

**Statement On Behalf of the Business Software Alliance
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“Review of Patent Law Decisions”

**Hearing Before The
Subcommittee on Intellectual Property, Competition and the Internet
Committee on the Judiciary
U.S. House of Representatives**

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Mr. Chairman, Ranking Member Watt, and members of the Subcommittee.

My name is Andrew J. Pincus, and I am a partner in the law firm Mayer Brown LLP. I am honored to appear before the Subcommittee today on behalf of the Business Software Alliance (“BSA”), which is an association of the world’s leading software and hardware technology companies. A significant part of my law practice focuses on Supreme Court and appellate litigation, and I represented BSA in many of the cases that I will discuss today. From 1997 to 2000, I served as the General Counsel of the United States Department of Commerce, where I was responsible for a number of intellectual property issues.

BSA has been a strong supporter of patent reform throughout the nearly six years that this Committee has been focused on modernizing our patent laws. BSA companies are innovators, and substantial patent holders, and at the same time are frequently named as defendants in patent infringement actions. They therefore have a particularly acute interest in properly calibrated standards for obtaining patents, for challenging dubiously-issued patents in administrative proceedings, and for enforcing patents in the courts.

The last five years have seen a dramatic change in the Supreme Court’s attention to patent law issues. From 2000-2005, the Court decided only 3 patent cases; from 2006 through the end of the current term, the Court will have ruled on 8 patent issues. Many of the areas of the law that provided the impetus for legislative reform have now been addressed by the Court. The Court of Appeals for the Federal Circuit also has been active in clarifying previously uncertain or unjustified legal principles.

What are the reasons for this change?

This Committee’s intensive focus on the problems in our patent litigation system is, I believe, one of the principal reasons for the courts’ increased activity in this area. On June 8, 2005, Mr. Chairman you, along with Chairman Smith, Mr. Berman, Mr. Conyers, Ms. Lofgren, Mr. Coble and others introduced H.R. 2795, “The Patent Reform Act of 2005.” Chairman Smith explained that the purpose of the bill was to “eliminate legal gamesmanship from the current

system that rewards lawsuit abuses over creativity. It will enhance the quality of patents and increase public confidence in their legal integrity.”¹

The 2005 patent reform bill addressed three basic areas: (1) provisions targeting judicially-adopted rules for patent litigation that unbalanced the litigation system and permitted the assertion of abusive claims; (2) provisions to improve the quality of the patent examination process and to better enable the experts at the Patent and Trademark Office to correct errors made in the examination process; and (3) adoption of the first-to-file standard for patent grants.

When this bill was introduced in 2005, the most controversial patent litigation issue was the standard for issuing injunctions in patent infringement actions. The Federal Circuit had held that injunctions should be issued in every case in which the plaintiff prevails “absent exceptional circumstances.” The technology industry argued that the jurisprudence in the area of patents was out of step with every other area of the law, where courts are required to weigh equities before granting an injunction—and asked Congress to intervene to restore the appropriate standard for injunctive relief. The very next year, while Congress was considering the issue, the Supreme Court took up this issue in *eBay Inc. v. MercExchange, L.L.C.*, 547 U.S. 388 (2006), and held unanimously that the general standard for granting injunctions applies in patent infringement actions as well.

The 2005 bill, as well as the 2007 and 2009 patent reform bills considered by this Committee addressed a number of other problems in the litigation system:

- The standard for determining whether a patent application should be denied on obviousness grounds;
- The test for awarding multiple damages based on a finding of “willful” patent infringement;
- The standard for determining the amount of a “reasonable royalty” in cases in which the alleged infringement relates to a minor component or feature of a complex product;
- Extraterritorial application of the U.S. patent laws under Section 271(f);
- The standard of proof applicable to judicial challenges to patent validity; and
- Rules governing the permissible venue for patent infringement actions.

The Supreme Court’s decision in *eBay* was a harbinger of things to come with respect to these issues. Over the past several years, the Supreme Court and the Court of Appeals for the Federal Circuit have in a series of cases addressed these issues, ameliorating the perverse situation in which the standards for asserting claims under the patent law were in fact imposing very substantial obstacles to the discovery of new products and services in the most dynamic sectors of our economy.

¹ Patent Act of 2005: Hearing Before the Subcomm. on Courts, the Internet, and Intellectual Property of the House Comm. on the Judiciary, 109th Cong., 1st Sess. 1 (2005).

As a result of this judicial activity, the legal standards governing patent litigation are in a much better state than they were when this Committee first led the charge on patent reform. While of course not all of our concerns have been addressed fully, at this time, the courts are moving in the right direction. I say “at this time” because continued vigilance is essential. The past imbalances in the law were in many cases created by the courts, and there is no way to predict the path of future jurisprudence. There is, however, good reason to be optimistic.

Even though the litigation issues are being addressed by the courts, there is still essential work for Congress on patent reform. The courts cannot implement the necessary improvements to the PTO’s processes or the first-to-file system and recent jurisprudence of false patent marking has created new risk for inventors. Those reforms require action by Congress.

BSA member companies believe the time has arrived to move beyond old controversies and enact a balanced, consensus patent reform bill. As this Committee proceeds with patent reform legislation, we urge the Committee to focus on the following key elements:

- **Funding the Patent and Trademark Office.** The PTO needs the freedom to set its own fees in order to achieve the import goals of continuing to reduce pendency, enhance patent quality and improve the overall efficiency of its operations.
- **“Weeding out” bad patents.** A post-grant review system for patents should be established to provide an early opportunity to challenge newly-issued patents to improve overall patent quality and, the inter partes reexamination process should be made more effective by removing existing disincentives and avoiding new barriers to instituting a reexamination.
- **Allowing third parties to submit prior art.** Third parties should be allowed to submit prior art for the PTO to consider in connection with pending published patent applications.
- **Putting an end to the “False Marking” litigation cottage industry.** A very recent trend has seen aggressive litigation alleging, “false marking” of products containing patented inventions. The damages regime for false marking cases should be changed to prevent outsized awards where no one has suffered any actual harm.
- **Adopting a “First Inventor to File” system.** The United States should join the rest of the world by moving to a “first inventor to file” system for granting patents.

My testimony first discusses the recent judicial decisions addressing key issues in many of the areas by the various reforms this Committee has considered, including the 2007 patent reform legislation reported by this Committee and passed by the House. I conclude by pointing out that there are some aspects of the current patent system—changes in the standards and procedures by the Patent and Trademark Office and false patent marking—that only Congress can address.

I. The Courts Respond to the Problem of Abusive Litigation

This Committee has long recognized that “abusive practices particular to patent litigation” were a key factor that “hindered the ability of patents to spur innovation today and have put at risk future innovation.” H. Rep. No. 110-314, at 21 (2007). The courts, particularly the Supreme Court, have in the last four years mitigated many of the abuses of the patent litigation system, restoring the necessary balance to patent litigation rules. There is more to be done on some issues, but the courts appear focused on the problems and well on the road to solving them.

A. The Supreme Court

1. Test for Issuance of Injunctions

When a court adjudicated a party as infringing a patent, the Federal Circuit for many years applied a rule automatically granting a permanent injunction, “absent exceptional circumstances.” That meant that a plaintiff would be able to disrupt the defendant’s business, even when the patent at issue was a minor component of the product and where the harm suffered by the plaintiff could be remedied completely through an award of monetary damages. Because such an injunction could be fatal to a business, the threat of such relief coerced defendants into unfair and unjustified settlements.

The Supreme Court in *eBay Inc. v. MercExchange, L.L.C.*, 547 U.S. 388 (2006), rejected this automatic injunction rule, finding instead that the traditional four-factor test for the exercise of equitable relief applied in virtually every other context is also appropriate for the Patent Act. *Id.* at 391-92. As Justice Kennedy explained in his concurring opinion for himself and three other Justices, “an injunction, and the potentially serious sanctions arising from its violation, can be employed as a bargaining tool to charge exorbitant fees to companies that seek to buy licenses to practice the patent. When the patented invention is but a small component of the product the companies seek to produce and the threat of an injunction is employed simply for undue leverage in negotiations, legal damages may well be sufficient to compensate for the infringement and an injunction may not serve the public interest.” *Id.* at 396-97. Applying traditional equitable principles properly balances the rights of stakeholders and reduces the possibility of abuse.

2. Standard for Obviousness

The crux of any patent is the “inventive step,” that is, a patent must describe a novel innovation not obvious to a “person having ordinary skill in the art.” One of the reasons that the PTO may grant a patent erroneously is if the examiner fails to recognize that the application describes a purported invention that would have been obvious to someone versed in the relevant art. Whether a patent was properly granted may be tested in the course of litigation, but for many years, the Federal Circuit shielded these patents from adequate scrutiny, holding that a patent may be shown to be obvious by the combination of two or more pieces of prior art only if some “teaching, suggestion, or motivation” to combine that art can be shown in the documented prior art. Common sense was, according to the Federal Circuit, simply insufficient.

The Supreme Court in *KSR International Co. v. Teleflex Inc.*, 550 U.S. 398 (2007), rejected this test for obviousness, finding that it inappropriately protected patents of poor quality.

Instead, the Court concluded that when considering obviousness, “the analysis need not seek out precise teachings directed to the specific subject matter of the challenged claim, for a court can take account of the inferences and creative steps that a person of ordinary skill in the art would employ.” *Id.* at 418. The Court explained that “the results of ordinary innovation are not the subject of exclusive rights under the patent laws. Were it otherwise patents might stifle, rather than promote, the progress of useful arts.” *Id.* at 427. *KSR* thus ensures that, when the PTO grants a patent notwithstanding that the claimed invention was obvious, a party in litigation may effectively challenge the patent.

3. Standard for Patentability

In *Bilski v. Kappos*, 130 S. Ct. 3218 (2010), a party sought to patent a claimed invention relating to a classic business method by which buyers and sellers of commodities in the energy market may hedge against price changes. The Federal Circuit rejected the patent, finding that “process patents” are permissible only when they relate to a machine or when they transform some material into a different state or thing. *Id.* at 3224. This was known as the “machine-or-transformation” test. *Id.* That was a troubling test for many of our members.

In resolving *Bilski*, the Supreme Court reversed the Federal Circuit’s rule, holding that the machine-or-transformation test was not the sole means for an innovation to be eligible for a patent as a process (130 S. Ct. at 3226-27), and four members of the Court strongly suggested that “inventions in the Information Age” require process patents that reach beyond machine-or-transformation alone (*id.* at 3227). The Court likewise rejected the view that all business processes were unpatentable. *Id.* at 3228-29.

The Court did, however, reject the claimed patent in *Bilski*. 130 S. Ct. at 3230-31. And rightfully so. As the Court concluded, the particular business process at issue there was an abstract idea, not the sort of discrete, innovative process that may qualify for patent protection. Not only was this the correct result, but it reaffirmed the vitality of the important principle that abstract ideas are not patentable.

4. Exhaustion of Method Patents

The Court has also addressed exhaustion of method patents and reached the common-sense conclusion that when a company sells or licenses its intellectual property, it has exhausted its patent for all downstream users. In *Quanta Computer, Inc. v. LG Electronics, Inc.*, 553 U.S. 617 (2008), LGE licensed certain method patents to Intel, which used them in making microprocessors. Intel then sold its chipsets to Quanta, who used the chips to build computers. Although the LGE license with Intel permitted the sale of the processors, LGE attempted to limit the ability of third parties to practice the patent in an unapproved manner. LGE thus sued Quanta for patent infringement, alleging that—despite Quanta’s purchase of the chips from LGE’s licensee who had already paid for a license—Quanta was infringing on LGE’s patent. The Federal Circuit agreed with LGE. *Id.* at 624-25.

The Supreme Court, however, reversed. The Court found that when a party’s method patent is embodied in a product, sale of the product exhausts the underlying method patent. *Quanta*, 553 U.S. at 628-29. The Court arrived at the sensible conclusion that “[t]he authorized

sale of an article that substantially embodies a patent exhausts the patent holder's rights and prevents the patent holder from invoking patent law to control postsale use of the article." *Id.* at 638. Holding otherwise would have opened the gates for abusive patent litigation, permitting all downstream users to have to obtain licenses from the patent holder.

5. Extraterritorial Liability

Traditionally, United States patent law does not apply to products made and sold in other countries; the law of the place in which a product is made or sold controls. Section 271(f) of the Patent Act is a limited exception that creates liability where one supplies from the United States patented "components" that will be used in a "combination" abroad. In *Microsoft Corp. v. AT&T Corp.*, 550 U.S. 437 (2007), the Supreme Court appropriately limited the scope of this Section to ensure that it attaches only to components actually made in this country.

In that case, AT&T held a patent relating to a method for encoding and compressing recorded speech. A version of Microsoft's Windows operating system had the potential infringe the patent when installed on a computer. The question arose whether copies of Windows installed on computers abroad would infringe within the meaning of Section 271(f). AT&T argued it did because Windows operating software generally is a "component" that was used abroad. The Court disagreed: although software may be a component, the Court concluded that it was only a "component" within the meaning of Section 271(f) when it was copied into a computer-ready format. *AT&T*, 550 U.S. at 449-52. Therefore, because Microsoft made the individual copies abroad, the "component" in question did not come "from the United States."

This sensible interpretation of Section 271(f) ensures that U.S. patent law is properly limited to the territorial jurisdiction of the United States. Overly expansive extraterritorial application of the patent laws risks needless conflict between U.S. and foreign law.

6. Availability of Declaratory Judgments

Finally, in *MedImmune, Inc. v. Genentech, Inc.*, 549 U.S. 118 (2007), the Supreme Court opened the doors to declaratory judgments in the context of patents. This is a particularly important development to ensure that licensees may obtain a judicial determination on the validity of a patent without being required first to infringe the patent. A ruling to the contrary would have continued denying effective access to the courts for companies that were accused of making infringing products but either had (or had been offered) a license.

In *MedImmune*, the holder of a patent license filed a declaratory judgment action seeking to invalidate the patent it had licensed. The district court and the Federal Circuit found that the licensee lacked standing under Article III of the Constitution because the existence of the license precluded any possibility of liability for infringement. *MedImmune*, 549 U.S. at 122. Following standards that it had applied in other areas of the law, the Court, however, rejected the view that a company must potentially gamble its very existence to review the validity of a patent: "The rule that a plaintiff must destroy a large building, bet the farm, or (as here) risk treble damages and the loss of 80 percent of its business before seeking a declaration of its actively contested legal rights finds no support in Article III." *Id.* at 134. The declaratory judgment tool is of

crucial importance to manufacturers and service providers; the Court's decision eliminates practical barriers to the use of this remedy.

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Two additional cases raising issues related to legal rules that enable excessive litigation are currently pending before the Supreme Court.

7. Inducement Liability

The Patent Act imposes liability on a person who induces another to infringe. The Federal Circuit has applied a lax knowledge and intent requirement in inducement claims, recently finding that deliberate indifference was sufficient to establish inducement liability on the theory that it established that the defendant knew or should have known of the patent. The Court granted certiorari in *Global-Tech Appliances, Inc. v. SEB S.A.*, No. 10-6, to consider the appropriate standard to apply in this context.

Many leading innovators filed *amicus curiae* submissions in that case, urging the Court to adopt specific knowledge and intent requirements. When a company develops a new product, even the most diligent patent search may fail to uncover a potentially relevant patent. Thus, patent infringement, to the extent it occurs, often is the product of a good faith mistake particularly with respect to the technology sector in which there are hundreds of thousands of patents that may potentially be relevant to a product or service. Direct patent infringement is a strict-liability offense. But inducement liability—which is essentially an aiding and abetting theory—requires more than just an underlying infringement. A party should be liable for inducing another to infringe only when it is aware of the asserted patent and where it intends for another to take actions that will constitute infringement. A rule to the contrary would be a substantial disincentive for innovators. (A copy of the BSA's *amicus* brief in this case is attached to my testimony.)

8. Standard of Proof for Establishing Patent Invalidity

As I noted with respect to *KSR*, a crucial guarantee of patent quality in the United States is the ability for litigants to demonstrate that a patent issued by the PTO is invalid because it does not, in fact, satisfy all the criteria of patentability. The Federal Circuit has long held that a party asserting patent invalidity must establish proof by clear and convincing evidence. The Supreme Court granted certiorari in *Microsoft Corp. v. i4i Limited Partnership & Infrastructure for Information, Inc.*, No. 10-290, to consider this issue.

The Federal Circuit's rule is particularly troubling in circumstances in which the patent is challenged on obviousness grounds and the PTO never considered the most relevant prior art. During the prosecution of a patent, the PTO reviews the prior art submitted by the inventor and also conducts its own search of prior art databases. The time the PTO spends conducting its search, however, is quite limited. Studies show that the PTO rarely relies on non-patent prior art and of course, neither PTO databases or even the Library of Congress has collections of actual products that were in the market—often the best prior art. Not surprisingly, there are often circumstances where the PTO did not consider important prior art.

It makes no sense to substantially tilt the scales toward patent holders in such cases based on nothing more than the mere happenstance of PTO error. But that is precisely what happened in *i4i Limited Partnership*. The plaintiff asserted that Microsoft infringed its patent, but prior art not considered by the PTO—that the patentee then destroyed—casts significant doubt on the validity of the plaintiff’s patent. In these circumstances, the patent holder and a party challenging the patent’s validity should be placed on a level playing field. The preponderance of the evidence standard is therefore the appropriate standard of proof. (A copy of the BSA’s amicus brief in this case is attached to my testimony.)

B. The Federal Circuit

Although the results have been less uniform for the innovators, certain strands of case-law demonstrate that the Federal Circuit is becoming sensitive to patent abuse.

1. Standard for Willful Infringement

Section 284 provides that the court in a patent infringement action “may increase the damages up to three times the amount found or assessed.” The statute does not specify the grounds that could justify multiple damages and, although courts had said that proof of “willful infringement” was required, the Federal Circuit applied what was effectively a negligence standard: “Where . . . a potential infringer has actual notice of another’s patent rights, he has an affirmative duty to exercise due care to determine whether or not he is infringing. Such an affirmative duty includes, *inter alia*, the duty to seek and obtain competent legal advice from counsel *before* the initiation of any possible infringing activity.” *Underwater Devices Inc. v. Morrison-Knudsen Co.*, 717 F.2d 1380, 1389-90 (Fed. Cir. 1983) (citations omitted).

This standard allowed the inclusion of a willfulness claim in virtually every infringement action. H. Rep. No. 110-314, *supra*, at 28. In response, defendants “commonly assert[ed] an advice of counsel defense. Under this defense, an accused willful infringer aims to establish that due to reasonable reliance on advice from counsel, its continued accused activities were done in good faith. Typically, counsel’s opinion concludes that the patent is invalid, unenforceable, and/or not infringed. Although an infringer’s reliance on favorable advice of counsel, or conversely his failure to proffer any favorable advice, is not dispositive of the willfulness inquiry, it is crucial to the analysis.” *In re Seagate Technology, LLC*, 497 F.3d 1360, 1369 (Fed. Cir. 2007) (en banc).

But this legal rule subjected defendants to a Hobson’s choice: an opinion of counsel was key to avoiding multiple damages, but producing an opinion of counsel was held to waive attorney-client privilege—and that waiver was held by some courts to extend broadly to all documents and conversations provided to the client that embodied an opinion of counsel or a prediction regarding the outcome of the litigation, even those from *trial* counsel. Producing the opinion letter therefore could force the defendant to reveal its entire trial strategy.

In a series of decisions in recent years, the Federal Circuit has significantly altered these rules. First, in *Knorr-Bremse Systeme Fuer Nutzfahrzeuge GmbH v. Dana Corp.*, 383 F.3d 1337 (Fed. Cir. 2004) (en banc), the court addressed its precedents permitting a party’s failure to acquire an opinion of counsel or a party’s assertion of an attorney-client or work-product

privilege with respect to that opinion to be considered as evidence of willfulness by the trier of fact. With respect to attorney privileges, the court concluded that the proper working of the attorney-client relationship barred using assertion of the privilege as an adverse inference. 383 F.3d at 1344-45. It also concluded that a party did not have an obligation to obtain an opinion of counsel letter for every known patent, explaining the enormous “burdens and costs” such a requirement would impose. *Id.* at 1345.

Next, in *In re Seagate Technology, LLC, supra*, the Federal Circuit observed that its prior precedents had lowered the standard for proving willful infringement to a test that was “akin to negligence.” 497 F.3d at 1371. Applying the Supreme Court’s recent decision in *Safeco Insurance Co. of America v. Burr*, 551 U.S. 47 (2007), which construed a statutory willfulness requirement in the context of the Fair Credit Reporting Act, the *Seagate* court held that “to establish willful infringement, a patentee must show by clear and convincing evidence that the infringer acted despite an objectively high likelihood that its actions constituted infringement of a valid patent.” *Id.*

Together, these two cases substantially clarify the standard for awards of multiple damages and attorneys’ fees, thereby reducing significantly the ability of plaintiffs to coerce unjustified settlements by threatening defendants with draconian liability.

2. Standard for Calculating Reasonable Royalty

Under the Patent Act, damages for patent infringement shall not be “less than a reasonable royalty for the use made of the invention by the infringer.” 35 U.S.C. § 284. This Committee has explained that “courts often have difficulty in assuring that damages are: 1) ‘to compensate for the infringement’ (i.e., compensatory, not punitive); 2) ‘reasonable;’ and 3) related to ‘the use made of the invention by the infringer.’” H. Rep. No. 110-314, *supra*, at 25. The Committee “was presented with numerous studies showing that”—because of the vague and uncertain principles applied by the courts—“current litigation practices often produce a royalty award substantially in excess of a reasonable royalty. This cycle is harmful to our overall economy and especially damaging to technology innovation.” *Id.* at 26.

In *Lucent Technologies, Inc. v. Gateway, Inc.*, 580 F.3d 1301 (Fed. Cir. 2009), the Federal Circuit took the first step in reforming the standards for calculating a reasonable royalty. The plaintiff in that case asserted that its patent was infringed by a “date picker” tool that “enable[d] the user to select a series of numbers, corresponding to the day, month, and year, using graphical controls” to enter the date for a calendar entry in Microsoft Outlook and other programs. *Id.* at 1317. Even though the case involved, in the words of the Federal Circuit, “but a tiny feature of one part of a much larger software program” (*id.* at 1332), the plaintiff claimed as a reasonable royalty 8% of the total sales value of the allegedly infringing software (which it estimated at \$8 billion) for a total award of \$561.9 million. The jury instead awarded nearly \$357.9 million.

The Federal Circuit stated: “Outlook is an enormously complex software program comprising hundreds, if not thousands or even more, features. We find it inconceivable to conclude, based on the present record, that the use of one small feature, the date-picker, constitutes a substantial portion of the value of Outlook.” *Id.* at 1332.

The plaintiff argued that the royalty should have been calculated as continuous, whereas Microsoft contended it would have been a one-time lump-sum payment. The jury sided with Microsoft, but awarded \$357.9 million regardless. The Federal Circuit found that the evidence for such a substantial award was lacking. Indeed, the evidence offered at trial suggested that average lump-sum payments were one-third to one-fourth the amount of the award. *Lucent Techs.*, 580 F.3d at 1332. Looking at the relevant factors, the court was “left with the unmistakable conclusion that the jury’s damages award is not supported by substantial evidence, but is based mainly on speculation or guesswork.” *Id.* at 1335. The court likewise concluded that other aspects of the damage calculation were erroneous, and it remanded the case. *Id.* at 1338-39. This decision represented a substantial change from the extremely deferential standard that the Federal Circuit previously had applied in reviewing reasonable royalty awards.

The positive developments with respect to constrained royalties was next evidence in a district court case, *Cornell University v. Hewlett-Packard Co.*, 609 F. Supp. 2d 279 (N.D.N.Y. 2009), in which Judge Rader—now the Chief Judge of the Federal Circuit—handled the case, sitting by designation as a trial judge. Cornell alleged that HP infringed a patent relating to the functioning of a computer processor. On damages, the court excluded evidence that sought to introduce the total market value of the “entire server and workstation market.” *Id.* at 284. It concluded that the patented technology did not drive customer demand or form a substantial value of the entire product. *Id.*

Notwithstanding this order, at trial, Cornell still attempted to prove damages based on a total economic value of \$23 billion, the total value of server and workstations sold. On this basis, the jury awarded \$184 million in damages. The court, however, found that this royalty base was inappropriate. The court found that introduction of entire market value was impermissible because Cornell had not provided “market evidence that the claimed invention formed the basis for demand for the CPU bricks, or even the existence of a market for CPU bricks.” *Cornell Univ.*, 609 F. Supp. 2d at 287. Instead, the court concluded that the appropriate royalty base for the processors was approximately \$6.7 billion, thus entitling Cornell to damages of about \$53.5 million. *Id.* at 291-92.

This positive trend recently culminated in the Federal Circuit’s decision of *Uniloc USA, Inc. v. Microsoft Corp.*, 2011 WL 9738 (Fed. Cir. 2011), a case which eliminated the “rule of thumb” and also sharply restricted the use of “entire market value” evidence.

For several years, courts have permitted use of the “rule of thumb” whereby a court would take 25% of the profits of a product as the starting point for the calculation of a reasonable royalty regardless of the importance of the invention to the overall product or the reasons why consumers were attracted to the product. *Uniloc*, 2011 WL 9738, at *18. The Federal Circuit, however, wholly repudiated this doctrine, finding that (1) the rule “fails to account for the unique relationship between the patent and the accused product,” (2) it “fails to account for the unique relationship between the parties,” and (3) “the rule is essentially arbitrary and does not fit within the model of the hypothetical negotiation within which it is based.” *Id.* at *17. Rather than a one-size-fits all approach, the court now requires parties to analyze the context-specific factors of the case alone in determining a reasonable royalty.

Additionally, the Federal Circuit limited the use of evidence regarding the entire market value of a product. Plaintiffs invariably attempt to introduce evidence of a products total market value in order to argue that the damages they seek are “reasonable.” The problem with this strategy, however, is that the patent at issue often has nothing whatsoever to do with the product’s market value, and thus can only serve to lead the jury astray in assessing damages.

The Federal Circuit reiterated that the “entire market value rule allows a patentee to assess damages based on the entire market value of the accused product only where the patented feature creates the ‘basis for customer demand’ or ‘substantially create[s] the value of the component parts.’” *Uniloc*, 2011 WL 9738, at *22 (quoting *Lucent Techs., Inc. v. Gateway, Inc.*, 580 F.3d 1301, 1336 (Fed. Cir. 2009) & *Rite-Hite Corp. v. Kelley Co.*, 56 F.3d 1538, 1549-50 (Fed. Cir. 1995)). The Court explained that:

This rule is derived from Supreme Court precedent requiring that “the patentee ... must in every case give evidence tending to separate or apportion the defendant’s profits and the patentee’s damages between the patented feature and the unpatented features, and such evidence must be reliable and tangible, and not conjectural or speculative,” or show that “the entire value of the whole machine, as a marketable article, is properly and legally attributable to the patented feature.” *Garretson v. Clark*, 111 U.S. 120, 121 (1884).

Id.

Here, the court agreed with Microsoft that the patented device created neither customer demand for the software nor the substantial value of the products. *Uniloc*, 2011 WL 9738, at *22. And the court refused to fashion any sort of exception to permit consideration of the entire market value for a “minor patent improvement[.]” when the patent holder “assert[s] a low enough royalty rate.” *Id.* at *24. The court found that inappropriately-admitted evidence of the entire market value of a product can unduly taint a jury’s perspective as to the reasonable royalty of any single component. *Id.* at *24-25.

In sum, the Federal Circuit has taken several significant steps with respect to the calculation of a reasonable royalty.

First, the court has announced that it will scrutinize awards to ensure that jury verdicts are adequately supported by sufficient evidence.

Second, the court has rejected one-size-fits-all rules, like the rule of thumb. Instead, parties must present context-specific evidence about the damages actually apparent in any particular case.

Third, the court has limited the use of entire market value, evidence that likely leads a jury to award massive damage verdicts entirely disproportional to the injury that reasonably can be attributed to infringing conduct. Rather than being admissible in every case, this evidence can be presented to a jury only when the patent at issue actually contributes, in a realistic manner, to the market value of the product at issue.

3. Venue

Patent infringement claims may be filed in any judicial district in which the defendant is subject to personal jurisdiction. 28 U.S.C. §§ 1391(c) & 1400. As most states extend personal jurisdiction to the outer constitutional limits, a patent plaintiff typically may bring a suit anywhere in the country where a defendant sells a product or an infringing patent is practiced. For many companies, that means venue is available anywhere in the country.

Abuse of venue rules has been another feature of problematic patent litigation, with cases filed principally in a few “magnet” jurisdictions in which plaintiffs seem to believe they will obtain more favorable treatment. This Committee in 2007 recognized “the widespread use of forum shopping” and the need to address the problem. H. Rep. No. 110-314, *supra*, at 40.

The Federal Circuit has in recent years issued several decisions that limit this practice.

In *In re TS Tech USA Corp.*, 551 F.3d 1315 (Fed. Cir. 2008), the Federal Court took an important step toward ensuring fair venue. After a plaintiff filed suit in the Eastern District of Texas, the defendant moved to transfer the case to the Southern District of Ohio, where the physical and documentary evidence was located, as well as many of the key witnesses. *Id.* at 1318. The defendants contended that the Eastern District of Texas had no meaningful connection to the suit. After the district court refused the motion to transfer, defendants sought—and obtained—a writ of mandamus.

Applying the venue-transfer factors from the United States Court of Appeals for the Fifth Circuit (when the Federal Circuit considers non-patent law issues, it applies the law of the circuit in which the district court sits), the Federal Circuit concluded that the district court committed several errors including giving “too much weight to [the plaintiff’s] choice of venue,” failing to “assess[] the cost of attendance for witnesses,” not considering “the relative ease of access to sources of proof,” and disregarding “the public interest in having localized interests decided at home.” *TS Tech USA Corp.*, 551 F.3d at 1319-21. The court thus ordered transfer of the case to Ohio.

Subsequently in *In re Nintendo Co.*, 589 F.3d 1194 (Fed. Cir. 2009), Nintendo sought to transfer a case from the Eastern District of Texas to the Western District of Washington. Just like *TS Tech USA Corp.*, Nintendo had no meaningful contacts with the eastern District of Texas, whereas all U.S.-based evidence was in Washington. In granting mandamus to order a transfer, the Federal Circuit found that Nintendo’s “extensive” contacts in Washington “indisputably make it a proper venue.” *Id.* at 1198. The court underscored that “[t]he convenience and cost of attendance for witnesses is an important factor in the transfer calculus.” *Id.* And, once again, the court noted that the plaintiff’s choice of venue does not weigh against transfer. *Id.* at 1200. The Federal Circuit has also ordered transfer in other actions on similar grounds. *See, e.g., In re Microsoft Corp.*, 630 F.3d 1361 (Fed. Cir. 2011); *In re Acer America Corp.*, 626 F.3d 1252 (Fed. Cir. 2010); *In re Genentech, Inc.*, 566 F.3d 1338 (Fed. Cir. 2009).

The same approach was followed in *In re Hoffmann-La Roche Inc.*, 587 F.3d 1333 (Fed. Cir. 2009), where the Federal Circuit again granted mandamus. Notably, in that case, plaintiffs attempted to manufacture a connection to the Eastern District of Texas by converting 75,000

pages of electronic documents to electronic format, transmitting them to the offices of litigation counsel in Texas, and then claiming convenience of evidence. *Id.* at 1336-37. The court refused to consider such “a fiction which appears to be have been created to manipulate the propriety of venue.” *Id.* at 1337.

Similarly in *In re Zimmer Holdings, Inc.*, 609 F.3d 1378 (Fed. Cir. 2010), the plaintiff asserted that the Eastern District of Texas was an appropriate venue because it had moved its principal place of business to Texas and moved files there. The court found, however, that “the realities of this case makes it clear that the Eastern District of Texas is convenient only for MedIdea’s litigation counsel.” *Id.* at 1381. MedIdea was registered in Michigan and its corporate officers were there, one of whom was the inventor of the disputed patent. The court concluded that “[t]his is a classic case where the plaintiff is attempting to game the system by artificially seeking to establish venue by sharing office space with another of the trial counsel’s clients.” *Id.*

4. False Marking

A new form of abusive patent litigation has recently emerged. The False Marking Act (35 U.S.C. § 292) is a *qui tam* provision that imposes a \$500 fine for each instance that an individual falsely marks an item as patented in order to deceive the public. In *Forest Group, Inc. v. Bon Tool Co.*, 590 F.3d 1295, 1301 (Fed. Cir. 2009), the Federal Circuit interpreted the Act as imposing a separate \$500 fine for *each* item marked. Following this decision, an enormous number of False Marking complaints have been filed. In 2010 alone, over 600 such cases were filed.

Plaintiffs in these cases follow a typical pattern: they search supermarket and warehouse shelves looking for products that are stamped with an expired patent. They then file suit against the manufacturer of the product, alleging that the mark intended to deceive the public. The huge number of these suits will yield significant financial burden on the economy.

A case is currently pending in the Federal Circuit, *FLFMC, LLC v. Wham-O, Inc.*, No. 2011-1067, in which a False Marking defendant is contending that the statute is unconstitutional because it violates the Take Care Clause of the Constitution. One district court has already adopted this argument. *Unique Prod. Solutions, Ltd. v. Hy-Grade Valve, Inc.*, 2011 WL 649998 (N.D. Ohio. Feb. 23, 2011).

The Supreme Court has held that *qui tam* actions, such as the False Claims Act, are permissible delegations of sovereign authority to private parties because they contain safeguards to preserve the role of the government. If the government does not approve of an action brought in its name, it can intervene. Wham-O, and the *amici* supporting it, have raised substantial arguments that the statute currently is unconstitutional because it fails to provide the government sufficient control over the actions.

This is an area where Congressional action remains essential. The patent reform bill considered by this Committee in the previous Congress contained a change in the law that would make an enormous difference. The bill would require that only persons who could demonstrate

that they sustained actual harm from the false mark would have the standing to sue. We believe this would be an important change in the law and should be enacted.

II. Issues that the Courts Cannot Address

Although the courts have to a very significant degree addressed the imbalances in the patent litigation system, they lack the power to alter the statutory standards and procedures applied by the PTO. Four significant changes, in addition to false patent marking point raised above, are essential.

First, enabling third parties to submit prior art during the examination process. The Committee explained in 2007 that “[m]uch of the reason for the issuance of patents on already known inventions is that evidence of the knowledge or use is not readily available to the patent examiners. This has proven to be especially true in newer areas of technology that previously did not exist, or were considered not to be eligible for patent protection.” H. Rep. No. 110-314, *supra*, at 37. Allowing third parties to submit prior art—with appropriate limitations, as in the bill reported by the Committee in 2007—addresses this issue, allowing examiners to “obtain the benefit of patents and publications they may not otherwise see, without significant additional burden.” *Id.*

Second, adoption of the first-to-file system will conform our patent law to that of our major trading partners.

Third, under current law, “a party seeking to challenge the validity and enforceability of the patent has two avenues under current law: a reexamination proceeding at the USPTO or litigation in district court.” H. Rep. No. 110-314, *supra*, at 30. This Committee explained in 2007 that “[t]he former is used sparingly and is considered not very effective; the latter is unwieldy and expensive. The average time between patent application and final outcome in patent litigation is a staggering 12 years, or 60% of a patent’s life.” *Id.*

The bill passed by the House created “a new post-grant review proceeding that will allow for limited USPTO review of a patent on the basis of patentability.” H. Rep. No. 110-314, *supra*, at 30. This Committee concluded that “the ability to have a quality check on issued patents is important to the integrity of the patent system. Patents of questionable validity may stifle innovation, especially in fast-moving technology industries.” *Id.* This essential reform—enabling the experts at the PTO to correct errors in the examination system—can be put in place only by Congress.

At the same time, there have been proposals by some to limit the inter partes reexamination system to a short period after service of the summons and complaint and otherwise try to reduce the chance that a party can file an inter partes reexamination. Since many patent cases involving our members are surprises—where the defendants had never heard about the patent before the suit was filed—we urge the Committee to avoid limitations that would eliminate the utility of this important tool in enabling the PTO to correct its mistakes.

Fourth, it is essential that Congress act to ensure consistent, adequate funding for the PTO and to preclude any diversion of patent fees for purposes other than funding the patent system.

Thank you for the opportunity to appear before the Subcommittee. I look forward to answering your questions.