

Are 'ROCKET DOCKETS' In Decline?



Court rulings should lead to more high-stakes patent suits in Connecticut

By **JAMES E. NEALON** and
WENDY A. CLARKE

Under the venue statute for patent infringement actions (28 USC § 1400), a plaintiff may bring an action in any United States judicial district where a corporate defendant is subject to personal jurisdiction, which includes any place where the alleged infringing product is marketed or sold. Large corporate defendants, which sell nationwide, are thus exposed to patent infringement suits anywhere in the country at the plaintiff's election, notwithstanding that in many instances the chosen district bears little relation to either the plaintiff or the defendant.

The Eastern District of Texas has long been a leading forum of choice for plaintiffs commencing high-stakes patent actions. A perceived increased probability of success on the merits, expedited time to trial, the relative infrequency of the invalidation of patents, a reluctance to issue stays pending patent re-examination requests and comparatively higher damage awards are all factors which appeal to patent plaintiffs, even those with the most artificial contacts to that venue.

The Eastern District of Texas crafted local patent rules designed to streamline patent litigation and its judges positioned themselves as jurists sophisticated in complex patent matters. The Eastern District of Virginia likewise became a common haven for plaintiffs bringing patent suits due to its similar reputation as a "rocket docket."

Not surprisingly, large corporate defendants generally do not wish to be haled into rocket docket jurisdictions or geographically remote venues. This has resulted in a torrent of motions by defendants in such cases seeking to change venue based on the convenience of the parties and witnesses under 28 U.S.C. § 1404(a). Historically, many district court judges granted considerable deference to a plaintiff's choice of forum, however contrived that choice, and routinely denied motions to transfer venue.

Message To Rocket Dockets

Over the last several years, however, the U.S. Court of Appeals for the Federal Circuit has issued a significant number of important opinions essentially compelling district courts hearing patent cases, many of which had given excessive deference to a plaintiff's choice of forum with no meaningful connections to the dispute, parties or witnesses, to carefully and rigorously apply the statutory criteria under Section 1404(a).

In 2008, there was a seismic shift in federal

venue transfer decisions in patent cases. In *In re TS Tech USA Corp.*, 551 F.3d 1315 (Fed. Cir. 2008), the Federal Circuit granted the extraordinary relief of mandamus, ordering the Eastern District of Texas to transfer a patent case to the Southern District of Ohio, based on the location of evidence and a number of key witnesses. Notwithstanding the plaintiff's failure to show any meaningful connection to Texas, the notoriously plaintiff-friendly district court in small-town Marshall, Texas, had found that convenience of the Ohio venue did not clearly outweigh deference to the plaintiff's choice of forum in the Eastern District of Texas. The Federal Circuit ruled that the district court had abused its discretion in denying the defendant's motion to transfer venue because it had given too much deference to the plaintiff's choice of forum; had erroneously refused to weigh the costs and inconveniences of the witnesses in a meaningful way; and had inaccurately analyzed the public's interest in having so-called localized matters decided at home. *TS Tech* captured the patent bar's attention and, given the history of the rocket dockets, rightfully, so.

Mandamus Actions

In response to *TS Tech*, some plaintiffs attempted to manufacture a nexus to a particular preferred jurisdiction through pre-filing maneuvering such as setting up a business location or changing its place of incorporation predominantly to provide justification for a venue choice. Recent mandamus actions demonstrate that the Federal Circuit, as well as the district courts, have become increasingly sensitive to and intolerant of some plaintiffs' efforts to game the system in patent litigation.

In June 2010, in *Zimmer Holdings Inc.*, the Federal Circuit, signaling a willingness to closely scrutinize a plaintiff's motive for setting up shop in a venue, held that presence in the forum would weigh against transfer only if such presence was not "recent, ephemeral, and an artifact of litigation." *In re Zimmer Holdings, Inc.*, 609 F.3d 1378, 1381 (Fed. Cir. 2010).

In the same vein, in November 2010, the Federal Circuit reversed yet another venue decision out of the Eastern District of Texas, finding that the plaintiff's actions to establish a business presence in Texas lacked any purpose other than to manipulate venue. *In re Microsoft Corp.*, No. 944, 2011 WL 30771 (Fed. Cir. Nov. 8, 2010). In *Microsoft*, the plaintiff had incorporated and established offices in Texas just prior to commencing the litigation, but did not have employees in the state or anywhere in the United States. The Federal Circuit noted that

plaintiff's venue arguments were grounded in the fallacious assumption that a court should give weight to the establishment of a business within a judicial district where the transparent purpose in doing so was entirely litigation oriented.

In *In re Acer America Corp.*, 626 F.3d 1252, 1256 (Fed. Cir. Dec. 3, 2010), the Federal Circuit again emphasized that a defendant's mere nationwide sale of an alleged infringing product does not give rise to a substantial interest in any single venue, unless there are also significant connections between that venue and the events giving rise to the suit. Thus, patent cases should generally be transferred when a substantial number of witnesses are located in — or the party seeking a change of venue is headquartered in or near — the proposed transferee venue, particularly when combined with the absence of a true business nexus, party or any meaningful number of witnesses in the plaintiff's chosen forum.

Why Connecticut?

Although the rocket docket jurisdictions remain a tempting lure for patent infringement plaintiffs, given the developing trends, a patent plaintiff needs to be careful to avoid selecting a geographically remote jurisdiction in which the choice of venue is unlikely to survive a determined challenge. Otherwise, they risk being punted to the potentially hostile backyard of their adversary and consequently diminishing the odds of prevailing in their lawsuit.

As such, Connecticut-based companies that contemplate bringing a patent infringement action should proceed cautiously before selecting rocket-docket venues, because in doing so, a Connecticut plaintiff loses the deference that the District of Connecticut would likely give to a Connecticut choice of forum in the face of a venue challenge from an out-of-state defendant.

In addition to convenience, there are also a number of additional non-patent factors that may provide benefits to a plaintiff commencing a patent litigation in Connecticut.

First, to the extent there are pendent state law claims, the Connecticut Unfair Trade Practices Act (CUTPA) prohibits a broad range of conduct and provides strong remedies in cases involving allegations of unfair or deceptive trade practices. Second, another benefit of litigating in Connecticut is that it has a very liberal pre-judgment remedy statute that permits attach-



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ment of a defendant's assets up to the amount of the claim upon a mere showing of probable cause and without consideration to the defendant's ability to pay.

Finally, Connecticut's Offer of Judgment Statute (Connecticut General Statutes Section 52-192a) allows a plaintiff to submit an offer of compromise and to recover 8 percent annual interest on the entire judgment amount retroactive to the commencement of the lawsuit so long as the plaintiff's recovery exceeds the offer of judgment amount. Due to the power of compounding, the additional offer of judgment interest potentially awardable to a successful patent plaintiff can be quite significant.

Conclusion

There may still be valid reasons for a Connecticut-based corporate plaintiff to strain to bring a patent infringement action in historically pro-patentee jurisdictions such as the Eastern Districts of Texas and Virginia.

Worth considering, however, is the increasing judicial hostility to forum shopping in patent cases and the resulting risk of a case being transferred back to an adversary's home court, in situations where no transfer would have been granted if the plaintiff chose Connecticut as its forum in the first place. The availability of additional substantive causes of action, as well as certain mechanisms favorable to plaintiffs, provide at least some offsetting significant advantages to litigating a patent case in Connecticut. ■

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Businesses Must Protect Against Cyber-Espionage

Attacks by employees or hackers can lead to civil, criminal charges

By **T. SCOTT COWPERTHWAIT**

The 2010 science fiction thriller "Inception" tells the story of a corporate spy and saboteur who is hired to invade the dream state of the heir to an energy empire. His mission is to plant a "new idea" inside the heir's mind, thus altering the future of the business.

While the concept of entering the human mind through dreams for espionage purposes seems far-fetched, similarities exist with respect to cyber-related economic espionage threats and vulnerabilities to businesses. Even an unsophisticated malware attack launched against a corporate computer network can cause significant eco-

effects on information technology, security, human resources and business planning which can lead to civil, criminal and/or regulatory actions or charges.

While a major corporation may be capable of withstanding the damage caused by economic espionage, small and mid-sized businesses whose value is typically tied to a single piece of technology or trade secret are less likely to survive. These businesses generally have limited resources or pay little to no attention to developing an effective cybersecurity program and, therefore, the damage resulting from economic espionage can be catastrophic.

Recent cases demonstrate that both criminal

The most common perpetrator remains the corporate insider. A current or recently terminated employee does not need to launch sophisticated computer intrusions because he or she likely has knowledge of and/or access to the targeted computer network or data. For example, in February 2010, a grand jury sitting in the U.S. District Court for the Southern District of New York returned an indictment charging Sergey Aleynikov, a computer programmer employed by Goldman Sachs, with theft of trade secrets in violation of the Economic Espionage Act, transportation of stolen property in interstate and foreign commerce, and unauthorized computer access in violation of the Computer Fraud and Abuse Act.

After accepting an employment offer with Teza Technologies LLC, a startup company dedicated to developing its own high-frequency trading business, Aleynikov had uploaded, compressed and encrypted hundreds of thousands of lines of source code, proprietary data housed on Goldman Sachs's servers, and transferred the data to an external server for future retrieval. While the court dismissed the count pursuant to the Computer Fraud and Abuse Act prior to trial, this past December the jury returned a guilty verdict on the remaining counts.



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In another case, also in December, the Hilton Hotel Corp. reportedly agreed to pay Starwood Hotels & Resorts \$75 million in connection with Starwood's claims that Hilton officials, who were former Starwood executives, stole confidential and proprietary information regarding Starwood's luxury, boutique hotel chain. Prior to the settlement, the U.S. Attorney's Office for the Southern District of New York moved to intervene and stay discovery in the civil action, raising the possibility that criminal charges pursuant to the Economic Espionage Act may be filed in connection with the corporate espionage acts.

Growing External Threat

But the corporate insider is not the only culprit with which companies should be concerned. There are more and more instances of both domestic and international espionage perpetrated by outsiders engaging in increasingly sophisticated tactics.

An emerging trend places criminal groups, hackers and, perhaps most alarmingly, nation-states at the epicenter of the economic and industrial espionage threat. While criminal groups and hackers tend to attack corporate computer networks for monetary gain or disruptive purposes, nation-states are sponsoring and/or engaging the services of these actors to launch cyber attacks against businesses to facilitate their information-gathering and espionage activities.

For example, last month, McAfee, a global security technology company, released a report finding that "coordinated covert and targeted cyber attacks have been conducted against global oil, energy, and petrochemical companies." These "Night Dragon" attacks, which originated from a

■ Continued on **PAGE 18**

BUSINESS LITIGATION

conomic damage, decrease competitive advantage, devalue brand recognition and reputation and undermine consumer confidence in the targeted business or industry.

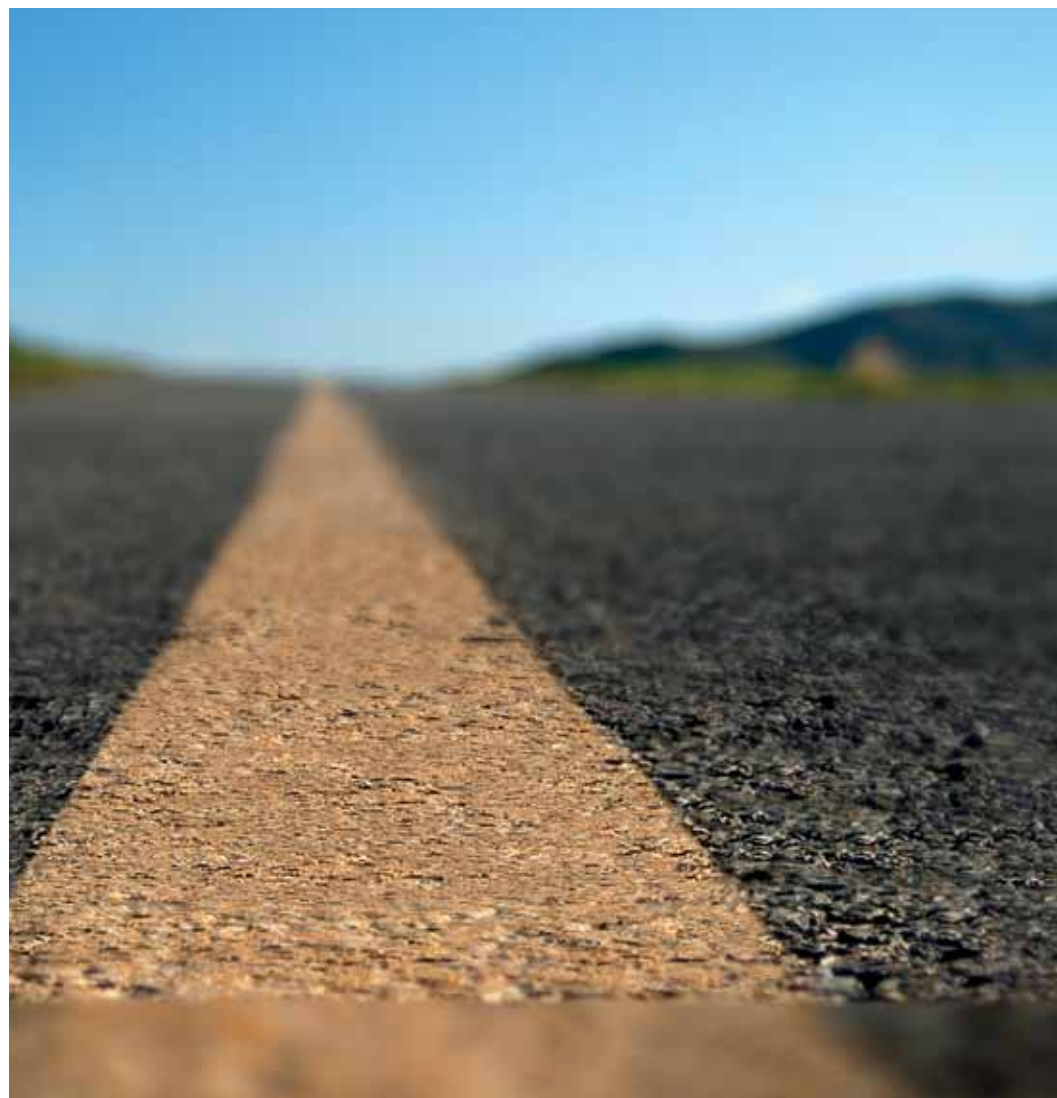
Targeted Industries

The rapidly changing and increasingly complex tools and capabilities used to infiltrate corporate computer networks and access proprietary corporate information and systems present new challenges to businesses. For companies in the private sector, the theft of trade secrets, critical technologies and other proprietary and sensitive business information can have serious

and civil enforcement of economic and industrial espionage for theft of trade secrets, proprietary and sensitive information and disruption of critical infrastructure is proceeding at an accelerated pace among the private sector and the U.S. government.

The most likely criminal charges are filed pursuant to statutes that include: 1) Economic Espionage Act; 2) Computer Fraud and Abuse Act; 3) Arms Export Control Act; 4) foreign/interstate transportation of stolen property; 5) mail and/or wire fraud; 6) honest services fraud; 7) money laundering; 8) false statements; and 9) obstruction of justice.

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A Rejection Of The 'Gifting' Theory

Decision affects debtors, creditors in commercial reorganization cases

By IRVE J. GOLDMAN

Core principle affecting the negotiations and outcome in most Chapter 11 reorganization cases is known in bankruptcy parlance as the "absolute priority rule." First developed in the railroad reorganization cases of the 1800s and codified by the Bankruptcy Code in 11 USC §1129(b)(2)(B), it provides that a plan of reorganization may only be confirmed over the opposition of a dissenting class of unsecured creditors – a so-called "cram-down" – if the unsecured creditors are paid in full or the equity holders of the Chapter 11 debtor will not receive or retain any property under the plan "on account of" their junior interests (i.e., junior to the unsecured creditors). 11 USC §1129(b)(2)(B) (i), (ii) (emphasis added).

The easiest example of compliance with the absolute priority rule is where the plan provides

debtor to retain their equity interests on account of "future labor, experience and expertise" they promised to provide to the reorganized debtor. And in *Bank of America v. 203 N. LaSalle Street Partnership*, 526 U.S. 434 (1999), the Supreme Court rejected a plan where the debtor's partners were, in effect, purchasing new equity in the debtor by agreeing to contribute \$6.1 million of capital to the reorganized debtor. This plan was rejected because it provided the old equity holders with the exclusive opportunity to purchase the equity, without the benefit of a marketing process or the opportunity for competing plans from creditors, which itself was considered to be property received "on account of" the partners' existing equity interests.

Now adding to the jurisprudence on the absolute priority rule is *In re DBSD North America*, 2011 WL 350480 (2d Cir. Feb. 7, 2011). In *DBSD*, the 2nd Circuit Court of Appeals considered

less than the amount of the creditor's claim. The theory advanced for approval of such a plan was that the undersecured creditor is "giving up" equity interests in the debtor to which it would otherwise be entitled and, therefore, general unsecured creditors have no right to complain.

From a statutory perspective, the question addressed in *DBSD* was whether old equity would be receiving these new shares "on account of" its junior equity interest in the debtor or, as was argued by the proponents of the plan, as a "gift" from the holders of the secured debt, who were senior in priority to the dissenting class of unsecured creditors and who could therefore "voluntarily offer a portion of their recovered property to junior stakeholders without violating the absolute priority rule."

The answer to this question has far-reaching consequences for debtors and creditors in commercial reorganization cases. If non-consenting unsecured creditors could be crammed down any time an undersecured creditor of the debtor went along with a plan which issued new shares to old equity, confirmation of Chapter 11 plans might be made much easier, but at the substantial expense of unsecured creditors. That potential consequence was apparently acceptable to the bankruptcy court in *DBSD* because it confirmed the company's Chapter 11 plan by adopting the "gifting" theory that had been advanced by the plan proponents.

The 2nd Circuit saw it a different way, however. With surgical-like precision, the appeals court traced the roots of the absolute priority rule and analyzed modern Supreme Court precedent when it held that existing shareholders receive property "on account of" their prior junior interests, and not simply "on account of" the generosity of an undersecured creditor, when a plan distributes new equity to existing shareholders with the acceptance of the undersecured creditor. Consistent with Supreme Court precedent, the 2nd Circuit interpreted the words, "on account of" to mean some form of "because of," i.e., if an existing shareholder receives any property under a plan "because of" his equity interest, the absolute priority rule would prevent confirmation of the plan.

The Court reasoned that the distribution of new shares to old equity, although argued to have been proposed to win their continued cooperation and assistance post-reorganization, and not on "account of" their equity interest, "was useful only because of the shareholder's position as equity holder and the rights emanating from the position." (emphasis added)

The 2nd Circuit also rejected the argument

that a transfer of the new shares partly on account of factors other than the shareholder's prior interest could satisfy the absolute priority rule, reasoning that if this was a result intended by Congress, the statutory language "on account of,"

would have been modified by the words, "only," "solely," or even "primarily."

Prior to *DBSD*, many bankruptcy practitioners, as well as the bankruptcy court itself in *DBSD*, were of the view that the 1st Circuit Court of Appeals decision in *In re SPM Manufacturing Corp.*, 984 F.2d 1305 (1st Cir. 1993) supported the gifting theory that had been used to confirm *DBSD*'s reorganization plan.

In that case, the 1st Circuit upheld an agreement between the debtor's secured creditor and a committee of unsecured creditors to share in the proceeds from a liquidation that had taken place prior to the conversion of the case to a Chapter 7, even though enforcing the agreement meant cutting out a distribution to a tax creditor that was in between those two classes in terms of priority.

While expressing no opinion on the result reached in *SPM*, the 2nd Circuit distinguished the case, principally on the ground that it involved a Chapter 7 and not a Chapter 11 case. This was considered an important distinction since unlike Chapter 11, Chapter 7 does not contain "the rigid absolute priority rule of §1129(b)(2)(B)."

A significant question expressly left open by the 2nd Circuit in *DBSD* is whether the Bankruptcy Code would sanction an agreement for the transfer of shares from an undersecured creditor to the existing shareholder "outside the plan," apparently after the creditor receives the entire equity interest of the debtor under the plan. Although such a scheme would appear to promote form over substance, it is perhaps a nuanced distinction that may receive acceptance by the courts.

There is little question that the ruling in *DBSD* takes away significant negotiating leverage for Chapter 11 debtors whose equity holders want to hold onto to their equity positions while paying unsecured creditors less than in full. It eliminates the option that the shareholders of the debtor and a dominating undersecured creditor can agree to share in the equity of the reorganized debtor while unsecured creditors are paid cents on the dollar, and points the way back to old-fashioned, hard bargaining. ■



Irve J. Goldman

BUSINESS LITIGATION

for the equity interests of shareholders to be "wiped out," with unsecured creditors to become the new owners of the reorganized debtor.

The U.S. Supreme Court has spoken twice about the absolute priority rule under the Bankruptcy Code and on both occasions, it was strictly construed. In *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1989), the Supreme Court rejected a plan providing for shareholders of the

whether the rule can be satisfied when a reorganization plan that is rejected by unsecured creditors distributes equity to the debtor's existing shareholders (colloquially referred to as "old equity") with the acceptance of a higher priority "undersecured" creditor with a lien on all assets. The term "undersecured" in this context simply means that the value of all of the debtor's assets, as measured on a going-concern or fair market value basis, is

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■ From BUSINESS on PAGE 17

server in China, are designed to steal specific, sensitive information, data and intellectual property by, among other things, penetrating computer networks through traditionally ordinary means (e.g., an infected e-mail that appears to come from a legitimate business or contact).

Proactive Steps

Recent cyber attacks and other espionage-related acts on corporations highlight the threats posed by the connectivity of our computer networks and vulnerabilities of our proprietary and sensitive information. Businesses can take proactive steps to prepare for and protect against these potential threats and their possible legal (and business) repercussions by encouraging: 1) strong internal communication and coordination among essential parties, e.g., physical and IT security, human resources, legal, management 2) identification of trade secrets and proprietary information/data, including non-traditional information, and analysis of potential loss (economic,

reputation, competitive advantage, etc.) 3) identification of potential internal or external threats, corporate-wide awareness training and development of loss mitigation and prevention plans 4) development, implementation and enforcement of electronic and social media/networking use policies and 5) coordinated and effective relationships with law enforcement authorities.

Because the private sector owns most of the nation's critical infrastructure, it is likely that most economic and industrial espionage cases involving the theft or misappropriation of trade secrets and/or proprietary data will continue to be most effectively redressed through civil remedies. There is an increasing trend to pursue criminal remedies, although this approach relies heavily on a business's willingness to work with government investigators. Businesses, however, need to keep in mind that they themselves may be liable to government regulators and/or their investors for failing to properly secure against and/or disclose material events and acts, perhaps even attempted acts, of economic and industrial espionage. ■

Revisiting Burden Of Proof In Patent Challenges

'Clear and convincing' evidence standard is unusual in civil cases

BY WILLIAM J. CASS

The U.S. Supreme Court is about to reconsider the burden of proof on a party seeking to invalidate a patent. Under Section 282 of the Patent Act, 35 U.S.C. § 282, "the burden of establishing invalidity of a patent or any claim thereof shall rest on the party asserting such invalidity."

The Federal Circuit has long interpreted the presumption of validity codified in the Patent Act to require proof of the factual predicate of invalidity by *clear and convincing evidence*, even when the prior art evidence on which the invalidity defense rests was never considered by the U.S. Patent and Trademark Office. See *e.g.*,

both U.S. and foreign patents.

What is often not fully understood is that the examiner is limited by both time and resources to consider other available information such as commercial products and technical literature not readily available on the Internet or in the databases maintained by the PTO.

Thus, in patent litigation, with the ability to take discovery, greater resources and/or the defendant's own records, the defendant may be able to locate much more pertinent prior art that was never considered by the patent examiner. Nevertheless, even though the defendant has uncovered such new prior art, which might include its own products, the defendant is bur-

dened with a jury instruction that invalidity be proven by clear and convincing evidence. (That is, the jury is instructed that it must have a clear conviction that the patent is invalid).

PTO's 'Expertise'

The so-called rationale for this standard, "that the PTO, in its expertise, has approved the claim" was noted more recently to be much more diminished when a defense rests on evidence that the PTO never addressed. See *KSR International v. Teleflex Inc.*, 550 U.S. 398, 426 (2007).

As part of the "statutory bargained-for-exchange by which a patentee obtains the right to exclude others," the inventor must disclose the best mode of practicing the invention at the time the patent application is filed. 35 U.S.C. §112. See *Eli Lilly & Co. v. Barr Labs. Inc.*, 251 F.3d 955, 963 (Fed. Cir. 2001). At the time the application is filed, there is no guarantee that a

patent will eventually issue. Many companies elect to maintain their technology as a trade secret as opposed to risking disclosure in an unsuccessful patent application. For example, source code that operates a machine or software program is typically maintained as a trade secret. Thus, vast amounts of industrial knowledge are not readily available to the PTO.

The clear and convincing evidentiary standard in civil cases is not a common standard. As noted by the Supreme Court, the appropriate standard of proof in civil cases is a preponderance of the evidence (more likely than not) "unless particularly important individual interests or rights are at stake." See *Grogan v. Garner*, 498 U.S. 279, 286 (1991). Such individual interests or rights meriting a higher burden of proof include termination of parental rights, civil commitment, deportation and denaturalization.

The Supreme Court now appears ready to revisit this evidentiary standard, granting a writ of certiorari on Microsoft's appeal in *Microsoft Corporation v. I4I Limited Partnership et al.* At trial, I4I alleged that certain versions of Microsoft's word processing software, Microsoft Word, infringed I4I's patent. Microsoft contended that I4I's patent was invalid because the disclosed invention had been embodied in the software product sold in the United States more than one year before the patent application was filed, thus rendering the invention unpatentable under the sale bar of 35 U.S.C. § 102(b).

That prior art software was never considered by the PTO during prosecution of the patent, yet because I4I had destroyed the source code for the software before filing its action against Microsoft, I4I's technical expert and counsel were able to stress to the jury repeatedly that Microsoft could not prove by clear and convincing evidence that the software embodied the patented invention. Ultimately the jury concluded that Microsoft failed to sustain this heightened standard of

proof. In support of its position, Microsoft presented a letter from one of the inventors touting the fact that the earlier and potentially invalidating software program provided the basis for the patent. In its brief, Microsoft has argued that the rule cannot be reconciled with the Court's longstanding presumption that in the absence of a constitutional congressional command to the contrary, civil cases are governed by the preponderance standard, noting that the statute is silent on the burden of proof. Microsoft also notes that patent litigation has played an important role in weeding out those patents that should not have been granted and that such a heightened standard is particularly inappropriate where the PTO did not consider the relevant prior art.

Numerous parties have offered briefs *amicus curiae* for the Court's consideration supporting both sides of the issue. For example, IBM has advocated that the high evidentiary standard be maintained and that lowering the burden of proof to a preponderance standard would eviscerate the deference owed to the PTO's decision-making process. Regardless of how the Supreme Court rules in the *I4I* litigation, this decision is eagerly anticipated by industry, patent practitioners and inventors alike. ■



William J. Cass

BUSINESS LITIGATION

American Hoist & Derrick Co. v. Sowa & Sons Inc., 725 F.2d 1350, 1359-60 (Fed. Cir. 1984).

Challenges to patents are often based on prior art that existed before the invention. For example, a product on sale more than a year before the patent filing date which anticipates the patent claims is a bar to patentability. 35 U.S.C. § 102(b). This is referred to as the "on-sale bar."

This heightened evidentiary standard is incongruent at best with the patent examination process. In a typical patent examination, the examiner may spend a dozen hours or so examining the prior art at his or her disposal, including

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Build Up Value Before Selling A Business

Management depth and diversified customer base are key elements

By MARK S. CAMPBELL

By most accounts there is a wave of small and medium sized businesses that will be sold in the next five to ten years. Studies have shown that of the 78 million members of the baby boomer generation, nearly ten percent of them are small business owners.

In addition, nearly two-thirds of business owners in the United States do not have children that plan on taking over the family business. This leaves an estimated 5 to 7 million small businesses without a family succession plan.

In all likelihood, these businesses will come to market in one of three ways:

- The owner will leave the business to his or her estate who will either sell or dissolve the company.
- The owner will become an absentee owner or dissolve the company and retire (leaving market share to be taken by another entity).
- The company will be sold to employees or a third party.

Of the three options, maximum value to the owner is typically achieved only by a sale to a third party. This article will discuss some items

small business owners should consider from a valuation and planning perspective to increase value from a sale of their business.

Valuation Basics

For a variety of reasons, most small businesses are typically valued based on the cash flows they generate. The basic formula used in valuing the cash flows of a business is comprised of two parts. The numerator consists of the normalized cash flow of the business, and the denominator consists of a discount rate minus a growth rate, which is also called a capitalization rate.

The discount rate can really be thought of as the risk associated with the normalized cash flows of the business. The more risk associated with the cash flows, the higher the discount rate will be resulting in a lower value for the business. Many systematic risks cannot be controlled by the business owner.

However, there are many unsystematic – or



Mark S. Campbell

company specific – risks that a business owner may have more control in trying to minimize. Two common risk areas are lack of management depth (key man risk) and customer or supplier concentration.

Increasing Value

Very often a business owner is focused on growing the top-line revenue of his or her business, which is obviously an important driver of value for a business. However, if the risk associated with those cash flows is still high, the incremental value being generated isn't as high as it could be. Taking steps to reduce the company-specific risk of the company can generate as much or more value for the business owner.

So how can a business owner reduce risk? As mentioned earlier, the two main ways are by increasing depth of management and diversifying customers and suppliers.

The number one value driver for companies is the management team. For many closely-held businesses, this management team consists of

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Another Route To Enjoining Deceptive Business Practices

The CUSPA can substitute for or supplement its better-known sibling

By EDWARD J. HEATH

Claims under the Connecticut Unfair Trade Practices Act, 42-110a, *et seq.* are a staple of business litigation. When a deceptive practice is at issue, and CUTPA's ascertainable loss element may be difficult to prove, claimants and counter-claimants would be wise to consider including an additional or alternative count under CUTPA's often-overlooked sibling, the private cause of action found in the Connecticut Unfair Sales Practices Act.

Specifically, CUSPA's Section 42-115e brings with it a less onerous standard and key statutory presumptions that together streamline the road to an injunction and the recovery of attorneys' fees and costs.

The reference to "Sales" in the name of the statutory chapter may be the cause of Section 42-115e's relative obscurity, but this private cause of action is not restricted to sales activities. The statute more generally provides that a claimant "likely to be damaged by a deceptive trade practice of another" may be awarded an injunction addressing that practice "under principles of equity and on terms the court considers reasonable." Conn. Gen.

Stat. Sec. 42-115e(a).

Although CUSPA does not define "deceptive trade practice," it is reasonable to interpret that phrase consistent with CUTPA. According to the Connecticut Supreme Court, a practice is "deceptive" for purposes of CUTPA if three requirements are met: "First, there must be a representation, omission or other practice likely to mislead consumers. Second, the consumer must interpret the message reasonably under the circumstances. Third, the misleading representation, omission or practice must be material—that is, likely to affect consumer decisions or conduct." *Caldor v. Heslin*, 215 Conn. 590, 597 (1990)

These three elements have been the subject of extensive analysis that need not be repeated here, but it is worth noting the importance of totality and context. In assessing those elements, and thus a claim under Section 42-115e, "the entire advertisement, transaction or course of dealing will be considered." *State v. American Recycling Technologies Inc.*, No. CV040832985, 2009 Conn. Super. LEXIS 1194, *10 (Conn. Super. Ct. May 5, 2009) (quoting F.T.C. Policy Statement appended to *Cliffdale Associates Inc.*, 103 F.T.C. 110, 174 (1984)).

Lightened Standard

CUSPA's punch comes in the second sentence of Section 42-115e. Unlike CUTPA's "ascertainable loss" requirement, CUSPA expressly relieves a claimant of the need to prove that the challenged practice caused a financial harm or had an impact on its ability to fairly compete. Likewise, a claimant need not show actual consumer confusion or misunderstanding. The test is whether the practice is "likely" to mislead or confuse consumers.

Added to this lightened standard is the presumption that the claimant has suffered irreparable injury and lacks an adequate remedy at law. In other contexts, Connecticut's Supreme and Appellate courts have concluded that when a statute provides for injunctive relief, a court should conclude that those two customary requirements are implicitly satisfied. See, e.g., *Gelinas v. West Hartford*, 225 Conn. 575, 588, 626 A.2d 259 (1993).

The logic is that the legislature would not have provided for an injunctive remedy unless it had already determined that a violation of the statute necessarily caused irreparable harm and left the claimant without an adequate legal remedy. In an unpublished 2006 decision, Superior Court Judge Samuel Sferazza thoroughly surveyed the relevant case law to conclude that this presumption should also apply to claims brought under 42-115e, regardless of whether the injunction sought is temporary or permanent, and whether the claimant is a private or governmental entity. *RW Group, Inc. v. Pharmicare Management Services Inc.* No. X07-CV-054003840S, 2006 Conn. Super. LEXIS 1256, *2-6 (Conn. Super. Ct. Apr. 27, 2006).

Finally, even though a claimant must demonstrate a "deceptive" practice, proof of an "intent to deceive" is not required." Sec. 42-115e(a). In other words, a deceptive practice that results

from negligence, or possibly mere inadvertence, may warrant an injunction under CUSPA. If, however, the claimant proves that the other party has "willfully" engaged in the deceptive practice, then the court may award attorneys' fees and costs.

It is unclear how the term "willfully" should be interpreted in this context. On the one hand, it could include a defendant who intentionally engages in the challenged practice, unaware of its deceptive potential.

On the other, the term may have a more restrictive meaning and be limited to situations where a defendant intentionally engages in a challenged practice in order to obtain the benefits of the deception. The section's limitation of fee awards to "exceptional" cases suggests that the latter application is likely the more reasonable one. Regardless of which interpretation holds, businesses who find themselves embroiled in trade practices litigation should not overlook Section 42-115e and its streamlined injunction standard. ■

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■ From BUILD on PAGE 19

one person. To build a valuable business, the management of the organization should include people with a variety of skills who can successfully run the business after the owner's departure and, collectively, do all that the owner does today.

Developing a strong management team helps in two ways. First, as described, it can increase value to a third-party buyer. However, it may also provide for an alternate exit strategy. If the management team is strong, they may have an interest in working with the business owner to structure a management buyout plan. In addition, delegating some of the responsibility of operating the business can help to reduce stress for the business owner.

A second way to increase value is to reduce customer or supplier concentration, which is often easier said than done. However, if a single customer makes up a majority of company sales, there can be ways

to try to reduce this risk.

As mentioned in the beginning, with so many other similarly situated companies out there, a possibility would be to merge with a business operating in your industry to diversify your customer base. Very often, one plus one can equal greater than two, by reducing risk and increasing cash flows.

Other Factors

Other factors to consider in exit planning include:

The Team: It is essential to put together an experienced advisory team to guide you through the exit planning process. This team can consist of one or more of the following: CPA, valuation expert, investment banker, business attorney, estate planning attorney, and wealth manager.

Allow Time: Many of these steps and processes take time to develop and implement. Starting early with a written plan for achieving them is key to successful implementation. ■

Prejudgment Remedy Denial Isn't The Last Word

PJR rulings don't preclude different finding in summary judgment phase

BY DAVID DOBIN

A February 2011 decision of the Appellate Court of Connecticut sheds light on the substantial procedural disparity between a prejudgment remedy proceeding and a subsequent proceeding on the merits. The opinion by Judge Richard A. Robinson rejects collateral estoppel effect to a plaintiff's failure to prove the necessary facts to obtain a prejudgment remedy, and removes one barrier to bringing prejudgment remedy applications.

In *Gateway, Kelso & Co. v. West Hartford No. 1*, 126 Conn. App. 578 (2011), after a one-day prejudgment remedy hearing, the trial court denied the plaintiff's application for a prejudgment remedy. The plaintiff claimed to be owed a com-

mission on a sale of real estate. The defendant argued that the plaintiff, an unlicensed real estate broker, was barred from bringing an action to collect a commission by Connecticut General Statutes § 20-325a. Finding that the plaintiff was an unlicensed real estate broker barred by statute from bringing a collection action against the defendant, the trial court denied the plaintiff's application for a prejudgment remedy.

BUSINESS LITIGATION

mission on a sale of real estate. The defendant argued that the plaintiff, an unlicensed real estate broker, was barred from bringing an action to collect a commission by Connecticut General Statutes § 20-325a. Finding that the plaintiff was an unlicensed real estate broker barred by statute from bringing a collection action against the defendant, the trial court denied the plaintiff's application for a prejudgment remedy.

One year later, the defendant moved for summary judgment, arguing that the trial court's factual finding on the prejudgment remedy application collaterally estopped the plaintiff from denying that it was "engaged in real estate business." The trial court denied that motion.

On appeal, the court described the three requirements of collateral estoppel: First, the issue

must have been "fully and fairly litigated" in the first action. Second, the issue must have been "actually decided." Third, the decision must have been "necessary to the judgment." The Appellate Court held that the issue of fact decided in the application for a prejudgment remedy had not been "fully and fairly litigated," and affirmed the trial court's denial of the defendant's motion for summary judgment.

In its decision, released Feb. 15, the Appellate Court based its holding on the "substantial procedural disparity between the prejudgment remedy proceeding and a subsequent proceeding on the merits." In particular, the court highlighted two important reasons why the prejudgment remedy proceeding did not afford the plaintiff an opportunity to fully and fairly litigate the merits of its

claim: First, the court explained the bases for the "firmly established" principle that a prejudgment remedy hearing "is not intended to be a full scale trial on the merits of the plaintiff's claim." (quoting *Fischel v. TKPK Ltd.*, 34 Conn. App. 22, 24, 640 A.2d 125 (1994)). "Prejudgment remedy proceedings are circumscribed by statute; General Statutes § 52-278d(a); and are not involved with the adjudication of the merits of the action brought by the plaintiff or with the progress or result of that adjudication. They are only concerned with whether and to what extent the plaintiff is entitled to have property of the defendant held in the custody of the law pending adjudication of the merits of that action.... The adjudication made by the court on [an] application for a prejudgment remedy is not part

of the proceedings ultimately to decide the validity and merits of the plaintiff's cause of action. It is independent of and collateral thereto...." (quoting *Morris v. Cee Dee LLC*, 90 Conn. App. 403, 411-12, 877 A.2d 899)

Second, the Appellate Court noted the "less demanding standard" of proof for a prejudgment remedy application, i.e., "probable cause that a judgment in the amount of the prejudgment remedy sought, or in an amount greater than the amount of the prejudgment remedy sought, taking into account any defenses, counterclaims or setoffs, will be rendered in the matter in favor of the plaintiff."

Full-Blown Trials?

Interestingly, in *Gateway*, the trial court denied the plaintiff's application for prejudgment remedy despite the significantly lower "probable cause" burden of proof. Therefore, according to the court's reasoning, even a finding that the plaintiff failed to meet the significantly lower "probable cause" burden of proof cannot be used against the plaintiff later in a proceeding on the merits.

Although the court seemed most concerned with prejudgment remedy hearings becoming full-blown trials, the decision also has the effect of removing a roadblock to plaintiff's filing



David Dobin

prejudgment remedy applications. In the past, Superior Court decisions have applied collateral estoppel to preclude the re-litigation of factual issues decided in earlier prejudgment remedy proceedings. See, e.g., *Coveny v. Gagner*, No. CV054012466s (Conn. Superior Court, Dec. 28, 2006); *Dinnis v. Roberts*, No. CV90-296974 (Conn. Superior Court, Jan. 15, 1992). These cases might have supported an argument that the earlier prejudgment remedy hearings had been fully and fairly litigated, but *Gateway* makes clear that such a conclusion would be wrong.

The lesson of *Gateway* is that lawyers should not shy away from filing an application for prejudgment remedy for fear of a collateral estoppel effect on subsequent fact-finding if that application is denied. More fundamentally, in light of the Connecticut Supreme Court's holding in *Margolin v. Kleban & Samor*, 275 Conn. 765, 782-783 (2005), that a failure to file an application for prejudgment remedy may be grounds for malpractice, it is incumbent on all Connecticut litigators, when representing a claimant (plaintiff or defendant), to speak to their clients about exploring all options for attaching defendants' assets prior to the entry of judgment. See also the Connecticut Rules of Professional Conduct § 1.0(f), which requires the client's agreement to a proposed course of conduct "after the lawyer has communicated adequate information and explanation about the material risks of and reasonably available alternatives to the proposed course of conduct." ■

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