition in connection with such subject matter which is not expressly incorporated in this Agreement shall not be binding upon either party. No modification, renewal, extension, waiver, and no termination of this Agreement or any of its provisions shall be binding upon the party against whom enforcement of such modification, renewal, extension, waiver or termination is sought, unless made in writing and signed on behalf of such party by one of its executive officers.

IN WITNESS WHEREOF, each of the parties hereto has caused this Agreement to be executed by their respective duly authorized officers or representatives.

[Signatures]