Federal Circuit Affirms ITC's Determination that Litigation Generally Cannot Be Used to Establish a Domestic Industry

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The Federal Circuit has established that litigation activities cannot generally be used to satisfy the requirement in a Section 337 case before the International Trade Commission that the complainant demonstrate a domestic industry has been established. The case has significant implications for non-practicing entities, who will likely need to establish that efforts were made to engage in licensing negotiations prior to the commencement of litigation.

In *John Mezzalingua Associates (d/b/a PPC, Inc.) v. ITC*, Case No. 2010-1536 (Fed. Cir. Oct. 4, 2011), the U.S. Court of Appeals for the Federal Circuit, by a 2-1 majority, affirmed a determination by the International Trade Commission (ITC) that the complainant failed to satisfy the domestic industry requirement of § 337 with respect to one of the asserted patents based on its litigation activities. This case was the appeal from the ITC's opinion in *Coaxial Cable Connectors*, Inv. No. 337-TA-650, which held that litigation activities (including patent infringement lawsuits) only satisfy the domestic industry requirement if a complainant can prove that those activities are related to licensing and pertain to the patent at issue.

Background

Section 337 of the Tariff Act of 1930 requires that, in order to prove a violation, a complainant demonstrate that an industry relating to articles protected by the patent asserted either exists or is in the process of being created. This is commonly referred to as the “domestic industry requirement.” The statute provides three methods by which domestic industry can be demonstrated: a “significant investment in plant and equipment,” a “significant employment of labor or capital,” or a “substantial investment in [] exploitation, including engineering, research and development, or licensing.”

Significantly, while the first two methods require proof that either the patentee or one of its licensees manufactures an article that meets one or more of the asserted patent’s claims (the so-called “technical prong” of the domestic industry requirement), the third method has historically not required such proof. Instead, complainants typically presented proof of investment in the exploitation of the asserted patent, and that the investment related to licensing and that the investment occurred in the United States. Given the added time and expense of proving the technical prong, complainants have increasingly relied on licensing activities to satisfy the domestic industry requirement.

In this case PPC appealed from the ITC's determination that it failed to meet the domestic industry requirement with respect to an asserted patent. At the ITC, PPC asserted it satisfied the domestic industry requirement based on expenses incurred in litigating three prior district court patent infringement actions. In the first of these district court actions ("the Florida action"), PPC asserted infringement of the patent in issue against a third party, Arris, which resulted in a jury finding of infringement and damages. In that case the district court also granted PPC's request for injunctive relief. In the second district court action ("the Colorado action"), PPC alleged infringement of the patent against a related party (to Arris), ICM. In the third district court action ("the Wisconsin action"), PPC alleged that Arris infringed a related patent, which also resulted in a jury finding of infringement.

Following judgment in the Florida and Wisconsin actions, and before the Colorado action went to judgment, the parties entered into a settlement that included a license agreement. The settlement and license agreement permitted Arris to practice all the patents that claim priority to a certain patent application, one of which was the patent asserted at the ITC. PPC argued that because the three district court actions ultimately resulted in a license to practice the asserted patent, its expenses in litigating those lawsuits should be considered "exploitation" of the asserted patent for purposes of satisfying the domestic industry requirement. While the Administrative Law Judge initially fully credited PPC's expenses related to litigating the patent, the ITC on review held that litigation expenses could only be credited toward a domestic industry if the complainant establishes that they are related to the licensing of the asserted patent. On remand, while crediting some of the litigation expenses, the presiding ALJ found that the expenses that could be credited toward licensing were not “substantial” as required under the statute. After the ITC declined to review this determination, PPC appealed.

The Federal Circuit

On appeal, the Federal Circuit addressed the argument as to whether *any* litigation activity can be used to establish that the domestic industry requirement is satisfied. The majority opinion (Bryson, J., and Linn, J.) held that “the Commission reasonably concluded that expenses associated with ordinary patent litigation should not automatically be considered a ‘substantial investment in … licensing,’ even if the lawsuit happens to culminate in a license.”

The majority explained that “PPC’s appeal raises only factual issues relating to the link between various litigation expenditures and licensing,” and applied the “substantial evidence” as to the ITC’s factual findings regarding the substantiality of PPG litigation expenses. In so doing, the majority concluded there was no evidence that PPC had ever engaged in settlement or licensing negotiations either before or during the prior district court lawsuits where it had asserted the patent. The majority noted that because PPC allowed the permanent injunction it received in the Florida case to remain in place for two years before it entered into a license agreement with Arris, “that delay suggests that PPC’s purpose in litigating was not to obtain a license, but, rather was to stop Arris from manufacturing infringing connectors.” The majority also noted that “[t]he fact that litigation adversaries eventually enter into a license agreement does not, as PPC suggests, mean that all of the prior litigation expenses must be attributed to the licensing effort.”

Noting that at least one of the prior litigations did not even involve the asserted patent, the majority found that “[b]ecause those cases had multiple objectives and were not all based on the [asserted] patent, the administrative law judge reasonably concluded that it would be inappropriate to treat most of the incurred legal fees as an investment in licensing of the [asserted] patent.” Additionally noting that PPC had only obtained one license to the asserted patent, the majority concluded that the ITC was “entitled to view the absence of other licenses issued or negotiated for the [asserted] patent as one factor supporting his conclusion that PPC's expenditures relating to licensing were not substantial.” Finally, the majority found that PPC failed to meet its burden of proving that any of its research and development investments related to designs protected by the asserted patent.

In dissent, Reyna, J., argued for a *per se* rule that “patent infringement litigation is an investment in the exploitation of a patent” within the meaning of § 337. The dissent argued the exclusion of litigation expenses not tied to licensing was “manifestly contrary to the statute” (and thus not entitled to deference under *Chevron*), and that it “impermissibly and arbitrarily limited the reach of § 337 for patent owners.”

Implications for ITC Litigants

This case has significant implications for non-practicing entities and other complainants who intend to rely upon their litigation expenses in order to satisfy the domestic industry requirement. As the facts of this case demonstrate, any complainant who intends to rely upon litigation expenses must clearly establish that those expenses are related to its effort to license the patent(s) at issue. The fact that litigation may have ultimately resulted in a license agreement covering the asserted patent is not sufficient on its own to retroactively establish that all expenses associated with that litigation were *ipso facto* related to the complainant's licensing activities.

Going forward, a complainant will need to establish that it made efforts to engage in licensing negotiations either before the litigation commenced or in the context of settlement discussions during the course of the litigation. Additionally, permitting a permanent injunction to remain in effect for a significant period of time before negotiating a license will likely be taken as proof that the underlying purpose of that litigation was not to obtain a license, but rather to exclude a competitor. Of course, a complainant that has negotiated several license agreements covering the asserted patent(s) before filing its complaint is more likely to be found to satisfy the domestic industry requirement.

The Federal Circuit did not foreclose the use of litigation expenses in order to satisfy the domestic industry requirement. Thus, the *PPG* decision should be read in conjunction with the ITC's July 22, 2011, opinion in Inv. No. 694, "Certain Multimedia Display and Navigation Devices and System Components Thereof and Products Containing Same," which identified several factors that may be used to determine whether activities tied to licensing a patent portfolio can satisfy the domestic industry requirement. Because this is a highly fact-intensive inquiry that is likely to be contested by respondents, summary determination on the domestic industry issue is less likely to be common in future ITC investigations.

For more information, see International Trade Commission Offers Guidance on Satisfaction of Domestic Industry Requirement.