Federal Circuit Provides Roadmap for Patent Actions at the ITC by Non-Practicing Entities

This article first appeared in the *Intellectual Property & Technology Law Journal*, Vol. 24, No. 2, February 2012.

by Evan Finkel

Evan Finkel
Intellectual Property
+1.213.488.7307
evan.finkel@pillsburylaw.com

Evan Finkel is a partner at Pillsbury Winthrop Shaw Pittman LLP, where he leads the Los Angeles Intellectual Property group. He can be contacted at evan.finkel@pillsburylaw.com.

A recent case decided by the Federal Circuit related to the "domestic industry" requirement for maintaining a patent infringement action at the International Trade Commission (ITC) was not directed at non-practicing entities (NPEs or patent trolls). However, the decision in John Mezzalingua Associates, Inc. v. International Trade Commission[1] *does have important implications as to NPEs that resort to district court litigation against a few test subjects to establish a "domestic industry" that might open the doorway at the ITC to sue dozens of companies.*

The Domestic Industry Requirement

The ITC is the forum in which to sue for unlawful importation into the United States of articles that infringe a valid and enforceable US patent or an article made by a process covered by the claims of a valid and enforceable US patent[2] only if the so-called "domestic industry" requirement is met. The domestic industry requirement is that an industry in the United States relating to the articles protected by the patent exists or is in the process of being established.[3]

The domestic industry requirement can be met in one of three ways:

> [A]n industry in the United States is considered to exist only if there is in the United States, with respect to the articles protected by the patent ... concerned—(A) significant investment in plant and equipment; [or] (B) significant employment of labor or capital; or (C) substantial investment in its exploitation, including engineering, research and' development, or *licensing*.[4]

It is often the case that an NPE cannot prove any of (A), (B) or (C) because it has no business other than enforcing its patents and because its licensing efforts have to date mostly failed. However, in a series of decisions in the *Mezzalingua* proceeding,[5] the ITC concluded that a would-be complainant can attempt to meet the licensing provision of (C) through substantial costs (investment) incurred in activities related to patent litigation to enforce its patent, *provided that those costs are related to licensing of the patent*. That is, the "licensing" efforts sufficient to satisfy the domestic industry requirement are not limited to "pre-litigation" licensing activities intended to promote production of the patented article and thus advance a domestic industry for the patented article in the United States. Rather, the "licensing" efforts may also extend to post-litigation licensing activities aimed at recovering royalties from existing production of the patented articles by defendants. The key, according to the ITC, is that the incurred expenses "serve to encourage practical applications of the invention or bring the patented technology to the market." In other words, the litigation expenses must be made in an effort to license the patented technology and thus spur the commercialization (i.e., use, manufacture, marketing) of the patented technology in the United States.

The Decision

The administrative law judge (ALJ) in this case ultimately ruled that complainant John Mezzalingua Associates, Inc., (doing business as PPC, Inc.) had not sufficiently tied its litigation costs to licensing and that any investment that PPC had made in licensing was not substantial. The ITC adopted the ALJ's opinion without modification, and that order became final. PPC appealed to the Federal Circuit.[6] The Federal Circuit affirmed in a 2-to-1. decision. Judge Bryson wrote the majority opinion, which Judge Linn joined. Judge Reyna dissented. The discussion below is directed to the majority opinion.

Regarding the standard of review, the Federal Circuit noted that "[t]he question whether a complainant has satisfied the domestic industry requirement typically presents issues of both law and fact, but PPC's appeal raises only factual issues relating to the link between various litigation expenditures and licensing." "In reviewing the Commission's factual findings as to whether particular expenses were related to licensing and whether those expenses, when viewed in the aggregate, were 'substantial,' we apply the 'substantial evidence' test"

Turning to the merits, the Federal Circuit first focused on a lawsuit that PPC had filed against Arris in 2001 in a Florida district court, alleging infringement of the patent of concern (the '539 design patent). In 2002, a jury found the '539 design patent valid and infringed and awarded PPC $1.35 million in damages. The court granted PPC's request for injunctive relief. The injunction remained in force for two years until 2004, when the parties entered into a settlement that included a license under the '539 design patent and other patents to resolve ongoing disputes.[7]

The ALJ found that PPC had failed to show that the expenses that it incurred in litigating the Florida action reflected a significant investment *in licensing*. First, there was no evidence of *pre-litigation* licensing activities. PPC never offered Arris a license under the '539 design patent before filing suit. There was no evidence that, prior to filing suit, PPC had sent a cease-and-desist letter to Arris or had otherwise communicated with Arris to raise the possibility of a license or settlement under the '539 design patent. Second, there was no evidence that PPC had conducted either settlement or licensing negotiations with Arris *during the lawsuit itself*.

On appeal, PPC argued that the ALJ had erred in finding that PPC had not engaged in *pre-litigation* licensing efforts. However, the Federal Circuit found that PPC's evidence—vague testimony by one executive that it made efforts to settle the case—was insufficient to establish that the ALJ had erred. PPC further argued that its failure to actively pursue pre-litigation licensing deals was justified because the industry is reluctant to accept a license to a design patent without litigation; thus litigation was a necessary precursor to licensing the '539 design patent. The Federal Circuit agreed with the ALJ that such was irrelevant because "the question before the administrative law judge was whether PPC made a substantial investment in licensing, and the administrative judge reasonably concluded that PPC failed to show that it did," In other words, it does not matter why PPC did not engage in pre-litigation licensing activities, all that matters is, that it did not and thus cannot establish "substantial investment in its exploitation … [through pre-litigation] … licensing [activities]" under § 1337(a)(3)(C).

As for *in-litigation* licensing activities, the ALJ concluded that the fact that PPC had sought and received a permanent injunction against Arris in the Florida action in 2002 and that the injunction remained in force for two years until PPC licensed the patent to Arris in 2004, suggests that PPC's purpose in litigating in 2001-2002 "was not to obtain a license but, rather, was to stop Arris from manufacturing infringing connectors." Further, the fact that a license was eventually granted "does not … mean that all of the prior litigation expenses must be attributed to the licensing effort." While "a request for or receipt of injunctive relief" may not "always bar a patentee from later seeking to establish the existence of a domestic industry through an investment in licensing," "the form of relief requested is a factor that that could be considered." In this case it proved to be an important factor, as there was no evidence of any licensing activities being conducted during the litigation. The Federal Circuit concluded that "[t]he administrative law judge was entitled to conclude that the Florida action expenses should not be credited as expenses related to licensing."

PPC further argued that its two other lawsuits-one against Arris' distributor in Colorado for infringement of the '539 design patent and one in *Wisconsin* for infringement of the '194 utility patent-had led to the settlement and license agreement executed in 2004 that included a license under the '539 design patent, and that the expenses incurred in all three litigations must be considered as licensing efforts that in fact succeeded. Here, the Federal Circuit's decision gets a little muddy.

The Federal Circuit described the Wisconsin action as "fundamentally different from either the Colorado action or the Florida action because it involved only the '194 utility patent," and summarized that the ALJ "ruled that . . . expenses associated with the enforcement of a different patent should not be credited as an investment in licensing the '539 design patent." The Federal Circuit rejected PPC's argument that "the Wisconsin jury verdict was necessary to force Arris to sign a license and that the administrative law judge should have credited more of PPC's expenses in that lawsuit toward its investment in licensing the '539 design patent." According to the Federal Circuit, "[a] lthough the license agreement was executed after the verdict in the Wisconsin case, it does not follow that PPC's actions in the ' Wisconsin case were directed toward licensing the '539 design patent."

That all makes perfect sense. But then the Federal Circuit changed direction and seemed to endorse PPC's theory, choosing instead to focus on examining evidence of what activities during all three lawsuits were actually directed to licensing the '539 design patent as opposed to being directed to litigation activities and/or the other patents, and whether those expenses represented a "substantial investment." The Federal Circuit began by noting that the ALJ "did not disregard the expenses of the Wisconsin litigation." Instead, the ALJ considered, the settlement and licensing negotiations related to all three cases in deciding whether PPC had made a substantial investment in licensing because at that point the three cases were "inextricably linked." The ALJ therefore "examined PPC's legal bills in all three cases and credited entries that had a work description related to 'licensing' or 'settlement' toward PPC's investment in licensing" The ALJ properly sought to "decide which of PPC's many expenses were truly related to licensing the '539 patent and which were not," "reasonably rel[ying] on attorney work descriptions as he identified which expenses related to PPC's litigation activities and which related to its investment in the domestic industry through licensing."

The ALJ "found that PPC had ... incurred some legal expenses related to the negotiation and drafting of the licensing agreement and therefore had made at least some investment with respect to licensing of the '539 design patent." However, the ALJ "found that the investment was not substantial." The ALJ "acknowledged PPC's argument that the 2004 agreement was not reached until after PPC had filed several lawsuits against Arris and ICM on several different patents," "[b]ut because those cases had multiple objectives and were not all based on the '539 design patent, [he] reasonably concluded that it would be inappropriate to treat most of the incurred legal fees as an investment in licensing of the '539 design patent" The Federal Circuit accepted that, stating "[w]e decline to disturb that ruling."

As one additional factor, the ALJ mentioned that "PPC had no formal licensing. program and that there was no evidence it had offered to license. the patent to any party other than its litigation opponents" The Federal Circuit cautioned that "there is no rule that a single license-such as an exclusive license-cannot satisfy the domestic industry requirement based on a substantial investment in licensing." "But the administrative law judge was entitled to view the absence of other licenses issued or negotiated for the '539 design patent as one factor supporting his conclusion that PPC's expenditures related to licensing were not substantial"

In view of all the factors, evidence, and analysis discussed above, the Federal Circuit concluded: "Based on the administrative law judge's . thorough review of the pertinent evidence, adopted in full by the Commission, we conclude that the

Commission's conclusion as to the licensing issue is supported by substantial evidence."[8]

Conclusion

Thus, the broad takeaways from the Federal Circuit's opinion are as follows. Failure to engage in licensing discussions, or at least raise the possibility of a license, under the patent of concern before filing suit should kill any chance of relying on pre-litigation activities to support a domestic industry claim through licensing. Further, "expenditures on patent litigation do not automatically constitute evidence of the existence of an industry in the United States established by substantial investment in the exploitation of a patent [through licensing]." Instead, one must. first look to the specific activities during litigation and identify those activities directed to seeking a license (or to compel the defendant to. take a license) under the patent of concern rather than being directed to litigation for other purposes or to other patents. Then a dollar value should be placed on those activities. Finally, that value has to rise to the level of a "substantial investment."

Given this, one should look to attorneys, particularly those representing NPEs in district court infringement actions with an eye towards future ITC proceedings, to resort to creative time sheets. Do not be shocked to find that time sheet entries end in the phrase "in an effort to compel or persuade the defendant to engage in, and hopefully consummate, a license agreement." Moreover, the Federal Circuit decision paves the way for an NPE to argue that, because it is not seeking an injunction and is only seeking a favorable judgment to persuade the defendant to take a license, that all .its activities are really directed to licensing. That will be buttressed by the NPE offering a license shortly after filing suit, most likely in a letter saying that suit was filed only to avert a declaratory judgment action and that the NPE hopes to avoid protracted litigation (or even requiring defendant to file an answer) by promptly negotiating and consummating a license. Possibly the NPE will sue but defer service of the complaint to provide time for licensing discussions to further drive home its position. And if no license is executed, the NPE may continue to raise the issue time and time again, just to enhance its claim. Also, the NPE would be best served by not suing on multiple patents if it intends to assert only some of them in an ITC proceeding. By limiting the district court action to only the patents to be asserted in a subsequent ITC proceeding, there will be no chance of the ITC's apportioning activities between the ITC and non-ITC patents. Under those types of circumstances, one must wonder whether the Federal Circuit would conclude that most of the activities by the NPE are directed to licensing and are quite substantial. That argument could be further supported by the NPE's not seeking an injunction for post-verdict activities by the defendant and instead limiting itself to seeking only post judgment royalties (which is likely all it would receive anyway).

1 John Mezzalingua Associates, Inc. v. International Trade Commission, —F.3d— (Fed. Cir. Oct. 4, 2011).

2 19 U.S.C. § 1337(a)(1)(B).

3 19 U.S.C. § 133.7(a)(2).

4 19 U.S.C. § 1337(a)(3).The terminology often used is that there is an "economic prong" and a "technical prong" of the domestic industry requirement. The economic prong of the domestic industry requirement is that there must' be the "significant investment" or "significant employment" as provided for in subdivisions (A), (B), and (C). The technical prong is that those activities are "with respect to the articles protected by the patent" as provided for in the preamble to those subdivisions.

5 Inv. No. 337-TA-650.

6 The first ALJ initial determination (ID) was that PPC had established a domestic industry. The ITC reviewed and reversed the ALJ's 'ruling. However, the ITC remanded the case to afford PPC an opportunity to show what portions of its enforcement-related expenses were in fact related to licensing; and that such expenses constitute a "substantial investment" as required by 19 U.S.C. § 1337(a)(3)(C) ("an industry in the United States shall be considered to exist if there is in the United States, with respect to the articles protected by the patent ... (C) *substantial investment* in its exploitation, including … licensing"). On remand, the ALJ ruled that PPC had not sufficiently tied its litigation costs to licensing and that any investment that PPC had made in licensing was not substantial. The ITC adopted the ALJ's opinion without modification, and that order became final. PPC appealed to the Federal Circuit.

7 In 2001, PPC sued Arris' distributor (ICM) in Colorado district court, again alleging infringement of the '539 design patent. In 2003, PPC sued Arris in a Wisconsin district court, asserting infringement of the '194 utility patent that claimed priority to the same parent application as the '539 design patent. A jury found the '194 utility patent valid and infringed. In 2004, following entry of judgment in the Florida and Wisconsin actions, and before the Colorado action went to judgment, the parties entered into the settlement agreement. The '539 design patent was licensed under the settlement agreement.

[8] The majority also rejected PPC's arguments regarding alleged "substantial investment in ... engineering, research and development." In a dissent, Judge Reyna wrote he "would reverse the ITC determination and remand for additional fact finding as to how much investment PPC made into the research and development of the design, and to determine whether PPC's infringement litigation costs, alone or in combination with its research and development costs, are substantial enough to give rise to the existence of a domestic industry."

Pillsbury Winthrop Shaw Pittman LLP | 1540 Broadway | New York, NY 10036 | 1.877.323.4171
© 2012 Pillsbury Winthrop Shaw Pittman LLP. All rights reserved.

Pillsbury Winthrop Shaw Pittman LLP

AR_v020912