

# Intellectual Property Newsletter



## Six Ways to Sunday: Recent Federal Circuit Opinion Highlights Uncertainty in the Patent Eligibility of Computer-Implemented Inventions

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*CLS Bank International v. Alice Corp. PTY. LTD, and CLS Services, Ltd.*, No. 2011-1301 (Fed. Cir., May, 2013).

<http://www.cafc.uscourts.gov/images/stories/opinions-orders/11-1301.Opinion.5-8-2013.1.PDF>

*“There has never been a case that could do more damage to the patent system than this one.”*

-- The Honorable Kimberly A. Moore, U.S. Court of Appeals for the Federal Circuit

The U.S. Court of Appeals for the Federal Circuit, sitting en banc, recently addressed the patent eligibility of computer-implemented inventions under 35 U.S.C. § 101 in *CLS Bank International v. Alice Corporation*. Section 101 broadly defines the subject matter that is eligible for patenting: “any new and useful process, machine, manufacture, or composition of matter, or any new and useful improvement thereof” is patent eligible. While courts have interpreted Section 101 broadly, they have recognized a judicially created exception that excludes from the statute’s scope abstract ideas, laws of nature, and natural phenomena.

Among the questions the *CLS Bank* court sought to answer were: (1) what test should be applied to determine whether a computer-implemented invention is a patent-ineligible abstract idea, and (2) when, if ever, does the presence of a computer in a patent claim lend patent eligibility to an otherwise patent-ineligible idea?

The ten-judge panel was sharply divided on these issues, resulting in the filing of five separate opinions and a set of “additional reflections” by

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Chief Judge Rader. Though a majority of the Court agreed that the asserted method and computer-readable media claims were not directed to patent-eligible subject matter under Section 101, no majority of judges agreed on the correct approach to the patent eligibility inquiry.

*CLS Bank* breathes additional uncertainty into the patent eligibility of computer-implemented inventions. In the words of Judge Moore, certain of the court's proposed approaches could lead to "the death of hundreds of thousands of patents, including all business method, financial system, and software patents as well as many computer implemented and telecommunications patents." Thus, it will be important to keep abreast of future legal developments in this area, as federal courts and the Patent Office struggle to make sense of the current state of the law.

## The District Court Proceeding

Alice Corporation's patents generally relate to "a computerized trading platform used for conducting financial transactions in which a third party settles obligations between a first and a second party so as to eliminate 'counterparty' or 'settlement' risk." The asserted claims include claims directed to methods of exchanging obligations, data processing systems, and computer-readable media containing program code for directing an exchange of obligations.

For purposes of summary judgment, the parties agreed that all asserted claims should be interpreted to require a computer including at least a processor and memory. The district court concluded on summary judgment that the asserted claims were invalid under Section 101. In particular, the district court held that the method claims were improperly directed to "an abstract idea of employing an intermediary to facilitate simultaneous exchange of obligations in order to minimize risk;" the system claims were ineligible because they "would preempt the use of the abstract concept ... on any computer;" and the media claims were improperly "directed to the same abstract concept despite the

fact they nominally recite a different category of invention." Alice Corporation appealed.

## The Federal Circuit Appeal

On appeal, a Federal Circuit panel reversed the district court decision, holding that the asserted claims were all patent eligible under Section 101. *CLS Bank* filed a petition for rehearing en banc, which was granted in October 2012. On May 10, 2013, the Federal Circuit issued a per curiam opinion, in which a majority of the court affirmed the district court's holding that the method and computer-readable media claims were not directed to patent-eligible subject matter, and an equally divided court affirmed the district court's holding that the system claims are not directed to patent-eligible subject matter.

Judge Lourie wrote a concurring opinion, in which Judges Dyk, Prost, Reyna, and Wallach joined. Judge Lourie articulated a multi-part test for determining patent eligibility. First, one must determine whether the claimed invention is a process, machine, manufacture, or composition of matter. If so, then one must determine whether the claim is drawn to a patent-ineligible abstract idea, law of nature, or natural phenomenon. To assess whether a claim raises "abstractness concerns," one must identify and define the abstract idea that could be preempted if the claim were upheld. Once the abstract idea is identified, one must evaluate the rest of the claim to determine if it contains enough "additional substantive limitations that narrow, confine, or otherwise tie down the claim so that, in practical terms, it does not cover the full abstract idea itself." Judge Lourie explained that "[I]mitations that ... are merely tangential, routine, well-understood, or conventional, or in practice fail to narrow the claim relative to the fundamental principle therein, cannot confer patent eligibility."

Applying these principles, Judge Lourie concluded that the balance of the asserted method claims did not represent "significantly more" than the underlying abstract idea, and failed to provide "enough" of a limitation to satisfy Section 101. Judge Lourie also concluded that the system and

computer-readable media claims were similarly patent ineligible because they were nothing more than re-articulated versions of the method claim: “Abstract methods do not become patent-eligible machines by being clothed in computer language.”

Chief Judge Rader, joined by Judges Linn, Moore, and O’Malley, disagreed with the district court concerning the system claims, concluding that they were patent eligible. Chief Judge Rader, joined only by Judge Moore, agreed with the district court, however, that the method and media claims were not patent eligible.

Chief Judge Rader’s approach centered on “whether a claim includes *meaningful* limitations restricting it to an application [of an idea], rather than merely an abstract idea.” Chief Judge Rader explained that a claim is not meaningfully limited if it covers all practical applications of an abstract idea, or if it contains only insignificant or token activity (such as identifying a relevant audience, a category of use, field of use, or technological environment), or if its purported limitations are overly-generalized. In contrast, Chief Judge Rader explained that a claim is meaningfully limited if it requires “a particular machine implementing a process or a particular transformation of matter,” or when the claim recites, in addition to the abstract idea, other limitations that are “central to the solution itself.” “[W]hile the mere reference to a general purpose computer will not save a method claim from being deemed too abstract to be patent eligible, the fact that a claim is limited by a tie to a computer is an important indication of patent eligibility.... At bottom, where the claim is tied to a computer in such a way that the computer plays a meaningful role in the performance of the claimed invention, and the claim does not pre-empt virtually all uses of an underlying abstract idea, the claim is patent eligible.”

Chief Judge Rader analyzed the claims as a whole to see if they were practically limited such that the patentee was not claiming the entire abstract idea, but rather only an application of that idea. With respect to the system claims, Chief Judge Rader

found that they were patent eligible because they provided additional structural elements that were not inherent in the abstract idea, and they were not stated at a high level of generality. Applying this same reasoning to the method and media claims produced the opposite result. Chief Judge Rader concluded that those claims recited only steps inherent in the abstract idea of using an escrow to avoid risk.

Judges Linn and O’Malley largely agreed with Chief Judge Rader’s analysis but disagreed on certain procedural issues, which led them to conclude, based on the district court record, that the method and media claims must rise and fall with the system claims because they contain the same computer-based limitations. Accordingly, Judges Linn and O’Malley concluded that the method and media claims are also patent eligible.

Judge Moore filed a separate dissenting-in-part opinion, in which Chief Judge Rader and Judges Linn and O’Malley joined, further explaining why the system claims are directed to patent eligible subject matter, and cautioning against the sweeping impact Judge Lourie’s approach could have on “hundreds of thousands of patents,” “decimat[ing] the electronics and software industries.” Judge Moore further expressed concern over the “staggering breadth” that has been applied to the narrow judicial “abstract ideas” exception, and invited the Supreme Court to weigh in on which claims “*are* and *are not* directed to patentable subject matter.”

Judge Newman wrote separately to express her view that the court is unnecessarily concerned about preemption because patented information is not barred from further study and experimentation. Thus, Judge Newman advocated that the court should “abandon its failed section 101 ventures into abstraction, preemption, and meaningfulness,” return to the plain language of the statute, and hold that “when the subject matter is within the statutory classes in section 101, eligibility is established.” According to Judge Newman, other provisions of the Patent Act, including those relating to novelty,

non-obviousness, and enablement, are sufficient to “place[] inventions in the statutory framework of patentability.”

The approaches of Chief Judge Rader and Judges Lourie and Newman are all rooted in Supreme Court and Federal Circuit precedent. None of their approaches “has the weight of precedent,” however, because no single opinion garnered a majority. Until this issue is taken up by the Federal Circuit again or resolved by the Supreme Court, litigants will need to consider all three approaches and carefully note the composition and leanings of their judicial panels.

## The Federal Circuit Affirms that “Infringement” Under 35 U.S.C. §284 Does Not Encompass Sales Outside the U.S.

John Harbin

*Power Integrations, Inc. v. Fairchild Semiconductor International, Inc., et al.*, Nos. 2011- 1218, - 1238 (Fed. Cir. Mar. 2013)

<http://www.ded.uscourts.gov/sites/default/files/opinions/lps/2013/march/08-309.pdf>

The Federal Circuit confirmed that U.S. courts do not have authority to award damages for patent infringement that takes place abroad, notwithstanding the Supreme Court’s command that patentees be fully compensated for infringement, even when the foreign sales are the direct and foreseeable result of domestic infringement.

Power Integrations sued Fairchild for infringing four U.S. patents relating to power supplies for electronic devices, technology used in mobile phone chargers. The jury found several claims willfully infringed and awarded damages of almost \$34 million, comprised of lost profits (both from lost sales and past and future price erosion) and royalty damages. Fairchild moved for remittitur, arguing the damages award was based on worldwide sales. The trial judge granted Fairchild’s motion and reduced the damages award by 82% to \$6.1 million.

Power Integrations appealed the remittitur and Fairchild challenged the reduced damages award.

Power Integrations argued that it should be compensated for the foreign sales because it was foreseeable that Fairchild’s infringement in the U.S. would cause a loss of sales abroad, citing the Supreme Court’s statement about the damages statute, 35 U.S.C. §284, that “Congress sought to ensure that the patent owner would in fact receive full compensation for ‘any damages’ he suffered as a result of the infringement.” *General Motors Corp. v. Devex Corp.*, 461 U.S. 648, 654-55 (1983).

The Federal Circuit found this creative argument to be “unpersuasive,” and cited the axiom that U.S. patent laws do not have extraterritorial effect. “[A] defendant’s foreign exploitation of a patented invention ... is not infringement at all.” The fact that the foreign sales might be the direct, foreseeable result of domestic infringement is immaterial. “[T]he entirely extraterritorial production, use or sale” of a patented invention “is an independent, intervening act that, under almost all circumstances, cuts off the chain of causation initiated by an act of domestic infringement.” Because the jury’s award was based mostly on foreign sales, the court affirmed the trial court’s ruling that the award was contrary to law.

The court also found that the testimony of the plaintiff’s damages expert was unreliable and that the trial court had abused its discretion in admitting it. First, the expert had relied on a document about worldwide Samsung phone sales of which he did not know the source. Second, the expert assumed, without any factual basis, that all Samsung phones came with a charger containing infringing circuits. The expert’s data and methodology were deemed unreliable and inadmissible under *Daubert v. Merrell Dow Pharm., Inc.*, 509 U.S. 579, 589–90 (1993); and *Kumho Tire Co., Ltd. v. Carmichael*, 526 U.S. 137, 148 (1999).

The court also vacated the trial court’s reduced damages figure of \$6.1 million. The remitted damages were based on the trial court’s acceptance of Power Integration’s evidence that 18% of the

products that resulted from infringement abroad had been imported back into the U.S. by ‘unnamed third parties,’ making Fairchild liable, the trial court found, as a contributory infringer. The source of this evidence was again Power Integration’s damages expert; he had relied on the hearsay document about Samsung’s worldwide sales that the court had already ruled too speculative and a second document about Samsung’s U.S. sales the court also found to be speculative. “The evidence demonstrates no direct connection between Samsung’s worldwide [or U.S.] sales of mobile phones and sales of Fairchild’s infringing power circuits.” In fact, the court noted, there was evidence that some of the phones Samsung sold did not contain Fairchild’s infringing circuit. The opinion of Power Integration’s expert that all Samsung phones contained the infringing circuit was pure speculation. The court noted that the parties had entered into a pre-trial stipulation that Fairchild had made or sold in the U.S., or imported into the U.S., accused devices with a value of only \$765,724, and the plaintiff’s counsel had read that stipulation to the jury.

Based on these evidentiary flaws, the court found both that the \$6.1 million in reduced damages calculated by the trial court (by removing, as noted, 82% of the plaintiff’s damages figure) was not supported by substantial evidence and that, more broadly, there was insufficient evidence to find Fairchild liable for contributory infringement.

The court then addressed a disputed issue about price erosion. Because the plaintiff had not marked its products per Section 287, and Fairchild’s first notice of infringement was the filing of the suit, the trial court had held that (a) Power Integration’s damages were limited to post-filing infringements and (b) evidence of pre-suit price erosion caused by Fairchild’s infringement was inadmissible, even as to post-suit sales by Power Integration. The Federal Circuit agreed with the trial court on the first issue but reversed the trial court’s exclusion of evidence as to the price erosion caused by Fairchild’s pre-notice infringements. Such evidence, the court

held, is relevant to establish damages from post-notice infringements.

As its final ruling on damages, the court reversed the trial court’s rejection of Power Integration’s request for an accounting of post-verdict infringement damages, but limited it to post-verdict damages from direct infringement.

The court also modified the trial court’s claims construction somewhat, and affirmed the rejection by the jury and trial judge of Fairchild’s obviousness defense. Regarding the §103 issue, Fairchild had cited a patent, the ‘Martin patent,’ issued more than 11 years before the filing date of the patents at issue. The only “salient” difference between the Martin patent and the claims at issue was that the Martin patent included EPROM memory. The court agreed with Fairchild that the EPROM’s function was distinct from the patented functionality. However, the court found significant secondary considerations of non-obviousness, which the court deemed “essential to the obviousness analysis.” This included evidence that the Martin EPROM added expense and complexity yet no one in the 11-year interval had suggested removing the EPROM; evidence of ‘overwhelming’ commercial success of the patented products, attributed to the patented features; advertising by both parties touting the patented features; awards to Power Integration; and evidence of Fairchild’s copying (reverse-engineering). In sum, the court found “substantial evidence of objective considerations of non-obviousness to support the jury’s conclusion that claim 1 ... would not have been obvious ....”

The court vacated the damages award based on contributory infringement and remanded the case for reconsideration of claims construction and a new trial on pre- and post-verdict damages for direct infringement. The court vacated, without discussion, the finding that the infringement had been willful, directing the trial court to reconsider that issue in light of the other rulings.

## Prosecution Disclaimer Trips Up Patentee on the Scope of “Device” in a Medical Device Case

Mark Francis

*Saffron v. Johnson & Johnson*, No. 2010-1426, 712 F.3d 549 (Fed. Cir. Apr. 4, 2013)

<http://law.justia.com/cases/federal/appellate-courts/cafc/12-1043/12-1043-2013-04-04.html>

Saffron’s U.S. Patent No. 5,653,760 claims a device for treating an injury (such as a fractured bone) by deploying a cellular or molecular treatment layer at the injury site to encourage regeneration of tissue. Saffron sued Cordis, alleging that its medicated Cypher stents infringe the patent. The parties disputed construction of the term “device,” and the E.D. Texas district court held that it was non-limiting preamble language (even though it also appeared in some claims’ bodies). At trial, the jury returned a verdict for Saffron, finding the patent infringed and valid. After adding pre-judgment interest, the Court awarded Saffron damages just under \$600 million.

On appeal, Cordis argued that a critical feature of the ‘760 patent was a “device” deploying treatment as a sheet (i.e., layer) at the injury site. Cordis focused on Saffron’s overcoming prior art rejections during prosecution by representing to the examiner that “[t]he device used is a sheet rather than a pre formed chamber.” Mindful its prior holdings that “prosecution disclaimer requires clear and unambiguous disavowal of claim scope” the Federal Circuit nevertheless acknowledged that “applicants rarely submit affirmative disclaimers along the lines of ‘I hereby disclaim the following . . .’ during prosecution and need not do so to meet the applicable standard.” The Court therefore construed “device” as limited to deployment of a sheet, and directed judgment of non-infringement for Cordis because stents are mesh structures and the medicated “layer is akin to paint on a chain link fence, not a continuous sheet wrapped around the mesh.”

The Court also reversed the district court’s ruling on the corresponding structure for a 112 ¶ 6 claim

term, holding the structure specifically requires a “hydrolyzable bond” between treatment materials and a device sheet. Because Cordis stents did not use a hydrolyzable bond, the Court directed judgment of non-infringement on these grounds as well.

## International Trade Commission Establishes A 100-Day Initial Determination Procedure For Early Resolution Of Dispositive Issues

Tony V. Pezzano and Jeffrey M. Telep

*Certain Products Having Laminated Packaging, Laminated Packaging, And Components Thereof*, Inv. No. 337-TA-874

[http://www.usitc.gov/secretary/fed\\_reg\\_notices/337/337\\_874\\_notice03222013sgl.pdf](http://www.usitc.gov/secretary/fed_reg_notices/337/337_874_notice03222013sgl.pdf)

On March 22, 2013, the Commission issued a Notice instituting *Certain Products Having Laminated Packaging, Laminated Packaging, And Components Thereof*, Inv. No. 337-TA-874 (“the 874 Investigation”). Unlike the typical Notice of Investigation, the Notice in the -874 Investigation directed Administrative Law Judge Theodore Essex to issue an early decision on whether the Complainant satisfied the economic prong of the domestic industry requirement by initial determination (“ID”) “within 100 days of institution,” subject to a limited extension of the ID for good cause. Because the Complainant in this investigation is a nonpracticing entity (“NPE”), there has been speculation that the Commission may be scrutinizing all NPEs who file a Section 337 Complaint and requiring them to prove their domestic industry before addressing the remaining merits of the investigation. Alternatively this may have been a more limited reaction by the Commission to the Amended Complaint in this investigation. More specifically, the Complaint initially did not allege that the asserted domestic industry was based on money spent on a licensing program in the United States, and subsequently was amended after considering comments by the Office of Unfair Import Investigations (“OUII”) during the 30-day pre-institution period.

As it turns out, this 100-day ID procedure was not intended to be limited to Complaints brought by NPEs or involving an isolated defective pleading. Rather, based on Chairman Williamson's recent comments made to the Spring Meeting of the ITC Trial Lawyers Association ("ITC TLA"), the Commission intends to employ this approach more broadly to address dispositive issues in other investigations, beyond the issue of economic prong of the domestic industry requirement. In fact, the Commission has employed such an approach in the past to address the dispositive issue of patent infringement.

In *Certain Products And Pharmaceutical Compositions Containing Recombinant Human Erythropoietin*, Inv. No. 337-TA-568, during the 30-day pre-institution period, proposed Respondents Roche Holding Ltd., F. Hoffmann-La Roche Ltd., Roche Diagnostics GmbH and Hoffmann-La Roche Inc. (collectively "Roche"), raised the issue with the Commission that all of Roche's importation of the accused product was solely for the purposes of obtaining FDA approval under 35 U.S.C. §271(e)(1), and therefore, the asserted patents were not infringed. Thereafter, the Commission's May 9, 2006 Notice of Investigation directed the ALJ (former Chief Judge Paul J. Luckern) "to consider at an early date any motions for summary determination based upon 35 U.S.C. §271(e)." Judge Luckern subsequently issued a Procedural Schedule requiring an expedited discovery period followed by briefing on Roche's motion for summary determination of noninfringement under 35 U.S.C. §271(e)(1). Judge Luckern granted Roche's motion for summary determination (Fed. Reg. Vol. 71, No. 172). Ultimately, after remand to the ITC following rehearing *en banc* by the Federal Circuit (*Amgen Inc. v. ITC* 565 F.3d 846 (Fed. Cir. 2009)), the investigation was terminated by the ITC on November 9, 2011 on the basis of settlement without issuance of an exclusion order or consent order (Fed. Reg. Vol. 76, No. 203).

Chairman Williamson did not address the specifics of any procedure during the 30-day pre-institution period by which the Complainant or a proposed Respondent or a member of the public could notify the Commission of a dispositive issue that it contends should be subject to the 100-Day ID procedure. In appropriate circumstances, a letter to the Commission during this time period could prompt the Commission to require a 100-Day ID procedure in the Notice Instituting the Investigation.

In any event, the ALJ's comments during the Judicial Panel at the ITC TLA Spring Meeting made clear that the Commission is certainly poised to begin the 100-Day ID procedure for early resolution of dispositive issues in more investigations. Specifically, Judge Essex commented on the -874 Investigation that the expedited hearing was just completed in this case on the economic prong issue and he intends to issue an ID on this issue within the 100-Day period. He advised that this approach may work very well. Chief Judge Bullock then advised that there is a procedure in place for assigning a Judge to an investigation involving a 100-Day ID procedure. This determination is made by the Chief Judge and a factor that is considered is finding a Judge who has a schedule that will least likely be disrupted.

**When does Comity allow Enjoining a Patentee from Enforcing a Patent Injunction obtained in a Foreign Jurisdiction in a RAND Dispute Originating in the U.S.?**

**Peter Dehlinger**

*Microsoft Corporation v. Motorola Mobility, Inc.*, No. 12-35352 (9<sup>th</sup> Cir. April, 2013).

<http://docs.justia.com/cases/federal/appellate-courts/ca9/12-35352/12-35352-2012-09-28.pdf>

This interlocutory appeal concerns an injunction obtained by Motorola against Microsoft in Germany prohibiting Microsoft from selling infringing product in Germany, and a preliminary injunction issued by the district court for Western Washington (hereafter, district court) enjoining Motorola from

enforcing its injunction in Germany. The case is a tangle of contractual rights and obligations involving a standard-setting organization (SSO), the H.264 video coding standards set by the International Telecommunications Union (ITU), and the delicate problem of comity between the courts of different countries.

SSO's, such as the ITU, attempt to mitigate the threat of patent holdup by owners of standard-setting patents by requiring its members to agree to license those patents to all comers on terms that are "reasonable and nondiscriminatory" or RAND. For purposes of the present case, the ITU has a Common Patent Policy that "a patent embodied fully or partly in a standard must be accessible to everyone without undue constraints," otherwise the standard shall not include provisions that rely on the patent. Pursuant to these requirements, Motorola submitted numerous declarations to the ITU stating that it will grant licenses on RAND terms for its H.264-related patents.

In October of 2010, Motorola sent Microsoft a letter offering to license certain of patents essential for H.264, at a proposed royalty of 2.25% per unit for each standard-compliant product. The letter included a list of about 100 U.S. and foreign patents owned by Motorola essential for H.264 compliance, and gave Microsoft a 20-day acceptance period.

In November, Microsoft filed a breach-of-contract suit against Motorola in the district court under Washington state contract law. Microsoft's theory of liability was that Motorola's proposed terms were unreasonable, and that therefore Motorola's offer letter breached its contractual RAND obligations to the ITU, to which Microsoft was a third party beneficiary. A breach of contract action and a patent infringement suit filed by Motorola against Microsoft the next day were consolidated at the district court, which granted partial summary judgment for Microsoft on its contract claims, holding that Motorola entered into a binding contractual obligation with the ITU, and that Microsoft is a third-part beneficiary of Motorola's commitments.

In July, 2011, Motorola sued Microsoft in a German Regional Court, alleging infringement of two of the patents listed in Motorola's earlier offer letter to Microsoft. The German Court ruled on May 2, 2012 that Microsoft did not have a license to use Motorola's patents, rejecting Microsoft's argument that Motorola's RAND commitment to the ITU created a contract enforceable by Microsoft, because German law does not recognize third-party contractual rights. The German Court then held that Microsoft had infringed the two specified Motorola patents, and enjoined Microsoft from any activity involving infringing products in the Federal Republic of Germany.

Following unproductive communications between the parties, and before the German Court issued its decision, Microsoft moved the district court for a temporary restraining order and preliminary injunction to enjoin Motorola from enforcing any injunctive relief it might obtain in the German action. On May 14, 2012, the district court granted a preliminary injunction barring Motorola from enforcing any injunctive relief it might receive.

The district court gave the following rationale for its decision to trump any German court decision. First, the district court concluded that the pending contract action before it would be dispositive of the German patent action, because the European patents at issue in German were included in Motorola's original offer letter to Microsoft, and because Motorola contracted with the ITU to license European patents on RAND terms to all customers. Second, the court determined that the German action raised concerns of inconsistent judgments, particular in that Motorola's commitments to the ITU involved approximately 100 patents, and the German action invoked only two of these. Finally, the district court concluded that the impact of the anti-suit injunction on comity would be tolerable, because the German action was filed after the U.S. action.

The 9<sup>th</sup> Circuit Court of Appeals, which heard the interlocutory appeal, relied heavily on *E & J Gallo Winery v. Andina Licores, S.A.*, 226 F.3d 989 (9<sup>th</sup>



Circuit 2006) and *Applied Med. Distrib. Corp. v. Surgical Co.*, 587 F.3d 909 (9<sup>th</sup> Cir. 2009), which together establish a three-part inquiry for assessing the propriety of an anti-suit injunction involving a foreign court. Applying the three-part test, the appeals court concluded that:

1. The parties and the issues are the same in both actions, and all of the issues in the German patent action can be resolved by the U.S. contract action.
2. The foreign litigation would frustrate the ability of the domestic court to reach a just result. Here the appeals court agreed with the district court “the timing of the filing of the German action raises concerns of forum shopping and duplicative and vexatious litigation,” particular since the German action involved only two of the approximately 100 patents potentially at issue in the U.S. action.
3. The injunction’s impact on comity is tolerable. The fact that the matter at hand was a private contractual dispute rather than a dispute involving public international law of government litigants weighed favorably in this conclusion, as did the order in which the suits were filed, and the limited scope of the injunction, which the appeals court considered “no broader than necessary to avoid the harm on which the injunction is predicated.”

## Appealing a Damage Awards—Lost Profit Calculations and the Danger of Not Appealing Denial of a *Daubert* Challenge

John Harbin

*Versata Software, Inc., et al. v. SAP America Inc, et al.*, Nos. 2012-1029, -1049 (Fed. Cir. May 1, 2013)

Affirming a damages award of \$345 million, the Federal Circuit, in an opinion by Judge Rader, underscored the importance of preserving objections to expert testimony. Versata alleged SAP infringed its patents concerning computer-based product pricing. The technology enabled efficient factoring of variables such as product type and customer type, size, and geographic location, called ‘hierarchical pricing.’ Versata

commercialized its invention in 1995 and applied for the first patent in 1996.

Versata enjoyed strong sales initially. In October 1998, SAP launched its hierarchical pricing product as part of its enterprise software, and the evidence showed that Versata’s sales plummeted, to the point that Versata stopped making significant marketing expenditures. In 2007, Versata sued SAP for infringement.

The case was tried twice. The first jury awarded \$138 million in damages, and the trial court granted SAP a new trial on damages. Before the second trial, SAP adopted a software patch to avoid infringement, but the second jury found that the infringement was continuing, and awarded \$345 million in damages, comprised of \$260 million in lost profits and a \$85 million royalty award. SAP appealed, *inter alia*, the denial of its JMOL motion on damages.

The lost profits issue invoked the four-factor *Panduit* test, which requires showing: (1) demand for the patented product, (2) absence of acceptable noninfringing alternatives, (3) capacity to exploit the demand, and (4) the amount of profit the patentee would have made. *Panduit Corp v. Stahlin Bros. Fibre Works, Inc.*, 575 F.2d 1152, 1156 (6th Cir. 1978).

Under the guise of arguing insufficiency of the evidence, SAP argued that Versata’s “but for” model was inconsistent with sound economic principles so that the expert’s opinion should have been excluded from evidence, and that Versata’s expert did not adhere to the *Panduit* framework for lost profits because he used multiple markets thereby rendering his analysis “legally defective.”

The court rejected these arguments as improperly raised, opining that SAP was questioning the admissibility of Versata’s expert testimony and whether his damages model was properly tied to the facts of the case. Such questions, the court held, should be resolved under the framework of the Federal Rules of Evidence and through a challenge under *Daubert v. Merrell Dow Pharm., Inc.*, 509

U.S. 579 (1993), and SAP did not appeal the denial of a *Daubert* motion. The court held that a ‘sufficiency of evidence’ argument is the improper context for deciding questions of admissibility of expert testimony.

SAP raised other arguments about the sufficiency of the damages evidence that the court considered on the merits and rejected. SAP argued that Versata could not prove demand during the damages period, which began in 2003, because Versata stopped selling its product in 2001. The court held, however, that “[p]atentees may prove lost profits through presenting a hypothetical, ‘but for’ world where infringement has been ‘factored out of the economic picture’”, citing *Grain Processing Corp. v. Am. Maize-Prods. Co.*, 185 F.3d 1341, 1350 (Fed. Cir. 1999). “While the hypothetical, but-for-world must be supported with sound economic proof, ‘[t]his court has affirmed lost profit awards based on a wide variety of reconstruction theories.’”

Because Versata proved demand for Versata’s product before SAP entered the market, including a 35% average win rate, the court found there was sufficient evidence of demand, noting that SAP’s expert admitted there was earlier demand for Versata’s product. Versata proved demand for the patented functionality during the infringement period from SAP’s documents and discovery of customers. While the patentee needs to be selling the item during the damages period, the court stated, that does not mean an item must have actually been sold, and Versata was engaged in ‘selling’ during the period. Also, the court held, the patentee does not need to prove demand for a particular embodiment of the patented functionality. “[T]he Panduit factors place no qualitative requirement on the level of demand necessary to show lost profits.” The court noted that SAP had the ability to cross-examine the damages expert and SAP’s expert had prepared an alternative lost profits analysis but SAP chose not to introduce it.

The court also rejected as contrary to the record SAP’s arguments that Versata did not prove the quantum of lost profits with reasonable probability,

that Versata made assumptions about demand and price elasticity that are inconsistent with the real world, and that Versata did not account for other market forces that might have caused its alleged losses.

Versata’s expert looked at a pool of 480 large customers to whom SAP sold its product during the damages period, and then deducted the 45 who had previously licensed Versata’s product, leaving 435 potential customers. The expert then applied Versata’s 35% win rate as a starting point and adjusted for certain market pressures including an assumption that Versata would not have resumed sales at that high a rate. He ended up opining that Versata lost 93 sales. The expert concluded that the average sales price, including the initial sale and subsequent maintenance and consulting revenue, would average a bit more than \$3 million per sale. The overall total was \$285 million and the jury awarded \$260 million.

The court found the expert adequately adjusted for market variables, costs, and price elasticity, and held that Versata made a prima facie showing of lost profits “and the burden shifted to SAP to prove that a different rate would have been more reasonable.”

Regarding the royalty award, the trial court had excluded the royalty calculation of Versata’s expert so Versata relied on the opinion of SAP’s expert, as modified on cross-examination. On direct, SAP’s expert testified to a hypothetical negotiation under *Georgia Pacific*, and opined that another software product offered by SAP, called Khimetrics, was comparable for damages purposes, that 12 customers had agreed to buy this add-on product, and that a lump-sum royalty of \$2 million would be appropriate in this case.

On cross-examination, SAP’s expert testified the average price paid for Khimetrics was \$333,000, and that a 40% royalty would be appropriate, resulting in a royalty per customer of \$133,200. The expert agreed that, subtracting for sales covered in the lost profits analysis, SAP had made roughly 1300 infringing sales and that applying the

Khimetrics royalty to the number of infringing sales (instead of the 12 buyers of Khimetrics) would result in damages of \$170 million.

The court rejected SAP's argument that this was an improper application of the entire market value rule, opining that the rule was never triggered because SAP's expert did not base the royalty on all of SAP's infringing sales but on the add-on that the expert deemed comparable to the patented technology. The jury, the court found, simply applied the royalty to a large number of infringing sales than SAP wanted, and the award was within the range encompassed by the record.

The court vacated as overbroad the trial court's injunction that prohibited SAP from offering maintenance and support for any of the 'infringing products.' SAP pointed out that the enjoined capability, defined as 'the capability to execute a pricing procedure using hierarchical access of customer and product data' represented only a fraction of the features contained in the infringing products. The court held that "SAP should be able to provide maintenance or additional seats for prior customers of its infringing products, so long as the maintenance or the additional seat does not involve, or allow access to, the enjoined capability." The court directed the trial court to modify the injunction accordingly.

## Patent Notes

**Is the USPTO issuing too many patents of low quality? Judge Posner sounds the alarm**

**Peter Dehlinger**

"The sheer number of patents in the U.S. is fueling frivolous litigation and drastic action is needed to make patents more difficult to obtain and easier to invalidate." according to Judge Richard Posner of 7<sup>th</sup> Circuit Court of Appeals, in comments made at a recent forum with retired Federal Circuit Judges Arthur Gajarsa and Paul Michel. Judge Posner was particularly critical of the glut of patents on relatively minor software innovations, which

"creates confusion and uncertainty about what one can do without running into patent minefields."

Judge Posner's view is that most patents are unnecessary because they grant a monopoly to exclude others from practicing what are often incremental improvements that take little time and investment to develop. Why, in other words, grant a monopoly on an invention unless the invention wouldn't have been made without giving the inventor a monopoly?

While the other two judges agreed that the number of low quality patents that are issued indicates that the PTO has problems that need to be addressed, they were unwilling to go as far as Judge Posner in calling for major reforms to the patent system, such as eliminating the presumption of patent validity and shortening the 20 patent term, at least in technologies like software that have a very short half-life.

Judge Posner's comments will resonate among many patent and industry observers. However, it may be unfair to blame the "patent minefield" problem on the PTO alone, especially given the rise of patent-troll litigation in recent years. This note takes a look at current PTO statistics and trends to see whether Judge Posner's critique of the PTO is justified.

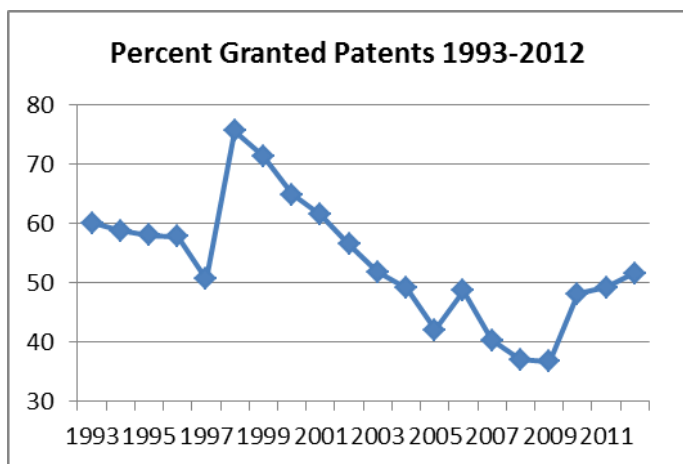
*Is there evidence that the PTO is granting more lower-quality patents?*

One measure of patent quality is the number of patents issued by the PTO, calculated as a percentage of total applications filed. Data for this analysis is available from U.S. Patent Statistic Chart for Calendar Years 1963-2012, accessible at [http://www.uspto.gov/web/offices/ac/ido/oeip/taf/us\\_stat.htm](http://www.uspto.gov/web/offices/ac/ido/oeip/taf/us_stat.htm).

Looking at the past 20-year period only, there has been a steady year-by-year increase in number of utility applications filed and the number of patents granted. In 1993, 174,743 utility applications were filed and 98,342 were granted; by 2003, those numbers had increased to 334,441 and 169,023, respectively; and by 2012, the numbers were at

542,815 and 253,155. Overall, the number of utility applications filed increased nearly 70% and the number of utility patents granted increased by over 60% in the past 20 years.

To examine changes in the “quality” of patents being issued over the 1993-2012 time period, the percentage of granted patents relative to the total number of applications filed was calculated for each year. For this calculation, the average period of pendency for an application was assumed to be 2 years, so the percentage of applications that mature into patents in any year was calculated based on number of applications filed two years earlier. Thus, for example, the percentage of patents issuing in 2012 was calculated as the ratio of patents issuing in 2012 divided by the number of applications filed in 2010. As a measure of patent quality, the numbers are imprecise for a variety of reasons in addition to prosecution-lag time: are patents being granted with narrower or broader claims and is the overall quality of inventions changing over time? More importantly, to Judge Posner’s point, is there a significant variation in quality among the different art units?



Putting these uncertainties aside, one can see from the plot above that standards for patentability have been on a roller coaster for the past 20 years. In 1998, the grant rate peaked at over 75%, then started a 10-year descent to a low of around 37% in 2008 and 2009 before trending upwards again to the current rate of about 50%. The trough in the 2008-

2009 period would correspond to *KSR* and its aftermath; the cause of the peak rates in 1998 and 1999 is less certain, but could be related to patent exuberance associated with the dot.com bubble.

But to return Judge Posner’s criticism, it would appear that the quality of patents issued since 2005 has been better on average than in the years leading up to 2005. In fact, however one feels about Judge Posner’s proposal to do away with the presumption of validity, a patent challenger might very well argue that the presumption should be given less weight for a patent granted in the late 1990’s than in the period since 2004.

*Has high turnover in the USPTO Examining Corps led to lower quality patents?*

A report in 2010 on examiner turnover in the PTO found that the percentage of examiners with less than 3 years’ experience has grown from less than 50% in 1996 to about 80% in 2009, while the percentage of examiner’s with 10+ years has decreased from 20% to less than 10% in the same period. Those numbers are not reassuring, since 3 years is a reasonable estimate of the time required to become a proficient and competent examiner. (see, for example, <http://www.patentlyo.com/patent/2010/02/patent-examiner-experience-levels.html>).

So how does the quality of patents granted by the USPTO stack up against patents granted by the EPO and JPO, both of which have better paid and more experienced examiners? An Encore Report on Patent Office Governance and Patent System Quality, for example, presents statistics from 2008 showing that USPTO examiners are expected to search and examine more than twice the number of claims as their EPO or JPO counterparts, while receiving a total compensation package that is only about 58% of EPO examiners and less than half that of JPO examiners. (the Encore report is accessible at [http://www.ecore.be/DPs/dp\\_1306940512.pdf](http://www.ecore.be/DPs/dp_1306940512.pdf)).

Using the percentage of patents granted/ number of applications filed in any year as a measure of patent quality, the USPTO appears to be holding its own.

# Intellectual Property Newsletter

For the years 2010 and 2011, the percentage of patents granted by the USPTO is slightly greater than 44%. In the EPO, the percentage of granted patents in the same two years is 38% and 43%-- lower than the U.S. numbers but not strikingly so, considering that the percentages in the U.S. were below 38% in the two years following the *KSR* decision. Moreover, the percentages don't reflect specific factors independent of quality that could explain the lower grant rates in the EPO, such as the EPO's stringent "written description" requirements.

Surprisingly, the JPO has a more generous grant rate than either the USPTO or EPO. For the years 2010 and 2011, the percentage of patents granted by the JPO were 64% and 76% respectively, comparable to the US only in the anomalous 1998-2001 time frame. Does this mean that Japan is granting lower quality patents, or (as seems more likely) that the JPO is granting more patents, but with narrower claim scope?

In short, the USPTO seems to be doing a respectable job in examining applications for patentability, despite the funding challenges that have limited the Office's ability to retain experienced examiners.

*What do affirmance rates on appeal say about the quality of patents issued by the USPTO?*

Perhaps the ultimate test of overall patent quality is the affirmance rates for patent validity on appeal before the CAFC or when challenged in a post-grant proceeding. Data on invalidation rates by district courts and the Federal Circuit can be found, for example, at [https://www.morganlewis.com/pubs/Smyth\\_USPatentInvalidity\\_Sept12.pdf](https://www.morganlewis.com/pubs/Smyth_USPatentInvalidity_Sept12.pdf).

Data from 2002 to 2012 shows that most patents being litigated survived an invalidity challenge. Invalidation rates by district courts varied between 12% (2006) and 26% (2007 and 2008), with an average over the 11-year period of slightly more than 20%.

Over the same period, the percentage of patents that were held invalid by the Federal Circuit varied

between about 8% in 2002 and 26% in 2012, consistent with the increased scrutiny that court is giving to the several requirements for patentability.

Data on the rates of claim cancellation and claim changes for patents tested by *ex parte* and *inter partes* reexamination are found, for example, at [www.aipla.org/committees/committee\\_pages/IP...in.../1%20Hill.ppt](http://www.aipla.org/committees/committee_pages/IP...in.../1%20Hill.ppt). Summarized in the table below are the percentages of reexamined patents whose claims have been confirmed, cancelled, or changed. The data show a surprising vulnerability of granted claims when reexamined in an *inter partes* proceeding. Either the PTO is harder on its own patents than the courts are or a more vulnerable group of patents are subject to *inter partes* reexamination than to a court challenge.

	<i>Ex Parte</i> (1981-Sept. 2011)	<i>Inter Partes</i> (1999-Sept. 2011) <small>Note: Limited data</small>
All claims confirmed	23%	11%
Claim changes	66%	44%
All claims canceled	11%	45%

In any case, the patent "failure" rate on reexamination is not too different from that observed for Opposition proceedings in the EPO. Statistics for the years 2000-2006 show that in nearly 60% of opposed patents, granted claims are either amended or rejected, and in 25% of the cases, all of the claims are rejected and the patents revoked.

Based on these various indicators, the quality of U.S. patents doesn't seem seriously out of balance with the quality of patents granted by the EPO or JPO.

## Chinese Supreme Court Opens Up Patent Disputes to Lower Courts

Peter Dehlinger

A recent decision by the Chinese Supreme Court will allow local lower courts to hear patent disputes. The decision was viewed as a step in the wrong direction by many patent observers who were hoping that China would move toward a centralized IP court that, in turn, would lead to more uniform and predictable patent standards.

China's court system has four levels: local or "grassroots" courts, intermediate courts, the high court, and the Supreme People's Court. Currently patent cases are heard at the intermediate court level. The problem, according to the Supreme Court, is that the increase in intellectual property disputes is straining the intermediate court system, where only about 70 or the approximately 400 intermediate courts have judges with experience in patent disputes. Nationwide, China's courts received over 87,419 first instance civil cases relating to intellectual property rights, an increase of 45.99% over the previous year.

While pushing patent cases to the lower courts will relieve the workload at the intermediate level, it could lead to more inconsistent decisions and, because lower courts can be expected to be more friendly to local industry, to increased protectionism. The shift to lower courts may also make it easier for patent trolls to drag multinational companies into patent infringement cases at the local level.

On the brighter side, the Supreme Court's decision may be a positive development in the long-term by relieving the pressure on intermediate courts, which are now forced to decide cases hastily. In other words, the problem of too many patent disputes and too few patent-savvy judges will not be resolved anytime [soon](#).

# Intellectual Property Newsletter

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