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Prepared Statement of

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Introduction

Members of the House Judiciary Committee, thank you for the opportunity to testify before this Committee about the detrimental impact patent assertion entities are having on U.S. businesses through their ever increasing use of the United States International Trade Commission (the "ITC") as a preferred forum for patent assertions. This Committee did extensive work to reform the patent system in the America Invents Act. However, most of those reforms and the improvements in case law that resulted from the Act do not apply to the ITC.

The ITC is an international trade forum charged with protecting U.S. businesses and U.S. consumers from unfair foreign trade practices. The ITC is not a general venue for patent disputes. Nonetheless, patent assertion entities who do not develop, do not make, do not sell and import products are now routinely using the ITC to assert their patents against U.S. operating companies, imposing great expense and burden on them and on U.S. consumers. These assertions in the ITC are injuring rather than protecting our domestic economy.

Prior to 2006, patent assertion entities (companies whose only business is licensing and litigating patents to make money) essentially did not use the ITC. But by 2011, patent assertion entity cases comprised one quarter of ITC investigations instituted, and nearly half of all respondents in the ITC were named in patent assertion entity investigations. This year, 40% of the investigations instituted are patent assertion entity cases, and they comprise 60% of ITC respondents. This is happening because the 1988 Congressional amendments to Section 337 of the Tariff Act of 1930 have been interpreted to require the ITC to accept complaints from entities that invest in ***any*** kind of domestic licensing, including "revenue-driven licensing."

"Revenue-driven licensing" also is sometimes termed "*ex post facto*" licensing. In other words, it is licensing or attempted licensing that occurs ***after*** another company has already sold products allegedly using the patented technology. Generally, the targeted products were independently developed without knowledge of the patent, and it is not uncommon for the patent claims to be drafted after the targeted product has already been sold. This is not the "production-driven licensing" activity, where licenses encourage the development and sales of new products, that Congress intended would satisfy the ITC's jurisdiction requirement when it amended the Tariff Act.

These types of cases have become particularly prevalent in recent years because the remedy the ITC may issue -- an exclusion order that bars a U.S. company from importing its products for sale in the U.S. -- has been unavailable to patent assertion entities in federal court since 2006, when the Supreme Court decided *eBay v. MercExchange*. In that case, the Supreme Court held that injunctive relief may only be awarded to patent holders who satisfy a traditional four prong equitable test for an injunction by proving, among other things, that their patent claims cannot be adequately satisfied by an award of money damages.[1] Patent assertion entities, which by definition are looking for money, have no standing to seek injunctive relief in federal courts. Because of this, they have turned their sights on the ITC as a preferred venue for

[1] *eBay Inc. v. MercExchange LLC*, 547 U.S. 388 (2006).

asserting their patents against U.S. operating companies, in order to threaten them with the prospect of exclusion orders that they would not be able to receive in a federal court. By filing in the ITC, these entities hope to extract more than the true value of the patented technology from U.S. operating companies.

The use of the ITC in this manner should not be allowed. Patent assertion entities do not engage in the kind of domestic licensing activities that should qualify them to use the ITC. Congress did not intend for its trade statutes to allow patent assertion entities who target existing products for licensing revenues to bring their claims in the ITC. The ITC is a trade forum intended to protect U.S. industry and U.S. consumers. It was not intended to be a forum for a few individuals to extract settlements far beyond what they would be entitled to receive if they sued in a U.S. court.

Claims by patent assertion entities can be and are adjudicated in federal district courts empowered to award money damages where appropriate. The ITC is an international trade forum intended to protect U.S. industry. Yet under current ITC practice, it is being used with increasing frequency by patent assertion entities to harm U.S. industry. My testimony addresses this problem of patent assertion entities' increasing filing of claims in the ITC and proposes a solution.

Introduction to Cisco

I am the Vice President of Litigation for Cisco, one of the world's largest developers of networking and telecommunications equipment that powers the Internet, with more than $45 billion in annual sales and over 36,000 U.S. employees. Cisco's success as a company is a direct result of our ability to innovate. Our products originally were designed for communications within private or enterprise networks. When the public Internet emerged in the mid 1990s, our products found immediate application for worldwide use. Today, Cisco's networking equipment forms the core of the global Internet and most corporate and government networks. We invested $5.8 billion in the 2011 fiscal year on researching and developing the next generation of networking equipment, with the goal of making the future of communication faster, more reliable and more secure. We have invested another $4.1 billion in research and development of our products in the first three quarters of fiscal year 2012 alone.

Like all successful technology companies based in the United States, Cisco has experienced a large increase in patent litigation over the past 5-10 years from entities that do not design, develop or sell any products. These entities who are suing Cisco are not universities, but instead are entities staffed by lawyers and backed by financiers who seek to profit from patent lawsuits. Of the dozens of patent infringement lawsuits currently pending against Cisco, virtually all of them were brought by patent assertions entities.

Over the past two years, patent assertion entities have begun filing claims against Cisco in the ITC. In calendar year 2011, approximately 60 ITC investigations were initiated by the Commission and Cisco was a respondent in about 5% of all cases filed in the ITC in that period. Looking at it another way, Cisco was a named respondent in exactly one ITC case up until 2010 (which was filed by a US practicing entity). Since the beginning of 2010, Cisco has been a named as a respondent in five matters, nearly all of which were filed by patent assertion entities.

The ITC's Role as an International Trade Forum Rather Than an Intellectual Property Forum

Complaints filed by patent assertion entity are turning the ITC into general patent forum. This is inconsistent with the role of the ITC as provided in its governing statute. The ITC is "an independent federal agency whose strategic operations are to determine import injury to U.S. industries in antidumping, countervailing duty, and global and bilateral safeguard investigations; direct actions against unfair trade practices involving patent, trademark, and copyright infringement; support policymakers through economic analysis and research on the global competitiveness of U.S. industries; and maintain the Harmonized Tariff Schedule of the United States."[2] The ITC is a trade forum whose mission is to protect U.S. industries and U.S. consumers from injuries they suffer from unfair foreign competition. Where appropriate, the ITC may issue an exclusion order to prohibit unlawful importation of an infringing product, where importation harms a domestic U.S. industry in articles protected by that patent.

The ITC is not, however, empowered to hear any and all U.S. patent infringement disputes. U.S. federal district courts have exclusive jurisdiction over most patent infringement lawsuits, where they can award relief such as monetary damages. The ITC only has authority to adjudicate patent disputes that involve unfair foreign imports that negatively impact U.S. industry. In particular, because the ITC exists to protect U.S. industry, the ITC is empowered to issue an exclusion order in a patent case only if "an industry in the United States, relating to the articles protected by the patent, . . . exists or is in the process of being established." (19 U.S.C. Section 1337). A patent owner can satisfy this domestic industry requirement in a patent case in one of three ways:

- By showing significant investment in plant and equipment in the U.S. related to an article protected by the patent;
- By showing significant employment of labor or capital in the U.S. related to an article protected by the patent; or
- By showing substantial investment in exploiting the patent via engineering, R&D or licensing in the U.S.

It is the third method of satisfying the domestic industry requirement -- exploiting patents via "licensing" investments in the U.S. -- that I will focus on in these comments. In particular, patent assertion entities, which do not design, develop, make, or sell any products, often rely upon the statute's reference to a "substantial investment" in "licensing" of articles protected by the patent to claim that they have a domestic U.S. industry in need of protection. In addition, such patent assertion entities often rely upon the domestic activities of their unwilling licensees (unwilling because most such licenses are agreed upon in settlement of litigation or after the licensee has been threatened with patent litigation on its existing products).

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[2] *United States International Trade Commission Strategic Plan*, Fiscal Years 2009-2014, available at http://www.usitc.gov/press_room/documents/strategic_plan_2009-2014.pdf

But this statutory language, added by Congress in 1988, should not apply to the "revenue-driven licensing" model. Patent assertion entities engaged in "revenue-driven licensing" target already existing products for licensing revenues. Congress added the "licensing" language to the Tariff Act in 1988 to permit a domestic industry based upon a substantial investment in production-driven licensing by patentees, such as universities or U.S. production companies, who had made substantial investments in developing technology and engaged in "production-driven licensing" to commercialize that technology -- licensing efforts that promote the adoption and use of a patented technology and create new products and industries. A "production-driven license" generally is between two willing parties; one party that developed the technology and another party that wants to use the technology to create its own products. "Revenue-driven licensing," by contrast, seeks to use patents, not as a basis for creating new goods, but rather for extracting licensing fees from others for sales of products that were already in the marketplace. "Revenue-driven licenses" generally involve an unwilling party who developed its products on its own and then entered into a subsequent license, often during or under threat of litigation. Further, in many of these cases, the patent holder did not even develop the technology, but instead purchased the patents from the original inventor.

We believe Congress intended to protect a domestic U.S. industry of new products created through licensing, not to create a windfall for those who seek to make money from suing operating companies after those companies have created and developed new products through their independent efforts and investments in the United States.

Increasing Use of the ITC by Patent Assertion Entities Harms U.S. Industry

The increasing use of the ITC by patent assertion entities (entities whose business is "revenue-driven licensing") appears attributable in substantial part to a Supreme Court case that has made real progress in balancing the enforcement of patents in the federal district courts, but that has been held to not apply to the ITC. In 2006, the U.S. Supreme Court issued its *eBay v. MercExchange* decision which made clear that patentees who can be adequately compensated with monetary damages, such as a reasonable royalty, should not be awarded permanent injunctions as a matter of course as had been the past practice. Rather, district courts should apply a four part test to evaluate the equities of granting injunctive relief. Under that test, patent assertion entities, which exist only to assert patents and collect money, do not have standing to obtain a permanent injunction. While they may pursue a reasonable royalty, they cannot use the threat of a permanent injunction to unfairly coerce U.S. operating companies to pay exorbitant and unreasonable royalties.

Since the *eBay* decision issued, patent assertion entities have sought to try to find new ways to impose the threat of an injunction against U.S. operating companies, in order to extract excessive royalties. Because the ITC may award exclusion and cease and desist orders in patent proceedings, these entities increasingly have used the ITC as a preferred forum for patent assertion. Indeed, prior to the *eBay* decision, patent assertion entities essentially did not use the ITC. However, the year following that decision, the ITC instituted four investigations brought by patent assertion entities, and the trend has continued ever since.

Although many companies believe that the domestic industry provisions of our trade statutes should prevent patent assertion entities from routinely using the ITC this way, case law has recognized a licensing model called "revenue-driven licensing" as being within the ambit of the statute.[3] Although the ITC has concluded that "revenue-driven licensing" is entitled to "less weight" than the "industry-creating, production-driven licensing activity that Congress meant to encourage" in its statute, ITC case law interprets the Tariff Act of 1930, as amended, as recognizing all licensing including "revenue-driven licensing."[4] Further, the ITC may consider the U.S. activities of such unwilling revenue-driven licensees as part of the domestic industry of the licensor. In light of this expansive interpretation of the licensing provision of the ITC statute, patent assertion entities routinely use the ITC as a preferred forum for their disputes, relying upon "revenue-driven licensing" to claim a substantial investment in licensing, rather than the "production-driven licensing" intended to be protected by Section 337.

Statistics unquestionably bear this out. Last year, we estimate that approximately ¼ of all ITC cases were filed by patent assertion entities, with the ITC reporting record breaking levels of ITC case filings. And, this figure understates the actual impact of these ITC cases because approximately 50% of all respondents named in an ITC investigation last year were respondents in ITC investigations filed by patent assertion entities. Further, based on the data available for this year, patent assertion entity cases account for over 40% of the entire 337 ITC docket and respondents in those cases account for over 60% of all respondents. Consistent with these observations, in the ITC's Budget Justifications for every year from FY 2008 to FY 2012, the ITC has noted its expanding case load, and has attributed this in substantial part to the availability of exclusionary relief in the ITC. In its Budget Justification for FY 2012, the ITC specifically referred to the *eBay* case as a contributing factor for this difference in remedies and the attractiveness of the ITC as a forum for patent suits.[5] The ITC has become so inundated with patent proceedings that it has noted the exceptional demands patent cases are placing on its budgets and staff, for example, supplementing its Human Capital Plan for 2009-2013 to change its procedures to reflect a record breaking increase in patent litigation.[6] Likewise, the FTC reported in 2011 that the *eBay* decision may be the cause of this activity and suggested that the ITC should only find domestic industry where there is a production-driven licensing activity.[7]

This increased use of the ITC by patent assertion entities is detrimental to the U.S. economy in many ways, and I will discuss one example involving Cisco below. Patent assertion entities -- often staffed by lawyers and backed by financiers -- purchase patents for the sole purpose of asserting them against operating companies as a tax on an operating company's research and development efforts. These entities are engaged in "revenue-driven licensing." Although "revenue-driven licensing" is recognized by the ITC as being entitled to "less weight"

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[3] *See, e.g., Certain Multimedia Display and Navigation Devices and Systems, Components Thereof, and Products Containing Same*, Inv. No. 337-TA-694, Comm'n Op. at 15 (Aug. 8, 2011).

[4] *Id*.

[5] U.S. International Trade Commission , *Budget Justification Fiscal Year 2012* at p. 21, available at http://www.usitc.gov/press_room/documents/budget_2012.pdf.

[6] U.S. International Trade Commission, *Supplement to the Strategic Human Capital Plan 2009-2013*, January 2011, available at http://www.usitc.gov/intellectual_property/documents/2009_13_SHCP.pdf

[7] FTC, *The Evolving IP Marketplace: Aligning Patent Notice and Remedies with Competition*, 29-30 (Mar. 2011).

than the “industry-creating, production-driven licensing activity that Congress meant to encourage,” the ITC still permits “revenue-driven licensing” to qualify for a domestic industry because the case law suggests all licensing activities qualify. “Revenue-driven licensing,” however, results in no new products; it merely raises the prices of existing products. Firms engaged in “revenue-driven licensing” are not a domestic industry that needs to be protected from foreign competition.

In addition to burdening U.S. industries and harming U.S. consumers, these cases also are straining the resources of the ITC. Patent assertion entity litigation has shifted the ITC from an administrative agency charged with protecting U.S. manufacturers and securing U.S. jobs to a generalized intellectual property court routinely used by patent assertion entities to place a tax on the development and sales of actual products by U.S. based companies. Patent assertion entity cases undermine the ITC’s purpose of protecting domestic industry from unfair foreign competition.

Cisco’s Recent History in the ITC Illustrates the Disproportionate Impact ITC Cases Can Have on Operating Companies

Patent assertion entity litigation before the ITC is particularly injurious to U.S. operating companies and the domestic economy because of the disproportionate costs such litigations impose. For example, although ITC cases comprise only about 10% of Cisco’s overall litigation docket, these few cases account for almost half of our overall litigation budget. Cisco spends more than ten million dollars defending individual actions in the ITC. Cisco’s experience in this respect is consistent with experiences described in legal trade journals, such as the American Lawyer’s law.com publication, which reported back in 2009 that litigating just one ITC case can “easily cost $10 million or more.”[8]

ITC cases are disproportionately expensive because the ITC allows for broader discovery than do the district courts. For example, the Federal Rules of Civil Procedure limit the number of interrogatories and substantive requests for admissions that can be asked of a party to 25, and limit the number of depositions of a side to ten. The ITC does not. In a recent ITC proceeding, a complainant asked Cisco over ***7,000*** Requests for Admission (6,975 more than a district court would permit) that had to be answered in short time frames. Similarly, the ITC does not limit the number of interrogatories a party can ask, although some Administrative Law Judges permit 175 interrogatories per party, which is still seven times the amount permitted by the Federal Rules for a district court matter. Depositions are typically not limited in number, either. In a recent case, 22 Cisco witnesses were deposed in 28 days, more than double the ten allowed by the Federal Rules. Cisco also produced over 3.5 million pages of documents in an extremely short time frame required by the ITC rules.

These enormous costs are becoming routine in cases brought by patent assertion entities. A recent example of such a case involving Cisco is Investigation No. 337-TA-778, *In the Matter of Certain Equipment for Communications Networks, Including Switches, Routers, Gateways, Bridges, Wireless Access Points, Cable Modems, IP Phones, and Products Containing Same*.

[8] *ITC Patent Disputes Continue to Provide Steady, Profitable Work* (Law.com, 2009).

Although we believe that the ALJ in charge of our Investigation did an excellent job adjudicating the matter -- taking unprecedented steps to address misconduct by our opponent -- the matter still consumed over ten million dollars in legal fees and costs, and imposed countless hours of business distraction on our company.

Complainant in the 778 Investigation was Mosaid Technologies, a company headquartered in Ottawa, Canada, that at the time of filing was publicly traded on the Canadian stock exchange, and in the business of patent acquisition and enforcement. Mosaid purchased a portfolio of patents from a failed Israeli company and then sent Cisco an unsolicited letter claiming that Cisco needed to license the patents. In 2010, after Mosaid accused Cisco of infringing these patents, Cisco filed a declaratory judgment action in the United States District Court for the District of Delaware seeking to establish that its products did not infringe and that the patents were invalid. In May 2011, apparently unhappy with what Mosaid claimed to be the slow pace in the district court, Mosaid brought claims against Cisco in the ITC accusing Cisco of infringing some of the same patents-in-suit in Delaware. Mosaid claimed, among other things, that it had a domestic industry based upon its licensing activities for the patents-in-suit and the activities of its alleged licensees. And, in a transparent attempt to enhance its domestic industry case (given that it is a Canadian company), Mosaid rushed to open its only "office" in the United States -- in Plano, Texas -- shortly before filing its ITC complaint against Cisco. But that was just the beginning. Mosaid had to rely on the "licensing" prong to show a domestic industry, so it Mosaid served subpoenas on two third parties, including at least one of its licensees, requesting documents and testimony from them to support Mosaid's domestic industry claims. In a further attempt to bolster its claims, Mosaid improperly gave inducements to these two third parties in order to generate "goodwill" from them to respond to the subpoenas that they were legally obligated to respond to under the law.

After Cisco's counsel learned of these facts, Cisco filed a motion to preclude Mosaid from relying on any evidence connected to Mosaid's misconduct. The ALJ ruled in Cisco's favor, finding that Mosaid improperly compensated third parties to obtain evidence from them in support of Mosaid's claims. The ALJ then took an unprecedented step of ordering the trial of Mosaid's case to proceed first on domestic industry, expressing skepticism over whether Mosaid could establish a domestic industry in light of the sweeping exclusion of evidence. After several of these orders had issued, on the eve of trial Mosaid dismissed its entire ITC case – sending the parties back to Delaware where they had started. Cisco had by then spent thirteen million dollars litigating in the ITC. Cisco produced in excess of 3.5 million pages of documents, responded to 121 interrogatories (five times the amount permissible in a district court case), and presented 22 of its personnel for depositions over a period of 28 days (more than double the number permitted in a district court case), all within an expedited time frame.

Although Cisco greatly appreciates the time and attention that the ALJ put into the Mosaid matter, and the public orders that preceded the dismissal, Cisco believes that as a matter of public policy this case should not have been before the ITC in the first place. Mosaid is a Canadian company; other than its purported Plano office opened just before the ITC complaint was filed, it has no U.S. presence. More important, it has no product business and so it sought to rely upon licenses it entered into after it purchased the patents-in-suit. If the current proposed amendments had been in place, Mosaid would not have been able to make even a colorable argument that it satisfied the domestic industry requirement.

This matter caused Cisco to spend millions of dollars that could otherwise have supported the research and development of Cisco's own products. Every dollar spent on ITC litigation detracts from Cisco's ability to employ people in the United States to develop new products. And Cisco is but one example. Last year, over 230 respondents in the ITC were named in investigations initiated by patent assertion entities. This trend harms U.S. competitiveness, U.S. industry and U.S. consumers, and detracts from the ITC's guiding principle to protect U.S. competitiveness, U.S. industry and U.S. consumers from unfair foreign competition.

Congressional Legislation Clarifying when Licensing May Support a Domestic Industry and Confirming Applicability of the *eBay* Factors Would Benefit U.S. Industry

Cisco appreciates the efforts by the ITC -- including its Commissioners, Administrative Law Judges, Office of General Counsel, and Staff -- to handle a burgeoning caseload of patent infringement proceedings and the ITC's focus on domestic industry and public interest issues. Cisco also appreciates the ITC's ongoing efforts to explore ways to reduce costs such as developing electronic discovery guidelines.

Cisco believes there is a simple solution to the problem posed by patent assertion entities and their "revenue-driven licensing" models. Specifically, Congress should amend Section 337 of the Tariff Act of 1930 to clarify that complainants in the ITC cannot rely on "revenue-driven licensing," or the activities of revenue-driven licensees, to satisfy the domestic industry requirement and gain access to the ITC. Instead, a domestic industry can be established only through licensing efforts that promote the market adoption and use of the patented technology, *i.e.*, where the license was entered into before the licensee's adoption and use of the patented technology. The Federal Trade Commission has made a similar recommendation in its March 2011 Report, *The Evolving IP Marketplace: Aligning Patent Notice and Remedies with Competition*. Congress should state that the ITC should only grant exclusion orders in accordance with traditional equitable factors as set forth in *eBay*. Doing so would align the ITC with traditional principles of equity set forth in the Supreme Court's *eBay* decision.

Patent assertion entities would still have federal courts available to them and could still pursue fair monetary damages if they showed ownership of a valid and infringed patent and an entitlement to damages. And domestic manufacturers and universities would continue to benefit from the ITC's protections. What patent assertion entities would lose is the ability to use the ITC to threaten companies with the prospect of an exclusion order, and the certainty of an extraordinarily expensive patent litigation, to obtain settlements far in excess of the true value of the patented technology. This litigation tactic does not benefit any U.S. industry.