December 2008
Volume 4, Issue 4

Stein, McEwen & Bui LLP Newsletter

Federal Circuit Limits Which Methods Can be Patented

In En Banc Ruling, Federal Circuit Requires Methods to Comply with Machine-or-Transformation Test

In *In re Bilski*, 545 F.3d 943, 88 USPQ2d 1385 (Fed. Cir. 2008), the Federal Circuit upheld the final decision of the Board of Patent Appeals and Interferences (hereinafter, "the Board") in rejecting all eleven claims of U.S. Patent Application No. 08/833,892 (hereinafter, "the '892 application"). As will be explained below, the Federal Circuit held that, for purposes of defining patentable subject matter for method claims, claims must meet the "machine-or-transformation" test for subject matter eligibility and expressly rejected the "useful, concrete, and tangible result" test spelled out in *State Street Bank & Trust Company v. Signature Financial Group, Inc.*, 149 F.3d 1368 (Fed. Cir. 1998).

As background, Bernard L. Bilski and Rand A. Warsaw (hereinafter, "the Applicants") filed the '892 application on April 10, 1997. Claim 1 of the '892 application reads:

> A method for managing the consumption risk costs of a commodity sold by a commodity provider at a fixed price comprising the steps of:
>
> (a) initiating a series of transactions between said commodity provider and consumers of said commodity wherein said consumers purchase said commodity at a fixed rate based upon historical averages, said fixed rate corresponding to a risk position of said consumer;
>
> (b) identifying market participants for said commodity having a counter-risk position to said consumers; and
>
> (c) initiating a series of transactions between said commodity provider and said market participants at a second fixed rate such that said series of market participant transactions balances the risk position of said series of consumer transactions.

That is, taking claim 1 as representative, the '892 application claims a method of hedging risk in commodities trading. During prosecution, the Examiner ultimately rejected claims 1-11 under 35 U.S.C. §101 because "the invention is not implemented on a specific apparatus and merely manipulates [an] abstract idea and solves a purely mathematical problem without any limitation to a practical application." On appeal, the Board affirmed the rejection of claims 1-11, while also holding that the Examiner erred in requiring implementation on a specific apparatus. That is, the claims may still be statutory if "there is a transformation of physical subject matter from one state to another."

In response, the Applicants appealed to the Federal Circuit on the question of whether the claims are drawn to statutory subject matter under 35 U.S.C. §101. The Federal Circuit decided *sua sponte* to hear the case *en banc* in order to decide a standard to determine whether a given claim recites a "new and useful" process so as to be statutory subject matter under 35 U.S.C. §101.

The Federal Circuit noted that 35 U.S.C. §101 reads as follows:

"Whoever invents or discovers any new and useful process, machine, manufacture, or composition of matter, or any new and useful improvement thereof, may obtain a patent therefor, subject to the conditions and requirements of this title."

While recognizing that the term "process" has a broad ordinary meaning which the claims otherwise would meet, the Federal Circuit held that the Supreme Court has more narrowly defined the term "process." Specifically, the Federal Circuit found that the Supreme Court has already established that a process claim is not statutory if it claims “laws of nature, natural phenomena, [or] abstract ideas,” *Diamond v. Diehr*, 450 U.S. 175, 185 (1981). *Diehr* emphasized a pre-emption test that held a process claim unpatentable if the effect of allowing it would allow the patentee to pre-empt substantially all uses of that fundamental principle. The Federal Circuit noted that *Diamond* relied upon an earlier Supreme Court case, *Gottschalk v. Benson*, 409 U.S. 63, 70 (1972) for the proposition that processes drawn only to a fundamental principle are not patentable as fundamental principles are exclusive to no one. Thus, the Federal Circuit found that patentability of process claims under 35 U.S.C. §101 was dependant on whether the ‘892 claims recite a fundamental principle and, if so, whether they would pre-empt substantially all uses of that fundamental principle if allowed. In so doing, the Federal Circuit definitively articulated a standard of review to determine whether a process claim pre-empts all uses of a fundamental principle in contravention of 35 U.S.C. §101.

In order to determine this standard, the Federal Circuit contrasted *Diehr* and *Benson*. The Federal Circuit noted that the Supreme Court held in *Diehr* that an automated process of curing rubber using an algorithm was patentable as it did not preempt all uses of that particular algorithm since the claim was tied to a specific application and process and could be used for other substances or with other process steps. In contrast, in *Benson*, a binary conversion technique using an algorithm could only be used on a computer and therefore allowing the claimed process would preempt all uses of that algorithm. Thus, the Federal Circuit held that the Supreme Court requires that, for a process to be patentable, the process must be directed to an application of a principle, but cannot be directed to all applications of the principle which would pre-empt substantially all uses of the principle.

The Federal Circuit further found that the Supreme Court, in *Parker v. Flook*, 437 U.S. 584, 589 n. 9 (1978), additionally held that processes which are tied to a particular apparatus are also patentable since it does not preempt substantially all uses of the principle behind the claimed process.

After reviewing these cases, the Federal Circuit held that such a test had been collectively articulated by the Supreme Court in *Benson*, 409 U.S. at 70, *Diehr*, 450 U.S. at 192, and *Parker*, 437 U.S. at 589 n. 9. The Federal Circuit named this test the machine-or-transformation test, which is as follows:

> “A claimed process is surely patent-eligible under §101 if: (1) it is tied to a particular machine or apparatus, or (2) it transforms a particular article into a different state or thing.”

The Federal Circuit, in explaining the machine-or-transformation test, noted two corollaries to the test. For the first corollary, the Federal Circuit explained that field of use limitations did not render non-statutory process claims statutory. Specifically, the Federal Circuit noted that the Supreme Court in *Diehr* found that patent ineligibility "cannot be circumvented by attempting to limit the use of the formula to a particular technological environment." *Diehr*, 450 U.S. at 191-92. While recognizing that there is tension between preemption and whether a field of use limitation provides sufficient limitation to be compliant with 35 U.S.C. §101, the Federal Circuit found that such field of use limitations are not effective in limiting claims to a particular application of a fundamental principle. Specifically, the Federal Circuit held that "[p]re-emption of all uses of a fundamental principle in all fields and pre-emption of all uses of the principle in only one field both indicate that the claim is not limited to a particular application of the principle." As such, field of use limitations still retain the characteristic of improper claiming of a fundamental principle and do not convert an unpatentable process into a patentable process.

For the second corollary, the Federal Circuit stated that insignificant post-solution activity does not render a non-statutory process claim compliant with 35 U.S.C. §101. *Diehr* at 191-92. The Federal Circuit thus stated that even in situations where a process is nominally tied to a specific machine or transformation, if such a tie is insignificant, the process remains non-statutory.

Relying on this analysis, the Federal Circuit held that whether a process is statutory is now exclusively determined by the machine-or-transformation test, and found that its prior tests were incorrect. Thus, in addition to establishing the machine-or-transformation test, the Federal Circuit dismissed its prior tests: the *Walter-Abele* test and the *State Street* test.

Specifically, the Federal Circuit found that the *Walter-Abele* test has two steps: (1) determining whether a claim recites an algorithm, then (2) determining whether the algorithm is applied in any manner to physical elements or process steps. *In re Walter*, 618 F.2d 758 (CCPA 1980) and *In re Abele*, 684 F.2d 902

(CCPA 1982). Citing other cases that had already recognized a claim's patentability despite failing that test (*In re Grams*, 888 F.2d 835 (Fed. Cir. 1989)), the Federal Circuit held the *Walter-Abele* test inadequate.

Under *State Street*, a method claim is found patentable if it produces a "useful, concrete, and tangible result." While recognizing that this test may provide guidance in determining whether a claim is drawn to a fundamental principle or a practical application thereof, the Federal Circuit unequivocally found this test to be "insufficient," "inadequate," and "never intended to supplant the Supreme Court's test" (i.e., the machine-or-transformation test). However, the court did evoke *State Street*'s rejection of categorical exclusions beyond fundamental principles to reaffirm that all process claims (including business method claims) are subject to the same legal requirements (i.e., the machine-or-transformation test), and specifically declined, in footnote 23, to extend such a categorical exclusion to software claims.

In applying the machine-or-transformation test to claim 1 at issue, rather than provide guidance, the Federal Circuit noted that there was no machine at issue and claim 1 did not attempt to be tied to a particular machine. Instead, the Federal Circuit specifically held that they "leave to future cases the elaboration of the precise contours of machine implementation, as well as the answers to particular questions, such as whether or when recitation of a computer suffices to tie a process claim to a particular machine." Thus, as claim 1 was not tied to a machine, it could only be patentable if the recited process was compliant with the transformation prong of the machine-or-transformation test.

In applying the transformation prong, the Federal Circuit addressed the types of things that constitute an "article" such that their transformation is sufficient to be compliant with 35 U.S.C. §101. The Federal Circuit held that chemicals and physical objects and substances are articles for purposes of the machine-or-transformation test. On the more difficult questions of electronic signals and electronically-manipulated data, the court turned to prior case law to convey some benchmarks.

The Federal Circuit began by noting that electronic signals and electronically-manipulated data are the "raw material-age processes." Thus, data and signals can be transformed by a process for purposes of statutory process claims. Specifically, where a claim does not specify a particular type or nature of data, or how or from where the data is obtained, such data is not an article for purposes of transformation. *Abele*, 684 F.2d at 909. However, where data clearly represents physical and tangible objects (for example, X-ray attenuation data represents the structure of bones, organs, and other body tissues), the data is an article. *Id.* at 908-909. Accordingly, an electronic transformation of said data into a visual form does constitute a transformation and there is no requirement that the underlying physical objects be transformed.

In contrast, a data-gathering step added to an algorithm does not convert that algorithm into a patent eligible process. *In re Grams*, 888 F.2d 835, 840 (Fed. Cir. 1989). That is, gathering data (for example, by performing a clinical test) does not constitute a transformation of an article. Moreover, such operations may be inherently required in the recited process such that the extra step does not restrict the scope of the claim and preempts substantially all uses of the fundamental principle of the recited algorithm. The court, though, did indicate that by specifying how the data is gathered or on what medium data is recorded after a process is performed on the gathered information, some relevance may be imputed onto such data gathering or recording such that it is not an insignificant extra-solution activity.

On the facts of the case at hand, the court dismissed the Applicants' reliance on the *State Street* test, and asserted the machine-or-transformation test as exclusively dispositive. Applying this test, the court holds that the '892 application seeks to "claim a **non-transformative process** that encompasses a **purely mental process** of performing requisite mathematical calculations **without the aid of a computer or any other device**, mentally identifying those transactions that the calculations have revealed would hedge each other's risks, and performing the post-solution step of consummating those transactions" (*emphasis added*). Thus, because the claimed process does not involve transforming an article into a different state or thing and, as admitted by the Applicants, does not involve a machine implementation, the '892 claims are not drawn to patent-eligible subject matter under 35 U.S.C. §101.

Significance for Patent Owners

Bilksi represents a significant retrenchment of the prior interpretations as to the scope of patentable inventions under 35 U.S.C. §101. While the decision itself focused on preventing pure business methods from qualifying as patentable subject matter and even specifically noted that software patents themselves are not categorically unpatentable, it is very likely that this analysis will be broadly used by the United States Patent and Trademark Office to reject method claims involving software. That being said, the decision is limited to method claims, and does not affect apparatus or recording medium claims. Moreover, of significance for software method claims, *Bilksi* specifically noted that certain types of data transformation methods are patentable, as well as methods which are tied to a particular machine in more than a nominal way. As such, while it is likely that Examiners will aggressively apply *Bilksi* against all kinds of method claims, the extent to which *Bilksi* will represent a long-term hurdle to patenting non-business-method inventions has yet to be seen.

Federal Circuit Interprets Term "Providing a Communication Link" using the Objects of the Invention and Abstract

In *Netcraft Corp. v. eBay et al.*, No. 2008-1263 (Fed. Cir. 2008), Netcraft obtained two patents related to Internet billing methods: U.S. Patent No.6,351,739 (the '739 patent) and U.S. Patent No. 6,976,008 (the '008 patent). Both patents claimed priority to U.S. Patent No. 5,794,221 (the '221 patent), and thus both patents contained identical specifications. Netcraft sued eBay and eBay's subsidiary PayPal for infringement of these patents. eBay raised a non-infringement defense, arguing that eBay did not provide Internet access and therefore did not "provid[e] a communication link" as recited in the asserted claims. The District Court agreed, and granted eBay's motion for summary judgment of non-infringement. Netcraft appealed to the Federal Circuit, which upheld the District Court's ruling.

The Federal Circuit's ruling revolved around the meaning of the disputed term "providing a communication link...through equipment of the third party", which was recited in the representative claim 1 of the '739, but which was not used or defined in the specification. Consistent with claim construction principles, the Federal Circuit turned first to the specification for insight as to the meaning of the disputed term.

Netcraft argued that the specification provided no support for the District Court's claim construction. However, the Federal Circuit found ample evidence in the specification to support the District Court's position. Specifically, the specification repeatedly referred to objects of "the present invention" relating to providing Internet access, and summarized that the objects of "the present invention" were achieved by "the provider creates access to the Internet for the customer through the provider's equipment." Additionally, the abstract explicitly stated that "the provider creates access to the Internet for the customer." *Netcraft*, at 8. The Federal Circuit highlighted the consistent use of the phrase "the present invention" as indicated that the invention, as a whole, required the providing of the communication link.

Netcraft argued that these references to the "present invention" should not be seen as limiting. While acknowledging that the mere "use of the phrase 'the present invention' does not 'automatically' limit the meaning of claim terms in all circumstances, and that such language must be read in the context of the entire specification and prosecution history," the Federal Circuit found that the repeated use of the phrase the "present invention" and the prosecution history supported the District Court's interpretation. In this case, the specification repeatedly conveyed the impression that the invention as a whole relating to the provider/third party providing Internet access as part of the billing method. The Federal Circuit found no evidence within the specification to indicate that the provider/third party did not provide Internet access or that another party could provide internet access instead of the provider/third party doing the billing method. For example, Figure 2 of the '739 patent disclosed a step labeled "Connect Customer to Internet", while Figure 3 disclosed a step labeled "Customer Connects to Internet". Netcraft argued that the language of Figure 3 supported a conclusion that the third party was not required to provide Internet access. According to the Federal Circuit, however, nothing in the specification foreclosed the District Court's construction; in particular, other elements of the two figures differentiated the two methods shown. Furthermore, the specification specifically referred to equipment as equipment that enabled Internet access.

The Federal Circuit next chided the District Court for failing to take the prosecution history of the asserted patents into account. The Federal Circuit nevertheless concluded that this error was harmless, because the prosecution history did not clearly support Netcraft's argument. In one amendment, the prosecuting attorney indicated an example of a link as being a web site or E-mail address of the vendor. The Federal Circuit, however, could not determine whether the web site and E-mail addresses were examples of a communication link (as argued by Netcraft) or examples of additional features of an Internet access provider (as argued by eBay). Prosecution history proffered by eBay was also found lacking. The ambiguity of the prosecution history did not support either side's position, and the District Court's failure to consider the prosecution history was therefore harmless.

Significance to Patent Applicants

In *Netcraft Corp. v. eBay et al.*, the Federal Circuit provided an object lesson in the dangers of using claim terminology that is not used in the specification. Specifically, the Federal Circuit construed the term "providing a communications link", to require providing a customer with Internet access. Since this term was not used or defined in the specification except through a single embodiment in which the internet access is provided by the equipment of the provider providing the billing, the court was free to use broad language defining "the present invention" to restrict the meaning of the term in the claim to not include third parties providing internet access to the provider. The Federal Circuit's decision upholding the District Court's claim construction highlights two errors in the Netcraft patents' specification and claims. First, the claims used a term that was not used or defined in the specification in a manner allowing a broader interpretation of the providing operation. Since the specification is an important source of information for interpreting claim terms, the omission provided the accused infringer with an opportunity to interpret the specification in a limiting fashion, which is the interpretation adopted by the courts. Second, the specification repeatedly referred to "the present invention", which allowed the court to limit the interpretation of the claims to the particular objects described and did not indicate that the recited features can be independently provided. Broader language, such as "aspects of the present invention" or other language indicating that the specification referred to examples which can be used separately, would have constrained the court's ability to limit the claims to require use of all of the examples described. Lastly, in terms of claim construction, the situation could have been resolved by instead removing the "providing" feature from the method claims. Thus, where ministerial features are being recited in method claims and these features need not be performed by the same entity for purposes of infringement, claims should be drafted to ensure that the claims cover infringement without the recited ministerial feature. In *Netcraft*, the providing of a communication link is a fairly routine feature which can be provided by any number of entities. By removing the "providing" operation and instead relying on a "provided" communication link, the result in *Netcraft* might have been avoided.

Federal Circuit Finds "Mechanism for Moving" to be Means plus Function Term

In *Welker Bearing Company v. PHD, Inc.*, Case 2008-1169 (Fed. Cir. Dec. 15, 2008), the Welker Bearing Company (Welker) owns U.S. Patents 6,786,478 ('478 patent), which issued on September 7, 2004, and 6,913,254 ('254 Patent), which issued on July 5, 2005. The '254 and '478 patents, which have identical specifications, are directed towards locating and clamping assemblies for use during welding, with both claiming pin clamps to securely hold an item while being worked upon or welded. The pin clamps are topped with a locating pin inserted into holes in the item and clamping fingers extending from the pin clamp to secure the item to an annular ring on the pin clamp.

Claim 1 of the '478 patent contains 5 clauses directed towards locating an clamping assembly, with the fifth clause reciting "said assembly characterized by a mechanism for rotating in response to said rectilinear movement of said locating pin for moving said finger radially." The Federal Circuit states that Welker, with the PTO allowing the claims of the '478 patent to issue without any note of rotational movement as a required limitation for allowance of the '478 patent, felt invited to file a continuation application having broader claims. The continuation application issued as the '254 patent. As such, claim 1 of the '254 patent recites "said assembly characterized by a mechanism for moving said finger along a straight line into and out of said locating pin perpendicular to said axis A in response to said rectilinear movement of said locating pin."

Welker filed suit in the Eastern District of Michigan claiming that the PHD devices, Clamp I and Clamp II, infringed Welker's '478 and '254 patents. However, Welker conceded to the District Court that PHD's Clamp II does not infringe the '478 patent because the Clamp II does not have a rotational mechanism for the clamping fingers. As such, the District Court only looked into Clamp I's infringement of the '478 patent and Clamp II's infringement of the '254 patent.

The District Court construed the language of claim 1 of the '254 patent, wherein it stated "mechanism for moving said finger," to be a means-plus-function limitation, and consequently, requiring a structure in the specification to correspond to the functional language. The only such structure found in the specification was the rotating central post to move the finger in and out of the locating pin, found at Col. 6 of the written description of the '254 patent. The District Court found that the record did not show that the Clamp I device was made, used, sold or offered for sale by PHD after the '478 patent was issued and thus granted summary judgment of noninfringement. With respect to the '254 patent, the District Court granted summary judgment of noninfringement because PHD's Clamp II did not have a rotating central post. Welker appealed both decisions in the Federal Circuit.

The Federal Circuit, in affirming the District Court's decision regarding the '478 patent, stated that the record did not show that PHD conducted any activity that infringed the '478 patent after the '478 patent was issued. Prototypes of the Clamp I were made and given to General Motors (GM) in late 2003 or early 2004, but were never produced or used commercially. The '478 patent issued on September 7, 2004. The record also contained no evidence showing PHD sold any of the Clamp I units to GM after this date or even continued to offer the Clamp I unit for sale after the issuance date. Welker asserted that PHD "had an affirmative duty at the point in time the patent issued to take the product off the market," however, the Federal Circuit stated that "PHD did not have any burden to prove it retracted any putative offer for sale," because "the burden remains with the patentee to prove infringement, not on the defendant to disprove it." Thus, the Federal Circuit upheld the District Court ruling finding noninfringement of the '478 patent.

Additionally, as the '254 patent issued nearly 10 months after the '478 patent, the Federal Circuit found that Clamp I cannot infringe the '254 patent for the same reasons Clamp I does not infringe the '478 patent.

With respect to the '254 patent and Clamp II, the Federal Circuit reviewed the District Court's construal of "mechanism for moving said finger" as being a means-plus-function limitation of claim 1. The Federal Circuit noted that they have "consistently held that "[m]eans-plus-function claiming applies only to purely functional limitations that do not provide the structure that performs the recited function." *Phillips v. AWH Corp.*, 415 F.3d at 1311 (Fed. Cir. 2005). Moreover, the Federal Circuit noted that "a patentee's use of the word 'means' in a claim limitation creates a presumption that 35 U.S.C. §112 paragraph 6 applies. *TriMed, Inc. v. Stryker Corp.*, 514 F.3d 1256, 1259 (Fed. Cir. 2008)."

The Federal Circuit noted that, while the '254 patent claim language uses the word "mechanism" rather than "means," 35 U.S.C. 112 paragraph 6 can also apply for the "generic terms 'mechanism,' 'means,' 'element,' and 'device,' [which] typically do not connote sufficiently definite structure," and that "[t]he term 'mechanism' standing alone connotes no more structure than the term 'means.'," *citing Massachusetts Institute of Technology v. Abacus Software*, 462 F.3d 1344, 1354 (Fed. Cir. 2006). On the other hand, the Federal Circuit noted that in *Greenberg v. Ethicon Endo-Surgery, Inc.*, 91 F.3d 1580 (Fed. Cir. 1996), where "mechanism" was preceded by the word "detent," they examined several definitions of 'detent' and stated that "[b]ecause these definitions connoted adequate structure that was reasonably well understood in the art, this court concluded that 'detent mechanism' was not a mere functional placeholder."

In applying the above case law to determining the meaning of "mechanism for moving said finger," the Federal Circuit stated that "[n]o adjective endows the claimed "mechanism" with a physical or structural component. Further, claim 1 provides no structural context for determining the characteristics of the "mechanism" other than to describe its function…one of skill in the art would have no recourse but to turn to the '254 patent's specification to derive the structural connotation for the generically claimed "mechanism for moving said finger." Consequently, the Federal Circuit found that the District Court was correct in applying the means-plus-function treatment to the noted term of claim 1 of the '254 patent.

Next, the Federal Circuit reviewed the District Court's determination of "the corresponding structure, material, or acts described in the specification and equivalents thereof." 35 U.S.C. §112, Par. 6. The Federal Circuit noted that, when making such a determination, "a court may not import functional limitations that are not recited in the claim, or structural limitations from the written description that are unnecessary to perform the claimed function." *Wenger Mfg., Inc. v. Coating Mach. Sys., Inc.*, 293 F.3d 1225, 1233 (Fed. Cir. 2001). The District Court adopted the construction of "mechanism for moving" as proffered by PHD, and which included a "rotating central post." Welker argues that such construction is wrong because the specification teaches that a "rotating central post" isn't necessary for the function of "moving said finger along a straight line…" However, the Federal Circuit stated that the specification of the '254 patent supports the District Court's analysis because "[t]he specification repeatedly identifies a rotating central post as the disclosed structure for performing the claimed function of "moving said finger…"," and such is shown in Fig. 7 of the '254 patent.

The Federal Circuit went on to say that other claim construction doctrines, including claim differentiation, ordinary meaning and clear disavowal of claim scope do not change the construction of the noted claim element. As per claim differentiation, with respect to claim 1 of the '478 patent reciting a rotating element and claim 1 of the '254 patent, which doesn't recite a rotating element, the Federal Circuit stated that "[t]his difference between claims in different patents does not change the meaning of these means-plus-function limitations…Because both terms share the same specification with the same structure corresponding to the claimed function, this court cannot give these terms any different scope." As such, the Federal Circuit upheld the District Court's determination of the corresponding structure of the means-plus-function claim.

In reviewing the District Court's analysis of the infringement of the means-plus-function claim, the Federal Circuit noted that "[l]iteral infringement…"requires that the relevant structure in the accused device perform the identical function recited in the claim and be identical or equivalent to the corresponding structure in the specification." *Applied Med. Research Corp. v. United States Surgical Corp.*, 448 F.3d 1324, 1333 (Fed. Cir. 2006)." However, the only embodiment of the structure involved a rotating central post, and "[n]othing in the specification suggests any other structure for moving the claimed fingers." While literal infringement of a means plus function limitation requires analyzing the disclosed structure and equivalents thereof, the Federal Circuit found that "Welker Bearing effectively concedes" that the two structures are not equivalent "by arguing that 'once claim 1 of the '254 patent is construed as not requiring any rotating mechanism, PHD's Clamp II reads on claim 1 of the '254 patent . . . .'" Consequently, PHD's Clamp II, which moves the clamping fingers using a mechanism that moves linearly, is found to not literally infringe on Welker's claim the scope of which is limited to a structure which moves the clamping fingers with a rotating central post or equivalents thereof.

The Federal Circuit goes on to reject Welker's argument that PHD's Clamp II might infringe under the doctrine of equivalents, because the case does not present a doctrine of equivalents issue. Specifically, under the given facts, only a structural equivalents issue under §112 par. 6 arises. Though the inquiries under the two doctrines are similar as per analyzing the insubstantiality of differences between a disclosed structure and an accused infringing structure, the two doctrines differ as per the timing of the accused infringing structure. For structural equivalents under §112 par. 6, the equivalent structure "must have been available at the time of the issuance of the claim," while a "technology developed after the issuance of the patent," can fall under the doctrine of equivalents. *Al-Site Corp. v. VSI Int'l, Inc.*, 174 F.3d 1308, 1320 (Fed. Cir. 1999). Because PHD's Clamp II mechanism for driving the finger movement was well know in the art at the time of the invention, the Federal Circuit stated that "it cannot be classified as an after-arising technology" and is only available for equivalency analysis under §112 par. 6. Thus, no doctrine of equivalents analysis is performed and the §112 par. 6 findings arise and subsume a doctrine of equivalents analysis with regard to existing equivalencies. Under such analysis, the Federal Circuit agreed with the District Court ruling in granting summary judgment of noninfringement of the '254 patent.

In summary, the Federal Circuit affirmed the District Courts rulings of summary judgment, in favor of PHD, on noninfringement for both the '254 and '478 patents.

Significance to Patent Applicants

Welker Bearing presents a reminder that, in order to avoid the limitations of 35 U.S.C. §112, par. 6, applicants cannot merely replace the word "means" with a generic term. Instead, applicants need to include sufficient structure to describe the generic term, thereby adding structural features, or simply use structural terms such as "circuit" which have a defined (albeit broad) meaning. Moreover, in order to guard against narrow interpretations, applicants need to ensure that the specification includes alternate examples of how a mechanism can be achieved. Of significance in *Welker Bearing* was the lack of an example other than the rotating post on which the patent owner could rely to find another structure in the specification supporting the recited means for moving.

Federal Circuit Finds Unenforceability for Failure to Disclose Patents to Standards-Setting Organization

In *Qualcomm v. Broadcom*, 548 F.3d 1004 (Fed. Cir. 2008), Qualcomm is the owner of U.S. Patent Nos. 5,452,104 ("the '104 patent") and 5,576,767 ("the '767 patent"). The '104 and '767 patents relate to video compression technology.

The Joint Video Team ("JVT") is a standards-setting organization ("SSO") which was established in late 2001 as a joint project by two parent SSOs to develop a single "technically aligned, fully interoperable" industry standard for video compression technology. In order to avoid "patent hold-up," the JVT required participants to disclose and/or give up intellectual property rights ("IPR") covering a standard. In May 2003, the JVT adopted and published the official H.264 standard. Qualcomm was a member of the JVT during the development of the H.264 standard, but did not disclose the existence of the '104 and '767 patents as required by the SSOs.

On October 14, 2005, Qualcomm filed a lawsuit against Broadcom in the United States District Court for the Southern District of California, claiming that Broadcom infringed the '104 and '767 patents by making products compliant with the H.264 video compression standard. The District Court concluded that Qualcomm breached its duty to disclose the '104 and '767 patents to the JVT, where these determinations of a duty to disclose were based upon the written JVP IPR policies and the JVT participants' treatment of the JVT IPR policies. As a remedy, the District Court ordered the '104 and '767 patents unenforceable against the world, and on both Qualcomm's JVT misconduct and its litigation misconduct by failing to turn over relevant emails during discovery, the court determined that this was an exceptional case and awarded Broadcom its attorney fees. Qualcomm appealed the District Court's decision that it breached its duty to disclose U.S. Patent Nos. 5,452,104 ("the '104 patent") and 5,576,767 ("the '767 patent") to the Joint Video Team ("JVT") standards-setting organization ("SSO").

In reviewing the District Court's judgment, the Federal Circuit addressed whether (1) Qualcomm, as a participant in the JVT, had a duty to disclose patents to the JVT prior to the release of the H.264 standard in May 2003; (2) if so, what was the scope of its disclosure duty; (3) whether Qualcomm breached its disclosure duty by failing to disclose the '104 and '767 patents; and (4) if so, whether it was within the District Court's equitable authority to enter an unenforceability remedy based on the equitable defense of waiver in the SSO context.

(1) Existence of a Disclosure Duty

First, as the District Court noted, the Federal Circuit found that the JVT IPR policies identify IPR by JVT participants as critical to the development of an effective industry standard. While the language of the JVT IPR policies may not have expressly required disclosure by all participants in all circumstances, it at least incorporated a best efforts standard for such disclosure. And as Qualcomm admitted, it did not present evidence of *any* efforts to disclose patents associated with the standardization proposal to the JVT prior to the release of the H.264 standard.

Besides the disclosure obligations provided in the JVT IPR policies, the Federal Circuit agreed with the District Court that Qualcomm also had disclosure obligations under the rules of the JVT parent organizations. Thus, the Federal Circuit held that even if the written IPR policies did not unambiguously require by themselves the disclosure obligations, the language of the JVT IPR policies coupled with the District Court's findings and conclusions as to the JVT participants' understanding of the policies further established that the policies imposed disclosure duties on participants. The Federal Circuit accepted the factual findings of the District Court, noting that the District Court was in the best position to determine the significance and implications of the record testimony in the first instance and that the cited testimony provided sufficient evidentiary support for its findings.

(2) Scope of Disclosure Duty

The District Court, relying on *Rambus, Inc. v. Infineon Technologies AG*, 318 F.3d 1081 (Fed. Cir. 2003), found that Qualcomm was required to disclose any patent that "reasonably might be necessary" to practice the standard. Qualcomm argued that this standard was too broad, and that a patent must actually be necessary to practice the H.264 standard in order to trigger the disclosure duty. However, the Federal Circuit found that this interpretation was contrary to the plain language used in *Rambus*. Furthermore, in *Rambus*, The Federal Circuit noted that it explained the "reasonably might be necessary" standard by stating that "the disclosure duty operates when a reasonable competitor would not expect to practice the standard without a license under the undisclosed claims" and clarified that the standard is objective and "does not depend on a member's subjective belief that its patents do or do not read on the proposed standard." *Id.* at 1100-01, 1104. Thus, the Federal Circuit agreed with the District Court's determination that the language required JVT participants to disclose patents that "reasonably might be necessary" to practice the H.264 standard.

(3) Breach of Disclosure Duty

It was undisputed that Qualcomm did not disclose the '104 and '767 patents to the JVT prior to the release of the H.264 standard, so Qualcomm breached its disclosure duty if the '104 and '767 patents "reasonably might be necessary" to practice the H.264 standard. The Federal Circuit found that the District Court did not err in finding clear and convincing evidence that the '104 and '767 patents fell within the "reasonably might be necessary" standard and thus properly determined that Qualcomm breached its disclosure duty by failing to disclose the '104 and '767 patents to the JVT prior to the release of the H.264 standard in May 2003.

(4) Equitable Remedies

The District Court analyzed the consequence of Qualcomm's failure to disclose the '104 and '767 patents under the framework of waiver as a consequence of silence in the face of a duty to speak. Under the waiver doctrine, the failure to disclose the '104 and '767 patents rendered the patents unenforceable since the actions waived the right to enforce the '104 and '767 patents. The parties disagreed as to whether waiver was the appropriate equitable framework and whether the scope of the unenforceability remedy was within the District Court's equitable authority. Qualcomm argued that the District Court's findings did not constitute waiver as a matter of law, arguing that "true waiver" requires a voluntary or intentional relinquishment of a known right. Specifically, Qualcomm claimed that the District Court's findings in this case ran directly contrary to any claim that Qualcomm intended to voluntarily waive its patent rights. The Federal Circuit agreed with Qualcomm on this point because the District Court's findings demonstrated that Qualcomm, rather than relinquishing its rights, intentionally organized a plan to shield its patents from consideration by the JVT, intending to later obtain royalties from H.264 compliant products. For this reason, it appeared that "true waiver" was not the appropriate framework.

However, the Federal Circuit also reviewed whether an implied waiver had occurred. As to implied waiver, Qualcomm argued that, "even if Broadcom had proven an *intentional* breach of the JVT disclosure duty, waiver could be inferred only if Qualcomm knew that nondisclosure alone would (with no detrimental reliance by any party) *necessarily* result in the loss of those rights." The Federal Circuit again noted that Qualcomm knew JVT participants treated the JVT policies as imposing a duty, that it knew the asserted patents "reasonably might be necessary" to practice the H.264 standard and that it intentionally shielded the patents from consideration by the JVT, which demonstrated that Qualcomm had sufficient awareness of the relevant circumstances. The Federal Circuit found that the District Court's findings were sufficient to support the application of an implied waiver defense.

Qualcomm argued that equitable estoppel, rather than waiver, in appropriate circumstances is the proper remedy for breach of SSO disclosure duties but because Broadcom chose not to pursue equitable estoppel at trial, it was foreclosed from raising equitable estoppel on appeal because it did not cross-appeal the preclusion of that defense. In actuality, the equitable estoppel defense had not been permitted due to Qualcomm's false factual assertions in opposition to Broadcom's equitable estoppel defense and its withholding of evidence of its JVT participation for which Qualcomm had been sanctioned by the District Court. The Federal Circuit, therefore, noted that the deficiencies in Broadcom's pleadings were caused, in significant measure, by Qualcomm's failure to disclose its participation in the H.264 standard-setting process, and under these circumstances, deficiencies in Broadcom's pleadings should not permit Qualcomm to escape the consequences of its malfeasance. Furthermore, a cross-appeal would have been improper here because the alternative doctrine of equitable estoppel would not enlarge the judgment relative to the doctrine of waiver relied upon by the District Court. The Federal Circuit concluded that Broadcom properly raised equitable estoppel as an alternative ground to uphold the judgment, rather than a cross-appeal.

Qualcomm also argued that the remedy of unenforceability entered on Broadcom's defense of waiver was contrary to law, arguing that because waiver was pled as an affirmative defense, it could not result in a judgment of unenforceability. The Federal Circuit disagreed, finding it entirely appropriate for the District Court to address the defense of waiver after the jury returned a non-infringement verdict. Qualcomm was correct that patent misuse does not render a patent unenforceable for all time, but the limited scope of unenforceability does not necessarily mean that an unenforceability remedy is unavailable in the waiver context in this case. In appropriate circumstances, the District Court may order patents unenforceable as a result of silence in the face of an SSO disclosure duty, as long as the scope of the District Court's unenforceability remedy is properly limited in relation to the underlying breach. The Federal Circuit vacated the unenforceability remedy and remanded with instructions to enter an unenforceability remedy limited in scope to any H.264-compliant products.

Finally, Qualcomm argued that the District Court should not have awarded Broadcom attorney fees under the "exceptional cases" standard of 35 U.S.C. § 285 because the determination was based in part on Qualcomm's JVT-related activities. The Federal Circuit, however, found that Qualcomm's arguments did not show that the District Court's findings were clear error. The litigation misconduct findings were sufficient standing alone to support the exceptional case determination here, and in the circumstances of the present case, it was not error for the District Court to additionally consider the related JVT misconduct, which was an important in understanding and evaluating the litigation misconduct.

Significance to Patent Owners

In *Qualcomm*, the Federal Circuit clarified the remedy available where a patent owner or applicant participates in a standard setting organization. In interpreting *Rambus, Inc. v. Infineon Technologies AG*, 318 F.3d 1081 (Fed. Cir. 2003), the Federal Circuit did not rely on the mere IPR policy in place, and looked to extraneous disclosure requirements (including implied in fact contractual requirements) to show that Qualcomm was required to disclose its patent despite a vaguely worded IPR policy. Further, the Federal Circuit provided additional information on the appropriate remedy for a failure to disclose, which is limited to a waiver of right to enforce the patent against technologies within the standard. As such, the Federal Circuit clarified that while it is willing to award equitable relief against a non-disclosing patent owner based on the totality of the evidence, the waiver of the enforcement right for non-disclosure is limited and does not affect the entire scope of the patented invention.

Federal Circuit Finds Obviousness-Type Double Patenting Where Claims Recited Interchangeable Combinations of Genus and Species Elements

In *In re Basell Poliolefine Italia S.P.A.*, 547 F.3d 1371 (Fed. Cir. 2008), Basell Poliolefine Italia, S.P.A. ("Basell") appeals two decisions of the United States Patent and Trademark Office ("PTO") Board of Patent Appeals and Inferences ("Board") that affirmed the rejections of all claims of U.S. Patent 6,365,687 ("the '687 patent") as unpatentable under 35 U.S.C. §§ 102(b) and 103(a) and the doctrine of obviousness-type double patenting. The '687 patent's pending claims generally involve the production of crystalline copolymers of alpha-olefines having four or more carbon atoms, using a catalyst obtained by reacting an aluminum alkyl with a titanium halide.

On June 7, 2007, the PTO initiated a Director-ordered reexamination for all claims based on double patenting in view of two expired patents issued to Natta, U.S. Patents 3,256,235 and 3,403,139. During the course of reexamination, the Examiner added double patenting rejections based on two other expired patents issued to Natta, including U.S. Patent 3,582,987 ("the '987 patent"). On March 30, 2005, the Board affirmed the double patenting rejections. The Board determined that the patentees were entitled only to a one-way test for double patenting because the patentees "significantly controlled the rate of prosecution throughout the chain of ancestor applications." The Board also upheld the Examiner's double patenting rejections on each ground.

In a second appeal, on March 29, 2007, the Board finalized all of the obviousness-type double patenting rejections. The Board also affirmed additional rejections based on a Vandenberg (U.S. Patent 3,058,963), but the Federal Circuit did not address this issue.

On appeal, Basell argues that the Board erred in rejecting the claims for obviousness-type double patenting in view of the '987 patent. Basell first asserted that the Board erred by failing to apply a two-way test for double patenting. In determining double patenting, a one-way test is normally applied, in which "the examiner asks whether the application claims are obvious over the patent claims." *In re Berg*, 140 F.3d 1428, 1432 (Fed. Cir. 1998). Only in unusual circumstances, in which an applicant has been unable to issue its first-filed application because "the PTO [wa]s solely responsible for the delay in causing [a] second-filed application to issue prior to [a] first," may a two-way test apply. In those cases that are a narrow exception to the general rule of the one-way test, "the examiner also asks whether the patent claims are obvious over the application claims." *Id*. Here, however, the record showed that Natta's actions had a direct effect on the prosecution, and, thus, the PTO was not solely responsible for the prosecution delays. The Federal Circuit, therefore, agreed with the Board that the two-way test for double patenting did not apply.

Basell's second argument was that the '987 patent was considered during original prosecution of the '687 patent and thus cannot be considered during reexamination under the previous version of 35 U.S.C. § 303(a). The '987 patent was cited during the prosecution of a different patent application, which was ultimately abandoned, and the claims of that application differed from the claims of the '687 patent in that the recited catalyst contained a titanium chloride limitation, whereas the '687 patent encompasses catalysts that generally include the generic titanium halides. Because the earlier rejection based on the '987 patent involved different claims than those at issue, the Federal Circuit agreed with the Director that the Board was not precluded from relying on the '987 patent in its double patenting rejection.

The main issue before the Federal Circuit was then whether the claims of the '687 patent defined an obvious variation of the claims of the '987 patent. The Federal Circuit noted that both the claims of the '987 patent and the '687 patent cover alpha olefins of C_4 to C_6, and the '987 patent covers genuses that include the other elements of claim 1 of the '687 patent. The Federal Circuit noted that, "[w]hile it is true that a generic expression does not render obvious all of the species that it encompasses, these claims are both generic and specific to each other in interchangeable ways, involving the same groups of species." For this reason, the Federal Circuit agreed with the Board's conclusion that the claims of the '687 patent were not patentably distinct from claim 1 of the '987 patent.

The Board and the Federal Circuit also looked at statements from the two patents' specifications as evidence of what was intended to fall within the meaning of the claims. Relying on *In re Kaplan*, 789 F.2d 1574 (Fed. Cir. 1986), Basell asserted that the rejection had to be reversed because the Board improperly used the '987 patent specification to narrow the scope of the '987 patent claims in determining that the claims were not patentably distinct. The Federal Circuit pointed out, however, that *In re Vogel*, 422 F.2d 438 (CCPA), which reaffirmed the holding in *Kaplan*, held that while not usable as evidence of prior art, a patent's specification may be used to determine whether an application claim is merely an obvious variation of an invention claimed in a patent by using it to learn the meaning of terms and to "interpret the coverage of [a] claim." Thus, the use of the specification for purposes of definition was permissible, whereas the use of the specification for evidence of prior art is not. Since the Board opinion referred to the specification solely for purposes of defining the claim terms and not as prior art itself, the Federal Circuit found that the references to the specification in the Board opinion were not improper.

Basell's last major assertion was that the double patenting rejection should have been reversed because the Board failed to expressly conduct an analysis under *Graham v. John Deere Co.*, 383 U.S. 1 (1966), as of the earliest filing date claimed in the '687 patent. The Federal Circuit, however, found that the Board carefully considered claim 1 of the '987 patent and the claims of the '687 patent and determined that a person of ordinary skill in the art would have found the '687 patent claims to have been obvious. Moreover, the Federal Circuit noted that obviousness for purposes of obviousness-type double patenting is "similar to, but not necessarily the same as, that undertaken under 35 U.S.C. § 103 in determining the propriety of a rejection for double patenting." *quoting In re Braat*, 937 F.2d 589, 592-93; 19 USPQ2d 1289, 1292 (Fed. Cir. 1991). Thus, the Federal Circuit found no basis for reversing the Board's decision merely because the Board failed to expressly set forth each of the *Graham* factors in its analysis.

In total, the Federal Circuit found that the Board did not err in concluding that the pending claims of the '687 patent were barred under the doctrine of obviousness-type double patenting, and, thus, affirmed the Board's decision.

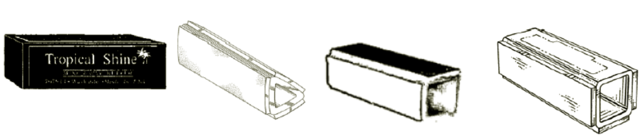
SIGNIFICANCE TO PATENT APPLICANTS

In re Basell Poliolefine Italia provides a reminder as to how broadly the doctrine of obviousness-type double patenting is defined, and more importantly, the type of evidence that is required for an Examiner to make a prima facie obviousness-type double patenting rejection. So long as a genus feature in one claim of a first patent covers a species feature in another claim of a second patent, the Examiner may decide that there is an obviousness-type double patenting issue and will use the specification as evidence of claim scope to determine whether a genus is known to cover the species. Moreover, in establishing a prima facie rejection, it appears that the Examiner need only point out that the genus feature of one patent covers the species feature of another patent without going into the more detailed analysis normally required for finding obviousness under 35 U.S.C. §103. When faced with such an analysis, it is thus incumbent on the applicant to provide evidence of non-obviousness, or to file a terminal disclaimer.

In En Banc Ruling, Federal Circuit Clarifies Test for Design Patent Infringement

In *Egyptian Goddess, Inc. et al., v. Swisa, Inc. and Dror Swisa*, 543 F3d 665, 88 USPQ2d 1658 (Fed. Cir. 2008) *en banc*, the Federal Circuit unanimously redefined the test for infringement with regard to design patents to remove the "point of novelty" prong of the analysis. Egyptian Goddess, Inc. (EGI) brought suit in the District Court for the Northern District of Texas alleging that Swisa, Inc. and Dror Swisa (Swisa) had infringed EGI's U.S. Design Patent No. 467,389 (the '389 patent). The '389 patent claimed a design for a nail buffer, "consisting of a rectangular, hollow tube having a generally square cross-section and featuring buffer surfaces on three of its four sides." The accused Swisa product had a rectangular, hollow tube having a square cross-section and featuring buffer surfaces on all four of its sides.

Swisa filed a motion for summary judgment of noninfringement, which the District Court granted Swisa stating that a "plaintiff in a design case must prove both (1) that the accused device is 'substantially similar' to the claimed design under what is referred to as the 'ordinary observer' test, and (2) that the accused device contains 'substantially the same points of novelty that distinguished the patented design from the prior art.'" The District Court held that the Swisa product did not incorporate the "point of novelty" of the '389 patent. In determining that the "fourth, bare side to the buffer" was the point of novelty, the District Court looked to Nailco's U.S. Design Patent No. 416,648 (the Nailco patent) and the Falley Buffer Block as the closest prior art. The Nailco patent discloses a nail buffer with an open and hollow body, raised rectangular pads, and open corners having a triangular cross-section. The Falley Buffer Block has a solid, rectangular cross-section with slightly raised buffers on all sides. Because the accused Swisa product did not include the fourth side without a buffer surface, the District Court concluded that the Swisa product did not incorporate the point of novelty of the '389 patent; thus, the Swisa product did not infringe. The four buffer blocks are illustrated as follows:



Falley Buffer Block — Nailco Patent — Swisa Buffer — '389 patent

The Federal Circuit traced the roots of the interpretation of the two prong test for infringement to two cases: *Gorham Co. v. White* and *Litton Systems v. Whirlpool Corp*. In *Gorham*, the Supreme Court stated, "[I]f in the eye of an ordinary observer, giving such attention as a purchaser usually gives, two designs are substantially the same, if the resemblance is such as to deceive such an observer, inducing him to purchase one supposing it to be the other, the first one patented is infringed by the other." 81 U.S. 511, 528 (1871). However, in *Litton Systems*, the Federal Circuit held that proof of similarity under the ordinary observer test was insufficient to find infringement. There, the Court required that the accused design "must also appropriate the novelty of the claimed design in order to be deemed infringing." 728 F.2d 1423 (Fed. Cir. 1984). Later courts interpreted such precedent as requiring proof of both the ordinary observer test and the point of novelty test to find infringement. The Federal Circuit noted that application of the point of novelty test is relatively simple when the patented design departs from the prior art in a single respect but that the point of novelty test becomes increasingly difficult when the patented design includes multiple features that depart from multiple prior references.

EGI argued that the ordinary observer test is able to accomplish the purposes for which the point of novelty test was designed but less confusingly. Swisa disagreed and argued that the Federal Circuit may not and should not abandon the point of novelty test as such test was adopted and required by the Supreme Court in *Smith v. Whitman Saddle Co.*, 148 U.S. 674 (1893). Swisa argued that *Whitman Saddle* dictates that the point of novelty is a second and distinct test for design patent infringement. The Federal Circuit, however, disagreed with Swisa and determined that the point of novelty test was actually developed relatively recently.

Upon a review of the case law, the Federal Circuit concluded that "the point of novelty test, as a second and free-standing requirement for proof of design patent infringement, is inconsistent with the ordinary observer test…, is not mandated by *Whitman Saddle*…, and is not needed to protect against unduly broad assertions of design patent rights." The Federal Circuit interpreted *Whitman Saddle* to mean "that, viewed in light of the similarities between the prior art and the patented design, the accused design did not contain the single feature that would have made it appear distinctively similar to the patented design rather than like the numerous prior art designs," and as such, did not infringe. Slip at page 13. More importantly, *Whitman Saddle* indicated that the ordinary observer test should be applied in light of the prior art. The Court analyzed several cases illustrating the development of the ordinary observer test in light of the prior art. *See Bevin Brothers Manufacturing Co. V. Starr Brothers Bell Co.*, 114 F. 362 (C.C.D. Conn. 1902) (for the proposition that no point of novelty test was applied but that the "ordinary observer test in which the observer was comparing the patented and accused designs in the context of similar designs found in the prior art."); *see Zidell v. Dexter*, 262 F. 145 (9th Cir. 1920) (emphasizing the importance of similar prior art designs to the determination of infringement under the ordinary observer test); and *see Applied Arts Corp. v. Grand Rapids Metalcraft Corp.*, 67 F.2d 428 (6th Cir. 1933) (in which the ordinary observer test was applied in light of similar objects found in the prior art).

The Court then noted the precedent developed to be applied in *Sears, Roebuck & Co. v. Talge*, 140 F.2d 395 (8th Cir. 1944), in which the Eight Circuit stated that the test for infringement involves two elements: (1) the sameness of effect as a whole upon the eye of an ordinary purchaser must be such as to deceive him, inducing her to purchase one, supposing it for the other, and (2) the accused device must appropriate the novelty in the patented device which distinguishes it from the prior art. The Federal Circuit saw that *Sears, Roebuck & Co.* and *Applied Arts* became the principal precedents relied upon in *Litton Systems*. Despite the Federal Circuit applying *Litton Systems* for the proposition that "the point of novelty test is separate from the ordinary observer test and requires the patentee to point out the point of novelty in the claimed design that has been appropriated by the accused design," the Federal Circuit now interprets such cases as being more properly read as "applying a version of the ordinary observer test in which the ordinary observer is deemed to view the differences between the patented design and the accused product in the context of the prior art."

> "[W]e hold that the "ordinary observer" test should be the sole test for determining whether a design paten has been infringed. Under that test, as this court has sometimes described it, infringement will not be found unless the accused article embodies the patented design or any colorable imitation thereof." Slip opinion at page 21 (internal quotes and citations omitted).

However, the ordinary observer is to be applied in light of the prior art. *See* slip at pages 17-21. Further, the accused infringer will retain the burden of production as to comparison prior art, and the patentee retains the burden of proof to demonstrate infringement by a preponderance of the evidence. Slip opinion at pages 22-23.

In applying the ordinary observer test, the Federal Circuit demonstrated that the application of the ordinary observer test is in light of multiple features of multiple prior art references. "Where the frame of reference consists of numerous similar prior art designs, those designs can highlight the distinctions between the claimed design and the accused design as viewed by the ordinary observer." Slip at page 19. The distinction as indicated by the Court is that the ordinary observer informed of the prior art may focus her attention on the proper inquiry, "whether the accused design has appropriated the claimed design as a whole," as opposed to the inquiry of the point of novelty test, whether the accused design has appropriated a single specified feature of the claimed design. *Id.*

As an example, the Court indicated that when more points of novelty are identified in the patented design, the accused infringer has more room to argue that the accused product does not infringe because the accused design does not copy all of the points of novelty, even though the accused design may copy most of the points of novelty and even though the accused design may give the overall appearance of being identical to the patented design. In such case, the test that asks how the ordinary observer having knowledge of the prior art would view the differences between the two designs will produce results congruent with the purposes of design patent protection.

The Federal Circuit also noted that it has held that trial courts have a duty to conduct claim construction in design patents. However, the Federal Circuit clarified that the Court has not prescribed any particular form that the construction must take place. Given that the illustration in the drawing views is its own best description and the perceived difficulties of attempting to describe such with words, "the preferable course ordinarily will be for a District Court not to attempt to "construe" a design patent claim by providing a detailed verbal description of the claimed design." Slip at page 24. Thus, it is within the trial court's discretion as to whether to provide a verbal elaboration of the claimed design, and such court's decision will not be reversible error without a showing of prejudice. *Id.*

The Court turned to the analysis of the facts of the case given the newly-minted standard and determined the question to be: "whether an ordinary observer, familiar with the prior art Falley and Nailco designs, would be deceived into believing the Swisa buffer is the same as the patented buffer." Slip at page 27. As shown above, the Falley nail buffer has a solid, rectangular cross-section with slightly raised buffers on all sides, and the Nailco patent has a hollow, triangular cross-section with raised buffers on all sides. Further, the '389 patent has a hollow, square cross-section with raised buffers on three of four sides, while the Swisa buffer has a hollow, square cross-section with raised buffers on all four sides, one on each side.

EGI argued that the ordinary observer would not find the addition of the fourth buffer to greatly alter the ornamental effect and appearance of the whole design of the accused design from the whole patented design. However, Swisa argued that, in light of the close prior art buffers, including a number having square cross-sections, an ordinary observer would notice the differences between the two products. Swisa emphasized that the number of sides having abrasive surfaces thereon would be important to purchasers, i.e., a "three way buffer" versus a "four way buffer."

The Court took exception with EGI's argument in that it did not address that the only difference between the accused design and the Nailco prior art design was that the accused design had four sides instead of three. The Court stated that nothing "explains why an ordinary observer would regard the accused design as being closer to the [patented] design than to the Nailco prior art patent." Slip at page 29. As such, the Court concluded that no reasonable fact-finder could find that EGI met its burden of showing that an ordinary observer, taking into account the prior art, would believe that the accused design was the same as the patented design.

Federal Circuit Finds Reduction of Compensatory Damages Requires New Trial By Jury and that Actual Notice of Infringement Can Occur With a Qualified Charge of Infringement

In *Minks v. Polaris Industries, Inc.*, 546 F.3d 1364 (Fed. Cir. 2008), Floyd M. Minks ("Minks") designs electronic components for all-terrain vehicles. Minks holds U.S. Patent No. 4,664,080 ("the '080 patent"), which is drawn to an electric governor system for internal combustion engines which uses a circuit to limit the reverse speed of an all-terrain vehicle ("ATV"). When the ATV is shifted into reverse gear, the reverse speed limiter circuit senses the direct current (DC) voltage. Once activated, the circuit also senses the alternator's alternating current (AC) output to thereby sense engine speed. If the alternator's AC voltage output exceeds a predetermined limit, the circuit emits a control signal to interrupt the ignition of the engine.

Polaris Industries ("Polaris") is a manufacturer of ATV's and a purchaser of Mink's electrical components since about 1970. In 1996, Polaris engaged Minks in discussions regarding the '080 patent and its ability to purchase reverse speed limiters from different manufacturers. Minks responded by informing Polaris that reverse speed limiters based on engine speed and a DC input were covered by the '080 patent. Polaris then began implementing a new speedometer in its ATVs that had an integrated reverse speed limiter that sensed engine speed, and when Minks confirmed that the new Polaris ATV infringed the '080 patent, he sent Polaris a letter to this effect on November 23, 2004.

When Minks did not get a positive response to the November 23, 2004 letter, Minks then filed suit against Polaris on December 22, 2005, alleging that Polaris infringed apparatus claim 2 of the '080 patent. After a trial, the jury found that Polaris infringed the '080 patent. Moreover, the jury found that since Polaris received actual notice of infringement for purposes of 35 U.S.C. §287(a) on November 23, 2004 such that all damage calculations are relative to November 23, 2004. The jury also found that Polaris willfully infringed claim 2 of the '080 patent, and that Minks was entitled to $1,294,620.91 in royalty damages.

The jury did not find that the discussions prior to November 23, 2004 were sufficient to find notice had been given prior to this date. Specifically, the District Court instructed the jury on actual notice that "[t]he date notice was given is the date on which Minks communicated to Polaris a specific charge that one of its products may infringe claim two of the '080 patent." The jury found that Minks's November 23, 2004 letter to Polaris satisfied 35 U.S.C. §287(a)'s notice requirement.

Additionally, Polaris filed a JMOL motion for noninfringement, contenting that claim 2 included a means plus function element for which there was no corresponding part in Polaris's speed limiter. However, the District Court denied the motion because Figure 2 in the '080 patent is the only structure linked or associated with the functions required by claim 2. Thus, the District Court concluded that "the means-plus-function limitations of claim 2 are limited to the structures set forth in Figure 2 (and their equivalents)." Based on this, the District Court denied Polaris's JMOL motion of noninfringement, ruling that "to one skilled in the art of circuit design/electrical engineering, [the amplitude and the frequency of the AC voltage] are equivalent for purposes of determining speed." Therefore, the jury "could reasonably conclude that the methods employed in the '080 Patent and in the accused devices were equivalent or interchangeable."

The District Court judge did, however, grant Polaris's Motion for a Reduction in Damages and came to a final award of $117,316.50. The District Court judge further reduced the damages award as a matter of law under Federal Rule of Civil Procedure 50 without offering Minks a new trial on damages.

As for enhanced damages and attorney fees under 35 U.S.C. § 285, the District Court determined that a "reasonable fee" would be $234,633.00 after all deductions. However, the District Court only awarded half this amount as it found Minks to have wasted a great deal of trial time with his "economic nonsense" damages theory.

The court denied Minks's motion for reconsideration, so Minks filed a notice of appeal on July 25, 2007, challenging (1) the District Court's reduction of the damages award, (2) the amount of attorney fees awarded, and (3) the jury instruction on actual notice.

Reduction of Compensatory Damages Without New Trial

The first issue on appeal before the Federal Circuit was whether the Seventh Amendment required the District Court to offer Minks the option of a new trial in lieu of accepting the reduced damages award. The Reexamination Clause of the Seventh Amendment states that "no fact tried by a jury, shall be otherwise re-examined in any Court of the United States, than according to the rules of the common law." The Supreme Court's interpretation history of the Seventh Amendment has required that the exercise of a District Court's discretion to set aside an excessive jury award be accompanied by an offer of a new trial. *See e.g.*, *Kennon v. Gilmer*, 131 U.S. 22, 29 (1889), *Hetzel v. Prince William County*, 523 U.S. 208, 211 (1998). However, the Eleventh Circuit held in *Johansen* that when a jury's award is premised on "legal error," a court may reduce the award and enter an absolute judgment in an amount sufficient to correct the legal error without offering the plaintiff the option of a new trial in two situations—"where a portion of a verdict is for an identifiable amount that is not permitted by law" or when the award "enter[s] that 'zone of arbitrariness that violates the Due Process Clause of the Fourteenth Amendment.'" *N.Y., L.E. & W.R. Co. v. Estill*, 147 U.S. 591 2007-1490, -1491 (1893), *Johansen v. Combustion Eng'g, Inc.*, 170 F.3d 1320, 1330-31 (11th Cir. 1999).

The District Court examined the evidence in the record with respect to the components of a reasonable royalty—number of infringing sales, royalty base, and royalty rate—and found that the evidence could not support the jury's damages award. However, in determining a reasonable jury award, the Federal Circuit found that the District Court necessarily engaged in an independent review of the evidence and substituted its conclusion for that of the jury on the factual issue of compensatory damages. The District Court's decision amounted to an exercise of discretion subject to *Hetzel*'s requirement that Minks be offered a new trial. Thus, the Federal Circuit vacated the District Court's order reducing the jury's compensatory damages award and remanded for a new trial on damages.

Reduction of Enhanced Damages

In the second issue on appeal, the Federal Circuit discussed the District Court's award of enhanced damages and attorney fees to Minks under 35 U.S.C. § 285. The Federal Circuit detected no abuse of discretion in the District Court's reduced award of attorney fees seeing as even on appeal, Minks did not articulate a coherent damages theory. The Federal Circuit, therefore, affirmed the award of attorney fees but noted that the trial judge could exercise discretion to modify the award if it warranted further consideration on remand.

Actual Notice under 35 U.S.C. §287

In the third issue on appeal, the Federal Circuit addressed the jury instruction on the issue of notice. Under 35 U.S.C. § 287(a), where a patentee has failed to mark its patented product, "no damages shall be recovered by the patentee in any action for infringement, except on proof that the infringer was notified of the infringement and continued to infringe thereafter, in which event damages may be recovered only for infringement occurring after such notice." Minks Engineering did not mark its products, so damages recoverable by Minks were limited by the date that Polaris received notice satisfying the requirements of 35 U.S.C. § 287(a).

Minks argued that the District Court's jury instruction on actual notice was inadequate because a patentee can provide sufficiently specific notice to an accused infringer before the patentee discovers the actual infringement by the accused. Thus, a patent owner can give notice both by a positive charge of infringement as well as by a qualified charge of infringement. The Federal Circuit agreed with Minks that the given instruction did not fairly and correctly state the issues and the law, and that the jury should have been more clearly instructed that it was permitted to find notice prior to the date Minks discovered Polaris's infringement. Minks made a qualified charge of infringement when he informed Polaris that reverse speed limiters that sensed engine speed and a DC input infringe the '080 patent, and as a long time customer of Minks, Polaris knew of the '080 patent. Moreover, as early as 1997, Minks specifically communicated his belief that reverse speed limiters sensing engine speed and a DC input infringed the '080 patent. Therefore, the Federal Circuit found that the District Court's instruction to the jury should have more clearly articulated that in this context, knowledge of a specific infringing device was not a legal prerequisite to a finding of actual notice. Thus, the Federal Circuit also required a new trial on this issue.

Infringement of Means Plus Function Element

Additionally, Polaris cross-appealed from the District Court's denial of its JMOL motion on noninfringement. On appeal, the Federal Circuit noted that claim 2 is a means plus function claim whose bounds are construed by identifying the claim's function then identifying the corresponding structure in the written description necessary to perform that function. *Texas Digital Sys., Inc. v. Telegenix, Inc.*, 308 F.3d 1193, 1208 (Fed. Cir. 2002). It is undisputed that the circuitry of the accused devices differs and has different components than that taught by Figure 2 of the '080 patent. However, based on expert testimony and the teachings of the '080 patent, the Federal Circuit found that the functions of the accused device and the claim were identical, that the two devices had equivalent structures (noting that difference in physical structure alone is not determinative of § 112 ¶ 6 equivalents), and that the structures performed in substantially the same way. The Federal Circuit, therefore, agreed with the District Court that the jury's verdict of infringement was supported by substantial evidence that the accused devices met claim 2 of the '080 patent and affirmed that the District Court's denial of Polaris's JMOL motion.

Willfulness

Lastly, the Federal Circuit addressed Polaris's second cross appeal that the jury instruction on willful infringement constituted plain error based on the Federal Circuit's decision in *In re Seagate Technology, LLC*, 174 F.3d 1360 (Fed. Cir. 2007) (en banc). The Federal Circuit did not decide this issue because Polaris made no argument and cited no evidence to establish two of the elements for plain error as outlined by *In re Seagate*. Furthermore, because in the order granting Minks's request for enhanced damages the trial court concluded that "it is fairly clear" that Polaris deliberately copied Minks's patented reverse speed limiter "and the case was not close," the Federal Circuit said it appeared that error in the jury instruction was not prejudicial because the jury probably would have arrived at the same result nevertheless. The Federal Circuit found that Polaris did not demonstrate plain error in the jury instruction on willfulness and affirmed the jury's finding of willful infringement.

Federal Circuit Finds Inequitable Conduct Where Statements in Prosecution Provide Evidence That Prior Art Devices Were Highly Material

In *Praxair, Inc. v. ATMI, Inc.*, 543 F.3d 1306 (Fed. Cir. 2008), Praxair brought suit against ATMI, alleging infringement of three Praxair owned patents: U.S. Patent No's: 6,045,115 (the '115 patent); 6,007,609 (the '609 patent); and 5,937,895 (the '895 patent). All three patents involve pressurized storage containers, used in the semiconductor industry, limiting the rapid discharge of hazardous gasses. The '115 and '609 patents focus on capillary flow restrictors, while the '895 patent concerns a release valve. Both Praxair and ATMI produce pressurized gas cylinders used to store the hazardous gasses used in the semiconductor industry.

Praxair filed suit on December 22, 2003 in the U.S. District Court for the District of Delaware, asserting that several claims of each of the above-noted patents are infringed by ATMI. ATMI responded by asserting an affirmative defense of invalidity of the Praxair patents and asserted counterclaims for a declaratory judgment of noninfringement and invalidity with regards to the '115, '609 and '895 patents.

Additionally, ATMI filed an amended answer adding the affirmative defense of unenforceability due to inequitable conduct as per the three Praxair patents. For the inequitable conduct affirmative defense argument, ATMI alleged that applicants for the above three patents withheld information from the United States Patent and Trademark Office (USPTO). The purportedly withheld references were U.S. Patent No. 5,409,526 (the Zheng patent) and information on restricted flow orifices (RFOs) as existing devices in the prior art.

The District Court, in a bench trial, first analyzed whether such information was material to Praxair's patents. As per the '115 and '609 patents, the District Court determined that the Zheng patent and the RFOs were material to the '115 and '609 patents. The District Court also ruled that the attorney who prosecuted the '115 and '609 patents, John Tolomei, had knowledge of the Zheng patent and the RFOs, but credited Tolomei's claim that he had a good faith basis for not disclosing the Zheng patent. Thus, there was no intent to deceive the USPTO as per not disclosing the Zheng patent.

However, as per the RFOs, the District Court found that Tolomei knew about the RFOs, which were widely used in the art prior to the application for the '115 and the '609 patent. In particular, the District Court relied upon four statements, made by the patent applicants in the prosecution of the '115 and '609 patents, that the District Court believed could not have been made had the material prior art been in front of the USPTO. Additionally, with a lack of testimony explaining why there was a failure to disclose the prior art, the District Court found that "the level of materiality of the RFO art is sufficiently high so at to support an ultimate finding of inequitable conduct." Additionally, the court stated that conclusory statement effectively stating that the applicant had no intention to deceive the USPTO did not merit consideration.

On appeal, the Federal Circuit reiterated the standard set forth in 37 C.F.R. §1.56(a) in regards to the duty of disclosure as follows: "Each individual associated with the filing and prosecution of a patent application has a duty of candor and good faith in dealing with the [PTO], which includes a duty to disclose to the [PTO] all information known to that individual to be material to patentability…" Furthermore, the Federal Circuit found that a breach of the above duty can be shown by:

> "clear and convincing evidence that the applicant (1) made an affirmative misrepresentation of material fact, failed to disclose material information, or submitted false material information, and (2) intended to deceive the [PTO]." *Cargill, Inc. v. Canbra Foods, Ltd.*, 476 F.3d 1359, 1363 (Fed. Cir. 2007).

The Federal Circuit noted that showings of materiality and intent are distinct and thus, showing materiality itself does not result in showing of intent. However, intent to deceive can be inferred when "(1) highly material information is withheld; (2) the applicant knew of the information [and]…knew or should have known of the materiality of the information; and (3) the applicant has not provided a credible explanation for the withholding," *citing Ferring B.V. v. Barr Labs, Inc.*, 437 F.3d 1181, 1191 (Fed. Cir. 2006).

MATERIALITY

With respect to the '115 patent, the Federal Circuit affirmed the District Court's finding that RFOs are material such that the first prong of the test was satisfied. Specifically, the Federal Circuit dismissed Praxair's counterargument that RFOs were cumulative because other references in front of the examiner disclosed devices similar to RFOs. In dismissing the argument, the Federal Circuit acknowledged that when information is considered to be cumulative, it specifically is not material.

However, because Praxair failed to raise the cumulative argument before the District Court, the Federal Circuit held that the argument is waived on appeal.

INTENT TO DECEIVE INFERRED BASED UPON STATEMENTS IN PROSECUTION HISTORY

With respect to intent to deceive and the '115 patent, the Federal Circuit, citing *Pfizer, Inc. v. Teva Pharms USA, Inc.*, 518 F.3d 1353, 1367, stated that where evidence of intent is not available and the prior art is highly material, intent can be inferred from three findings:

(1) that the art was highly material;

(2) that applicants knew of RFO art and knew or should have known of its materiality; and

(3) that patentee failed to produce a credible good faith explanation of why there was a failure to disclose information to the PTO.

The District Court found the RFOs to be highly material not based upon the RFOs themselves. Instead, the District Court found the high degree of materiality based upon four statements made during prosecution of the '115 patent. The Federal Circuit sustained this ruling because Praxair offered no coherent argument as to why the RFOs were not highly material in the context of the statements made in the '115 prosecution. Thus, for purposes of inferring intent, the RFOs were highly material.

With regards to the knowledge element for inferring intent, the District Court found that Tolomei, the prosecuting attorney, and LeFebre, an inventor, knew of the RFO art that was not disclosed to the USPTO. This finding was based upon testimony that Tolomei and LeFebre provided during the bench trial. Praxair doesn't dispute the testimony, but argues that testimony provided by a Praxair employee, Furhop, was relied upon improperly by the District Court in proving Tolomei's and LeFebre's knowledge. However, the Federal Circuit noted that the District Court recognized that there was no allegation of inequitable conduct on the part of a Praxair employee, and as such only used Furhop's testimony to show widespread commercial use of RFOs. As such, the Federal Circuit sustained the District Court's findings of knowledge for purpose of inferring intent, stating that "there is no question that Tolomei and LeFebre "knew of information" withheld from the USPTO.

The Federal Circuit sustained the District Court decision that no good faith explanation was proffered by those who knew of the information withheld from the USPTO for the failure to disclose known material information. Furthermore, the Federal Circuit stated that conclusory statements, such as Tolomei's claim that he never intentionally misled the USPTO, garner no weight as per an explanation. Tolomei additionally testified that unspecified references before the USPTO were cumulative of the RFO art. The Federal Circuit stated that such testimony fails to provide a good faith explanation for three reasons:

> (1) the testimony does not suggest that Tolomei believed that disclosure of the RFO would have been cumulative at the time of the '115 prosecution;
>
> (2) Tolomei did not say that cumulativeness was the reason he did not disclose the RFO art to the PTO; and
>
> (3) Tolomei failed to identify a particular reference making the RFOs cumulative.

As such, the Federal Circuit stated that:

> "Hindsight construction of reasons why a reference might have been withheld cannot suffice as a credible explanation of why, at the time, the reference was not submitted to the USPTO."

Therefore, for the three reasons discussed above, the Federal Circuit found that the District Court properly inferred intent to deceive the USPTO on the part of the applicants in failing to disclose the RFO art to the USPTO. As such, the Federal Circuit affirmed the District Court's ruling that the failure to disclose the existence of RFO prior art devices rendered the '115 patent unenforceable due to inequitable conduct.

In discussing the '609 patent, the Federal Circuit found that the District Court was correct to find the existence of RFO devices in the prior art to be material to the '609 patent, but the District Court was incorrect in inferring an intent to deceive on the part of the applicants. The Federal Circuit noted that statements, on the part of the applicants, used to show the materiality of RFOs, were made with respect to the prosecution of the '115 patent and were not made in the prosecution of the '609 patent. In fact, the statements made in the '115 prosecution were made at a time when the '609 patent had a notice of allowability for all claims to be issued. For this reason, the Federal Circuit reversed the District Court's finding of inequitable conduct as per the '609 patent. However, the Federal Circuit remanded for reconsideration of the issue of infringement of the '609 patent in view of revised findings of claim interpretation.

As per the remaining '895 patent, the District Court found to be invalid for indefiniteness. The Federal Circuit reversed the District Court's finding that a specific term in the '895 patent, "port body," is indefinite. Specifically, the Federal Circuit found that a port body was disclosed in a Summary of the Invention, and is also depicted in a drawing. Thus, the Federal Circuit found that, while the specification "may not be a model of clarity, the specification adequately explains that the port body is a housing that sealingly engages the outlet of the cylinder and defines the fluid discharge path" for purposes of 35 U.S.C. §112. Issues regarding the '895 patent were thus remanded to the District Court.

Significance to Patent Applicants

Praxair is of interest to the extent that the evidence of intent was not based upon anything in the prior art itself, but was instead inferred from arguments which the Federal Circuit believed made the prior art highly material. Moreover, the Federal Circuit required the patent attorney who made the statement to provide a credible explanation as to why information was not submitted in light of the arguments, and would not accept that the information was cumulative since such explanation was not in the context of the time during which the arguments were made. Significantly, the patent owner failed to argue that the unsubmitted information was cumulative in the context of the extent of materiality, which likely would have affected the outcome. In either case, *Praxair* reminds applicants to be brief in their arguments since statements made during prosecution can be used not only to limit the scope of a claimed invention, but can also establish the materiality of prior art for purposes of inferring intent and finding inequitable conduct.

Federal Circuit Defines Substantial New Question of Patentability for Purpose of Reexamination Not Precluded by District Court Validity Finding

In *In re Swanson*, 540 F3d 1368 (Fed. Cir. 2008), -Surmodics, Inc. ("Surmodics") appealed the Federal Circuit for the United States Patent and Trademark Office's ("PTO") Board of Patent Appeals and Inferences ("Board"), which upheld the examiner's rejection of claims 22-25 of U.S. Patent No. 5,073,484 ("the '484 patent") in a reexamination proceeding. The Federal Circuit affirmed.

On February 23, 1983, Melvin Swanson and Patrick Guire filed the '484 patent. The '484 patent discloses a method of quantitatively analyzing small amounts of biological fluids (e.g., milk, blood, urine, etc.) to detect the presence of a particular substance (the analyte). The method discloses one or more "reaction zones" that contain a bound reactant and are spaced out on a test strip made of a liquid-permeable solid. When a test solution is applied to the test strip, it moves along a flow path to sequentially encounter the reactant-containing zones. When a solution containing the requisite analyte reaches each of the reaction zones, selected detectors in the reaction zones indicate, preferably by a change of color, the presence of analyte, reactant, or predetermined product. The specification does not limit the invention to a certain type of detection and suggests that the analyte can be "substantially all chemical substances that are reactive with a reactant to form a product."

The independent claim at issue, claim 22, claims a method of detection in which the analyte and reactant form a ligand-antiligand binding pair. Claims 23, 24, and 25 are dependent claims. Claim 23 limits the detection of the ligand-antiligand pair via a chemical moiety, and claims 24 and 25 further limit this chemical moiety to include an enzyme and to be a radioisotope, respectively.

The prior art at issue in this appeal is U.S. Patent No. 4,094,647 ("Deutsch"), which also discloses a method of detecting ligand-antiligand binding pairs in order to determine the presence of a ligand (the analyte) in a biological fluid sample. Deutsch claims a detectable product that may be labeled with "any chemical substance or moiety having a detectable characteristic including radioactivity." Further, U.S. Patent No. 3,641,235 ("Weiss") teaches a similar immunoassay method for visually detecting the presence of an analyte in biological fluid. Finally, U.S. Patent No. 3.466,241 ("Tom") discloses another immunoassay method, in which of the reagents comprises "a signal creating system" that includes "radioactive substances, enzymes and chromogenic substances."

In the '484 patent's initial examination, the examiner rejected all the claims in the application that resulted in the '484 patent as obvious under 35 U.S.C. § 103 in light of various combinations of references, and used Deutsch as a secondary reference for purposes of immunoreactions examples. The claims were amended, and on December 17, 1991, the '484 patent was granted. The '484 patent was subsequently assigned to Surmodics, who exclusively licensed the patent to Abbott Laboratories ("Abbott").

On December 30, 1998, Abbott sued Syntron Bioresearch, Inc. ("Syntron") for infringement of the '484 patent. Syntron counterclaimed that the patent was invalid because, inter alia, claims 22 and 23 were invalid in light of Deutsch. On October 4, 2001, the jury returned a special verdict finding that the '484 patent was not infringed and that Syntron had failed to prove by clear and convincing evidence that the claims were anticipated, obvious, or otherwise invalid. The District Court entered judgment accordingly.

Abbott appealed, and Syntron cross-appealed to the Federal Circuit, which affirmed-in-part and remanded-in-part the judgment of noninfringement of the '484 patent and affirmed the judgment of validity on all asserted claims of the '484 patent. In particular, the Federal Circuit sustained the judgment that Deutsch did not anticipate the asserted claims, noting that "the burden having been on Syntron to prove by clear and convincing evidence that the claims were anticipated, [the Federal Circuit could not] conclude that the jury verdict on anticipation was not supported by substantial evidence." The Federal Circuit explained that the only issue regarding anticipation was whether Deutsch taught "flowing said solution along the medium," and it agreed that the jury reasonably could have found it did not.

Following appeal, Syntron filed a request for an ex parte reexamination of the '484 patent, claiming that there was a substantial new question of patentability, and in part, asserted that certain claims were anticipated or made obvious in light of Deutsch. The examiner granted the request and after reviewing the claims in light of prior art, rejected claims 22, 23, and 25 as anticipated by Deutsch, claims 22 and 23 as anticipated by U.S. Patent No. 3,641,235 (Weiss) under 35 U.S.C. § 102(b), and claim 24 as obvious under 35 U.S.C. § 103 in light of Deutsch and a secondary reference, U.S. Patent No. 3,466,241 (Tom).

The Board affirmed the examiner's rejections of claims 22, 23, and 25 of the '484 patent. First, the Board rejected Surmodics's argument that Weiss lacked detection "in the reaction zone" and agreed with the examiner that, "detection may occur in a 'reaction zone' by determining whether dye has been displaced from the particle or not." Second, the Board affirmed the examiner's finding that Deutsch anticipated claims 22, 23, and 25, rejecting Surmodics's argument that Deutsch could not anticipate the claims because it uses a developing fluid to provide the required flow through the test medium. The Board agreed with the examiner that "the claim is open to additional steps as it uses the term 'comprising.'"

Last, the Board rejected Surmodics's claim that reexamination was improper as to Deutsch because Deutsch did not raise "a substantial new question of patentability" as required by 35 U.S.C. § 303. The Board found that the reference did raise a substantial new question of patentability despite having been cited in the original prosecution because it was not cited in regard to the presently rejected claims, and it was not relied upon for the same reason the examiner now relied upon it. Moreover, the Board dismissed Surmodics's argument that because a jury had affirmed a finding of validity over the reference and the Federal Circuit had affirmed, Deutsch could not raise a substantial new question of patentability for purposes of 35 U.S.C. §303.

On appeal, the Federal Circuit noted that the civil courts and PTO have different standards of proof for determining invalidity. In civil litigation, a challenger who attacks the validity of patent claims must overcome the presumption of validity with clear and convincing evidence that the patent is invalid. 35 U.S.C. § 282. If the statutory burden is not met, it simply means that patent challenger did not carry his or her burden of establishing invalidity, not that the patent is valid. On the other hand, the Federal Circuit noted that during examinations and reexaminations, the standard of proof is a preponderance of the evidence, which is substantially lower than in a civil case. *In re Caveney*, 761 F.2d 671, 674 (Fed. Cir. 1985). Also, for the USPTO there is no presumption of validity, and the Federal Circuit noted that "examiner is not attacking the validity of the patent but is conducting a subjective examination of the claims in light of prior art." *In re Etter*, 756 F.2d 852, 856-58 (Fed. Cir. 1985). Unlike in District Courts, in reexamination proceedings, "[c]laims are given 'their broadest reasonable interpretation, consistent with the specification….'" *Trans Tex. Holdings*, 498 F.3d at 1298 (quoting *In re Yamamoto*, 740 F.2d 1569, 1571 (Fed. Cir. 1984)). Therefore, based on the differences outlined above, the Federal Circuit noted that considering an issue at the District Court is not equivalent to the USPTO having had the opportunity to consider it such that a finding of validity over a reference by a District Court does not preclude the USPTO from rejecting the claims over the same reference.

Next, the Federal Circuit addressed Surmodics' argument that the District Court's decision in light of Deutsch precludes the use of Deutsch during reexamination due to 35 U.S.C. §303. In 2002, 35 U.S.C. § 303(a) was amended to state that the USPTO may only grant a reexamination request if "[t]he existence of a substantial new question of patentability is not precluded by the fact that a patent or printed publication was previously cited by or to the Office or considered by the Office." The statute does not define what constitutes a "substantial new question of patentability." As such, the scope of the "substantial new question of patentability" requirement had not yet been evaluated since the 2002 amendment, so the Federal Circuit had the duty of first impression in this case.

In reviewing the provision, the amended statute specifically discusses references "previously cited by *the Office* or considered by *the Office*," 35 U.S.C. § 303(a) (2002) (emphasis added), but does not address any prior citation or consideration by the courts. The 2002 amendment removed the focus of the inquiry from whether the reference was previously considered, and returned it to whether the particular question of patentability presented by the reference in reexamination was previously evaluated by the USPTO. It remained unchanged pre- or post-amendment that an "argument already decided by the Office, whether during the original examination or an earlier reexamination" cannot raise a new question of patentability. H.R. Rep. No. 96-1307; see also H.R. Rep. No. 107-120, at 3. Likewise, the legislative history for both the original and amended reexamination statute suggest that Congress was concerned only with the consideration of issues in prior USPTO examinations, not prior civil litigation. As such, the Federal Circuit found that the only issues precluded by 35 U.S.C. §303(a) are those raised and resolved by the USPTO during the initial examination, not those raised and resolved by a District Court during litigation.

Moreover, in regards to issues resolved outside of the USPTO in District Court, the Federal Circuit found that 35 U.S.C. §303 did not preclude raising such issues again during a reexamination. The Federal Circuit relied upon the language of 35 U.S.C. §303 language and legislative history, and further relied upon the differences between the two proceedings, all of which suggested that Congress did not intend a prior court judgment upholding the validity of a claim to prevent the USPTO from finding a substantial new question of validity regarding an issue that had never been considered by the USPTO.

Surmodics argued that this reading of the statute—allowing an executive agency to find patent claims invalid after an Article III court had upheld their validity—violated the constitutionally mandated separation of powers. The Federal Circuit disagreed. The court's final judgment and the examiner's rejection were not duplicative, and the examiner's rejection of claims in the '484 patent pursuant to reexamination did not disturb the court's earlier holding that Syntron had not met its burden of proving that the '484 patent was invalid. The examiner instead evaluated the '484 patent claims in light of prior art, some of which Syntron had presented at trial, and found there was a preponderance of evidence supporting invalidity. *Cf. Stevenson*, 713 F.2d at 710. There is no Article III issue created when a reexamination considers the same issue of validity as a prior District Court proceeding. Therefore, the Federal Circuit concluded that the Board did not err in holding that the prior District Court litigation did not prevent the Deutsch reference from raising a "substantial new question of patentability" under § 303(a). As properly interpreted, a "substantial new question of patentability" referred to a question that had never been considered by the USPTO; thus, a substantial new question can exist even if a federal court previously considered the question.

Surmodics also argued that Deutsch did not raise "a substantial new question of patentability" because Deutsch was also considered by the USPTO during the initial examination and relied on as a secondary reference for rejecting various dependent claims as obvious. It urged the Federal Circuit to adopt a bright-line rule that "would preclude rejections in reexaminations based solely on references used in a rejection of claims in the original patent prosecution." The Federal Circuit declined this invitation, finding that such a rule would be inconsistent with the clear text of the amendment.

Instead, the Federal Circuit found that, to decide whether a reference that was previously considered by the USPTO creates a substantial new question of patentability, the USPTO should evaluate the context in which the reference was previously considered, the scope of the prior consideration, and determine whether the reference is now being considered for a substantially different purpose. <u>See</u> H.R. Rep. No. 107-120, at 3. The Federal Circuit agreed with the Board that whether Deutsch anticipated claims 22-24 raised a substantial new question of patentability under the amended § 303(a) since Deutsch had not previously been relied upon for purposes of anticipation, but had instead only been relied upon for purposes of an example of an immunoreactions. Substantial evidence supported the Board's conclusion that in the initial examination, "Deutsch was relied upon, as a secondary reference," for the limited purpose of "teaching immunoreactions in general, and not for the specific method steps claimed." The independent claims were found obvious without any reliance on Deutsch, and Deutsch was cited only to reject the dependent claims that limited the analyte-reactant pair used in the method to a ligand-antiligand pair. Nowhere in its decision did the examiner consider the particular analytical method disclosed by Deutsch. In light of the extremely limited purpose for which the examiner considered Deutsch in the initial examination, the Board is correct that the issue of whether Deutsch anticipated the method disclosed in claims 22, 23, and 25 was a substantial new question of patentability, never before addressed by the USPTO.

In conclusion, the Federal Circuit held that under 35 U.S.C. § 303(a), as amended in 2002, despite consideration of the Deutsch patent in the initial examination and the Federal Circuit's prior decision, there was a substantial new question of patentability regarding whether Deutsch anticipated and made obvious claims 22-25 that made reexamination warranted. As Surmodics did not raise additional objections to the Board's rejections over Deutsch, the Board's finding that claims 22-25 of the '484 patent were anticipated and would have been obvious in light of Deutsch was affirmed.

Significance to Patent Owners

In *Swanson*, the Federal Circuit confirmed that the scope of reexamination has been significantly enlarged to any issue not considered by the Examiner during the original prosecution, even where a particular reference has already been considered during that prosecution. On a more troubling note for patent owners, the Federal Circuit allowed the reexamination to continue in spite of what had otherwise been a final resolution of the issue at the District Court level. While rationalizing that the standards of review are different, the practical effect is that accused infringers will be tempted to initiate reexaminations at the same time they are asserting invalidity at the District Court level. While this will increase the likelihood of an invalidity ruling without substantially more cost to the infringer, it will force the patent owner to incur substantially greater costs in defending the patent in different fora and will represent a cloud on enforceability even after a finding of validity.

Ninth Circuit Finds Creation of Custom Programs under Contract which is Silent as to Intellectual Property Grants an Unlimited License to Use and Modify the Custom Programs

In *Asset Marketing Systems, Inc. v. Kevin Gagnon, d/b/a Mister Computer, D.C.* 542 F3d 748; 88 USPQ2d 1343 (9th Cir. 2008), Kevin Gagnon, doing business as Mister Computer ("Gagnon") appeals from the District Court's grant of summary judgment in favor of Asset Marketing Systems, Inc. ("AMS"). The Court of Appeals for the Ninth Circuit affirmed.

Background

From May 1999 to September 2003, AMS, a field marketing organization offering sales and marketing support to insurance marketing entities, hired Gagnon at-will as an independent contractor to assist with its information technology needs. Gagnon was asked to develop six custom software programs for AMS. Over the course of the companies' four year relationship, AMS paid Gagnon over $2 million for this development. However, no agreement was agreed to governing rights in the intellectual property for the developed software programs.

When AMS terminated Gagnon's services in June 2003, it offered Gagnon an employment position, but he declined. In back and forth written communications, Gagnon demanded payment from AMS for its right to continue to use the programs and for Gagnon's agreement not to sell the programs to AMS' competitors. Gagnon eventually ordered AMS to remove "all original and derivative source code" and related program files. In response, AMS refused to cooperate with any of Gagnon's orders, demanded copies of the source code for all software developed by and on behalf of it, and asserted that Gagnon was not authorized to utilize the software that AMS believed it owned. A week prior to his termination, Gagnon registered the copyright for the six programs with the United States Copyright Office, and this action incited AMS to take legal action.

AMS filed a complaint in California Superior Court against Gagnon alleging misappropriation of trade secrets and conversion. In turn, Gagnon removed the case to federal court and then filed numerous counterclaims alleging, among other claims, copyright infringement for the six programs, trade secret misappropriation, and unfair competition. The District Court remanded AMS' claims back to the state court, and AMS filed the remanded claims as counter-counterclaims in order to maintain all related claims in federal court.

The District Court granted AMS' motion for summary judgment as to Gagnon's counterclaims. Specifically, the District Court found that Gagnon had granted AMS an implied nonexclusive license to use, modify, and retain the source code of the programs. Gagnon's trade secret misappropriation claim was, therefore, also defeated. Further, because no trade secret agreement existed as between Gagnon and AMS with respect to the source code, Gagnon's unfair competition claims were deemed invalid under California law. Gagnon's remaining state law claims also failed for these reasons. Next, Gagnon filed a motion for reconsideration, which was denied. The case was then reassigned to a new judge, and Gagnon appealed the grant of summary judgment. Upon successful limited remand, the District Court denied the motion for reconsideration and returned the case to the Ninth Circuit Court of Appeals.

Court of Appeals for the Ninth Circuit

On appeal, the Ninth Circuit first noted that although exclusive licenses must be in writing, 17 U.S.C. § 204 grants of nonexclusive license need not be in writing and may be granted orally or by implication. The Ninth Circuit has held that an implied license is granted when "(1) a person (the licensee) requests the creation of a work, (2) the creator (the licensor) makes that particular work and delivers it to the licensee who requested it, and (3) the licensor intends that the licensee-requestor copy and distribute his work." *I.A.E., Inc. v. Shaver*, 74 F.3d 768, 776 (7th Cir. 1996). For example, in *Effects Assocs., Inc. v. Cohen*, 908 F.2d 555-56 (9th Cir. 1990), a movie producer hired Effects Associates to create certain special effects for a movie. Though the film footage containing the special effects was used without the producer's obtaining a written license from Effects Associates, the Ninth Circuit found that an implied license had been granted because the footage was created at the producer's request with the intent that it be used in the film with no warning that use of the footage would constitute infringement. *Id.* at 558-59 & n.6. The Ninth Circuit applied the same analysis used in *Effects* to implied licenses for computer programs.

As to the first factor, Gagnon argued that AMS never specifically requested that he create the programs, but "rather relayed its needs to Mr. Gagnon and he satisfied them by providing either computer hardware or computer software at his discretion." The Ninth Circuit found this interpretation of "request" to be strained. Gagnon did not create the programs on his own initiative and market them to AMS; rather, he created them in response to AMS' requests. Also, after prototype software was developed, he made changes to the programs in response to AMS' requests.

As to the second factor, it was undisputed that Gagnon created the programs for AMS. However, the remaining question was whether Gagnon delivered the programs to AMS. The Ninth Circuit agreed with the District Court that Gagnon delivered them when he installed them onto the AMS computers and stored the source code on-site at AMS. Gagnon had argued that even if he had installed the programs onto the AMS computers, he never delivered the source code so that AMS could modify the code. Gagnon further argued that if, in fact, AMS did not have the right to modify the code, AMS may have infringed Gagnon's copyright by exceeding the scope of its license. However, the Ninth Circuit noted that "Gagnon's conduct manifested an objective intent to give AMS an unlimited license at the time of creation; thus, when he stored the source code at AMS, the code was delivered." Therefore, the Ninth Circuit held that the scope of the license necessarily included the unlimited license to modify the source code as well as use the executable object code.

As to the third factor, the Ninth Circuit concluded that Gagnon's conduct did manifest an intent to grant a license. Specifically, the Ninth Circuit noted that the relevant intent is the licensor's objective intent at the time of the creation and delivery of the software as manifested by the parties' conduct. See *Effects*, 908 F.2d at 559 n.6; *see also John G. Danielson, Inc. v. Winchester-Conant Props., Inc.*, 322 F.3d 26, 42 (1st Cir. 2003), *I.A.E.*, 74 F.3d at 777. Gagnon and AMS had an ongoing service relationship in which Gagnon provided technical support for all computer-related problems at AMS, and he created certain custom software applications at AMS' request. The parties' relationship indicated neither an intent to grant nor deny a license without Gagnon's future involvement.

Moreover, the Ninth Circuit held that courts have looked to contracts, even if unexecuted, as evidence of the intent of the party submitting the contract. In the instant case, there were several documents that reflected the parties' objective intent: a Technical Services Agreement (TSA), an Outside Vendor Agreement (OVA) submitted by Gagnon, and Gagnon's letter objecting to AMS' proposed changes to the OVA. The TSA that both parties signed in May 2000 stated only that Gagnon "[would] provide" AMS "specific add-on products." Nothing in the TSA indicated Gagnon's understanding or intent that continued use of the custom application programming undertaken by Gagnon would be prohibited after the TSA terminated, nor did the TSA mention anything about a license. Also, Gagnon was well paid for his services. It is highly unlikely that AMS would have paid Gagnon for his programming services if AMS could not have used the programs without further payment pursuant to a separate licensing arrangement that was never mentioned in the TSA and never otherwise requested at the time. Moreover, the TSA was not renewed beyond its April 30, 2001 expiration although the relationship continued. Moreover, the Ninth Circuit noted that custom software is far less valuable without the ability to modify it, and because the TSA was set to expire in one year, one would expect some indication of the need for future licensing if the custom programs were to become unusable after the TSA expired. Thus, the TSA, while silent as to the intellectual property rights, was evidence that the right to use and modify the software programs after termination of the TSA.

The parties additionally attempted to draft an Outside Vendor Agreement (OVA) but were unable to agree upon a version, and it was never executed. The Ninth Circuit found that the unexecuted OVA submitted to Gagnon did not evidence any intent by Gagnon to limit AMS' use of the programs.

Lastly, the Ninth Circuit noted that Gagnon and AMS did not discuss a licensing agreement until their relationship was ending. Gagnon delivered the software without any caveats or limitations on AMS' use of the programs. The first time that Gagnon expressed a contrary intent was in a letter to AMS, sent after AMS had decided to terminate Gagnon's services. Gagnon had to express an intent to retain control over the programs and limit AMS' license if he intended to do so. A belated statement that the programs could not be used after Gagnon's departure, made after the termination decision and well after the creation and delivery of the programs, for which substantial sums were paid, was not sufficient to negate all other objective manifestations of intent to grant AMS an unlimited license. For these reasons, the Ninth Circuit held that Gagnon granted AMS an unlimited, nonexclusive license to retain, use, and modify the software, and because AMS paid consideration, this license was irrevocable. The Court of Appeals, therefore, affirmed the District Court's grant of summary judgment in favor of AMS on the copyright infringement claim.

Significance to Software Licensors

While not an entirely unexpected result, *Asset Marketing Systems* confirms that where software is custom built, the entity writing the code will own the code, but the entity funding the work will be entitled to an unlimited license to the resulting work. As such, where parties envision a more restricted license, the parties need to ensure that the contract includes provisions which explicitly provide these restrictions.

California Court Finds UCC Infringement Indemnification Does Not Require Underlying Infringement Claim to Succeed So Long As Underlying Claim Is Not Frivolous

In *Pacific Sunwear of California v. Olaes Enterprises, Inc.*, 167 Cal. App. 4th 466; 84 Cal. Rptr. 3d 182; 2008 Cal. App. LEXIS 1573 (CA 4th Ct. App. Oct. 9, 2008), Pacific Sunwear of California, Inc. (PacSun) appealed a trial court order granting summary judgment in favor of Olaes Enterprises, Inc. (Olaes) in PacSun's breach of warranty lawsuit. As background, Olaes supplies PacSun with T-shirts for resale in PacSun stores. In 2004, PacSun purchased 16,000 T-shirts depicting a monkey drinking hot sauce, with the captions "Smile Now" and "Cry Later." On January 12, 2005, clothing maker Smile Now Cry Later Inc. (SNCL) filed suit against PacSun alleging that the hot sauce monkey shirts violated SNCL's trademark. SNCL filed a motion for a preliminary injunction barring further sales of the hot sauce monkey shirts, but the District Court denied this motion, finding that SNCL failed to carry its burden under an eight-factor test utilized by the Ninth Circuit to determine likelihood of confusion.

In May 2006 PacSun filed an action in superior court, alleging that Olaes breached the statutory warranty that the hot sauce monkey shirts were "free of the *rightful* claim of any third person by way of infringement or the like," as contained in section 2312, subdivision (3) of the California Uniform Commercial Code (§ 2312(3)). Both parties filed cross-motions for summary judgment. The trial court denied PacSun's summary judgment motion, but with respect to Olaes' motion, the court ruled that "SNCL's underlying claims of infringement were not 'rightful claims' under § 2312(3) and thus Olaes did not breach the warranty provided for under that section" and relied upon the fact that SNCL did not carry its burden to succeed on the motion for preliminary injunction in the underlying trademark suit.

On appeal, PacSun argued that the trial court erred in ruling, as a matter of law, that SNCL's trademark infringement claim was not a rightful claim because "at the very least," there is a disputed factual issue as to whether the claim is "rightful," which precludes summary judgment. The issue before the Court of Appeal for the Fourth Appellate District of California was whether the trial court properly ruled on a motion for summary judgment that the § 2312(3) warranty did not apply because the trademark suit filed by SNCL was not a rightful claim of infringement. Olaes suggested that a rightful claim is a valid claim, meaning one that has proven, or will likely prove, meritorious in litigation. By contrast, PacSun argued that any claim "in the form of litigation" constitutes a rightful claim regardless of its underlying merits.

Citing *84 Lumber Co. v. MRK Technologies, Ltd.* 145 F.Supp.2d 675 (W.D.Pa. 2001), the Court of Appeals noted that other courts have found that the phrase "rightful claim" under the UCC as being somewhere between these interpretations. However, there were no California cases that discussed § 2312(3) and the definition of a rightful claim. As such, the Court of Appeals applied the general rules of statutory interpretation.

First, looking to the text of the statute itself, the phrase "rightful claim" is not defined in the California Uniform Commercial Code, and due to the multitude of definitions of "rightful" in common usage that leave the term ambiguous, the court then turned to extrinsic aids. The court looked to the official commentary to the Uniform Commercial Code, as an especially helpful aid under California caselaw as done in *AmerUS Life Ins. Co. v. Bank of America, N.A.*, 143 Cal.App.4th 631, 638 (2006); *Wilson v. Brawn of California, Inc.* 132 Cal.App.4th 549, 555 (2005); *Cohen v. Disner* 36 Cal.App.4th 855, 862 (1995). This demonstrated that, contrary to Olaes' position, the term "rightful claim" as used in the statute is intended to broadly encompass any nonfrivolous claim of infringement that significantly interferes with the buyer's use of a purchased good. The court of appeals found that the comments, by stating that the seller warrants that there will be "no claim of infringement," and by asserting that the buyer's remedy arises immediately upon notice of infringement, strongly suggests that any significant claim of infringement – whether or not ultimately meritorious- triggers the § 2312(3) warranty. The court also noted public policy arguments that supported interpreting the warrant to encompass all nonfrivolous claims of infringement. For example, the seller's incentive to reduce or eliminate prospective claims of infringement is undermined if the § 2312(3) warranty applies only to meritorious claims, leaving the risk of closely contested, but ultimately unsuccessful, infringement claims to be borne by unsuspecting purchasers, who are less familiar with the product than the seller.

Lastly, the Court of Appeals noted that this interpretation was consistent with another court's decision on the same basic warranty provision: *Sun Coast Merchandise Corp. v. Myron Corp.* 393 N.J.Super. 55; 922 A.2d 782, 796–797 (App.Div. 2007), which held that a rightful claim is a claim that "cast[s] a 'substantial shadow' on the buyer's ability to make use of the goods in question." However, the Court of Appeals modified this standard to clarify that to cast a substantial shadow, the claim must be non-frivolous since whether a claim is frivolous is more consistent with terminology used in California law. As such, the Court of Appeals settled on the following standard:

> A rightful claim under section 2312(3) is a nonfrivolous claim of infringement that has any significant and adverse effect, through the prospect of litigation or otherwise, on the buyer's ability to make use of the purchased goods.

Because the evidence presented on Olaes' summary judgment motion demonstrated that there was at least a triable issue of material fact as to whether SNCL's infringement claim was a rightful claim, the trial court erred in granting Olaes' motion for summary judgment. The trial court could not properly resolve that question, as a matter of law, in favor of Olaes.

Olaes then contended that even if the court of appeals disagreed with the trial court's interpretation of rightful claim, it could still affirm the summary judgment ruling on the alternate ground not ruled on by the trial court: that Olaes' breach of the warranty was not the proximate cause of PacSun's damages. Olaes argued that the warranty breach cannot be considered the proximate cause of the damages because PacSun knew of the purported defect in the hot sauce monkey shirt before it ordered them. The court of appeals, however, did not find that the evidence presented on Olaes' summary judgment met the threshold for a ruling in Olaes' favor.

The trial court's interpretation of "rightful claim" was erroneous; a rightful claim under § 2312(3) is not synonymous with a claim that ultimately will prove successful in litigation. Under this standard, the trial court could not properly conclude on the evidence before it, as a matter of law, that the third party infringement claim against PacSun was not a rightful claim. The court of appeals reversed the judgment of the trial court.

Significance to Merchants and Sellers

Pacific Sunwear confirms what an ordinary review of the UCC reveals: warranties of non-infringement are to be broadly interpreted. While few cases exist on the subject, sellers and distributors should be aware of the scope of this indemnification. Moreover, *Pacific Sunwear* also highlights the need to disclaim these warranties in order to ensure that a seller are able to limit its liability, or at least control its liability and ensure its participation in the defense of an allegedly infringing article.

Implementation of New Appeal Rules Delayed

On December 10, 2008, the United States Patent and Trademark Office (USPTO) issued a Notice in the Federal Register indicating that the new rules applicable to the patent appeals process are not being implemented as originally planned. According to this Notice, the Office of Management and Budget (OMB) has not completed its review of the rules and is still reviewing information on the proposed rules. The delay is likely due to substantial questions being raised as to the USPTO's estimates for the cost applicants will incur in complying with the new rules. *BREAKING NEWS: USTPO Appeal Rules Delayed by OMB* (December 9, 2008) (http://www.pli.edu/patentcenter/blog.asp?view=plink&id=385). It is estimated that the OMB action will delay implementation until at least late January 2009. As previously noted in Fadi N. Kiblawi and James G. McEwen, *An Overview of the New Rules for Appeal Briefs* STEIN, MCEWEN & BUI LLP NEWSLETTER, pp. 18-21 (Vol. 4, Iss. 3)(September 2008), this rule package had encountered substantial objections from the Intellectual Property community due to the substantial new risks and burdens being visited on the applicants. Therefore, until further notice, applicants need not comply with the proposed new rules for cases on appeal.

Report On FTC Hearing on the Evolving IP Marketplace Held December 5, 2008

By James G. McEwen[1]

Introduction

On December 5, 2008, the Federal Trade Commission (FTC) conducted its first of multiple hearings to explore the continuing evolution of intellectual property marketplace and the effect of this marketplace on competition. Entitled *The Evolving IP Marketplace*, the hearings are a continuation of the FTC work first published in *To Promote Innovation: The Proper Balance of Competition and Patent Law and Policy A Report by the Federal Trade Commission* (October 2003) (hereinafter the "2003 FTC Report"), and to revise its findings in light of changes in law since 2003. Of special interest, according to William Kovacic, Chairman, Federal Trade Commission, is to ensure that the FTC is able to obtain empirical solutions to IP marketplace issues as they affect competition law, and to determine the extent to which the theory meets practice in regards to optimizing the interface between IP and competition law. As such, the December 5, 2008 hearing is only one of multiple planned sessions. All materials presented, including transcripts and slide show presentations, are available on the FTC website at http://www.ftc.gov/bc/workshops/ipmarketplace/.

First Panel: Developing Business Models

The first panel dealt with the new business models being developed which are based upon "the buying, selling and licensing of patents." On the panel were Mallun Yen, Vice President, WW Intellectual Property, Cisco Systems Inc.; Peter N. Detkin, Founder & Vice Chairman, Intellectual Ventures, Inc.; Daniel P. McCurdy, CEO, Allied Security Trust; Chairman, PatentFreedom, L.L.C.; Raymond Millien, founder PCT Companies and CEO, PCT Capital, L.L.C.; and Brian Kahin, Senior Fellow, Computer & Communications Industry Association. Peter N. Detkin and Raymond Millien generally represented the entities involved in the new business models. Mallun Yen, Daniel P. McCurdy, and Brian Kahin generally represented the views of the established industry.

Starting off the panel, Raymond Millien gave an overview of the types of new business models which are based upon using existing patents.[2] He began by noting that the US economy is increasingly being based not upon traditional physical assets, but on its intellectual property. Patents are representing an increased percentage of property, and the new business models being created are a reflection of this reality. Patents and intellectual property in general are increasingly being seen as a measure of wealth, and further, patents are being seen and utilized increasingly as a commodity which can bring that wealth to its creator. Mr. Millien broke down and categorized the types of new business models aimed at maximizing this new phenomenon into seventeen (17) separate categories, ranging from Patent Licensing and Enforcement Companies (such as Acacia Research; Fergason Patent Prop.; Lemelson Foundation; LPL; NTP; Patriot Scientific RAKL TLC; TPL Group) to Patent - Based Public Stock Indexes (such as the Ocean Tomo Indexes; Patent Board WSJ Scorecard). Mr. Millien hypothesized that these categorized will soon further

[1] The opinions in this article do not represent the official positions of Stein, McEwen & Bui, LLP. Special thanks to Nathan H. Cristler for his help in this report.

[2] A copy of Mr. Millien's presentation, entitled *The IP Marketplace Players*, is available at http://www.ftc.gov/bc/workshops/ipmarketplace/docs/rmillien.pdf.

adapt to the commoditization of patents so as to allow for trading patents as an asset class, such as through traded exchanges, IP hedge funds, and urban IP zones.

Next on the panel was Peter N. Detkin, who provided a more detailed and spirited defense of the new business models. Mr. Detkin began by emphasizing that the Constitutional purpose of patents is to ensure that inventors are rewarded for their innovation, which more closely tracks the language of Article I, Section 8 of the Constitution as compared to merely insuring innovation benefits in the abstract. As such, he proposed that the key question is whether the new business models do a better job of benefitting and rewarding inventors, as is the Constitutional charge for patents, or whether the existing models are sufficient. Mr. Detkin asserted that, under existing models, for an independent inventor to obtain the reward for a patented invention, the inventor needed at least 8-24 months for coming to a license, which is time the inventor is not inventing new discoveries but is instead locked in negotiations. Citing a Small Business Administration report, Mr. Detkin stated that the small inventor is the largest generator of patents at 60%, whereas data taken from publicly available financial documents indicates that the small inventor gets less than 10% of patent royalties.

Moreover, corporations have large pools of unused patents and are unable to efficiently utilize these resources to obtain this reward since the patent marketplace is disorganized and requires diverting resources to enter into the 8-24 months of licensing negotiations. According to Mr. Detkin, the larger corporations tend to benefit from the lack of organization since they are the largest user of patents, but do not need to pay for the use since the market is too chaotic to make enforcement practical. At the same time, when an inventor does attempt to obtain a royalty, the royalty is generally inflated in order to account for the expense of the 8-24 months of licensing negotiations or litigation. Thus, the royalties for specific patents tend to be disproportionate to the actual value of the invention due to the costs of enforcement and licensing.

Mr. Detkin highlighted specific problems, but noted that a great deal of uncertainty exists in evaluating the IP marketplace due to a lack of data. He specifically requested that the FTC concentrate on gathering data on royalties, settlements, and damages since most studies in this area rely on anecdotal evidence. All members of the panel agreed that this information is crucial in determining whether these new business models are beneficial.

Among the issues, Mr. Detkin noted that users of IP have problems due to the new technologies evolving in multiple fields, such that multiple sources of IP exist. Moreover, there is a need to be able to efficiently use and share patents for purposes of interoperability and adoption of the new technologies. In contrast, generators of IP tend to have a problem in that their property is illiquid and difficult to monetize, leaving patent portfolios underutilized due to the legal risks inherent in licensing and enforcement. According to Mr. Detkin, the new business model resolves many of these issues by creating a marketplace which both rewards inventors and allows IP users to efficiently acquire needed patent rights at a more reasonable cost and with less risk as compared to the existing system. Thus, Mr. Detkin believes that the problems can generally be resolved while still allowing the inventor to be rewarded as Constitutionally required by activating "free market forces (capital, information, liquidity scale, aggregation) to ensure fair compensation for inventors" and allowing patents to become an asset class distinct from capital.[3]

In response, Daniel P. McCurdy presented a view with an emphasis that the purpose of patents is really for the protection of innovation, and not merely the reward of inventors.[4] In that vein, the emphasis on inventors has led to the growth of non-practicing entities (NPEs) acquiring and enforcing patents. According to Mr. McCurdy, these NPEs represent the biggest threat to innovation and should not be classified or thought of in the same was as practicing entities, which actually developed the technology as opposed to purchasing the patent on the technology. Moreover, NPEs do not use the patent itself since licensing is selling, not using. As a non-user of the technology, NPEs are not restrained in choosing litigation targets as are the practicing entities, and NPEs are not deterred by the potential of the practicing entity filing a counter suit of patent infringement which otherwise reduces litigation between practicing entities. As evidence Mr. McCurdy presented slides showing a sharp increase in instances in the number of practicing entities being defendants in litigation with NPEs between 2000-2008, whereas the number of practicing entities being plaintiffs in the litigation was relatively steady during the same period. As a result, Mr. McCurdy asserted that NPEs raise the

[3] Peter N. Detkin, *To Promote the Progress…of Useful Arts: Investing in Invention*, slides 9-10 (2008) (available at http://www.ftc.gov/bc/workshops/ipmarketplace/docs/pdetkin.pdf).
[4] A copy of Mr. McCurdy's presentation, entitled, *Unique Operating Companies Involved in Patent Litigation with NPEs; Patent Litigation Involving NPEs and Operating Companies*, is available at http://www.ftc.gov/bc/workshops/ipmarketplace/docs/dmccurdy.pdf.

risk of operation for practicing entities and represent a competitive harm to practicing entities since they represent a barrier to entry to practicing entities.

In support of Mr. McCurdy, Mallun Yen also emphasized that weak patents harmed innovation.[5] Specifically, taking time to respond to charges of infringement takes money away from R&D budgets and innovators away from innovation. Ms. Yen noted that, from her experience, when Cisco is sued by NPEs, the NPEs have purchased the patents being asserted. Moreover, citing AIPLA figures, the cost of defending baseless suits ranges from $4-5 million at the low end all the way up to $25 million. Moreover, Cisco has seen a dramatic increase in suits against it, mostly starting in FY04. The loss of budget and the time requirements imposed on Cisco personnel in having to defend against these increasing numbers of suits represent a loss of ability to innovate by a practicing entity, thereby harming innovation. As such, Ms. Yen indicated that the use of patent as an asset in by NPEs also presents harm to innovation.

As the final panelist, Brian Kahin noted that patents and the IP marketplace present tension at a policy level.[6] Specifically, Mr. Kahin stated that innovation is the goal of the patent system, and that the use of patents by NPEs does not further this goal. Mr. Kahin contested Mr. Detkin's and Mr. Millien's premise that patents are truly assets since they are merely promises to sue. Mr. Kahin also indicated that even Judge Giles Rich was mistaken about patents when he stated that patents are "not for exceptional inventors but for average inventors and should not be made hard to get for average inventors and should not be made hard to get" since if the invention is not commercially hot, the inventor's monopoly is for something which has no value.[7] Thus, according to Mr. Kahin, the use of patents as an asset is improper.

Also, citing a Carnegie-Mellon survey of manufacturing R&D managers from 1994-1995, Mr. Kahin noted that the popular view of patents is that they prevent copying. However, Mr. Kahin indicated that this popular view is not valid in light of the NPEs.

[5] A copy of Ms. Yen's presentation, entitled *Cisco Systems, Inc. FTC Hearing on the Evolving IP Marketplace*, is available at http://www.ftc.gov/bc/workshops/ipmarketplace/docs/myen.pdf.
[6] A copy of Mr. Kahin's presentation, entitled *The Patent Ecosystem in IT: Business Practice and Arbitrage*, is available at http://www.ftc.gov/bc/workshops/ipmarketplace/docs/bkahin.pdf.
[7] *Quoting* Giles S. Rich, *The Principles of Patentability*, 28 Geo. Wash. L. Rev. 393, 407 (1960), *reprinted in* John Witherspoon, ed., *Non-Obviousness: The Ultimate Condition of Patentability*, at 2:1, 8 (BNA 1980).

Further, Mr. Kahin indicated that the use of patents by NPEs does not further innovation and instead represents an unfair ambush on practicing entities. Specifically, Mr. Kahin asserted that the real problem is a patent ambush. In such an ambush, a patent owner can hold back claims, wait for a product to emerge, and then add the claims so as to obtain protection covering the product with the practicing entity not having been able to design around the added claims to avoid the infringement. This prospect does not promote openness since the patent holder will keep such patent claims secret until the last possible minute so as to ambush the practicing entity.

Mr. Kahin indicated a number of potential harms being caused by NPEs and the use of patents as assets which can be bought and sold like any other asset.[8] Thus, he noted that the FTC should concentrate on bringing economic analysis as a consideration in patent policy making, which was also recommendation 10 of the 2003 FTC Report. However, like Mr. Detkin, Mr. Kahin noted that there has yet to be made public good data needed to evaluate current patent policies and to actually apply the economic analysis to improve patent law. Specific suggestions for improving the quality of the data included requiring registration of all licenses, and possible changes in SEC filings to require disclosure of licensing costs. Whatever the source, Mr. Kahin indicated that additional data needs to be available which clarifies true patent ownership, the price of a patent sale, the price and circumstances of a patent sale (i.e., one way for money or cross license), and costs of settlements.

Keynote Address: Honorable Paul R. Michel, Chief Judge, Court of Appeals for the Federal Circuit

Judge Michel generally praised the work of the FTC as well as their work in creating the 2003 FTC Report. However, he noted that much has changed in the law since 2003, and that this report is very dated in its recommendations in view of court decisions issuing since 2003. He also highlighted that the biggest challenge for the FTC is to find what changes in the patent system will serve all inventors, all companies, and all technologies. Lastly, whatever changes are proposed,

[8] These include uses which inhibit market entry with portfolios; present a hold up for complex products; ambush standards; exploit imbalance in litigation resources; portfolio evergreening; instill uncertainty in competitors' customers; collusive settlements (suppress prior art, transfer patents); use of portfolios to defeat exclusive rights; use of RAND licensing to extract cross-licenses; temporary assignments (both offensive and defensive); assignments out of portfolios for surrogate attacks; situational assertions (IPOs, product launches); and track and capture standards.

there is the overriding need that the system be fair and efficient.

Panel 2: Recent And Proposed Changes In Remedies Law

The second panel dealt with the "proposed changes in remedies law, their impact on innovation." On the panel were Thomas F. Cotter, Briggs and Morgan Professor of Law, University of Minnesota Law School; John R. Thomas, Professor, Georgetown University Law Center; John Squires, Chief Intellectual Property Counsel, Goldman Sachs & Co.; Q. Todd Dickinson, Executive Director, American Intellectual Property Law Association; and Hon. Roderick R. McKelvie, Covington & Burling, former judge for United States District Court for the District of Delaware.

The panel started off with Mr. Cotter, who presented an overview of patent remedies in general, including both interim remedies and final remedies available for infringement. He also indicated that it is useful to note that patent remedies can be expressed in terms of protecting patents as property rights or as liability rule entitlements.[9] If thought of as a personal property right, the patentee and user are forced into private transactions to allow use of the property. Moreover, as the user and patentee generally have the best information on the value of the patent as compared to a court, the parties are more likely to accurately estimate the value of the patent. In contrast, where patents are not considered property but instead are liability rule entitlements, the public interest is more likely to be protected and the courts can act as a safety valve to protect the public interest. An example he used was the use of 28 U.S.C. §1498 as a mechanism for the government to ensure patents do not prevent manufacture of essential medicine. As such, where patents are liability rule entitlements, courts can protect against patent holdups (i.e., inadvertent infringement and surprise) to the extent that the holdup exceeds the inherent value of the patent.

Mr. Cotter noted that the rule post *eBay v. MercExchange*, 547 U.S. 388 (2006) is that permanent injunctions must satisfy a traditional balancing test. However, such a balance does not inherently prevent NPEs from obtaining an injunction. Moreover, he noted that lower courts, in deciding whether to impose a permanent injunction, should focus on whether the infringement has the indicia of patent holdups, whether a patentee has a legitimate business interest in *exclusive* licenses as opposed to non-exclusive licenses, whether voluntary licensing is otherwise possible, and whether the denial of a permanent injunction runs afoul of TRIPs article 28.[10]

Lastly, Mr. Cotter reviewed damages law and noted that "damages should render patentee neither better nor worse off as a result of the infringement," but that "[d]epartures from baseline are sometimes necessary to avoid either under- or over deterrence."[11] As such, courts apply reasonable royalty analysis generally, but will apply lost profits if needed to ensure that the patentee is put in the same competitive position it would have enjoyed without the infringement. Where deterrence is needed in addition to traditional damages, courts should apply enhanced damages. The problem is that such analysis can be distorted by using the entire market value rule, which tends to inflate damages by creating a large base against which even a small royalty rate can result in inflated damages.

Next on the panel, John Thomas generally agreed with Mr. Cotter's summary, but noted that a problem that the courts face when attempting to craft appropriate damages is that there is no market against which to compare the proposed damage award.[12] Moreover, he noted that it is not always clear whether the increased accuracy of finding the true market cost is worth the increased cost of obtaining that information. Without this market, he indicated that courts have found an average reasonable royalty of 13.3% of the purchase price. However, this rate may well exceed the profit actually enjoyed by the infringer. As a result, such high royalty rates would indicate that the damages are acting as disgorgement since they likely exceed the profit margin of the infringing product, as opposed to merely representing the result of a true bargain between the parties. Lost profits has a similar problem since such awards are likely to exceed the profit margin that the patentee would have enjoyed had the infringement not occurred.

An additional issue to affecting awards, according to Mr. Thomas, is that courts are not applying apportionment as required under the *Georgia Pacific* factors.[13] Instead, the courts are applying the entire market value rule

[9] Mr. Cotter's presentation is entitled *Remedies for Patent Infringement: Theory and Practice* and is available at http://www.ftc.gov/bc/workshops/ipmarketplace/docs/tcotter.pdf.

[10] While not stated, it is noted that Article 31: *Other Use Without Authorization of the Right Holder* would seemingly also be applicable.

[11] Professor Thomas F. Cotter, *Remedies for Patent Infringement: Theory and Practice*, slide 7 (Dec. 5, 2008) available at http://www.ftc.gov/bc/workshops/ipmarketplace/docs/tcotter.pdf.

[12] A copy of Mr. Thomas' presentation, entitled *Patent Damages: Principles and Current Problems*, is available at http://www.ftc.gov/bc/workshops/ipmarketplace/docs/jthomas.pdf.

[13] The *Georgia Pacific* factors are 15 factors set forth in *Georgia-Pacific Corporation v. U. S. Plywood-Champion Papers Inc.*, 318 F. Supp 1116 (S.D.N.Y. 1970) *aff'd with modification* 446 F2d 295 (2d Cir. 1971).

without accounting for the actual value of the infringed component to the overall apparatus. As a result, he urged the FTC to ensure that they look at the theory of damages and study what is the proper goal for damages.

Following Mr. Thomas on the panel, Q. Todd Dickinson discussed the changes in law since the 2003 FTC Report which affect its prior recommendations. Mr. Dickinson noted that the Supreme Court's decision in *eBay v. MercExchange*, 547 U.S. 388 (2006) ensured that permanent injunctions are not required, which thus addressed a concern of the 2003 FTC Report that the threat of an automatic injunction created market distortion. Further, the threats of business uncertainty by assertions of infringement have been somewhat ameliorated by the Supreme Court's decision in *MedImmune v. Genentech*, 549 U.S. 118 (2007). The result of this decision is that it is now easier for an accused infringer to bring a declaratory judgment to determine if there is infringement, thus allowing for greater business certainty and helping to prevent the distortions of concern in the 2003 FTC Report.

Mr. Dickinson also noted that there were concerns in 2003 that the threshold for finding willfulness was too low. Thus, there were those in the user community who wanted a clearer notice standard for purposes of willfulness, as well as more good faith defenses to charges of willful patent infringement. However, this concern has been somewhat addressed by the Federal Circuit's decision in *In re Seagate*, 497 F3d 1360 (Fed. Cir. 2007) (en banc), which established an objective recklessness standard to find willful infringement and eliminated a duty of due care. Such standard in later Federal Circuit decisions appears to increase the types of good faith defenses available to an accused infringer. In view of these decisions, Mr. Dickinson indicated that the FTC should concentrate on and identify the following: "What are the remaining problems in need of solving? What is the best approach to solving these problems? In view of legislative stalemates on patent reform should the focus be on improving the USPTO and leaving it to the courts to further clarify the law?"[14] Mr. Dickinson agreed that damages law should be reformed to focus more heavily on properly apportioning the true value of an invention within an infringing device, but indicated that the courts are in the best position to provide such guidance. Lastly, he cautioned that legislative solutions should only be attempted in those areas of law where "change is needed that cannot be accomplished through the courts."[15]

John Squires next addressed the impact of the Supreme Court's decision in *Quanta Computer Inc. v. LG Electronics Inc.*, 128 S.Ct. 2109 (2008) in further addressing certain concerns outlined in the 2003 FTC Report dealing with damages.[16] Specifically, he noted that the Supreme Court's decision in *eBay* not to make injunctions automatic upon a finding of patent infringement was important, but that there also needed to be clarification on the issue of exhaustion. Specifically, NPEs are not deterred from bringing suit merely because there is a decreased likelihood of an injunction. Instead, such NPEs are motivated by increasing the possible damages, and do so with the entire market value rule. As an example, Mr. Squires presented a hypothetical in which a cell phone is sold for $10, and has four patented components each costing $2 but having a 10% patent royalty imposed on each component ($2*10%*4=$0.80 per cell phone). In contrast, if one of the components is evaluated using the entire market value rule, even at a reduced 5% royalty, one of the components has an effective royalty of 25% ($10*5%*1 = $0.50 for a $2 component). This distortion due to the entire market value rule being selectively applied to the four patented components would reduce the return on investment for the overall cell phone from 12% to 9%. This represents a chill on innovation and is solely due to skewed valuation caused during litigation and only aids the short term goals of NPEs without aiding commercialization. It was Mr. Suires' hope that *Quanta* will be applied to help decrease the ability of patent owners to effect control over related, unpatented items.

Last on the panel was Roderick R. McKelvie, who discussed the impact of *In re Seagate* on the law of willfulness.[17] Mr. McKelvie began by noting that, at the time of the 2003 FTC Report, problems caused by the law of willfulness were perceived to be that the law discouraged researching patents, did not function to deter culpable conduct, interfered with lawyer-client relations, and spawned inefficiencies in patent litigation. As such, the 2003 FTC Report indicated that willfulness should be limited to situations in which there is only copying or written notice of infringement. The

[14] Q. Todd Dickinson, *Federal Trade Commission Workshop: Recent and Proposed Changes in Remedies Law*, slide 18 (Dec. 5, 2008) available at http://www.ftc.gov/bc/workshops/ipmarketplace/docs/qtdickinson.pdf.

[15] *Id* at slide 26.

[16] A copy of Mr. Squires' presentation, entitled *Patent Remedies: Can Quanta Finish What eBay Started?*, is available at http://www.ftc.gov/bc/workshops/ipmarketplace/docs/jsquires.pdf.

[17] A copy of Mr. McKelvie's presentation, entitled *Seagate Plus One: How the District Courts are Implementing Seagate*, is available at http://www.ftc.gov/bc/workshops/ipmarketplace/docs/rmckelvie.pdf.

National Academies report, "A Patent System for the 21st Century," proposed instead that the affirmative duty of care be abolished and that the trials be bifurcated on the issue of willfulness. Since that time, the Federal Circuit issued *In re Seagate* in which it abandoned its holding in *Underwater Devices, Inc. v. Morrison-Knudson Co. Inc.*, 717 F. 2d 1380 (Fed. Cir. 1983) that had established the affirmative duty of due care. In rejecting *Underwater Devices*, the Federal Circuit replaced this affirmative duty of care with an objective test based upon recklessness.

After reviewing District Court cases since *In re Seagate*, Mr. McKelvie showed that District Courts have generally not granted summary judgment to remove the issue of willfulness (or at least stay discovery). In contrast, his research indicated that post trial, District Court judges were likely to find no willful infringement in non-jury trials, and were also likely to overrule a jury on willfulness. Moreover, his research indicated that willfulness is still pled in complaints at roughly the same rate as prior to *In re Seagate*. As such, Mr. McKelvie indicated that the law of willfulness post *In re Seagate* has likely not resolved the problems of concern in 2003. As possible solutions, Mr. McKelvie noted that the Federal Circuit could be helpful in encouraging resolving willful infringement issues at summary judgment, and that a legislative solution may be the best way to resolve the issues such as by not allowing willfulness to be pled until after infringement is established or by making the decisions on willfulness be decided by judges as opposed to juries.

Panel 3: Legal Doctrines That Affect the Value and Licensing Of Patents

The third panel dealt with the "changes in legal doctrines that affect the value and licensing of patents" as well as the "role of unpredictability and notice in the IP marketplace." On the panel were John F. Duffy, Oswald Symister Colclough Research Professor of Law, George Washington University Law School; Joseph S. Miller, Associate Professor, Lewis & Clark Law School; Visiting Associate Professor, University of Georgia Law School; Michael Meurer, Michaels Faculty Research Scholar, Professor of Law, Boston University School of Law; Jeffrey P. Kushan, Partner, Sidley and Austin; and Duane R. Valz, VP & Associate General Counsel, Global Patents, Yahoo!.

Starting off the panel, Mr. Michael Meurer presented results based upon his book, Patent Failure: How Judges, Bureaucrats, and Lawyers Put Innovators at Risk Princeton University Press (March 23, 2008). Among other results, Mr. Meurer noted that his research indicates that patents under the current state of the law are not functioning well as property with one exception: pharmaceutical patents. He posits that the reason for this failure is the lack of notice as to the scope of the patented property. In pharmaceutical patents, the claims refer to a defined chemical structure and the structural nature of the claims provides a possible infringer with notice of what the patent covers. In contrast, in other technologies, the claims are described in functional terms which do not provide the requisite notice that allows potential infringers to know when they are using the patented invention. As such, Mr. Meurer concludes that a change in law or procedure to require claims in more structural terms would help to ensure that patents function more as property.

These conclusions were challenged by other members of the panel partially on the grounds that structural claiming is not feasible in other technologies, and since certain of the numbers which supported Mr. Meurer's conclusions could be explained due to other factors.

Next on the panel was John F. Duffy, who discussed the impact of *KSR International Co. v. Teleflex Inc.*, 127 S.Ct. 1727 (2007) on patents. Mr. Duffy noted that *KSR* stood for the proposition that the exclusive test for obviousness under 35 U.S.C. §103 was not the teaching-suggestion-motivation test as previous Federal Circuit decisions seemed to indicate, but was instead a broader inquiry into the facts and circumstances of the state of the art at the time of the invention. However, Mr. Duffy acknowledged that the decision in *KSR* created a problem by adding uncertainty into the determination of validity, both during litigation and prosecution of patent applications. This uncertainty will need to be resolved in order to provide stability in the valuation of patents.

Following Mr. Duffy on the panel was Mr. Miller, who presented information on the impact of *MedImmune* and its follow on cases on licensing and licensing strategies.[18] Mr. Miller noted that, in light of *MedImmune*, licensors are more likely to include new clauses to attempt to mitigate the effect of the rule which allows licensees under contract to bring a declaratory judgment action. Such clauses could be automatic license termination when the patent is challenged, license termination or royalty increases if the patent is unsuccessfully challenged, and requirements that the licensee pay the licensor's legal fees during the challenge. However, it is uncertain as to whether such clauses would be enforceable to the extent that the clauses interfere with the ability of the

[18] A copy of Mr. Miller's testimony, entitled *Testimony of Professor Joseph Scott Miller, Lewis & Clark Law School*, is available at Testimony of Professor Joseph Scott Miller, Lewis & Clark Law School http://www.ftc.gov/bc/workshops/ipmarketplace/docs/jmiller.pdf.

licensee to bring the declaratory judgment action within the spirit of *MedImmune*. As such, Mr. Miller noted that license royalty rates may increase to account for the potential costs of a challenge. However, Mr. Miller indicated that this increase should be small for a strong patent, which is likely to be held valid and thus less likely to be challenged, but larger for weaker patents.

Mr. Miller also noted that licensing strategies will be more strongly affected by *MedImmune* since potential licensees are going to be more difficult to approach. Citing *SanDisk Corp. v. STMicroelectronics, Inc.*, 480 F.3d 1372 (Fed. Cir. 2007), he noted that declaratory judgments can be brought even while negotiations are ongoing. As such, any licensing approach which provides sufficient notice to give rise to liability under 35 U.S.C. §287 would also place the patent owner in jeopardy of a declaratory judgment action.

Moreover, Mr. Miller noted that in *Micron Technology, Inc. v. Mosaid Technologies, Inc.*, 518 F.3d 897 (Fed. Cir. 2008), a declaratory judgment action was allowed merely because the patent holder was suing others in the industry and the plaintiff assumed that it was the next logical target. Therefore, a licensing campaign can still be exposed to a declaratory judgment action even prior to notice sufficient for 35 U.S.C. §287 purposes.

As such, there is a temptation for potential licensing targets to jointly force a declaratory judgment action in anticipation of such a licensing campaign. However, Mr. Miller noted that such joint defense agreements may expose the potential licensing targets to possible antitrust exposure. Specifically, where multiple accused infringers use this expansion of declaratory judgment jurisdiction to collectively file suit using a joint defense agreement, a single patent owner may claim competitive harm as an impermissible group boycott of the patent license. However, he concluded that such collective responses should not be considered an impermissible group boycott since the inquiry is not so much a boycott of the license but is instead an inquiry into information: whether a license is valid. Thus, allowing joint defense agreements in the context of declaratory judgment actions have pro-competitive effects and efficiencies which should allow their existence without implicating antitrust concerns.

Next on the panel, Duane R. Valz noted that there was a need for certainty in the patent field.[19] Specifically, the changes have occurred not by changes in statutory or regulatory law, but by the courts. Further, despite such changes, the patent system is still out of balance. As examples, Mr. Valz pointed to the continuing need to address the focus on litigation rather than value-promoting licensing, and he noted damages and venue reform are still lacking. He noted that at the time of the 2003 FTC Report, there was a perception that patents were too strong and that new economy companies would be discouraged due to patent thickets or own too much of the public domain by patenting software. Noting that start up companies still emerge and that open source is a viable option, these concerns have not come to pass. However, the issue now is due to NPEs creating a secondary market to buy patents, and it is these NPEs which put the new economy companies on the defensive as opposed to the new economy companies consolidating excess power through patents.

Mr. Valz gave an overview of judicial decisions impacting patents, and noted that the general result has been to curb power of individual patents. However, the question remains as to whether such reforms will encourage value-based licensing. Citing *In re Bilski*, 88 USPQ2d 1385 (Fed. Cir. 2008) (en banc), Mr. Valz noted that the law concerning 35 U.S.C. § 101 is currently being applied very inconsistently. Moreover, he noted that the holding in *KSR* was more appropriate in the litigation context where there is greater access to the facts relevant to this inquiry, but is not the standard which can be easily applied during the *ex parte* patent prosecution since those facts are not well developed or available, which also results in inconsistent application of the law of obviousness. Thus, Mr. Valz argued that these court decisions need to be harmonized by the USPTO to provide certainty, and to ensure that there is also consistency with foreign patent offices. However, Mr. Valz noted that these changes have not had much effect on the licensing of patents.

Moreover, while acknowledging that the decisions in *In re Seagate* and *MedImmune* had some beneficial aspects, Mr. Valz found that the practical result is that patent owners (and mostly NPEs) are more likely to go to court instead of first attempting to license their patents. It is the litigation by NPEs which he believes are draining resources from the marketplace and otherwise suppressing value-added licensing. Thus, Mr. Valz asserted that there remains a need to better calibrate the patent law and policy as well as trade law and policy, and that there remains a need for a legislative fix in the areas of damages and venue.

Last on the panel was Jeffrey P. Kushan, who argued that the impact of *MedImmune* has not been positive in regards to licensing. Specifically, the relationship has become asymmetric with regards to licensees.

[19] A copy of Mr. Valz's presentation, entitled *Yahoo! Inc- FTC Hearing on The Evolving IP Marketplace*, is available at http://www.ftc.gov/bc/workshops/ipmarketplace/docs/dvalz.pdf.

MedImmune allows the licensee to bring suit against the licensor during the term of the license, but the licensor cannot bring suit against the licensee during the term of the license. Moreover, Mr. Kushan went on to discuss the impact of inequitable conduct on patent acquisition and enforcement, and noted that the doctrine has gone perhaps too far in finding inequitable conduct when there is little evidence of intent and little evidence that the prior art was truly material to an Examiner. Almost any issue can be put forth as grounds for inequitable conduct, and is not limited to those that actually concern the Examiner. By way of example, Mr. Kushan noted that court cases have found that by incorrectly claiming small entity status, a patent can be rendered unenforceable under this doctrine. This issue is of great concern in bio, the practice in which Mr. Kushan is involved. As such, Mr. Kushan would like the FTC to address this growing problem.

Conclusion

While nominally the hearings are related only to the effect of IP on competition law, which is the expertise of the FTC, the impact of the recommendations arising out of these hearings should not be underestimated. The prior report, *To Promote Innovation: The Proper Balance of Competition and Patent Law and Policy*, was widely distributed and used as a basis for multiple changes in rules, and in drafting the Patent Reform Act. Moreover, this report was cited both in the dissent in *Laboratory Corp. of America Holdings v. Metabolite Laboratories Inc.*, 548 US 124 (U.S. 2006) (Breyer, Stevens, Souter dissent) and in a concurrence in *eBay Inc. v. MercExchange LLC*, 547 US 388 (2006) (Kennedy, Stevens, Souter, and Breyer concurrence) as evidence of public sentiment and a need for judicial reform. Moreover, more than one panelist, including former USPTO commissioner Q. Todd Dickinson noted the importance of this prior report. Therefore, it is anticipated that the next report will form a further basis on which new patent reforms, including judicial reforms, will be based.

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Stein, McEwen & Bui LLP

About us ...

Address:
1400 Eye Street, N.W.
Suite 300
Washington, DC
20005

Phone:
202.216.9505

Fax:
202.216.9510

E-mail:
email@smbiplaw.com

www.smbiplaw.com

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