

Intellectual Property Outlook for 2011

BY ROBERT M. MASTERS & BROCK S. WEBER

Introduction

In the coming year we anticipate, as we have in the past few years, a series of decisions that have great potential to impact intellectual property law and the way we advise our clients. This article highlights some of the cases pending and which we are monitoring, as each presents an important intellectual property issue for decision. The article also addresses other important court decisions from 2010 that will affect the intellectual property landscape in 2011 and beyond. Lastly, we take a look at a continuing trend in the intellectual property marketplace and some key legislation.

Case Trends to Watch

The Standard for Proving Invalidity – Clear and Convincing Evidence or Something Lower?

On November 29, 2010, the U.S. Supreme Court granted Microsoft's petition for a writ of certiorari in *Microsoft Corp. v. i4i LP* (No. 10-290). The Supreme Court's decision to hear Microsoft's appeal of a \$290 million patent infringement judgment, the largest ever upheld by the Federal Circuit, may reshape the law on patent invalidity and upend decades of legal precedent. Currently, patent holders enjoy a considerable advantage in defending against claims that their patents are invalid in view of the prior art. Patents are presumed valid by law (see 35 U.S.C. § 282) and during litigation invalidity must be proven by meeting a clear and convincing evidence standard—a very tough burden. In practice, patent holders trumpet this high standard to the jury and suggest that the defendant is attacking the government for granting the patent. In contrast, patent holders need only prove infringement by a preponderance of the evidence.

Microsoft argues that this is the incorrect balance of power, especially where the prior art being asserted at trial was not before the United States Patent and Trademark Office ("PTO"). Microsoft argues there should be a lower, more flexible evidentiary standard for proving invalidity, including taking into account situations where certain prior art was not considered by the patent examiner during prosecution. Microsoft's position is supported by an impressive 11 *amici* briefs, filed by the likes of Google, Verizon, Dell, Hewlett-Packard, Walmart, Apple, Facebook, Yahoo!, Intel, Intuit, Netflix, Toyota, Cisco Systems, General Motors, the Securities Industry and Financial Markets Association, and a group of 36 law, business, and economics professors¹.

If a majority of the Court agrees, it could become much easier to invalidate patents in court, thus affecting a party's cost/benefit analysis when deciding whether to settle or challenge the patent in

litigation. A lowered standard would also potentially increase the workload of stretched-thin PTO examiners because patent applicants would be highly motivated to dump every conceivable reference on the examiner during prosecution in the hopes of diminishing the potential impact of those references during litigation (assuming the high Court makes a distinction on whether art was considered by the PTO).

The litigation in this case began in March 2007 when Toronto-based i4i LP sued Microsoft in the Eastern District of Texas, claiming that Microsoft's Word® software infringed one of its patents. The jury found that Microsoft had infringed, and the company was ordered to pay \$290 million and halt sales of certain Word® versions. The jury rejected Microsoft's claim that the patent was invalid in view of prior art that had not been considered by the patent examiner during prosecution of the patent-in-suit. The Federal Circuit later affirmed the ruling and declined to rehear the case *en banc*. In its cert. petition filed in August 2010, Microsoft asks the high court to reconsider a standard established in a 1984 Federal Circuit decision that requires a party challenging a patent's validity to prove invalidity by "clear and convincing" evidence, even when a defendant is relying on prior art that was never considered by the patent examiner.²

The crux of Microsoft's argument is that when an examiner fails to look at prior art, for whatever reason, the standard for proving invalidity should be lowered to a "preponderance of the evidence" (i.e., more likely than not). According to Microsoft, the current standard of "clear and convincing" presumes that the PTO has done its job, but that cannot be true when it never considered, or had the opportunity to consider, relevant evidence. Microsoft's position in this regard is largely based on the Supreme Court's seminal decision in *KSR Int'l Co. v. Teleflex Inc.* in 2007, which suggested that the presumption of validity "seems much diminished" when invalidity defenses are grounded in evidence not before the PTO.³ Further, Microsoft notes that other circuit courts, before the creation of the Federal Circuit in 1982, rejected a heightened evidentiary standard for invalidity defenses when prior art was not considered by PTO. Plaintiff i4i maintains, on the other hand, that there is no reason to overturn 26 years of settled law, especially when Congress has given its tacit approval for the "clear and convincing" standard by never revising it.

The fact that the Supreme Court has decided to hear the case suggests to us that the Court will modify the current standard. In practice, defendants often rely on prior art not considered by the patent examiner, whereas the use of a "clear and convincing" standard is geared more to the situation where the relied-upon prior art was considered. The current standard is the type of rigidity that the Court rejected in *KSR*—the rigidity of the "teaching, suggestion, or motivation" test for obviousness was rejected—and if recent prior Supreme Court decisions are any indications, it will make a change. In any event, the Supreme Court's opinion in *Microsoft v. i4i* will be one of the most important IP decisions in recent years.

The "Deliberate Indifference" Standard For Proving Inducement

An important quiver in a patent plaintiff's bow can be a claim for indirect infringement. In many cases, the direct infringers of a patent will be an impractically numerous group of actors. For example, the direct infringers in software patent cases are often end-users, but it is impractical and/or not worth it to pursue each one for patent infringement. So, a plaintiff will frequently sue the software developer in this situation and rely on indirect infringement liability, which provides, in part, that "[w]hoever actively induces infringement of a patent shall be liable as an infringer." 35 U.S.C. § 271(b). It may become more difficult to prove a claim for inducement in the future, however, as the Supreme Court granted certiorari on October 12, 2010 in *Global-Tech Appliances, Inc. v. SEB S.A.* (No. 10-6) to determine the mental state that must be shown to impose liability for inducing another's infringement under § 271(b).

Petitioner Global-Tech developed a deep-frying appliance after essentially copying several features of a similar device that SEB made. Global-Tech had also obtained an opinion of counsel that its appliance did not infringe any United States patent, but counsel was unaware that Global-Tech had investigated SEB's device prior to developing their own appliance. Global-Tech first learned of SEB's patent when SEB sued a company that had bought the appliance from Global-Tech. SEB subsequently sued Global-Tech directly under the theory that Global-Tech induced their customers' infringement of SEB's patent. The jury found for SEB. *SEB S.A. v. Montgomery Ward & Co., Inc.*, No. 99-9284 (S.D.N.Y.).

On appeal to the Federal Circuit, Global-Tech argued that they could not be liable for inducement under § 271(b) because they were not aware of SEB's patent before making and selling their device. *SEB S.A. v. Montgomery Ward & Co., Inc.*, 594 F.3d 1360 (Fed. Cir. 2010). However, the Federal Circuit rejected this position and held that a defendant could be liable for inducement—even without evidence of its actual knowledge of the patent-in-suit—if the evidence indicated that the defendant acted with “deliberate indifference” of a known risk that the patent existed. The Federal Circuit stated that “deliberate indifference” to a known risk is a form of actual knowledge. In this case, the court found evidence that (i) Global-Tech copied SEB, (ii) apparently hid this fact from its attorney and (iii) was well versed in the U.S. patent system sufficient to prove Global-Tech's “deliberate indifference” to the risk that SEB had a patent that covered the copied deep fryer.

In Global-Tech's petition to the Supreme Court it asked the Court to hold that the legal standard for the state of mind element for inducement under § 271(b) is “purposeful, culpable expression and conduct to encourage an infringement.” According to the petition, this standard is required under the Supreme Court's ruling in a copyright infringement case that active inducement requires “an affirmative intent that the product be used to infringe.” *MGM Studios Inc. v. Grokster Ltd.*, 545 U.S. 913 (2005). Further, Global-Tech relies on *DSU Medical Corp. v. JMS Co., Ltd.*, 471 F.3d 1293 (Fed. Cir. 2006) (en banc), where the Federal Circuit ruled that a party must have actual knowledge of the infringed patent to be liable for inducement.

The Court's resolution of this case will be of considerable interest to patent holders, developers and manufacturers. If the Court holds that a plaintiff must prove that the defendant had actual knowledge of the infringed patent, inducement liability will be more difficult to establish than if the Court ratifies the Federal Circuit's use of the “deliberate indifference” standard. One possible side-effect of a heightened knowledge requirement would be that patent holders would be more inclined to inform competitors, or the marketplace in general, of their patents. However, it would be difficult to strike a balance between bolstering a potential inducement (and willfulness) claim with the desire to prevent a competitor from establishing standing to sue for declaratory judgment. Ultimately, the Supreme Court should provide helpful guidance on what it means to have knowledge of patent for indirect infringement purposes and will again affect the relative bargaining position of patent plaintiffs and defendants.

Government Funding of Inventions and Standing

In a setback to the patent policies and expectations of universities and other federal contractors across the country, the Federal Circuit ruled in 2009 that Stanford University did not have standing to sue biotech company Roche Molecular Systems for patent infringement because one of Stanford's researchers, and a named inventor of the patents-in-suit, had assigned his rights to certain inventions to a Roche predecessor (Cetus). *Stanford University v. Roche Molecular Systems, Inc.*, 583 F.3d 832 (Fed. Cir. 2009). The Federal Circuit denied standing to Stanford even though the researcher had “agree[d] to assign” his future patent rights to Stanford before the researcher's agreement with Cetus, and even though Stanford had elected to retain title to the federally funded inventions at issue under the Bayh-Dole Act (35 U.S.C. §§ 200-212). The Supreme Court has the opportunity to clarify the

Bayh-Dole Act's statutory scheme for patent rights allocation, however, as the Court granted Stanford's petition for review on November 1, 2010. Stanford's petition presented the following question for decision: "Whether a federal contractor university's statutory right under the Bayh-Dole Act, 35 U.S.C. §§ 200-212, in inventions arising from federally funded research can be terminated unilaterally by an individual inventor through a separate agreement purporting to assign the inventor's rights to a third party." *Stanford University v. Roche Molecular Systems, Inc.*, No. 09-1159.

The federally funded inventions in this case involve methods for evaluating the effectiveness of treatments for Human Immunodeficiency Virus (HIV). Stanford scientists first created the invention while subject to a contractual duty to assign any inventions to Stanford. After agreeing to assign his rights to Stanford, but prior to the invention, one of the inventors agreed to immediately assign his rights in all future inventions to Cetus. Eventually, the inventor's research produced an assay that could quantify HIV in humans, and Stanford filed the patent application that would become the parent application for the patents-in-suit. Because the HIV research at Stanford had been funded by National Institutes of Health (NIH), Stanford "formally notified the Government that it elected to retain title to the inventions under the Bayh-Dole Act" during prosecution of the patents-in-suit. After failing to reach a licensing agreement with Roche on the assay for HIV, Stanford filed suit in 2005 against Roche for infringement. Roche defended, in part, by alleging that it had an ownership interest in the patents-in-suit and that Stanford therefore lacked standing to bring suit.

The district court rejected Roche's defense on two grounds. 487 F. Supp. 2d 1099. First, the district court found that Roche's lengthy delay in asserting an ownership right barred the claim under the statute of limitations and the doctrine of laches. Second, the district court found that the researcher's purported assignment to Cetus conflicted with Stanford's "superior right to retain title to the patents" under the Bayh-Dole Act. On appeal, the Federal Circuit held that Roche's affirmative claim for ownership was barred, but that Roche could still assert ownership as a defense. In that regard, the Federal Circuit held that Roche could not be liable for patent infringement because the Bayh-Dole Act was not designed to automatically void contractual transfers made by an inventor simply because the research received federal funding. The Federal Circuit found that the agreement with Cetus trumped both Stanford's earlier agreement with the inventor and the assignment recorded later with the PTO. The court reasoned that the "agree to assign" language of the assignment to Stanford "reflect[ed] a mere promise to assign rights in the future," while the "do hereby assign" language of the Cetus agreement "effected a present assignment" of the researchers future inventions to Cetus. The Federal Circuit concluded that the Stanford agreement was simply a "promise" to assign, while the Cetus Agreement was an "immediate transfer of an expectant interest."

Stanford argues to the Supreme Court that the Federal Circuit's ruling runs counter to the Bayh-Dole's text and purpose. Stanford asserts that the Bayh-Dole Act establishes federal contractors (e.g., research universities such as Stanford) as the first in line to obtain title to federally funded inventions, followed by the federal government, which "may obtain" title if the contractor does not exercise its first option or otherwise violates a provision of the Bayh-Dole Act. Only if the contractor does not elect to retain title, Stanford argues, does the inventor have the ability to petition the government for title. Stanford points to the Bayh-Dole Act's origins and policy as favoring a contractor's superior claim to title because contractors are in a better position to convert inventions into practical applications. As a result, the Bayh-Dole Act gives the first option to title to contractors even though the government would normally be in the superior position to claim title due to the federal funds used to support the inventive effort, according to Stanford.

Stanford's position was fully endorsed by the United States when the Solicitor General filed a brief in support of Stanford's cert. petition. The Solicitor General argued that individual inventors can only

secure rights to federally funded inventions if a contractor elects not to retain title and the federal government affirmatively assigns the rights to the inventor. Leading research institutions, such as MIT and the Wisconsin Alumni Research Foundation, joined the Solicitor General and urged the Supreme Court to grant Global-Tech's petition for review, citing the billions of dollars and thousands of jobs that have been generated by university licensing of inventions that stem from federally funded research. In reply, Roche argued that the Bayh-Dole Act does not alter an inventor's right to assign his or her invention and that Stanford's right to the patents-in-suit were not terminated, but were only shared with Roche.

The pending Supreme Court decision may affect the standing of federal contractors to sue for patent infringement, and the viability of such claims, if individual inventors are allowed to affect title in this manner. After all, a university may not be confronted with a competing claim to patent title until years after the invention is made, thus injecting a fair measure of uncertainty into the equation and possibly impeding commercialization efforts. While contractors could possibly reduce such risks by refining agreements with employees to clarify assignment obligations, the Federal Circuit's approach also undermines the integrity of the government's interest in federally funded inventions. If a contractor's claim to title rests on the soundness of the assignment that it receives from the inventors, the government's ability to obtain title—as the Bayh-Dole Act provides for under certain circumstances—would be substantially compromised. On the other hand, if the Federal Circuit is overturned, those involved with assignments and other allocations of patent rights are not going to know if such commitments are valid until contractors have completed the funding and patent application processes. Ultimately, the Supreme Court will allocate these risks involved in federally funded inventions and the decision in *Stanford v. Roche* is one to watch for in 2011.

Patent-Eligible Subject Matter – Update on Bilski

Last summer, after months of waiting, the Supreme Court issued its decision in *Bilski v. Kappos*. As we reported in our [IP Outlook article](#) last year, *Bilski* was an appeal that presented fundamental questions regarding the scope of patentable subject matter and in particular whether methods of doing business were patentable and what test should be used to evaluate the patentability of subject matter. Despite numerous *amicus* briefs and the frenzied lead-up to the decision, *Bilski* was more subtle than ground-breaking.

In *Bilski v. Kappos*, 130 S.Ct. 3218 (2010), the Supreme Court ruled that the Federal Circuit's machine-or- transformation test is not the sole test for patent eligibility under § 101 of the Patent Act. Under § 101, an ordinary meaning of "process" would not necessarily require it to be "tied to a particular machine" or "transform an article." Thus, the Court found that the machine-or-transformation test remains a "useful and important clue," but not the "sole test" for determining whether an invention is patent-eligible under § 101. Instead, the Court held that the inquiry should be whether the claimed invention falls within the definition of statutory subject matter and is not merely a law of nature, physical phenomena, or an abstract idea.

However, the Court did not offer an example of an invention that would not be tied to a machine or transform an article and still pass the subject matter test, limiting its holding to the fact that the patent-at-issue in *Bilski* disclosed an abstract idea and was invalid. The Court also refused to interpret the Patent Act to categorically exclude business methods. Thus, the Supreme Court left much of the work of crafting interpretative precedent to the lower courts.

Federal Circuit Interpretation of *Bilski*

The first Federal Circuit decision to come down on patent-eligible subject matter after *Bilski* was the Federal Circuit's opinion in *Research Corp. Tech. v. Microsoft Corp.*, 2010 WL 4971008 (Fed. Cir. Dec. 8, 2010). In *Research Corp.*, the Federal Circuit reversed a lower court ruling of invalidity of the plaintiff's patents, which concerned a process for rendering a "halftone image" in digital computer displays and printer images. Taking a wide look at *Bilski*, the court emphasized the Supreme Court's language that the patent-eligibility inquiry is only a "coarse eligibility filter" and should not become a substitute for a patentability decision based on an analysis of prior art or other substantive statutory requirements: "In other words, Section 101 does not permit a court to reject subject matter categorically because it finds that a claim is not worthy of a patent."

As in *Bilski*, the Federal Circuit focused its inquiry on whether the plaintiff's patent covered an unpatentable abstract idea. Heeding the Supreme Court's disparagement of rigid formulae or definitions for abstractness, the court refused to define "abstract" beyond recognizing that any disqualifying characteristic should "exhibit itself so manifestly" as to override the broad statutory categories of eligible subject matter. Not the most helpful insight for practitioners, unfortunately.

The court held that the plaintiff's software patents were not abstract because they presented functional and discernable applications in the field of computer technology. While the patents relied on algorithms to control the claimed digital displays, the algorithms did not make the claims unpatentable because inventions do not lose eligibility, according to the Federal Circuit, even if several method steps require a mathematical equation. More importantly, the court found that the patentees did not seek to patent a mathematical formula for any and all future uses, but rather only for a process of half-toning in computer applications.

The next Federal Circuit opinion to touch upon patent eligibility was a redo of a case that had previously been remanded by the Supreme Court in light of its *Bilski* decision—*Prometheus Laboratories, Inc. v. Mayo Collaborative Services*, No. 2008-1403 (Dec. 17, 2010). In this case, the Federal Circuit ruled for the second time, despite the Supreme Court's remand, that Prometheus's claims to methods for optimizing the therapeutic efficacy for treatment of gastrointestinal disorders were directed to patent-eligible subject matter.

The claims included steps of "administering a drug" and "determining the level" of a known substance. The Federal Circuit held that (1) the claimed methods did not preempt all uses of natural correlations between drug levels and efficacy or toxicity, and (2) steps of "administering" and "determining" satisfied the transformation prong of the machine-or-transformation test, which the Supreme Court said remains a "useful and important clue" to patent-eligibility. Specifically, the Federal Circuit found that the administering step caused the human body to undergo a transformation, while the step of determining a substance level necessarily involved a transformation of a blood sample or other material.

Taken together, these two Federal Circuit opinions indicate that district courts may have taken a more limited view of the *Bilski* decision than the Federal Circuit.⁴ It appears that the Federal Circuit has heeded the Supreme Court's rejection of rigid patent rules over the years and will analyze patent eligibility in a permissive manner. For instance, the claims in *Prometheus* seem to border on the abstract, yet they were found eligible for patent protection because of an interesting application of the machine-or-transformation test. Ultimately, courts and patent examiners must develop workable standards for determining patent eligibility that includes—but is also more flexible than—the machine-or-transformation test. Future innovation will likely call for new analyses and the challenge will be in applying an appropriately flexible test for determining patent eligibility.

Still, further guidance from the courts is forthcoming. For example, it will be interesting to see how the Federal Circuit handles the business method patent at issue in *Fort Properties, Inc. v. American Master Lease, LLC*, in light of the Supreme Court's restrictive-sounding language on business methods. *Fort Properties*, 609 F.Supp.2d 1052, stay lifted by No. 2009-1242 (Fed. Cir. Dec. 1, 2010). In *Fort Properties*, the Federal Circuit will review the lower court's pre-*Bilski* ruling that the patent-in-suit, which claims a method for creating an investment instrument from real property, did not satisfy the "transformation" prong of the machine-or-transformation test.

The ITC's Interpretation of Bilski

The U.S. International Trade Commission ("ITC") has also had reason to issue its first full commission opinion regarding patent eligibility since *Bilski*. On November 17, 2010, the ITC upheld an administrative law judge's ruling that two "machine vision" software patents were not directed to patent eligible subject matter. *In the Matter of Certain Machine Vision Systems, Software and Products Containing Same*, No. 337-680.

The two patents disclose methods of "finding and locating patterns representing real-world objects in images for the machine vision industry." The ITC found that the asserted claims "cover an idea without a link to any real-world undertaking" and were not tied to any particular machine, even though the specifications taught that many imaging devices, including X-rays, TV cameras and MRI machines, existed for implementing the claimed invention. As such, the ITC held that the "the asserted claims have unbridled scope and attempt to preempt any use of the claimed idea regardless of the machinery used to implement the idea." The ITC further stated that the asserted claims did not transform anything, but simply collected data.

The ITC's opinion perhaps provides guidance for further administrative law judges, showing that the ITC is willing to use *Bilski* as a meaningful filter. Potential ITC complainants may be more weary to use the ITC as a forum if there is a *Bilski* issue involved with their patents. It is interesting to note, however, that this ITC opinion came out before the two Federal Circuit decisions discussed above. As such, the ITC should continue to be monitored for developments on the *Bilski* front.

International Copyright Exhaustion

Since the Supreme Court's seminal decision in *Quanta Computer v. LG Electronics* and the Federal Circuit's following decision in *Fujifilm Corp. v. Benun* regarding territorial limits on *Quanta*, it has been understood that the sale of a product substantially embodying a patented invention will exhaust a patentee's exclusive rights under the patent, but not if the sale occurred outside the United States. Thus, the location of the authorized sale seems to control the issue of patent exhaustion under Federal Circuit precedent. However, a recent copyright case affirmed by the Supreme Court in a 4-4 split (J. Kagan was recused) and without opinion may add a wrinkle to this understanding.

On December 13, 2010, the United States Supreme Court affirmed the Ninth Circuit Court of Appeal's decision in *Costco Wholesale Corp. v. Omega, S.A.*, 541 F.3d 982 (9th Cir. 2008). This appeal involved whether the first-sale doctrine of copyright law applies to goods manufactured abroad and then imported into the United States. Under the first-sale doctrine, an entity that purchases a copyrighted work, like a movie, can later sell the work to another without the permission of the copyright holder. While the question regarding whether the first-sale doctrine applies to imported goods remains unanswered outside the Ninth Circuit (due to the Supreme Court split), the decision will still make an impact.

As background, retailer Costco acquired genuine Omega watches manufactured in Switzerland and sold abroad. Costco then re-sold the watches in U.S. stores below the price charged by authorized

Omega watch dealers (i.e., they were “gray market” goods). The watches contained an Omega copyright covering the globe design engraved on the back of the watches. Omega filed a lawsuit against Costco under § 602(a) of the Copyright Act, claiming that Costco’s importation of the watches bearing the copyrighted design was without Omega’s permission. In the lawsuit, Omega claimed that it had authorized the sale of the watches bearing the copyrighted design abroad, but it did not sanction their importation into the U.S. or the sales made by Costco. Costco defended by relying on the first-sale doctrine of § 109(a) of the Copyright Act, which generally allows parties who have acquired ownership of copyrighted goods “lawfully made under” the Copyright Act to freely resell those copies.

The district court in California granted summary judgment in favor of Costco based on the first-sale doctrine. On appeal, Omega argued that the watches sold by Costco were not “lawfully made” because they were manufactured and first sold outside the United States. Costco, on the other hand, argued that the first-sale doctrine applies to goods manufactured both domestically and overseas. The Ninth Circuit reversed the district court’s decision, holding that the first-sale doctrine did not apply to copies manufactured outside the United States.

Much of the decision turned on interpreting the Supreme Court’s opinion in *Quality King Distributors, Inc. v. L’anza Research International*. In *Quality King*, the Court held that the first-sale doctrine applied to goods that were manufactured domestically, exported, first sold abroad and then imported back into the U.S. without the authorization of the copyright holder. In contrast to this “round trip” importation, the Ninth Circuit found that the first-sale doctrine was not a defense to Costco’s sale of the watches because Costco’s transactions involved a “one way,” non-authorized importation from authorized manufacturing and sales abroad. Thus, under *Costco*, the applicability of the first sale doctrine depends on the location of manufacture, while the location of the sale can be irrelevant.

Accordingly, companies now have a greater incentive to shift production overseas to provide for more control over all re-sales in the U.S. market, not only imported re-sales, because retailers are sometimes unable to differentiate between goods produced in the U.S. versus abroad. The *Costco* decision may also impact patent law as well. For instance, the Federal Circuit’s reliance on the location of the sale to trigger patent exhaustion in *Fujifilm* comes into question. It will be interesting to see the extent to which the *Costco* decision impacts future copyright and patent cases.

En Banc Federal Circuit Guidance on Inequitable Conduct

In the last few years, the Federal Circuit has appeared very interested in restricting the defense of inequitable conduct by tightening substantive standards and pleading requirements. For example, the court in *AstraZeneca Pharm. LP v. Teva Pharm. USA, Inc.*, rejected the notion that a defendant can prove inequitable conduct by making a proportionally lesser showing of intent to deceive the PTO if it has shown that the alleged omission or representation was highly material. 583 F.3d 766 (Fed. Cir. 2009). In other words, the requirements of intent and materiality are independent of one another, and both need to be shown by clear and convincing evidence. Previously, the Federal Circuit also held that “the inference of intent must not only be based on sufficient evidence and be reasonable in light of that evidence, but it must also be the single most reasonable inference able to be drawn from the evidence.” *Star Scientific Inc. v. R.J. Reynolds Tobacco Co.*, 537 F.3d 1357 (Fed. Cir. 2008). The Federal Circuit tightened pleading requirements in *Exergen v. Wal-Mart Stores, Inc.*, 575 F.3d 1312 (Fed. Cir. 2009), where the court held that the requirements of pleading fraud with specificity also apply to the defense of inequitable conduct.

Now we await the Federal Circuit’s *en banc* decision in *Therasense, Inc. v. Becton, Dickinson & Co.*, No. 2008-1511 (Fed. Cir. 2010). We discussed the background of the case [here](#) and [here](#), and

discussed impressions from the oral arguments on November 9, 2010 [here](#). The decision promises to add clarity to the analysis of what constitutes materiality (i.e., whether to abandon the current standard based on what a “reasonable examiner” would find material to patentability), as well as define the degree of specificity with which intent to deceive must be shown, including whether the analysis of intent should be completely independent of materiality. It may also touch upon the impact of a finding of inequitable conduct; that is, will it remain that the entire patent is unenforceable if inequitable conduct is proven?

Will the Courts Restrain False Patent Marking Litigation Before Congress Does?

The false marking litigation craze has been a hot issue since the Federal Circuit ruled that companies can be fined \$500 for every product they mark with an expired patent, with false marking plaintiffs entitled to half of the penalty. *Forest Group, Inc. v. Bon Tool Company*, 590 F.3d 1295 (Fed. Cir. 2009). Since that ruling—and despite a Federal Circuit setback for plaintiffs in June 2010⁵—false marking plaintiffs have filed about 550 individual suits in federal district courts around the country. For instance, Promote Innovation, a firm based in Houston, has brought 58 false marking suits in Eastern Texas for expired or otherwise defective patents. Its cases name 87 defendants, including big pharmaceutical players like Sanofi-Aventis, tech giants like Motorola, retailers like Home Depot, and other large companies.

There is the feeling among commentators and large companies (and us) that this litigation explosion has gone too far. The current prospect for controlling the trend is the current petition for mandamus at the Federal Circuit in *In re BP Lubricants*, No. 10-M960 (Fed. Cir. Sept. 14, 2010), which seeks dismissal of Thomas Simonian's false marking suit against BP in Illinois. *Simonian v. BP Lubricants*, No. 10-1258 (N.D. Ill. August 25, 2010). Much the same way the defense of inequitable conduct was limited by *Exergen's* imposition of heightened pleading requirements (see above), the petition for mandamus in *BP Lubricants* seeks to restrict false marking suits by requiring false marking complaints under 35 U.S.C. § 292 to be plead with particularity, as required for complaints sounding in fraud under Federal Rule of Civil Procedure 9(b).

In the Northern District of Illinois, Thomas Simonian filed suit against BP under § 292 alleging that BP is a “sophisticated” company that knows or should know that the patent marked on BP's Castrol® products has expired, and that, “on information and belief,” BP marks Castrol® products with the patent number intending to deceive the public. The district court denied BP's motion to dismiss, concluding that Simonian's complaint met the requirements of Rule 9(b) of the Federal Rules of Civil Procedure. BP's petition for mandamus argued, however, that the district court erred by allowing knowledge of patent expiration to be plead generally and without support. A decision by the Federal Circuit is likely to come within a few weeks. It will be interesting to see whether a strong decision limiting false marking suits will curb efforts at false marking reform in Congress, which has significantly progressed, as discussed below.

Standard Setting and Patent Misuse—An Update on *Princo v. ITC*

The Federal Circuit, sitting *en banc* last August, rejected the notion that restrictions placed on licenses to a patent pool covering an adopted technical standard constituted patent misuse. In *Princo Corp. v. ITC*, the court considered whether an agreement between U.S. Phillips Corp. and Sony not to license their pool of patents constituted patent misuse where the agreement prevented licensing the patent pool—which covered their jointly developed technical standards on recordable CD technology (“Orange Book” standards)—to competitors of the adopted standard. 616 F.3d 1318 (Fed. Cir. 2010). In other words, the patent pool was set up in such a way that it prevented the development of alternatives to the Orange Book standards based on the patented technology. Further, other companies, such as

Princo Corp., could only license the entire pool in order to make Orange Book-complaint CDs, even though not all of the pooled patents were necessary for this.⁶

The Federal Circuit's *en banc* decision in *Princo* came after a round of ITC decisions and Federal Circuit remands. The Federal Circuit's majority opinion found two separate grounds for sustaining the latest ITC decision that rejected Princo's patent misuse defense to Phillip's infringement action. First, the majority formulated the doctrine of patent misuse narrowly and stated that "the defense of patent misuse is not available to a presumptive infringer simply because a patentee engages in some kind of wrongful commercial conduct, even conduct that may be anticompetitive." Under the facts of the case, the court held that Phillips did not impose restrictions that expanded the "physical or temporal scope" of the patents actually required to comply with the Orange Book standards. Instead, Phillips merely agreed with Sony to restrict the license to an unnecessary patent, which was not asserted in the underlying complaint of patent infringement at the ITC. The Federal Circuit concluded that this arrangement did not require licensees such as Princo to agree to anti-competitive terms that impermissibly expanded the scope of the asserted patent. Thus, Princo's claims merely hinged on the agreement between Phillips and Sony, which is not patent misuse according the Federal Circuit. The court therefore relied significantly on the form of the restriction to reject Princo's misuse defense.

Second, the majority found that even if the Phillips-Sony agreement prevented use of the unnecessary patent to develop a competing standard, this is not presumptively anticompetitive. The court termed the standard setting process and resulting patent pool as a "joint venture," holding that "Phillips and Sony acted legitimately in choosing not to compete against their own joint venture." The majority therefore characterized the parties' restriction on licensing patents for use outside of the Orange Book standard as an "ancillary restraint." In antitrust law, an ancillary restraint is an agreement between parties that, alone, might be deemed a *per se* illegal horizontal restraint. However, the court analyzed the restraint in this case under the more flexible "rule of reason" standard because it is an integral part of a larger, pro-competitive joint venture. The court found that the pro-competitive effects of standard setting organizations outweighed the restraint in *Princo*.

Thus, *Princo* raised the bar for aggrieved tech companies and other plaintiffs who seek to attack the activities of standard setting organizations with patent misuse and antitrust allegations. Conversely, companies may feel more liberty to restrict access to necessary patent pools with conditions that require licenses to non-necessary patents and/or conditions that will restrict the development of alternative technology standards.

In any event, the coming year may shed more light on the effect of *Princo* on the activities of standard setting organizations, patent pools, and the continued viability of the patent misuse doctrine, as Princo filed a petition for Supreme Court review on January 5, 2011. Princo argues that the Federal Circuit's ruling is contrary to the Supreme Court's "repeated admonition" that the form or method used to try to extend the patent monopoly is irrelevant. Instead, a robust patent misuse doctrine is essential to safeguard the public policy of the patent laws by removing the incentive for collusive agreements aimed at suppressing alternative technology, Princo argues.

Update on Venue Transfer

Venue transfer is another trend that should continue throughout 2011, especially in relation to patent infringement cases filed in the Eastern District of Texas. For plaintiffs, early litigation strategy always involves an analysis of where suit should be brought, and certain jurisdictions have been favored in patent cases. Defendants chances of obtaining transfer, while traditionally difficult, has become easier since the Federal Circuit issued its mandamus order in *In re TS Tech*, 551 F.3d 1315 (Fed. Cir. 2008)

directing a court in the Eastern District of Texas to transfer the case before it to the Southern District of Ohio.

Since *TS Tech*, the Federal Circuit has issued a number of opinions that clearly show increased skepticism of district courts (mainly the Eastern District of Texas) refusing transfer requests when there is little to link the case to that district, as explained in our previous [client alert](#). That trend continued late last year, despite an opinion denying transfer, and defendants should continue seeking transfer in the year to come.

On December 3, 2010, the Federal Circuit granted a petition by Acer America Corp. and 11 other parties for a writ of mandamus directing the Eastern District of Texas to transfer the patent infringement suit to the Northern District of California. *In Re Acer America Corp.*, No. 2010-M942. Despite tenuous ties to the Eastern District, the district court had denied transfer. Namely, the suit was filed by MedioStream, a computer company headquartered in the Northern District of California and five of those seeking transfer were headquartered in the Northern District of California. Defendant Dell was headquartered in Texas, but not in the Eastern District. The Federal Circuit held that “the convenience of the parties and witnesses, the sources of proof, the local interest, and the compulsory process factors all significantly favor transfer. Meanwhile, no factor remotely favor[ed] keeping this case in the Eastern District of Texas.” Even though Dell resided in Texas, the court explained that its “prior orders in venue transfer cases make clear that the combination of multiple parties being headquartered in or near the transferee venue and no party or witnesses in the plaintiff’s chosen forum is an important consideration.”

In contrast to *Acer America*, the Federal Circuit found that considerations of “judicial economy” supported the denial of a petition for transfer in *In Re Vistaprint Ltd.*, 10-M954 (Fed. Cir. Dec. 15, 2010). In that case, the Federal Circuit denied Vistaprint’s petition for a writ of mandamus directing the transfer of a patent infringement suit from the Eastern District of Texas to Massachusetts. The judge in the Eastern District denied transfer because the court had substantial experience with the patent based on prior litigation and because there was a second case involving the patent filed in the same district. The Federal Circuit found that the gain in judicial economy by keeping the case in Texas was “more than negligible” even though the convenience factors weighed in favor of transfer. Notably, the court found that the convenience factors favored transfer despite the fact that no defendant was actually located in Massachusetts and the witness presence there was “not overwhelming.”

These two recent decisions from the Federal Circuit reinforce the continued prospects for transfer. The *Acer* case will diminish the ability of plaintiffs to keep a case in a district just because one of the defendants may be located somewhere else in the state. The *Vistaprint* case should have limited negative impact on transfer requests because the facts of the case were semi-unusual and because the court still found that convenience factors favored transfer. Thus, defendants may remain emboldened to seek transfer and plaintiffs may think twice about bringing suit in venues with little connection to their case. The trend should continue to mature in the coming years.

IP Marketplace Trends to Monitor

Firms have been sprouting up in recent years to acquire large pools of patents in certain technology sectors to be used in a defensive fashion, primarily against non-practicing entities (“NPEs”). However, the line between defensive patent aggregators and the litigious NPEs themselves has been continually blurring as well.

Intellectual Ventures

Such is the case with Intellectual Ventures (“IV”), a privately-held company that seeks to patent its own inventions and invest in the inventions of others. Initial investors in IV bought into its Patent Defense Fund, which provided members with licenses to protect them against infringement suits by NPEs. Over the past few years, however, IV has acquired over 30,000 patents and continues to acquire more. The patents cover many technologies, especially in the fields of computer chip manufacturing and design and telecommunications technology. IV acquires its patents through dummy shell companies and investors are bound by strict confidentiality agreements.

For the past year or so, however, IV has been selling litigation-ready chunks of its portfolio to NPE shell companies. In this way, IV has already been in the game of catalyzing more patent litigation, instead of protecting against it. In fact, it has been reported that IV cuts backend deals on its IP sales transactions to share in proceeds from litigation.

Despite these trends, IV has purportedly maintained a policy of trying to license its technology without directly instigating litigation, but, of course, that requires the payment of a large sum of money to obtain a license. That trend may be over. On December 8, 2010, IV ended its decade of litigation restraint by launching its first series of lawsuits against companies that have refused to pay license fees. The firm’s first three lawsuits were directed against four companies in the software security industry, including Symantec and McAfee, three companies involved in manufacturing type of integrated circuit, and Hynix and Elpida over their DRAM and flash memory products.

Thus, as discussed in our previous [alert](#), patent pools such as IV should be closely monitored as their assets have begun to be used as swords in litigation, rather than as shields to simply protect a company from litigation. With its massive IP portfolio, IV is potentially the most powerful NPE in the world.

Patent Legislation to Watch

Congress has been considering a comprehensive overhaul to the U.S. patent system for over four years. Some of the reforms would align elements of the U.S. system with those that are common in other developed economies. Other provisions attempt to codify existing case law, while still others appear aimed at general improvements to the system. We highlight two significant reform measures that may take effect in 2011, and one that was just recently signed into law. However, it seems that Congress has other priorities dealing with the economy, national debt and jobs that may prevent it from enacting any substantive reform any time soon.

Patent Reform Act of 2011

Sen. Patrick Leahy (D-Vermont), Chairman of the U.S. Senate Judiciary Committee, introduced the Patent Reform Act of 2011 on January 25, 2011, constituting the fourth year in a row that a patent reform act has been introduced in the Judiciary Committee. The text of the latest iteration is very similar to the amendment to S. 515 released on March 4, 2010, and can be accessed [here](#). The Patent Reform Act makes the following key changes to the current patent regime:

First-to-Invent versus First-Inventor-to-File System

The Patent Reform Act would change the U.S. system’s procedure for dealing with competing inventors from one in which the first-to-invent is entitled to the patent to one in which the first-inventor-to-file a patent application is entitled to the patent. The U.S. is the only developed country with a first-to-invent system.

Supporters of the reform argue that the legislation will streamline the system and reduce the number of legal battles over patents. They point out the advantages of aligning the U.S. system with patent systems around the world, as harmonization could mean fewer duplicate patents or inventions around the world, and less international litigation. Opponents assert that, among issues, the change would trigger a flood of applications from large corporations, therefore smothering smaller, independent inventors.

Third-Party Prior Art Submissions And Post-Grant Review

The Senate's reform act allows anyone to submit to the PTO patents or other publications that are potentially relevant to a pending patent application for inclusion in the prosecution record. Third parties can submit prior art under this provision for six months after the patent application is published, unless a notice of allowance or first rejection is issued earlier. The prior art submission must contain a concise description of the relevance to the pending application of each reference submitted. In contrast, a "protest" can be filed against a pending application, but only before the application is published, under the current regulations.

Further, the Patent Reform Act creates a post-grant opposition proceeding, open for nine months after the grant of a patent. This would allow challengers to contest patents of questionable validity. The forum may turn into an overused reexamination-type proceeding, however, for companies to prevent a competitor's patented invention from being used offensively.

On the other hand, these changes have the potential to ease the prior art search burden of PTO examiners. Also, the quality of issued patents could increase as patent applicants will likely need to show improvement over a larger set of prior knowledge. Litigation activity could potentially temper as well if more applications are shown to be anticipated or obvious during prosecution.

Damages

Under the reform, courts must act as strict gatekeepers for parties' damages theories and evidence. As such, courts must identify for the record the methodologies and factors relevant to the determination of reasonable royalty damages for which there is a sufficient evidentiary basis and direct the jury to consider only those factors. In other words, parties can only introduce evidence on damages if it is relevant to the factors and methodologies identified by the court.

Thus, the reform bill is aimed at controlling the unpredictable way in which judges and juries currently address damages in patent infringement cases. Also, the Act requires courts to grant requests to bifurcate liability from damages absent good cause to deny such requests.

Willfulness and Enhanced Damages

The Patent Reform Act essentially codifies the Federal Circuit's decision in *In re Seagate* that holds a defendant may only be found to have willfully infringed a patent if the plaintiff demonstrates by clear and convincing evidence that the infringer acted with objective recklessness and the objectively-defined risk was either known or so obvious that it should have been known by the infringer. The Act also (i) requires that allegations of willfulness be pled with particularity, (ii) limits the use of vague pre-suit notifications, (iii) prohibits mere knowledge of a patent from being the basis of a willfulness finding, and (iv) does not allow the failure to obtain advice of counsel to be used to show willfulness or inducement of infringement.

Further, a court may not enhance damages if it determines that the case was close regarding validity, infringement, or enforceability, even if a trier of fact finds that the infringer acted willfully. Essentially, this is a codification of Federal Circuit precedent. *E.g., Odetics, Inc. v. Storage Tech. Corp.*, 185 F.3d 1259 (Fed. Cir. 1999).

These reforms, in conjunction with the proposed reforms to the damages analysis, are largely aimed at stemming a growing trend of very large damages awards with questionable foundations. In many cases, evidence that a defendant knew about the plaintiff's patent, coupled with allegations of "stealing," can give patentees what some consider to be an unfair upper hand in front of the jury. The Senate's version of the bill would try to limit willfulness findings to the most extreme cases, much in the same way the inequitable conduct defense is being limited by the courts.

False Marking Lawsuit Reform

In conjunction with the Federal Circuit's attempts to limit the onslaught of false patent marking lawsuits, Congress has gotten in the game. On January 7, 2011, Rep. Robert Latta (R-Ohio) introduced H.R. 243, a bill aimed at limiting false patent marking suits to plaintiffs suffering actual "competitive injury" from an alleged violation. Further the bill would limit damages for any violation of the false marking statute to "\$500, in the aggregate, for all offenses," as opposed to \$500 per falsely marked article, the rule established by the Federal Circuit in *Forest Group* (2009).

Thus, H.R. 243 would go much farther in limiting false marking suits than any potential decision by the Federal Circuit in *BP Lubricants*. In fact, the proposed amendment would seem to terminate the main motivation for the false marking litigation craze—the enticement of an award based on \$500 per falsely marked article. The prospects for adoption are currently uncertain, but it stands to reason that large, influential companies would support the bill.

Pilot Program In District Courts For Patent Cases

A new program has started to increase the skill of district courts for handling patent cases. Specifically, the President signed in law on January 4, 2011 an "Act to establish a pilot program in certain United States district courts to encourage enhancement of expertise in patent cases among district judges." H.R. 628. The bill would permit the chief judge in certain district courts to designate judges within the district to hear patent cases if the judge selected at random (the normal process) declines the case. The Director of the Administrative Office of the U.S. Courts will have six months within which to designate not less than six district courts in at least three different judicial circuits where the pilot program will be carried out. The designated district courts must be selected from amongst the fifteen district courts handling the largest number of patent cases, and which have adopted local rules for patent cases. The pilot program would run for ten years after the designation of participating district courts. Thus, it remains to be seen whether the bill will achieve its goal of reducing the number of reversals at the Federal Circuit.

Conclusion

We should see significant developments in the intellectual property arena in the coming year, just as in years past. The courts will be grappling with issues that have far-reaching impact on how companies choose to pursue, litigate, and invest in intellectual property. The year promises to shed further light on the continuing evolution of, and interaction between, case law, the intellectual property marketplace and patent-related legislation.

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

Washington, D.C.

Robert M. Masters
1.202.551.1763
robmasters@paulhastings.com

Brock S. Weber
1.202.551.1783
brockweber@paulhastings.com

¹ The group of professors went even farther than Microsoft, arguing that the burden of proof as to invalidity should always be the "preponderance of the evidence" standard because the PTO does not spend enough time on each patent application to entitle its decisions to any deference.

² *Am. Hoist & Derrick Co. v. Sowa & Sons, Inc.*, 725 F.2d 1350 (Fed. Cir. 1984).

³ *KSR Int'l*, 550 U.S. 398, 426 (2007).

⁴ See also *Ultramercial, LLC v. Hulu, LLC*, 2010 WL 3360098 (C.D. Cal. Aug. 13, 2010) (granting defendant's motion to dismiss for lack of patentable subject matter)

⁵ *Pequignot v. Solo Cup Co.*, 608 F.3d 1356 (Fed. Cir. 2010).

⁶ We discussed the background of the *Princo* case in more detail in our previous client alert.