

**INTERNATIONAL TRADE COMMISSION AND
PATENT DISPUTES**

HEARING
BEFORE THE
SUBCOMMITTEE ON
INTELLECTUAL PROPERTY,
COMPETITION, AND THE INTERNET
OF THE
COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES
ONE HUNDRED TWELFTH CONGRESS
SECOND SESSION

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CONTENTS

JULY 18, 2012

	Page
OPENING STATEMENTS	
The Honorable Bob Goodlatte, a Representative in Congress from the State of Virginia, and Chairman, Subcommittee on Intellectual Property, Competition, and the Internet	1
The Honorable Melvin L. Watt, a Representative in Congress from the State of North Carolina, and Ranking Member, Subcommittee on Intellectual Property, Competition, and the Internet	3
The Honorable John Conyers, Jr., a Representative in Congress from the State of Michigan, Ranking Member, Committee on the Judiciary, and Member, Subcommittee on Intellectual Property, Competition, and the Internet	4
WITNESSES	
Colleen V. Chien, Professor, Santa Clara University School of Law	
Oral Testimony	7
Prepared Statement	10
David B. Kelley, Intellectual Property Counsel, Ford Global Technologies, LLC	
Oral Testimony	23
Prepared Statement	24
Neal A. Rubin, Vice President of Litigation, Cisco Systems, Inc.	
Oral Testimony	27
Prepared Statement	29
Bernard J. Cassidy, General Counsel and Executive Vice President, Tessera Technologies, Inc.	
Oral Testimony	35
Prepared Statement	37
Albert A. Foer, President, American Antitrust Institute	
Oral Testimony	47
Prepared Statement	49
APPENDIX	
MATERIAL SUBMITTED FOR THE HEARING RECORD	
Attachments to the Prepared Statement of Colleen V. Chien, Professor, Santa Clara University School of Law	76
Material submitted by Bernard J. Cassidy, General Counsel and Executive Vice President, Tessera Technologies, Inc.	145
Material submitted by the Honorable Melvin L. Watt, a Representative in Congress from the State of North Carolina, and Ranking Member, Subcommittee on Intellectual Property, Competition, and the Internet	172
Letter from Catherine A. Novelli, Vice President, Worldwide Government Affairs, Apple Inc.	247

OFFICIAL HEARING RECORD

MATERIAL SUBMITTED FOR THE HEARING RECORD BUT NOT REPRINTED

Federal Trade Commission report entitled “The Evolving IP Marketplace, Aligning Patent Notice and Remedies With Competition,” submitted by the Honorable Zoe Lofgren, a Representative in Congress from the State of California, and Member, Subcommittee on Intellectual Property, Competition, and the Internet. This submission is available at the Subcommittee and can also be accessed at:

<http://www.ftc.gov/os/2011/03/110307patentreport.pdf>

Item entitled “Patently Protectionist? An Empirical Analysis of Patent Cases at the International Trade Commission,” submitted by Colleen V. Chien, Professor, Santa Clara University School of Law. This submission is available at the Subcommittee and can also be accessed at:

<http://ssrn.com/abstract=1150962>

Paper entitled “Protecting Domestic Industries at the ITC,” submitted by Colleen V. Chien, Professor, Santa Clara University School of Law. This submission is available at the Subcommittee and can also be accessed at:

<http://ssrn.com/abstract=1856608>

INTERNATIONAL TRADE COMMISSION AND PATENT DISPUTES

WEDNESDAY, JULY 18, 2012

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON INTELLECTUAL PROPERTY,
COMPETITION, AND THE INTERNET,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The Subcommittee met, pursuant to call, at 10:07 a.m. in room 2141, Rayburn House Office Building, the Honorable Bob Goodlatte (Chairman of the Subcommittee) presiding.

Present: Representatives Goodlatte, Coble, Chabot, Issa, Jordan, Marino, Adams, Amodei, Watt, Conyers, Berman, Chu, Deutch, and Lofgren.

Staff Present: (Majority) Blaine Merritt, Subcommittee Chief Counsel; Olivia Lee, Clerk; and (Minority) Stephanie Moore, Subcommittee Chief Counsel.

Mr. GOODLATTE. The Subcommittee on Intellectual Property, Competition, and the Internet will come to order.

I will recognize myself for an opening statement.

Our Subcommittee had much to celebrate following passage of the Leahy-Smith America Invents Act, or AIA. The most comprehensive change to American patent law in 175 years, the AIA addresses a number of issues. The dynamic that compelled our Subcommittee to debate patent reform for 6 years was the prevalence of frivolous patent suits that drained resources from R&D projects and compromised job creation in several industries. I am confident that several of the AIA reforms, such as post-grant review, changes to joinder and U.S. district court litigation, and a transitional program to scrub business method patents, will rid the system of many of these bogus lawsuits.

One would think that such a legislative accomplishment obviates the need for the Subcommittee to conduct additional patent review in this Congress. Unfortunately, that is not the case. Today's hearing focuses on the operations of the International Trade Commission, or ITC, and how that organization handles patent disputes.

Increasingly, many high-profile patent disputes are adjudicated before the ITC. The Commission is an independent, quasi-judicial government agency that provides nonpartisan counsel to the legislative and executive branches of the government. It assesses the impact of imports on U.S. industries, maintains the Harmonized Tariff Schedule of the United States, and oversees actions against

certain unfair trade practices, including subsidies; dumping; and patent, trademark, and copyright infringement.

As part of the Trade Act of 1974, Congress created the modern ITC along with its main attributes: independence as a Federal agency, final decision-making authority subject to a Presidential veto, the power to issue cease and desist as well as exclusion orders, formalized coverage of unfair trade proceedings by the Administrative Procedure Act, or APA, and a requirement that the Commission issue decisions with dispatch.

Agency proceedings regarding patent infringement are governed by Section 337 of the Tariff Act of 1930 as well as the adjudicative provisions of the APA and the Commission's procedural rules that are typically supplemented by ground rules issued by the presiding administrative law judge. Section 337 declares the infringement of certain statutory intellectual property rights and other forms of unfair competition in import trade to constitute unlawful practices. Most Section 337 investigations involve allegations of patent or registered trademark infringement.

To be successful, a complainant must prove the following elements: first, the existence of unfair methods of competition or unfair acts in the importation of articles into the United States. For patent cases, infringement of a valid U.S. patent constitutes an unfair act. And, second, the importation of articles or the sale of such articles in the United States, the threat of which is to destroy or substantially injure a domestic industry. This also includes preventing the establishment of such an industry or restraining or monopolizing trade and commerce in the United States.

Remedies for Section 337 violations generally consist of either a limited exclusion order that is directed to a respondent specifically found to have violated Section 337 or a general exclusion order that applies to all infringing goods, whatever the source. A general exclusion order has sweeping application and therefore requires a complainant to demonstrate that the remedy is necessary to prevent circumvention of a limited exclusion order or because there is a pattern of statutory violation and it is difficult to identify the source of the infringing goods.

Prior to the Supreme Court's 2006 decision in *eBay v. MercExchange*, the issuance of injunctions in patent disputes was almost automatic. But the Court's ruling that the traditional four-factor injunctive relief test applies equally to patent disputes now means that a patent holder has, on average, a one-in-three chance of securing an injunction from a U.S. district court. By contrast, a patent holder who prevails in the ITC is virtually guaranteed to obtain an exclusion order, the functional equivalent of an injunction, absent truly exceptional public interest concerns.

This has become of great interest to patent trolls who do not commercialize their patents. eBay restricts their access to injunctive relief in U.S. district court, but it is technically possible for them to fulfill the domestic industry requirement of ITC adjudication through licensing activities. The advent of globalization has led to a migration of manufacturing resources from the United States to other countries.

This reality, combined with particular elements of ITC practice, has made the Commission an increasingly attractive forum for all

patent holders to defend their property rights. In fact, the average number of ITC complaints filed annually during the past decade is nearly triple the average for the previous decade. And at least one study indicates that many of the complainants are larger firms with multiple product lines and valuable patent portfolios that have a better chance to win in the ITC than in U.S. district court.

However, according to some reports, over the past half-decade we have also seen a dramatic increase in the number of cases brought at the ITC by nonpracticing entities as well as the number of defendants named in these cases. The number of defendants in these cases grew from 22 in 2010 to 232 in 2011. This begs the question of whether certain parties are flocking to the ITC in the wake of the stricter joinder rules and other provisions enacted as a part of the America Invents Act.

Given the Commission's burgeoning and high-profile caseload, it is a good time for our Subcommittee to conduct an oversight hearing about ITC operations and how the agency handles patent disputes. The scope of the hearing is free-ranging and will address any relevant topic, but the Subcommittee will certainly want to address such issues as whether ITC rulings complement or conflict with U.S. district court decisions, how the ITC treats standard-essential patents, how a plaintiff satisfies the domestic industry requirement of an investigation, and whether exclusion orders are too cavalierly granted.

That concludes my opening statement, and I am now pleased to recognize the Ranking Member of the Subcommittee, the gentleman from North Carolina, Mr. Watt.

Mr. WATT. Thank you, Mr. Chairman.

Let me start by thanking Chairman Goodlatte for two things: number one, his excellent summary of some of the concerns that have been raised that give rise to this hearing. By going into such detail, it enables me to gloss across the surface of a number of things. And what an excellent presentation.

Second, I want to thank Chairman Goodlatte and his staff for their willingness to expand the witness panel. We usually have three or four witnesses, but today we have five. And that is important. By doing so, it enabled us to invite Bernard Cassidy from Tessera, a company that specializes in microelectronic solutions, which, in addition to having a facility in my congressional district in Charlotte, North Carolina, will provide some different perspectives on some matters for which there is otherwise near-unanimity on the panel. And while I may not agree with everything Mr. Cassidy will have to say, I always think it is important to hear the full range of perspectives on these issues. And I am happy to welcome Mr. Cassidy here today from my congressional district.

Over the past several months, there have been numerous reports of patent wars within the tech and other industries. The technology titans especially have been embroiled in contentious battles accusing each other of infringing each other's patents. Companies that previously cross-licensed their technologies in the marketplace now instead engage in tactics designed to undermine their rivals.

In addition, companies are expanding their patent portfolios by purchasing hundreds and thousands of patents to bolster their ability to counterclaim. In July 2011, a consortium of companies, in-

cluding Apple and Microsoft, bought 6,000 Nortel patents in an auction for \$4.5 billion. In August 2011, Google purchased Motorola Mobility, including its 17,000 patents, for \$12.5 billion. In April 2012, Microsoft purchased 925 patents from AOL for \$1.1 billion. And Facebook, also in April of this year, purchased 650 of the 925 AOL patents from Microsoft for \$550 million. These expanding patent arsenals certainly do not signal a retreat in the patent arms race.

While robust enforcement of intellectual property rights, including by litigation, is a necessary and often an effective means to further innovation and restore order to the marketplace, a recent migration of patent infringement actions to the International Trade Commission has intensified concerns about the possibility of patent holdups, in which patent holders can use the threat of an exclusion order banning infringing products from entering the country, often as an unfair negotiating tool.

Patent holdups are particularly concerning where standard-essential patents are involved. Last month, Chairman Smith, Ranking Member Conyers, and I wrote a letter to the ITC in which we cautioned that, quote, “the ability to leverage standard-essential patents to obtain an exclusion order may result either in these products being excluded from markets altogether or in companies paying unreasonable royalty rates to prevent an exclusion,” close quote. In either case, the consumer loses.

The uptick in cases before the ITC has also reinvigorated calls for Congress to address the so-called patent trolls. The 2006 Supreme Court decision in *eBay v. MercExchange* arguably made it substantially, some would say decisively, more difficult for patent holders to obtain injunctions against infringing products by requiring parties to justify why money damages are insufficient to remedy the infringement. Perhaps, as a consequence, it is argued, entities that own but do not practice or otherwise commercialize their patents find the ITC a more favorable forum to extract undeserved settlements.

I know our witnesses have passionate views to share about the extent to which these activities foster an uncompetitive environment and stifle innovation. So I will conclude with the observation that, in my view, whether we are talking about battles between industry leaders in the technology space or those so-called trolls preying upon the deep pockets of those leaders, it is time for the patent wars to find patent peace. They are a drain on the economy, a tremendous diversion of resources away from innovation, and ultimately not good for the consumer or the country.

I look forward to hearing the various perspectives and proposed solutions from our witnesses, and again thank the Chairman for the hearing and yield back.

Mr. GOODLATTE. I thank the gentleman.

The Chair is pleased to recognize the Ranking Member of the Judiciary Committee, the gentleman from Michigan, Mr. Conyers.

Mr. CONYERS. Thanks, Chairman Goodlatte.

Today’s hearing is to look at the specifics of how the International Trade Commission process is used to protect the American industry and property. But I would like to frame my comments by reminding that our system should first and foremost protect com-

petition and the American workers who create intellectual property from monopolistic and anticompetitive practices that unfortunately are too much in existence at the present time. That is why I think this is a good hearing, and I look forward to the comments from our witnesses on this part of our responsibilities.

Now, against the backdrop of deregulation, offshore cash-hoarding, insufficient antitrust enforcement, our government is at a crossroads when it comes to protecting our workers and our consumers. The patent litigation system should protect American ideas and lay the foundation for American enterprise, but it shouldn't be distorted to favor those with the largest budgets and cash reserves. And I am hopeful that the International Trade Commission is accomplishing that objective.

The large, more or less monopolistic players have taken to collecting patents as a way to attack competitors. It has just become a part of the competition that goes on. And, of course, it ends up concentrating market power in an unhealthy way. Patents have never been more valuable than they are now, and the large corporations have taken to collecting patents as a legitimate competitive tool to concentrate market power. And I hope this concern is examined as carefully as we can with the time we have.

Now, I believe that antitrust review must play an increased role in the functioning of Standards-Setting Organizations, SSOs. Standards-Setting brings competitors together to work on an industry's future so that we must make sure that there is less competitive activity occurring—maybe, ideally, no competitive activity occurring. Standards for interoperability and access are crucial to the development of high technology, and most evident, at the moment, in the evolution of mobile smart phones.

Now, *eBay v. MercExchange*, the Supreme Court decision, is cited by my staff as a mostly good decision, that injunctive relief can only be awarded to patent holders who satisfy the traditional four-prong equitable test for an injunction. To file suit in the ITC, a patent owner must meet the domestic industry requirements, which can be shown by demonstrating substantial investment in the patent's exploitation, including engineering, research, and development, or licensing.

Now, it is not clear how much of the rise in ITC litigation is caused by patentees seeking to avoid the *eBay* court decision, but this is because IT litigation has been increasing prior to the 2006 decision. So, more than any other time that I can recall, we need a more effective and efficient patent system, and that is why we are here.

Thank you, Mr. Chairman.

Mr. GOODLATTE. I thank the gentleman.

Without objection, other Members' opening statements will be made a part of the record.

And we will turn to our witnesses. Each of the witnesses' written statements will be entered into the record in its entirety. I ask that each witness summarize their testimony in 5 minutes or less.

To help you stay within that time, there is a timing light on your table. When the light switches from green to yellow, you will have 1 minute to conclude your testimony. When the light turns red, it signals that the witness' 5 minutes has expired.

And as is the custom with this Subcommittee, I would ask that the witnesses stand and be sworn.

[Witnesses sworn.]

Mr. GOODLATTE. We have a distinguished witness panel today.

Our first witness is Colleen Chien, Assistant Professor at the Santa Clara University School of Law in the congressional district of the gentlewoman from California, Ms. Lofgren. And I believe this is the second law professor from Santa Clara we have had just within the last month testify before this Subcommittee.

And I have had the opportunity to visit Santa Clara on a number of occasions for State of the Net West conferences. So you are very welcome.

Professor Chien is nationally known for her research and publications surrounding domestic and international patent law and policy issues. Her work has been cited by the Federal Trade Commission and in Congress. She has testified before government agencies on patent issues, frequently lectures at national law conferences, and has published several in-depth empirical studies on topical patent matters. She is an expert on the International Trade Commission, a topic on which she has authored several articles.

Prior to joining the Santa Clara law faculty in 2007, Professor Chien prosecuted patents at a San Francisco law firm, served as an advisor to the School of Social Medicine at Harvard Medical School, worked as a spacecraft engineer at NASA's Jet Propulsion Lab, and was an investigative journalist at the Philippine Center for Investigative Journalism as a Fulbright Scholar. She earned her A.B. and B.S. in Engineering from Stanford University and her law degree from Boalt Hall at the University of California, Berkeley—a well-rounded a witness, I would say.

Our next witness is David B. Kelley, Intellectual Property Counsel for Ford Global Technologies. Mr. Kelley handles a wide variety of IP matters for Ford, including litigation management, licensing evaluation, and invention docket management. Prior to joining Ford, Mr. Kelley was an associate attorney at a large IP law firm and practiced several years as a civil litigator. He earned degrees in Computer Science and Mechanical Engineering from Michigan State University and a law degree from the University of Toledo.

Our next witness is Neal Rubin, Vice President of Litigation at Cisco Systems. In that capacity, Mr. Rubin is responsible for managing the company's portfolio of commercial intellectual property and employment litigation as well as other business disputes. In addition to hiring outside counsel and resolving litigation worldwide, Mr. Rubin counsels Cisco's business units on ways to mitigate legal risk.

Prior to joining Cisco, Mr. Rubin was Assistant United States Attorney for the Northern District of California. He also practiced law, focusing on intellectual property and technology litigation, claims for violations of corporate security laws, and employment disputes. Mr. Rubin has been a trial advocacy and moot court instructor at Stanford Law School. He earned his B.A. with honors from Amherst College and his J.D. from the University of Southern California Law School.

Our next witness is Barney Cassidy, General Counsel and Executive Vice President of Tessera. Before coming to Tessera, Mr.

Cassidy served for more than 9 years as General Counsel and Senior Vice President for Tumbleweed Communications, where he was responsible for corporate development and legal matters. He also practiced law at two firms and clerked for the Honorable John Noonan, Jr., at the United States Court of Appeals for the Ninth Circuit. Mr. Cassidy earned his Bachelor's Degree from Loyola University in New Orleans, his master's in philosophy from the University of Toronto, and his law degree from Harvard, where he served as editor of the Harvard Law Review.

Our final witness is Albert Foer, President of the American Antitrust Institute. Prior to his work at the Institute, which he founded, Mr. Foer practiced law in Washington, worked at the Federal Trade Commission's Bureau of Competition, and served as the CEO of a chain of jewelry stores. Mr. Foer also teaches antitrust law to undergraduate and graduate business students. He has published widely and is the co-editor of "The International Handbook on Private Enforcement of Competition Law" and of the forthcoming "Private Enforcement of Antitrust Law in the United States." He earned his undergraduate degree from Brandeis, a Master's degree in Political Science from Washington University, and his law degree from the Chicago School of Law.

Welcome to you all.

And we will begin with Professor Chien.

**TESTIMONY OF COLLEEN V. CHIEN, PROFESSOR,
SANTA CLARA UNIVERSITY SCHOOL OF LAW**

Ms. CHIEN. Thank you, Chairman Goodlatte, Ranking Member Watt, and Members of the Subcommittee. It is a huge honor to be here today.

We are here to talk about the ITC, and I want to make three points today. I want to talk about how the ITC is being used, why some of these uses are problematic in my opinion, and how they could be addressed.

First, about how the ITC is being used, my research shows that the ITC is being used broadly. Although created to address foreign piracy, the venue hears many types of disputes: competitor cases, pure domestic disputes, and others. This means that sometimes the ITC is being used properly in the way intended, a domestic industry against a foreign company. About 17 percent of cases fit this profile. A number of other cases are being filed there because, to its credit, the ITC is fast and predictable. Litigants like that.

But sometimes the ITC is being used opportunistically, meaning it is being used by parties specifically to get the injunction that they can't get in district court. As Chairman Goodlatte said, if you are a troll, it is almost impossible to get a district court injunction. Even if you make products a quarter of the time, you are going to be denied an injunction in district court.

But exclusion orders are still the norm in the ITC. Litigants know this. They have compared ITC injunctions to Damocles' swords that ratchet up the pressure. How prevalent in this practice? By my count, a quarter of cases, naming nearly half of the respondents, have been brought by trolls. American companies are nearly twice as likely to be named in these suits as foreign ones.

I have one slide to show that point.

To me, that litigants are calling ITC injunctions Damocles' swords to get big settlements, a lot of times against American companies, is bad news. What we see on the slide here is, if you look at all of the troll cases that have been brought at the ITC in the last 18 months and you count up all the defendants that are named, you see that 209 of them have been from the U.S., versus only 123 from foreign jurisdictions. Many of these are from California, 92 of them, New Jersey, New York, and Texas. So even though you think about the ITC as wanting to protect American companies, often it is being used against them.

I think this is something that we need to consider. And that ITC injunctions, again, can be considered Damocles' swords is not a good development. It contributes to a favorable climate for patent trolling that we have talked about already, and it drives investment toward patent speculation and away from productive enterprise.

We are talking about the law today, but what really matters is how the law drives investment and hiring decisions. What do I mean? Well, Congressman Watt mentioned the Nortel patent purchase. In that single purchase, Apple contributed \$2.6 billion to buy patents from Nortel. In that same year, they only spent \$2.4 billion on R&D.

Last week, I was disheartened to read and confirm with a prominent venture capitalist that companies that used to invest in startups have now begun investing in patent assertion. Why the change? Less risk and bigger potential gains. The bottom line is, if it is easier for people to make money using patents rather than compete or build new companies, they will do so.

If there is a problem, then, real or perceived, how can it be fixed? I see two ways: to change the way that the law applies or to change the law. The ITC can do the former; Congress, if needed, should do the latter.

Let me explain. The ITC statute is expansive enough that, as it exists, it gives the ITC discretion to change course and narrow the gaps between it and the district courts. It could do so in three ways.

First, it could change the way it grants injunctions. An injunction hurts. Literally, it means that you have to stop selling your product. That is your entire business, selling products. But if you give a company transition time, it hurts less. If you allow them to grandfather in existing products, that also reduces the pain to consumers and competitors. The ITC could do both things and, indeed, has done them before.

The ITC could also be more evenhanded about how it applies the domestic industry requirement. Right now, ironically, it is easier to prove this if you don't make something than if you do, with respect to the technical prong. And, finally, I believe the ITC could be more proactive when it decides cases and affirmatively set policy direction.

Now, so far, the ITC has made some positive changes: on domestic industry precedent when deciding cases, and progress also in using delays and grandfathering with respect to public interest. So that is encouraging. It has also, however, been reluctant to say it

is making policy and precedent when it decides cases, and progress has been slower as a result. That is less encouraging.

Now, however, I believe the ITC has received a lot of attention, more than in a long time. As a result, I think it will continue to evolve the law and maybe do so faster. Over the next 6 to 12 months, they may have opportunities to prove their adaptiveness to the changing conditions. I say “may” because it will depend on getting the facts right before them and in the right cases, and also for parties not settling.

Congress’ role, I think, should be to exercise oversight and evaluate how quickly the ITC is moving. If the ITC doesn’t move to discourage opportunistic behavior because it can’t or won’t, Congress should step in.

Thank you very much.

Mr. GOODLATTE. Thank you.

[The prepared statement of Ms. Chien follows:]

The International Trade Commission and Patent Disputes
 Testimony of Colleen V. Chien,¹ Santa Clara University School of Law
 House Committee on the Judiciary
 colleenchien@gmail.com
 July 18, 2012

Background: Is There a Problem?

The International Trade Commission (ITC) is an integral part of the American patent system. Although it can only block imports on behalf of domestic industries, now that most technology products are manufactured abroad and Congress has relaxed the domestic industry requirement,² nearly every patentee is a potential ITC complainant and nearly every patent defendant is a potential ITC respondent. The ITC decides patent cases in less than half the time district courts do, on average,³ and hears a significant share of the nation's patent trials.⁴

But the ITC is also an outlier in the American patent system. The ITC can't award damages or hear counterclaims. It's easier to get an injunction from the ITC than from a district court, particularly if you are a patent assertion entity ("PAE" or patent "troll") that uses primarily

¹ Assistant Professor © 2012. My testimony draws upon the scholarly literature about the International Trade Commission, including three law review articles, an amicus brief, and an ITC treatise that I have authored or co-authored: *Patently Protectionist? An Empirical Analysis of Patent Cases at the International Trade Commission*, 50 WM. & Mary L. Rev. 63 (2008); *Protecting Domestic Industries*, 28 Santa Clara Computer & High Tech. L. J. 169, 171 (2011); *Patents, Holdup, and the ITC* (with Mark Lemley), Cornell Law. Rev. (forthcoming 2012) available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1856608; *RAND Patents and Exclusion Orders: Brief of 19 Economics and Law Professors*, submitted in ITC Case 337-TA-745 (July 2012) (with Carl Shapiro, Richard Gilbert, Arti Rai and 14 others), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2102865; and *Section 337 Patent Investigation Management Guide 11-20* (with Peter Menell and others) Lexis Nexis (forthcoming 2012), available at <http://ssrn.com/abstract=1603330>. Able empirical research assistance was provided by Nicole Shanahan, Wesley Helmholtz, Pcluchette, and Daniclle Debroeck, and data was generously supplied by RPX Corp., the PricewaterhouseCoopers' Litigation Study, Lex Machina, Gazelle Technologies, Robert Fram and Ashley Miller. Support was provided by Dirk Calcoen.

² See *John Mezzalingua Assocs. v. International Trade Comm'n*, 660 F.3d 1322 (Fed. Cir. 2011) (discussing the statutory change that permitted PAEs to claim "domestic industry" status at the ITC).

³ Comments of Deanna Okun, ITC Chairwoman as reported in May 4, 2012 Daily Update -- BNA's Patent, Trademark & Copyright Journal (reporting that ITC actions took, on average 13.7 months, versus an average district court pendency in 35.3 months). Accord. Chien, *Patently Protectionist*, *supra*, at Abstract.

⁴ Approximately 15% in 2010, *Protecting Domestic Industries*, *supra*, at n6.

patents for licensing, rather than to support the commercialization or transfer of technology.⁵ In the 6 years since the Supreme Court decided *eBay*,⁶ district courts have given contested injunctions to PAEs exactly once by our count, and three-quarters of the time to practicing companies;⁷ in contrast, the ITC still routinely awards injunctions to all comers. The impact of an ITC “exclusion order” preventing importation of a product can be dramatic. To comply with such an order, a company must pull its products from the market or redesign them. The Supreme Court has repeatedly said that an injunction is an extraordinary remedy,⁸ but the ITC is not bound by the Court’s jurisprudence on patent injunctions.⁹

Patent litigants know this. As a practitioner said recently, “[when] you are asking people to write [checks that] are sufficiently large [] they can’t write them without the Sword of Damocles of a jury verdict or [an] ITC injunction hanging over their heads.”¹⁰ Because injunctions remain readily available at the ITC, PAEs and product-producing companies alike have flocked to this once-obscure trade agency, generally in search of an injunction or the credible threat of one.

In the last 18 months (Jan. 2011-Jun 2012), for example, PAEs brought more than a quarter of Section 337 patent cases, and nearly half of the total respondents appearing before the ITC were there because of a PAE-initiated case.¹¹ Usually, the patent was purchased by the

⁵ See e.g. Justice Kennedy’s concurrence in *eBay*, 547 U.S. 396 (2006) (describing “firms [that] use patents not as a basis for producing and selling goods but, instead, primarily for obtaining licensing fees.”).

⁶ *eBay Inc. v. MercExchange*, L.L.C., 547 U.S. 388 (2006).

⁷ Patent Holdup *supra*, at Figure 1.

⁸ See, e.g., *Weinberger v. Romero-Barcelo*, 456 U.S. 305, 312 (1982), citing *Railroad Comm’n v. Pullman Co.*, 312 U.S. 496, 500 (1941); see also *Rizzo v. Goode*, 423 U.S. 362 (1976) (“the principles of equity [] militate heavily against the grant of an injunction except in the most extraordinary circumstances.”).

⁹ *Spanston, Inc. v. ITC*, 629 F.3d 1331, 1359 (Fed. Cir. 2010).

¹⁰ Interview with contingent fee patent lawyer as reported in David Schwartz, *The Rise of Contingent Fee Lawyer Representation in Patent Law*, __ Ala. Law Rev. __ (forthcoming 2012), at 32, May 30 2012 draft, file with the author, a version of the paper available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1990651.

¹¹ 23 out of 81 patent investigations and 332 out of 701 non-unique patent respondents, using data provided by RPX Corp., and further coded and analyzed. See also Robert D. Fram & Ashley Miller, *The Rise of Non-Practicing Entity Litigation at the ITC: The State of the Law and Litigation Strategy* (Jan. 5, 2011), at 7 (unpublished manuscript on

PAE.¹²

Though Section 337 was created to keep foreign pirates out of American markets, recent PAE cases have targeted domestic companies almost twice as often as foreign respondents (209 times vs. 123 times).¹³ (Appendix A). Companies in California (92), New Jersey (25), New York (14), and Texas (14) have together been named more times than companies in the rest of the world. In addition to Cisco and Ford, who are also testifying today, American companies--like Apple, Walmart, and Schering Plough¹⁴--have been sued by foreign and domestic complainants.

In my opinion, that some litigants are taking advantage of the ITC's injunction record to hold up respondents is a significant problem, though not the only problem, in today's patent system. It undoes the progress that *eBay* represents, and it contributes to the favorable climate for patent trolling and holdup present in today's patent system. This climate is driving investment towards patent speculation, and away from productive enterprises. Although the focus of today's hearing is on the law, what really matters is what happens outside the courtroom, particularly among companies making investment decisions. Consider the following:

- Earlier this year, Google spent \$12.5B to buy Motorola Mobility and its patents.¹⁵ It spent less than half of that, \$5.2B on R&D in 2011.¹⁶ In 2011, Apple spent \$2.4B on R&D¹⁷

file with the author (reporting an increase in the percentage of companies relying on their licensing activities to show a domestic industry from 13% in 2000-2006 to 35% in the first 8 months of 2010). Based on an extension of their database provided for purposes of this testimony, the rate in 2011 (through Oct. 1) was 41%. Okun, *supra*, reported that 8-10% investigations from 2006 to 2011 were brought by PAEs/NPEs, our analysis found the number to be 12%.

¹² Available assignment records at the USPTO indicate that at least 15 of the 23 investigations were based on patents reassigned from their original owner, in some cases many times (*see, e.g.* patent 5,862,511, reassigned 7 times before being asserted by Beacon GmbH of Switzerland in investigation 337-TA-814).

¹³ Based on an analysis of 332 unique respondents named in PAE suits from January 2011-June 2012, 123 were from foreign jurisdictions and 209 were from domestic jurisdictions. See Appendix A

¹⁴ *See, e.g.*, TA-337-710 and TA-337-768.

¹⁵ Google Official Blog, We've acquired Motorola Mobility, <http://googleblog.blogspot.com/2012/05/weve-acquired-motorola-mobility.html> (last visited May 24, 2012); Jenna Wortham, Google Closes \$12.5 Billion Deal to Buy Motorola Mobility, <http://bits.blogs.nytimes.com/2012/05/22/google-closes-12-5-billion-deal-to-buy-motorola-mobility/> (last visited May 24, 2012).

¹⁶ Google, Inc., Annual Report (Form 10-K), (Jan 26, 2012), *available at* <http://www.sec.gov/Archives/edgar/data/1288776/000119312512025336/d260164d10k.htm> (reporting an R&D expenditure of \$5.2B in 2011).

but contributed more, approximately \$2.6B, to a single transaction to buy patents from Nortel.¹⁸ Though these patent investments will obviously last more than the single year in which they were bought, the same can also be said of the R&D investments.

- Acacia, a very well-managed company that asserts patents as a business model, has a market capitalization of close to \$2B and 55 employees, which puts it into the bottom 1/2% of public companies in the service sector in terms of employees.¹⁹ Other companies in their sector with comparable market cap have an average of 11,500 employees, based on our analysis.²⁰ Although they create revenue for the patentholders that they partner with, this is not unique among service sector companies, many of which generate revenue for their customers.
- As one investor put it on a blog board recently:

“In the past six months I have been approached by two investors with interests in large patent portfolio investment. They used to invest in start-ups. Why the change? Less risk [and?] bigger potential gains. It’s a no brainer. Investing in invention is for schmucks. They are wrong but accurate.”²¹

When I asked renowned venture capitalist Brad Feld if this was really happening, he replied “of course it’s happening... It’s the classically grotesque side of it all - money always goes to where there’s a perceived opportunity, regardless of the dynamics around it. And in this case it has nothing to do with creating jobs or innovation or anything productive for society.”²²

If There’s a Problem, How Can It be Fixed?

If it’s true that there’s a problem, how can the problem be remedied? Could the ITC fix it? Will private litigants work it out for themselves? Or does Congress need to step in? The

¹⁷ Apple, Inc., Annual Report (Form 10-K), (Oct. 26, 2011), available at <http://www.sec.gov/Archives/edgar/data/320193/000119312511282113/d220209d10k.htm> (reporting an R&D expenditure of \$2.4B in fiscal year 2011 (ending September 30, 2011)).

¹⁸ Apple, Inc., Quarterly Report (Form 10-Q), (July 20, 2011), available at <http://www.sec.gov/Archives/edgar/data/320193/000119312511192493/d10q.htm> (“On June 27, 2011, the Company, as part of a consortium, participated in the acquisition of Nortel’s patent portfolio for an overall purchase price of \$4.5 billion, of which the Company’s contribution will be approximately \$2.6 billion.”).

¹⁹ Microaxis investing report, http://www.macroaxis.com/invest/ratio/ACTG--Number_of_Employees

²⁰ Based on an analysis of 32 companies in the service sector in the \$1.9-\$2.0B market capitalization range.

²¹ Comments of Nicolas White, Tangible IP, in response to Joff Wild, Intellectual Asset Management blog post *Now that IP is Mainstream, Let’s Not Mess This Once in a Lifetime Opportunity Up*, July 6, 2012, both available at <http://www.iam-magazine.com/blog/Detail.aspx?e=b9610bab-d371-4401-bd6f-6b12368b8cb0>

²² Personal email exchange on file with the author.

remainder of this submission addresses these questions, keeping in mind that even if 27% of ITC patent cases are brought by patent trolls, the vast majority of patent cases are not; that the ITC has a proven record of efficiently resolving patent disputes; and that in some cases, due to a lack of jurisdiction over the defendant, the ITC represents the only form of relief available to a complainant.²³ My answer in short is that the current statute gives the ITC many options for reducing rent-seeking behavior among litigants. It should use these options. If the ITC proves unwilling or unable to do so, Congress should act.

What the ITC Could Do

To the question of what the ITC could do, I say: a lot.

Tailor Exclusion Orders through Grandfathering, Delay, and in some cases Denial

First, the ITC could reduce holdup by changing the way it issues exclusion orders. The statute does not compel the ITC to grant exclusion orders in all cases, but only when consistent with the public interest.²⁴ The ITC has rarely tailored or denied relief based on the statutory public interest factors, but today's cases present new challenges, including whether a patent over a small invention by a patent troll should be used to exclude a big product,²⁵ or whether a standards-essential patent subject to a promise to license on reasonable and non-discriminatory terms (RAND) should be the basis for the exclusion order.²⁶ Exclusion orders in these cases can

²³ Based on my research, two-thirds of ITC cases have a district court counterpart, suggesting that is not often the case. Chien, *Patently Protectionist*, *supra*. at Abstract. However, it is possible that the counterpart district court case named fewer defendants, due to a lack of jurisdiction.

²⁴ 19 USC 1337(d)(1).

²⁵ See, e.g. in Chien & Lemley *supra*, see also Colleen Chien & Mark Lemley, *Patents and the Public Interest*, NEW YORK TIMES.COM, Dec. 13, 2011, available at <http://www.nytimes.com/2011/12/13/opinion/patents-smartphones-and-the-public-interest.html>

²⁶ 18 professors and I argue that it generally should not, unless district court jurisdiction is lacking. See Chien et. al., *RAND Patents and Exclusion Orders*, *supra*.

harm competitive conditions and consumers when many productive, non-infringing components, third-parties relying on the enjoined product, and pro-consumer, pro-competitive benefits are shut down to give the patentee control over only a single small component.

The ITC could deny exclusion orders in certain types of cases. However, this could be unsatisfying after an intense and expensive trial, especially in cases where the patentee has no other recourse. A more palatable suggestion, then, would be for the ITC to issue exclusion orders but structure them to ameliorate the harms to competition and consumers. Two ways to do so are to tailor injunction scope and stay injunctions. In a case where a design-around is possible, for example, awarding an injunction but delaying its start could deter infringement in a way that minimizes disruption to consumers and the holdup to manufacturers.²⁷ The ITC could do so without interfering with patentee incentives: a prevailing patentee can seek damages in federal court for infringing sales in addition to bringing a case in the ITC. If the patent truly was essential, the patentee could obtain an injunction after the stay expired. If the ITC does make expanded use of stays, it should also clarify existing procedures for obtaining Commission approval of design-arounds,²⁸ in order to avoid confusion and delay in introducing the new product.

In some cases, more significant limits on exclusion orders may be warranted. Suppose, for instance, the infringing component is small but, because of the nature of the product, the potential impact of an exclusion order on downstream products, related products, and third parties is large. In such a case, the Commission could tailor the scope of the injunction to reduce harm to competition, for example by grandfathering in existing products. ITC cases that don't

²⁷ See, e.g., Mark A. Lemley & Carl Shapiro, *Patent Holdup and Royalty Stacking*, 85 TEX. L. REV. 1991, 2035-40 (2007) (showing that a stay in injunctive relief to allow design-arounds significantly reduces holdup risk).

²⁸ See, e.g., in Blakeslee & Christopher V. Meservy, *Seeking Adjudication of a Design-Around in Section 337 Patent Infringement Investigations: Procedural Context and Strategic Considerations*, 35 AIPLA Q.J. 385, 408-411 (2007).

implicate these types of concerns, for example covering patented pharmaceuticals or piratical copying, shouldn't be affected.

In Accordance with the Statute, Consistently Apply the Domestic Industry Requirement

A second way the ITC could limit the ability of PAEs to bring cases in the ITC is by more consistently and rigorously enforcing the statute's domestic industry requirement to licensing-based complainants.²⁹ The ITC typically requires complainants to prove that they practice the asserted patent on an element-by-element basis. However, it applies a relaxed "nexus" standard to licensing-based complainants, even when their licensees are making products. This practice is inconsistent with the statute and its history.³⁰ The ITC should require just as much of a connection to be proven between the asserted patent and an "article" (provided that the technology exists and is not in the process of being made), when licensing-based complainants bring their cases as when others do.³¹ It should apply the statutory preference it recognized in the *Coaxial Cable* case for ex ante over ex post licensing³² in order to exclude rent-seeking behavior.

Change, Within Limits, is Underway and More Opportunities Exist for It To Continue

There are some signs that the ITC is willing to evolve in these directions. The ITC recently tailored its exclusion order in the 337-TA-710 case to include delay and grandfathering,³³ and it has evolved its domestic industry case law.³⁴

²⁹ See Chien, *Protecting Domestic Industries*, *supra*.

³⁰ *Id.* (describing same)

³¹ *Id.*

³² *Certain Coaxial Cable Connectors and Components Thereof and Products Containing Same*, USITC Inv. No. 337-TA-650, Comm'n Op. at 49-50 (Apr. 14, 2010), EDIS Doc. No. 422832.

³³ Commission Decision in *Personal Data and Mobile Communications Devices* TA-710-337 at 83 ("HTC shall be permitted to import into the United States [for 19 months] . . . refurbished handsets to be provided to consumers as

Yet, these changes have come slowly, especially relative to developments in the industry of patent assertion.³⁵ The ITC's domestic industry and public interest caselaw has not stopped PAEs from flocking to the ITC as nuanced injunctive relief remains the exception at the ITC, not the rule. The Federal Circuit has said on several occasions that "the Commission has broad discretion in selecting the form, scope, and extent of the remedy."³⁶ Yet the ITC has been reluctant to embrace this discretion and role in setting patent policy. Commissioners have repeatedly said that, as a quasi-judicial creature of statute, the ITC is "not a policy-making body."³⁷ Yet the largely deferential standard of review that the ITC's remedy determinations enjoy³⁸ gives the ITC the ability to make policy through its adjudication.³⁹

Thus, it seems that for the Commission to change course, the right cases need to come up and the facts need to be properly developed. Progress will necessarily be slower if the ITC fails to exercise the discretion it has to evolve its caselaw, make forceful precedents, and set policy direction. The Supreme Court has not, to my knowledge, ever taken an ITC case, but perhaps it

replacements") and 81 ("T-Mobile itself has advised the Commission that a four-month transition period would likely be sufficient We find T-Mobile's suggestion to be reasonable and within our authority to implement.").

³⁴ See, e.g., *Coaxial Cables, supra* and *Certain Multimedia Display and Navigation Devices and Systems, Components Thereof, and Products Containing Same*, USITC Inv. No. 337-TA-694, Comm'n Op. at 8 (Aug. 8, 2011), EDIS Doc. No. 456236 (stressing the need for a particular nexus between the asserted patent and portfolio licensing expenses to be shown).

³⁵ Described, e.g. in Colleen Chien, *Turn the Table on Patent Trolls*, *Forbes.com* August 9, 2011 available at <http://www.forbes.com/sites/ciocentral/2011/08/09/turn-the-tables-on-patent-trolls/>, and Colleen Chien *The Economics of Patent Assertion*, draft paper in progress.

³⁶ *Hyundai Electronics Industries Co., Ltd. v. U.S. Intern. Trade Com'n*, 899 F.2d 1204, 1209 (Fed. Cir. 1990), citing *Viscofan, S.A. v. United States Int'l Trade Comm'n*, 787 F.2d 544, 548 (Fed. Cir. 1986).

³⁷ See, e.g., Stanford Patent Institutions Summit May 21, 2012, video available at http://www.youtube.com/watch?v=Qgo_lx1xwXw

³⁸ The ITC's remedy determinations are subject to reversal only when they are "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." *Spanson*, 629 F.3d 1331 at 1358; *accord Epistar Corp. v. Int'l Trade Comm'n*, 566 F.3d 1321, 1333 (Fed. Cir. 2009); *Hyundai Elecs. Indus. Co. v. Int'l Trade Comm'n*, 899 F.2d 1204, 1208 (Fed. Cir. 1990); see also *Kyocera Wireless Corp. v. U.S. Intern. Trade Com'n*, 545 F.3d 1340, 1355 (Fed. Cir. 2008) (applying the framework established by *Chevron U.S.A. Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984) to an ITC order, and stating that if "the statute in question is ambiguous and the agency's interpretation is reasonable," "a court must defer to an agency's construction of a statute governing agency conduct." (quoting *Cathedral Candle Co. v. U.S. Intern. Trade Com'n*, 400 F.3d 1352, 1361 (Fed. Cir. 2005)).

³⁹ As its Commissioners have recognized, see, e.g., Stanford Patent Institutions Summit May 21, 2012, video available at http://www.youtube.com/watch?v=Qgo_lx1xwXw

should, at the recommendation of the Solicitor General for example. The ITC could also use additional input from agencies whose consultation to the ITC is required by statute.⁴⁰

The ITC now has a number of cases before it that raise the issues contemplated by this hearing, in some cases for the first time. Through public interest commentary, they are developing a better sense of how exclusion orders impact consumers and competitive conditions. Unusually, the ITC has also recently received the attention of governmental agencies like the FTC, DOJ,⁴¹ and Director Kappos of the PTO.⁴² In the next six to twelve months, the ITC will have a chance to react and potentially change course in response to this greater input from outside stakeholders.

The Role of Litigants

Will litigants be able to solve the “ITC problem” on their own through private ordering? I am not optimistic – they have less access to help and self-help than they do in district court. However, litigants can play an important role in evolving the ITC’s decision-making.

Help the ITC and Document the Impact of ITC Jurisprudence

Litigants sued in the ITC have several options. Accused parties can try to invalidate the patent, form joint-defense groups, or control costs.⁴³ However, some litigant self-help measures don’t translate to the ITC. Many of the AIA provisions that were intended to curb litigation

⁴⁰ 19 USC 1337(b)(2), read with its statutory history, requires the ITC to consult with governmental departments and agencies when considering the public interest in the context of an exclusion order “as it considers appropriate.”

⁴¹ With respect to the issue of RAND patents and injunctions, described e.g. in Chien, et. al. *RAND Patents and Exclusion Orders*, *supra* and during Senate hearings on this issue on July 11, 2012 described <http://www.fosspatents.com/2012/07/at-senate-hearing-ftc-and-doj-argue.html>

⁴² Joff Wild, *Kappos Explains Concerns over FRAND-related Injunctions and Calls for Balanced Approach*, Intellectual Asset Management Blog, <http://www.iam-magazine.com/blog/Detail.aspx?g=3a9386c9-ee12-4159-918a-377310ccc49c> (June 27, 2012).

⁴³ A variety of self-help measures are described, e.g., in Colleen Chien, *Turn the Table on Patent Trolls*, *Forbes.com* August 9, 2011 available at <http://www.forbes.com/sites/ciocentral/2011/08/09/turn-the-tables-on-patent-trolls/>

abuses, such as the misjoinder rules and provisions relating to stays of cases pending a Section 18 challenge to transitional covered business method patents, apply to civil cases, not to Section 337 actions at the ITC. By statutory mandate, the ITC must resolve cases “at the earliest practicable time,”⁴⁴ making it harder for the agency to wait for the Patent and Trademark Office (PTO) or district court to determine if a patent is valid or infringed. ITC cases are extremely resource intensive, making attorneys less willing to share costs. As is the case with respect to district court cases, PAEs that bring ITC actions are invulnerable to countersuit.

Perhaps the greatest contribution litigants can make to reforming the ITC is to help the ITC help itself. In order for the ITC to make good law, parties need to, for example, avoid settlement before the ITC can make a decision, help develop the factual record, ask for flexible remedies and the desired application of domestic industry, and where appropriate, appeal Commission decisions to allow for appellate courts to weigh in. In short, litigants can engage in strategic or impact litigation, and continue to help other governmental bodies understand the impact of exclusion orders on consumers and competitive conditions.

What Congress Could Do

Exercise Oversight

Through these hearings, members of Congress are already providing welcome attention to the ITC. This attention should be informed by the good work of the ITC and its important role in today’s economy. However, the areas that this and related Committees find problematic should also be brought to the attention of the ITC with the policy direction that the ITC is reluctant to develop. As the ITC makes decisions over the next 6-12 months, on PAEs and other cases before it, Congress could commission a study or further hearings to look at the how the

⁴⁴ 19 USC 1337(b)(1).

ITC has changed its decision-making in response to the oversight and input it receives and the impacts of these decisions. Has the ITC done anything to discourage rent-seeking behavior through interpretation of its standing requirements? Have companies been able to design around exclusion orders or had to pull their products? Have the injunction standards diverged even further as district courts decide similar cases and come to different results? Perhaps members of Congress could hold hearings with the Commission and/or commission a study of the evolution and impact of the ITC's cases over the next 6-12 month period. If this study shows that things have not changed, Congress should change the law.

Change the Law

If Congress does change the statute, it should focus on harmonizing ITC and district court remedies. The most effective way to prevent the ITC from becoming a way to circumvent *eBay* is to require *eBay* to apply to ITC proceedings as well. However, the change should not be limited to *eBay*, but be done in a way that allows the ITC to benefit from the future evolution of Federal Circuit and Supreme Court jurisprudence on patent remedies. I take no position on whether or not the ITC should be authorized to decide damages, a topic which raises a host of issues.⁴⁵ However, modifying existing bond and penalty provisions to provide more flexibility to the ITC to award damages would make the option of denying an exclusion order more palatable, and reduce the pressure on the ITC to grant injunctions.⁴⁶ It may also make sense to consider creating a "fast track" to district court for ITC cases that have been decided in favor of the patentee but without an exclusion order.

I am more cautious about attempts to redraw the domestic industry requirement. Such

⁴⁵ Some of which are discussed in Chien, *Patently Protectionist*, *supra*.

⁴⁶ These suggestions are more fully fleshed out in Chien & Lemley, *supra*.

attempts must be evaluated with attempts to circumvent the new line in mind – determined investors may partner with practicing companies to bring ITC actions or invest in commercialization efforts just to gain standing at the ITC should the rules be changed in particular ways, for example. In addition, the history of accusations of violations of national treatment from our trading partners should also be kept in mind.⁴⁷ That the ITC has remained relatively available to patentholders belies, in part, accusations that the venue is protectionist.⁴⁸

Finally, if Congress amends the law to reform patent litigation (for example through reforms like the misjoinder rules), it should also keep the ITC in mind and consider how the reforms should apply, perhaps in some modified form.

Conclusion

The ITC's unique features create opportunities as well as challenges for the patent system and its litigants, namely rent-seeking caused by the ITC's more favorable injunction standard. The statute provides ways for the ITC to overcome some of these challenges, however the ITC must use them. If the ITC does not show a willingness or ability to do so within a limited period of time, Congress should act. I thank the Chairman and members of the Committee for the privilege and honor of serving our Government by testifying today.

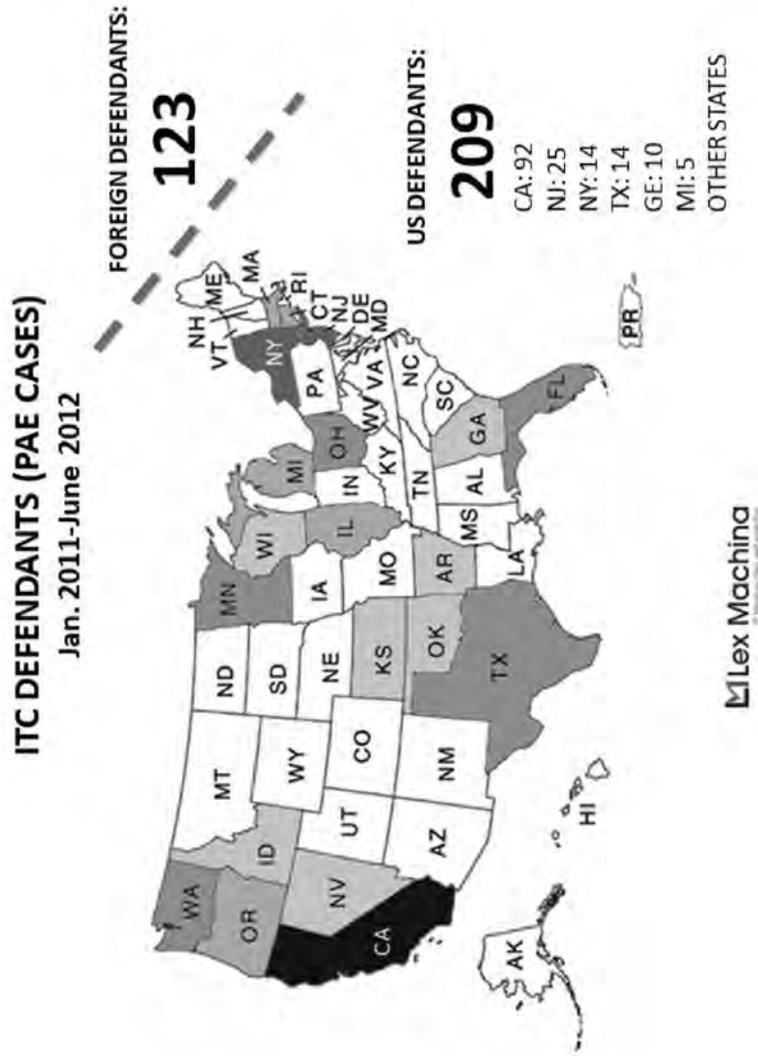
Respectfully Submitted,

Colleen Chien

⁴⁷ See e.g., in Chien, *Patently Protectionist supra*.

⁴⁸ *Id.*

Appendix A



See Appendix for the attachments submitted with this statement.

Mr. GOODLATTE. Mr. Kelley, welcome.

**TESTIMONY OF DAVID B. KELLEY, INTELLECTUAL PROPERTY
COUNSEL, FORD GLOBAL TECHNOLOGIES, LLC**

Mr. KELLEY. Mr. Chairman, Ranking Member Watt, and Members of the Committee, thank you for inviting me here to this hearing today. It is my honor and privilege to appear before you.

I am an Intellectual Property Counsel for Ford Motor Company, and I am here to testify regarding a problem plaguing production and manufacturing companies, who employ hundreds of thousands of Americans workers. At Ford, we directly employ more than 65,000 Americans, and our dealers employ more than 150,000 Americans.

Ford wholeheartedly supports the underlying purpose of Section 337 investigations—that is, to prevent unfair competition from foreign entities and to protect American industry, jobs, and innovation. We have utilized the ITC to prevent importation of products that blatantly infringed our intellectual property and that unfairly competed with our auto parts.

Nonetheless, Ford has also recently been hauled into the ITC under circumstances that cry out for reform. In November of last year, a Swiss-based patent-holding company, Beacon Navigation GmbH, brought one of the largest Section 337 cases ever against major manufacturers, American manufacturers. The case, involving GPS navigation systems, named as respondents every major producer of automobiles in the United States. These companies employ hundreds of thousands of Americans in good-paying manufacturing jobs.

Beacon asserted that certain Ford vehicles should be excluded from the U.S. market; this, despite the fact that these Ford vehicles contain a high percentage of content manufactured in the U.S. by American workers. In addition, the navigation component that Beacon claimed was covered by its patents was a small part of the navigation system and a miniscule part of the total vehicle value.

And so, a highly complex product with thousands of parts, many of which were manufactured and assembled in the U.S. by tens of thousands American workers, was subject to exclusion from the U.S. Market by a foreign patent assertion entity with a patent allegedly covering a small component of that product. Beacon ultimately withdrew its complaint, but not before costing respondents tens of millions of dollars in defense fees. Rather than protect the jobs, U.S. jobs, the case threatened U.S. jobs.

Beacon should not have been allowed to initiate a 337 investigation in the first place because it had no real trade grievance; it was only seeking money damages. Nonetheless, Beacon was able to proceed because there is no procedure to challenge the reasonableness of an ITC investigation at the beginning and because they claimed domestic industry under the licensing clause in Section 337.

In my opinion, the Federal court system, particularly the Federal Circuit Court of Appeals, is doing an excellent job in recognizing the PAE problem and fashioning judicial policy to put appropriate limits on PAE abusive practices. Congress also deemed it necessary to correct some of these practices in the recently enacted America

Invents Act, which, in part, limits a PAE's ability to include unrelated defendants in a patent lawsuit.

Unfortunately, the adjustments made by the courts and Congress to limit PAEs do not apply to the ITC, and the ITC is not bound by Supreme Court precedent that requires a thorough, equitable evaluation prior to the grant of injunctive-type relief. In fact, the ITC has only exercised its public interest equitable powers to deny an exclusion order a handful of times over the last 40 years.

While I have the utmost respect for the ITC, including the commissioners, ALJs, staff, general counsel, and others, it is clear to me that the ITC is not able to remedy the problem. The ITC is constrained by statute and, to its credit, stays within the statutory authority. Some believe the ITC has the ability to fix this problem without statutory change. There is no evidence that it will do so. To the contrary, the ITC has stated that it will not distinguish between innovators and PAEs that claim domestic industry based on licensing activities.

It is therefore necessary, and I ask you here today, to remedy the problems I have described by supporting the following statutory changes to the Trade Act of 1930. First, institute an inquiry into the equities of each 337 investigation at an early stage of the proceeding. Second, change the domestic industry requirements by limiting qualification to those who engage in production-based licensing. These changes will preserve legitimate uses of the ITC while shunting PAEs who have an adequate remedy at law to the Federal courts where they may belong.

Thank you, Mr. Chairman and Ranking Member, for holding this hearing and shining a light on a problem that is harming American manufacturers.

Mr. GOODLATTE. Thank you, Mr. Kelley.

[The prepared statement of Mr. Kelley follows:]

**Prepared Statement of David B. Kelley, Intellectual Property Counsel,
Ford Global Technologies, LLC**

Chairman Smith, thank you for inviting me to this hearing today. It is my honor and privilege to appear before this subcommittee.

I am an Intellectual Property counsel for Ford Global Technologies, LLC, a wholly owned subsidiary of Ford Motor Company that handles all intellectual property matters for the company. I am here to testify regarding a problem plaguing production and manufacturing companies who employ hundreds of thousands of American workers. At Ford, we directly employ more than 65,000 Americans—and our dealers employ more than 150,000 Americans.

We believe that Section 337 of the Tariff Act is an important tool for the protection of American jobs and intellectual property. Section 337 is a US trade law, enacted in 1930. It was designed to protect U.S. manufacturers from unfair foreign competition, and empowers the U.S. International Trade Commission (ITC) to exclude products from the U.S. market. The statute is particularly useful in intellectual property enforcement cases because it sometimes is difficult to enforce a patent against foreign infringers in the U.S. courts due to jurisdictional issues. Section 337 permits direct action against the infringing products, whether or not the maker of the products is subject to the U.S. courts.

Increasingly, Section 337 is being abused by Patent Assertion Entities (PAEs) who acquire and hold patents for the purpose of litigation. PAEs don't produce goods—they don't actually use technology to create products or jobs in the United States. Their goal is to threaten other businesses with patent litigation in the hope that those other businesses will agree to pay royalties rather than face continuing legal claims.

In recent years, PAEs have targeted Americans manufacturers, threatening their U.S. operations, and trying to force them into cash settlements that would not be

awarded by a court. This began after the U.S. Supreme Court ruled, in the 2006 *eBay* decision, that U.S. courts could issue injunctions in patent cases only if the plaintiff could show the traditional requirements for injunctive relief. Most importantly, the plaintiff is required to show that irreparable harm would occur if the injunction did not issue. A PAE that is only seeking money can't show irreparable harm: money can always be awarded later. So the Supreme Court decision meant that PAEs would have to prove their damages. But the PAE business model is to seek quick negotiating leverage, not to pursue a long patent case for damages. So after the *eBay* decision, Section 337 became more attractive to PAEs. It offers an injunction-like remedy without requiring proof that an injunction is warranted. PAEs use the threat of a Section 337 exclusion order to obtain bargaining leverage, just as prior to *eBay* PAEs used the threat of a court injunction.

By the time a manufacturer enters production, the company has spent great sums of money on design integration, tooling, and other investments to incorporate a particular technology. The technology itself may not be valuable—it may be trivial—but it is very expensive to change it after the investments have been made. PAEs can assert a minor patent against such a company and demand exorbitant sums—amounts far beyond the actual value of the technology in the market—because the manufacturer must either pay or walk away from its sunk costs.

This tactic is a patent “hold-up.” That is, the PAE demands royalties that are large not because the patent is valuable, but because the target is vulnerable. This behavior by PAEs hinders innovation instead of promoting the adoption of new technology.

Some believe that most, if not all, Section 337 cases are brought against shadowy Asian companies that are counterfeiting American goods or infringing U.S. patents. In fact, only a small percentage of Section 337 cases are brought by a U.S. company against foreign companies. Most cases are brought against a mix of U.S. and foreign companies. PAEs like to bring their cases against prominent U.S. companies, because their goal is not to exclude foreign products from the United States or to protect American manufacturers: it is to negotiate a royalty stream to earn a return on their investment. In recent years PAEs have brought Section 337 actions against such prominent U.S. companies as Apple, Ford, Google, General Motors, Hewlett Packard and Intel, among many others.

These U.S. manufacturers, and others, operate on a global basis: they sell their products globally, and they ensure their products are internationally competitive by purchasing parts and materials globally as well. Exclusion of critical parts or components from the U.S. market can lead to a calamitous shut-down of U.S. operations.

The intensity and fast pace of ITC litigation creates an atmosphere where a respondent in the ITC must divert extensive resources quickly to its defense or face a rapid, adverse and unfair result. Even if a company is confident that its imported products do not infringe a patent, the costs of litigation, the uncertainty of litigation, and the risks of an interruption of business are so great that the company may be tempted to settle.

Ford wholeheartedly supports the underlying purpose of Section 337 investigations, that is, to prevent unfair competition from foreign entities, and to protect American industry, jobs, and innovation. We have utilized the ITC to prevent importation of products that blatantly infringed our intellectual property and that unfairly competed with our parts.

Nonetheless, Ford has also been recently hauled into the ITC under circumstances that cry out for reform. In November of last year, a Swiss-based patent holding company, Beacon Navigation GmbH, brought one of the largest Section 337 cases ever *against* major American manufacturers. The case, involving GPS navigation systems, named as respondents every major producer of automobiles in the United States, including Chrysler, Ford, General Motors, Honda, BMW, Mercedes, Nissan and Toyota. These companies employ hundreds of thousands of Americans in good-paying manufacturing jobs. Rather than *protect* U.S. jobs, the case *threatened* U.S. jobs. Beacon also sued the companies in Delaware district court. The patents underlying the 337 investigation allegedly cover certain aspects of automotive navigation systems. Despite the fact that Beacon has only a handful of employees in the US, did not itself make any products, had not undertaken any research or development related to navigation systems, had purchased the patents from another party, was only interested in obtaining royalties, and had questionable licensing activities, it claimed that it qualified as a “domestic industry” under the licensing clause of the statute.

Beacon asserted that certain Ford vehicles assembled in Mexico and Canada should be excluded from the U.S. market. This despite the fact that these Ford vehicles contain a high percentage of content manufactured in the U.S. by American workers, and despite the fact that the vehicles were imported under the North

American Free Trade Agreement (NAFTA). In addition, the navigation component that Beacon claimed was covered by its patents was a relatively small percentage of the total vehicle value. And so a highly complex product with thousands of parts, many of which were manufactured and assembled in the U.S. by tens of thousands of American workers, was subject to exclusion from the U.S. market by a foreign PAE.

Beacon was using the ITC to obtain exorbitant royalties far beyond a reasonable value. And they attempted to use the ITC as leverage to extract higher fees on products made in the U.S., such as Ford F-150 trucks, that contain a small component from a global supplier. Beacon even tried to get royalties for vehicles in countries where it had no patents by using the leverage of the ITC investigation.

Only after diligent inquiry by defense counsel and by forceful direction from the ITC judge did it become apparent that Beacon could not sustain its claim of a domestic industry. It subsequently withdrew its complaint. But not before costing the respondents tens of millions of dollars in defense fees.

The Beacon case demonstrates the extent to which 337 investigations have strayed from their intended purpose. Beacon should not have been allowed to initiate a 337 investigation because it had no real trade grievance—it was only seeking money damages. Its alleged licensees do not make automotive navigation systems, and even if they did, they do not have the capacity to supply even a fraction of the industry that Beacon sought to exclude. Nonetheless, Beacon was able to proceed because they claimed domestic industry under the licensing clause in Section 337, and because there is no procedure to challenge the reasonableness of an ITC remedy at the beginning of an investigation.

Licensing is permitted in the domestic industry test to allow innovators who don't make products, like universities, to use Section 337. Innovators engage in production-based licensing, sometimes called "ex-ante" licensing. That is, innovators license their patents before a product is developed and encourage their licensees to bring new products to market. This helps create American jobs in product development and manufacturing. On the other hand, PAEs obtain and license their patents after a product has come to market, and seek to share in the value already created by others. This is referred to as revenue-based licensing, or "ex-post" licensing. While a PAE may have a claim in district court, it should have no place in the ITC, which is intended to protect U.S. industries and jobs, not to allocate existing value among claimants by awarding damages. The current domestic industry test in Section 337 does not specifically distinguish between production-based licensing and revenue-based licensing. And so, under current practice, almost any patent owner, even foreign based PAEs with virtually no presence in the U.S. and licensees with limited capacity, can bring an action against an entire U.S. industry. The ITC is thus essentially operating as an alternate patent court in many respects.

In my opinion, the federal court system, particularly the Federal Circuit Court of Appeals, is doing an excellent job in recognizing the PAE problem and fashioning judicial policy within their authority to put appropriate limits on abusive PAE practices. Congress also deemed it necessary to correct some of these practices in the recently enacted America Invents Act (AIA), which, in part, limits a PAE's ability to include unrelated defendants in a patent lawsuit.

Unfortunately, the adjustments made by the courts and Congress to limit PAEs do not apply to the ITC. PAEs can name any number of respondents in their complaints. Recent statistics clearly show an increase in the number of respondents in 337 investigations, mainly the result of PAEs. And the ITC is not bound by Supreme Court precedent that requires a thorough equitable evaluation prior to the grant of injunctive type relief. In fact the ITC has only exercised its public interest equitable powers to deny an exclusion order a handful of times in the many hundreds of investigations it has undertaken over the last forty plus years.

While I have the utmost respect for the ITC, including the Commissioners, ALJs, Staff, General Counsel, and others, it is clear to me that the ITC is not able to remedy the problem. This is so because, by its own admission, it is not a policy-making body. The ITC is constrained by statute and, to its credit, stays strictly within its statutory authority. However, this has resulted in a mechanistic application of the law which has ultimately led to absurd situations like the Beacon case that I've related, which is one of many examples of PAE abuse in the ITC.

Some believe that the ITC has the ability to fix this problem without statutory change. There is no evidence that it will do so. To the contrary, the ITC has stated that it will not distinguish between entities that claim domestic industry based on particular licensing activities. That is, any entity that can show it has licensed a patent to another party, even if it is revenue-based "ex-post" licensing, qualifies as a "domestic industry" under current ITC law. And while recent decisions and proposed rule changes indicate that the ITC may genuinely be trying to address the

problem in limited respects, these attempts will likely fall far short of eliminating PAE activity from unfairly burdening productive US manufacturers that employ hundreds of thousands of American workers.

It is therefore necessary, and I ask you here today, to remedy the problems I've described by supporting the following statutory changes to the Trade Act of 1930:

First, institute an inquiry into the equities of each 337 investigation at an early stage of the proceeding, or even before an investigation is begun. The inquiry preferably would be the first matter undertaken by an ALJ. An initial determination by an ALJ on this issue should be immediately reviewable by the Commission, and a Commission determination should be reviewable by the Federal Circuit Court of Appeals. This inquiry will allow the ITC to use its discretion in preventing abusive PAEs from initiating non-trade related investigations. The inquiry could be similar to that used by the courts before awarding injunctive relief.

Second, change the domestic industry requirements by either limiting qualification to those who engaged in production-based (ex-ante) licensing, or by eliminating the licensing aspect entirely, as licensing entities are really seeking money and the ITC cannot award damages.

These changes will preserve legitimate uses of the ITC while shunting PAEs who have an adequate remedy at law to the federal courts, thus protecting U.S. industry, jobs and technology from abusive and destructive litigation in the ITC.

Thank you Mr. Chairman and Ranking Member for holding this hearing and shining a light on a problem that is harming American manufacturers. I appreciate your efforts to bring forth legislation that will deliver a fair solution that preserves the intent of the law while fixing the abuses of PAEs.

Mr. GOODLATTE. Mr. Rubin, we are pleased to have your testimony.

**TESTIMONY OF NEAL A. RUBIN, VICE PRESIDENT OF
LITIGATION, CISCO SYSTEMS, INC.**

Mr. RUBIN. Although the International Trade Commission hears many patent cases, it is fundamentally a trade forum, charged with protecting U.S. industry and U.S. consumers from unfair foreign competition.

I am here today because, under the ITC's interpretation of its governing statute, a Canadian company with one employee in the United States that buys a portfolio of Israeli patents can seek to enjoin Cisco, a U.S. company that employs tens of thousands of U.S. engineers, from selling its products into the U.S. because some of the component parts are sourced from abroad.

That is one example, and there are many others, where patent assertion entities that do not design, develop, sell, or import any products can nevertheless meet the definition of a U.S. industry worthy of ITC protection, while U.S. companies that employ thousands of engineers can be deemed foreign competitors whose products can be excluded from U.S. markets. That needs to be remedied.

My name is Neal Rubin, and I am the Vice President of Litigation for Cisco Systems. Headquartered in San Jose, California, Cisco is one of the world's largest makers of telecom equipment, with 36,000 employees here in the U.S. Cisco invested \$5.8 billion in our most recent year on research and development, 80 percent of that in the United States, with the goal of making the future of communication faster, more reliable, and more secure.

Cisco has more than 9,000 U.S.-issued patents. But like every successful technology company in the U.S., Cisco has experienced an extraordinary increase in patent litigation in the last 5 to 10

years. Of the dozens of patent infringement lawsuits filed against Cisco, virtually all of them are brought by patent assertion entities.

In the last few years, these entities have begun to sue Cisco in the ITC because, under the Supreme Court's *eBay* decision, companies that do not build products can no longer obtain injunctions when they sue for infringement in district court. Cisco was a respondent in only one ITC case prior to 2010. Since then, we have been named five times. Cisco will spend considerably more than \$20 million this year defending these cases.

While this Committee did extensive work to reform the patent system, resulting in the American Invents Act, most of these reforms do not apply to the ITC.

Because the ITC is designed to protect U.S. industry, it can issue an exclusion order only when a domestic industry related to the patent exists or is being established. One way a patent owner can establish and satisfy the domestic industry requirement is to show substantial investment in exploiting the patent via its licensing efforts.

But the Tariff Act and its legislative history illustrate that the licensing activity Congress intended to satisfy, the domestic industry requirement, is production-driven licensing, meaning efforts that promote the adoption and use of the patented technology to create new products and new industries. The ITC, however, has recognized a new licensing model, one that we call revenue-driven licensing. Patent assertion entities engaged in revenue-driven licensing do not design, develop, sell, or import any products. Their efforts merely raise the price of existing products.

The Supreme Court's *eBay* decision recognized exactly this policy distinction between production-driven licensing and revenue-driven licensing, and precluded injunctive relief in district court for parties engaged solely in revenue-driven licensing. The ITC, however, is not bound by the *eBay* decision and has moved in the opposite direction, holding the entities engaged solely in revenue-driven licensing meet the domestic industry requirement.

The result is that these patent assertion entities are increasingly turning to the ITC, with the number of filings and the number of companies sued spiking dramatically. The data from last year shows PAE cases represent 40 percent of the entire 337 ITC docket and includes 60 percent of the respondents.

One Cisco case from earlier this year is illustrative of the problem. The complainant was MOSAID Technologies, a company headquartered in Ottawa, Canada, in the business of patent acquisition and enforcement. MOSAID bought a portfolio of patents from a failed Israeli company. And in 2011, MOSAID sued Cisco in the ITC, seeking to exclude many of Cisco's products from sales in the U.S. because foreign-made components allegedly infringed those patents.

In an effort to manufacture evidence of a domestic industry, MOSAID rushed to open its only office in the United States shortly before suing. MOSAID had one employee there at the time.

But that was just the beginning. MOSAID had to rely on the licensing prong to show a domestic industry, and therefore served subpoenas on their licensees, requesting documents and testimony to support their domestic industry claim. MOSAID then paid these

licensees to respond to the subpoenas and to testify, even though they were obligated by law to do so.

MOSAID ultimately dismissed its case when its misconduct was uncovered. But in the end, Cisco spent more than \$13 million litigating a case that should never been brought in the ITC. And but for MOSAID's misconduct, we could still be there.

Congress can solve this problem by clarifying that complainants in the ITC can establish a domestic industry only through licensing that promotes the market adoption of the patented technology. Doing so would return the focus of the ITC to its original intent and align the ITC with patent law and the Federal courts. PAEs could still pursue monetary damages in Federal courts, and domestic manufacturers and universities would continue to benefit from the ITC's protections. What PAEs would lose is the ability to use the ITC to threaten companies with the prospect of an exclusion order that does not benefit any U.S. industry.

Thank you for giving Cisco an opportunity to provide input on this important topic. I look forward to your questions.

Mr. GOODLATTE. Thank you, Mr. Rubin.

[The prepared statement of Mr. Rubin follows:]

**Prepared Statement of Neal A. Rubin, Vice President of Litigation,
Cisco Systems, Inc.**

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*" *K* 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 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 assertion 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 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 policy-makers through economic analysis and research on the global competitiveness of U.S. industries; and maintain the Harmonized Tariff Schedule of the United

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

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).

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

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

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” 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,” how-

³See, 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.*

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

⁶U.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.

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

ever, 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*. 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

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

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.

Mr. GOODLATTE. Mr. Cassidy, welcome.

**TESTIMONY OF BERNARD J. CASSIDY, GENERAL COUNSEL
AND EXECUTIVE VICE PRESIDENT, TESSERA TECHNOLOGIES, INC.**

Mr. CASSIDY. Thank you, Chairman.

Chairman Goodlatte, Ranking Member Watt—

Mr. GOODLATTE. Mr. Cassidy, you may want to turn on that microphone and pull it close.

Mr. CASSIDY. Thank you.

Chairman Goodlatte, Ranking Member Watt, and Members of the Subcommittee, my name is Bernard Cassidy. I am the Executive Vice President and General Counsel at Tessera Technologies, Inc., headquartered in the heart of Silicon Valley in San Jose, California, with operations in Charlotte, North Carolina, and elsewhere. I deeply appreciate this opportunity to speak before you regarding the importance of the ITC to my company and to the innovation economy.

Tessera is a cofounder of the Innovation Alliance, a coalition of companies seeking to enhance America's innovation environment by improving the quality of patents and protecting the integrity of the U.S. patent system. The Judiciary Committee and its Members appreciate the importance of strong intellectual property law to the U.S. economy. We applaud your leadership in helping to build a legal system that encourages investment and innovation. The IA welcomes a discussion of the role of the ITC in safeguarding American industries from unfair trade. Nonetheless, we are skeptical about many of the changes being discussed today. We believe that the long-term interests of our innovation-based economy outweigh the near-term interests of a few important companies.

Licensing U.S. intellectual property strengthens the economy and improves our trade balance. Section 337, the statute that regulates unfair practices in import trade, is a key element of the Nation's trade laws and ensures that American innovators, including companies that license their patents, will not be harmed by the importation of goods that infringe valid U.S. patents.

Permit me to briefly address four issues.

First, the domestic industry inquiry. To be able to pursue an action in the ITC, a patent holder must be or be in the process of establishing a domestic industry. What is clear to us is that the ITC has interpreted this term of art in a balanced manner. Harnessing its administrative expertise, it has consistently remained mindful of the 1998 amendment's intent to liberalize Section 337, but also remained equally vigilant in not allowing an expansion of the domestic industry test beyond the intent of Congress. Congressional action, despite the real concerns of some of my fellow panelists, should be reserved for a time when there is strong disagreement with the interpreted efforts of the ITC.

Second, public interest factors. Section 337 states that the Commission, quote, "shall," end quote, exclude goods it has found to be infringing from entry into the United States, quote, "unless," end quote, it finds that relief is not appropriate in light of four public interest factors set out in the statute.

Importantly, even if the ITC decides that remedy is appropriate, the President has the power to prevent the remedy from going into effect if he or she determines that a remedy is not appropriate for what the statute refers to as, quote, “policy reasons,” an open-ended, undefined term. In short, the statute provides a remedy with robust built-in safeguards against misuse.

Moreover, in November of 2011, about 8 months ago, the ITC issued new rules that allowed the administrative law judges to develop full records about public interest factors early in each case. This new and early focus on public interest factors supplements the multiple opportunities that interested parties have today to comment during the full commission review at the end of the case. We believe it would be premature for Congress to legislate on the process until the ITC has had an opportunity to determine whether it sufficiently and fairly addresses the concerns voiced about these factors.

Third, the *eBay* factors. The argument that the ITC should be required to apply the so-called *eBay* standards for injunctions used in U.S. district court ignores the fact that the ITC and district courts are markedly different venues with different jurisdictions and different powers, necessitating different standards. Mandating application of *eBay* would substantially weaken the power of the ITC to deal with unfair trade practices.

Fourth, standard-essential patents. A blanket a priori rule prohibiting or limiting the availability of exclusion orders to holders of patents that may be standard-essential patents would tip the balance in favor of infringers, to the detriment of innovation and, ultimately, consumers. Such proposals would essentially create a compulsory licensing regime and are contrary to the intent of SSO policies that encourage good-faith bilateral negotiations. One must consider whether innovators would have any incentive to participate in an SSO if their patents were effectively made unenforceable. That would result in technologically inferior standards and reduce investments in research and development, postponing innovation and competition that are the drivers of U.S. economic growth.

In conclusion, the ITC has the capability, the resources, and the track record to permit it to resolve the difficult questions being examined by this Committee and to apply the law. If there are specific examples of where the ITC has erred that warrant attention, the Innovation Alliance will be happy to work with Congress to develop consensus solutions. But, to be clear, we are generally of the view that the long-term interests of our innovation economy and the public better will be better served if the ITC is permitted to fulfill its obligations pursuant to existing law.

Thank you.

Mr. GOODLATTE. Thank you, Mr. Cassidy.

[The prepared statement of Mr. Cassidy follows:]

Prepared Testimony of Bernard J. Cassidy

Executive Vice President & General Counsel, Tessera Technologies, Inc.

July 18, 2012

Before the House Committee on the Judiciary
Subcommittee on Intellectual Property, Competition and the Internet

Hearing on: The International Trade Commission and Patent Disputes

Chairman Goodlatte, Ranking Member Watt, and Members of the Subcommittee,

My name is Bernard J. Cassidy, and I am Executive Vice President and General Counsel at Tessera Technologies, Inc., which is headquartered in the heart of Silicon Valley, in San Jose, California. We have facilities in Charlotte, North Carolina, Rochester, New York, and Arcadia, California as well as in Europe and Asia. I deeply appreciate this opportunity to speak before you regarding the importance of the International Trade Commission to my company and our innovation economy.

The Tessera Story

Tessera Technologies, Inc. is a small publicly-traded holding company that traces its roots to three former IBM technology pioneers who set out on their own in 1990. Tessera, Inc., our oldest subsidiary, pioneered chip-scale packaging solutions for the semiconductor industry. We have become a leader in semiconductor packaging via our inventions which are now widely adopted by the semiconductor industry. This technology enables electronics devices such as cell phones to become as small as they are today.

Today, through subsidiaries, we operate two businesses: Intellectual Property and DigitalOptics. Our Intellectual Property business generates revenue from patented innovations through license agreements with semiconductor companies and outsourced semiconductor assembly and test companies. Our DigitalOptics business offers breakthrough imaging technologies and products that will bring full-featured digital still camera capabilities to the mobile phone camera market through its miniaturized camera module solutions.

None of this would have been possible had we not had a strong patent system to protect our inventions and reward our innovators. Maintaining a strong patent system is essential to our continuing success.

The Innovation Alliance

Tessera Technologies, Inc. is a co-founder of the Innovation Alliance (“IA”), a coalition of companies seeking to enhance America’s innovation environment by improving the quality of patents and protecting the integrity of the U.S. patent system. The Innovation Alliance represents innovators, patent owners and stakeholders from a diverse range of industries that believe in the critical importance of maintaining a strong patent system. Many Innovation Alliance members also manufacture and/or sell products and services that use not only their own patents, but those of third parties as well. The IA’s positions on a strong patent system – on the importance of high-quality patents, the pro-innovation and pro-competitive benefits of voluntary standardization efforts and bilateral negotiation of licenses and cross-licenses among standardization participants – are not new.

The Judiciary Committee and its Members appreciate the importance of strong intellectual property law to the U.S. economy. We applaud your leadership in safeguarding our Nation's intellectual property, thereby helping to build a legal system that encourages investment in innovation. The Innovation Alliance welcomes a discussion of the role of the ITC in safeguarding American industries from unfair trade. We believe that the Committee will conclude that the long-term interests of our innovation-based economy outweigh the near-term interests of a few.

Licensing U.S. intellectual property strengthens the economy and improves our trade balance. Section 337, the statute that regulates unfair practices in import trade, is a key element of the nation's trade laws and ensures that American innovators, including licensing companies, will not be harmed by the importation of goods that infringe valid and enforceable U.S. patents. Importers of foreign made products – both U.S. based and foreign companies – have appealed to Congress for several changes to Section 337 that would, in effect, limit access to the ITC and/or weaken the powers of the ITC to deal with cases of unfair trade practices. Weakening the ITC's jurisdiction would benefit foreign economies, foreign competitors, and other foreign manufacturers to the detriment of the U.S. economy. Although one can appreciate the near-term concerns expressed by some U.S.-based technology companies, a discussion of issues affecting the ITC should be undertaken with the long view in mind. Specifically, weakening Section 337 to disadvantage patent holders relative to infringing importers will retard American innovation, weaken the trade position of the United States, and hurt American innovation and manufacturing by protecting infringing products manufactured in other countries.

The International Trade Commission

The U.S. International Trade Commission (“ITC”)¹ is a federal administrative body that “administer[s] U.S. trade remedy laws within its mandate in a fair and objective manner.”² Among those trade laws, the ITC administers Section 337 of the Tariff Act of 1930, as amended (“Section 337”), which makes the ITC responsible for regulating “unfair practices in import trade.”³ To enable the ITC to perform this regulatory duty, Section 337 vests the ITC with authority to issue orders excluding articles from entry into the United States where those articles are imported utilizing (1) unfair methods of competition and unfair acts or (2) infringement of U.S. intellectual property rights.

Section 337 was enacted in 1930, the decade that expanded the role of federal administrative agencies. From the onset of this era, a central pillar supporting administrative expansion was the necessity of regulating technical fields that demanded expertise beyond that found in the legislative and judicial branches of government. Stemming from this longstanding policy, Congress and the federal courts have accorded administrative agencies deference and discretion to implement their prescribed regulatory tasks as reflective of their heightened

¹ The ITC was established in 1916 as the “Tariff Commission.” Its name was changed to the International Trade Commission in 1974.

² *Mission Statement, U.S. INT'L TRADE COMM'N*, http://www.usitc.gov/press_room/mission_statement.htm (last visited May 3, 2012).

³ 19 U.S.C. § 1337 (2006).

expertise. In light of this practice, the ITC's interpretation of Section 337 should not be disturbed, unless or until Congress finds fault with the Commission's interpretation of the law.

The 1988 Amendments Recognized the Importance of Licensing to Our Economy

Prior to amendment in 1988, Section 337 treated all unfair import trade practices alike. By the 1980s, however, manufacturing was shifting abroad, and the United States was increasingly becoming a technology-based economy. Therefore, Congress amended Section 337 in 1988⁴ to reflect these economic realities. Importantly, the 1988 amendments restructured Section 337 to treat intellectual property infringement separately—and more liberally—from other types of unfair acts.

Particularly noteworthy among these changes, the 1988 amendments eased the domestic industry requirement for Section 337 investigations based on intellectual property rights. First, Congress removed the “injury” requirement, thereby eliminating any test of economic harm to the domestic industry. Second, a new provision, § 1337(a)(3)(C), provided that a domestic industry could be established where there was “substantial investment in [the asserted intellectual property’s] exploitation, including engineering, research and development *or* licensing.”⁵

Until quite recently, the procedural posture of many Section 337 investigations prevented the ITC from fully defining the boundaries of new § 1337(a)(3)(C).⁶ However, in more current Section 337 investigations where parties have attempted to establish domestic industries based exclusively upon licensing, the ITC has been utilizing its administrative expertise to determine, on a case-by-case basis and in a series of balanced and carefully-considered Commission opinions, which entities Congress sought to protect in enacting the 1988 amendments.

Four Key Issues

The remainder of this written submission will briefly address four issues of recent interest to the ITC patent community: domestic industry, public interest factors, the so-called *eBay* principles, and standard-essential patents. I incorporate by reference the attached papers recently published by the Innovation Alliance which deal with the latter two issues in more detail.

The ITC's Ongoing Development of the Domestic Industry Inquiry Under § 1337(a)(3)(C)

The first notable instance where the ITC thoroughly elaborated upon the standard for establishing a domestic industry based upon licensing occurred twenty years after the 1988 amendments, in *Certain Stringed Musical Instruments and Components Thereof* (“*Stringed*”).

⁴ See Omnibus Trade and Competitiveness Act of 1988, 102 Stat. 1107, Pub. L. 100-418 (Aug. 23, 1988).

⁵ *Id.* (emphasis added). In addition to this new statutory provision, the 1988 amendments retained the ability of a complainant to establish a domestic industry under Section 337 by demonstrating the more traditional manufacturing-based elements.

⁶ Indeed, many investigations where the issue had arisen settled prior to the ITC having an opportunity to refine the meaning of this new provision in an authoritative Commission Opinion.

Instruments”).⁷ In *Stringed Instruments*, the complainant, an individual inventor, invested \$8,500 on research and development over multiple years and made numerous unsuccessful attempts to license the asserted patents at trade shows. At issue was whether this investment in licensing and research and development was “substantial” enough to establish a domestic industry under § 1337(a)(3)(C).

Upon a thorough analysis of Section 337’s legislative history,⁸ the ITC stressed that the proper inquiry is highly “fact-dependent,” and set forth the following guidelines:

There is no minimum monetary expenditure that a complainant must demonstrate to qualify as a domestic industry under the ‘substantial investment’ requirement of [§ 1337(a)(3)(C)] [S]howing the existence of a domestic industry will depend on the industry in question, and the complainant’s relative size. . . . [T]here is no need to define or quantify the industry itself in absolute mathematical terms.⁹

After carefully applying the facts to this standard, the ITC held that that the individual inventor had not made a showing “of substantial investment of the type described in Section 337(a)(3)(c).”¹⁰ However, based upon its earlier statutory analysis, the ITC cautioned that “access to section 337 should not be foreclosed to individual inventors simply because their operations or activities are not on the scale of many corporations or universities.”¹¹

In 2010, in *Certain Coaxial Cable Connectors and Components Thereof Containing Same* (“*Coaxial Cable*”),¹² the ITC further developed its interpretation of the 1988 statutory provision. At issue was whether expenses incurred in prior patent litigation could be considered investments in licensing and, thus, help establish a domestic industry under § 1337(a)(3)(C). After thoroughly examining Section 337’s text and legislative history,¹³ the ITC determined that litigation expenses, per se, could not establish a domestic industry under § 1337(a)(3)(C). However, the Commission also held that, if prior litigation expenses exhibited a clear nexus to the complainant’s concerted efforts to license the asserted patent, they could be considered as one factor, among others, as to whether there was substantial investment in exploiting the patent via licensing efforts.¹⁴ Thus, *Coaxial Cable*—carefully interpreting Section 337’s text and

⁷ 337-TA-586, Comm’n Op. (May 16, 2008).

⁸ See *id.* at 14–16 (analyzing House and Senate reports pertaining to Section 337’s 1988 amendments).

⁹ *Id.* at 25–26.

¹⁰ *Id.* at 26.

¹¹ *Id.* at 27.

¹² 337-TA-650, Comm. Op., (Apr. 14, 2010), *aff’d*, *John Mezzalingua Assocs., Inc. v. Int’l Trade Comm’n* (Fed. Cir. 2012).

¹³ *Id.* at 44–50.

¹⁴ The Commission provided the following guidance as to whether a sufficient nexus between litigation expenses and licensing efforts may exist:

Depending on the circumstances, [licensing activities] may include, among other things, drafting and sending cease and desist letters, filing and conducting a patent infringement litigation, conducting settlement negotiations, and negotiating, drafting and executing a license. The mere fact, however, that a license is executed does not mean that a complainant can necessarily capture all expenditures to establish a substantial investment

legislative history—deliberately built upon *Stringed Instruments*, allowing for interpretation of the statute to develop as additional factual nuances arose in future investigations.

The ITC further honed its interpretation of § 1337(a)(3)(C) in *Certain Multimedia Display and Navigation Devices and Systems, Components Thereof, and Products Containing Same* (“*Navigation Devices*”).¹⁵ In *Navigation Devices*, the primary issue was whether a complainant could establish a domestic industry based upon its investment in licensing its entire patent portfolio without allocating expenditures to licensing the asserted patents. Despite public comments advocating this broad approach, the ITC determined that Congress did not intend Section 337 to encompass such a liberal interpretation. Instead, the Commission stated that the test is governed by “the strength of the nexus between the licensing activity and the asserted patent.”¹⁶ Specifically, the Commission analyzed the complainant’s patent portfolio and related activities in three areas to determine whether a “substantial investment” had been made to exploit the patents at issue, namely: (1) “the relative importance or value of the asserted patent within the portfolio”; (2) the extent to which activities are “solely related to licensing” versus “serv[ing] multiple purposes,”; and (3) “the extent to which the complainant conducts its licensing operations in the United States, including the employment of U.S. personnel and utilization of U.S. resources in its licensing activities.”¹⁷ Consequently, the ITC determined that the burden is on the complainant to “present evidence that *demonstrates the extent of the nexus between the asserted patent and the complainant’s licensing activities and investments.*”¹⁸

With respect to the “substantial investment” test, the Commission stated that “[t]he type of efforts that are considered a ‘substantial investment’ under 337(a)(3)(C) will vary depending on the nature of the industry and the resources of the complainant.”¹⁹ The Commission also

in the exploitation of the patent. *A complainant must clearly link each activity to licensing efforts concerning the asserted patent.*

Id. at 43–44 (emphasis added). Ultimately, the Commission remanded the investigation to the ALJ for determination of whether the complainant’s litigation expenses exhibited a sufficient nexus to licensing efforts. A portion of the prior litigation expenses satisfied the nexus test. However, they were not sufficiently “substantial” under 1337(a)(3)(C).

¹⁵ Inv. No. 337-TA-694, Comm’n Op. (Aug. 8, 2011).

¹⁶ *Id.* at 9.

¹⁷ *Id.* at 9–15. The nexus between the licensing activity and the asserted patent, as well as the nexus between the activity and the U.S., is “fact-focused and case-specific.” *Id.* at 9, 14.

¹⁸ *Id.* (emphasis added). In so holding, the ITC provided a list of non-exhaustive considerations to better guide future litigants:

In determining whether there is a strong enough nexus between an asserted patent and a larger patent portfolio as a whole, the ITC identified the following non-exhaustive factors: “(1) the number of patents in the portfolio, (2) the relative value contributed by the asserted patent to the portfolio, (3) the prominence of the asserted patent in licensing discussions, negotiations and any resulting license agreement, and (4) the scope of technology covered by the portfolio compared to the scope of the asserted patent.

Id. at 10.

¹⁹ *Id.* at 15. The ITC also provided a list of several additional factors to take into consideration:

Other factors that might be relevant in determining whether a complainant’s investment is substantial are (1) the existence of other types of ‘exploitation’ of the asserted patent such

emphasized that investment in licensing “must be domestic, i.e., it must occur in the United States.”²⁰ Ultimately, the Commission found that the complainant had not made a substantial U.S. investment in exploitation of the specifically asserted patents through its licensing activities. By carefully analyzing and applying the statutory language, the Commission determined that the complainant’s activities did not create the type of domestic industry envisioned by Congress.

The Commission’s most recent comments on the economic prong of the domestic industry analysis came in *Certain Liquid Crystal Display Devices, Including Monitors, Televisions, Modules, and Components Thereof* (“*Liquid Crystal Display Devices*”)²¹ and demonstrate that the ITC’s balanced interpretation of § 1337(a)(3)(C) continues. In *Liquid Crystal Display Devices*, the complainant purchased a substantial patent portfolio covering a broad array of technology and subsequently filed parallel suits at the district court and the ITC against a number of respondents. The Commission was tasked with determining which of the complainant’s activities and investments related to its efforts to license the patents at issue in the suit and ultimately determined that only the “activities relating to [complainant’s] LCD licensing program, including employee time, facility use, travel, and product acquisition,” qualified as “substantial investment” under Section 337(a)(3)(C).²² The Commission began its analysis by reiterating the guidance laid out in *Navigation Devices*, that “the complainant must demonstrate that a particular activity: (1) relates to the asserted patent; (2) relates to licensing; and (3) occurred in the United States.”²³ Importantly, the Commission determined that expenses and activities related to the purchase of patent portfolios, litigation of underlying 337 investigations and parallel district court actions, and reexamination of the patents at issue did not qualify as exploitation through licensing.²⁴

Specifically, the Commission reasoned that the act of purchasing a patent portfolio “is solely related to ownership, not licensing,” and noted that “Congress clearly stated that it did not intend mere patent ownership to constitute a domestic industry.”²⁵ Similarly, the Commission rejected complainant’s argument that expenses relating to reexamination of the patents in the context of licensing negotiations initiated by one of the respondents during the course of the investigation should qualify as exploitation through licensing. The Commission thus held that, like the act of purchasing a portfolio, “reexaminations are simply a continuation of prosecution that reaffirm or modify the boundaries of the patentee’s ownership.”²⁶

as research, development, or engineering, (2) the existence of license-related ancillary activities such as ensuring compliance with license agreements and providing training or technical support to its licensees, (3) whether complainant’s licensing activities are continuing, and (4) whether complainant’s licensing activities are those that are referenced favorably in the legislative history of Section 337(a)(3)(C). The complainant’s return on its licensing investment (or lack thereof) may also be circumstantial evidence of the complainant’s investment.

Id. at 16.

²⁰ *Id.* at 8.

²¹ *Liquid Crystal Display Devices*, Inv. Nos. 337-TA-741, 337-TA-749, Comm’n Op. (Jul. 6, 2012).

²² *Id.* at 110.

²³ *Id.* at 109 (citing *Navigation Devices* at 7-8).

²⁴ *Id.*

²⁵ *Id.* at 111.

²⁶ *Id.* at 115.

Finally, the Commission reaffirmed ITC precedent that, generally, only activities occurring before the filing of the complaint are eligible to qualify as part of the “substantial investment” analysis.²⁷ Consequently, the Commission rejected complainant’s argument that its litigation expenses for an underlying 337 investigation and parallel district court action should count towards the establishment of a domestic industry. This, the Commission noted, “would essentially eliminate the domestic industry requirement.”²⁸ The Commission added that “[p]ermitting complainants to rely on these activities and investments to establish a domestic industry, would be inconsistent with the statute and legislative history,”²⁹ again demonstrating the ITC’s abiding commitment to careful and well-reasoned statutory interpretation.

The preceding discussion illustrates that the ITC has interpreted Section 337 in a balanced manner. Harnessing its administrative expertise, it has consistently remained mindful of the 1988 amendments’ intent to liberalize Section 337 but also remained equally vigilant in not allowing an expansion of the domestic industry test beyond the intent of Congress. As illustrated in Commission opinions analyzing § 1337(a)(3)(C), the ITC continues to interpret Section 337 in a balanced, case-by-case manner, carefully considering the statutory language and intent of Congress. As the ITC continues to harness its expertise, further Congressional action should be reserved for a time when there is disagreement with the interpretive efforts of the ITC.

Public Interest Factors in Fashioning ITC Remedies

The ITC has no authority to award damages based upon past infringement; it can only issue prospective relief by issuing limited or general exclusion orders that block infringing goods at the border, as well as and cease and desist orders that forbid the domestic sale of already-imported infringing goods. Section 337 states that the Commission “shall” exclude goods it has found to be infringing from entry into the United States, “unless” it finds that relief is not appropriate in light of its consideration of four public interest factors set out in the statute:

- the public health and welfare,
- competitive conditions in the United States economy,
- the production of like or directly competitive articles in the United States,
- and United States consumers.

Importantly, even if the ITC decides that a remedy is appropriate, the President has the power to prevent the remedy from going into effect if he or she determines that a remedy is not appropriate for what the statute refers to as “policy reasons,” an open-ended term not defined in the statute.

²⁷ *Id.* at 113. “The Commission agrees with the ALJ that, as a general matter, ‘only activities that occurred before the filing of a complaint with the Commission are relevant to whether a domestic industry exists or is in the process of being established,’” (quoting *Certain Coaxial Cable Connectors, Components Thereof and Prods. Containing Same*, Inv. No. 337-TA-650, Comm’n Op., at 51 n.17 (Apr. 14, 2010)).

²⁸ *Id.*

²⁹ *Id.* at 114. Section 337 “imposes an affirmative requirement of demonstrating the domestic industry, one which cannot be automatically fulfilled by the filing of a Section 337 complaint.”

In short, the statute provides a remedy along with robust built-in safeguards against misuse.

Moreover, following the 2007 investigation titled *Baseband Processor Chips*, the ITC plunged itself into an internal and public comment review of how the public interest factors would best be treated within the investigation process. The result was a pilot program which in turn was followed by the issuance of new rules in November 2011. Under this recently enacted regime, the complainant must file a statement on the public interest concurrently with the complaint, and include certain information relevant to the public interest factors. The respondents and the general public have an opportunity to respond and the complainant may reply. These filings help the ITC Administrative Law Judge to develop a full record about public interest factors early in the case, and supplement the multiple opportunities interested parties have to comment during full Commission review at the end of the case.

It would seem be premature for Congress to legislate on the public interest factors process until the ITC has had an opportunity to determine whether its new process sufficiently and fairly addresses the concerns voiced about these factors.

eBay: Should an Interpretation of the Patent Act Be Imported Into the Tariff Act?

It has also been suggested that the ITC be required to apply the so-called *eBay* standards for injunctions used in U.S. district courts. This argument ignores the fact that the ITC and U.S. District Courts are markedly different venues with different jurisdiction and powers necessitating the differing standards. Given that the only remedy available to the ITC is exclusion orders, mandating application of *eBay* would substantially weaken the power of the ITC to deal with unfair trade practices. Furthermore, the Federal Circuit Court of Appeals expressly rejected homogenization of injunction and exclusion standards in the case of *Spanston, Inc. v. ITC*, 629 F.3d 1331 (Fed. Cir. 2010).

Standard-Essential Patents

Finally, a few important comments about standard-essential patents (“SEPs”). The Innovation Alliance hopes the Congress will seriously consider the adverse and unintended consequences of a blunt response to dealing with disputes involving SEPs. The IA would be very concerned if the ITC or the courts established a bright line rule or presumption that prohibited a patent holder from seeking or obtaining an exclusion order/ injunction due to the “possibility” of patent hold-up or because the patent(s) at issue is a SEP. A rule prohibiting or limiting the availability of exclusion orders or injunctions to SEP holders would tip the balance in favor of infringers to the detriment of innovation and ultimately consumers.

There is no evidence to suggest that such sweeping changes to the current law, remedies or processes are necessary or in the public interest. Rather than presume hold-up exists in every instance, it should be noted that a patent holder and a standards implementer both have strong incentives to negotiate in good faith. The implementer does not wish to risk an injunction that could prevent or disrupt its manufacturing, and the patent holder wants a return on its investment and funding for continued R&D. These incentives encourage negotiation, which has been the

preferred mechanism under most standard setting organization (“SSO”) policies for establishing license terms. Under a no-exclusion-order/no-injunction policy, however, the implementer has little incentive to bargain in good faith because by litigating it can avoid paying royalties until at least the litigation is over, if not longer. Moreover, a patent holder’s good faith offer becomes a ceiling that caps the implementer’s litigation risk. The result would be more and longer litigation, with the inefficiency that litigation entails, and an unjustified shift in bargaining power from patent holders to implementers that would destroy the balance which currently exists.

A no-injunction rule would also create a perverse incentive: innovators who participate in SSOs (and give FRAND commitments) would have fewer rights than innovators that do not participate. The predictable result would be that fewer innovators would participate in SSOs with such IPR rules (or make FRAND commitments if they do participate) or engage in R&D for technologies that may be standardized. Reduced participation in SSOs or reduced funding of R&D would likely result in delay, technologically inferior standards, and reduced information about patents implicated by standards. Refusals to make FRAND commitments would similarly lead to delay and technologically inferior standards as SSOs would attempt to “design out” the technologies of companies that refuse to make FRAND commitments.

Conclusion

The ITC has the capability, resources, and track record to permit it to resolve the difficult issues being examined by this Committee and apply the law. If there are specific examples of where the ITC has erred that warrant attention, we will work with the Congress to develop consensus solutions. Nevertheless, we are generally of the view that the long term interests of our innovation economy and the public will be served if the ITC is permitted to fulfill its obligations pursuant to existing law.

At a time when policymakers rightly argue that other countries need to do more to clamp down on IP infringement overseas, it is unwise to impose new hurdles on U.S. IP owners trying to protect their IP rights against foreign infringers.

Tessera and the Innovation Alliance thank the Subcommittee for affording us the opportunity to provide our views. We stand ready to work with the Congress on consensus proposals to enhance the rights of patent owners and improve the operation of our courts and the ITC.

Mr. GOODLATTE. And, Mr. Foer, we are pleased to have your testimony.

**TESTIMONY OF ALBERT A. FOER, PRESIDENT,
AMERICAN ANTITRUST INSTITUTE**

Mr. FOER. Thank you, Mr. Chairman, Ranking Member Mr. Watt, and Subcommittee Members.

As president of the American Antitrust Institute, an independent, nonprofit Washington think tank, I am pleased to offer our observations and recommendations regarding standards-setting, intellectual property, and antitrust.

We believe that globalization and the rapid pace of technological development have brought us to a point where it is no longer feasible to muddle through with three distinct legal regimes—intellectual property, antitrust, and international trade—each working more or less independently of the others.

The current system of mutual assured destruction, requiring the acquisition of huge portfolios of patents as a condition of competing, together with the emergence of substantial nonpracticing entities committed to maximally aggressive patent enforcement activity, is enormously wasteful. The system often blocks rather than facilitating innovation. It is unduly anticompetitive. It has led to proliferation of patent holdup conduct and resulting corruption of open standards initiatives that would otherwise promote more competitive market outcomes.

I am going to summarize a dozen points that receive more detail in my statement.

Coordination is essential, both within the U.S. and among economies of the globe. Resolution of standards issues should include consultations with foreign jurisdictions in an effort to achieve the maximum feasible global consistency. The basic goal is to achieve better balance between competition and exclusion in the name of innovation. Improved functioning of standards-setting organizations is crucial to achieving better balance. Antitrust considerations must play a larger role in the functioning of standards-setting organizations. And in this regard, we urge Congress to revisit the Standards Development Organization Advancement Act of 2004, which has failed to reduce the risks of ex post anticompetitive patent holdup outcomes.

Congress should also state its intent that the antitrust authorities and courts should apply the principles of the Hydrolevel case to the standard-essential patent situation. And coalitions of leading competitors should not be permitted to purchase patent portfolios with an intent to exclude from the market or otherwise seriously disable one or more nonincluded competitors.

The concept of FRAND—fair, reasonable, and nondiscriminatory commitments—itself needs to be more standardized. We would apply the following five principles: One, FRAND should imply a waiver of the right to seek an injunction against a user of the standard. Two, FRAND should imply meaningful ex ante transparency on both price and nonprice license terms. Three, FRAND should imply that nonprice conditions to license a standard-essential patent be reasonable. Four, FRAND should imply that acquirers of standard-essential patents should be required to fully

adhere to prior owners' public commitments to SSOs or others to license on FRAND terms. And, five, FRAND should imply a commitment to arbitrate disputes on the application of the FRAND commitment.

Let me comment very quickly on the role of the International Trade Commission, which after the *eBay* opinion of the Supreme Court has become a primary forum for challenging alleged patent infringements.

We support the Supreme Court's approach to injunctions and urge that its principles be applied by the ITC such that exclusionary injunctions would no longer be so automatic a remedy. Now, the ITC has recently shown signs of flexibility, and perhaps that agency can deal with the problem that has emerged by applying a broader interpretation of the public interest jurisprudence in their statute. If not, then we believe that Congress ought to act.

I would be happy to elaborate on any of these points in the questioning. Thank you very much.

Mr. GOODLATTE. Thank you, Mr. Foer.

[The prepared statement of Mr. Foer follows:]

Statement of Albert A. Foer, President
THE AMERICAN ANTITRUST INSTITUTE
Before the
HOUSE JUDICIARY COMMITTEE
SUBCOMMITTEE ON INTELLECTUAL PROPERTY, COMPETITION, AND
THE INTERNET
Hearing on
THE INTERNATIONAL TRADE COMMISSION AND PATENT DISPUTES
July 18, 2012

Chairman Goodlatte, Ranking Member Watt, and members of the Subcommittee:
The American Antitrust Institute (AAI) is an independent non-profit consumer organization devoted to enhancing the role of competition in the economy and sustaining the vitality of the antitrust laws.¹ We believe that competition benefits consumers and the economy by lowering prices, promoting innovation, elevating customer service, and enhancing the choices available to consumers.

For many years America has muddled through with three separate regimes that collectively shape the competitive structure of our industries. Please picture an equilateral triangle with a silo situated at each corner. These silos are three legal regimes: antitrust, intellectual property, and international trade. To an unfortunate extent, each regime has developed and operated separately. Each works within its own statutory and regulatory framework, each is associated with a separate occupational sociology, each has its own values, special interests, and political oversight. So long as intellectual property played a relatively unimportant role in our economy, so long as most of trade was not conducted by global mega-corporations in highly concentrated global industries, so long as antitrust,

¹ The AAI is managed by its Board of Directors with the guidance of an Advisory Board consisting of more than 130 prominent antitrust lawyers, economists, and business leaders. The Board of Directors alone has approved this written testimony; individual views of members of the Advisory Board may differ from the AAI's positions.

trade, and IP did not constantly bump up against one another, the competition triangle managed to function.

But something has dramatically changed. Picture the triangle again -- only this time fill up the space enclosed by the triangle with global high technology companies, companies with names like Microsoft, Google, Apple, Cisco, IBM, Samsung, Sony and the like. And recognize that the way they do business and the way governments oversee and regulate them require their constant collision with all the sides of the triangle. There is a mismatch between the three legal regimes and the facts of today's most important economic life. Reform has rather suddenly come to appear essential.

In particular, the current crisis in standards results from the emergence of an essentially unplanned system of Mutual Assured Destruction, in which the major high technology companies accumulate large portfolios of patents that are intended to be used as both offensive and defensive weapons against competitors, indeed as bargaining chips for assuring access to essential patents and protection against claims of infringement.

This system has three grievous faults. First, it is enormously wasteful of resources, including both the resources to purchase portfolios of intellectual property, and also expensive, time-consuming, attention-demanding litigation to utilize or protect these portfolios.² Second, it creates a barrier to entry and innovation by companies that do not already own a large portfolio and would therefore find themselves at high risk that their entry product would be attacked as infringing someone's patent, or perhaps hundreds of patents. The risk would deter investment. Third, it enables and incents and has therefore led to proliferation of patent holdup conduct and resulting corruption of open standards initiatives that would otherwise promote more competitive market outcomes.

² In a current "high-stakes patent infringement trial pitting Apple Inc. against Samsung Electronics Corp." before the International Trade Commission, Apple was represented by a 70-lawyer team from Wilmer Cutler Pickering Hale and Dorr and Quinn Emanuel Urquhart & Sullivan. "In the months leading up to trial, Wilmer lawyers deluged the court with documents—for example, when the judge asked for a simple chart, lawyers submitted a 3,000-page filing." "According to patent analyst Florian Mueller, Apple and Samsung are currently opponents in about 50 patent suits spanning 10 countries and four continents, fighting for dominance in the \$100 billion-plus global smartphone market." Jenna Greene, "In Apple fight, sharp elbows," *The National Law Journal*, June 25, 2012. <http://www.nlj.com>.

But Mutual Assured Destruction has another flaw that has almost literally blown up the system. This flaw has been given a nasty nickname: patent trolls. It also has a more neutral name, non-practicing entities (“NPEs”) that we will use. When organizations buy up patents, not to utilize them in productive output but to use them as assets upon which they can demand monopoly rents by attacking companies on patent infringement grounds, *without having to worry about return fire*, something new and potent has been injected into the armory.

The AAI has been listening to a wide variety of companies and experts on the overlap of antitrust and intellectual property. In keeping with the subject matter of this hearing, but providing somewhat enlarged scope, we offer the following dozen observations with regard to standards and competition policy.

1. Better coordination is essential.

To the maximum extent feasible, the Department of Justice and the Federal Trade Commission should promulgate the same approach. Joint guidelines following the model of the Horizontal Merger Guidelines would be an appropriate vehicle. The International Trade Commission, U.S. Trade Representative, the U.S. Patent and Trademark Office, and the Intellectual Property Enforcement Coordinator should all have an important say in the development of these guidelines. In addition, however, given the global nature of so many issues, the U.S. agencies should work as closely as possible with the European Commission and other major trading nations to maximize international consistency.

2. The basic goal is to achieve better balance between competition and exclusion in the name of innovation.

A consensus on basic objectives seems to be within reach. The basic understanding would be that the exclusionary power of intellectual property can provide an important incentive for innovation, but that without appropriate limitations, IP can become a mechanism that not only facilitates monopolistic waste in the economy but actually inhibits innovation. The consensual goal is to find a socially beneficial balance between competition and exclusion.

3. Standard setting organizations are crucial to achieving balance.

Standards for interoperability and access are crucial to the development of high technology, most evident at the moment in the evolution of mobile smartphones. The primary institution for developing standards is the standard-setting organization (“SSO”), a self-governing mechanism for the members of an industry to come together to make critical technical decisions about the future of their industry. Overwhelmingly, these are discussions among engineers and their function is positive, but when antitrust investigations have focused on SSOs, it has become clear that they have a potential for anticompetitive abuse. Once a standard is agreed upon, it is often too late for the industry to switch to another direction. Thus, it is appropriate for government to focus on best practices for SSOs and, as a matter of priority, especially on standard-essential patents (SEPs).

4. Antitrust must play a larger role in the functioning of SSOs.

Because standard-setting brings competitors together to work on an industry’s future, there is always a risk of anticompetitive activity. The Standards Development Organization Advancement Act of 2004 (“SDOAA”) mandates application of the antitrust “rule of reason” rather than any stricter antitrust rule or scrutiny for SSOs’ “standards development activity,” defined to include “actions relating to [an SSO’s]

intellectual property policies.”³ It also enables SSOs to avoid the treble damages remedy that would otherwise be automatic for any antitrust violation⁴ and to obtain an award of the costs of suit including reasonable attorneys’ fees against any antitrust claimant if the claim against the SSO was “frivolous, unreasonable, without foundation, or in bad faith.”⁵ The statute thereby protects or exempts SSOs from central aspects of the antitrust laws that apply to many other kinds of concerted activity among competing enterprises.

This Act was intended “to encourage disclosure by intellectual property rights owners of relevant intellectual property rights and proposed licensing terms”; it “further encourages discussion among intellectual property rights owners and other interested standards participants regarding the terms under which relevant intellectual property rights would be made available for use in conjunction with the standard or proposed standard.”⁶ In short, the Act sought to incent SSOs to experiment with new policies and practices that would increase ex ante transparency about intellectual property rights and associated license terms, thereby reducing risks of ex post anticompetitive patent holdup outcomes.

In the immediate aftermath of that enactment, two SSOs -- VITA and IEEE -- adopted new policies of that very kind, both of which received antitrust comfort under DOJ’s Business Review Procedure.⁷ To our knowledge, however, few if any other SSOs have even begun to move in any similar direction. In short, all too many SSOs have been slow to embrace any such effort or even to consider the continued adequacy of their longstanding patent policies as protections against patent holdup outcomes in their standards. It is thus not surprising that there has been a dramatic

³ Pub. L. No. 108-237, 118 Stat. 661, 15 U.S.C. §§ 4301-02.

⁴ 15 U.S.C. § 4303.

⁵ 15 U.S.C. §§ 4304-05.

⁶ 150 Cong. Rec. 3657 (June 2, 2004).

⁷ See Letter from DOJ to VITA counsel (Oct. 30, 2006), *available at* <http://www.justice.gov/atr/public/busreview/219380.htm>; Letter from DOJ to IEEE counsel (Apr. 30, 2007), *available at* <http://www.justice.gov/atr/public/busreview/222978.htm>.

increase in patent holdup conduct and associated litigation over the eight years since enactment of the SDOAA. In short, it appears that the SDOAA has failed to incent SSOs in the desired direction. Indeed, by reducing antitrust exposure, it may well have had the opposite effect.

Accordingly, the AAI suggests that Congress now consider (a) repeal or revision of the SDOAA in conjunction with (b) a Congressional statement of intent that the antitrust authorities and courts should apply the principles of *American Society of Mechanical Engineers v. Hydrolevel Corp.*,⁸ to the standard-essential patent situation. The Supreme Court there established an SSO's strict antitrust liability in circumstances where anticompetitive harm occurs as a result of the SSO's failure to implement procedures aimed at preventing abuse of its processes. As the Court said, "a standard setting organization . . . can be rife with opportunities for anticompetitive activity"; "a rule that imposes liability on the standard setting organization -- which is best situated to prevent antitrust violations through abuse of its reputation -- is most faithful to the congressional intent that the private right of action deter antitrust violations."⁹ Congress should accordingly confirm its support for applying those precepts to the situation here at issue: an SSO's failure to implement effective safeguards against patent holdup outcomes from its proceedings should result in that SSO's liability for the resulting anticompetitive effects.

5. The concept of F/RAND itself needs to be standardized.

It is not uncommon for SSOs to require that any participant in a standard-setting process who owns a patent that reads on the proposed standard has an obligation to identify the patent and/or agree to license it on a fair, reasonable, and non-discriminatory basis. Europeans abbreviate this as a FRAND commitment,

⁸ 456 U.S. 556 (1982).

⁹ *Id.* at 571-73.

Americans as “RAND”, or increasingly as “F/RAND”. As a first step in clarifying the concept, we propose recognizing that all three abbreviations have essentially the same meaning and can all therefore be referred to as “FRAND”.

Unfortunately, FRAND has no agreed-upon minimal meaning, which leads to expensive, drawn out, and largely unnecessary litigation. The AAI calls attention to the following areas in which the provision of a minimal standard meaning would resolve many of the problems of SEPs: unreasonable price; other unreasonable conditions; assuring that subsequent owners are bound by prior owners’ commitments; arbitration of disputes; and limitations on the use of injunctions.

6. FRAND should imply that ex ante negotiations on price are both legitimate and critical.

Although it is not feasible to establish perfect rules on what price for licensing a SEP would be fair and reasonable, some minimal standards are appropriate. The AAI agrees with the FTC’s promotion of two principles. First, the determination should rest on ex ante incremental value rather than ex post total market value. Second, the royalty base should be the smallest affected component rather than the entire device.

Because FRAND commitments are today so generally vague that they do not provide adequate protection against holdup conduct, SSOs should be required to move in the direction of ex ante disclosure of proposed or maximum license terms. (A SEP owner should not be required, however, to specify a royalty rate when it is not in fact looking for royalties and therefore commits not to assert its SEPs against any implementer of the standard in question.)

7. FRAND should imply that non-price conditions to license a SEP be reasonable.

With current vagueness, SEP owners sometimes demand overly broad grantback provisions. The AAI believes it is inconsistent with a FRAND commitment for the SEP licensor to demand a grantback covering licensee patents beyond those that are essential to the same standard implicated by the licensor's patents. It is unreasonable for the SEP owner to demand a higher royalty for the license to its SEPs than it is willing to pay as a royalty for SEPs within the scope of the required grantback. There should always be a "cash-only" option available to any licensee in lieu of any grantback demand. Where defensive termination provisions or covenants not to sue are functionally similar to grantback provisions, they too should not be "unreasonably" broad.

8. FRAND should imply that acquirers of SEPs should be required to fully adhere to prior owners' public commitments to SSOs or others to license on FRAND terms.

It is essential to a balanced SSO process that FRAND commitments be maintained, even if the SEP is later transferred. The AAI believes that a new SEP owner's enforcement activity in a manner inconsistent with an applicable FRAND commitment may constitute "exclusionary conduct" in violation of Section 2 of the Sherman Act and Section 5 of the FTC Act. Moreover, a patent portfolio's acquisition that may enable or facilitate this kind of exclusionary conduct can, on that basis, be challenged as a violation of Section 7 of the Clayton Act. (SSOs can assist in this regard by clarifying that participants making FRAND commitments during their proceedings thereby promise to condition any sale of the covered patents on the promise to abide by the same commitments.)

9. FRAND should imply a commitment to arbitrate disputes on the application of the FRAND commitment.

The disproportionate leverage that a patent owner has in the interpretation of a FRAND commitment rests largely on the time and expense of reaching a solution via litigation. If an SSO's rules or legislation were to require that a FRAND commitment automatically includes an agreement to arbitrate disputes over the interpretation of the FRAND commitment, the dynamics would change in a substantial way, with the overall result that a FRAND commitment would be given weight it does not currently carry.

10. FRAND should also imply a waiver of the right to seek an injunction against a user of the standard.

An injunction is not an appropriate remedy for SEP infringement as a matter of both good law and good policy. In deciding the Apple/Motorola case in Illinois just a few weeks ago, Judge Posner noted that the Supreme Court requires a plaintiff seeking an injunction on a patent infringement claim to first establish that monetary damages are inadequate to compensate for any alleged injury.¹⁰ Yet when a SEP owner makes a FRAND commitment, it has implicitly acknowledged that a reasonable royalty is adequate compensation for a license to use the patent.¹¹ Monetary damages are therefore adequate compensation for infringement of a FRAND-encumbered SEP. Moreover, monetary damages avoid the disproportionate outcomes and public harm that can result from injunctive relief. Particularly where an infringer benefits by infringing on a patent that accounts for only a small component of a device, and the effect of an injunction is to remove the entire device from the market, the penalty imposed on the infringer

¹⁰ See *Apple, Inc. v. Motorola, Inc.*, No. 1:11-cv-08540, at 21 (N.D. Ill. Jun. 22, 2012) (citing *eBay Inc. v. MercExchange, L.L.C.*, 547 U.S. 388, 391-92 (2006)).

¹¹ *Id.* at 19.

far outstrips the benefit the infringer enjoys for infringing, not to mention the harm caused to the SEP-owner.¹² The result is a punitive rather than compensatory remedy that provides a windfall to the SEP-owner and unnecessarily deprives the public of access to the affected device and competition in the affected market.¹³

SSO rules should make clear that the provider of a FRAND commitment in the course of a standard development proceeding waives any right to seek either injunctive relief in court or an exclusion order at the International Trade Commission. The AAI endorses the FTC's ITC comments¹⁴ and the legislative advocacy of the ITC Working Group.¹⁵ We are encouraged by signs that the ITC appears to be taking a serious look at whether it can become more flexible and less automatic in its use of exclusionary injunctions. We hope that the ITC will be able to apply the principles that the Supreme Court evoked in its *e-Bay* opinion¹⁶ under its "public interest" authority. If not, Congress should be prepared to customize an appropriate application of these principles.

11. Resolution of standards issues should include consultations with foreign jurisdictions, in an effort to achieve the maximum feasible global consistency.

The issues being aired in these hearings are of concern to many of our

¹² *Id.* at 25.

¹³ *Id.*

¹⁴ United States International Trade Commission investigation N. 337-TA-745 and 337-TA-752. Third-Party United States Federal Trade Commission's Statement on the Public Interest (June 6, 2012).

¹⁵ See Jan Wolfe, *Tech-Sector Working Group Wants 'Patent Trolls' Out of the ITC*, LAW.COM (Mar. 22, 2012), http://www.law.com/jsp/cc/PubArticleCC.jsp?id=1202546503103&TechSector_Lobbying_Group_Wants_Patent_Trolls_Out_of_the_ITC.

¹⁶ *eBay Inc. v. MercExchange, L.L.C.*, 547 U.S. 388 (2006).

trading partners. For example, in 2011, the European Commission adopted in final form its Guidelines on the Applicability of Article 101 of the Treaty to Horizontal Co-operation Agreements.¹⁷ Section 7 of the Guidelines addresses requirements for “standardization agreements” to avoid violation of Article 101. Note in particular that par. 283 expressly requires that the SSO’s rules ensure access to the standard on FRAND terms; par. 285 says that, to ensure the effectiveness of the FRAND commitment, “there would also need to be a requirement on all participating IPR holders who provide a commitment to ensure that any company to which the IPR owner transfers its IPR . . . is bound by that commitment, for example through a contractual clause between buyer and seller.” Par. 286 says the IPR policy “would need to require good faith disclosure, by participants, of their IPR that might be essential for the implementation of the standard under development.”

Par. 289 says in “case of a dispute, the assessment of whether fees charged for access to IPR in the standard-setting context are unfair or unreasonable should be based on whether the fees bear a reasonable relationship to the economic value of the IPR” and “it may be possible to compare the licensing fees charged by the company in question for the relevant patents in a competitive environment before the industry has been locked into the standard (ex ante) with those charged after the industry has been locked into the standard (ex post).” Par. 290 says “Another method could be to obtain an independent expert assessment of the objective centrality and essentiality to the standard at issue of the relevant IPR portfolio. . . . The royalty rates charged for the same IPR in other comparable standards may also provide an indication for FRAND royalty rates.” Par. 299 promotes ex ante disclosures of most restrictive licensing terms including maximum royalties.

The proposed guidelines published for comment in 2010 flatly prohibited ex ante “joint negotiation” of license terms. In response to objections from several

¹⁷ See C.11/56, Official Journal of the European Union 14.1.2011.

companies that that prohibition was in conflict with U.S. FTC and DOJ guidance in their 2007 IP Report that said such joint negotiation should be assessed under the rule of reason, the EC dropped the prohibition altogether and simply omitted the whole subject from these final guidelines.

The AAI urges the U.S. government to make every effort to provide comparable guidance. To the extent possible, U.S. and EC guidelines should be substantively similar.

U.S. authorities and U.S. consumers should be concerned when SEP owners seek and obtain injunctions from courts in Germany; EC and Asian authorities and consumers should be concerned when SEP owners seek and obtain ITC exclusion orders. SSOs develop standards that define the shape and competitiveness of global markets regardless of where their working groups meet or the language in which they conduct their meetings. Patent holdup conduct directed against innovative entrants into new markets in Europe or Asia can adversely affect competition within the U.S. as well as in their home countries. For all of these reasons, SEP-related problems demand global solutions. Public and private stakeholders throughout the world will need to deepen their dialogue about the desirable policies and remedies in this area.

12. Coalitions of leading competitors should not be permitted to purchase patent portfolios with an intent to exclude from the market or otherwise seriously disable one or more non-included competitors.

An antitrust issue arose when the Rockstar group, consisting of three leading (and three other) mobile device operating system competitors, combined to bid five times as much as their competitor, Google, in order jointly to acquire Nortel's portfolio of patents. As the AAI wrote to the DOJ at the time, this "raises questions about the concerted intentions and objectives

of the six consortium members that could not be achieved through independent bidding and eventual individual ownership or licensing of some or all parts of the patent portfolio at stake.”¹⁸ The acquisition was not challenged but a post-acquisition question is also raised because of Rockstar’s apparently “new” status as an NPE owning 4,000 of the 6,000 Nortel patents and now committed to maximizing revenue from them. Congress should urge the antitrust agencies to aggressively investigate any coalition of leading competitors that appears to be formed or utilized for the purpose of disadvantaging an excluded rival such as by depriving it of access to a SEP.

We thank the subcommittee for its consideration of these observations and recommendations.

¹⁸ See Letter from the AAI to Christine Varney (July 6, 2011), *available at* <http://www.antitrustinstitute.org/sites/default/files/Nortel%20letter%20to%20DOJ.7.6.11.pdf>.

Mr. GOODLATTE. We will now beginning our questioning, and I will start with a question that I will direct to the three in the middle—Mr. Kelley, Mr. Rubin, and Mr. Cassidy.

Are you generally satisfied with how the ITC operates now as it conducts Section 337 investigations? And what changes, if any, would you make to agency operations?

Mr. Kelley?

Mr. KELLEY. Thank you, Mr. Chairman, for the question.

We are satisfied with the ITC handling of cases that we brought there. As I said, we have utmost respect for the ITC.

I think with respect to cases that are brought against us by the PAEs, we believe that there should be some changes made. One change would be to address the appropriateness of an exclusion order at the beginning of an investigation. So we believe that that would be more fair to everyone involved. And it would reduce the amount of litigation cost that many companies spend in the ITC, and I believe it would also reduce the ITC's workload.

Mr. GOODLATTE. Thank you.

Mr. Rubin?

Mr. RUBIN. Well, I agree that the ITC is doing a terrific job with the cases in front of it. But I think that the world has changed dramatically, Mr. Chairman, since the last time Congress amended this particular law in three significant ways: number one, the rise of patent assertion entities that we are talking about today; number two, a global economy where companies like ours, it is virtually impossible to have a supply chain that is purely domestic, so you source products from all over the world to remain globally competitive; and then, number three, as you pointed out earlier, the *eBay* decision that takes away the injunctive remedy in Federal court for patent assertion entities.

So it is those three changes that lead to the rise of all of this patent assertion litigation that you are seeing today in the ITC and require a change. And the change that we would like to see made is just to narrow the licensing prong of the domestic industry requirement so that only those licensing efforts that are before the fact, that are designed to actually foster the use of the new patented technology, can meet the domestic industry requirement, but that after-the-fact licensing efforts that are really a game of gotcha after a huge amount of investment is made, those should not be sufficient to meet the domestic industry requirement. I think that distinction needs to be drawn.

Mr. GOODLATTE. Thank you.

Mr. Cassidy?

Mr. CASSIDY. Generally, Chairman Goodlatte, we are satisfied. We think that the ITC is a very effective Federal agency. We don't think it is fair to characterize it as a tool that people use for patent holdup.

Mr. GOODLATTE. You don't think the statistical trend that we have seen here of the increasing number of U.S. defendants in these cases is an indication that this is being used for a purpose that it wasn't originally intended?

Mr. CASSIDY. No, sir. I think it is an indication of the increased importance of intellectual property in our economy today.

To give one example, there are 7 billion people on the planet; there are 6 billion mobile phone subscriptions. This is not an industry that is being held up by the ITC or anyone else. It is a burgeoning, successful industry.

Similarly, I think in the cases discussed here today there have been successful outcomes for companies that have been attacked by people that did not have sufficient status to meet the domestic industry requirement.

I feel for companies that are dragged into court, but we have to look at this from a systemic point of view, not from the point of view of the individual litigant. And it has been successful.

I hesitate to think of what it would be like if we weaken the ITC. I believe the United States consumers would be——

Mr. GOODLATTE. Even if we try to say, hey, the ITC is intended for domestic companies so be a domestic company before you bring an action?

Mr. CASSIDY. The concern with that, Mr. Chairman, would be that it would be discriminatory against others who have intellectual property rights in the United States.

Mr. GOODLATTE. Well, certainly they have intellectual property rights in the United States, but that is not the intention of the ITC, the formation of the ITC.

Mr. CASSIDY. A fair point.

Mr. GOODLATTE. Let me ask Professor Chien, is the ITC an appropriate forum to settle disputes over royalties for standard-essential patents between domestic industries, which is essentially how it is being used in a number of these cases?

Ms. CHIEN. Thank you for your question, Mr. Goodlatte—Chairman Goodlatte.

I think the way that the ITC is set up now it is not really designed to decide royalties. It doesn't have that statutory authority. Nor because of the time frame it is on you can't really put the time in to deciding that.

I think that your question raises a good possible use of the ITC to try to get people to settle potentially by using delay, but I don't think the way that it is structured now under the statute can really accomplish the aim of getting damages or royalties awarded, if that is was your question.

Mr. GOODLATTE. Let me ask another question. Should the ITC's jurisdiction over patent disputes be limited to those in which the accused infringer is not subject to a Federal court's jurisdiction?

Ms. CHIEN. That would be a clean way to separate out and make sure that the ITC is really complementing rather than overlapping or conflicting with the district court, to actually just have it be hearing those cases which cannot in real life be heard in district court. I think, however, that the ITC does provide some valuable functions beyond just jurisdiction filling, that because it is a fact venue that it is—and also an efficient one that those are merits that would give it—would benefit the system in general, not just those small cases.

Mr. GOODLATTE. Thank you.

My time has expired. The gentleman from North Carolina, Mr. Watt, is recognized.

He is going to defer his questioning; and we will now recognize the gentleman from Michigan, Mr. Conyers, for 5 minutes.

Mr. CONYERS. Thank you very much, and I apologize for my absence. But I was so impressed with the appearance of Mr. Cassidy but not as impressed by his comments, and so I am going to have to direct my questions to the president of the American Antitrust Institute.

I am concerned about the larger corporations using patents to enhance their competitive position. Let's be honest with it. Some of you have testified that is not much of a problem. Some have been neutral on it. Where do you see this going, Bert Foer?

Mr. FOER. Thank you, Mr. Conyers.

I don't think I see it as a big-versus-small issue particularly. I think it is a matter of getting the process right. For years and years, antitrust pretty much ignored standards-setting. It only came up in a couple of extreme cases. And generally this has been a totally deregulated area, which is good, except that now we have some problems. And when you take a look at the system for standards-setting, it is time to give more antitrust oversight to the way things work.

If the Standards-Setting Organizations would voluntarily do what Congress urged them to do, then they could have—they could have a lot of this taken care of. But they haven't done that. They have conflicts internally with their members, and they can't seem to reach the right kinds of decisions. So I think Congress needs to become involved if antitrust is really going to work.

Mr. CONYERS. Wasn't that the process—isn't it endangered by the larger corporate interests that are squabbling here? I mean, I can't—we are in a capitalist system, whether you like it or not. The question, is how do we regulate? And I don't think it is the little companies that are keeping us disorganized. I gave up that naivete many decades ago.

Mr. FOER. Well, certainly the largest corporations that participate in a standards-setting process are going to have more clout in that process, which means we have got to make the process fair, we have to standardize the process itself much more than it is. And if we can't get the organizations to do it voluntarily, then Congress should step in and push it along.

Mr. CONYERS. Okay.

Mr. FOER. Because if it is going to be a fair process, then it has to have fair rules.

Mr. CONYERS. Who else wants to comment here?

Mr. RUBIN. Congressman, I would I agree that I don't see this as a big-company/small-company issue. Even large companies like Ford and Cisco were small companies. Less than a generation ago, Cisco was started by Stanford professors who couldn't communicate between disparate computer systems.

And so we you agree that when you look at who can be a litigant in ITC you have to make sure that small businesses, universities, and large businesses alike have access to the ITC. We agree with that. But if you look at the problems that we are talking about today about domestic industry, if you have research and development activities like universities, small businesses, and large busi-

nesses, you have access to the ITC. If you employ labor and capital, you have access to the ITC, and you should.

The only issue that we are looking at is this question of licensing. And we don't think that all licensing efforts need to be excluded, just those licensing efforts that don't support the adoption of new products. We don't think that really meets the definition of a trade group, and therefore that shouldn't be protected by the ITC, which is designed to protect U.S. industries.

Mr. CONYERS. Mr. Cassidy, you get the closing comment.

Mr. CASSIDY. I am sorry. I lost track of the question.

Mr. CONYERS. So have I, but you get the closing comment anyway.

Mr. CASSIDY. There is a question about whether or not licensing is a protected industry under statute, under 337. This has already been litigated, and the answer is when Congress said licensing in 1988, it meant licensing. It did not mean merely licensing for products that are already fully adopted or merely licensing for products that have not yet been adopted. It meant licensing which covers both spectrums. So that is the law, and I don't see the reason to change it.

Mr. CONYERS. Thank you, Mr. Chairman.

Mr. GOODLATTE. I thank the gentleman.

The gentleman from California, Mr. Issa, is recognized for 5 minutes.

Mr. ISSA. Thank you, Mr. Chairman.

Professor Chien, your figure that 17 percent of the ITC patents—or cases—are essentially large U.S. companies. U.S. companies to U.S. companies exploiting the ITC in order to have a battle in the second venue.

Ms. CHIEN. In order to have a what?

Mr. ISSA. In order to have a battle in the second venue, whether it is *Broadcom v. Qualcomm* or *Kodak, Apple, or Motorola*. Were these, in your opinion, part of the original intent? Did we intend to have major U.S. entities in ITC over what is often essentially the importation of a component?

Ms. CHIEN. That is a great question. And just to get clear on the numbers, my 2008 report shows that actually about 60 percent of cases involved competitors or large companies being sued. So it is a larger percentage than 17. That is the number that applies to foreign companies being sued by domestic industries.

Mr. ISSA. So, in effect, it is the majority of companies simply seeking an alternate venue not originally intended in the statute.

Ms. CHIEN. That is correct. I believe that two-thirds of cases in the ITC have a district court counterpart. So they are not cases that could not have been brought in district court. In fact, they are being brought in district court as well. But here I think is where the ITC has provided a service to our economy and to these companies by providing a faster venue for—this needs to be resolved.

Mr. ISSA. This is a Committee that has been working on the rocket docket. A great deal of the work done in patent reform originated in this Committee. I think we are all for it.

Look, we are the jurisdiction not of the ITC. The ITC is not really our game. Our game is the Article III courts. If what you are saying here today is two-thirds of the cases don't really belong in

the ITC, they belong in Article III courts, but they are in the ITC for one of two reasons: one, likelihood of an exclusion order, which is effectively an injunctive relief when they may or may not be given it under the *eBay* decision, and speed to trial.

If that is the case, then from a standpoint of protecting the Federal Government, protecting the taxpayer ultimately, shouldn't we find a way to have an ITC level of speed on those cases that would otherwise be or already are in Article III courts? In other words, the time to a decision if it was accelerated to meet or exceed the ITC, wouldn't that in fact eliminate the government spending money twice, particularly in the cases in which the Article III court may not stay the case?

Ms. CHIEN. Yes, I think that would be the ideal solution. I don't think that our Federal court system is there yet. But through proposals and different initiatives like the patent pilot program then maybe we will get there.

Mr. ISSA. So let me just ask one follow-up, though.

This Committee was very involved in the SOPA-PIPA discussion. You may have heard that. During that discussion one of—sometimes truth is the first casualty. There were a lot of statements made, but since I have you here, is it true that the ITC is less administratively burdensome, less expensive, and quicker to decision than Article III courts?

Ms. CHIEN. I think that the schedules are compressed so it is actually more expensive in a shorter amount of time. Many of the cases do not settle and so net usually the cases are more expensive to litigate, but they are litigated on a faster basis.

Mr. ISSA. But that is a question of cases that are not settled. I mean, if you take out the ones that aren't settled in an Article III court, they go longer, cost more.

And I don't know about everybody else here, but I, for one, have paid those multimillion dollar legal fees. I will tell you that your expense goes up during time often more than actual work. Every month you are in litigation you have a certain large amount of money for reevaluating, rethinking, redoing.

So the reason I ask the question is during that discussion when we were looking at—and I still have a bill that would move intellectual property in the case of overseas piracy of copyright, move some jurisdiction into the ITC. Many people wanted to say that it was likely to not be able to quickly expand, as though we can get Federal judges quickly in Article III, and that it would be more expensive and take longer. Is there any basis under which you think that was true—would be true?

Ms. CHIEN. I think that the ITC has proven able to keep its deadline of trying to keep cases resolved as quickly as possible and that they have experience in doing that and doing it well.

Mr. ISSA. Thank you.

Mr. Chairman, I thank you for the opportunity to ask questions that were tangential to today's hearing but important to I think the Committee, and I yield back.

Mr. GOODLATTE. I thank the gentleman. And the Chair is now recognizing the gentlewoman from California, Ms. Lofgren, for 5 minutes.

Ms. LOFGREN. Thank you, Mr. Chairman; and it is great to see a majority of the witnesses from the 16th congressional district, Cisco headquartered in the district and also Tessaera. And you can see that not everyone in Silicon Valley sees this the same way.

And certainly, Professor Chien, it is great to have you here with your tremendous expertise and such a distinguished member of my alma mater.

So I think this is a very important hearing.

And I guess one of the questions that I have, I think that certainly there are is an issue here—and you have identified it, Professor, as our witness Mr. Rubin—is how to get a remedy in a time frame that is reasonable.

You know, I was thinking as Mr. Berman walked out that in 1997, as a freshman Member, I ended up helping manage a patent reform bill that ultimately through other iterations passed last year. It takes a long time for the Congress to do anything.

And so the question is, what can the FTC do? The court has I think indicated that they can't merely adopt the *eBay* rule without some guidance from us. However, the FTC has suggested—and, Mr. Chairman, I would ask unanimous consent to put the FTC report into the hearing record, at least the relevant pages that—in using kind of an *eBay* standard—

Mr. GOODLATTE. Without objection, the report will be made a part of the record.*

Ms. LOFGREN [continuing]. To determine jurisdiction that you could end up with the same result. Have you seen that FTC report from last year and do you think that is a viable approach?

Ms. CHIEN. I have seen the report, and I think that the report correctly identified the flexibility that the public interest statutory framework gives the ITC to do its analysis. It is not completely aligned, and I think one of the big differences is thinking about irreparable harm which is something you have to prove in district court and ITC will really focus on competitive conditions and impact consumers. But I think that in important ways we can coalesce the standards in this way.

Ms. LOFGREN. Mr. Rubin, do you have a comment on that same question?

Mr. RUBIN. Well, I think the FTC got it right. You can certainly apply the *eBay* factors. For example, irreparable harm, almost by definition dollars will fix this problem. There is not going to be irreparable harm if an injunction isn't issued, because you are talking about a company that doesn't actually compete in the marketplace. So while I do think that *eBay* factors can be applied, I think they can be applied pretty quickly and rather easily.

I think what the ITC has, though, here is sort of two problems.

The first is the question of jurisdiction that we are talking about. Who can be a plaintiff? Who can be a complainant? And that goes to this issue.

The second one that we are talking about in terms of how expensive are these cases, how fast are they, it is true that longer tends

*The Federal Trade Commission report entitled "The Evolving IP Marketplace, Aligning Patent Notice and Remedies With Competition," is not reprinted in this hearing record. The report is on file at the Subcommittee and can be accessed at:

<http://www.ftc.gov/os/2011/03/110307patentreport.pdf>

to be costlier, but if you look at the ITC there are no limits on the type of discovery that can be taken in the ITC. In the case I was discussing earlier in my comment, Cisco was asked to respond to 7,000 requests for admissions. The Federal courts only allow 25. So while it is the case that sometimes ITC cases move more quickly, it is an incredible flurry of activity and incredibly costly.

Ms. LOFGREN. Mr. Cassidy, you may have a counterpoint of view on the FTC suggestion.

Mr. CASSIDY. Our main point is not that there may not be lurking problems and issues that deserve the attention of Congress but that the horror stories have not arisen to the level that congressional action is needed.

To date, the ITC has been careful in applying both the domestic industry requirements to shield companies from nuisance lawsuits and we believe has been careful in applying the public interest factors and has been flexible in the way it has applied its remedies.

Ms. LOFGREN. Thank you, Mr. Cassidy.

EBay also is headquartered in the 16th congressional district, and I think they did a tremendous service for the country in spending the money to bring that case really to stop shakedowns, is what it was about. And the question is—we have a shakedown situation here that has migrated to the FTC and how can that be fixed.

Here is a question: Could the ITC have the same kind of hearing we are? Have they reached out to you, Professor, to see whether they could heal themselves? And is that something that we might suggest to them that might lead to a suitable resolution faster than the ordinary legislative process?

Ms. CHIEN. That is a great question, and I think if you look at their case law you see that they are considering the input that they are getting from different quarters and trying to use that to reflect their decision making.

But the problem is that they have to wait for the right cases to come forward. They have to take them forcefully. They need to take a strong line. And I think they have been reluctant to do that because they do not see themselves as a policymaking body. So I do think that Congress can play a constructive role in holding oversight hearings and talking to ITC and reminding them of what the basis is.

As to these comments about, for example, domestic industry which I think have been very compelling in hearing the stories of companies that have affected by IT actions. If you look in the congressional history, there is an emphasis that favors production-based licensing over revenue-based licensing, as these gentlemen have put it. In the *Coaxial Cable* decision, the ITC has acknowledged that, but they didn't take a strong line in saying this is what we are going to do in the future. They said, this is going to be case by case, and they didn't send I think the strong message that they could have. So I do believe that within their statutory power and with some encouragement they could try to reform some of their own—

Ms. LOFGREN. Mr. Chairman, my time has expired, and we can discuss this further, but I would love to see some kind of interface between us and the commission, if that is possible to do. I think we might have some real benefit for the process.

Mr. GOODLATTE. If the gentlewoman would yield, I think the gentlewoman has a good suggestion. And I won't speak for the Ranking Member, but I think there is interest in a bipartisan fashion to communicate with the commission and offer some of our ideas and ask them if there is such a process they could pursue.

Ms. LOFGREN. Thank you, and I yield back.

Mr. GOODLATTE. I thank the gentlewoman.

The Chair is pleased to recognize the gentleman from Nevada, Mr. Amodei.

Mr. AMODEI. Thank you, Mr. Chairman. I yield my time back.

Mr. GOODLATTE. The gentleman yields his time back.

The Chair will move over to gentleman from Pennsylvania, Mr. Marino.

Mr. MARINO. I yield back.

Mr. GOODLATTE. He yields back as well.

So we will turn to the gentlewoman from California, Ms. Chu, for 5 minutes.

Ms. CHU. Thank you, Mr. Chair.

I would like to ask Mr. Rubin. You spoke at length regarding Cisco's experience defending a patent suit against a nonpracticing entity, also known as "troll," in the ITC. Can you provide us with additional details about the suit? Did the entity have jobs in the U.S.? Did it invest in R&D?

Mr. RUBIN. The short answer is, no, it did not. We were already engaged in litigation with that company in Federal district court in Delaware when this entity decided to sue in the ITC. At the time it brought the lawsuit it quickly tried to open one office in Plano, Texas. It had one employee in the United States. And it did that because it felt like it needed—correctly needed to meet the domestic industry requirement, and that is why it opened that particular office.

Their view was that the litigation in Delaware was moving too slowly, and so they wanted to bring the case as well in the ITC. But I think the thinking was, well, Cisco is not going to want to defend this case in two different forums. We will be able to deluge Cisco with discovery requests. And, in fact, that is what they did. And, ultimately, as I said before, Cisco spent \$13 million defending itself in the ITC in a case that was ultimately voluntarily dismissed.

So it really turned the case into the world's most expensive dress rehearsal. Because now we are back in Delaware where the case started, litigating these exact same issues. And I think that is why it is emblematic of the problem here. When you have the ability to bring cases in Federal court and the ITC, it doubles or potentially triples the cost with really very little benefit.

Ms. CHU. In fact, you stated that companies have been able to achieve settlements far beyond what they would have been entitled to receive if they were sued in U.S. court. Can you give an example of those settlements?

Mr. RUBIN. Well, our company has fared reasonably well in the ITC. But what you have is the threat of injunction in the ITC that now no longer exists in Federal district court. And so the negotiation is different by sometimes an order of magnitude. Because when a company has already made the commitment of R&D, has

a product out in the market, that company is, frankly, vulnerable to any risk of disruption to its supply chain, disruption to its sales. And so that is the context in which you are negotiating to try to settle the case.

The irony here, Congresswoman Chu, is the patent assertion entities don't even want the exclusion order that they are asking for. They want money damages at the end of the day, but they feel as though the ITC provides a forum where they are more likely to get larger damages.

Ms. CHU. Mr. Kelley and Mr. Rubin and Professor Chien, there has been the critique about the patent adjudication substantially increasing partly because of the Supreme Court's decision in *eBay v. MercExchange*. And to back up the point, the article published just last year showed that the average number of ITC complaints annually has nearly tripled from the previous decades. To what do you attribute the rise in cases and what should Congress do about it?

Mr. KELLEY. Thank you, Congresswoman, for that question.

I attribute the rise in those cases at the ITC to the *eBay* case in part because it allowed or it prevented the PAEs from going into district court and getting the injunction.

And I believe it also is attributable in part to the fact, as has been discussed, a PAE can get a very heavy hammer to use in leverage negotiations with the companies that it is litigating against. So I think that that is a big part of why we are seeing these rise in cases.

Ms. CHIEN. Traditionally, the ITC has been reserved for domestic industries against foreign imports. But now that everyone makes—or many products are made overseas, it becomes easier. Every potential patent defendant becomes a potential ITC defendant as well. So I believe that the growth in global economy is a major driver as well as the favorable conditions for injunctions that the ITC presents.

As to your question of what Congress can do, I think that I am in agreement, I think, with the gentleman from the American—on the antitrust side as well that there may be some opportunity for the ITC to reform itself with some oversight and direction from Congress, but if that is not proven to work out that Congress should act to change the statute.

Ms. CHU. Mr. Rubin?

Mr. RUBIN. I agree with the comments that were made that the impetus here is the rise of patent assertion entities, the rise of a global economy that requires companies to source materials and parts abroad and then the *eBay* decision. All three of those things result in the rise of this kind of litigation in the ITC.

I think the answer is to segregate out what licensing is appropriate and what is not and make it very clear that licensing efforts that are designed to promote the advancement of the technology related to the patent, that is to be protected, but not after-the-fact licensing when products are already out in the marketplace. And I think that can be done statutorily.

Ms. CHU. Thank you. I yield back.

Mr. AMODEI [presiding]. The Chair recognizes the distinguished gentleman, who is also a member of the Congressional Baseball Hall of Fame, from the Tarheel State, Mr. Watt.

Mr. WATT. I thank the gentleman for all of that introductory comment.

Let me see if I can approach this and explore some other options that might be available.

Mr. Kelley, you talked about the Beacon case; and Mr. Rubin talked about a case in which they spent—what—\$17 million—

Mr. RUBIN. Thirteen.

Mr. WATT [continuing]. Thirteen million dollars only to have the cases dismissed. Does ITC have any kind of authority to really punish somebody or bite somebody who brings a case with faulty intentions such as maybe assessing \$13 million in cost to the other side or attorneys fees? What discretion does the ITC have there to get at this in an absolutely different way?

Mr. KELLEY. Thank you for the question, Ranking Member Watt.

I believe that the ITC does have the ability to assess sanctions or some other penalties, but in practice and reality that is not done. So in the Beacon case that I have discussed, after Beacon dismissed the case in the ITC, we sought to get sanctions. There were some shenanigans going on in this case, and they ultimately withdrew. And there are some procedural issues that get in the way of us being able to successfully pursue sanctions.

I like your thinking. I believe that that is one way perhaps to go about this, and I believe that the ITC should consider perhaps going down that route, and that might prevent some of what we consider this frivolous and expensive litigation.

Mr. WATT. What would you think of that approach, Mr. Cassidy, as a precursor to legislative action?

Mr. CASSIDY. I think the ITC should have the ability to shift fees and otherwise impose the ordinary sanctions that district courts are allowed to impose against litigants who are acting in bad faith, absolutely.

Mr. WATT. And do you—let me be clear. Do you acknowledge that some of these cases are being brought in bad faith? I mean, you walked a pretty tight line there. You said we shouldn't be acting yet. It is not at crisis proportions. But do you acknowledge that there is some gaming of the system?

Mr. CASSIDY. I think all of litigation is gaming the system, generally.

Mr. WATT. I agree with you that there is a lot of gaming of the system in all litigation.

Mr. CASSIDY. But to answer your question, I am not aware personally of a single bad-faith litigant.

Mr. WATT. You don't think this case—either of these two cases that these gentleman have described were brought in bad faith?

Mr. CASSIDY. No, sir. I have no evidence whatsoever to draw that conclusion. I think in each case the correct outcome was reached; and I think, for better or for worse—

Mr. WATT. \$13 million in cost?

Mr. CASSIDY. Yes, sir. And I think some of the same law firms that represent Cisco represent Tessera, and they are expensive.

But it is a part of our system to allow people into court and into the ITC at a very low threshold. That is one the fundamental parts of the American civil justice system that we fought a revolutionary war to obtain, and every district court judge knows there are going to be nuisance cases brought, there are also going to be strike suits brought—

Mr. WATT. They also have some pretty aggressive sanctioning capacities, and they use them quite often to discourage people from gaming the system. And so it sounds like maybe perhaps in our discussions if we create a dialogue with ITC or have that opportunity, that might be at least one option that can be looked at.

Did you have a comment, Professor?

Ms. CHIEN. I just think it is a very interesting proposal or idea. And I would just say I have done some empirical work and I think Mr. Cassidy is right, that nuisance suits have existed since Justinian time. They have always been around. And Europe has tried with the English rule, fee shifting, and other jurisdictions have studied a lot of different jurisdictions that have tried to do it.

And I think it is hard, that I think that judges are reluctant to say any litigant is bringing their case in bad faith. They want to give everybody an equal chance. So it is hard to tell before the fact if somebody is bringing something in bad faith, and so I think the problem with these rules is that they don't deter as much as they should.

Mr. WATT. Okay, well, I thank all of you for testifying.

I will yield back. It is not my role to thank the panel, but I thank you anyway. Good hearing.

Mr. AMODEI. Thank you.

I would like to thank our witnesses on behalf of myself and the Ranking Member today.

Mr. WATT. You want to ask questions? You are the last person on—

Mr. BERMAN. Me? This hearing goes on because I showed up?

Mr. WATT. One could say that, but one could also say it was a worthy purpose for the hearing to go on because you showed up.

Mr. AMODEI. In keeping with responsibility where it is due, the Chair now recognizes either for purposes of questions or yielding back the distinguished gentleman from the Golden State.

Mr. BERMAN. Ten seconds.

Mr. WATT. Now you really are holding us up.

Mr. CASSIDY. Mr. Chairman, during that time may I ask that two documents that I incorporated into my testimony—my prepared testimony be submitted to the record? A letter to the ITC from the Innovation Alliance and a white paper we wrote on the ITC.

Mr. AMODEI. Without objection, they will be included as part of the record today.*

Mr. WATT. And since we are trying to give Mr. Berman more time, let me ask unanimous consent to insert three articles from Professor Rudolph Peritz: one called "Intellectual Property Rights as State-Initiated Restraints of Competition—or State-Initiated Competition;" two, "Patents and Payoffs or How Generics are Kept Off the Market;" and, three, "Competition Within Intellectual Prop-

*The material referred to is available in the Appendix.

erty Regimes—the Instance of Patent Rights.” And also a submission of views by Kevin H. Rhodes for the Coalition for 21st Century Patent Reform and 3M Company.

Mr. AMODEL. Without objection, they will be included in the record of today’s hearing.*

Mr. Berman?

Mr. BERMAN. I am getting some of this secondhand, as you might imagine, and I apologize for not being here during the whole testimony, and I thank you very much for indulging me here to just catch up.

There was one particular issue that I am told there may or may not have been agreement on, and basically it is that Mr. Cassidy testified that he was open to addressing—address some of these issues at the ITC if there was some remedy that was needed. And Mr. Rubin in his testimony described a situation with a Canadian patent—Canadian asserting a patent presumably showing it isn’t quite as simple as about a domestic industry. Is that the kind of an issue that you think becomes problematic in terms of the current way the ITC is working?

Mr. CASSIDY. I think the intent of the ITC was not in its creation to govern American companies—but rather to govern importation when it comes to the matters we are discussing here under Section 337. And I think, as other panelists would readily agree, the world has changed and we all import. Every manufacturer virtually imports. And when you import something into the United States, that is not a right, that is a privilege, and it comes with certain responsibilities. And I think it is settled law that importing an infringing good of—infringing a valued patent is an unfair trade practice.

The question is, should we rewrite the law so that if you have to be headquartered in the United States you can import and not be subject to those rules? I don’t think anyone is proposing that. But I think in working toward something that makes more sense and takes on the character of a 21st century ITC we would have to look very carefully at who is an American company and what rights come with that when one imports.

I don’t think there is an easy solution at all. And to be candid, notwithstanding the significant issues that are raised here, none of these specific proposals are compelling to a company and to an alliance that represents people who invent for a living, who instead of manufacturing create things and leave it to others to implement them. It is an important part of our economy.

Mr. BERMAN. Look, I shouldn’t even be taking everybody’s time, because I wasn’t here for the whole testimony. But my assumption is it was certainly part of both the Chair’s and the Ranking Member’s opening statements, which I did hear, there is something that seems inappropriate that in the context of importation things can happen that in the context of the general patent system don’t always happen. And it seems to me that was the quandary that this hearing was trying to sort of develop, delve into. Is that an unreasonable reaction?

Mr. CASSIDY. No.

Mr. BERMAN. Okay. I think I will stop there.

*The material referred to is available in the Appendix.

Mr. RUBIN. I would just conclude, Congressman Berman, that the problem we are seeking to address is jurisdictional in nature. Who can be a complainant in the ITC?

Like Mr. Kelley, I like Congressman Watt's idea about thinking about other sanctions. Are there other things that we can do to strengthen this?

At the end of the day, nobody is taking away a patent assertion entity's right to go to court. The Federal district court, that forum is readily available, and dozens of cases are filed every day.

The only question here is who can be a plaintiff, who can be a complainant in the ITC and you need a domestic industry. So the question to Mr. Cassidy's point about what is a U.S. industry, what is an American company, who has a U.S. industry worthy of protection, that is really the issue we are dealing with today; and I think the proposals that have been made actually can quite help solve that problem.

Mr. BERMAN. I guess another jurisdictional issue is ours with the Ways and Means on ITC.

Thank you very much. I appreciate you indulging me here.

Mr. AMODEI. Thank you.

I would like to thank our witness for your testimony today.

Without objection, all Members will have 5 legislative days to submit any additional materials for inclusion into the record in addition to those that we have already dealt with.

Finally, without objection, all Members will have 5 legislative days to submit to the Chair additional questions for witnesses, which we will forward and ask the witnesses to respond as promptly as they can so that their answers may be part of the record of the hearing today.

With that, again I want to thank you gentlemen and lady for coming here today and being witnesses; and this hearing is adjourned.

[Whereupon, at 11:43 a.m., the Subcommittee was adjourned.]

A P P E N D I X

MATERIAL SUBMITTED FOR THE HEARING RECORD

**Attachments to the Prepared Statement of Colleen V. Chien, Professor,
Santa Clara University School of Law***

By Electronic Filing
July 9, 2012
The Honorable James R. Holbein
Secretary, U.S. International Trade Commission
500 E Street, S.W.
Washington, DC 20436

Re: In the Matter of Certain Wireless Communications Devices, Portable Music and Data Processing Devices, Computers, and Components Thereof, Investigation No. 337-TA-745

SUBMISSION OF 19 ECONOMICS AND LAW PROFESSORS

The Statute Requires the ITC To Consider Competitive Conditions and Consumers

19 U.S.C. § 1337(d)(1) states: “If the Commission determines, as a result of an investigation under this section, that there is a violation of this section, it shall direct that the articles concerned, imported by any person violating the provision of this section, be excluded from entry into the United States, unless, after considering the effect of such exclusion upon the public health and welfare, competitive conditions in the United States economy, the production of like or directly competitive articles in the United States, and United States consumers, it finds that such articles should not be excluded from entry.”¹ Congress intended public interest considerations to be “paramount” to the statute’s administration. S. Rep. No. 93-1298, 93rd Cong., 2d Sess. 193 (1974).² Under Commission Order, administrative law judges of the ITC now may take evidence on the public interest at the outset of a case, rather than waiting until the end.³

Our Qualifications To Talk about Competitive Conditions and Consumers

In this submission, we consider one aspect of Section 337 (d)(1): the impact of excluding products that practice standards-essential patents (SEPs) on competitive conditions and United States consumers.⁴ We have studied patent and competition policy for years, and in some cases decades. Collectively we have published over 100 scholarly articles, casebooks, treatises, and book chapters, on the subjects of standards,

¹ 19 U.S.C. § 1337(d)(1).

² The Senate Report further reads: “Should the Commission find that issuing an exclusion order would have a greater adverse impact on the public health and welfare; on competitive conditions in the United States economy; on production of like or directly competitive articles in the United States; or on the United States consumer, than would be gained by protecting the patent holder [] then [an] [] exclusion order should not be issued.” S. Rep. No. 93-1298, 93rd Cong., 2d Sess. 197 (1974).

³ Rules of Adjudication and Enforcement, 19 CFR Part 210, 76 Fed. Reg. 64803 (Oct. 19, 2011) *available at* http://www.usitc.gov/secretary/fed_reg_notices/rules/finalrules210.pdf.

⁴ In so doing, we take no position on Questions 1-6 of the Request for Written Submissions, which ask about the particulars of this case.

*Two additional attachments submitted by this witness are not reprinted in this record but are available at the Subcommittee and can be accessed at:

<http://ssrn.com/abstract=1150962> and <http://ssrn.com/abstract=1856608>

competition policy, patent remedies, patent licensing, administrative law, and the International Trade Commission.

We provide these views as teachers and scholars of economics, antitrust and intellectual property, remedies, administrative, and international intellectual property law, former Department of Justice lawyers and chief economists, a former executive official at the Patent and Trademark Office, a former counsel at the ITC Office of the General Counsel, and a former Member of the President's Council of Economic Advisers.

The ITC Should Not Grant Exclusion Orders Based on SEPs Subject to RAND Commitments

Some of us have been called "pro-competition"; others among us have been accused of being "pro-patent." However, we all agree that ITC exclusion orders⁵ generally should not be granted under § 1337(d)(1) on the basis of patents subject to obligations to license on "reasonable and non-discriminatory" (RAND) terms. Doing so would undermine the significant pro-competitive and pro-consumer benefits that RAND promises produce and the investments they enable. A possible exception may arise if district court jurisdiction is lacking, the patent is valid and infringed, and the public interest favors issuing an exclusion order. We explain our position below.

SEPs Subject to RAND Commitments Differ from Other Patents

The Federal Circuit has said that "Congress intended injunctive relief to be the normal remedy for a Section 337 violation."⁶ However, the Federal Circuit has also repeatedly stated that "the Commission has broad discretion in selecting the form, scope, and extent of the remedy."⁷ Furthermore, a unique set of factors comes into play for SEPs that are subject to RAND commitments. Holders of SEPs put aside their rights to exclude when they agree to make their technology available on terms that are reasonable and non-discriminatory and imply that legal remedies (i.e. monetary damages) are adequate.⁸ Through their promises, patent holders have traded the right to exclude for the privilege of being declared essential to the standard.

Having a patent declared standards-essential benefits the patent holder. Broadly-adopted standards like Wi-Fi get implemented in thousands of products sold to

⁵ And ITC cease and desist orders, the grant of which are governed by § 1337(f)(1).

⁶ *Spanion, Inc. v. United States Int'l Trade Comm'n*, 629 F.3d 1331, 1358 (Fed. Cir. 2010), cert. denied, 132 S. Ct. 758, 181 L. Ed. 2d 482 (U.S. 2011).

⁷ *Hyundai Electronics Industries Co., Ltd. v. U.S. Intern. Trade Com'n*, 899 F.2d 1204, 1209 (Fed. Cir. 1990), citing *Viscofan, S.A. v. United States Int'l Trade Comm'n*, 787 F.2d 544, 548 (Fed.Cir.1986).

⁸ See *eBay Inc. v. MercExchange, L.L.C.*, 547 U.S. 388, 391 (2006) (a plaintiff must demonstrate the inadequacy of legal remedies before a court may grant injunctive relief).

hundreds of millions of consumers, in many cases earning large royalty streams. Failure to be included in a standard, in contrast, can relegate a technology to irrelevance. Knowing this, patent owners are often willing to provide standards setting organizations (SSOs) with RAND commitments and lobby for the privilege to do so,⁹ even though the standards setting process may be painstaking and slow.¹⁰ Indeed, royalty-free or RAND licensing of standard-essential patents is required by many of the major standards bodies including American National Standards Institute (ANSI), which administers and coordinates US private sector standards among 100,000 companies, and the European Telecommunication Standards Institute (ETSI), which sponsors the development of European telecommunications standards among more than 700 members.¹¹

Critically, SEPs cannot, by definition, be designed around without sacrificing compliance with the standard. This makes them different than non-SEP patents that, if they cover minor features, can be designed around without sacrificing key functionality. While inventing around does not eliminate the danger of patent hold-up, it does provide a check on the bargaining power wielded by patent holders that seek injunctive relief. This check is much weaker when the patents are standards-essential. There, disabling even a single feature to avoid infringement of an SEP can greatly detract from the value of a product by making it inoperable for its intended purpose, for example, a laptop that cannot connect to a Wi-Fi network. Furthermore, many consumers, counting on standards to provide the functionality they require, are unwilling to purchase non-compliant products. An exclusion order that forces manufacturers to produce non-compliant products would undermine the network effects associated with successful standards and harm consumers.

Furthermore, hundreds or even thousands of patents can read on a single standard, especially in the information and communications sector of the economy. In the ETSI

⁹ Joseph Farrell et al., *Standard Setting, Patents and Hold-Up*, 74 *Antitrust L.J.* 603, 606 (2007).

¹⁰ Discussed, e.g. in Carl Shapiro, *Setting Compatibility Standards: Cooperation or Collusion?*, in *EXPANDING THE BOUNDARIES OF INTELLECTUAL PROPERTY* 85 (Rochelle Dreyfuss et al. eds., 2001), and Timothy Simcoe, *Standard Setting Committees: Consensus Governance for Shared Technology Platforms*, 102 *American Economic Review* 305 (2012).

¹¹ Guidelines for Implementation of the ANSI Patent Policy (February 2011), ANSI Essential Requirements, at Section II and available at <http://publicaa.ansi.org/sites/apdl/Documents/Standards%20Activities/American%20National%20Standards/Procedures,%20Guides,%20and%20Forms/Guidelines%20for%20Implementation%20of%20ANSI%20Patent%20Policy%202011.pdf>; ETSI's IPR Policy (Nov. 30, 2011), at Annex 6 available at <http://www.etsi.org/website/aboutetsi/iprsinetsi/iprsinetsi.aspx>. See also Mark A. Lemley, *Intellectual Property Rights and Standard-Setting Organizations*, 90 *Calif. L. Rev.* 1889, 1906 (2002) (finding that 29 out of the 36 standard-setting organizations studied with policies required RAND licensing, another 6 required outright assignment and three others suggested but did not require FRAND licensing). See also Benjamin Chiao, Josh Lerner, and Jean Tirole, *The Rules of Standard-Setting Organizations: An Empirical Analysis*, 38 *RAND Journal of Economics* 905.

standard setting organization, patent owners have declared more than 750 unique patent families as essential to the GSM cellular standard, more than 1,600 as essential to the third-generation UMTS cellular standard, and more 500 as essential to the fourth generation LTE cellular standard.¹² More than 900 patents have been declared to be essential to the MPEG-2 standard for encoding digital video and audio, including over 100 US patents.¹³

This situation – which is common to SEPs – gives owners of SEPs undue bargaining leverage if they are permitted to obtain injunctions, because the inability to practice even a single SEP will result in the product being noncompliant. As a result, the bargaining leverage of patents covering minor aspects of the standard far outweighs their contribution.¹⁴ The Federal Trade Commission has reached this same conclusion, based on reasoning very similar to ours.¹⁵

Excluding Products that Practice SEPs Adversely Impacts Competitive Conditions and Consumers

19 U.S.C. § 1337(d)(1) does not compel the Commission to grant exclusion orders. Rather, it empowers the ITC to evaluate whether or not an exclusion order is in the public interest, and to proceed accordingly. The Federal Circuit parses the statute to identify four separate factors.¹⁶ “The enumerated public interest factors include: (1) the public health and welfare; (2) competitive conditions in the United States economy; (3) the production of like or directly competitive articles in the United States; and (4) United States consumers.”¹⁷ On the three occasions that the ITC has declined to enter an injunction,¹⁸ its focus has been on two factors: the public interest in health and welfare and the unavailability of alternatives. We use these precedents to inform our

¹² K. Blind et al., *Study on the Interplay between Standards and Intellectual Property Rights (IPRs)*, Tender No ENTR/09/015 (OJEU S136 of 18/07/2009) Final Report, April 2011.

¹³ MPEG LA, MPEG-2 Patent Portfolio License Briefing (Aug. 4, 2010); See also Richard J. Gilbert, *Ties That Bind: Policies to Promote (Good) Patent Pools*, 77 Antitrust Law Journal No. 1, 13 (2010).

¹⁴ See Farrell, et. al, supra, Mark Lemley and Carl Shapiro, *Patent Holdup and Royalty Stacking*, 85 Texas Law Review 1991, Carl Shapiro, *Injunctions, Hold-Up, and Patent Royalties* (2010), 12 American Law and Economics Review 218; See also Richard J. Gilbert, *Deal or No Deal? Royalty Negotiations by Standard Development Organizations*, 77 Antitrust Law Journal 855 (2011).

¹⁵ *United States Federal Trade Commission Statement on the Public Interest*, Inv. No. 337-TA-745. (June 2012)

¹⁶ See *Spansion*, 629 F.3d at 1358 (Fed. Cir. 2010).

¹⁷ *Id.*

¹⁸ See Opinion of Vice Chairman Alberger and Commissioners Bedell and Stern *In re Certain Automatic Crankpin Grinders* at 17-18, USITC Inv. No. 337-TA-60 (Dec. 17, 1979); Commission Action and Order *In re Certain Inclined-Field Acceleration Tubes* at 22-31, USITC Inv. No. 337-TA-67, (Dec. 29 1980); Commission Memorandum Opinion *In re Certain Fluidized Supporting Apparatus and Components Thereof*, at 1-2, USITC Inv. No. 337-TA-182, 337-TA-188, 225 U.S.P.Q. 1211, 1984 WL 63741 (Oct. 5, 1984).

description below of how competitive conditions and consumers are particularly impacted when the use of SEPs is withheld through an exclusion order.

First, companies count on the availability of standards-essential technology to make significant investments. Electronics manufacturers spend hundreds of millions of dollars on fabrications plants that can make products compatible with a standard such as the IEEE 802.11 wireless local area network protocol. Comparable sums are spent in the information and communications sector to design and build products that comply with various product standards. The companies making these investments depend on their ability to license any technology necessary to comply with these standards on reasonable terms. They typically become “locked-in” to the standard, meaning that a significant portion of their investments would be rendered uneconomic if they were blocked from producing standards-compliant products.

If the ITC were generally to allow RAND-obligated patents to be used as the basis of injunctions, this would undermine the basic bargain RAND commitments represent. Industry participants would be less willing to make the investments needed to design and build standards-compliant products, due to the risk they will later be unable to make and sell those products. A clear statement from the ITC that it will generally *refrain* from issuing exclusion orders for SEPs, in contrast, will increase certainty for firms making investments in complementary technology.¹⁹

Second, these investments promote competition and inure to the benefit of United States consumers.²⁰ There are an estimated 700,000 standards and technical regulations around the world, and 450 standards setting organizations in the United States alone.²¹ Without these organizations and the standards they develop, the Internet would not work, phones could not talk to each other, and it would be harder to buy printer paper.²² Standards facilitate network effects – the more devices that can read my text messages, the more valuable my text messages become. Open standards enable greater

¹⁹ Federal Trade Commission, *supra* at 5.

²⁰ For a thoughtful recent statement describing how standards promote competition and generate substantial benefits to consumers, while elevating the dangers of patent holdup, see the February 13, 2012 Statement by the Department of Justice’s Antitrust Division regarding its decision to close its investigations into several transactions involving SEPs, *available at* http://www.justice.gov/atr/public/press_releases/2012/280190.htm. It closed these investigations in part based on commitments not to seek injunctions in disputes involving SEPs. However, citing “more ambiguous statements that do not provide the same direct confirmation,” the Division stated that it “continues to have concerns about the potential inappropriate use of SEPs to disrupt competition and will continue to monitor the use of SEPs in the wireless device industry.”

²¹ Report to the European Round Table of Industrialists (ERT) prepared by FIPRA International, October 2010, pp.3, 12 and *available at* http://www.ert.eu/sites/default/files/Standard%20setting%20in%20a%20changing%20global%20landscape%20Final%20Report_0.pdf.

²² Lemley, *supra* at 1892.

competition in interoperable products and services.²³ A lack of standardization, in contrast, can leave a consumer “stranded” - as anyone who has forgotten the charge cord for their mobile phone can attest.

Proprietary formats can lead to greater market power when the technology is not made available to all comers.²⁴ Undoing the standards bargain through an exclusion order may leave consumers who have already bought the product stranded, unable to get support or services for products already purchased.²⁵

Furthermore, issuing an order to exclude standards-compliant products would have consequences not only on individual respondents but also on third parties – for example, service providers, application developers, and other members of the ecosystem of the enjoined product.²⁶ The larger the market for the enjoined product, the greater the collateral impact.

Finally, we are mindful of several other relevant sources of authority. One is the Federal Trade Commission’s official comment on issues of public interest in this case.²⁷ Similar to the present comment, it urges the ITC to consider the “[h]igh switching costs combined with the threat of an exclusion order could allow a patentee to obtain unreasonable licensing terms despite its RAND commitment...because implementers are locked into practicing the standard.”²⁸ Agencies don’t often comment publicly in ITC cases,²⁹ giving the FTC’s statement additional significance. The Department of Justice has also publicly expressed its concern about the use of RAND patents to seek

²³ Shapiro, *supra* at 89-90.

²⁴ *Id.*

²⁵ *Id.* at 72, 79-84.

²⁶ See *Certain Baseband Processors*, p. 153 (“The potential harm to economic actors, in this case including handset manufacturers and telecommunications service providers, is properly part of our *EPROMs* analysis, and we have indeed fully weighed potential harm to third parties and to legitimate trade in that prior analysis. In fact, under our *EPROMs* analysis, we found that full downstream relief was *not* permitted in this investigation due to, among other things, the magnitude of the impact on third parties.”) (ultimately concluding “a downstream remedy with a grandfathering exception does not raise public interest concerns” because “the relief we propose has a much more limited impact on availability of 3G-capable handsets, and thus a lesser impact on the public interest.”) (see *also id.* at 153-154).

²⁷ *United States Federal Trade Commission Statement on the Public Interest*, Inv. No. 337-TA-745 (June 2012).

²⁸ *Id.* at 3.

²⁹ Based on a search of EDIS, the ITC’s electronic docketing system and related research. Politicians have sent letters on behalf of their constituents to the ITC. See generally Colleen Chien, *Publicly Influencing the ITC* (unpublished paper, on file with the author). 19 USC 1337 (b)(2) requires the ITC to consult with governmental departments and agencies “as it considers appropriate.” According to the legislative history, the requirement of these consultations reflects Congress’ “[belief] that the public health and welfare and the assurance of competitive conditions in the United States economy must be the overriding considerations in the administration of this statute.” S. Rep. No. 93-1298, 93rd Cong., 2d Sess. 197 (1974).

injunctions.³⁰ The President has made several statements about the importance of wireless technologies for consumers and the national economy.³¹ In previous cases when the ITC has declined to award or has tailored an exclusion order, it has relied upon such official comment and agency, Presidential and Congressional policy to explain its position.³²

In addition, the statute's legislative history addresses opportunistic behavior by patent holders. It cautions against using the statute to reward such behavior, noting that an "exclusion order should not be issued...particularly in cases where there is evidence of price gouging or monopolistic practices in the domestic industry." S. Rep. No. 93-1298, 93rd Cong., 2d Sess. 107 (1974).

Money Damages, not Injunctions, are the Appropriate Remedy for SEPs Subject to RAND Commitments

In short, though standards create value by facilitating interoperability and enabling competition in complementary products to thrive, they increase the vulnerability of standards implementers to patent holdup. RAND promises counter these concerns. They reassure companies that they will not be held up, but rather will be able to access the required technologies on fair, reasonable, and non-discriminatory terms.

Holders of SEPs who have promised to license their patents on reasonable terms should not generally be allowed to obtain injunctions against products that comply with the standard. Regardless of the respondent specifics referred to in Question 7 of the Request for Written Submissions, the patentee has received the benefit of the bargain by having their patented technology included in the standard. In return, they are obligated to license their patent on RAND terms. Allowing holders of SEPs to obtain injunctions would give the RAND licensing obligation an implicit "unless we don't feel like it" clause that would render the commitment virtually meaningless.

³⁰ See February 13, 2012 Statement by the Department of Justice's Antitrust Division, *supra*.

³¹ See *Verizon Statement on the Public Interest*, Inv. No. 337-TA-745 (June 2012).

³² See Commission Action and Order *In re Certain Inclined-Field Acceleration Tubes* at 21, USITC Inv. No. 337-TA-67, (Dec. 29 1980) (citing in support of its decision to not grant an order enjoining Dowlish tubes used for research, "the President and the Congress have issued declarations of support for basic science research," and "[t]he National Science Foundation Act" (in this case the NSF submitted a comment); Opinion of Vice Chairman Alberger and Commissioners Bedell and Stern *In re Certain Automatic Crankpin Grinders* at 17-18, USITC Inv. No. 337-TA-60, 205 U.S.P.Q. 71, 0079 WL 419349 (Dec. 17, 1979)(justifying the Commission's decision not to exclude efficient crankpin grinders in part by "the fact that Congress and the President have also clearly established a policy requiring automotive companies to increase the fuel economy of the automobiles they produce."); See also Commission Decision in *Certain Baseband Processor* (TA-337-543), where the ITC custom tailored the injunction it ordered, and cited the public comments of FEMA and the FCC.

Patent owners may legitimately worry that without the threat of an injunction, infringers will turn down reasonable offers. We are sympathetic to these concerns. However, district courts are in a better position to deal with them by imposing attorneys' fee sanctions for bad behavior or enhanced damages in certain situations.³³ District courts also can issue injunctions, even for SEPs subject to RAND commitments, if the equities favor doing so.

Exceptions to the Rule and Injunction Tailoring

As one of us has written elsewhere: "[t]here is at least one situation where an ITC action and exclusion order on the basis of a RAND patent may be appropriate, however. [] In the cases when the district court lacks jurisdiction over a defendant but the *in rem* jurisdiction of the ITC is available,³⁴ the ITC provides the patentee with its only recourse."³⁵ In such cases, ITC review and relief may be appropriate, provided that the other prerequisites to relief have been met. However, it may well be the case that even if the ITC is the only venue in which relief is available, an exclusion order is still not appropriate due to the failure to meet public interest or other prerequisites.

If the ITC decides to issue injunctions based on SEPs subject to RAND commitments, we urge the Commission to consider tailoring its order to minimize harm to the public interest, for example through delay or grandfathering. Delaying injunctions can address certain holdup problems. Faced with the threat of an exclusion order, the respondent will sometimes design around the standard even if it means disabling standards essential functionality.³⁶ But if the patent is found invalid or not infringed, the effort will have been wasted.³⁷ Delaying the exclusion order reduces investment in unnecessary design-arounds and gives competitors time to adjust.³⁸ Grandfathering existing models can also help consumers, at a minimal cost to the patentee. Thus, in *Certain Baseband Processors*, the Commission adjusted the scope of the exclusion order by grandfathering

³³ Joseph Scott Miller, *Standard Setting, Patents, and Access Lock-In: RAND Licensing and the Theory of the Firm*, 40 *Ind. L. Rev.* 351, 390 (2007).

³⁴ 65% of ITC cases have a district court counterpart, suggesting that this isn't a problem in the majority of cases, since the ITC and district court both have the power to hear the case. See Colleen Chien, *Patent Protectionist? An Empirical Analysis of Patent Cases at the International Trade Commission*, 50 *WM. & MARY L. REV.* 63, 64 (2008).

³⁵ Colleen Chien & Mark Lemley, *Patents, Holdup, and the ITC* __ *Cornell Law Rev.* (forthcoming 2012), at 53, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1856608.

³⁶ See Lemley & Shapiro, *supra* at 2002.

³⁷ See *id.* at 2002, n. 71.

³⁸ See *id.* at 2038, Commission Decision in *Personal Data and Mobile Communications Devices TA-337-710*, at 81. ("T-Mobile itself has advised the Commission that a four-month transition period would likely be sufficient. . . . We find T-Mobile's suggestion to be reasonable and within our authority to implement.").

in existing models of handsets.³⁹ Likewise, in *Personal Data and Mobile Communications Devices*, the Commission grandfathered refurbished replacement handsets into its exclusion order.⁴⁰ In *Sortation Systems*⁴¹ and *Transmission Trucks*,⁴² the ITC exempted from its exclusion order spare parts to service existing systems and facilities, citing public interest.

Responses to Questions 8-13

In sum, we believe that ITC relief should generally not be granted under §1337(d)(1) on the basis of patents subject to RAND commitments.⁴³ A possible exception arises in cases where district court relief is unavailable due to a lack of jurisdiction and the patent is valid, infringed, and public interest favors granting relief. In the rare case where an ITC exclusion order is appropriate, the ITC should make use of its remedial flexibilities, including grandfathering and delay, to minimize harm to competition and U.S. consumers.

Applying these principles to the Commission's specific questions,⁴⁴ we believe that the answer to Question 8 is "affirmative": a RAND obligation should generally preclude issuance of an exclusion order, except as we have described. The addition of the patentee's unwillingness to offer or license their RAND obligated patents as contemplated by Questions 9-12, or a failed negotiation as contemplated by Question 13, should not change this result. The patentee has committed to making the technology available on RAND terms, and received the benefit of that bargain. If the respondent fails to accept an offer made to them that has been determined by a

³⁹ Commission Decision in *Certain Baseband Processors* Inv. No. 337-TA-543, *supra* at 150.

⁴⁰ Commission Decision in *Personal Data and Mobile Communications Devices* 337-TA-710, *supra* at 83. ("ITC shall be permitted to import into the United States [for 19 months] . . . refurbished handsets to be provided to consumers as replacements.").

⁴¹ *Certain Sortation Systems, Parts Thereof, and Products Containing Same*; Notice of Violation of Section 337 of the Tariff Act of 1930 and Issuance of Limited Exclusion Order, 68 Fed. Reg. 5047 (Jan. 31, 2003) ("The Commission determined to include an exemption in the limited exclusion order for importations of spare parts for United Parcel Service's Hub 2000 facility in Louisville, Kentucky.").

⁴² *Certain Automated Mechanical Transmission Systems for Medium-Duty and Heavy-Duty Trucks, and Components Thereof*, Termination of Investigation; Issuance of a Limited Exclusion Order and a Cease and Desist Order, at 3, EDIS Doc. ID. 228343, USITC Inv. No. 337-TA-503 (Apr. 7, 2005) ("The limited exclusion order does not cover parts necessary to service infringing automated mechanical transmission systems installed on trucks prior to the issuance of the order.").

⁴³ Though the question of whether relief should be relief on the basis of SEPs not subject to FRAND is beyond the scope of the ITC's request, we note that many of the same impacts to consumers and competitive conditions discussed in this comment also extend to this situation.

⁴⁴ As discussed above at note 2 we take no position on Questions 1-6 which ask about this specific investigation or otherwise do not implicate public interest concerns. Question 7 is addressed *supra* at the top of page 6.

suitable fact finder to be RAND, district court damages, sanctions, and/or injunctions may be appropriate.

We thank the Commission for the opportunity to comment on these important issues.

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Patent Holdup, the ITC, and the Public Interest¹

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ABSTRACT

The Supreme Court's eBay decision requires district courts to weigh the equities before permanently enjoining a defendant. This is a good thing. Since eBay, the tactic of threatening injunctions to, in the Court's words, "extract exorbitant fees" has declined. It's now harder for a patent assertion entity (PAE), or patent "troll," and in certain cases, operating companies, to win an injunction. But eBay's discretionary test doesn't apply at the ITC. This has had the unintended consequence of driving those who seek to circumvent eBay's ruling to the ITC, where the odds of getting an injunctions are better. In this paper, we document that trend, which is dramatic. Increasingly, cases filed at the ITC are filed by PAEs against an entire industry, often information technology. Practicing entities too have turned to the ITC to seek injunctions district courts won't give them, for example on patents covering industry standards.

Because the ITC can't award damages, it has granted injunctions as a matter of course. But as we suggest in this paper, the Commission has more power to adjust the remedy it grants than previously recognized. We think it should use that flexibility to limit exclusion orders when competitive conditions demand it. A PAE may not be any more justified to receive an exclusion order from the ITC under its public interest analysis than to receive an injunction from a district court applying eBay. Even practicing entities should be denied the power to exclude in some circumstances, for example when the patents are standards-essential and/or encumbered by a RAND license, there is no evidence of bad faith, and the patentee can seek damages in the district court. When exclusion orders are issued, delays in their implementation and grandfathering in existing products can reduce holdup. Bond and penalty provisions could be used to ensure that patentees are compensated for ongoing infringement during these transition periods. Using its discretion wisely, the ITC can administer the statute to fairly and efficiently give patentees their due while minimizing harm to the public interest.

¹†© 2012 Colleen V. Chien & Mark A. Lemley. This is the 7/17/12 version submitted for the purposes of the House Committee on the Judiciary Subcommittee on Intellectual Property, Competition and the Internet 7/18/12 Hearing on the ITC and Patent Disputes. The final version of this article will be posted to www.ssrn.com. An earlier version of this article provided the basis for our Editorial, *Patents and the Public Interest*, NEW YORK TIMES.COM, Dec. 13, 2011, <http://www.nytimes.com/2011/12/13/opinion/patents-smartphones-and-the-public-interest.html>.

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TABLE OF CONTENTS

INTRODUCTION 3

I. THE RUSH TO THE ITC 10

II. EXCLUSION ORDERS AND THE PUBLIC INTEREST 23

III. TAILORING, BONDING, AND PAUSING IN THE PUBLIC INTEREST 34

 A. Grandfathering/Tailoring Injunction Scope 39

 B. Delay 41

 C. Bonds and Penalties 45

 D. In Sum 48

IV. CONCLUSION 52

Introduction

In the wake of the Supreme Court's 2006 *eBay* decision,⁴ courts rarely grant injunctions to parties that assert patents as a business model, aka "patent trolls" or patent-assertion entities (PAEs).⁵ This is a good thing. By requiring courts to consider the equities of a particular case before granting an injunction, the Court in one fell swoop wiped out much of the holdup problem that had beset the patent system. As Justice Kennedy put it in his *eBay* concurrence, this hold up problem results when "an injunction . . . can be employed as a bargaining tool to charge exorbitant fees []."6

But there is another jurisdiction that routinely grants injunctions in patent cases: the International Trade Commission (ITC). In the past five years, both PAEs and product-producing companies have flocked to this once-obscure trade agency, generally in search of an injunction or the credible threat of one.⁷

⁴ *eBay Inc. v. MercExchange, L.L.C.*, 547 U.S. 388 (2006).

⁵ Colleen V. Chien, *From Arms Race to Marketplace: The Complex Patent Ecosystem and Its Implications for the Patent System*, 62 HASTINGS L.J. 297, 328 (2010) (PAEs are "entities . . . focused on the enforcement, rather than the active development or commercialization of their patents."), accord, FTC *The Evolving IP Marketplace: Aligning Patent Notice and Remedies with Competition* 8 n.5 (Mar. 2011), available at <http://www.ftc.gov/os/2011/03/110307patentreport.pdf>. We use this term at various points, rather than the more popular (and more all-encompassing) "non-practicing entity (NPE)" because, as our data show, various types of non-practicing entities do get injunctions after *eBay*, though PAEs rarely do.

⁶ *eBay*, *supra* note 4, at 396.

⁷ See, Sapna Kumar, *The Other Patent Agency: Congressional Regulation of the ITC*, 61 FLA. L. REV. 529, 529, 532 (2009); Editorial, *The Android Patent War*, WALL ST. J., at A16, Dec. 5, 2011, available at <http://online.wsj.com/article/SB10001424052970204826704577074523539966352.html> (subscription required). Accord Testimony of Laura Quatela, Eastman-Kodak, before the Federal Trade Commission, Hearings on The Evolving Patent Marketplace Hearings, April 17, 2009, transcript at p. 127, available at <>("eBay has driven a lot of litigation towards the ITC, and that trend is clear.")

Indeed, the ITC is busier with patent cases than it has ever been before.⁸ The result – a double standard in patent law about when an injunction is available – has drawn the scrutiny and in some cases, fury of mainstream media,⁹ academics,¹⁰ practitioners,¹¹ and the Federal Trade Commission.¹² The practical effect has been to undo much of the desirable effect of *eBay*.

The impact of an ITC “exclusion order”¹³ preventing importation of a product can be dramatic. To comply with such an order, a company must pull its products from the market and

⁸ See, e.g., Jenna Greene, *Record Number of ITC Cases Filed in First Half of 2011*, **Nat'l L.J.**, July 5, 2011. The ITC instituted 56 IP investigations in the first nine months of 2011, as many as it did in all of 2010, and a record 70 investigations throughout 2011. http://www.usitc.gov/press_room/337_stats.htm.

⁹ See, e.g., *id.* (calling an ITC patent case “a weapon of protectionist mass destruction against competitors”; and section 337 an “absurdity...that could do great economic harm to one of the few U.S. industries that is growing rapidly.”); Editorial, *Smoot-Hawley's Revenge*, WALL ST. J., Aug. 23, 2006, at A10 (describing section 337 as “potentially crippling the U.S. wireless-phone industry”); and Colleen V. Chien & Mark A. Lemley, *Patents and the Public Interest*, NEW YORK TIMES.COM (Dec. 13, 2011).

¹⁰ See, e.g., Colleen V. Chien, *Patently Protectionist? An Empirical Analysis of Patent Cases at the International Trade Commission*, 50 WM. & MARY L. REV. 63, 67-68 (2008); Robert W. Hahn & Hal J. Singer, *Assessing Bias in Patent Infringement Cases: A Review of International Trade Commission Decisions*, 21 HARV. J.L. & TECH. 457, 464 (2008); Sapna Kumar, *supra* note 7, *The Other Patent Agency: Congressional Regulation of the ITC*, 61 FLA. L. REV. 529, 532-33 (2009); Thomas A. Broughan, III, *Modernizing § 337's Domestic Industry Requirement for the Global Economy*, 19 FED. CIR. B.J. 41, 78-79 (2009); Taras M. Czebiniak, *When Congress Gives Two Hats, Which Do You Wear? Choosing Between Domestic Industry Protection and IP Enforcement in § 337 Investigations*, 26 BERKELEY TECH. L.J. 93, 93-94 (2011) (all noting and describing the divergence in federal court and ITC rules and law); see also Eric L. Lane, *Keeping the LEDs on and the Electric Motors Running: Clean Tech in Court after eBay*, 2010 DUKE L. & TECH. REV. 13, at i-ii, xxx-xxxi (2010) (noting that non-practicing patentees have moved to the ITC to avoid eBay and warning that this may “adversely affect implemented clean technologies”).

¹¹ See, e.g. Edward H. Rice & Marina N. Saito, *After eBay: Can the ITC Offer Better Remedies than District Courts?*, 19 INTELL. PROP. LITIG. vol. 19 no.2 (2008), available at <http://www.ioeb.com/afterebaycantheitcofferbetterremediesthandistrictcourts/>; James R. Klaiber & Ethan Lee, *Seeking Disapproval: Presidential Review Of ITC Orders*, LAW360, Nov. 10, 2011, <http://www.law360.com/articles/283970/seeking-disapproval-presidential-review-of-itc-orders> (subscription required).

¹² See FTC, *supra* note 5, at 239 (noting that the “discrepancy [between the ITC and District Court injunction standards] has generated some concern that the ITC may attract suits by patentees that are less likely to obtain injunctions in district court, potentially leading to hold-up and the resulting consumer harm”).

¹³ 19 U.S.C. §1337(d). To similar effect is an ITC cease and desist order. 19 U.S.C. §1337(f).

redesign them.¹⁴ Many household devices including computers, flat-screens, GPS devices, and printers have been the subject of an ITC 337 investigation.¹⁵ In 2011, every major smartphone maker was embroiled in a dispute there.¹⁶ As the impact of this trade agency has grown, mainstream commentators have warned that the ITC “could do great economic harm to [] U.S. industries that [are] growing rapidly,”¹⁷ and calls for legislative reform of the ITC have intensified.¹⁸ Driving these calls is the perception that the ITC’s exclusion orders are

¹⁴ See Kumar, *supra* note 7, at 538; see also Mark A. Lemley & Carl Shapiro, *Patent Holdup and Royalty Stacking*, 85 TEX. L. REV. 1991, 1996 (2007) (discussing the withdrawal from market in the context of downstream firms).

¹⁵ See generally, e.g., *In re* Computer Products, Computer Components and Products Containing Same, USITC Pub. 4183, Inv. No. 337-TA-628 (September 2010), available at 2009 ITC LEXIS 2440 (computers); Certain Flat Panel Digital Televisions and Components Thereof; Notice of Investigation, 75 Fed. Reg. 51286 (Aug. 19, 2010) (flat screens); *In re* Certain GPS Chips, Associated Software and Systems, and Products Containing Same, USITC Pub. 4133, Inv. No. 337-TA-596 (March 2010), available at 2010 ITC LEXIS 582 (GPS devices); *In re* Certain Inkjet Ink Supplies and Components Thereof, Order No. 14, Inv. No. 337-TA-730 (Aug. 3, 2011), available at 2011 ITC LEXIS 1702 (printers).

¹⁶ Certain Electronic Devices with Communication Capabilities, Components Thereof; Notice of Institution of Investigation; Institution of Investigation Pursuant to 19 U.S.C. 1337, 76 Fed. Reg. 60870, 60870 (Sept. 30, 2011) (HTC Corp. is the complainant and Apple Inc. is the respondent); Certain Electronic Devices, Including Wireless Communication Devices, Portable Music and Data Processing Devices, and Tablet Computers; Notice of Institution of Investigation; Institution of Investigation Pursuant to 19 U.S.C. 1337, 76 Fed. Reg. 45860, 45860 (Aug. 1, 2011) (Samsung is the complainant and Apple is the respondent); *In re* Certain Mobile Telephones and Modems, Order No. 17, Inv. No. 337-TA-758 (Aug. 11, 2011), available at 2011 ITC LEXIS 1557 at *1 (terminated ITC investigation involving Sony and LG); *In re* Certain Mobile Devices, Associated Software, and Components Thereof, Initial Determination on Violation of Section 337 and Recommended Determination on Remedy and Bond, Inv. No. 337-TA-744 (Dec. 20, 2011) (Motorola is the respondent); Certain Wireless Devices with 3G Capabilities and Components Thereof; Notice of Institution of Investigation, 76 Fed. Reg. 54252, 54253 (Aug. 31, 2011) (Nokia is the respondent); *In re* Certain Mobile Telephones and Wireless Communication Devices Featuring Digital Cameras, and Components Thereof, Notice of Commission Determination to Affirm in Part and Reverse in Part a Determination of No Violation of Section 337: Remand of the Investigation for Further Proceedings at 2, Inv. No. 337-TA-703 (Jun. 30, 2011) (on going ITC investigation involving Research in Motion). Major mobile handset and smartphone makers, based upon market share, include Apple, Samsung, Sony, LG, Motorola, Nokia, and RIM. See Global Smartphone Sales for 2011 Pegged at 420 Million Units, Infographic, <http://www.infogenra.com/global-smartphone-sales-for-2011-pegged-at-420-million-units-infographic.html> (last visited Feb. 21, 2012).

¹⁷ *The Android Patent War*, *supra* note 7.

¹⁸ See Bernard Cassidy, *Follow the Money – Will the ITC Lose its Patent Jurisdiction?*, IP Watch Dog Blog Post, available at <http://www.ipwatchdog.com/2012/02/27/follow-the-money-will-the-itc-lose-its-patent-jurisdiction/id=22470/> (describing the “ITC Working Group” as a lobby that “wants to block the

“economically destructive and inflexible.”¹⁹ The ITC can’t award damages; it can only exclude products in what, indeed, might seem to be an all-or-nothing affair.²⁰

We believe, however, that the Commission has more flexibility in remedies than has been previously recognized. In this paper, we offer suggestions for how the ITC can use its statutory authority to decide both whether to grant an injunction and how to structure its remedies to minimize harm to the public interest.

In the sections that follow, we review the rules the ITC uses in deciding whether to grant an injunction.²¹ While the Federal Circuit has held that *eBay*’s equitable test does not apply to the ITC,²² the agency must consider the effect of an injunction on the public before it orders one.²³ To date the ITC hasn’t given these public interest factors many teeth. We think the ITC should pay more attention to the public interest and use prevailing economic theory and its precedents to assess the impact of patent injunctions on consumers and competitive conditions.

International Trade Commission (ITC) from hearing patent infringement cases brought by ‘non-practicing entities’ — i.e., patent holders like universities, independent inventors, and others who license their patents for manufacturers to commercialize. And second, it wants to weaken the ITC’s power to block the importation of infringing products into the U.S.’); Michael A. Ladra, *Domestic Disturbances: The Latest from the ITC on Establishing a Domestic Industry*, 11-12 (2011) Presentation to the Advanced Patent Law Institute Palo Alto, Dec 9, 2011 (presentation on file with journal) (describing fall 2011 efforts to lobby Congress to change the ITC), program available at http://www.uticle.org/conference_programs/2011/PJ11.pdf. But see Colleen V. Chien & Mark A. Lemley, *Patents and the Public Interest*, NEW YORK TIMES.COM (Dec. 13, 2011), *supra* note 9 (arguing that legislative reform of the ITC is not necessary).

¹⁹ *The Android Patent War*, *supra* note 7.

²⁰ See 19 U.S.C. §§1337(d), (f).

²¹ The ITC offers three forms of injunctive relief: a limited exclusion order, a general exclusion order, and a cease and desist order. 19 U.S.C. § 1337 (d)-(f).

²² *Spanson, Inc. v. ITC*, 629 F.3d 1331, 1359 (Fed. Cir. 2010). For an argument that it should, see Federal Trade Comm’n, *The Evolving IP Marketplace: Aligning Patent Notice and Remedies with Competition* 31-72 (2011).

²³ See 19 U.S.C. § 1337.

In a common situation, for example, the patent covers a small part of a larger product and the defendant's infringement was inadvertent. If the infringing feature is covered by an industry standard,²⁴ removing it is may disable the product.²⁵ Consumers are harmed when a big product is eliminated from the market because of a small patent, and competition is distorted as a large number of lawful components and features are blocked from the market along with the infringing one.²⁶

In another common situation, a patent holder brings a case against a large number of product companies, threatening to hobble an entire industry. An injunction would exclude a large number of participants from the marketplace and dramatically reduce competition.²⁷

In each of these scenarios, the harm to consumers and competition from an exclusion order is greater than the contribution made by the individual infringing component. One way for the ITC to address these harms is to decline to award exclusion orders at all. But that would leave the patentee without a remedy, in the ITC at least. Alternatively, the ITC could issue exclusion orders but structure them to ameliorate the harms to competition and consumers. In

²⁴ On the prevalence of industry standards in many industries, see Mark A. Lemley, *Intellectual Property Rights and Standard-Setting Organizations*, 90 CALIF. L. REV. 1889, 1892-95 (2002).

²⁵ For example, Innovatio IP Ventures has sued several companies including Cisco, Motorola, Accor North America, Caribou Coffee Co., Inc., Cosi, Inc., Dominick's Supermarkets, Inc., LQ Management LLC, Meijer, Inc., and Panera Bread Company on patents directed at the IEEE 802.11 standards, or "Wi-Fi". See Defendants' Motion to Stay This Matter Pending Resolution of Cisco Systems, Inc. and Motorola Solutions, Inc. v. Innovatio IP Ventures, LLC, Case No. 1:11-CV-00425 (D. Del.) at 1, 3, Innovatio IP Ventures, LLC v. ABP Corporation, et al., No. 1:11-cv-01638 (N.D. Ill. Jun. 15, 2011), *available at* [http://vmo-blog.com/files/106598-99438/Innovatio_Ventures_\(Customers_Motion_to_Stay\).pdf](http://vmo-blog.com/files/106598-99438/Innovatio_Ventures_(Customers_Motion_to_Stay).pdf). If a wireless router does not comply with this standard, it cannot provide wireless services. See *id.* at 6-7.

²⁶ See generally, Mark A. Lemley & Carl Shapiro, *Patent Holdup and Royalty Stacking*, 85 TEX. L. REV. 1991 (2007) (demonstrating the holdup cost in this situation)..

²⁷ See S. Rep. No. 93-1298, 93rd Cong., 2d Sess. 197, at *7330 (1974).

this paper, we discuss three methods of structuring injunctions: tailoring injunction scope,²⁸ staying injunctions, and bonding.

These ways of structuring injunctions provide the ITC with previously-unappreciated flexibility in ordering remedies. In a case where a design-around is possible, for example, awarding an injunction but delaying its start could deter infringement in a way that minimizes disruption to consumers and the holdup to manufacturers.²⁹ And it could do so without interfering with patentee incentives; patentees can seek damages in federal court for infringing sales in addition to bringing a case in the ITC, and if the patent truly was essential, the patentee could obtain an injunction after the stay expired. A change to the statute or the way the Commission applies it would enable the Commission to extend the terms of the bond it normally sets during the Presidential Review period to compensate for the entire stay period.³⁰

In some cases, more significant limits on exclusion orders may be warranted. Suppose, for instance, the infringing component is small but, because of the nature of the product, the potential impact of an exclusion order on downstream products, related products, and third parties is large. In such a case, the Commission could tailor the scope of the injunction to reduce harm to competition, for example by grandfathering in existing products. The ITC

²⁸ The proper scope of patent injunctions has come under greater scrutiny recently. *See, e.g.,* Tivo Inc. v. Echostar Corp., 646 F.3d 869, 879, 889 (Fed. Cir. 2011) (en banc); John M. Golden, *Injunctions as More (or Less) than “Off Switches”: Patent-Infringement Injunctions’ Scope*, 90 TEX. L. REV. 1399, 1400-01 (forthcoming 2012).

²⁹ *See, e.g.,* Lemley & Shapiro, *supra* note 26, at 2035-40 (showing that a stay in injunctive relief to allow design-arounds significantly reduces holdup risk).

³⁰ *See* 19 U.S.C. §1337(j). Doing so might require some tweaks to the statutory language, or alternatively that the Commission delay final entry of its order pending the period of delay. *See infra* Part III.C.

already has the power to use the injunction levers we have identified in these situations.³¹ In this paper, we explain why, and develop the economic grounding for how it could do so.

Alternatively, if the ITC won't use its existing public interest authority (or if the Federal Circuit won't let it), Congress could easily act to apply *eBay* to the ITC. But we don't think that is necessary. The ITC has proven to be adaptive to the changing conditions of competition. The agency is in a better position to adapt its decision-making to the particular facts before it than is the Federal Circuit or Congress, which has already given the ITC the authority to take into account consumers and competition. The ITC, in short, already has the power to take account of the effect of an exclusion order on competition; it just needs to use that power.

We realize that a move away from the current practice of issuing automatic, immediate, and comprehensive exclusion orders does have a downside: It decreases the predictability that has long been associated with the ITC and the clarity it provides to the parties about the remedy. We think the loss of certainty is outweighed by the benefits to competition of tailoring remedies to the facts of the case. But there are ways to reduce the uncertainty problem. Early proceedings on issues of public interest and remedy³² could be used to provide notice to litigants about the likelihood and form of an exclusion order should the patentee prevail.

The paper proceeds as follows. In Part I we examine how *eBay* has affected patent law and practice, both in the district courts and in the ITC. In particular, our empirical study shows a major shift to the ITC, particularly by PAEs filing complaints against multiple defendants. In Part II, we review the public interest factors that the ITC must consider before awarding an

³¹ And indeed, the limited times that they have done so before is described in Part III *infra*.

³² Using a motion analogous to a summary judgment motion in district court, parties in the ITC can move for "summary determination" on any issue in a Section 337 investigation. 19 C.F.R. § 210.18 (2011).

exclusion order and describe how the economic theory of holdup maps to these factors. In Part III, we discuss options for tailoring injunctive relief available to the ITC.

I. The Rush to the ITC

The Supreme Court's 2006 decision in *eBay v. MercExchange*³³ represented a sea change in patent litigation. Before 2006, a patentee that won its case was entitled to an injunction that prevented the defendant from selling its product.³⁴ The result was a significant problem with patent holdup.³⁵ Patentees who owned rights in very small pieces of complex, multi-component products could threaten to shut down the entire product.³⁶ As a result, even a very weak patent could command a high royalty in settlement from defendants afraid of gambling their entire product on a jury's decision.³⁷

eBay changed all that. Under *eBay*, district courts have to consider four equitable factors before granting an injunction, including whether money damages are adequate, and whether public and private interests, on balance, favor granting or denying the injunction.³⁸ Justice Kennedy, concurring in *eBay*, emphasized that injunctions might be inappropriate when the plaintiff licenses the patent as a business model or when the patent covered only a small component of the product.³⁹

³³ *eBay*, *supra* note 4.

³⁴ See Mark A. Lemley & Carl Shapiro, *Patent Holdup and Royalty Stacking*, 85 TEX. L. REV. 1991, 2008-09 (2007).

³⁵ *See id.*

³⁶ *See id.*

³⁷ *See id.*

³⁸ *See eBay*, 547 U.S. at 391.

³⁹ *See eBay*, 547 U.S. at 396-97 (Kennedy, J., concurring) ("When the patented invention is but a small component of the product the companies seek to produce and the threat of an injunction is employed

Some version of the “four-factor test” standard has been used by courts for centuries to decide whether or not to award an injunction.⁴⁰ The Supreme Court has repeatedly said an injunction is an “extraordinary remedy.”⁴¹ In the marketplace, an injunction disrupts the free flow of goods and services, impacting not only the parties but the public who must abruptly adjust to life without the enjoined product or service.⁴² By its terms, *eBay* prescribes injunctive relief as a last-ditch option – justified only when the harm cannot be fixed by money and the hardships and public interest, carefully considered, weigh in favor of granting it.⁴³

Commentators predicted *eBay* would make it harder to get injunctions.⁴⁴ They were right. Based on our review of district court decisions since *eBay*,⁴⁵ about 75% of requests for

simply for undue leverage in negotiations, legal damages may well be sufficient to compensate for the infringement and an injunction may not serve the public interest.”).

⁴⁰ See DOUGLAS LAYCOCK, *THE DEATH OF THE IRREPARABLE INJURY RULE* 19-23 (1991) (tracing the origins of the “irreparable injury rule” to the specialization in remedies by the courts of chancery and the courts of law in 14th century Britain and its transmission to the courts of the colonies and United States in the 17th century); *But see* DOUGLAS LAYCOCK, *MODERN AMERICAN REMEDIES* 426-27 (Aspen Publishers, Inc. 4th ed. 2011) (criticizing the majority’s characterization of the traditional four-factor test as the norm in remedies law).

⁴¹ See, e.g., *Weinberger v. Romero-Barcelo*, 456 U.S. 305, 312 (1982), citing *Railroad Comm’n v. Pullman Co.*, 312 U.S. 496, 500 (1941); see also *Rizzo v. Goode*, 423 U.S. 362 (1976) (“the principles of equity [] militate heavily against the grant of an injunction except in the most extraordinary circumstances.”).

⁴² See, e.g., *Paice v. Toyota*, No. 2:04-CV-211-DF, 2006 U.S. Dist. LEXIS 61600, at *16 (E.D. Tex. Aug. 16, 2006) (discussing potential disruption of an injunction against Toyota’s hybrid cars to car dealers, parts suppliers, and related business entities); *Broadcom v. Qualcomm*, No. SACV 05-467 JVS (RNBx), 2007 U.S. Dist. LEXIS 97647, at *15, *20, *28 (C.D. Cal. Dec. 31, 2007) (citing the harm to the public caused by the removal of a “beneficial, cutting-edge service” from millions of customers and tailoring the injunction to allow for an 18-month transition period).

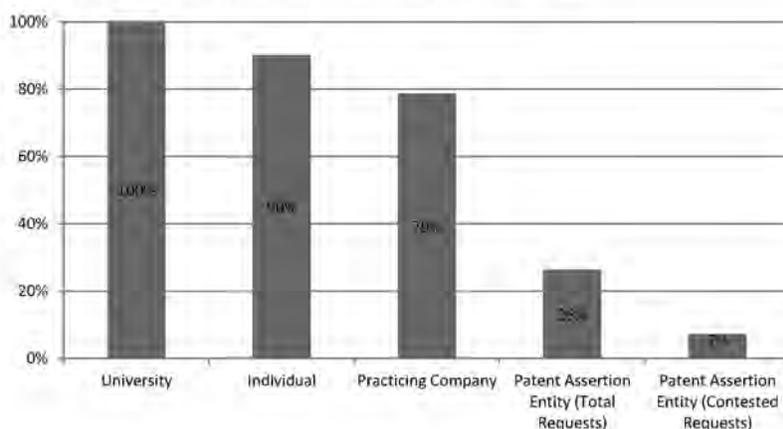
⁴³ See *eBay*, at 391-92.

⁴⁴ See, e.g., Steve Seidenberg, *Troll Control*, 92 A.B.A. J. 51, 52 (2006).

⁴⁵ There were 191 requests post-*eBay* through August 11, 2011. List of cases and outcomes initially sourced from the excellent website www.patstats.org, and obtainable at <http://patstats.org/Patstats2.html> (“Post-*eBay* Permanent Injunction Rulings in Patent Cases to 8-11-11”) and checked by a research assistant. In a few instances that we checked, the injunction was later vacated due to a change in the court’s liability determination. However, because the reasoning of the court was not challenged by this later determination, we kept the cases and the court’s decision on injunction in the database.

injunction have been granted,⁴⁶ down from a 95% rate pre-eBay.⁴⁷ There is more to the story, of course. The courts are distinguishing between different types of entities and their different types of behavior. While individuals and universities have actually enjoyed higher than average injunction grant rates, PAEs have been denied injunctions about three-quarters of the time, and over 90 percent of the time when the injunction has been contested, as Figure 1 demonstrates,

Figure 1: post-Ebay District Court Injunction Rates by Plaintiff Type⁴⁸



⁴⁶ *Accord*, FTC Evolving Marketplace Report, at 217 (reporting an injunction rate of 72-77%).

⁴⁷ See Steve Malin et al., *Injunctive Relief after eBay v. MercExchange*, Presentation to the AIPLA 2007 Annual Patent Law Committee, available at <http://www.justintellectuals.com/publications/InjunctiveReliefAfterEbay.ppt> (describing the pre-eBay injunction rate at about 95%).

⁴⁸ Source: authors' analysis, based on cases taken from May 16, 2006 to August 11, 2011. We used Patstats.org for the list of cases and outcomes, and PACER, Lex Machina, Lexis and Westlaw for the decisions. We profiled the plaintiffs based on the methodology we have previously described in Colleen V. Chien, *Of Trolls, Davids, Goliaths, and Kings: Narratives and Evidence in the Litigation of High-Tech Patents*, 87 N.C. L. Rev. 1571, 1593-99 (2009). We categorized CSIRO as a university although others may classify them as a troll because of their active engagement in the development and transfer of technology.

Category	Grant Rate	Granted	Denied	Total
University/Research Org	100%	3	0	3
Individual	90%	9	1	10
Practicing Company ⁴⁹	79%	126	33	159
PAEs ⁵⁰ (total injunction requests)	26%	5 ⁵¹	14	19
PAEs ⁵² (contested injunction requests)	7%	1 ⁵³	14	15

These results may seem surprising, particularly our finding that certain non-practicing entities have been more successful than practicing companies at getting injunctions. Based on our analysis of post-*eBay* district court decisions, however, we found that courts, based on a variety of fact patterns, have reached results that are remarkably consistent with each other. When practicing companies have been denied an injunction, it's because they aren't practicing

⁴⁹ This category includes cases brought by i4i, LP and US Philips Corp., the patent subsidiaries of operating companies i4i, Inc. and Koninklijke Philips Electronics N.V. (Royal Philips Electronics), respectively. See *U.S. Philips Corp. v. Iwasaki Elec., Ltd.*, 2006 U.S. Dist. LEXIS 71276, *13 (S.D.N.Y. Sept. 28, 2006) ("The Local Rule 1.9 Statement filed by U.S. Philips reveals that there is a public affiliate known as 'Koninklijke Philips Electronics N.V.'"); *U.S. Philips Corp. v. Iwasaki Elec. Co.*, 505 F.3d 1371, 1373 (Fed. Cir. 2007) ("U.S. Philips Corporation is 'an IP holding company on behalf of . . . the overall Philips organization' and has no employees.").

⁵⁰ We classified as "PAEs" entities that, based on the pleadings and internet research, we believe used patents primarily for enforcement purposes, rather than to transfer or commercialize technology. See Chien, *Of Trolls*, supra note 48, at 1578 (defining an NPE as a "corporate patent enforcement entity that neither practices nor seeks to develop its inventions."); accord, Chien, *Arms Race*, supra note 5, at Abstract (defining as a patent assertion entity as an entity that primarily uses patents to obtain license fees, rather than transfer or commercialize technology.).

⁵¹ The reasoning of these cases is described *infra* note 57.

⁵² We classified as "PAEs" entities that, based on the pleadings and internet research, we believe used patents primarily for enforcement purposes, rather than to transfer or commercialize technology other than the patent itself. See Chien, *Of Trolls*, supra note 48, at 1578 (defining an NPE as a "corporate patent enforcement entity that neither practices nor seeks to develop its inventions."); accord, Chien, *Arms Race*, supra note 5, at Abstract (defining as a patent assertion entity as an entity that primarily uses patents to obtain license fees, rather than transfer or commercialize technology.).

⁵³ The reasoning of these cases is described *infra* note 57.

the particular patent they've asserted, for example.⁵⁴ Or they can't show irreparable harm because it's a multiple-competitor market, and it therefore can't be assumed that defendant's gains have come at plaintiff's expense.⁵⁵

Conversely, universities, who do not practice their own patents, nonetheless have been able to get injunctions by suing on behalf of their exclusive licensees who are in fact practicing the patent.⁵⁶ Of all groups, PAEs are the least likely to get an injunction, and by and large have succeeded in their requests only when the defendant has failed to object.⁵⁷ In the single case we found since eBay where a no-longer-practicing company sued and succeeded in getting a

⁵⁴ See, e.g., *Ricoh v. Quanta*, No. 06-cv-462-bbc, 2010 U.S. Dist. LEXIS 38220, at *3-4 (W.D. Wis. Apr. 19 2010). This case was described in the press under the headline "Ricoh gets the Troll Treatment." See Jan Wolfe, *Patent Litigation Weekly: At Injunction Time, Ricoh Gets the Troll Treatment*, THE PRIOR ART, (Apr. 8, 2010), http://thepriorart.typepad.com/the_prior_art/2010/04/ricoh-v-quanta.html.

⁵⁵ See, e.g., *Advanced Cardiovascular v. Medtronic Vascular*, 579 F. Supp. 2d 554, 559-60 (D. Del. 2008); *Bosch v. Pylon*, 748 F. Supp. 2d 383, 408 (D. Del. 2010); *LG Elec. USA Inc. v. Whirlpool Corp.*, 798 F. Supp.2d 541, (D. Del. Jul. 1, 2011).

⁵⁶ See, e.g., *Emory University v. Nova Biogenetics, Inc.*, No. 1:06-CV-0141-TWT, 2008 U.S. Dist. LEXIS 57642, *3-4, *12-13 (N.D. Ga. Jul. 24, 2008); *Johns Hopkins v. Datascope*, 513 F. Supp. 2d 578, 581 (D. Md. 2007).

For a discussion of universities as non-practicing entities, see generally Mark A. Lemley, *Are Universities Patent Trolls?*, 18 *FORDHAM INTELL. PROP. MEDIA & ENT. L.J.* 611, 629-30 (2008) (arguing that they aren't).

⁵⁷ PAEs obtained five injunctions since eBay, in the following cases: *Acticon Techs. v. Heisei Elecs. Co., Ltd.*, 2008 U.S. Dist. LEXIS 8978, *2-3 (S.D.N.Y. Feb. 5, 2008) (defendant failed to object to Magistrate judge's report, therefore the Court adopted the Magistrate's findings) *adopt'g* *Acticon Techs. v. Heisei Elecs. Co.*, 2007 U.S. Dist. LEXIS 100081, *10-12 (S.D.N.Y. Aug. 1, 2007); *Antonious v. Merchs. of Golf, Inc.*, 2011 U.S. Dist. LEXIS 3332, *1-2 (C.D. Cal. Jan. 5, 2011) (defendant's initial failure to respond resulted in default judgment and the entering of an injunction); *PB&J Software LLC v. Code 42 Software, Inc.*, No. 0:09-cv-00206-DWF-JSM (D. Minn. 2011), available at <https://lexmachina.com/cases/80048/documents/2000026538.pdf> (login required) (Cucku consented to entry of final judgment for injunctive relief); *Systemation Inc. v. Production Prod. Inc.*, No. 1:11-cv-487-LPS, 1-2 (D. Del. Jun. 27, 2011) (injunction entered because two parties settled); *Joyal Prods. v. Johnson Elec. North Am., Inc.*, 2009 U.S. Dist. LEXIS 15531, *30-31, *33 (D.N.J. Feb. 26, 2009) (Joyal was not an on-going business and looked to sell its patent; failure to grant an injunction would severely affect the sale value of the patent) *but see* *Voda v. Cordis*, No. CIV-03-1512-L, 2006 U.S. Dist. LEXIS 63623, *18-19, *21 (W.D. Okla. Sept. 5, 2006) (harm to right to exclude is not enough to justify an injunction), *aff'd in relevant part*, 536 F.3d 1311, 1315 (Fed. Cir. 2008).

contested injunction, the court cited its belief that the patent would be sold to a manufacturer.⁵⁸

When applying *eBay*, courts have focused on the first two prongs: irreparable injury and adequate remedy at law.⁵⁹ Competitive considerations have predominated: courts have been willing to grant injunctions when the defendant's infringement credibly threatens the market share,⁶⁰ reputation,⁶¹ or business model⁶² of the plaintiff, and unwilling to grant injunctions when these harms are absent.⁶³ Predicted loss of market share, reputation and goodwill are

⁵⁸ *Joyal Products v. Johnson Elec. North America*, No. 04-5172 (JAP), 2009 U.S. Dist. LEXIS 15531, *30-31 (D.N.J. Feb. 26, 2009) (ailing company plaintiff Joyal's patents would be worth less in the marketplace if unable to/incapable of excluding others, and "the most likely purchaser of the patent would be a manufacturer"); *but see Voda v. Cordis*, No. CIV-03-1512-L, 2006 U.S. Dist. LEXIS 63623, *18-19, *21 (W.D. Okla. Sept. 5, 2006) (harm to right to exclude is not enough to justify an injunction), *aff'd in relevant part*, 536 F.3d 1311, 1315 (Fed. Cir. 2008).

⁵⁹ It is hard to come up with circumstances that would distinguish irreparable injury from the absence of an adequate remedy at law.

⁶⁰ In the following cases, the court cited the indicated market-share related reason when deciding to grant the injunction: *i4i LP v. Microsoft*, 670 F. Supp. 2d 568, 599-601 (E.D. Tex. 2009) (citing injury to market share, brand); *Wald v. Mudhopper*, No. CIV-04-1693-C, 2006 U.S. Dist. LEXIS 51669, *16 (W.D. Okla. Jul. 27, 2006) (market share, damage to reputation); *Global Traffic Technologies LLC v. Tomar*, No. 05-756 MJD/AJB, Findings of Fact, Conclusions of Law, and Order for Injunctive Relief at 9 (D. Minn. 2008), available at <https://lexmachina.com/cases/9356/documents/278997.pdf> (login required) (market share, customer relationships); *Broadcom v. Qualcomm*, 2007 U.S. Dist. LEXIS 97647 at *16 (market share in the market for design wins); *Emory* at *12 and *Johns Hopkins* at *586 (both citing competition including in a two-competitor market); *see also Advanced Cardiovascular v. Medtronic Vascular*, 579 F. Supp. 2d at 558 (injunctions usually granted in scenarios where there is two-competitor market).

⁶¹ *See, e.g. CSIRO v. Buffalo*, 492 F. Supp. 2d 600, 604 (E.D. Tex. 2007), *vacated and remanded on other grounds*, 542 F.3d 1363 (Fed. Cir. 2008) (harm to reputation); *Emory*, 2008 U.S. Dist. LEXIS 57642 at *12-13 (harm to reputation and goodwill); *Johns Hopkins*, 513 F. Supp. 2d at 586 (harm to reputation).

⁶² *See, e.g. Judkins v. HT Window*, 704 F. Supp. 2d 470, 477 (W.D. Pa. 2010) (exclusive licensor would experience harm to business relationships); *ReedHycalog, LP v. Diamond*, No. 6:08-CV-325, 2010 U.S. Dist. LEXIS 83011, *35-36 (E.D. Tex. Aug. 12, 2010) (disruption to P's business and licensing and pricing strategy); *Joyal v. Johnson*, 2009 U.S. Dist. LEXIS 15531 at *30-31 (denial of injunction would decimate the value of the patent in planned asset sale).

⁶³ In each of these cases the following factors were cited in the denial of the plaintiff's request for injunction: *Advanced Cardiovascular v. Medtronic Vascular*, 579 F. Supp. 2d at 559; *Bosch v. Pylon*, 748 F. Supp. 2d at 408; *LG Elec. USA v. Whirlpool*, 798 F. Supp.2d 541, 563 (D.Del. 2011); *Sundance v. Demonte*, No. 02-73543, 2007 U.S. Dist. LEXIS 158, *8 (E.D. Mich. Jan. 4, 2007) (all citing presence of a multiple-competitor market); *Nichia v. Seoul Semiconductor*, No. 06-0162 MMC, 2008 U.S. Dist. LEXIS

difficult to quantify and restore, making money damages inadequate.⁶⁴ Entities that don't sell products typically don't experience these types of harms.⁶⁵

The relationship between the patented invention and the enjoined product has also mattered in a number of cases. Following Justice Kennedy's suggestion,⁶⁶ when the patented invention covers a small component of the defendant's product, courts have been less inclined to award an injunction.⁶⁷ Courts have also taken into account the impact on consumers, under the auspices of the public interest prong.⁶⁸

12183, *5 (N.D. Cal. Feb. 7, 2008) (no loss of market share, reputation or brand); Ricoh, 2010 U.S. Dist. LEXIS 38220 at *3-4 (plaintiff not in competition with defendant because plaintiff does not practice invention); Hynix v. Rambus, 609 F. Supp. 2d 951, 984-85 (N.D. Cal. 2009) (no harm to reputation, but harm to defendant's business); Telcordia v. Cisco, 592 F. Supp. 2d 727, 747 (D. Del. 2009) (no evidence of "lost sales, licensing, or research and development opportunities"); Calcar v. Honda, No. 06cv2433 DMS (CAB), 2008 U.S. Dist. LEXIS 106476, *2-3 *(S.D. Cal. Nov. 18, 2008) (insufficient evidence of lost opportunities, reputation); Paice, 2006 U.S. Dist. LEXIS 61600 at *14 (unable to prove damage to market share or brand name); WhitServe LLC v. Computer Packages, Inc., No. 3:06CV01935 (AVC), Whitserve's Motion for Permanent Injunction (D. Conn. 2011), (no evidence of lost market share, customers, or goodwill), order denying injunction at <https://lexmachina.com/cases/80048/documents/2000025538.pdf> (login required); Creative Advertising v. Yahoo! Inc., 674 F. Supp. 2d 847, 852 (E.D. Tex. 2009); Enpat v. Budnic, 773 F. Supp. 2d 1311, 1317 (M.D. Fla. 2011); Orion IP v. Mercedes-Benz USA, No. 6:05 CV 322, 2008 U.S. Dist. LEXIS 108683, *12 (E.D. Tex. Mar. 28, 2008); Paice, 2006 U.S. Dist. LEXIS 61600 at *13-14 (no evidence that money damages are inadequate to compensate licensing company's loss).

⁶⁴ *Emory*, 2008 U.S. Dist. LEXIS 57642 at *13.

⁶⁵ NPEs sometimes assert injury to their reputation resulting from the fact that the defendant used a product that turned out to be covered by the patent claims. See *CSIRO v. Buffalo Tech.*, 492 F. Supp. 2d 600, 604 (E.D. Tex. 2007), *vacated*, 542 F.3d 1363 (Fed. Cir. 2008). This theory strikes us as wildly implausible. To the extent consumers are even aware of the patent and the fact that the defendant infringes it, it is hard to see how awareness of that fact will injure the NPE's reputation. If anything, the widespread use of the patentee's technology should enhance its reputation.

⁶⁶ *eBay* at 396-97.

⁶⁷ See *Ricoh*, 2010 U.S. Dist. LEXIS 38220 at *6 (small component of the overall product); *Sundance v. Demonte*, 2007 U.S. Dist. LEXIS 158 at *7-8 (patented tech is but one feature of the defendant's product); *z4 v. Microsoft*, 434 F. Supp. 2d 437, 441 (E.D. Tex. 2006) (in a small component scenario, damages are sufficient); see also *Broadcom v. Qualcomm*, 2007 U.S. Dist. LEXIS 97647 at *19-21 (tailoring the injunction to ameliorate the impact on consumers by providing time for design around when the scope of the infringed patent is limited); accord *Steve Malin & Ari Rafilson, Empirical Analysis of Permanent Injunctions Following eBay*, presented at FTC Hearing: The Evolving IP Marketplace (Feb. 12, 2009), available at

Hundreds of district courts throughout the country, then, have engaged in the same exercise of considering whether an injunction is really justified in cases of patent infringement.⁶⁹ Yet one decisionmaker has been exempt from doing so. The ITC, an administrative agency rather than Article III court, has declined to follow *eBay*, a practice that has been approved by the Federal Circuit.⁷⁰ This apparent anomaly has a simple explanation: although the ITC applies patent law⁷¹ to decide whether there has been an unlawful importation,⁷² the Commission follows its own procedures and prescribes its own remedies. As the Federal Circuit explained in *Spansion*, “[there are] different statutory underpinnings for . . . Section 337 actions and . . . district courts in suits for patent infringement.”⁷³ As a result, the ITC neither hears counterclaims nor recognizes certain defenses to infringement,⁷⁴ and can’t

<http://www.ftc.gov/bc/workshops/ipmarketplace/feb11/docs/smalin.pdf>, at 29. (reporting a district court injunction rate of 0% when the invention was a “trivial component” of a product, as compared to 75% grant rate when the infringing feature was not a trivial component).

⁶⁸ See, e.g., *Amgen v. Hoffman-La Roche*, 581 F. Supp. 2d 160, 213 (D. Mass. 2008) (considering patient health, Medicare savings, and the public’s interest in a robust patent system in its decision to grant an injunction).

⁶⁹ See *supra* notes 49-65.

⁷⁰ *Spansion, Inc. v. ITC*, 629 F.3d 1331, 1359 (Fed. Cir. 2010).

⁷¹ As well as other forms of intellectual property law, see *TianRui Group Company Limited v. U.S. International Trade Commission*, 661 F.3d 1322, 1326-27 (Fed. Cir. 2011) (confirming that section 337 applies to imported goods produced through the exploitation of trade secrets). The majority of 337 cases are patent cases, however. See Colleen Chien, *Patently Protectionist*, 50 WM & MARY L. REV. 63, 70, n. 123 (2008) (patent cases make up 85% of the ITC’s § 337 docket and explaining why copyright and TM cases are less likely to be brought in the ITC). The ITC has heard a handful of antitrust cases, and commentators have speculated that it could also be used for child labor and other violations. (Described, e.g. in Tom Schaumberg, ed. *A Lawyer’s Guide to Section 337 Investigations before the International Trade Commission* ABA-Intellectual Property Section, Chapter 17.A.2., p. 226-27.) And one pending bill would give the ITC the authority to oversee the issuance of cease and desist orders against “rogue websites” for copyright infringement. See OPEN Act, H.R. 3782 (2011).

⁷² 19 U.S.C §1337(a)(1)(B).

⁷³ *Spansion*, 629 F.3d at 1359.

⁷⁴ See *Kinik Co. v. Int’l Trade Comm’n*, 362 F.3d 1359, 1362 (Fed. Cir. 2004) (holding that 271(g)(2) does not apply in the ITC); Colleen V. Chien, *Protecting Domestic Industries*, 28 SANTA CLARA COMPUTER & HIGH TECH. L. J. 169, 171 (2011) (“In an ITC proceeding, there are no juries, no counterclaims, few stays for reexamination, and no damages.”).

award damages.⁷⁵ These omissions were intended to speed things along,⁷⁶ reflecting the original intent of the ITC to offer a special solution to the special problem of foreign infringement.⁷⁷ Now that most technology products are manufactured overseas⁷⁸ and Congress has relaxed the domestic industry requirement,⁷⁹ nearly every patentee can bring an ITC complaint and nearly every accused infringer is a potential ITC defendant, converting the ITC into a mainstream venue in which to file patent grievances.⁸⁰

The statute's history and structure limit its uptake of changes to the patent system. Legislative and judicial improvements made to patent law procedures and remedies simply don't apply in the ITC. When Congress recently enacted a rule limiting the naming of multiple defendants in a patent infringement lawsuit,⁸¹ for example, the reform did not extend to the ITC.⁸² While the number of defendants per case declined in the district court immediately following passage of the law, it has stayed steady in the ITC, as Figure 2 shows.

⁷⁵ See 19 U.S.C. §1337.

⁷⁶ See Czebiniak, *supra* note 10, at 93-94, 105-06.

⁷⁷ See *id.* at 95.

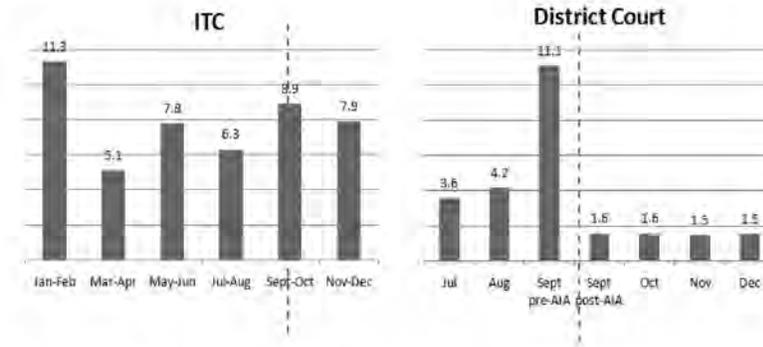
⁷⁸ See, e.g., Commission Decision in Personal Data and Mobile Communications Devices and Related Software TA-710-337 (“[T]o HTC’s knowledge no smartphones . . . are produced in the United States; rather they are all manufactured overseas and imported in the United States.”) (Citing HTC Br. at 161).

⁷⁹ See *John Mezzalingua Assocs. v. International Trade Comm’n*, 660 F.3d 1322 (Fed. Cir. 2011) (discussing the statutory change that permitted PAEs to claim “domestic industry” status at the ITC and interpreting the new statute); Czebiniak, *supra* note 10, at 110.

⁸⁰ See *id.* at 107-08. Figure 4 reports the growth in the portion of ITC cases involving NPES.

⁸¹ See PUBLIC LAW 112–29—SEPT. 16, 2011. LEAHY–SMITH AMERICA INVENTS ACT § 19(d), 35 U.S.C. § 299 (limiting joinder of defendants to cases relating to the same transactions, occurrences, or accused products.).

⁸² See Colleen V. Chien, *Protecting Domestic Industries*, 28 SANTA CLARA COMPUTER & HIGH TECH. L. J. 169, 175 (2011).

Figure 2: 2011 NPE⁸³ Defendants/Case Pre and Post- AIA (red dashed line)

Data Source: RPX Corporation © 2012

The most pointed rift has been created by *eBay*. While the overall injunction rate in the district court has declined to 75% since *eBay*, it has remained steady at 100% in the ITC over the last five years.⁸⁴ (Figure 3) The difference in grant rates is even more dramatic for patent assertion entities – which are unlikely to get an injunction from district court,⁸⁵ but, based on its track record, are virtually guaranteed one in the ITC.⁸⁶ This is in part because injunctions are not only the preferred remedy at the ITC, they are the only remedy.⁸⁷ An agency whose administrative law judges carry out investigations without juries, the ITC is not statutorily authorized to grant money damages.

⁸³ RPX Corp. defines NPEs as entities that have substantially no assets other than the patent and substantially no revenue other than licensing, which could include individuals and universities as well as patent assertion entities. Because we rely on their data, we report NPE, rather than PAE figures, in this and related charts.

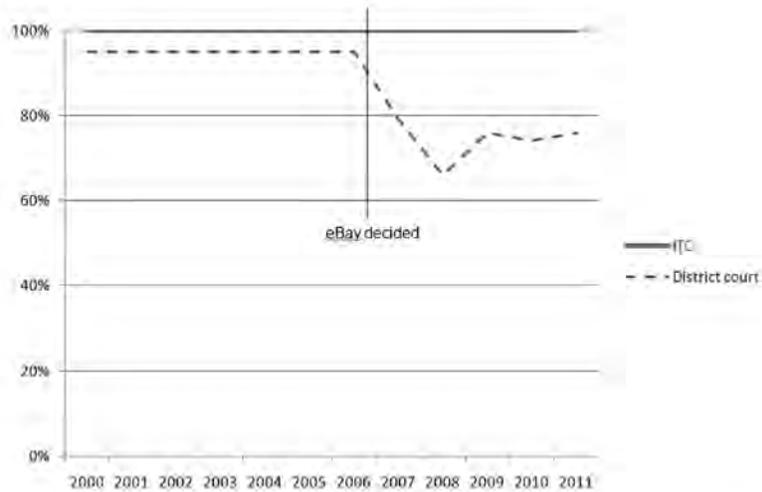
⁸⁴ See Figure 3.

⁸⁵ See *supra* Figure 1.

⁸⁶ See *supra* note ____.

⁸⁷ See *Spanston*, 629 F.3d at 1358. (citing the statute's legislative history for the proposition that "an injunction is the only available remedy for violations of Section 337.").

Figure 3: Post-eBay Injunction Rates in the ITC and District Court⁸⁸



The word has apparently gotten out, earning the ITC a reputation for being “a more advantageous forum for patent holders with what is viewed to be a less stringent standard for obtaining injunctive relief.”⁸⁹ NPEs, and in particular PAEs, are flocking to the ITC (Figure 4).⁹⁰

⁸⁸ Author analysis based on: *Injunctive Relief after eBay v. MercExchange*, Presentation to the AIPLA 2007 Annual Patent Law Committee, available at <http://www.justintellectuals.com/publications/InjunctiveReliefAfterEbay.ppt> (for pre-eBay injunction rate of 95%); see also, Scott McClelland, *A Model for Predicting Permanent Injunctions After eBay v. MercExchange*, 8 INTELL. PROP. REPORT 11, (Nov. 2011) http://www.bakerbotts.com/file_upload/2011NovemberIPReporteBayVMercExchange.htm (describing the district court injunction grant rate in the year prior to eBay as 100%); Patstats.org post-eBay injunction database, supra note 45 (for post-eBay district court injunction rate); author’s own database of ITC cases developed in conjunction with Chien, *Patently Protectionist*, supra note 10, RPX Corp. database of ITC cases (for pre- and post-eBay ITC injunction rate).

⁸⁹ Albert B. Chen & Matthew Abbott, *Protecting Green Patents: District Court vs. ITC*, LAW360, Jan. 5, 2012, <http://www.law360.com/articles/295637/protecting-green-patents-district-court-vs-its> (login required).

In the years following eBay, the number of ITC investigations brought by NPEs has grown from 2 in 2006 to 16 in 2011 and the number of total respondents named in NPE cases has grown from 8 to 235.⁹¹ Growth in ITC NPE⁹² cases has outpaced the growth in ITC cases in general during this period, with the NPE share of all ITC cases growing from 7% to 25%,⁹³ and the number of respondents from NPE-initiated ITC cases growing to over 50% of all ITC respondents, as Figure 4 shows.

Figure 4: Growth in share and number of NPE⁹⁴ cases at the ITC

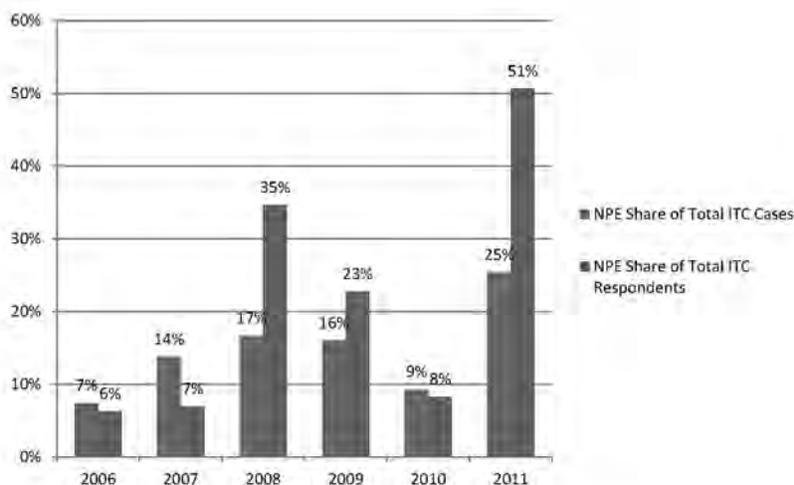
⁹⁰ See Figure 4; accord Robert D. Fram & Ashley Miller, *The Rise of Non-Practicing Entity Litigation at the ITC: The State of the Law and Litigation Strategy*, 10 (Jan. 5, 2011) (unpublished manuscript on file with the authors) (finding an increase in the number of ITC complaints brought by companies relying on their licensing activities in accordance with 19 U.S.C. § 1337(a)(3)(c) to show standing from 13% from 2000-2006 to 27% from 2007-August 2010).

⁹¹ Analysis on file with journal.

⁹² Category includes universities and individuals as well as patent assertion entities. See RPX Corp. definition of NPE described *supra* at note 83.

⁹³ 2 out of 27 ITC patent cases in 2006 and 16 out of 63 ITC patent cases in 2011 were brought by NPEs. The growth in ITC cases is somewhat surprising in light of the concern of some that the ITC's *Kyocera* decision would result in a noticeable decline in ITC filings. See Chris Cotropia, *Strength of the International Trade Commission as a Patent Venue*, 20 TEX. INTELL. PROP. L.J. 1, 3 (2011); *Kyocera v. ITC*, 545 F.3d 1340. That hasn't happened. See Cotropia, *supra* note 93. at 4.

⁹⁴ Category includes universities and individuals as well as patent assertion entities. See RPX Corp. definition of NPE described *supra* at note 83.



Source data of NPE designation: RPX Corporation © 2012

This divergence in remedies undoes the progress *eBay* represents.⁹⁵ Parties who win in the district court but would not receive an injunction under *eBay* can circumvent the result by refiling their cases in the ITC.⁹⁶ The denial of an injunction request by a district court is no

⁹⁵ It is also potentially illegal under international law. Statutory changes to the law in 1995 were meant to cure the statute of the advantages it gave to domestically-made goods – specifically a mandatory timetable, parallel proceedings against foreign manufacturers, and the inability of defendants to raise counterclaims – which a GATT panel found to be in violation of TRIPS. (See Report of the Panel, United States—Section 337 of the Tariff Act of 1930, ¶ 4.2, L/6439 (Nov. 7, 1989); GATT B.I.S.D. at 365/345 (1990), ¶5.20.) Under the logic of that case, that certain domestically made goods may be immune from injunctions while international ones are not could similarly be found to violate national treatment. See *id.* Accord Computer and Communications Industry Association (CCIA), submitted comment to the ITC’s Notice of Proposed Rulemaking 75 FR 60671 (Oct. 1, 2010) on the taking of public interest evidence, summarized at <http://www.gpo.gov/fdsys/pkg/FR-2011-10-19/html/2011-26664.htm> (suggesting that the ITC adopt *eBay* in order to comply with United States obligations under Article III: 4 of the GATT, specifically, a GATT decision, United States—Section 337 of the Tariff Act of 1930 (Nov. 7, 1989)).

⁹⁶ Compare, e.g., *Paice LLC v. Toyota Motor Corp.* (Paice II), 504 F.3d 1293, 1314-15 n.14 (Fed. Cir. 2007) (upholding the district court’s failure to issue an injunction) with *Certain Hybrid Electric Vehicles and Components Thereof*, USITC Inv. No. 337-TA-688, Complaint (Oct. 5, 2009), EDIS Doc. No. 411596 (initiating an investigation of the behavior not enjoined by the district court); described in Chien, *Protecting Domestic Industries*, 28 SANTA CLARA COMPUTER & HIGH TECH. L.J. 169 at nn. 96-102.

barrier to the grant of an exclusion order by the ITC. The result is an end-run around *eBay* that allows patent holders to block the defendant's product even without a district court injunction.

II. Exclusion Orders and the Public Interest

The ITC statute does not compel the Commission to grant exclusion orders. It states:

If the Commission determines, as a result of an investigation under this section, that there is a violation of this section, it shall direct that the articles concerned, imported by any person violating the provision of this section, be excluded from entry into the United States, unless, after considering the effect of such exclusion upon the public health and welfare, competitive conditions in the United States economy, the production of like or directly competitive articles in the United States, and United States consumers, it finds that such articles should not be excluded from entry.⁹⁷

The Federal Circuit parses the statute to identify four separate factors.⁹⁸ “The enumerated public interest factors include: (1) the public health and welfare; (2) competitive conditions in the United States economy; (3) the production of like or directly competitive articles in the United States; and (4) United States consumers.”⁹⁹

Taken together, these factors might seem to give a fairly wide-ranging power to the ITC to consider things like patent holdup, the relationship between the patent and the ultimate product, and whether or not the patentee practices the invention. Indeed, the statute directs the ITC to take the public interest into account every time it considers issuing a remedy.¹⁰⁰

⁹⁷ 19 U.S.C. § 1337(d)(1).

⁹⁸ See *Spanston*, 629 F.3d at 1358.

⁹⁹ *Id.*

¹⁰⁰ See, e.g., 19 U.S.C. § 1337(d)(1) (covering exclusion orders) and § 1337(f)(1) (covering cease and desist orders). Indeed, we believe that the mandate that the ITC “shall” exclude articles “unless” one of the public interest cautions otherwise, as a matter of statutory interpretation, requires their consideration, more so than it does the ITC’s remedy. See also, e.g., Commission Opinion IN THE MATTER OF CERTAIN AUTOMATED MECHANICAL TRANSMISSION SYSTEMS FOR MEDIUM-DUTY AND

Nonetheless, in the vast majority of § 337 cases, the International Trade Commission (“ITC”) finds that excluding goods does not threaten the public interest. Historically, the ITC has found that the public interest trumped exclusion in only three cases: car parts necessary for improved fuel efficiency,¹⁰¹ scientific equipment for nuclear physics research,¹⁰² and hospital burn beds.¹⁰³ The unifying theme in those cases is that the products were necessary for something important (human health or some other nationally-recognized policy goal) and that no other supplier could meet demand in a commercially reasonable period of time.¹⁰⁴ And none of those cases was decided in the last twenty-five years. More recently, the ITC has indicated that unless something is a drug or medical device it is unlikely to meet the public interest exception.¹⁰⁵

The reason seems to be that the ITC views enforcing patents as in the public interest, with the result that the public interest analysis starts out with a thumb on the scale in favor of

HEAVY-DUTY TRUCKS AND COMPONENTS THEREOF, USITC Inv. No. 337-TA-503, Pub. No. 3934 at 7 (“Section 337(d) and (f) directs the Commission to consider public interest factors before issuing remedial orders, including the effect of any such remedial order on the ‘public health and welfare, competitive conditions in the United States economy, the production of like or directly competitive articles in the United States, and United States consumers.’”).

¹⁰¹ See Commission Determination and Order In re Certain Automatic Crankpin Grinders at 1, USPTO Inv. No. 337-TA-60 (Dec. 17, 1979); Opinion of Vice Chairman Alberger and Commissioners Bedell and Stern In re Certain Automatic Crankpin Grinders at 17-18, USPTO Inv. No. 337-TA-60 (Dec. 17, 1979); *infra* at notes **Error! Bookmark not defined.**-113.

¹⁰² See Commission Action and Order In re Certain Inclined-Field Acceleration Tubes at 1, USITC Inv. No. 337-TA-67, 0080 WL 594319 (Dec. 29 1980); Commission Action and Order In re Certain Inclined-Field Acceleration Tubes at 22-31, USITC Inv. No. 337-TA-67, (Dec. 29 1980); *infra* at notes 114-116.

¹⁰³ See Commission Memorandum Opinion In re Certain Fluidized Supporting Apparatus and Components Thereof, at 1-2, USITC Inv. No. 337-TA-182, 337-TA-188, 225 U.S.P.Q. 1211, 1984 WL 63741 (Oct. 5, 1984); *infra* at notes 117-**Error! Bookmark not defined.**, 120-123.

¹⁰⁴ See *generally* notes **Error! Bookmark not defined.**-123.

¹⁰⁵ See In re Certain Toothbrushes And The Packaging Thereof, Commission Opinion On Remedy, The Public Interest, And Bonding at 6, USITC Inv. No. 337-TA-391, 1997 WL 803475, at *2 (October 15, 1997) (“toothbrushes are not the type of product that have in the past raised public interest concerns (such as, for example, drugs or medical devices).”)

the patentee. The Federal Circuit has accepted this approach. In *San Huan New Materials High Tech, Inc. v. International Trade Com'n*, the Federal Circuit affirmed the ITC's imposition of a significant penalty, saying:

Finally, addressing the “public interest” factor, the Commission determined that the public interest favors the protection of intellectual property rights and weighs in favor of a “significant penalty.”¹⁰⁶

And the court has interpreted the legislative history as supporting exclusion of infringing products:

The legislative history of the amendments to Section 337 indicates that Congress intended injunctive relief to be the normal remedy for a Section 337 violation and that a showing of irreparable harm is not required to receive such injunctive relief.¹⁰⁷

The Federal Circuit's review of ITC remedies is deferential,¹⁰⁸ meaning that most of the substantive discussions of the public interest factor come from ITC decisions, not Federal Circuit decisions.

In the three cases the ITC has in fact denied injunctive relief, its focus has been on two factors: the public interest in health and welfare and the unavailability of alternatives. When the ITC has denied an exclusion order, both factors have been present.¹⁰⁹

¹⁰⁶ *San Huan New Materials High Tech, Inc., et al. v. International Trade Commission, et al*, 161 F.3d 1347, 1363 (Fed. Cir. 1998). *But cf.* *Rosemount, Inc. v. U.S. Intern. Trade Com'n*, 910 F.2d 819, 822 (Fed. Cir. 1990) (examining section 1337(e); “We also agree with the Commission's rejection of the view that the public interest inevitably lies on the side of the patent owner because of the public interest in protecting patent rights, although that is one factor to consider and may be a dominant factor.”).

¹⁰⁷ *Spansion*, 629 F.3d at 1358.

¹⁰⁸ The Federal Circuit “reviews the Commission's action in awarding injunctive relief as to whether it is arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.” *Spansion, Inc. v. Int'l Trade Comm'n*, 629 F.3d 1331, 1358 (Fed. Cir. 2010).

¹⁰⁹ See Opinion of Vice Chairman Alberger and Commissioners Bedell and Stern In re Certain Automatic Crankpin Grinders at 17-18, USITC Inv. No. 337-TA-60 (Dec. 17, 1979); Commission Action and Order In re Certain Inclined-Field Acceleration Tubes at 22-31, USITC Inv. No. 337-TA-67, (Dec. 29 1980);

The ITC first denied a remedy on the basis of the public interest exception in *In re Certain Automatic Crankpin Grinders*.¹¹⁰ The ITC based its decision on the public interest in fuel efficiency, which automobile manufacturers claimed was put in jeopardy without access to the crankpin grinders.¹¹¹ The ITC noted that the domestic industry could not meet the demand in a reasonable length of time and that the President and Congress had a clearly established policy of increasing fuel economy.¹¹² The existence of a major oil crisis in 1979 probably contributed to the decision.¹¹³

Something similar occurred the following year in *In re Certain Inclined-Field Acceleration Tubes*.¹¹⁴ There, the Commission was confronted with claims of public interest in “pure

Commission Action and Order *In re Certain Inclined-Field Acceleration Tubes* at 21, USITC Inv. No. 337-TA-67, (Dec. 29 1980).

¹¹⁰ Opinion of Vice Chairman Alberger and Commissioners Bedell and Stern *In re Certain Automatic Crankpin Grinders* at 17-18, USITC Inv. No. 337-TA-60, 205 U.S.P.Q. 71, 0079 WL 419349 (Dec. 17, 1979).

¹¹¹ *See id.*

¹¹² *See id.*

¹¹³ The Commission wrote:

The primary reason for our determination is that the domestic industry cannot supply the demand for new orders of the patented product within a commercially reasonable length of time.

. . .

In view of the fact that Congress and the President have also clearly established a policy requiring automotive companies to increase the fuel economy of the automobiles they produce and that some of these companies are encountering difficulties in obtaining automatic crankpin grinders on a timely basis, to produce the statutorily mandated energy efficient automobiles, we believe that it is not in the public interest to provide a remedy in this case. In this period of rapid changes in the energy field, there are overriding public interest considerations in not ordering a remedy which will hamper the supply of energy efficient automobiles. This is not merely a matter of meeting the demands of individual consumers for fuel efficient automobiles. The public as a whole has an interest in conserving fuel through the provision of energy efficient alternatives represented in this case by automobiles with more efficient engines which are produced with the assistance of crankpin grinders which are the subject of this investigation. *See id.* at 18, 20.

¹¹⁴ *See* Commission Action and Order *In re Certain Inclined-Field Acceleration Tubes* at 1, USITC Inv. No. 337-TA-67, 0080 WL 594319 (Dec. 29 1980); Commission Action and Order *In re Certain Inclined-Field Acceleration Tubes* at 22-31, USITC Inv. No. 337-TA-67, (Dec. 29 1980).

scientific research and the advancement of knowledge” in the context of federally-funded nuclear research.¹¹⁵ The ITC concluded that the infringing Dowlish tubes were “greatly superior” and “substantially less expensive” than their counterparts, and that they were “indispensable” to research, and that research was in turn in the public interest.¹¹⁶ Thus, as in *Crankpin Grinders*, the Commission believed both that the public needed the infringing products for health and welfare reasons and that the products wouldn’t be available if it granted the exclusion order.

¹¹⁵ Commission Action and Order In re Certain Inclined-Field Acceleration Tubes at 21, USITC Inv. No. 337-TA-67, (Dec. 29 1980).

¹¹⁶ The Commission wrote:

We believe that basic scientific research, such as the nuclear structure research conducted with inclined-field acceleration tubes, is precisely the kind of activity intended by Congress to be included when it required the Commission to consider the effect of a remedy on the public health and welfare. . . . Although there are few indications in the record of practical applications for nuclear structure physics, it shows that the tubes at Los Alamos are used for nuclear weapons development and the University of Arizona uses them as mass spectrometers for carbon 14 dating, essential to paleontological and archaeological applications. Many scientists would argue, of course, that basic research is intrinsically beneficial regardless of immediate practical application. The support of universities and public agencies is ample support for that proposition.

...

Finally, the President and the Congress have issued declarations of support for basic science research. The National Science Foundation Act, which supports with grants much of the research done with both the domestic and imported tubes, is codified in title 42, United States Code, which is entitled Public Health and Welfare.

...

The users consider the Dowlish tube to be greatly superior in performance to the High Voltage tube—not to mention substantially less expensive—and therefore indispensable [sic] to their research efforts. The tubes provide the greater stability of operation and more consistent results essential for accurate research.

...

Once the importance of basic research in nuclear structure physics is established, we are faced with a difficult balance—the impact of a remedy on users of the imported device versus the impact of the violation on the owner of the patent. After weighing these considerations, we determine that public interest factors preclude a remedy in this investigation. *See id.* at 22, 23, 27, 29.

The final case in which the Commission denied an exclusion order is *In re Certain Fluidized Supporting Apparatus and Components Thereof*.¹¹⁷ Unlike the other two, this case involved denial of temporary relief under § 1337(e).¹¹⁸ The ITC noted that this allowed it more discretion in framing a remedy, just as district courts have more freedom to deny preliminary injunctions.¹¹⁹ The technology in *Fluidized Supporting Apparatus* was hospital burn beds.¹²⁰ The ITC concluded that the infringing beds “provide[d] benefits unavailable from any other device or method of treatment” and that other suppliers could not meet the demand within a reasonable time.¹²¹ The Commission affirmed the ALJ’s finding that “if a temporary exclusion order were issued some patients might not have access to burn beds at all in the interim period,” both because of the patentee’s higher prices and because of concerns about the ability of the patentee to meet manufacturing demand.¹²² Unlike the others, this case focused more on the public interest in health than on unavailability, but the Commission did find at least partial unavailability.¹²³

In contrast to these cases, the Commission has regularly rejected public interest arguments when it found either that alternative suppliers could provide comparable products or that the products were not critical to public health and welfare. For example, the

¹¹⁷ See Commission Memorandum Opinion *In re Certain Fluidized Supporting Apparatus and Components Thereof*, at 1-2, USITC Inv. No. 337-TA-182, 337-TA-188, 225 U.S.P.Q. 1211, 1984 WL 63741 (Oct. 5, 1984).

¹¹⁸ See *id.* at 1.

¹¹⁹ See *id.* at 3 (“if the relevant substantive elements are established, the issuance of temporary relief is largely discretionary, while the issuance of permanent relief is mandatory”).

¹²⁰ Commission Memorandum Opinion *In re Certain Fluidized Supporting Apparatus and Components Thereof*, at 1.

¹²¹ *Id.* at 23.

¹²² See *id.*

¹²³ See *id.* at 23-25.

Commission has recognized the public interest in supplying consumers with needed drugs.¹²⁴

However, it has held that if the patentee can supply all domestic demand, there is not a public interest problem even if the patentee would satisfy the demand only at a higher price.¹²⁵

Significant public health interests, then, aren't enough unless coupled with unavailability.

On the other end of the spectrum, the Commission has also held that the unavailability of equivalent products is insufficient grounds to refuse an exclusion order when there is no reason to think there is an important health or welfare interest in the products. In *Certain Hardware Logic Emulation Systems*, the respondent argued that while the patentee provided hardware logic emulators, they were not of the same quality as the respondent's emulators.¹²⁶ The Commission rejected that argument, not by disagreeing with the factual claim, but by concluding that emulators weren't critical to the public interest:

hardware logic emulators are not the type of product that has in the past raised public interest concerns (such as, for example, drugs or medical devices) and we

¹²⁴ See *In re Certain Crystalline Cefadroxil Monohydrate, Public Disclosure Version: Commission Opinion On The Issue Under Review, And On Remedy, The Public Interest, And Bonding* at 46, USITC Inv. No. 337-TA-293, 1990 WL 10008086 at *17 (March 21, 1990).

¹²⁵ "There is, of course, an additional public interest in maintaining an adequate supply of pharmaceuticals for U.S. consumers. This interest also does not bar relief. Bristol has sufficient capacity and resources to satisfy all domestic demand for cefadroxil, as it had until respondents entered the market in March 1989. Moreover, the availability of other cephalosporins will not be affected by the issuance of relief. The record indicates that Bristol perceives a number of these cephalosporins to be competitive with cefadroxil; that at least one of the competitive cephalosporins, cephalexin, is available in generic form; and that, even if generic cefadroxil were unavailable, [] [redaction in original]. The record consequently refutes respondents' contention that granting relief will somehow deprive the ill and indigent of necessary medication.

The only remaining argument respondents make is that granting relief will raise prices to consumers. The Commission has previously held that this alone is not sufficient grounds for denying relief."

Id. at 46-47. 1990 WL 10008086 at *17-18.

¹²⁶ *In The Matter Of Certain Hardware Logic Emulation Systems And Components Thereof, Commission Opinion On Remedy, The Public Interest, And Bonding* at 8, USITC Inv. No. 337-TA-383, 1996 WL 1056217 at *5 (October 15, 1996).

are not aware of any other public interest concern that would militate against entry of the remedial orders we have determined to issue.¹²⁷

Thus, it seems to be the confluence of both the unavailability of alternatives and the important nature of the products that leads the Commission to deny an exclusion order.¹²⁸

The result might not seem particularly encouraging for the use of the public interest exceptions to combat patent holdup. Patent holdup tends to occur in complex, multi-component products, particularly in the information technology industries.¹²⁹ Holdup is a greater risk in those industries not only because there are more patents asserted in those industries, but also because those patents tend to cover small parts of a much larger product.¹³⁰ A patent that covers the active ingredient in the drug gives the patentee the right to prevent the sale of that drug; that isn't holdup, but the normal right of the patentee to exclude infringing products. By contrast, a patent on a particular circuit layout may constitute only a tiny fraction of the value of the microprocessor that uses the layout, but an exclusion order will exclude the microprocessor as a whole, preventing the defendant from importing both the

¹²⁷ *Id.* at 9, 1996 WL 1056217 at *5

¹²⁸ See also *In re Certain Toothbrushes And The Packaging Thereof*, Commission Opinion On Remedy, The Public Interest, And Bonding at 6, USITC Inv. No. 337-TA-391, 1997 WL 803475, at *2 (October 15, 1997) (“the public interest favors the protection of U.S. intellectual property rights, the U.S. market for toothbrushes of the type at issue could be supplied by complainant or by noninfringing alternatives, and toothbrushes are not the type of product that have in the past raised public interest concerns (such as, for example, drugs or medical devices).”); CERTAIN PROCESSES FOR THE MANUFACTURE OF SKINLESS SAUSAGE CASINGS AND RESULTING PRODUCT, INVESTIGATION NO. 337-TA-148/169; REVIEW OF INITIAL DETERMINATION, REMEDY, BONDING, AND THE PUBLIC INTEREST, USITC GC-84-187, 1984 WL 273326 (November 9, 1984) (“Sausage casings are not an essential item for the preservation of the public health and welfare.”).

¹²⁹ See FTC, *supra* note 5 at 3, 35, 160. Indeed, John Turner finds that PAEs depend for their business model on a critical mass of other inventions made by product-producing companies. John L. Turner, *Patent Thickets, Trolls and Unproductive Entrepreneurship* (working paper August 2011).

¹³⁰ See, e.g., Mark A. Lemley, *Ten Things to Do About Patent Holdup of Standards (and One Not To)*, 48 B.C. L. REV. 149, 150-51 (2007).

(small) infringing element and the (much larger) non-infringing elements. The social harm in the latter case is disproportionate to the social benefit, as many productive, non-infringing components are shut down to give the patentee control over only a single small component. The ITC cases applying the public interest exception, however, have generally not found much of a public health and welfare interest in IT products, where the holdup problem is most acute.¹³¹

Nonetheless, there are reasons to think the application of the public interest factors going forward may be broader than they have been in the past. To begin, it is worth noting that the ITC has traditionally focused most of its attention on only a subset of the statutory factors. Commission cases pay close attention to the effect of such exclusion upon the public health and welfare and the production of like or directly competitive articles in the United States.¹³² But they have paid very little attention to competitive conditions in the United States economy and the effect on United States consumers.¹³³

¹³¹ See J. Gregory Sidak, *The Law and Economics of Section 337 Exclusion Orders for Patent Infringement at the International Trade Commission* 49-60 (working paper October 18, 2011) (arguing that the existing public interest analysis at the ITC does not sufficiently take account of the problem of holdup).

¹³² See *supra* notes Error! Bookmark not defined.-123.

¹³³ Congress indicated that competitive conditions were intended to be an important part of the public interest analysis. From the legislative history:

“ The Committee believes that the public health and welfare and the assurance of competitive conditions in the United States economy must be the overriding considerations in the administration of this statute. Therefore, under the Committee bill, the Commission must examine (in consultation with other Federal agencies) the effect of issuing an exclusion order or a cease and desist order on the public health and welfare before such order is issued. Should the Commission find that issuing an exclusion order would have a greater adverse effect on the public health and welfare; on competitive conditions in the United States economy; on production of like or directly competitive articles in the United States; or on the United States consumer, than would be gained by protecting the patent holder (within the context of the U.S. patent laws) then the Committee feels that such exclusion order should not be issued. This would be

The mix of cases before the Commission has changed. When a domestic company is suing a foreign counterfeiter, the public interest is clear: ban the importation. However, this type of case is becoming less and less common – only 12% of ITC cases fit the prototypical profile of a domestic plaintiff suing a foreign defendant.¹³⁴ Cases brought against “knockoffs” are also comparatively rare – 58% of cases were brought against public companies, who are, for reasons of reputation and brand, unlikely to fit in the category of “counterfeiters.”¹³⁵ In addition, more cases are fitting the troll profile.¹³⁶

In the wake of *eBay* and various changes to the ITC statute and case law, non-practicing entities are flocking to the ITC, both because of the relaxed domestic industry requirement¹³⁷ and because courts are no longer a sure bet for injunctions.¹³⁸ The cases they are bringing disproportionately involve complex, multi-component technologies.¹³⁹

As a result, the balance of public interest factors is different today than it traditionally has been. First, one of the factors that the Commission has always considered important – will another company fill the gap created by exclusion – is less likely to be satisfied when the complainant is a non-practicing entity. That is especially true when the patentee complains

particularly true in cases where there is any evidence of price gouging or monopolistic practices in the domestic industry.

S. Rep. No. 93-1298, 93rd Cong., 2d Sess. 197, at *7330 (1974).

¹³⁴ Chien, *Patently Protectionist*, *supra* note 10 at 89, Table 3.

¹³⁵ *Id.* p. 92 table 4.

¹³⁶ See *supra* Figure 4.

¹³⁷ See *Czebiniak*, *supra* note 10, at 110.

¹³⁸ See *eBay*, 547 U.S. at 391.

¹³⁹ Eighty-six percent of ITC cases filed by NPEs between 2005 and 2011 were in high-tech sectors. Michael Kallus and James Conlon, *International Trade Commission: The Second Theater*, RPX Corp. 10/3/11 Presentation, slide (on file with author) (showing that 86% of ITC NPE cases involved mobile communications, semiconductors, consumer electronics, PCs, networking, storage, or e-commerce technologies, in contrast to ITC cases in general, 63% of which involved these sectors.) [ER 14]

against a host of companies at once, as is often the case in troll actions.¹⁴⁰ If the patentee claims that the entire industry infringes, there is no one exempt from the exclusion order available to fill market demand.¹⁴¹

Second, both competitive conditions and consumers are affected to a greater degree by the grant of exclusion orders in complex multi-component cases than was true in traditional counterfeiter cases. The effect is not just on the supply of the infringing feature, but also on the price and supply of non-infringing features and functionalities, customers and third parties that rely on these non-infringing features, and – through the mechanism of holdup – on the research and development activities of the defendants and of companies who make the noninfringing components.¹⁴² Patent holdup was not a feature of most ITC actions until recently, both because they weren't filed by PAEs against an entire industry and because they weren't usually filed against complex, multi-component products.¹⁴³ The changed circumstances permit the ITC to take a different approach.

There is some reason to think the ITC may be open to rethinking its public interest case law. In 2011, the ITC incorporated public interest considerations into its decision not to deny,

¹⁴⁰ See Figure 2.

¹⁴¹ The issue is more complex when the patentee sues an entire industry but settles by licensing some parties before trial. In that case, the settlement means that there are in fact some parties who can sell licensed products if an exclusion order issues against the remaining defendants. But it would seem odd to say that whether a patentee can exclude defendants should depend on whether other defendants choose to go to trial. District courts after *eBay* have been unwilling to view nonexclusive licenses granted in settlement of patent disputes as evidence of irreparable injury justifying injunctive relief, see *z4*, 434 F. Supp. 2d at 440; the same logic might apply here.

¹⁴² See, e.g., Cease and Desist order in Broadband Base Processors at 1, USITC Inv. No. 337-TA-543 (restricting Qualcomm's research, development, and testing of broadband base processors) discussed in Commission Opinion on Remedy, the Public Interest, and Bonding in Broadband Base Processors at 154, USITC Inv. No. 337-TA-543 (rejecting Qualcomm's position that a Cease and Desist order would impair the public interest).

¹⁴³ See *supra* Part I.

but to delay the start of, an exclusion order in a case involving smartphones.¹⁴⁴ Around that time, the ITC has changed its rules to allow an administrative law judge, under Commission order, to take evidence on the public interest at the outset of a case, rather than waiting until the end.¹⁴⁵ This information could be used to identify likely remedies earlier in the proceedings, leading to the more efficient resolution of cases.

We applaud this new-found flexibility. In the next Part, we offer specific suggestions for how the Commission could update the public interest considerations for the new, post-*eBay* world.

III. Tailoring, Bonding, and Pausing in the Public Interest

Remedies in the ITC might seem to be an all-or-nothing affair. The ITC can't award damages; it can only exclude products.¹⁴⁶ As a result, even judges and Commissioners who believe an exclusion order is not in the public interest might hesitate to apply the public interest standard to deny relief, for fear that the result will be that the patentee wins its case but gets no remedy at all. That fear has always been somewhat overstated; patentees can file suit in district court in parallel with the ITC (and do, two-thirds of the time¹⁴⁷), and they may be entitled to an award of damages in court even if neither the ITC nor the court enjoins the sale

¹⁴⁴ Order in 337-TA-710, Personal Data and Mobile Communications Devices and Related Software, at 3 (December 19, 2011); see also Colleen V. Chien and Mark A. Lemley, *Patents and the Public Interest*, *supra* note 9, NEW YORK TIMES.COM, December 13, 2011 (recommending this very tailoring remedy in that case).

¹⁴⁵ Rules of Adjudication and Enforcement, 19 CFR Part 210, 76 Fed. Reg. 64803 (Oct. 19, 2011), http://www.usitc.gov/secretary/fed_reg_notices/rules/finalrules210.pdf.

¹⁴⁶ See 19 U.S.C. §1337; Chien *Patently Protectionist*, *supra* note 10, at 102.

¹⁴⁷ Chien, *Patently Protectionist*, *supra* note 8, at 70 (noting that “65 percent of the ITC cases studied had a district court counterpart”).

of the defendant's product.¹⁴⁸ But that may be cold comfort to patentees who will have wasted the time and effort of going to the ITC only to have the Commission give it no remedy. And the Commission may understandably be reluctant to condemn itself to seeming irrelevance.

In fact, however, we think the Commission has more flexibility in remedies than previously recognized. Historically, the ITC has used this flexibility at several points to restrict the relief given to patentees. In 1981, the Commission created the limited exclusion order to supplement the remedy of a general order, as "a limitation on the relief afforded a prevailing complainant."¹⁴⁹ It did so while determining the proper scope of an injunction even though "Congress ha[d] never specifically authorized the Commission to issue limited exclusion orders as the final remedy in a section 337 investigation."¹⁵⁰ In the *EPROMs* case, the Commission

¹⁴⁸ In the case of co-pending ITC and district court cases, the district court case shall be stayed upon a timely request. See 28 U.S.C. § 1659(a) ("district court shall stay, until the determination of the Commission becomes final, proceedings in the civil action with respect to any claim that involves the same issues involved in the proceeding before the Commission"). While the ITC's findings are not accorded res judicata by the courts, *Texas Instruments, Inc. v. Cypress Semiconductor Corp.*, 90 F.3d 1558, 1568-69 (Fed. Cir. 1996), in practice, the default assumption is that district courts are to reach a similar result on the same claims and explain and distinguish the ITC decision if they don't.

¹⁴⁹ As recounted in 337-TA-276, *EPROMs*, n. 159. ("[T]he limited exclusion order is itself a limitation on the relief afforded a prevailing complainant, created by the Commission without specific authority in the statute. Congress has never specifically authorized the Commission to issue limited exclusion orders as the final remedy in a section 337 investigation, although it has specifically authorized them when directed at defaulting respondents. Nevertheless, the Commission has been issuing limited exclusion orders since 1981. In light of the extensive attention devoted to section 337 in the past two years, resulting in the amendments effected by the OTCA, we believe it is reasonable to infer Congressional acquiescence in the Commission's practice of issuing limited exclusion orders from Congress' silence on the matter. This is particularly so, since with respect to remedy matters, Congress noted the Commission's belief that it was precluded from issuing both exclusion and cease and desist orders with respect to the same unfair act, and provided specific authority for the Commission to do so, presumably in order to expand the extent of relief available to a prevailing complainant. Had Congress objected to the issuance of limited rather than general exclusion orders as insufficient relief, it would presumably have acted to limit the Commission's authority to issue such orders.")

¹⁵⁰ *Id.* In general, an administrative agency's latitude to craft appropriate remedies, while not unlimited, is broad. See *Jacob Siegel Co. v. Federal Trade Comm'n*, 327 U.S. 608, 613 (1946) ("the courts will not interfere except where the remedy selected has no reasonable relation to the unlawful practices found to exist").

devised a special, 9-factor test to apply when so-called “downstream products”, products that incorporated the infringing component, were implicated by an exclusion order.¹⁵¹ This test reflects, in large part, a concern about the proportionality of the ITC remedy to the “wrong” of patent infringement as reflected in Factor 1 (the value of the infringing articles compared to the value of the downstream products in which they are incorporated), Factor 3 (the incremental value to the complainant of the exclusion of downstream products), Factor 4 (the incremental detriment to respondents of exclusion of such products), and Factor 5 (the burdens imposed on third parties resulting from exclusion of downstream products).¹⁵² When the value of the invention is small compared to the value of the enjoined article that incorporates that invention downstream, the ITC has paused to consider whether and what type of injunction is deserved.¹⁵³ Today’s component cases raise the same concerns about undue interference with the market.

¹⁵¹ EPROMs, *supra* note 149 at 124-26. The nine EPROM factors require the ITC to evaluate:

- (1) the value of the infringing articles compared to the value of the downstream products in which they are incorporated;
- (2) the identity of the manufacturer of the downstream products, i. e., whether it can be determined that the downstream products are manufactured by the respondent or by a third party;
- (3) the incremental value to the complainant of the exclusion of downstream products;
- (4) the incremental detriment to respondents of exclusion of such products;
- (5) the burdens imposed on third parties resulting from exclusion of downstream products;
- (6) the availability of alternative downstream products that do not contain the infringing articles;
- (7) the likelihood that the downstream products actually contain the infringing articles and are thereby subject to exclusion;
- (8) the opportunity for evasion of an exclusion order that does not include downstream products; and
- (9) the enforceability of an order by Customs.

¹⁵² *See supra* note 151.

¹⁵³ *See, e.g., EPROMs, supra* note 149, at 127.

Although the *EPROMs* standard has arguably diminished in importance with the Federal Circuit's *Kyocera* decision,¹⁵⁴ the concerns that prompted it endure. High-tech component cases are now the norm at the ITC: eighty-six percent of ITC cases filed by NPEs between 2005 and 2011 were in high-tech sectors.¹⁵⁵ In this section, we suggest some ways in which the ITC can use its discretion to craft remedies consistent with the statute's public interest provisions and the Commission's *EPROMs* test.

Much of that flexibility results from the statute, which gives the ITC broad discretion to fashion an appropriate remedy.¹⁵⁶ The Federal Circuit is largely deferential to the ITC's remedy determinations, reversing them only when they are "arbitrary, capricious, an abuse of

¹⁵⁴ At least as applied to the exclusion of downstream products through a limited exclusion order, which *Kyocera* prohibited. See *Kyocera Wireless Corp. v. International Trade Commission*, 545 F.3d 1340, 1357-58 (Fed. Cir. 2008).

¹⁵⁵ *Kallus*, *supra* note 139.

¹⁵⁶ See 19 U.S.C. § 1337(c) ("Commission determinations . . . with respect to its findings on the public health and welfare, competitive conditions in the United States economy, the production of like or directly competitive articles in the United States, and United States consumers, the amount and nature of bond, or the appropriate remedy shall be reviewable in accordance with [5 U.S.C. § 706]."), and *Hyundai Elecs. Indus. Co. v. Int'l Trade Comm'n*, 899 F.2d 1204, 1208 (Fed.Cir.1990) (finding, based on a review of section 337 legislative history, that 5 USC 706 2(A) governs the Federal Circuit's review of ITC remedy determinations.); 5 U.S.C § 706 2(A) ("The reviewing court shall . . . hold unlawful and set aside agency action, findings, and conclusions found to be (A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law"); *accord*, *Spansion, Inc. v. Int'l Trade Comm'n*, 629 F.3d 1331, 1358 (Fed. Cir. 2010) citing *Epistar Corp. v. Int'l Trade Comm'n*, 566 F.3d 1321, 1333 (Fed. Cir. 2009).

discretion, or otherwise not in accordance with law.”¹⁵⁷ This standard of review is less stringent than the one that applies to the ITC’s substantive patent law determinations.¹⁵⁸

The structure of the ITC process also provides some flexibility. Once the Commission finds a violation, it is entitled to enter an exclusion order keeping infringing products out of the market.¹⁵⁹ In some circumstances, the Commission holds a separate hearing after a liability finding to determine whether and what particular form of injunctive relief is appropriate.¹⁶⁰ Assuming it is (and as noted above,¹⁶¹ the Commission essentially always finds that it is), the order is then subject to a 60-day Presidential review period.¹⁶² But the exclusion order goes into effect immediately – *before* the Presidential review period – unless the respondent posts a bond adequate to compensate for sales made during the review period.¹⁶³ And once the Commission’s order is final, the respondent can appeal to the Federal Circuit.¹⁶⁴

¹⁵⁷ See *Spansion*, 629 F.3d 1331 at 1358; *accord* *Epistar Corp. v. Int’l Trade Comm’n*, 566 F.3d 1321, 1333 (Fed. Cir. 2009); *Hyundai Elecs. Indus. Co. v. Int’l Trade Comm’n*, 899 F.2d 1204, 1208 (Fed. Cir. 1990); see also *Kyocera Wireless Corp. v. International Trade Commission*, 545 F.3d 1340, 1355 (Fed.Cir.2008) (applying the framework established by *Chevron U.S.A. Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, (1984) to an ITC order, and stating that if “the statute in question is ambiguous and the agency’s interpretation is reasonable,” “a court must defer to an agency’s construction of a statute governing agency conduct.” (quoting *Cathedral Candle Co. v. U.S. ITC*, 400 F.3d 1352, 1361 (Fed. Cir. 2005)).

¹⁵⁸ *Hyundai* at 1208 (“Congress . . . desire[d] to subject Commission determinations on the public interest . . . bonding, and remedy, to a less stringent standard of judicial review than determinations of substantive violations of section 337.”).

¹⁵⁹ 19 U.S.C. § 1337(e)(1).

¹⁶⁰ Commission Decision in *Personal Data and Mobile Communications Devices* TA-710-337.

¹⁶¹ See Figure 3.

¹⁶² 19 U.S.C. § 1337(j)(2) (“If, before the close of the 60-day period beginning on the day after the day on which he receives a copy of such determination, the President, for policy reasons, disapproves such determination and notifies the Commission of his disapproval, then, effective on the date of such notice, such determination and the action taken under subsection (d), (e), (f), (g), or (i) of this section with respect thereto shall have no force or effect.”).

¹⁶³ 19 U.S.C. § 1337(e)(1) (“The Commission shall notify the Secretary of the Treasury of its action under this subsection directing such exclusion from entry, and upon receipt of such notice, the Secretary shall, through the proper officers, refuse such entry, except that such articles shall be entitled to entry under bond prescribed by the Secretary in an amount determined by the Commission to be sufficient to

This process creates three remedies less harsh than simply excluding the products but more powerful than simply denying an injunction. First, the ITC can decide *what* its exclusion order will cover. That is to say, it can choose, and indeed has chosen,¹⁶⁵ to include certain products, and exclude others in its orders. Second, the ITC can decide *when* it will implement its exclusion order. It doesn't have to choose between immediately enjoining the product or doing nothing; it can delay the order or apply it only prospectively. Finally, the ITC can use its statutory authority to set a bond to permit continued importation during the review period, but condition that importation on the payment of money. Small tweaks to these aspects of how the ITC awards injunctions can potentially yield big benefits to the public interest, as we explain below.

A. Grandfathering and Tailoring Injunction Scope

19 U.S.C. §1337 (d) directs the Commission to exclude infringing articles unless public interest concerns dictate otherwise. Read with an eye towards tailoring, the provision essentially requires the Commission to fashion its exclusion order so that it will pass public interest muster. An exclusion order tells a company to stop importing its product.¹⁶⁶ But it is a remedy whose harshness can be softened, for example, if existing models or units are grandfathered in. When the product remains available in some form, and the exclusion order is

protect the complainant from any injury. If the Commission later determines that the respondent has violated the provisions of this section, the bond may be forfeited to the complainant.”); *id.* § 1337(j)(3) (“articles directed to be excluded from entry under subsection (d) of this section or subject to a cease and desist order under subsection (f) of this section shall, until such determination becomes final, be entitled to entry under bond prescribed by the Secretary in an amount determined by the Commission to be sufficient to protect the complainant from any injury. If the determination becomes final, the bond may be forfeited to the complainant. The Commission shall prescribe the terms and conditions under which bonds may be forfeited under this paragraph.”).

¹⁶⁴ *Id.* §1337(c).

¹⁶⁵ *See, infra* Part III(A).

¹⁶⁶ 19 U.S.C. §1337(d)(1).

applied to future versions or units of the product, consumers and competition are less likely to suffer.

These types of public interest concerns have led the ITC to engage in just this kind of tailoring. In *Certain Baseband Processors*, the Commission found that the requested exclusion order was “not permitted in [the] investigation” due to the potential harm to third parties.¹⁶⁷ However, the Commission adjusted the scope of the exclusion order by grandfathering in existing models of handsets.¹⁶⁸ The exemption enabled the exclusion order to “adequately address public interest concerns”¹⁶⁹ and the Commission to issue the exclusion order.

The Commission has tailored exclusion scope in other cases as well. In *Personal Data and Mobile Communications Devices*, the Commission grandfathered refurbished replacement handsets into its exclusion order.¹⁷⁰ In *Sortation Systems*¹⁷¹ and *Transmission Trucks*,¹⁷² the ITC exempted from its exclusion order spare parts to service existing systems and facilities, citing the exemptions in its public interest analysis. We believe it could use grandfathering and

¹⁶⁷ Commission Decision in *Certain Baseband Processors* Inv. No. 337-TA-543, *supra* note 142, at 83. [ER 16]

¹⁶⁸ *Id.* at 150-1.

¹⁶⁹ *Id.* at 150.

¹⁷⁰ Commission Decision in *Personal Data and Mobile Communications Devices* 337-TA-710, *supra* note 78, at 83. (“HTC shall be permitted to import into the United States [for 19 months] . . . refurbished handsets to be provided to consumers as replacements”).

¹⁷¹ *Certain Sortation Systems, Parts Thereof, and Products Containing Same; Notice of Violation of Section 337 of the Tariff Act of 1930 and Issuance of Limited Exclusion Order*, 68 Fed. Reg. 5047 (Jan. 31, 2003) (“The Commission determined to include an exemption in the limited exclusion order for importations of spare parts for United Parcel Service’s Hub 2000 facility in Louisville, Kentucky.”).

¹⁷² *Certain Automated Mechanical Transmission Systems for Medium-Duty and Heavy-Duty Trucks, and Components Thereof, Termination of Investigation; Issuance of a Limited Exclusion Order and a Cease and Desist Order*, at 3, EDIS Doc. ID. 228343, USITC Inv. No. 337-TA-503 (Apr. 7, 2005) (“The limited exclusion order does not cover parts necessary to service infringing automated mechanical transmission systems installed on trucks prior to the issuance of the order.”)

related exemptions in appropriate circumstances to protect consumer access to the noninfringing portions of a complex, multicomponent product.¹⁷³

B. Delay

The Commission may also choose in certain circumstances to delay the exclusion order.¹⁷⁴ The Commission normally imposes an exclusion order immediately, though as noted above, the respondent can effectively stay that injunction for 60 days by posting a bond.¹⁷⁵ The respondent may also be able to obtain a stay of the exclusion order pending appeal to the Federal Circuit.¹⁷⁶ But even if neither occurs, the Commission has the power to delay the implementation of the exclusion order for a period of time. It could do so to give the respondent time to design around the patent or substitute non-infringing products for goods in the pipeline, or to ensure that consumers don't go without products until the patentee can ramp up production.

Delaying injunctive relief has the potential to significantly ameliorate the holdup problem. As Mark Lemley and Carl Shapiro have shown, holdup is a result of two factors: the fact that an injunction will prevent the sale of noninfringing as well as infringing components in a complex multi-component product and the fact that roughly ¾ of litigated patents are either

¹⁷³ See also John M. Golden, *Injunctions as More (or Less) Than "Off Switches": Patent-Infringement Injunctions' Scope*, 90 *Tex. L. Rev.* __ (forthcoming 2012).

¹⁷⁴ Commission Decision in *Personal Data and Mobile Communications Devices* TA-710-337, *supra* note 78, at 81. ("T-Mobile itself has advised the Commission that a four-month transition period would likely be sufficient. . . . We find T-Mobile's suggestion to be reasonable and within our authority to implement.")

¹⁷⁵ 19 U.S.C. §1337(e)(1).

¹⁷⁶ *Id.* at §1337(c).

invalid or not infringed.¹⁷⁷ The fact that the injunction will shut down non-infringing matter means that it costs the respondent more than the patent itself is worth.¹⁷⁸ Rather than pay that extra cost in settlement, the respondent will sometimes design around the patent to avoid the effect of an injunction.¹⁷⁹ But because most patent suits lose, most advance design-arounds are wasted effort.¹⁸⁰ The patentee can opportunistically capture in settlement the cost of design-around, even if the patent is likely to be invalid or not infringed.¹⁸¹

Delaying onset of the injunction or exclusion order changes that dynamic. As Lemley and Shapiro show, respondents who can count on a delay to allow them to design around the patent don't need to invest in unnecessary design-arounds to avoid the risk of injunction holdup.¹⁸² As a result, they don't need to pay the owners of weak patents a premium to avoid spending the money on design-arounds. They can design around the patent only if it becomes necessary to do so. Design-arounds take time – not only to devise, test, and implement in the

¹⁷⁷ Lemley & Shapiro, *supra* note 26 at 1996, 2019, n. 71. A number of scholars have tried to attack this holdup analysis. See Einer Elhauge, *Do Patent Holdup and Royalty Stacking Lead To Systematically Excessive Royalties?*, 4 J. COMPETITION L. & ECON. 535, 535-40 (2008); J. Gregory Sidak, *Holdup, Royalty Stacking, and the Presumption of Injunctive Relief for Patent Infringement: A Reply to Lemley and Shapiro*, 92 MINN. L. REV. 714, 718-20 (2008). But those attacks miss the mark; rather than demonstrate that holdup doesn't exist, these scholars have uniformly argued that patentees *deserve* the holdup value of their patents, asserting that patentees – unlike everyone else in a market economy – should be paid the full social value of their invention. See Thomas M. Cotter, *Patent Holdup, Patent Remedies, and Antitrust Responses*, 34 J. CORP. L. 1151, 1153-54, 1162-71 (2009) (making this point).

John Golden has taken a different tack, arguing that it is unfair to treat PAEs differently than product-producing plaintiffs. John M. Golden, *"Patent Trolls" and Patent Remedies*, 85 TEX. L. REV. 2111, 2114-17 (2007). But that too misses the point; if one patient needs a kidney and another doesn't, it is not discrimination to give a kidney only to the one who can show they need it. Similarly, granting injunctions only to parties who can prove they will suffer irreparable injury without it isn't discrimination even though it has different effects on different plaintiffs. See Mark A. Lemley & Carl Shapiro, *Patent Holdup and Royalty Stacking: Reply*, 85 TEX. L. REV. 2163, 2163-65, 2169 (2007);

¹⁷⁸ Mark A. Lemley & Philip J. Weiser, *Should Property or Liability Rules Govern Information?*, 85 TEX. L. REV. 783, 794-95 (2007).

¹⁷⁹ See Lemley & Shapiro, *supra* note 26, at 2002.

¹⁸⁰ See *id.* at 2002, n. 71.

¹⁸¹ See *id.* at 2002, 2005.

¹⁸² See *id.* at 2038. Accord Golden, *supra* note ___, at 2131.

manufacturing process, but sometimes also to gain necessary regulatory approvals. With a transition period, the blow of abruptly pulling a product from the market is softened. The Federal Circuit acknowledged this in *Broadcom v. Qualcomm*, remarking that the “sunset provisions mitigate the harm to the public” as a remedy that protected rights “while allowing . . . time to develop non-infringing substitutes.”¹⁸³

A limited delay to allow design-around has another benefit as well – it can help distinguish between patents that really are critical and those that aren’t. Giving a respondent, say, six months to design around the patent provides a sort of acid test of the claim that the patent is in fact necessary to practice the invention. If the respondent can design around the patent in six months, the invention it embodies arguably wasn’t that valuable, and it probably isn’t worth holding up the entire product for a patent that was essentially optional. By contrast, if the respondent can’t design around the patent and still sell a product economically, the patent really is valuable, and arguably we should worry less about the risk of holdup caused by the exclusion order. And unlike the district courts with their limited Article III jurisdiction, the ITC has the power to issue an advisory opinion as to whether the design-around is also infringing the patent,¹⁸⁴ a fact that can save a great deal of cost and uncertainty in subsequent litigation.¹⁸⁵

¹⁸³ *Broadcom Corp. v. Qualcomm Inc.*, 543 F.3d 683, 704 (Fed. Cir. 2008) (approving a district court’s injunction that included a twenty month “sunset provision” that reduced harm to the public interest); *Verizon Servs. Corp. v. Vonage Holdings Corp.*, 503 F.3d 1295, 1311 n. 12 (Fed. Cir. 2007) (noting, in dicta, the benefits of a workaround period, though one was not requested by the defendant.). See also Golden, *supra* note , at note 261 (noting and describing cases where courts have delayed to avoid the “special disruption” of immediately entered injunctions.)

¹⁸⁴ 19 C.F.R. §210.79; *Eaton Corp. v. United States*, 395 F. Supp. 2d 1314, 1318 (Ct. Int’l Trade 2005) (noting this option). For discussion of the strategic considerations that go into deciding whether to seek such an opinion, see Merritt R. Blakeslee & Christopher V. Meservy, *Seeking Adjudication of a Design-*

Patentees might object that delaying the injunction is unfair to them, because if the respondent can design around the patent, the patentee ends up getting nothing. That’s not entirely true; if the design-around costs more than the original product, the parties should be able to settle for the difference in value – which is really the value of the patent in the first place. And if the design-around is easy and just as cheap, the actual value of the patented technology is zero; any payment to the patentee in that case is a windfall.

The ITC has started to recognize the benefits of staying exclusion orders. In *Personal Data and Mobile Communications Devices*, the Commission found that the immediate exclusion of the infringing devices “would not be in the public interest” because of its impact on market competition.¹⁸⁶ A four-month period of exclusion, however, would provide time for replacement handsets to be devised and provided to customers.¹⁸⁷ The Commission tailored its injunction accordingly, explaining that “competitive conditions in the United States do not weigh against the issuance of an exclusion order, but favor providing a transition period.”¹⁸⁸

As this case demonstrates, incorporating a delay allows the ITC to award exclusion orders where public interest might dictate otherwise. During the period of stay, there may be a way for patentees to be compensated for the value of their technology during the period of stay. That relates to the final area of remedial flexibility at the ITC – monetary relief.

Around in Section 337 Patent Infringement Investigations: Procedural Context and Strategic Considerations, 35 *AIPLA Q.J.* 385, 408-411 (2007).

¹⁸⁵ Indeed, in *Ninestar*, the Federal Circuit chastised the respondent for not taking advantage of this procedure before implementing its alleged design-around. *Ninestar Tech. Co. v. ITC*, 667 F.3d 1373, ___ (Fed. Cir. 2012)

¹⁸⁶ Commission Decision in *Personal Data and Mobile Communications Devices* USITC Inv. No. 337-TA-710, *supra* note 78, at 81 (noting the immediate exclusion of HTC devices would have a “substantial impact on T-Mobile’s competitiveness”).

¹⁸⁷ *See id.*

¹⁸⁸ *Id.* at 83.

C. Bonds and Penalties

Although the ITC doesn't routinely award stays, it does routinely sanction the continued importation of an article even after it has been found infringing. That is because, while the ITC cannot award damages, 19 U.S.C. § 1337(j)(3) authorizes it to set a a bond that the respondent can post and continue importation under through the 60-day Presidential review period.¹⁸⁹ The amount must be "sufficient to protect the complainant from any injury,"¹⁹⁰ and is typically based on the difference in price between complainant's product and the infringing imports.¹⁹¹ Requiring respondents to post a bond to delay implementation of the exclusion order pending the Presidential review period is effectively a payment of an ongoing royalty.

The President essentially never reverses an ITC decision,¹⁹² which means that respondents always forfeit the bond. They are paying an ongoing royalty for the privilege of continuing to sell their products for another 60 days. And if the bond is set correctly, it will mimic the amount of an ongoing royalty in district court: the value of the patent based on the number of goods sold.¹⁹³ There is no policy reason the ITC shouldn't be allowed to impose a delay longer than 60 days in exchange for payment of a comparably higher bond. It could stay the order pending appeal, for instance, subject to a bond.

¹⁸⁹ See 19 U.S.C. § 1337(j); Tom Schaumberg, ed. *A Lawyer's Guide to Section 337 Investigations Before the US International Trade Commission* ABA-IP Section (2011), p. 186 n. 41.

¹⁹⁰ 19 U.S.C. § 1337(j)(3).

¹⁹¹ Commission Decision in *Personal Data and Mobile Communications Devices* TA-710-337, *supra* note 78, at 85.

¹⁹² The White House has done so only five times ever. See, e.g. Tom Schaumberg, ed. *A Lawyer's Guide to Section 337 Investigations Before the US International Trade Commission* ABA-IP Section (2011), p 187 fn. 45. As of 2005, the White House delegated this power to the U.S. Trade Representative. 70 Fed. Reg. 43251 (July 26, 2005).

¹⁹³ On the calculation of ongoing royalties in district court, see Mark A. Lemley, *The Ongoing Confusion Over Ongoing Royalties*, 76 Mo. L. Rev. 695, 701-02 (2011).

The amount of the bond would depend on the equities of the case. In *Personal Data and Mobile Communications Devices*, where implementation of the exclusion order was delayed by four months, the ITC entered a bond amount of zero,¹⁹⁴ although in other cases it may be more.¹⁹⁵ Combining a delay in the implementation of an exclusion order with a bond compensating the patentee for the value of the invention during the period of delay would allow the ITC to approximate the power a district court has to deny or stay injunctive relief while ordering payment of an ongoing royalty.¹⁹⁶ It will often be the best possible remedy, and certainly it is preferable to the other apparent options – patent holdup by an immediate exclusion order or no remedy at all.

Implementing bond periods longer than 60 days may require some creativity, however. Section 1337(j)(3) seems to contemplate that the bond must terminate at the end of the presidential review period when the Commission’s order becomes “final,” even though that

¹⁹⁴ The opinion suggests that the amount could have been higher had Apple presented better evidence of the price differential. Commission Opinion in *Personal Data and Mobile Communications Devices*, *supra* note 78, at 85 (“Apple failed to satisfy its burden . . .”).

¹⁹⁵ The amount of the bond is often set at 100%. (*see, e.g.*, Certain Radio Control Hobby Transmitters and Receivers and Products Containing Same, Limited Exclusion Order at 2, USITC Inv. No. 337-TA-763 (Sept. 27, 2011); Certain Birthing Simulators and Associated Systems, Limited Exclusion Order at 2, USITC Inv. No. 337-TA-759 (Aug. 29 2011); Certain Toner Cartridges and Components Thereof, Cease and Desist Order at 2, USITC Inv. No. 337-TA-740 (Sept. 27, 2011)) though this also seems like in many cases this would be far more than “sufficient to protect the complainant from any injury,” (as provided in 19 U.S.C. §1337(j)(3)) especially when the invention is a small component of the infringing article.

One complication for bonding, both under our proposal and in existing practice, arises with the growth of NPEs at the ITC. If the patentee doesn’t sell the patented invention, there is no price differential to use as a baseline to measure the value of the patent. But district courts confront the valuation problem all the time, and a variety of mechanisms economists use there for apportionment of the value of complex products may be used here to set the amount of a bond in an NPE case.

¹⁹⁶ The analogy isn’t perfect; a bond is presumably set against the possibility of some contingent future event, however unlikely. The power to order payment of a bond might not extend to the power to order the payment of money directly to the complainant with no hope of recovery. But conditioning a bond on something like an appeal will generally achieve the same result.

final order is still subject to appeal.¹⁹⁷ One possibility is to change this language to give the ITC more flexibility in determining the length of time covered by a bond. Another, simpler, possibility is that the Commission not publish its final notice of finding of violation in the Federal Register until after the period of delay ends. By making a preliminary holding rather than a published “determination,” the ITC may be able to delay the beginning of the 60-day clock for presidential review.¹⁹⁸

The ITC’s authority to assess and impose civil penalties for violations of Commission orders provide another option for the ITC to provide a monetary component to its remedy, even in spite of its inability to award damages.¹⁹⁹ The ITC has been given wide latitude in setting penalties, which are reviewed for an abuse of discretion.²⁰⁰ In *San Huan Materials High Tech, Inc. v. International Trade Commission*, the Federal Circuit endorsed the ITC’s approach to

¹⁹⁷ 19 U.S.C. § 1337(c).

¹⁹⁸ 19 U.S.C. § 1337(j)(1) provides that the 60-day review period begins when the Commission publishes its determination in the Federal Register and transmits the finding to the President; the order becomes final 60 days thereafter.

¹⁹⁹ See 19 U.S.C. § 1337(f)(2):

Any person who violates an order issued by the Commission under paragraph (1) after it has become final shall forfeit and pay to the United States a *civil penalty* for each day on which an importation of articles, or their sale, occurs in violation of the order of not more than the greater of \$100,000 or twice the domestic value of the articles entered or sold on such day in violation of the order. Such penalty shall accrue to the United States and may be recovered for the United States in a civil action brought by the Commission in the Federal District Court for the District of Columbia or for the district in which the violation occurs.

²⁰⁰ See *Ninestar Tech. Co. v. ITC*, 667 F.3d 1373, 1377 (Fed. Cir. 2012) (“Assessment of a civil penalty under 19 U.S.C. §1337(f) is reviewed on the standard of abuse of discretion”); *Genentech, Inc. v. International Trade Comm’n*, 122 F.3d 1409, 1414 (Fed. Cir. 1997). This means review for whether the ruling: “(1) is clearly unreasonable, arbitrary, or fanciful; (2) is based on an erroneous conclusion of law; (3) rests on clearly erroneous fact findings; or (4) follows from a record that contains no evidence on which the decision-making body could rationally base its decision.” *Ninestar*, at 1379. Commission penalties may also trigger constitutional review if due process concerns are raised. See *id.* at 1382.

setting penalties based on: “(1) the good or bad faith of the respondent; (2) any injury due to the infringement; (3) the respondent’s ability to pay the assessed penalty; (4) the extent to which the respondent benefitted from its violations; (5) the need to vindicate the authority of the Commission; and (6) the public interest.”²⁰¹ The Commission’s approach to determining the amount of penalty “[takes] into account the ‘three overarching considerations enumerated by Congress in the legislative history [of section 337(f)(2)], viz., the desire to deter violations, the intentional or unintentional nature of any violations, and the public interest.’”²⁰² A Commission interested in ensuring that patentees were compensated but unwilling to exclude products altogether might be able to use this authority to effectively “preannounce” the penalty for violating an exclusion order – in effect converting that penalty into a price to be paid for the importation of infringing goods.

D. Exercising Discretion Wisely

The ITC has broad discretion within the bounds of the statute in setting and conditioning the remedy for infringement.²⁰³ We think the ITC should exercise its remedial flexibility when the risk of holdup is substantial. That is likely when the defendant sells a multi-component product and the novel feature of the patent covers only a small part of that product.²⁰⁴

Different remedies might be appropriate in different situations:

²⁰¹ *Ninestar* at 1379, citing *San Huan New Materials High Tech, Inc. v. Int’l Trade Comm’n*, 161 F.3d 1347, 1362 (Fed. Cir. 1998). *Ninestar* also confirms that the ITC, rather than the solely district court, also has the authority to determine and enforce civil penalties. *See id.* at 1384.

²⁰² *San Huan* at 1362.

²⁰³ 19 U.S.C. § 1337(c) (providing that review of remedial decisions is subject to deference under the Administrative Procedures Act, including presumably *Chevron* deference to reasonable interpretations of the statute).

²⁰⁴ Patent claims will often be written to cover an entire product even though the patentee’s contribution is limited to a single small feature. The inventor of the intermittent windshield wiper, for

- Switching costs are high once interoperable products are designed to work together (e.g. standards).²⁰⁵ In this case, grandfathering in of existing models can ameliorate the harms.
- The short-term impact on consumers is high in cases where switching, costly or not, imposes significant harm on customers who cannot get support or service for products already sold.²⁰⁶ In this case, either a stay or an exception allowing service and spare parts might help solve these problems.²⁰⁷
- Collateral damage to third parties who make noninfringing products may be high in multi-component cases because those third parties have already made irreversible investments. Grandfathering can help in some of these cases, but not all; bonding may be the best remedy in this circumstance.²⁰⁸

instance, might claim a car with an intermittent windshield wiper. The Commission should focus on what the patentee actually contributed to the art, not the form in which the patentee chooses to write the claim. See Mark A. Lemley, *Point of Novelty*, 105 Nw. U. L. REV. 1253 (2011).

²⁰⁵ See, e.g., *Certain Baseband Processors* at p. 149 (“As to competitive conditions in the U.S. economy, exclusion would likely result in some adverse impact on the development of advanced telecommunications technology and on expansion of broadband internet access. These technologies are important in their own right, but they also have significant effects on other economic activity in the United States. Downstream relief would make it more difficult for telecommunications companies to expand 3G cellular telephone services and broadband internet access, and make it more difficult for consumers, including businesses, to access these services”).

²⁰⁶ See Commission Opinion in *Personal Data and Mobile Communications Devices* 337-TA-710, *supra* note 78, at 72-73.

²⁰⁷ See *id.* at 72, 79-84.

²⁰⁸ See *Certain Baseband Processors*, p. 153 (“The potential harm to economic actors, in this case including handset manufacturers and telecommunications service providers, is properly part of our *EPROMs* analysis, and we have indeed fully weighed potential harm to third parties and to legitimate trade in that prior analysis. In fact, under our *EPROMs* analysis, we found that full downstream relief was *not* permitted in this investigation due to, among other things, the magnitude of the impact on third parties.”) (ultimately concluding “a downstream remedy with a grandfathering exception does not raise public interest concerns” because “the relief we propose has a much more limited impact on availability of 3G-capable handsets, and thus a lesser impact on the public interest.”) (*see id.* at 153-154).

Greg Sidak has developed a detailed taxonomy for applying the public interest factors to holdup situations.²⁰⁹

Finally, it may be appropriate to consider three other factors in setting ITC remedies: whether the patentee is a PAE, whether the defendant is a willful infringer, and whether the patent is standards-essential. While the statutory public interest factors are party-neutral,²¹⁰ the patentee's status as a PAE can influence the impact of an exclusion order to competition and consumers, since it affects the patentee's need for an injunction (a competitive condition) and, when many defendants are sued, the likelihood that consumers will have access to alternative products.

In a similar vein, we believe that standards-essential patents, in particular those that are subject to reasonable and nondiscriminatory (RAND) licensing obligations, should generally not be given injunctions by the ITC. The ITC has the power to reject an exclusion order where the respondent is licensed to import the product.²¹¹ Whether or not a RAND commitment to a standard-setting organization is an executable license,²¹² we believe that competition and consumers would be disserved if patents promised to be available for licensing on fair and reasonable terms were the basis of an exclusion order. And if the suit is brought late in the product life-cycle, after a standard has been adopted,²¹³ switching costs to consumers and

²⁰⁹ Sidak, *supra* note __, at 60-93, 170-72

²¹⁰ See 19 U.S.C. §1337(c). In contrast, the domestic industry requirement is not, as currently interpreted by the ITC, party-neutral. NPEs do not need to prove the so-called technical prong that requires "articles protected by the patent." One of us has argued that this is inconsistent with the statute and its legislative history. See Chien, *Protecting Domestic Industries*, *supra* note 74 at 180-81; 19 U.S.C. §1337(a)(3).

²¹¹ *Tessera, Inc. v. International Trade Comm'n*, 646 F.3d 1357, 1370-71 (Fed. Cir. 2011).

²¹² For an argument that it is, see Lemley, *Standard-Setting*, *supra* note 24, at 1925.

²¹³ Research by Brian Love shows that NPEs tend to assert their patents late in the life of the patent, as compared to practicing entities. See Brian Love, *An Empirical Study of Patent Litigation: Could a Patent*

competitors will likely be higher. The DOJ has expressed similar concerns about using such patents to get injunctions, noting that, “F/RAND requirements have not prevented significant disputes from arising in connection with the licensing of [] [standards essential patents], including actions by patent holders seeking injunctive or exclusionary relief that could alter competitive market outcomes... the division continues to have concerns about the potential inappropriate use of SEPs to disrupt competition.”²¹⁴ There is at least one situation where an ITC action and exclusion order on the basis of a RAND patent may be appropriate, however. A RAND commitment is essentially a promise that money will be considered adequate compensation to patentees for use of their technology. Only district courts can award money damages, putting them in the best position for deciding disputes over RAND patents. However, in the cases when the district court lacks jurisdiction over a defendant but the *in rem* jurisdiction of the ITC is available,²¹⁵ the ITC provides the patentee with its only recourse. In such cases, ITC action is appropriate. In addition, we don’t want the absence of injunctive relief to encourage companies to copy and take their chances while infringing. That isn’t much of a problem in the IT industries today; the evidence suggests that virtually all patent cases are filed against innocent infringers, not copiers.²¹⁶ But proof of deliberate infringement or other evidence of bad faith (for example, shirking licensing obligations) should incline the Commission

Term Reduction Decimate Trolls Without Harming Innovators? (unpublished draft, on file with the authors), at 1, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1917709.

²¹⁴ US Department of Justice Statement of the Department of Justice’s Antitrust Division on Its Decision to Close Its Investigations of Google Inc.’s Acquisition of Motorola Mobility Holdings Inc. and the Acquisitions of Certain Patents by Apple Inc., Microsoft Corp. and Research in Motion Ltd., February 13, 2012, available at www.justice.gov/opa/pr/2012/February/12-at-210.html

²¹⁵ 65% of ITC cases have a district court counterpart, suggesting that this isn’t a problem in the majority of cases, where both the ITC and district court have the power to hear the case. See Chien, *Patently Protectionist*, supra note ___ at 64.

²¹⁶ Christopher A. Cotropia & Mark A. Lemley, *Copying in Patent Law*, 87 N.C. L. REV. 1421, 1424 (2009).

to look askance at claims that the defendant needs an opportunity to design around a patent; the intentional infringer presumably has had that opportunity already.²¹⁷

We make an additional suggestion related to procedure. One downside of increased tailoring of ITC exclusion orders is that it could lead to increased unpredictability as to the remedy, at least in the short term. Currently, “Summary Determination” proceedings in the ITC²¹⁸ rarely if ever happen on issues of remedy.²¹⁹ But there is no reason why such motions couldn’t be brought. Indeed, the ITC’s recent move to allow for earlier briefing on public interest issues seems to support just this possibility.²²⁰ If a case is not one in which an exclusion order is appropriate, it is better for all concerned to make that clear up front, before the parties litigate questions of validity and infringement unnecessarily.

We make one final recommendation, directed not solely at the ITC, but also at the other agencies and departments government that the ITC is required to consult when carrying out its

²¹⁷ We use the term “deliberate infringement” rather than “willfulness” here because patent law’s willfulness doctrine varies in significant ways from what an ordinary observer would think of as purposeful conduct. Because willfulness is a continuing offense, patent law may designate someone willful merely because they didn’t stop selling the product once sued. See Mark A. Lemley & Ragesh K. Tangri, *Ending Patent Law’s Willfulness Game*, 18 BERKELEY TECH. L.J. 1085, 1089-93 (2003). That is not deliberate conduct in any normal sense. On the other hand, willfulness will not be found if the defendant’s conduct was objectively reasonable, even if the defendant intended to infringe. See *In re Seagate Tech.*, 497 F.3d 1360, 1371 (Fed. Cir. 2007) (en banc), (“the standard of ‘recklessness’ appears to ratify intentional disregard”) at 1385 (Newman, J., concurring).

²¹⁸ 19 CFR §210.18 prescribes the procedures that are used for Summary Determination. As subsection (b) describes:

The determination sought by the moving party shall be rendered if pleadings and any depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a summary determination as a matter of law.

²¹⁹ See Czebiniaik, *supra* note 10, at 107.

²²⁰ Rules of Adjudication and Enforcement, 19 CFR Part 210, http://www.usitc.gov/secretary/fed_reg_notices/rules/finalrules210.pdf.

investigations.²²¹ On several occasions, the ITC has relied on policies of other parts of the government to support its decision-making. In two out of the three cases in which the ITC declined to award an exclusion order, it relied upon the policies of the President and Congress to explain its position.²²² In the *Baseband Processor* case, where the ITC custom tailored the injunction it ordered, the Commission cited the public comments of FEMA and the FCC.²²³ In the recent *Mobile Handsets* case, in which the ITC delayed the start of the exclusion order for four months, it drew from statements of the DOJ and President Obama to support its decision-making.²²⁴ We found few instances of agencies submitting formal comments to ITC investigations,²²⁵ but where a proposed exclusion order poses a danger to the public interest, other agencies can and should weigh in during the ITC review process.

²²¹ 19 USC 1337 (b)(2) states:

During the course of each investigation under this section, the Commission shall consult with, and seek advice and information from, the Department of Health and Human Services, the Department of Justice, the Federal Trade Commission, and such other departments and agencies as it considers appropriate.

²²² See Commission Action and Order In re Certain Inclined-Field Acceleration Tubes at 21, USITC Inv. No. 337-TA-67, (Dec. 29 1980) (citing in support of its decision to not grant an order enjoining Dowlish tubes used for research, “the President and the Congress have issued declarations of support for basic science research,” and “[t]he National Science Foundation Act”); Opinion of Vice Chairman Alberger and Commissioners Bedell and Stern In re Certain Automatic Crankpin Grinders at 17-18, USITC Inv. No. 337-TA-60, 205 U.S.P.Q. 71, 0079 WL 419349 (Dec. 17, 1979)(justifying its decision not to exclude efficient crankpin grinders in part by “the fact that Congress and the President have also clearly established a policy requiring automotive companies to increase the fuel economy of the automobiles they produce.”)

TA-337-67 and TA-337-70 cases as described and excerpted *supra* at footnotes ____ and ____.

²²³ *Baseband Processors*, *supra* note ____, at ____.

²²⁴ *Mobile Handsets*, *supra* note ____, at ____.

²²⁵ Based on a search of EDIS for “comments,” in 337 actions, turning up submissions from Congress and a few states, but none from public agencies.

IV. Conclusion

The *eBay* case has had the unintended consequence of driving patentees to the ITC in hopes of obtaining an injunction no longer available in district court. Though *eBay*'s flexible four-factor test doesn't apply at the ITC, the Commission has more power to adjust the remedy it grants than commentators have previously recognized. We think it should use this power to limit exclusion orders in circumstances where the patentee can hold up defendants. Delays in implementing the exclusion order and grandfathering in existing products can avoid holdup problems. Bond and penalty provisions can ensure that patentees are compensated for ongoing infringement during these transition periods; a few tweaks to the statutory language would give the ITC still more freedom to tailor its remedies. The resulting system won't look exactly like *eBay*, but it will accomplish many of the same ends.

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December 13, 2011

Patents and the Public Interest

By COLLEEN V. CHIEN and MARK A. LEMLEY

Postscript Appended

Next week, in a case closely watched both by analysts and retailers, the International Trade Commission will decide whether the handset maker HTC should be allowed to import its products into the United States. The controversy? A claim by Apple that HTC infringed on two of the estimated 250,000 patents covering smartphone technology. If the commission agrees, it is likely to issue an "exclusion order," which would in effect say "keep out" (of the United States) to HTC's Android phones during the Christmas season.

It's cases like this that have many people concerned that soon judicial decisions, rather than consumers, will decide what products make it onto Santa's sleigh. While smartphone patent disputes are being waged around the world, with injunctions in play on several continents, the I.T.C. ruling has the potential to be the most significant one to date, given the size of the United States market. As patent law experts who appreciate the efficiency of the I.T.C.'s decision-making, we believe that a small change in how the commission does its job could yield big dividends for competition and consumers by reducing the disruption an exclusion order can wreak.

But first, some background.

The Apple-HTC dispute isn't the only one at the I.T.C. with a potentially huge impact on consumers. Makers of GPS devices and flat-screens, and most major smartphone makers, are also embroiled in disputes there, all of them hoping that the I.T.C. will not prevent their products from being on the United States market.

How did this once-obscure trade court become one of the most important battlegrounds of consumer technology? The answer lies in part in the speed of the I.T.C., but even more so in the power it has to keep products out of the United States.

In 2006, the BlackBerry manufacturer Research in Motion was almost blocked from making its phones when NTP — a “patent troll” whose sole business is profiting from patents — sought to enforce some patents. Though a jury had awarded just \$23 million in damages, R.I.M. agreed to pay NTP what later amounted to \$613 million in licensing fees to avoid having its phones shut down by the court.

Later that year the Supreme Court’s eBay decision made it harder to impose such “holdup” fees by doing away with the practice of automatically awarding an injunction. After eBay, a court must consider the harms to the parties and the public that an injunction would present before deciding to grant one. This new case-by-case standard has gone a long way to solving the holdup problem that had beset the patent system.

But in the wake of eBay, both patent trolls and product companies like Apple have flocked to the I.T.C., where a federal ruling held that eBay’s new equitable test does not apply. The commission’s caseload has more than doubled, from 29 cases in 2005 to 64 and counting this year. And while the injunction grant rate in district courts has declined to around 75 percent for companies that make products and much lower than that for trolls, the I.T.C.’s injunction rate has held steady at 100 percent. The result has been to undo much of the desirable effect of eBay.

Although the I.T.C. is supposed to consider an exclusion order’s impact on competition and consumers relating to the effect of any exclusion order, it hasn’t given these so-called “public interest” factors many teeth. But it should. The I.T.C. has the power to tailor the remedy to fit the crime, for example delaying an injunction to allow a defendant to redesign its product, or even refusing to exclude the imports at all.

Tailoring remedies makes sense. When a patent holder doesn’t compete in the market or risk irreparable harm, fast-tracking the case to a district court to assess damages may be the better option. But when the dispute is between competitors, or involves a start-up or university seeking to commercialize its invention, an exclusion order should be the default.

Even in such cases, shutting out imports of an infringing product is not always the right answer. If the patent covers a small part of the product, the defendant could design around it, and if the defendant’s infringement was inadvertent, the I.T.C. could award an exclusion order but delay its start. During the delay period, the infringer could pay remuneration through a bond, allowing the patentee to get paid but not holding up a large product because of a small patent.

A delay would allow companies and consumers to adjust to the ruling. The alternatives — for companies to change their products every time they are sued, no matter how meritlessly, or to shut down production altogether — would drive up costs unnecessarily. (As is often said: companies can manage bad news, it’s the bad surprises that they hate. Just ask Samsung and HTC, which have had to design around patent injunctions

in Germany and Australia.)

Congress could require the I.T.C. to consider these options. But it shouldn't have to. The I.T.C. has proven to be adaptive to changing competitive conditions. The agency has the power to make fair, case-by-case decisions on whether and how to block products from entering the country. It should use that power.

Colleen V. Chien is an assistant professor at Santa Clara University School of Law. Mark A. Lemley is a professor at Stanford Law School and a partner in the law firm of Durie Tangri.

Postscript: December 14, 2011

An earlier version of this article reported that the International Trade Commission's decision would be Wednesday; the decision has been postponed, and the article was changed to reflect the development.



Material submitted by Bernard J. Cassidy, General Counsel and Executive Vice President, Tessera Technologies, Inc.



July 9, 2012

United States International Trade Commission
500 E Street, S.W.
Washington, DC 20436

Re: The Innovation Alliance's Response to the Commission's Request for Written Submissions in *Certain Wireless Communication Devices, Portable Music and Data Processing Devices, Computers and Components Thereof*, Inv. No. 337-TA-745.

Dear Secretary Barton:

The Innovation Alliance ("IA") respectfully submits these comments in response to the Notice of Commission Decision to Review in Part a Final Initial Determination Finding a Violation of Section 337; Request for Written Submissions issued by the United States International Trade Commission in the matter of *Certain Wireless Communication Devices, Portable Music and Data Processing Devices, Computers and Components Thereof*, Inv. No. 337-TA-745, on June 25, 2012 (the "Commission Request").

Introduction to IA

The IA is a coalition of companies seeking to enhance America's innovation environment by improving the quality of patents and protecting the integrity of the U.S. patent system. IA represents innovators, patent owners and stakeholders from a diverse range of industries that believe in the critical importance of maintaining a strong patent system. Many of IA's members also manufacture and/or sell products and services that utilize not only their own patents, but those of third parties as well. IA's positions on a strong patent system – on the pro-innovation and pro-competitive benefits of voluntary standardization efforts and bilateral negotiation of licenses and cross-licenses among standardization participants – are not new.

IA's Response

Requests to the ITC for exclusion orders should be decided based on the facts and circumstances of each particular case. Any proposal to automatically deny exclusion orders on a blanket basis for all holders of standard-essential patents ("SEPs") who commit to grant licenses under reasonable and non-discriminatory ("RAND") terms would be inconsistent with the public interest. In this regard, IA is concerned that the

FTC's recent Public Interest Statement in ITC Inv. No. 337-TA-745 and similar submissions from others may overstate the prevalence of patent hold-up, does not consider factors that may militate in favor of exclusion orders in particular cases, and undermines the incentive scheme created by patent law and provisions such as Section 337.¹

Indeed, far from supporting a blanket prohibition on exclusion orders as a remedy for infringement of an SEP, the Statement's references to "potential" harm to US competition and "the possibility of patent hold up" underscore the need to decide requests for exclusion orders on a case-by-case basis, subject to consideration of the particular facts and circumstances of each case. The speculative nature of harm identified in the FTC's Statement likewise puts into question the arguments by certain voices that the ITC should, automatically refuse to issue import exclusion orders in cases involving SEPs. In short, proponents of a categorical rule that would effectively deny owners of SEPs a remedy in the ITC are asking the Commission to base sweeping changes of the U.S. trade laws only on the possibility of potential harm, and without any actual evidence of harm to U.S. consumers.

The misdirected focus of the proposed prohibition of the exclusion order remedy for SEPs is confirmed by the record compiled by the FTC in connection with its 2011 Patent Standards Workshop, as discussed below. In short, the fundamental underpinning of the position to limit remedies available in the ITC to SEP owners - *i.e.*, an endemic and systematic "hold up" problem - was shown to be unsupported. Moreover, the ITC through its public interest inquiry is equally capable as the federal courts to balance the interests at stake under the facts and circumstances of each case, and to consider the relevant public interest factors in such a light.

No Evidence of a Systemic Patent Hold-Up Problem

Following publication in 2011 of the FTC Report, the FTC sought public comment and held the FTC Patents Standards Workshop. According to the evidence the FTC compiled through these two undertakings, there is no systemic patent hold-up problem.

In short, the FTC's own record provides strong evidence that existing laws and processes have been effective in balancing the interests of diverse stakeholders in high-technology industries so as to stimulate investment across a value chain -- from basic research, to product development and manufacturing.² The record also demonstrates

¹ IA member company representatives were pleased to participate in the FTC's hearings resulting in the March 2011 "Evolving IP Marketplace" report (the "FTC Report") and the June 2011 Standards Patents workshop (the "FTC Workshop"). The IA also submitted written views to the FTC in connection with these public events.

² IA agrees with Professors Epstein, Kieff and Spulber that patent law is designed not merely to motivate innovation, but also to provide the legal rights, remedies and incentives necessary to spur the formation of

generally that standardization activity under existing law has contributed to robust competition, diversification of business models and product offerings, and job creation, while also bringing consumers the benefits of innovative technologies and services at continually lower prices. Indeed, numerous commentators, including standard setting organizations (SSOs), academics, industry analysts, licensors, and other stakeholders expressed strong views that hold-up is not a significant or widespread problem in the market:

- The Alliance for Telecommunications Industry Solutions (“ATIS”) reports that it “has not experienced the hold-up problem, nor has any such problem impeded in any way ATIS’ standards development efforts”.³
- TIA reports that it “has never received any complaints regarding such ‘patent hold-up,’” and “believes that the FTC is presuming that ‘patent hold-up’ is a widespread and fundamental problem, without considering the practical experiences of SSOs such as TIA”.⁴
- The American National Standards Institute (“ANSI”) reported that “for only a relatively small number [of standards] have questions ever been formally raised regarding the ANSI Patent Policy, including issues relating to improper ‘hold up’”.⁵
- Professor Jay Kean of the University of Illinois law school finds that “there is little or no empirical evidence indicating that there is a significant problem with patent ‘hold-up.’”⁶
- Cellular industry analyst Keith Mallinson contends that “there has been no evidence of ‘windfall gains’ to patent owners impeding the adoption of any technology-based standard.”⁷ Indeed, Mallinson shows that in the cellular industry, implementers and carriers already reap the overwhelming majority of profits generated by the products enabled by the licensed IP.⁸
- Microsoft, a frequent patent defendant as well as plaintiff, also sees “little evidence that ‘patent hold-up’ in the standards context is a real problem.”⁹

the whole network of private relationships required to bring an invention all the way from conception to the consumer. See Epstein et al. (Aug. 5, 2011) at 5-7.

³ *Id.* Comments of Alliance for Telecommunications Industry Solutions (ATIS) (June 14, 2011) at 1.

⁴ *Id.* Comments of Telecommunications Industry Association (TIA) (June 14, 2011) at 4.

⁵ *Id.* Comments of American National Standards Institute (ANSI) (June 10, 2011), submission 1, at 12.

⁶ *Id.* Comments of Professor Jay P. Kesan (June 14, 2011) at 2.

⁷ *Id.* Comments of Keith Mallinson (June 12, 2011) at 8.

⁸ See *id.* at 19-21.

⁹ *Id.* Comments of Microsoft (June 14, 2011) at 16.

- SAP states that it has participated in over 100 SSOs and has never accused a company or been accused of patent hold-up.¹⁰
- Citing cellular market statistics, Epstein et al. conclude that “the success on the ground bears out the theoretical insight that hold-ups are not a serious threat to collaboration over and around standards.”¹¹

There Should be No Presumption that Hold-Up Exists Generally or in Particular Cases

The evidence to date including the FTC’s own record is insufficient to warrant a presumption that owners of SEPs are breaching their RAND commitments in every instance, or that a public interest need exists to limit existing remedies available to SEP owners on a blanket basis. A licensor’s success depends on the success of its licensees. In addition, since innovators who participate in standard-setting often repeatedly contribute their technologies to a standard, a patentee that has failed to comply with its RAND commitment risks the exclusion of its technological solutions from future standards. Patentees also wish to avoid the expense and uncertainty of litigation. These incentives encourage negotiation which has been the preferred mechanism under most SSO policies for establishing license terms. Under a no-exclusion-order policy (and analogously a no-injunction policy), however, the implementer has little incentive to bargain in good faith because by litigating it can avoid paying royalties until at least the litigation is over, if not longer. The result would be more and longer litigation, with the inefficiency that litigation entails, and an unjustified shift in bargaining power from patent holders to implementers that would destroy the balance established by Congress in the patent system.

A no-exclusion-order (and analogously no-injunction) rule for SEPs/RAND-obligated patents would also create a perverse incentive: innovators who participate in SDOs (and give RAND commitments) would have fewer rights than innovators that do not participate. The predictable result would be that fewer innovators would participate in SDOs with such IPR rules (or make RAND commitments if they do participate) or engage in R&D for technologies that may be standardized. Reduced participation in SDOs or reduced funding of R&D would likely result in delay, technologically inferior standards, and reduced information about patents implicated by standards. Refusals to make RAND commitments would similarly lead to delay and technologically inferior

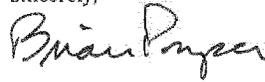
¹⁰ Naomi Abe Voetgli, SAP, Tr. at 20-21 (stating that SAP has participated in over 100 SSOs and has never accused a company or been accused of patent hold-up);

¹¹ *Id.* (“Epstein et al.”) (Aug. 5, 2011) at 14; *see also* Comments of Association for Competitive Technology (Aug. 5, 2011) at 2 (explaining that its members, small businesses, “are not convinced that there is a wide-spread patent hold-up problem”); Comments of InterDigital (Aug. 5, 2011) at 2 (“Based on our firsthand experience participating in industry standards, we do not believe that the current policies and practices of the various standards organizations in the wireless industry lead to unreasonably high prices to consumers, or otherwise result in market distortion.”); Comments of U.S. Chamber of Commerce (Aug. 5, 2011) at 8 (“[E]mpirical evidence supporting a concern with a widespread risk of holdup is lacking.”); Amy Marasco, Microsoft, Tr. at 23-24 (stating that litigation between patent holders and licensees is not necessarily evidence of hold-up); Jorge Contreras, Washington University in St. Louis School of Law, Tr. at 26-27 (agreeing that hold-up is “not happening that much”).

standards as SDOs would attempt to “design out” the technologies of companies that refuse to make RAND commitments. The results of a restrictive rule could be more and longer litigation, lack of deterrents for implementers to negotiate licenses or settlements, and the erosion of the existing balance of interests among the various stakeholders.

For all these reasons, the ITC should not adopt a rule or practice that systematically denies exclusion orders in favor of owners of SEPs based on a presumption of hold-up or any other presumption. Rather, the ITC should consider the propriety of such orders under the particular facts and circumstances of the case.

Sincerely,

A handwritten signature in black ink that reads "Brian Pomper". The signature is written in a cursive style with a large, prominent "B" and "P".

Brian Pomper
Executive Director
The Innovation Alliance



The ITC and Patent Disputes: Efforts to Weaken the ITC’s Remedial Authority Will Hamper Innovation and Export American Jobs

I. EXECUTIVE SUMMARY

This White Paper provides an assessment of proposed modifications to certain provisions of 19 U.S.C. §1337 (“Section 337”), the statute that regulates unfair practices in import trade and that is enforced by the International Trade Commission (“ITC”). The proposal, entitled “Modernizing the ITC Patent Process to Ensure Consistent Application of US Patent Law,” was proposed to address a perceived problem of overuse of the ITC by so-called non-practicing entities (“NPEs”)¹ and is intended to curb the ITC’s power under Section 337 to prevent products that infringe U.S. intellectual property rights from being imported into the United States.

In particular, the proposed changes to Section 337 would require the ITC to apply a four-prong equitable analysis before issuing an exclusion order preventing importation of infringing products into the United States. The proposed changes would also limit the statutory definition of a “domestic industry” to exclude any patent licensing activities that do not help bring a non-existent new product to market—a proposal that would effectively bar the ITC from remedying unfair trade practices against many R&D-centric entities. In sum, the proposal weakens the ITC’s ability to administer U.S. trade remedy laws, is predicated on erroneous assumptions, adds inappropriate and unnecessary requirements to Section 337, would lead to absurd outcomes and incentivize perverse behavior, and would have a detrimental impact on American innovation and the American economy.

¹ There is no agreed definition of an NPE. Although a handful of legal scholars and economists have attempted to do just that, their studies employ different definitions. See, e.g., Federal Trade Commission, *The Evolving IP Marketplace: Aligning Patent Notice and Remedies with Competition* § n.5 (March 2011) (“FTC Report”) (“Taken literally, the term NPE encompasses patent owners that primarily seek to develop and transfer technology, such as universities and semiconductor design houses.”); PwC, *2011 Patent Litigation Study* 34 (October 2011) (“PwC Study”) (“A non-practicing entity (“NPE”) is defined as an entity that does not have the capability to design, manufacture, or distribute products with features protected by the patent.”).

A. The Proposed Amendments Are Predicated on False Assumptions

The proposed amendments are premised on the notion that the ITC must be “modernized” in view of the Supreme Court’s decision in *eBay Inc. v. MercExchange, L.L.C.*, 547 U.S. 388 (2006), which directed federal courts to apply a four-prong equitable test when determining whether to grant permanent injunctive relief for infringing acts. Although the ITC and the federal courts both make patent-related determinations, the ITC and the federal courts are not (and should not be treated as) identical adjudicatory bodies. To the contrary, unlike the federal courts, the ITC’s sole purpose is to protect domestic industries from unfair practices in import trade. As such, the ITC was specifically designed and intended by Congress to operate under a different set of statutes and mandates than the federal courts. In fact, the U.S. Court of Appeals for the Federal Circuit (“the Federal Circuit”) has recognized the distinction between ITC exclusion orders and district court injunctions based on “the longstanding principle that importation is treated differently than domestic activity.” For this reason, the Federal Circuit has held that *eBay* does not apply to ITC remedy determinations under Section 337.² Accordingly, legal principals developed in the federal courts do not necessarily apply to the ITC.

The proposal also incorrectly notes that NPEs “have been the most aggressive in using the ITC in recent years to avoid application of *eBay*’s equitable test.” The data does not support such an assertion. Indeed, careful analyses of the data reveals that such conclusions rest upon unstated, undefined, and inaccurate assumptions. In fact, studies show that licensing companies represent only a fraction of the cases filed at the ITC. Moreover, while the total number of infringement cases brought to the ITC may be increasing, so too are the number of imported products manufactured in countries with cheap labor and weak, or even non-existent, intellectual property laws. And, there are factors other than the Supreme Court’s decision in *eBay* that explain the recent increase in the number of Section 337 cases filed at the ITC.

B. The Proposed Amendments Add Inappropriate and Unnecessary Requirements to Section 337

Importing an *eBay* analysis into Section 337 is inappropriate and unnecessary. Under *eBay*, a patentee must establish, *inter alia*, that it has suffered an irreparable injury and that the public interest would not be disserved by a permanent injunction. However, Congress already carefully considered and specifically eliminated the injury requirement as part of the Omnibus Trade and Competitiveness Act of 1988 (“the 1988 Amendment”), noting that the importation of goods that infringe a U.S. patent is an injury *per se*. Furthermore, the ITC is already required, by statute, to consider the effect of an exclusion order upon the public health and welfare, competitive conditions in the United States economy, the production of like or directly competitive articles in the United States, and United States consumers before issuing any such exclusion.

Likewise, narrowing the definition of domestic industry to exclude any licensing activity that does not result in a non-existent new product being brought to market would undermine one of the primary objectives of the 1988 Amendment, namely, providing a remedy “for those who

² *Spanson, Inc. v. International Trade Com’n*, 629 F.3d 1331 (Fed. Cir. 2010).

make substantial investments in the creation of intellectual property and then license creations.³ Congress did not intend to limit the types of licensing activities that the ITC can consider.⁴ As such, there is simply no legitimate basis to impose a sliding scale of patents rights based solely on a patentee's status as a manufacturer, technology transfer entity or on any other wholly-arbitrary basis. The proposed provision also ignores the reality of the technology marketplace where the development of advanced technologies and products that use them almost always outpaces the speed with which the United States Patent and Trademark Office ("PTO") can issue new patents. Indeed, the proposed legislation will actually encourage foreign manufactures to import infringing goods into the United States more quickly in an effort to undermine patentees' ability to block the importation of the infringing goods at the ITC.

C. The Proposed Amendments Would Lead to Absurd Results and Encourage Perverse Behavior

The proposed changes, if enacted, would lead to absurd outcomes and incentivize implementers to engage in perverse behavior. For example, patentees who are unable to satisfy the four-prong test under *eBay*, or who are unable to prove that they are engaged in a domestic industry because infringing goods have already entered the U.S. market, may be precluded from blocking the infringing imports at the ITC. The patentees may also be precluded from obtaining relief in the federal courts if the foreign manufacturer(s) of the infringing goods do not have a physical presence in the U.S. and, thus, are outside of the courts' jurisdiction. Thus, the proposal may leave many patentees with a right and no remedy.

Moreover, limiting patentees' access to the ITC will also harm their existing licensees, who may be undercut on price by unlicensed foreign manufacturers that refuse to pay fair licensing fees or royalties. As a result, companies that respect and value others' intellectual property rights will be penalized and put at a competitive disadvantage compared to those who show no regard for the U.S. intellectual property system. This perverse result reduces the incentives for all manufacturers (both domestic and foreign) to obtain patent licenses.

³ See 133 Cong Rec. 1794 (Statement of Sen. Lautenberg).

⁴ *Certain Coaxial Cable Connectors and Components Thereof and Products Containing Same*, Inv. No. 337-TA-650, Commission Opinion at 49-50 (April 14, 2010) ("[T]he plain language of the statute does not limit the types of licensing activities that the Commission can consider.").

D. The Proposed Amendments Would Negatively Impact American Innovation and the American Economy

Patent royalties are a critical source of funding for new research and development. Thus, any attempt to limit patentees' ability to enforce their patent rights (and recoup their investment) will necessarily reduce their ability and incentive to invest in future research and development. Such a state of affairs will retard future technological innovation and reduce future U.S. licensing revenue, which has become a significant part of the U.S. economy and one of the United States' only international trade surpluses.

II. THE PROPOSED AMENDMENTS ARE PREMISED ON SEVERAL FALSE ASSUMPTIONS

A fundamental problem with the proposal is that it incorrectly assumes that the ITC and federal courts are similar juridical entities that should be administered with identical procedures. The first subsection below examines the history of the ITC and demonstrates the fundamental differences in scope, purpose, and history between the ITC and its federal court counterparts. The second subsection below addresses another erroneous premise of the proposal, namely, that NPEs "have been the most aggressive in using the ITC in recent years to avoid application of eBay's equitable test." There is no data to support such an assertion. In fact, studies show that licensing companies continue to represent only a fraction of Section 337 cases.

A. There is a fundamental distinction between the ITC and Federal District Courts

1. History of the ITC and the Tariff Act

Section 337 forbids unfair methods of competition and unfair acts in the importation of articles into the United States. The history of this statute and the ITC demonstrates the original purpose of the statute, and highlights the fundamental distinctions between the federal courts and the ITC. This history and these distinctions are part of what make the proposed changes not only unnecessary but unwise.

The roots of Section 337 lie in section 316 of the Tariff Act of 1922 ("Section 316").⁵ Section 316 empowered the Tariff Commission to investigate unfair competition complaints and to make recommendations to the President.⁶ When unfair competition was found, the President had statutory authority either to increase the tax on violative articles or to ban the articles' importation.⁷ Thus, from its inception, Section 337 was focused on unfair competition and was intended to protect American innovation and industry through the nation's trade laws.

The Tariff Act of 1930, Pub.L. No. 71-361, 46 Stat. 590, created Section 337 by incorporating much of Section 316, although it eliminated the President's power to increase taxes

⁵ Robert Krupka, Philip C. Swain, and Russell E. Levine, *Section 337 and the GATT: The Problem of the Solution*, 42 Am. U. L. Rev. 779, 786 (1993).

⁶ *Id.* at 787.

⁷ *Id.*

on violative articles.⁸ Congress also eliminated the monetary remedy for import violations, ensuring that the President's exclusion power was the sole available remedy for violations of Section 337.

For forty years after its enactment in 1930, Section 337 was largely ignored as a means of protecting trade rights by excluding goods that infringe U.S. intellectual property.⁹ However, in 1974, Congress amended Section 337 to strengthen the nation's trade position by transferring the President's exclusion power to the ITC.¹⁰ Since that time Section 337 has also been utilized to halt the importation of articles that infringe U.S. patents as unfair trade acts.¹¹ However, although the ITC obtained the power to assess whether an article was infringing a valid U.S. patent, the focus of the statute remained on trade and protecting the American economy from unfair trade practices.

Among the most critical changes to Section 337 occurred when Congress amended the statute in 1988. The precipitating events were a series of ITC decisions in which the ITC denied relief to intellectual property owners that had demonstrated infringement of their intellectual property rights and had made significant investment in their industries but did not manufacture in the United States or could not show substantial injury due to infringing imports. Prior to 1988, the ITC interpreted the domestic industry provision to require manufacturing and related activities in the United States. The ITC had determined that, under the then-existing statutory language, licensing alone did not constitute a "domestic industry" sufficient to support jurisdiction.¹²

The ITC's decision in *Certain Products with Gremlins Characters*, Inv. No. 337-TA-201, (1986) was particularly controversial. In *Gremlins*, Warner Brothers filed a complaint with the ITC to forestall the flood of infringing Gremlins merchandise.¹³ Warner Brothers had an extensive licensing division that included market research, sales, sales promotions, graphics services, financial control, and business affairs departments. Warner Brothers contended that this licensing division constituted a domestic industry. However, the ITC concluded that Section 337's legislative history indicated that licensing activity, by itself, did not constitute a domestic industry. Thus, the ITC refused to exclude the infringing imports.

⁸ *Id.*

⁹ Harvey Kaye & Paul Plaia, Jr., *The Filing and Defending of Section 337 Actions*, 6 N.C. J. Int'l L. & Com. Reg. 463, 464-65 (1981) (discussing development of § 337).

¹⁰ See Trade Act of 1974, Pub. L. No. 93-618, § 341(a), 88 Stat. 1978, 2054 (1975) (codified as amended at 19 U.S.C. §§ 1337(d)-(e) (1988)) (permitting ITC to investigate unfair trade practices and to issue orders pursuant to investigations).

¹¹ See Donald K. Duvall, *Federal Unfair Competition Actions: Practice and Procedure Under Section 337 of the Tariff Act of 1930*, at 603 (1991) (describing § 337 as providing "an effective, expeditious, and reasonably fair quasi-judicial administrative process for the adjudication of petitions of domestic industries, as defined in the statute for protection of their claimed intellectual property rights from allegedly infringing imports or other unfair competition from abroad").

¹² *Certain Products with Gremlins Characters*, Inv. No. 337-TA-201, Comm'n Op. at 5 (Jan. 16, 1986); *Certain Limited-Charge Cell Culture Microcarriers*, Inv. No. 337-TA129, Comm'n Op. at 38-41 (Nov. 18, 1983) ("[C]omplainants' [licensing] operations in the United States are insufficient to constitute an 'industry ... in the United States.'").

¹³ 1 Int'l Trade Rep. (BNA) 238 (1984).

In response, Congress passed the Omnibus Trade and Competitiveness Act of 1988 (“the 1988 Amendment”) to amend Section 337 to make clear that the licensing of intellectual property is an independent and sufficient “domestic industry.”¹⁴ As such, the 1988 Amendment permitted U.S. patent holders who do not manufacture a product protected by an asserted patent to bring Section 337 complaints at the ITC.

Importantly, as noted by Senator Frank Lautenberg, the domestic industry amendments were supported by the U.S. Chamber of Commerce “and some of our most innovative industries” including “the Semiconductor Industry Association, the Electronics Industry Associations, the Intellectual Property Owners Association, the Motion Pictures Association of America, the Intellectual Property Alliance, which includes trade groups from computer equipment and software industries, the publishing industry, and the recording industry.”¹⁵

The 1988 Amendment was also notable because Congress eliminated the injury requirement for patents and other enumerated intellectual property rights, such as copyrights.¹⁶ This change was made directly in response to the ITC’s decision in *In the Matter of Certain Optical Waveguide Fibers*, 337-TA-189, (1985), where Corning proved infringement and a domestic industry but could not show injury.¹⁷

Accordingly, the history and evolution of Section 337 clearly demonstrate that its purpose and intent is to protect domestic industries (including those based exclusively on substantial licensing activities) from unfair acts in connection with import trade. Indeed, the ITC continues to recognize that its purpose is to manage the country’s international *trade* laws, including promoting the country’s competitiveness in the global marketplace.¹⁸ Because of this focus, Section 337 has a vastly different—and broader—purpose than the patent statutes.

2. Current Section 337

In its current form, Section 337 enables the ITC to investigate “unfair acts in the importation of articles ... into the United States, or in the sale of such articles by the owner, importer, or consignee, the threat or effect of which is ... to destroy or substantially injure an

¹⁴ See *Certain Digital Processors and Digital Processing Systems, Components Thereof, and Products Containing Same*, Inv. No. 337-TA-559, Order No. 24 at 88, 93 (June 21, 2007) (“It is clear that the intent of Congress was to allow entities that were actively licensing their patents in the United States to be able to meet the domestic industry requirement under the statute.”); see also 133 Cong. Rec. 2904 (1987) (Statement of Sen. Lautenberg) (“For those who make substantial investments in the creation of intellectual property and then license creations, there should be a remedy.”).

¹⁵ 133 Cong. Rec. S174 (Feb 4, 1987).

¹⁶ H.R. Rep. No. 100-40, at 155-56; S. Rep. No. 100-71, at 129.

¹⁷ *In the Matter of Certain Optical Waveguide Fibers*, Inv. No. 337-TA-189, Order at 19 (1985).

¹⁸ See About the USITC, U.S. INTL TRADE COMM’N, http://www.usitc.gov/press_room/about_usitc.htm (last visited Feb. 1, 2012) (“The mission of the Commission is to (1) administer U.S. trade remedy laws within its mandate in a fair and objective manner; (2) provide the President, USTR, and Congress with independent analysis, information, and support on matters of tariffs, international trade, and U.S. competitiveness; and (3) maintain the Harmonized Tariff Schedule of the United States (HTS).”).

industry in the United States.”¹⁹ Section 337 further makes it unlawful to import articles infringing a valid and enforceable patent “if an industry in the United States, relating to the articles protected by the patent ... exists or is in the process of being established.”²⁰

a. **Requirements of Proof**

A complainant in the ITC must establish, *inter alia*, ownership of a U.S. patent right that is being infringed by an article. Because the ITC is responsible for enforcing trade laws, however, a complainant must also show that the infringing articles are being imported. Therefore, infringement actions involving articles produced domestically, or declaratory actions by alleged infringers to challenge the validity of a U.S. patent, may not be brought in the ITC. These distinct features further underscore that the ITC’s purpose under Section 337 is to provide trade remedies and to protect domestic industries from unfair competition, including the importation of infringing goods made *abroad*.

Accordingly, a complainant at the ITC must also establish that it is engaged in a domestic industry that “exists or is in the process of being established.”²¹ An industry is considered to exist “if there is in the United States, with respect to articles protected by the patent ... concerned (A) significant investment in plant and equipment; (B) significant employment of labor or capital; or (C) substantial investment in its exploitation, including engineering, research and development, or *licensing*.”²² The ITC has generally divided this requirement into an economic prong that requires certain activities and a technical prong that requires that the activities relate to the intellectual property being asserted.²³ An industry is in the process of being established if a complainant can demonstrate that it is taking the necessary tangible steps to establish such an industry in the United States,²⁴ and there is a significant likelihood that the industry requirement will be satisfied in the future.²⁵

Finally, a complainant must establish that the imported article infringes a valid U.S. patent.

b. **Remedies**

Complainants may obtain relief in the ITC in three forms: general exclusion orders, limited exclusion orders, and cease and desist orders. General exclusion orders block the

¹⁹ 19 U.S.C. § 1337(a)(1)(A) (2006).

²⁰ 19 U.S.C. § 1337(a)(2).

²¹ 19 U.S.C. § 1337(a)(2).

²² 19 U.S.C. § 1337(a)(3) (emphasis added).

²³ See, e.g., *Certain Variable Speed Wind Turbines and Components Thereof*, Inv. No. 337-TA-376, Comm’n Op. at 14-17 (1996).

²⁴ S. Rep. 100-71 at 130.

²⁵ H. Rep. 100-40 at 157.

importation of all infringing products regardless of their source.²⁶ Limited exclusion orders block imports that are directly associated with the named respondents in an ITC complaint.²⁷ Cease and desist orders are issued when the ITC finds that a respondent possesses a commercially significant amount of infringing products within U.S. borders.²⁸ Critically, there are no monetary damages available in an ITC case as the focus of an ITC investigation is to remedy unfair acts in *import trade*—not to provide monetary compensation to resolve a commercial dispute between two parties.

3. Differences between the ITC and the Federal Courts

As noted above, the ITC was specifically designed by Congress to operate under a different set of statutes and mandates than the federal courts. Likewise, Section 337 is an entirely different statute than the Patent Act with a different purpose, different rights, and different remedies. Critically, Section 337 specifically states at the outset that certain unfair methods of competition and unfair acts “are unlawful and when found by the Commission to exist shall be dealt with, *in addition to any other provision of law*, as provided for in other provisions in section 337.”²⁹ Thus, Congress long ago recognized that Section 337 addresses issues and concerns that are different from those addressed by the Patent Act and preserved Section 337 as an additional and distinct source of redress for unfair trade practices related to the importation of infringing goods. These differences are critical to an understanding of why the proposed changes to “harmonize” Section 337 with the federal courts are inappropriate and may have serious unintended consequences with regard to the ITC’s ability to carry out its mandate.

First, the jurisdictional foundations of the ITC and the federal courts are different. The jurisdictional foundation for federal court cases is personal jurisdiction pursuant to 28 U.S.C. § 1338. Generally, a federal district court can only obtain personal jurisdiction over an allegedly infringing foreign company through a domestic affiliate. Therefore, in cases involving a foreign manufacturer that does not have a domestic affiliate, it may be impossible to establish federal district court jurisdiction.

By contrast, jurisdiction for complainants seeking exclusion in the ITC, which enforces a *trade statute*, is *in rem*³⁰ (rather than *in personam*) and derives from the importation of infringing goods into the United States. ITC jurisdiction therefore attaches to all allegedly imported infringing goods. This jurisdictional characteristic underscores that Section 337 is not a “patent statute” for adjudicating intellectual property rights between parties, but a trade statute designed to protect domestic industries from unfair competition resulting from the importation of infringing goods. Furthermore, by attaching jurisdiction to the allegedly infringing articles

²⁶ 19 U.S.C. § 1337(d)(2)(A) (a general exclusion may be ordered if it is “necessary to prevent circumvention of an exclusion order limited to products of named persons”).

²⁷ See 19 U.S.C. § 1337(d)(2) (exclusion orders “limited to persons determined by the Commission to be violating this section”).

²⁸ 19 U.S.C. § 1337(d)(2)(A) (allowing for the issuance of cease and desist orders on any person violating or believed to be violating § 1337).

²⁹ 19 U.S.C. § 1337(a)(1).

³⁰ This means that the ITC has jurisdiction and power over property and not a person or entity.

themselves, the ITC is able to remedy unfair trade practices of foreign manufacturers who may otherwise be outside of the federal courts' jurisdiction.

Second, complaints filed before the ITC and in federal court differ in both procedure and substance. These differences include the level of specificity required and mechanical differences in the filing process.

Third, the precedential posture is different. Section 337 is administered as a trade statute and determinations by the ITC in connection with patent-based matters are not enforcements of the nation's patent laws. For this reason, the ITC determinations as they relate to patent issues do not have collateral estoppel effect in the district courts.³¹

Finally, as mentioned above, the principle remedial instrument of the ITC is an exclusion order. An exclusion order is not an injunction, i.e., a court order requiring a party to refrain from engaging in certain activity. Rather, it is an order from one U.S. government agency (the ITC) to another (U.S. Customs and Border Protection ("CBP")) to exclude from entry into the country goods that infringe certain claims of patents at issue in a Section 337 investigation. This unique remedy, like the ITC's jurisdictional characteristics, further highlights the ITC's distinct role in the administration of U.S. trade remedy laws.

B. The Proposed Changes Are Based On the Unsupported Premise That NPEs Are Abusing the ITC

The notion that NPEs "have been the most aggressive in using the ITC in recent years to avoid application of *eBay*'s equitable test" is wrong. The data simply does not support such an assertion. Indeed, studies show that NPEs represent a mere fraction of the Section 337 cases filed at the ITC. Finally, although there has been an overall increase in the ITC caseload, there are numerous reasons why the ITC is a more favorable venue than federal district courts that have nothing to do with the *eBay* decision, undefined NPEs, or the ITC's treatment of licensing activities.

An entity called the ITC Working Group has recently circulated a paper entitled, "The Impact of Non-Practicing Entities at the ITC: The Numbers Speak for Themselves." The paper purports to demonstrate that a disproportionate number of suits filed in the ITC since 2006 have been brought by "NPEs"—though the paper neither precisely defines that term nor identifies its methodology for determining which filing entities constitute NPEs. The paper's allegations are wrong, woefully unsupported, and rest on flawed assumptions.

The paper asserts that "[p]rior to the 2006 Supreme Court decision in *eBay v. MercExchange*, no cases were filed by NPEs at the ITC." This assertion is demonstrably false. In fact, a review of the ITC docket reveals at least four entities that filed in the ITC prior to 2006 and that claimed a domestic industry based solely on licensing activity.³²

The paper further asserts that the number of cases filed by NPEs has increased as both a percentage share of the total number of cases filed and in actual numbers. The paper states that

³¹ *Texas Instruments v. Cypress Semiconductors*, 90 F.3d 1558 (Fed. Cir. 1996).

NPE cases have risen from 0% in 2005 to 26% in 2011. This is allegedly based on the increase in NPE cases from 2 in 2006 to 16 in 2011.

These numbers do not match with numbers calculated by other studies. For example, according to one study, NPEs filed 45 complaints, or approximately 19% of the total number of complaints, in the ITC since the Supreme Court's decision in *eBay*.³³ According to another study, NPEs filed 27 complaints, or approximately 11% of the total number of complaints, during this period.³⁴ And many of these NPEs comprised inventors, R&D companies, university affiliates, and manufacturers that, for various business reasons, did not produce products that practiced the particular patents asserted in the ITC complaints.

Moreover, of the 45 NPE complainants identified in the first study, only 7 were found by the ITC to have satisfied the domestic industry requirement. Similarly, of the 27 NPE complainants identified in the other study, only 5 were successfully able to demonstrate the existence of a domestic industry under Section 337.

The paper also bemoans the fact that the technology industry is disproportionately impacted by the increasing number of cases filed in the ITC. But this is simply a by-product of the technology age and is not related to NPEs. Indeed, among the largest, most intractable, and best known patent disputes in the country are the ceaseless battles between suppliers of wireless telecommunications devices.³⁵

In addition, while the paper accurately states that the ITC "has recently experienced an increase in cases filed under Section 337 of the Tariff Act," it makes no attempt to support its assertion that the increase has been directly caused by either the so-called licensing loophole or the Supreme Court's decision in *eBay*. The paper simply states, without citation or support, that such a connection exists. But this ignores a number of reasons that the ITC is viewed as a more

³² See *Certain Synchronous Dynamic Random Access Memory Devices, Microprocessors, and Products Containing Same*, 337-TA-431 (2000); *In the Matter of Certain Synchronous Dynamic Random Access Memory Devices and Modules and Products Containing Same*, 337-TA-437 (2000); *In the Matter of Certain Digital Satellite System (DSS) Receivers and Components Thereof*, 337-TA-392 (1996); *In the Matter of Certain Memory Devices with Increased Capacitance and Products Containing Same*, 337-TA-371 (1994).

³³ RPX, International Trade Commission: The Second Theater (October 3, 2011).

³⁴ Stern Kessler Goldstein Fox, Patent Enforcement Under Section 337 Before the USITC (2010), <http://64.237.99.107/media/pnc/9/media.1249.pdf>.

³⁵ See, e.g., *Certain Electronic Devices, Including Mobile Phones, Portable Music Players, and Computers*, Inv. No. 337-TA-701; *Certain Wireless Communications System Server Software, Wireless Handheld Devices and Battery Packs*, Inv. No. 337-TA-706; *Certain Personal Data and Mobile Communications Devices and Related Software*, Inv. No. 337-TA-710; *Certain Portable Electronic Devices and Related Software*, Inv. No. 337-TA-721; *Certain Wireless Communication Devices, Portable Music and Data Processing Devices, Computers and Components Thereof*, Inv. No. 337-TA-745; *Certain Mobile Devices and Related Software*, Inv. No. 337-TA-750; *Certain Electronic Devices, including Mobile Phones, Mobile Tablets, Portable Music Players, and Computers, and Components Thereof*, Inv. No. 337-TA-771; *Certain Mobile Electronic Devices, Including Wireless Communication Devices, Portable Music and Data Processing Devices, and Tablet Computer*, Inv. No. 337-TA-794; *Certain Electronic Devices with Communication Capabilities, Components Thereof, and Related Software*, Inv. No. 337-TA-808; *Certain Electronic Devices, Including Mobile Phones and Tablet Computers, and Components Thereof*, Inv. No. 337-TA-847.

favorable forum than district courts and that explain the uptick in Section 337 filings in recent years.

First, ITC actions must, pursuant to statute, be adjudicated expeditiously.³⁶ This means that ITC matters move on average far more swiftly than cases pending in district court. In fact, statistics show that “on average a district court case [takes] about twice as long as an ITC case to fully litigate.”³⁷

Second, the ITC gains jurisdiction over importers via the “mere act of importation.”³⁸ This makes obtaining jurisdiction over infringing products of foreign companies much easier, and less complex, than in United States district court where venue and personal jurisdiction rules can deny jurisdictional coverage over such defendants.

Third, given the exclusive jurisdiction over Section 337 cases, the Administrative Law Judges (“ALJs”) who preside over these cases are extremely experienced with patent and other intellectual property litigation.³⁹ The ALJs’ expertise on intellectual property issues and complex technology makes the ITC a favorable venue as well.

III. THE PROPOSED CHANGES ADD INAPPROPRIATE AND UNNECESSARY REQUIREMENTS TO SECTION 337

A. Proposed Changes to Section 337

The proposed changes to Section 337 can generally be grouped into two categories. The first category of proposed changes would require the ITC to utilize the traditional, four-prong equitable analysis utilized by federal courts sitting in equity to assess whether to issue permanent injunctive relief. The second category of proposed changes would limit the statutory definition of a domestic industry to exclude certain patent licensing activity. Both categories, however, would add inappropriate and unnecessary requirements into Section 337.

1. Adding an *eBay* analysis to the ITC

The purported impetus for importing a four-prong equitable analysis into Section 337 is the Supreme Court’s decision in *eBay*. In *eBay*, the Supreme Court considered whether federal courts sitting in equity may automatically issue a permanent injunction in a patent infringement action after infringement is proven or whether, even after infringement is proven, the district courts are required to analyze a four factor test. That test requires a plaintiff to demonstrate: (1)

³⁶ 19 U.S.C. § 1337(b) (2006) (requiring the ITC to complete an investigation “at the earliest practicable time after the date of publication of the notice of such investigation”)

³⁷ Colleen Chien, *Patently Protectionist? An Empirical Analysis of Patent Cases at the International Trade Commission*, 50 *Wm. & Mary L. Rev.* 63, 101-102 (2008).

³⁸ 19 U.S.C. § 1337(a)(1).

³⁹ Virginia L. Carron, *Intellectual Property Litigation at the U.S. International Trade Commission*, in *PATENT LITIGATION 2007*, at 1025, 1033 (PLI Pats., Copyrights, Trademarks, & Literary Prop., Course Handbook Ser. No. 910, 2007), available at WL, 910 PLI/Pat 1025 (indicating that one of the benefits of ITC litigation is that A.L.J.s are generally more familiar with technology than district court judges).

that it has suffered an irreparable injury; (2) that remedies available at law are inadequate to compensate for that injury; (3) that considering the balance of hardships between the plaintiff and defendant, a remedy in equity is warranted; and (4) that the public interest would not be disserved by a permanent injunction.⁴⁰

The Patent Act permits federal courts to issue injunctive relief against a patent infringer.⁴¹ Prior to the Supreme Court's decision in *eBay*, the Federal Circuit had established a practice whereby the general rule in patent disputes had been that the court would enter a permanent injunction against an alleged infringer once patent validity and infringement had been established by a patentee.⁴² The Supreme Court determined that a federal court sitting in equity must apply the traditional, equitable, four-part test even after patent infringement is proven.⁴³ The Court noted that the decision to grant or deny permanent injunctive relief is an act of equitable discretion by federal courts,⁴⁴ and in rejecting a categorical rule wherein an injunction automatically follows a finding of patent infringement, the Court sided with traditional equitable principles.⁴⁵

In a concurring opinion, Chief Justice Roberts, joined by Justices Scalia and Ginsburg, reviewed the "long tradition of equity practice" of "grant[ing] injunctive relief upon a finding of infringement in the vast majority of patent cases."⁴⁶ The Chief recognized however a distinction between "exercising equitable discretion pursuant to the established four-factor test and writing on an entirely clean slate."⁴⁷

Following *eBay*, the Federal Circuit considered whether the traditional equitable test for permanent injunctive relief should also be applied to exclusion orders issued by the ITC. In *Spanston, Inc. v. International Trade Com'n*, 629 F.3d 1331 (Fed. Cir. 2010), the Federal Circuit correctly held that the ITC was not required to apply the traditional four-factor test for injunctive relief used by the federal courts. The Federal Circuit noted that the only remedies available under Section 337 are exclusion orders and cease and desist orders. Given "the longstanding principle that importation is treated differently than domestic activity" and the different statutory underpinnings for relief before the ITC in Section 337 actions and before the federal courts in suits for patent infringement, the Federal Circuit held that *eBay* does not apply to ITC remedy determinations under Section 337.

⁴⁰ *eBay*, 547 U.S. at 391.

⁴¹ 35 U.S.C. § 283 (2000).

⁴² *MercExchange, L.L.C. v. eBay, Inc.*, 401 F.3d 1323, 1338 (Fed. Cir. 2005), vacated, 547 U.S. 388 (2006).

⁴³ *eBay*, 547 U.S. at 390. *eBay* was a controversial decision at the time it was issued and the appropriateness of the decision remains a source of serious debate.

⁴⁴ *eBay*, 547 U.S. at 390-391.

⁴⁵ *Id.* at 393 (citing *New York Times Co. v. Tasini*, 533 U.S. 483, 505 (2001); *Campbell v. Acuff-Rose Music, Inc.*, 510 U.S. 569, 578 (1994)). This argument is found in the Petitioner's Brief, Brief for Petitioner at 17-18, *eBay, Inc. v. MercExchange, L.L.C.*, 126 S. Ct. 1837 (2006) (No. 05-130).

⁴⁶ *eBay*, 547 U.S. at 395.

⁴⁷ *Id.* at 395.

2. Narrowly Defining Domestic Industries to Exclude Certain Licensing Activities

The proposed changes would also add a temporal limitation such that licensing activities that occur after the adoption of the relevant technology would not be considered when determining whether a complainant has established a domestic industry. For example, under the proposal, a patentee's efforts to license its U.S. patents (no matter how substantial) could not be relied upon to establish a domestic industry if the products embodying those patents have already been imported into the United States. Oddly, such a change would turn evidence that normally establishes a complainant's Section 337 claim into a fact that defeats it.

B. Amending Section 337 to Import an *eBay* Analysis is Inappropriate and Unnecessary

The proposed changes to require the ITC to engage in an *eBay* analysis before issuing an exclusion order preventing infringing products from entering the United States is inappropriate and unnecessary for at least four independent reasons: 1) monetary damages are unavailable under Section 337; 2) Congress has already explicitly determined that in the ITC irreparable harm is demonstrated through the importation of infringing goods; 3) the ITC already has the statutory authority and obligation to consider the public interest *before* issuing an exclusion order; and 4) the ITC has recently reaffirmed its focus on the impact of its exclusion orders on the public interest.

First, Section 337 does not provide for monetary damages. As detailed above, Section 337 of the Tariff Act of 1930 replaced the monetary remedy available under its predecessor statute. This choice represents the long-held legislative recognition that there is inherently an inadequate remedy at law for infringing goods imported into the United States. Moreover, the proposed amendments presume that a complainant would be able to forgo ITC exclusion and seek monetary damages in federal court. This ignores a large class of potential actions involving foreign manufactures over which it may be difficult or impossible to establish personal jurisdiction in the federal courts, or against whom it would be difficult (and often impossible) to enforce a federal court judgment. As a result, requiring a complainant to demonstrate the unavailability and inadequacy of damages at law is nonsensical and would undermine the ITC's mandate to remedy unfair trade practices that are harming domestic industries.

Second, importing an *eBay* analysis into the ITC would include a requirement that the complainant establish irreparable harm before the ITC may issue an exclusion order. However, such a change to Section 337 is entirely inappropriate because Congress has already carefully considered this issue as part of the 1988 Amendment and determined that irreparable injury exists when infringing goods are being imported into the United States. Indeed, the House Finance Committee and House Ways and Means Committee—both of which are charged with oversight of the ITC—definitively and correctly concluded that “[t]he importation of any infringing merchandise derogates from the statutory right, diminishes the value of the intellectual property, and thus indirectly harms the public interest. Under such circumstances, the

Committee believes that requiring proof of injury, *beyond that shown by proof of the infringement of a valid intellectual property right, should not be necessary.*⁴⁸

Third, the proposed changes would require the ITC to determine that the public interest would not be disserved by an exclusion order. But Section 337 *already* authorizes and obligates the ITC to assess the public interest prior to issuing any exclusionary orders. Specifically, Section 337 provides that if the Commission finds a violation it shall exclude the articles concerned from the United States “unless *after* considering the effect of such exclusion upon the public health and welfare, competition conditions in the United States economy, the production of like or directly competitive articles in the United States consumer, it finds that such articles should not be excluded from entry.”⁴⁹ In addition, pursuant to its statutory authority, the ITC may hold public hearings to take and consider comments and testimony from interested parties when an exclusion order may have far reaching effects.⁵⁰ Even in cases where no public hearing is held, the entire panel of Commissioners reviews any remedial order issued by an ALJ to ensure that the relief granted does not conflict with the public interest.⁵¹ And, following this review, the office of the U.S. Trade Representative performs a “presidential review” to ensure that the decision is compliant with the public interest.⁵² Thus, amending the statute to require the ITC to consider the impact of an exclusion order on the public interest would be entirely superfluous because the statute already requires it to do so.

Fourth, the ITC has recently demonstrated a renewed vigor in its consideration of the impact of its actions on the public interest. For example, effective November 7, 2011, after considering comments received from over 90 different companies, including many non-parties, the Commission amended its rules to enhance its consideration of the public interest. The following describes some of the more relevant rule changes that demonstrate the ITC’s focus on the public interest:

- The Commission added final rule 210.8(b) to require complainants to file a separate statement of public interest concurrently with the complaint.
- The Commission added final rule 210.14(f) to require respondents to submit a statement of public interest in response to complainants’ filings under 210.8(b) and (c)(2) when the Commission has delegated the matter of public interest to the presiding administrative law judge (“ALJ”).
- The Commission amended rule 210.50(a)(4) to request the parties to file comments on the public interest thirty (30) days after issuance of the presiding ALJ’s recommended determination (“RD”) on remedy, bonding, and where ordered, the public interest.

⁴⁸ H.R. Rep. No. 100-40, at 156 (1987) (emphasis added).

⁴⁹ 19 U.S.C. § 1337(d)(1) (emphasis added). The statute contains a similar provision related to cease and desist orders. 19 U.S.C. § 1337(f)(1).

⁵⁰ See 19 C.F.R. § 210.50 (2007)

⁵¹ See 19 C.F.R. § 210.50.

⁵² See 19 U.S.C. § 1337(c), (j).

- The Commission amended rule 210.10(b) to indicate that the comments received during the pre-institution period—under final rules 210.8(b) and (c)—are the general basis for the Commission’s determination as to whether to delegate the issue of public interest to the ALJ.
- The Commission added rule 210.42(a)(1)(ii)(C) to clarify that, when ordered to take evidence on the public interest, the ALJ shall include analysis of the public interest in his RD.

These rule changes demonstrate that the ITC is increasing its focus on the public interest by seeking information about the public interest from numerous sources with potentially many different views. The Commission is thus equipped and able to evaluate the public interest and tailor its remedies according to the facts of each specific case.

In addition to the ITC’s rule changes, the ITC has also demonstrated an increased focus on the public interest in its Section 337 investigations. Of particular note was the ITC’s decision in the 543 Investigation. There, the ITC initiated an investigation based on a complaint filed by Broadcom Corp.⁵³ Broadcom’s complaint sought a limited exclusion order directed to certain processor chips as well as downstream products that incorporated the chips, including cell phones, PDAs, and smart phones. After conducting an investigation, the ITC found a violation of Section 337. However, before issuing an exclusion order, the ITC held a two-day hearing on the public interest. The ITC heard from a large sample of wireless industry members and users on public interest issues ranging from the economic impact of an exclusion order to issues of public safety. The ITC subsequently issued a limited exclusion order barring entry of the accused chips and downstream products containing those chips. However, the ITC exempted from the exclusion order certain models that had already been imported into the U.S. for public interest reasons. The ITC’s decision expressly discussed issues relating to the public health and welfare, the interest of U.S. consumers, and competitive conditions in the United States economy.

In another, more recent, example of the ITC’s focus on the public interest, in *Certain Personal Data and Mobile Communications Devices and Related Software*, Inv. No. 337-TA-710, the ITC engaged in a lengthy analysis of the statutory public interest factors in determining whether to award Apple a limited exclusion order that would prohibit certain Android phones from being imported into the United States.⁵⁴ The ITC considered concerns about the effect on U.S. customers of such an order, and consequently provided an exemption to the scope of the exclusion order. Moreover, it also recognized that the case raised “some important competitiveness concerns.” Given those concerns, the ITC determined that, under the factual circumstances of that case, an immediate exclusion order would not be in the public interest and, therefore, permitted a 4-month transition period prior to the exclusion of the subject phones.

⁵³ *Certain Baseband Processor Chips and Chipsets, Transmitter and Receiver (Radio) Chips, Power Control Chips, and Products Containing Same, Including Cellular Telephone Handsets*, Inv. No. 337-TA-543

⁵⁴ *Certain Personal Data and Mobile Communications Devices and Related Software*, Inv. No. 337-TA-710, Order at 66-80.

C. There Is No Need To Amend Section 337 To Change The Definition Or Understanding Of What Constitutes A “Domestic Industry.”

Just as there is no need to amend Section 337 to import the *eBay* analysis into the ITC’s investigations, neither is there a necessity to amend the statute to limit the definition of a domestic industry. Narrowing the definition of domestic industry to exclude any licensing activity that does not result in a non-existent new product being brought to market would effectively negate the 1988 Amendment, which was enacted to provide a remedy “for those who make substantial investments in the creation of intellectual property and then license creations.” As evidenced by the legislative history of the 1988 Amendment, Congress did not intend to limit the types of licensing activities that the ITC can consider.

In addition, the ITC takes its jurisdictional requirements with the utmost seriousness and already demands evidence of genuine and demonstrable licensing activities, as well as a definite nexus between the domestic industry activities and the asserted patents. In short, the ITC is currently exercising its jurisdiction and denying relief to entities that cannot demonstrate a domestic industry. There is no need to restrict the definition of domestic industry further—particularly in the vague and unpredictable manner proposed—when the ITC has amply demonstrated its own ability to parse the jurisdictional requirement in the context of each specific case. The agency is best prepared, positioned, and experienced, to determine which complainants are deserving of a remedy under Section 337 based on the particular facts and circumstances of individual cases. There is no reason to exclude by the blunt instrument of legislative fiat whole classifications of complainants based on ill-defined judgments about their merits.

For example, in *Certain Coaxial Cable Connectors and Components Thereof and Products Containing the Same*, Inv. No. 337-TA-650 (2011), the ITC held that the complainant had failed to establish a domestic industry based on licensing investments. The ALJ had found a domestic industry based on evidence relating to litigation expenses directed to enforcing the patents.⁵⁵ On review by the Commission, the complainant relied solely on its activities related to the expenses associated with the litigation as evidence of the substantial exploitation of the patent at issue. The ITC rejected the argument that litigation activities alone (unrelated to engineering, research and development, or licensing) can constitute exploitation under Section 337.⁵⁶ The ITC explained that its decision was supported by the plain language of the statute because in listing what can constitute “exploitation” but not including patent infringement litigation, Congress made a determination that it was not to be included.⁵⁷ Furthermore, the ITC noted that a holding that patent infringement litigation activities taken alone constitute “exploitation” would render the domestic industry requirement a nullity.⁵⁸ The ITC noted that “licensing is an activity that is clearly within the realm of “exploitation” as contemplated by Section 337(a)(3)(C). The ITC specifically left open the possibility that litigation activities may

⁵⁵ *Certain Coaxial Cable Connectors and Components Thereof and Products Containing the Same*, Inv. No. 337-TA-650 (2011), Order at 42.

⁵⁶ *Id.* at 43.

⁵⁷ *Id.* at 44.

⁵⁸ *Id.* at 45.

satisfy the domestic industry requirements as long as a complainant can prove that these activities are related to licensing and pertain to the patent at issue, and can document the associated costs.⁵⁹ Thus, the ITC demonstrated that it is perfectly capable of parsing the statutory language and determining when a complainant has properly satisfied the domestic industry requirement.

Likewise, in *Certain Stringed Instruments*, a sole proprietor and inventor filed a complaint about an invention that related to improved stringed instruments which contained components that allow a musician to optimally tune the strings. In attempting to meet the domestic industry requirement, he established that he spent \$8,500 to make five product prototypes over a period of fourteen years and that he participated in unsuccessful pre-suit licensing discussions.⁶⁰ The complainant also established that he had engaged in research and development activities, and that he had successfully entered into two licenses after the complaint had been filed. These efforts, the ITC determined, failed to meet the economic prong of the domestic industry requirement.⁶¹ The ITC noted that the requirement for showing the existence of a domestic industry will depend on the industry in question, and the complainant's relative size. Despite the complainant's arguments that his activities had included initial research and development, engineering, initial designs, creating a prototype, testing, final design, marketing, distribution, sales, and licensing, the ITC held that these efforts were insufficiently documented and would have had to have been sufficiently focused or concentrated to find a substantial investment. And the complainant's pre-complaint efforts to obtain licenses did not constitute a substantial investment. The ITC specifically noted the absence of any actual licenses prior to the complaint and the fact that the only consummated licenses were acquired as a product of settlements with respondents in the investigation. This was all insufficient to establish a domestic industry.

As another example, in *Certain Multimedia Display and Navigation Devices and Systems, Components Thereof, And Products Containing Same*, Inv. No. 337-TA-694, the complainant, Pioneer, relied on its investments in licensing the asserted patents to demonstrate its domestic industry. Pioneer owns hundreds of GPS and navigation patents in the U.S. and world-wide. The primary issue presented for the ITC's consideration was whether Pioneer had satisfied the statutory standard based on its investment in licensing a large portfolio of patents. Because Pioneer's activities were associated both with the asserted patents and the unasserted patents, a key issue presented was the strength of the nexus between the activities and the asserted patents.⁶² The ITC stated that where the complainant's licensing activities and investments involve a group of patents or a patent portfolio, the complainant must present evidence that demonstrates the extent of the nexus between the asserted patent and the complainant's licensing activities and investments. This may be done by showing that the licensing activities are particularly focused on the asserted patent among the group of patents in the portfolio or through other evidence that demonstrates the relative importance or value of the

⁵⁹ *Id.* at 47-48.

⁶⁰ *Certain Stringed Musical Instruments and Components Thereof*, Inv. No. 337-TA-586, Comm'n Op. at 14 (2008).

⁶¹ *Id.*

⁶² *Certain Multimedia Display and Navigation Devices and Systems, Components Thereof, And Products Containing Same*, Inv. No. 337-TA-694, Order at 8 (2010).

asserted patent in the portfolio.⁶³ In that case, the ITC determined that Pioneer could not establish the domestic industry requirement because of an insufficient nexus between its in-house activities and the asserted patents. Moreover, the ITC also determined that Pioneer's activities were too limited in light of its resources, the scope of its portfolio of patents, and the relevant market to be a substantial investment under the economic prong.⁶⁴

It is clear from the above discussed investigations that the ITC is fully capable of—and indeed has been actively engaged in—drawing the necessary lines to determine when the complainant is a genuine domestic industry and when it is not.

Moreover, the ITC has recognized that Congress has determined that licensing activity, without more, constitutes a beneficial U.S. industry that the ITC should protect. *See Certain Variable Speed Wind Turbines and Components Thereof*, Inv. No. 337-TA-376, Comm'n Op. at 14-15 (Sept. 23, 1996). Thus, the ITC understands that Congress expressly intended to extend ITC relief to companies that invest heavily in research and development financed by licensing revenues, like Qualcomm, Tesser, InterDigital, and Dolby Laboratories; universities; small companies and startups that lack the resources to manufacture products based on their intellectual property; and individual inventors without the capital or inclination to build a factory. These entities serve valuable innovative functions. Given the ITC's commitment to rigorously enforce the domestic industry requirement, there is no need for Congress to amend the statute as it relates to licensing activity.

IV. THE PROPOSED WOULD LEAD TO ABSURD RESULTS AND ENCOURAGE PERVERSE BEHAVIOR

The proposal, if enacted, would lead to absurd outcomes and incentivize implementers to engage in perverse behavior.

First, importing the *eBay* analysis into the ITC in Section 337 cases would leave valid patent holders with a right but with no remedy.⁶⁵ The ITC cannot award monetary damages upon a finding of infringement. By contrast, if a district court has jurisdiction over a defendant and infringement is proven, it can award a monetary damage award as a first step toward compensating the plaintiff. If *eBay* were applicable to Section 337 proceedings and the ITC determined that the complainant had not shown that monetary remedies are inadequate to compensate it, the ITC would be forced to forego its remedial authority but without any guarantee that a district court would assert its jurisdiction or award monetary damages or fix a royalty. In these circumstances, there would be no *res judicata* effect to the ITC's determination of violation, and the complainant could be left without any remedy. In other words, in any investigation in which the traditional four-factor test would weigh against issuance of both an exclusion order and a cease and desist order, the Commission would not be able to issue any

⁶³ *Id.* at 9.

⁶⁴ *Id.* at 20.

⁶⁵ William Blackstone, *Commentaries on the Laws of England* 23 ("It is a settled and invariable principle . . . , that every right when withheld must have a remedy, and every injury its [sic] proper redress."); *see also Marbury v. Madison*, 5 U.S. (1 Cranch) 137, 162–163 (1803).

relief at all, thus effectively creating a right (a prohibition on unfair practices in the import trade) without a remedy.⁶⁶

The injustice of leaving an ITC complainant to the uncertainties of a district court action for monetary damages is perhaps best illustrated in the context of respondents from the Peoples Republic of China. A crucial issue in American trade today is the influx of infringing goods from China, where low labor costs have attracted a large portion of the world's manufacturing jobs. Monetary damages may well be determined theoretically adequate to compensate a non-practicing American innovator and patentee, and its right under Section 337 would be denied under the proposed legislation. But even if the U.S. patentee prevailed in the district courts and obtained a damages award, it is not likely to collect its judgment amount within a reasonable time period, if ever. Meanwhile, the Chinese infringer, having been encouraged by the unavailability of an ITC exclusion remedy for the non-practicing U.S. patent holder, would be permitted to continue its infringement indefinitely. This would be the practical effect of the proposed amendments on U.S. innovators and patentees.

Second, limiting the definition of a domestic industry would have a number of absurd consequences. For example, requiring a temporal limitation on licensing activity would prevent a holder of valid intellectual property rights from bringing a Section 337 action when an infringer has already successfully imported the infringing product into the United States.⁶⁷ The proposal ignores the reality that technology evolves and is "adopted" faster than the PTO can consider patent applications and issue patents. This proposal would thus leave without a remedy most high-tech patent owners seeking to license their patents. Moreover, the proposed changes perversely incentivize infringing foreign manufacturers to import infringing products instead of first seeking a license from a valid patent holder because, by doing so, it could defeat an otherwise valid Section 337 claim. In other words, companies would be better off "adopting" the patented technology without taking a license. The changes would turn proof of an infringing importation into a fact that defeats a Section 337 claim. The patentee would be unable to avail itself of Section 337 to obtain expeditious relief because it would have no licenses "prior to" the "adoption" of the IP right by the infringers. Such an outcome defeats the entire purpose of the ITC and Section 337, which is to protect American industries against infringing foreign imports. No amendments to Section 337 that actively incentivize foreign manufacturers to import infringing goods can possibly be in the best interests of American trade.

Third, the limited definition of domestic industry would also penalize holders of American intellectual property rights for attempting to commercialize a product. This is because the changes may be interpreted to preclude a patentee from relying on licensing to satisfy the

⁶⁶ See, e.g., *Doe v. County of Centre*, 242 F.3d 437, 456 (3d Cir. 2001) (noting "the common law principle, recognized by the Supreme Court as early as *Marbury v. Madison*, that a right without a remedy is not a right at all").

⁶⁷ For example, under the proposed amendment, IBM would not have been able to establish a domestic industry based on licensing activities in Inv. No. 337-TA-628, despite evidence showing that it had spent many months conducting technical analyses of products, putting together "proof packages" designed to show that the products infringed IBM patents, and successfully negotiating licenses resulting in hundreds of millions of dollars of revenue. See *Certain Computer Products, Computer Components, and Products Containing Same*, Inv. No. 337-TA-628, ID (unreviewed) at 163-64. Ultimately, a domestic industry was found, but a finding of no violation was reached on other grounds in this investigation.

domestic industry requirement if the patentee develops a prototype or model embodying the invention before approaching potential licensees. In this way, the patentee's efforts to commercialize a product protected by his patent may doom his right to bring an action in the ITC.

Fourth, a patentee might not meet the new domestic industry test because investments after the first license do not count. Under the proposed changes, a company might be unable to rely on any licensing activities that occur after the first licenses were entered into. For example, once a licensee adopts the technology, any later investments by the patentee would not be "prior to" and "promote[], the adoption of" the technology, and therefore would not count toward proving the requisite substantial investment in licensing to establish the existence of a domestic industry under Section 337(a)(3)(C). Thus, licenses occurring after the execution of the first license may not count toward the patentee's investments in a domestic licensing industry.

Fifth, the proposed changes to the domestic industry requirement would impact all different types of NPEs, including those that Congress has already considered worthy of protecting in the 1988 Amendment. These include universities, inventors, start-ups, R&D enterprises, holders of well-established trademarks and patents, and large and small businesses of all types and sizes.

Sixth, along the same lines, the proposed changes do not differentiate between types of intellectual property. Trademark owners with well established marks may be barred from the ITC as well. Although the cited problem in the Proposal is directed to patents, the proposed language is not limited to patents. By including the additional statutory IP rights currently protected under Section 337 (trademarks, copyrights, mask works and designs) within the proposed amendment, there may be unintended consequences with respect to those other enumerated IP rights. For example, the proposed language could result in a company with a long-established trademark, whose business it is to license authorized trademarked goods, being unable to satisfy the domestic industry requirement (and thus preclude the company's use of Section 337) when it is faced with a proliferation of imported counterfeit goods that are being sold in the U.S. because the timing of its investments in that business may not meet the proposed "prior to, and that promotes, the adoption of" language. This issue may also apply to the other enumerated statutory IP rights such as copyrights.

Seventh, the proposed legislation would incentivize infringement and discourage respect for valid intellectual property rights. For example, a U.S. manufacturer that recognizes the innovative contribution of a valid U.S. patent to a particular technology may elect to respect that patent and pay a reasonable royalty for the right to use it in its products. A foreign manufacturer of competing goods, however, would be emboldened by the proposed amendments to resist taking such a license and paying fair royalties. The foreign manufacturer will resist paying a just royalty because it knows that a non-practicing U.S. patentee will be denied an exclusion order in the ITC and will be forced to seek damages in district court and subsequently navigate the uncertain shoals of judgment execution and collection in a foreign country. This bizarre set of negative incentives will harm not only the U.S. patentee by denying it the value of its valid intellectual property, but it will also harm the licensee, which will be punished for respecting intellectual property and paying a royalty that Congress will have effectively immunized foreign

competitors from having to pay. This is precisely the kind of unfair competition that Section 337 is, and has always been, aimed at remedying.

V. THE PROPOSED CHANGES WOULD ADVERSELY IMPACT AMERICAN INNOVATION AND THE AMERICAN ECONOMY

A. Patents Are Critical to the American Economy

The patent system has played an enormously positive role in the evolution of the United States becoming the paramount technological innovator in the world.⁶⁸ Economists draw a distinction between innovation and invention: innovation involves a multifaceted effort that includes the discovery, development, improvement and commercialization of new processes and products while invention is the first critical step in that process. Economists generally concur that innovation is the most important factor in the growth of the economy. The patent system's principal purpose is to promote innovation by giving incentives to inventors.⁶⁹ Section 337's complementary purpose is to remedy acts of unfair competition related to the importation of infringing goods.

At bottom, the proposed changes to Section 337 would weaken the ITC's ability to protect American industries against foreign-manufactured articles and would adversely impact the United States economy in several ways.

Protecting American intellectual property rights is vitally important to our national economy. The President has recently spoken about the importance of encouraging American innovation.⁷⁰ The best way to encourage such innovation is to demonstrate a continued focus on protecting and valuing valid intellectual property rights—particularly as against foreign-based manufacturers. Some foreign businesses take advantage of delays and limitations inherent in the U.S. court system to infringe on the intellectual property rights of American competitors. Foreign businesses acquire market share by selling infringing imported products, while infringement cases against them languish in federal courts. Providing the ITC with a meaningful method of excluding such articles is essential to combat this conduct.

⁶⁸ See Marshall Leaffer, *Patent Misuse and Innovation*, 10 J. High Tech. L. 142, 143 (2010).

⁶⁹ *Id.* at 144.

⁷⁰ Office of the Press Secretary, White House, Remarks by the President in State of the Union Address (Jan. 25, 2011), available at <http://www.whitehouse.gov/the-press-office/2011/01/25/remarks-president-state-union-address> ("The first step in winning the future is encouraging American innovation. None of us can predict with certainty what the next big industry will be or where the new jobs will come from ... What we can do—what America does better than anyone else—is spark the creativity and imagination of our people. ... In America, innovation doesn't just change our lives. It is how we make our living."); President Ronald Reagan, Statement on Establishment of the President's Commission on Industrial Competitiveness (Aug. 4, 1983), available at <http://www.presidency.ucsb.edu/ws/index.php?pid=41678&st=&st1=#axzz1h8aDljNv> ("This nation's greatest competitive advantage in the past were ideas that helped America grow. We need to put the power of ideas to use again, for the good of our future. ... To sustain high rates of real economic growth, we must continue to create new 'miracles' of high technology—miracles both for innovation and for modernization of the major areas of our economy in manufacturing, agriculture, and services.").

This is particularly the case because some of the country's most formidable and aggressive trading partners, such as China, do not have an established intellectual property culture. Some countries simply have little to no recent experience with and understanding of the destructive power of rampant infringement. Rather, they only see the short-term trade opportunities and resent any obstacles to that trade, including American protection of intellectual property. In an exporting country that has no longstanding and ingrained culture of respect for intellectual property rights, weakening U.S. protections against infringing imports will likely have serious detrimental effects. Continued respect for and support of intellectual property rights against infringing imports will ensure that American industry is not undercut by foreign-based manufacturers.

B. Licensing is an Important Part of the American Economy

The notion that patent licensing in general, and patent licensing entities in particular, have no inherent value is simply wrong. Rather, they provide important economic benefits.⁷¹ U.S. licensing revenue has exceeded \$500 billion per year in recent years—an increase of more than 3000 percent over the last two decades. Furthermore, the U.S. economy relies heavily on the licensing of intellectual property to entities that manufacture products in foreign nations. Licensing has become one of the United States' only international trade surpluses, increasing by nearly 18 percent each year since 2003, and recently reaching \$64.6 billion.

In addition to stimulating the U.S. economy, the revenue from patent licenses is critical to encouraging efforts for future innovation because the royalties obtained from patent licenses are often used to finance innovators' future research and development.

As noted above, weakening the ITC's ability to exclude infringing articles from importation would also exacerbate the patent holdout problem wherein American-based industry members play by the rules of our intellectual property regime and obtain licenses from valid patent holders while foreign-based manufacturers that compete with the American companies refuse to obtain licenses and simply import infringing goods. If the ITC's ability to exclude such products is weakened or if complainants must jump through additional hurdles to keep such infringing products out of the country, the industry members who play by the rules will suffer economically because they will be undercut on the margins by manufacturers of infringing products that do not pay license fees or royalties. Not only does this system disrespect the intellectual property at issue but it leads to unfair price undercutting and market distortion.

⁷¹ See John C. Paul, Brian D. Kacedon & Michael V. O'Shaughnessy, Patent Trolls: A Stereotype Causes a Backlash Against Patents and Licensing, 41 *Les Nouvelles* 224 (2006) (explaining that patent licensing alone provides a good source of revenue).

Material submitted by the Honorable Melvin L. Watt, a Representative in Congress from the State of North Carolina, and Ranking Member, Subcommittee on Intellectual Property, Competition, and the Internet

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("eBay and Competition Policy: Taking Antitrust to Patent School.")

Intellectual Property Rights:
State-Initiated Restraints of Competition or State-Initiated Competition?

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Intellectual property ownership has become a critical issue in current debates concerning not only national competition policies but also international trade and development.

Why have intellectual property rights—IPRs—become the overriding issue in these intertwined debates? Simply put, because all three—competition, trade, development—call for attempts to mediate between stronger rights to encourage innovation on the one side and, on the other, better access to increase its dispersion.

Given my time allotment today, my paper focuses on national competition policy and the status of IPRs.

In the U.S. debates, the dominant view holds that stronger IP protection leads naturally to more innovation, more competition, and more economic growth. Given the dominant view, it is easy to forget that there is nothing natural about IPRs and that they are state-initiated restraints of competition.

IPRs have not always been held in high regard. When the U.S. Congress passed the first national patent and copyright acts in 1790, the statutes were viewed as necessary evils, as state-created monopolies to be minimized. This attitude persisted a century later, when the Sherman Anti-Trust Act, the national competition statute, was passed.

More recently, however, the relationship between IPRs and antitrust has been turned on its head. Since the 1980s, not only have IPRs been strengthened but antitrust enforcement has been diluted; now, IP ownership immunizes much anti-competitive conduct from antitrust scrutiny.¹

¹ refusals to deal, reverse payments, tying, vertical restraints, patent cartels & boycotts

This paper addresses two questions: First, what explains the reversal of fortunes—the decline of antitrust, the elevation of IPRs to primary importance, and, in consequence, a weakened commitment to free competition? Second, how can the benefits of free competition be re-introduced into the policy debates concerning IPRs, debates concerning the public benefits from advancing economic growth AND promoting fair distribution of its benefits? Of course these are large questions that deserve more attention than I can give today. This paper is an introduction to the issues; their development is left to another day.

And so the first question: Given the powerful rhetoric of free competition in the United States, what can explain the 30-year decline of antitrust and, at the same time, the expansion of IPRs despite their clear character as state-initiated restraints of competition?

The place to begin is the rhetoric of ‘free competition’. What exactly do we mean by ‘free competition’?

The answer becomes clear once we restate the question as follows: What is it we want to free competition from?

In the United States, this question has long summoned two responses. First, we want to free competition from political control, from oppressive government intervention. In this sense, free competition expresses a commitment to individual liberty. Second, we want to free competition from private economic control, from the oppressive power of accumulated private capital. In this second sense, free competition expresses a commitment to rough equality. In sum, free competition reflects commitments to both liberty and equality, and concerns about oppressive power, both political and economic.

But these commitments to equality and liberty produce a fundamental tension in the idea of free competition. When free competition’s commitment to economic equality calls for government intervention to curb private economic power, that very government intervention infringes on free competition’s commitment to liberty. The growing distrust of government intervention in the United States since the Nixon presidency has surpassed progressive concerns for economic and commercial inequality. In consequence, the dominant ideology in the U.S. now favors free markets in the belief that they are better left alone than supervised by distrusted government, whether the supervision is by antitrust enforcement or direct government regulation.

Despite this distrust of government, the same forces have driven the simultaneous rise of intellectual property rights, even though they are undoubtedly state-initiated restraints of free competition. First, IPRs infringe on free competition’s commitment to equality insofar as they grant IP owners the private power to pursue economic monopoly. Second, IPRs infringe on free

competition's commitment to **liberty** since they result from direct government intervention. But here, the distrust of government intervention has not taken hold.

So, what has led modern U.S. policy makers to expand IPRs despite general distrust of government intervention into commercial markets?

Two different conceptions of IPRs have justified the expansion despite their character as government-initiated restraints of free competition. First, some have viewed IPRs generally as natural rights. Second, others have viewed patent and copyright in particular as constitutional entitlements, as pre-governmental rights to encourage innovation. In both views, the government's active role has fallen out of the picture.

First, IPRs are broadly understood as a compelling form of natural property rights. Their moral foundation is especially appealing because they not only evoke John Locke's labor theory of property rights but also purport to reward the Romantic genius of individual imagination. In this light, the government is seen not as the source but rather the protector of morally ex ante IP rights. Thus expansion of IPRs is seen as fuller protection of perfectly natural rights, while their narrowing is seen as oppressive government restraint of the natural workings of competitive markets.

Second, there is the dominant scholarly and jurisprudential view of patent and copyright as constitutional rights, ex ante rights enacted but not created by government. In fact, the U.S. Constitution does empower Congress to enact patent and copyright protection for the specific purpose of advancing knowledge and industrial technology. And so patent and copyright are properly understood as the private means to produce the public benefits of inventive activity. This constitutional conception is supported by an intuitively attractive economic view that patent and copyright provide the necessary financial incentive for inventors to invent and for investors to invest in research and development. And when they do, all of society benefits from the economic progress that results.

Though the natural rights view is more popular, it is the constitutional rights view that dominates scholarly and policy debates in the U.S., the view that patent and copyright are the private means to promote the public benefits of innovation and economic growth. So it is worthwhile for us to investigate the economic incentive logic that has come to dominate the constitutional rights view of patent and copyright as the private means to produce the public benefits of economic progress.

Although the economic incentive rationale for patents and copyrights is intuitively attractive, the fact is that it simply does not hold because there are deep problems with the logic: First, there are theoretical criticisms that go back almost a century. In addition to questions

about the social costs of IP monopoly and whether market success provides sufficient incentive, there is the criticism that incentive theory does not take into account economic opportunity costs: That is, it does not account for the lost benefits of alternative investments, benefits that would have resulted from investment in, for example, more production or better infrastructure.

Second, in addition to theoretical criticism, over fifty years of economic studies have failed to find empirical support for an incentive theory of patent and copyright. Let me be clear about this: Despite fifty years of trying, there is no empirical evidence to support the view that the public benefits of intellectual property rights are worth their economic costs, nothing to support the belief that IPRs are superior to free competition in the production of innovation or the advancement of economic growth. There have been a smaller number of studies suggesting that patents are seen as important to business models in a few industries – pharmaceuticals and chemicals. In other sectors, patents were seen as having importance of the third or fourth order. Still, these studies address the question of patents as incentives to engage in research and development to pursue private profit. So it is crucial to remember that the private benefits of patents to pharmaceutical makers or chemical companies tell us nothing about effect of patents on the public good.

Still, the economic incentive story continues to dominate political and scholarly debates. There are at least two reasons for this unearned success. First, there is a neo-mercantilism that runs through the political debates, a belief that IP protection is the last great hope of the United States for competitive advantage against the onslaught of globalization. Of course, even if this is the case, it is not clear how long the current balance of trade in IPRs will continue to benefit the United States. Moreover, Adam Smith taught us long ago that maximizing private profits, including those from copyright monopolies, does not maximize a nation's wealth.

[this ¶ is repetitious] The second reason is related to the first: There is the persistent category error of equating means and ends, of equating private profit with public benefit. And so despite a century of scholarly criticism, too many scholars and judges in the United States still proceed as if maximizing patent rights serves to maximize innovation and, with it, economic progress. But they do not, so far as we can determine.

While the U.S. IP debates have only begun to include arguments about fair distribution voiced by the human rights community, criticisms of the incentive story have begun to take hold in mainstream IP literature and to reverberate in recent Supreme Court decisions.

These developments open the door to my second question: How can the benefits of free competition be re-introduced into the policy debates concerning IPRs, debates addressing the public interests of advancing economic growth and promoting fair distribution of its benefits? I

believe there are competition policies waiting to be applied, neglected competition policies that are already at hand.

The surprising source for these neglected competition policies lies within the IP domain itself. As I have shown in a series of papers, while patents are state-initiated restraints of competition, patent policy is shaped by its own fundamental commitment to free competition. The same can be said of copyright, trademark, and trade secret policies.

My paper today concludes with an example of patent policy's fundamental commitment to free competition. The example serves two purposes. First, it illustrates one important way competition policy shapes patent rights. Second, it shows how antitrust courts should apply patent's competition policy and, in consequence, reformulate their understanding of patent rights, a misunderstanding that excessively restrains free competition.

My example describes how attention to a recent and highly influential patent decision by the Supreme Court would correct one widespread mistake that has resulted from antitrust policy's overly deferential attitude toward patent rights. Antitrust courts have consistently and mistakenly concluded that as a general matter, patent ownership automatically justifies a dominant firm's refusal to deal so long as the refusal lies within the scope of a valid patent. Why? Because it is the patent owner's fundamental right to deny access to the patented invention.

But these antitrust decisions have failed to separate the question of a patent's validity from its power to exclude. They have failed to distinguish the patent right from the patent remedy. It is this very distinction that provides the logic for the Supreme Court's patent decision in the landmark *eBay* case.

The Supreme Court made it clear that ownership of a valid patent does not automatically justify an injunction to halt the infringing conduct. Rather, in determining whether to issue an injunction, judges must apply traditional principles of equity to balance the private and public effects of halting the infringing conduct. Since the *eBay* decision, patent holders have found it much more difficult to persuade courts to restrain infringing competitors from selling their patented inventions. As a result, more infringers continue to compete against the patent owner with the owner's patented invention. Of course the infringer does not get away free; they must pay damages and reasonable royalties. But they are permitted to compete.²

² form of compulsory or statutory license. Calabresi's liability rule of remedy. More efficient here than property rule? arguably yes, since post-injunction bargaining is single-sided monopoly, etc. [Does injunction analysis coincide with efficiency analysis?]

While the Supreme Court's *eBay* opinion has widely influenced lower courts in patent infringement cases, the decision has not been understood in competition terms and, in consequence, it has had no influence on antitrust decisions involving the competitive effects of patent ownership.

Yet it makes perfect sense that patent law's approach to injunctions should be imported into the antitrust analysis of refusals to deal by dominant firms because the legal questions and economic stakes are precisely the same.³ In both, patent owners seek judicial authorization to restrain competition on the logic of patent rights to exclude.

So, what would patent law's competition logic look like in an antitrust case involving a dominant firm's refusal to deal?

In a well-known case, Xerox persuaded the court that its patent ownership justified its refusal to sell its patented replacement parts to competitors who service and repair Xerox copiers. If the equitable approach taken in the Supreme Court's recent patent decision were imported into this antitrust case, then patent ownership would not automatically excuse the refusal. Rather, Xerox would have the burden of persuading the court that its refusal to sell replacement parts to independent service companies should be permitted in the circumstances. To determine whether the refusal should be permitted, the court would apply patent law's competition logic of equitable balancing. This traditional equity approach requires the court to evaluate and then balance four factors to determine whether the restraint would be fair in the circumstances.

First, Xerox would have to persuade the court that it would suffer irreparable harm if required to sell its patented replacement parts to a competitor. In this case, irreparable harm was not likely. First, there was no foreseeable harm to Xerox's reputation for making copiers. But what of loss of market share for repair service? Xerox would lose market share only if its services were inferior or if its prices were higher. And that harm results from competition on the merits, not from free riding on the Xerox's accomplishments.

What of Xerox's lost monopoly profits for replacement parts? Applying the second factor, Xerox would be permitted the refusal to sell only if damages would not provide adequate compensation. But generally, damages are viewed as adequate compensation for lost profits. And here profits would be lost only if Xerox sold replacement parts to independents at wholesale, something they would not be required to do. Moreover, profits might actually increase if better quality or lower prices increased demand for services and, with it, resulted in greater sales of replacement parts.

³ they are institutional and functional equivalents: injunction=refusal=reverse payments == judicial authorization to restrain comp

The third factor requires the court to balance the hardships on the parties: Would requiring Xerox to deal with competitors impose greater hardships on Xerox than allowing Xerox's refusal to deal with independent service companies? Here, requiring Xerox to deal would impose hardship on Xerox only if production of replacement parts could not meet demand, an unlikely event especially if parts manufacture is outsourced, as it usually is. On the other side, given the typical lack of interchangeability—for example, Kodak parts don't fit Xerox machines—permitting Xerox's refusal to deal would cause great hardship on all independent service companies and thus on competition in the repair market for Xerox copiers.

Fourth and finally, what would be the effect on the public interest of permitting Xerox's refusal to deal? Given U.S. antitrust's identification of public interest with consumers, the inquiry would address the narrower question of the impact on consumers. In the short run, antitrust's traditional static efficiency analysis would likely conclude that permitting the refusal to deal would harm consumers by leading to higher prices and lower quality in the market for repair of Xerox copiers.

In the long run, the dynamic efficiency analysis associated with more recent antitrust policy would inquire into the impact on innovation. The traditional answer is that a loss of monopoly profits would lower Xerox's incentive to innovate and, in consequence, social welfare would be harmed. But economic analysis has shown the traditional incentive theory to be unsupported in theory or in fact. So, even if Xerox might be worse off, that does not mean there will be less innovation or less progress overall. Indeed, society might be better off. Why? Because competition provides its own incentive to innovate, but without the social costs of monopoly profits.

So, an equitable balancing of the four factors derived from patent law's competition policy, when applied to antitrust analysis of whether to permit Xerox's refusal to deal, imposes a burden on Xerox to show that the factors clearly weigh in its favor. But they don't. There is no foreseeable harm to its reputation. Lost profits, if not the result of competition on the merits, are compensable by damages. The balance of hardships clearly falls not on Xerox but on the independent service companies, who have no alternative source of supply for replacement parts. And finally, the public interest, here defined in terms of consumer benefits of lower prices, better service, and continued innovation, all weigh on the side of requiring Xerox to sell repair parts to independent service companies. In sum, the competition analysis imported from the patent regime calls for a rejection of Xerox's claim that its patent rights should justify its refusal to deal.

Recall that the court in the actual antitrust case viewed patent ownership as an automatic business justification for Xerox's refusal to sell replacement parts to independent repair

companies. The result was no competition on the market. This mistaken view of patent rights and their relationship to antitrust policy underlines the importance of taking antitrust to the patent school of free competition:

We started the analysis with a patent, a state-initiated restraint on competition, and then applied its logic to an antitrust case, with the effect being state initiated-cooperation between a dominant firm and its rivals, and with the patent logic's ultimate result being state-initiated competition.

Patents and Payoffs
or How Generics are Kept Off the Market

A federal appeals court recently dismissed a case that could have saved consumers hundreds of millions of dollars. Solvay Pharmaceutical, the maker of a synthetic form of testosterone called Androgel, had sued several generic drug companies for patent infringement but agreed to settle the case if those companies would accept up to \$200 million dollars to stay off the Androgel market. Seeing this settlement as an agreement in restraint of trade, the Federal Trade Commission filed an antitrust suit to bar the settlement and, in their brief, noted that such settlement agreements are costing drug consumers \$3.5 billion dollars annually.

The federal appeals court rejected the FTC's claim that the settlement is a violation of the antitrust laws, concluding that agreements like the one in *Solvay* are shielded from antitrust scrutiny as long as they "fall within the scope of the patent." In short, the court decided that Solvay's patent rights in Androgel trump the antitrust prohibition against agreements that restrain competition. But this decision and the unbroken line of others like it since 2003 are wrong as a matter of law.

Although Solvay does have a right to stop the production and sale of generics that fall within the scope of its Androgel patent, the appeals court neglected the Supreme Court's teaching in a landmark 2006 patent decision. According to that *eBay* opinion, there is nothing automatic or absolute about a patent holder's remedies. Obtaining injunctions to stop others from making and selling their inventions requires patent holders to persuade the court that the specific circumstances of each case justify the exclusion.

The Supreme Court's unanimous *eBay* decision has widely influenced lower courts in patent infringement cases to issue fewer injunctions. The result has been more competition. But since the decision has not been understood in terms of competition, its mandate has gone unrecognized in antitrust cases.

It makes perfect sense to apply *eBay*'s patent logic to antitrust cases like the *Solvay* suit because the legal questions and economic stakes are the same. In both, patent owners seek judicial enforcement of efforts to restrain competition on the grounds that a patent justifies the restraint. But rightly understood, the *eBay* decision would require the branded drug maker in *Solvay* to persuade the court that the settlement agreement, particularly the pay-for-delay provision, meets patent law's test to enjoin competitors – that on balance, the benefits and harms, public and private, tip in favor of keeping the generic drug makers off the market. Only then would the settlement "fall within the scope of the patent," as prescribed by the Supreme Court in its *eBay* decision.

In antitrust cases like *Solvay*, this balancing test would call for courts to reject the settlement agreements. Rejecting them would not cause irreparable harm to the drug companies; they would still have their lawsuits and the full range of private legal remedies. The remaining issue would be whether it is in the public interest to reject them. Here too there is no doubt: The public would benefit from rejecting settlements that keep generics off the market. In short, the balance would clearly tip in favor of rejecting pay-for-delay settlement agreements. The result of applying *eBay's* patent logic to cases like *Solvay* would be more trials on the merits in drug patent infringement suits, trials that so far have invalidated patent claims more than seventy percent of the time.

Seventy percent more competition in the drug market would lower health care costs by as much as \$3.5 billion dollars annually. That is precisely what Congress intended when it expedited the FDA approval process for generic drugs. It is time to make antitrust and patent law work together, time to stop the drug companies from subverting the competitive process.

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Competition *within* Intellectual Property Regimes -
The Instance of Patent Rights

Rudolph J.R. Peritz*

Introduction

This chapter describes an emergent jurisprudence and a residual economics that converge to support the reconceptualization of U.S. patent policy as a competition regime. Its approach is inspired by an opinion that Justice Sandra Day O'Connor wrote for a unanimous Supreme Court some twenty years ago. The Court's recent patent jurisprudence sounds an echo of the opinion, which described the foundation of patent policy this way: "[F]ree exploitation of ideas will be the rule, to which the protection of a federal patent is the exception." There is, Justice O'Connor explained, a "baseline of free competition upon which the patent system's incentive to creative effort depends."

The chapter develops this proposition in three sections. The first explicates the economics of incentive theory, both its limits and its residual value. The second analyzes the jurisprudence of recent decisions by the Supreme Court and Federal Circuit Court of Appeals – the speciality court for patent and trademark. The third section presents some

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instances of progressive change that would come of extending the re-conception of the patent system as fundamentally a competition regime, an extension inspired by Justice O'Connor's image but informed by the failure of incentive theory as the economic logic for patent protection.

A. Crisis, Stalemate, and Progress

Intellectual property¹ protection and free competition have long been viewed as alternative means to encourage inventive activity and, through it, promote progress in the form of economic growth. Their relationship as means has sometimes been characterized as conflicting and other times as congruent. The same can be said about the progress they are intended to promote. In the United States, mainstream policy cabins these tensions of means and ends by treating IP protection as a domain of exclusionary rights and by removing free competition to a separate domain, to the domain of antitrust. With this bifurcation, the problem has been largely transformed into a question of adjudicating the relationship between two separate bodies of public policy.

Nonetheless, some competition doctrines linger within the IP realm. These doctrines, such as patent misuse and copyright fair use, have been characterized as intruders in the domain of exclusionary rights. Patent misuse is labeled an historical anomaly that properly belongs in antitrust, if anywhere at all, while copyright fair use is described as an interloper – either an alien article of political faith in First Amendment Speech Rights or a commercial artifact of market failures that temporarily limit the author's fundamental right to exclude.² Since the 1980s, IP policy makers have settled the problem of

¹ Unless otherwise specified, intellectual property refers only to the patent and copyright statutes enacted by Congress in accord with the Constitution's call to promote progress, though the term can plausibly be understood as referring as well to trade secret and trademark protection insofar as they have been increasingly justified in similar instrumentalist terms. The distinction is made in this chapter because the analysis of the patent domain takes account of Constitutional origin.

² See e.g., DJ Gifford, 'Antitrust's Troubled Relations with Intellectual Property' (2003) 87 *Minnesota Law Review* 1695 (patent); WJ Gordon, 'Fair Use as Market Failure: A Structural and Economic Analysis of the Bctamax case and its Predecessors' (1982) 82 *Columbia Law Review* (copyright).

malingering doctrine by favoring exclusionary rights over free competition and by proptertizing and otherwise extending IP rights.

This dynamic of bifurcation, preference, and expansion rests on the asserted superiority of exclusionary rights over open access in encouraging invention, a superiority that derives from reliance on an IP economics that holds neither in theory nor in practice.

There has long been trouble brewing in the IP economics that prevails in the United States. The trouble with IP economics recently reached the boiling point with an admission by William Landes and Richard Posner, the Chicago School's dynamic duo of law and economics, the admission that there is no ground for the dominant view of IP economics, no ground for the view that incentive theory can justify, explain, or rationalize IP rights. They made this confession in their book entitled *The Economic Structure of IP Law*.³ The book has received wide attention and much praise. But the public confession of incentive theory's failure has been largely ignored.

At virtually the same moment, a related but separate development was bubbling to the surface of IP jurisprudence: In a recent series of surprising opinions, the U.S. Supreme Court weakened patent protection and in the process expanded the role of free competition as an internal engine for promoting economic progress. The opinions were surprising because they run against the dominant view that pits an IP domain of exclusionary rights against an exogenous antitrust domain of free access. The recent opinions have destabilized this binary opposition between IP rights and free competition.⁴

³ WM Landes & RA Posner, *The Economic Structure of Intellectual Property Law* (2003).

⁴ This chapter takes up patent law as a competition regime, a theme that with respect to copyright, trade secret, and trademark as well is explored in my earlier writing, beginning with *Report to the IP Academy of Singapore* (2002-2003) (revised and published sub nom 'Competition Policy and its Implications for Intellectual Property Rights in the United States' in SD Andcrman (ed) *The Interface Between Intellectual Property Rights and Competition Policy* (2006) and variously investigated in other writing. The theme is a special case of the complex relationship between property rights and competition policy in American political economy, which I first developed in the domain of antitrust; see, e.g., 'A Counter-History of Antitrust Law' in Symposium: *The Frontiers of Legal Thought* (1990) *Duke Law Journal* 263; 'The "Rule of Reason" in Antitrust Law: Property Logic in Restraint of Competition' (1989) 40 *Hastings Law Journal*

In tandem, the failed economics and unstable jurisprudence have thrown the dominant approach to IP rights into crisis. The crisis is an emergent form of a long-term problem at the heart of both the economics and the jurisprudence, and it cannot be easily resolved.

On the economics side, informed policy makers have long recognized that economic progress is driven by the twin engines of IP monopoly and free competition. As economist Kenneth Arrow wrote in his landmark 1962 paper, the great difficulty lies in determining an optimal balance between them. Economist Joseph Schumpeter had earlier sought to merge the two engines in his vision of competition as serial monopoly, his perennial gale of creative destruction.⁵

As for the jurisprudence, the U.S. Constitution presents a corresponding legal challenge to balance the exclusionary rights of IP protection and the open access of free competition.⁶ The Constitution empowers Congress to enact copyright and patent protection for the explicit purpose of promoting “the Progress of Science and useful Arts.” So copyright and patent are not rewards, not natural rights. They are incentives – private means to a public end. But when does the private incentive of property protection promote the public benefits of progress? In both economic and jurisprudential terms, when does such protection produce more progress than would otherwise accrue with free

285, excerpted in ET Sullivan (ed) *The Political Economy of the Sherman Act: The First Hundred Years* 116 (1990) 116, reprinted in R Graves (ed) *Competition Law* (2003), reprinted in *Competition Law* (2004). The theme was extended to other domains in *Competition Policy in America: History, Rhetoric, Law* (1996, 2001). This chapter on patent policy is part of a larger project, whose working title is *The Political Economy of Progress: IP Rights and Competition*.

⁵ Schumpeter, *Capitalism, Socialism and Democracy* ([1942] 3d ed 1950); KJ Arrow, ‘Economic Welfare and the Allocation of Resources for Invention’ in R. Nelson (ed) *The Rate and Direction of Inventive Activity: Economic and Social Factors* (1962) 609. It should be noted that Arrow wrote about invention while Schumpeter emphasized innovation – that is, the commercialization of invention.

⁶ United States Constitution, Art. I, Sec. 8, cl. 8 states: “Congress shall have Power: . . . To promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries.”

competition? The answer to this question has proved elusive to both theorists and empirical researchers.⁷

Despite this indeterminacy, mainstream IP economics still rests on incentive theory, which holds that the scale and scope of IP rights should be determined by the degree to which they promote economic progress. Incentive theory's incapacity to guide such determinations results in an analytical stalemate between the exclusionary rights of IP protection and the open access of free competition, a stalemate because both produce economic growth but to indeterminable degrees. In this light, neither alternative deserves priority as the better means to promote economic progress.

This stalemate, this open question at the very core of IP policy, has put analysts and decision makers, including federal judges, between a rock and a hard place: On the one side, policy makers are pressed to make decisions; on the other, they are blocked from making reasoned decisions because there is no analytical methodology at hand. Policy makers have sought to extricate themselves from this predicament by taking a fall-back position, the position that maximizing the means maximizes the ends, that greater IP protection naturally leads to more invention and thus to more progress. In my view, this fall-back position explains the so-called propertization of IP rights, the normative shift to a Lockean entitlement from an instrumentalist (or means-ends) evaluation.

This fall-back into natural rights is not surprising, given the powerful ideology of private property rights in the United States. But it makes no logical sense. Nor is it supported in theory or fact. Indeed, it is well-known that too much IP protection as well as too little can stifle invention and impede economic progress. So both the economics and the law present IP policy makers with a Goldilocks problem. But there is no calculus for determining what amount of IP rights is 'just right,' particularly in a unitary system that does not discriminate among different kinds of inventions. And, of course, there is the

⁷ For close analysis of these issues, see my *Essay*, 'Thinking about Economic Progress: Arrow and Schumpeter in Time and Space' in J Drexel (ed) *Liber Amicorum: for Hanns Ulrich* (2009).

other side of the indeterminacy coin: Economic justification is equally lacking for simply eliminating IP rights entirely as a means for encouraging invention and thus promoting economic progress.

So, what's to be done? In my view, the answer is clear: Change the fall-back position. Reverse the presumption. When confronted with jurisprudential or economic indeterminacy, adopt the presumption that free competition better promotes the progress called for by constitutional directive. Given the indeterminate economic value of both free competition and IP rights in encouraging invention, policy analysis should begin with the presumption of free competition. In choosing between two rules or standards, policy makers should adopt the one that better expresses the policy of free competition.

Why adopt the presumption of free competition? In economic terms, because competition produces a tie-breaker for its indeterminacy stalemate with IP rights. The tie-breaker is competition's superior distributional outcome. When patents and other IP rights produce monopoly prices, they create welfare losses in both static and dynamic terms. In the short run, consumers pay higher prices or go to second best substitutes. In the longer run, subsequent inventors also pay higher prices or turn to second best substitutes, causing some combination of decline and path-diversion in follow-on inventive activity.⁸ In this light, a rule or policy that would strengthen IP rights should first be shown to promote greater progress than would otherwise occur.

B. Patent Economics: Incentive Gap, Stalemate, Presumption of Free Competition

This part begins by examining the state of mainstream IP economics in the United States, particularly the failure of incentive theory as the economic justification for IP protection,

⁸ The dynamic effects are a decrease in inventor welfare that results from the increased cost of new information or the denial of access at any price. See Peritz (n 67 below).

and proceeds by sketching the IP economics that remains viable. The section closes with discussion of the IP economics of competition.

Incentive theory and its critiques

In the United States, the current economics of progress has adopted a mythical origin not unlike that of Athena, the Greek goddess of wisdom and culture who sprang fully formed from the head of Zeus. Like Athena, the economic logic of progress is seen as springing fully formed from the divine thinking of Kenneth Arrow, whose eminence was established even before his award in 1972 of a Nobel Prize in Economics. His eminence stems from his canonical 1962 paper entitled *Economic Welfare and the Allocation of Resources for Invention*.⁹

Of course despite such mythology, there is a substantial pre-history that posed fundamental questions and deep criticism of IP protection, much of it still pertinent today. Virtually all the questions emerged in the widespread European debates of the 19th century over patent protection; many of the criticisms were sharpened in the trenchant analysis of Sir Arnold Plant in his 1934 article entitled *The Economic Theory Concerning Patents for Inventions*¹⁰ and in a companion piece on copyright. Plant raised many of the searching questions later addressed by American economists. The most difficult question concerned the opportunity cost of invention. Plant asked, when is use of society's resources to invent "superior to alternative uses from which they are diverted[?]"

The opportunity cost of invention opens a wide gap in the incentive logic of IP rights, a gap between the private value and the public benefits of IP rights. There is little doubt that IP rights create a private incentive to invent: indeed, few could afford simply to give

⁹ Arrow (n 5 above).

¹⁰ Plant, *Selected Economic Essays and Addresses* (1974 [1934]) 35. Cf. F Machlup and E Penrose, 'The Patent Controversy in the Nineteenth Century', (1950) 10 *Journal of Economic History* 1 (chronicling the European debates).

time to the enterprise of invention without remuneration. Yet the private value of IP rights has no necessary logical or economic relationship with their public benefits, benefits that depend on a wide array of factors. The opportunity cost of invention is but one powerful admonition to take account of what can be called the Incentive Gap. Ignoring it produces the category error of equating IP rights' private value with their public benefits. Taking the Incentive Gap into account transforms the question into an empirical inquiry.

None of this had noticeable impact in the United States before economist Fritz Machlup authored his 1958 Report to Congress, entitled *An Economic Review of the Patent System*. His was the most influential of 15 reports commissioned by a Congress concerned whether the costs of the patent system were justified. Here is Machlup's summary of the economic literature:

None of the empirical evidence at our disposal and none of the theoretical arguments presented either confirms or confutes the belief that the patent system has promoted the progress of the technical arts and the productivity of the economy.¹¹

What's to be done? "Muddle through," wrote Machlup. Why? Because there has been "a patent system for a long time," he declared, "it would be irresponsible, on the basis of our

¹¹ Study of the Subcommittee on Patents, Trademarks, and Copyrights of the Senate Judiciary Committee, 85th Cong., 2d Sess., *An Economic Review of the Patent System*, Study no. 15 (Comm. Print 1958) (written by Fritz Machlup) (hereinafter "Machlup Report") 79. The Machlup Report observes that "there is no functional relation between the earnings under a patent . . . and the 'social usefulness' of the invention which it covers." Machlup Report at 30. In this line of analysis, the Machlup Report observes that "The question is no longer whether the patent system stimulates inventive talents to use more of their time and energy than they otherwise would for the development of new technology, but rather whether it stimulates business corporations to hire more of these talents than they otherwise would for this task. If this is affirmatively answered, the second question arises whether this use of the talents is superior to the alternative uses from which they are diverted." Ibid 36. Note that this is a modern form of the question posed in the 19th century European debates about what we would term the opportunity costs of diverting scarce resources. Cf. Peritz, 'Patents and Progress: The Incentive Conundrum,' in A Kur (ed) *Intellectual Property Rights: Does one Size Fit All?* (2009) (2008 ATRIP Annual Conference, Max-Planck Institute, Munich, Germany, 21 July 2008).

present knowledge, to abolish it.”¹² There could be no weaker rationale for keeping patent protection.

It was under this cloud of indeterminacy that Kenneth Arrow published his landmark paper four years later. Like so many other sacred texts, Arrow’s paper has become the touchstone for theorists and others who identify themselves with the orthodox approach as well as those who oppose it.

Arrow questioned the impact of competition on incentives to invent. For economists, perfect competition is the Holy Grail. Its miraculous power produces allocative efficiency by taking society’s resources and putting them to their highest and best uses. But Arrow argued that perfectly competitive markets fail. They fail by discouraging inventors from inventing.

Arrow’s story has become a commonplace: Without patent protection, inventions are easily copied or imitated. Free access to their ideas discourages inventors from inventing and, thus, harms society. Patent rights correct this market failure by allowing inventors to profit and society to benefit from increased invention. Patent protection and the profits it generates are the means to an end. Patents are private rights that produce the public benefits of technological advancement and economic progress.

The dominant camp relies on the following quotation to support their call for stronger patent protection:

[Invention that is] . . . available free of charge . . . provides no incentive for investment in research.¹³

Those who call for more access and thus more competition rely on this quotation:

¹² Machlup Report (n 11 above) 80.

¹³ Arrow (n 5 above) 609.

. . . the incentive to invent is less under monopolistic than under competitive conditions.¹⁴

Both statements are accurate quotations from Arrow's landmark article. So it turns out both camps are right; and both are wrong. Why? Because reliance on one or the other quotation ignores Arrow's recognition that an incentive theory of patent protection creates a dilemma for welfare economics. The dilemma is that both patent rights and competition promote economic progress. And both impede it. Here is how Arrow described the dilemma:

In a free enterprise economy, inventive activity is supported by using the invention to create property rights; precisely to the extent that it is successful, there is an underutilization of the information.¹⁵

In short, patent protection is the private incentive necessary to spur invention and at the same time the social cost that prevents its optimal use. Arrow transformed this dilemma of IP rights and competition into a trade-off over time: Pay more now for better products in the future.¹⁶

Let's call this Arrow's Trade-Off. Arrow posed the social welfare question as a trade-off over time insofar as the current costs of patent monopoly pay for the future benefits of increased invention.

¹⁴ Ibid 619.

¹⁵ Ibid 617.

¹⁶ "[A]n incentive to invent can exist even under perfect competition in the product markets, though not, of course in the 'market' for the information contained in the invention." Arrow at 619. In his hypothetical world, Arrow does even better than transform a dilemma into a trade-off. He creates a model that neatly eliminates the present cost of the trade-off. He posits perfectly monopolistic markets for invention that provide inventors the greatest profit incentive and buyers in perfectly competitive markets for goods provide consumers the widest distribution at the lowest price. It's the best of all possible worlds though it is not the real world. In the real world, monopoly prices do not dissolve into the thin air of economic models. The hypothetical is perfected by Arrow's assumption that the invention is a new process that provides cost savings in the goods market that equal the monopoly prices paid for the new invention. Thus price and output in the goods market are not affected. Neat and tidy. But unlikely and perhaps economically illogical. See Peritz, *Arrow and Schumpeter in Time and Space* (n 7 above).

But in the end, Arrow's Trade-Off encompassed only part of the problem of IP's social value. It addressed the narrow question of IP's private value and its relationship to direct public costs and benefits but not its indirect effects, including opportunity costs. In consequence, the analysis did not speak to the Incentive Gap between the private value and the overall public costs and benefits of IP protection. The subsequent economic literature continued to pursue the broader question. But the theoretical scholarship largely rehearsed the European debates and Arnold Plant's economic analysis.

Empirical investigation

Ultimately the theoretical impasse resolved into empirical inquiry. What of the empirical literature that followed?¹⁷

A wide array of studies, almost all involving patents, developed various data sets to investigate different proxies for economic progress. Researchers have interviewed corporate decision makers; they have measured research and development expenditures and patenting activity on the input side, and productivity gains and economic growth on the output side. Studies have looked at single sectors, individual countries, and across countries.

The longest series of studies developed interview data from senior executives in the research and development departments of commercial firms. Five studies between 1959 and 2001 all reached the same conclusion: The prospect of patent protection was typically a factor of third or fourth order importance to research and development decisions, with the exception of the drug industry and perhaps chemicals. Still, it must be understood that these studies investigated only the private value of patents; neither public benefits nor public costs were addressed.

¹⁷ A working paper that takes a closer look at the literature is available from the author: 'Patents and Progress: The Incentive Conundrum' (2008).

Other recent studies *have* inquired into the public benefits by looking at the relationship between changes in patent protection and changes in research and development expenditures. Japanese and U.S. studies found the data inconclusive. One study across 29 countries found a mild positive correlation and another across 60 countries found a weak negative one. Moreover, the findings have been mixed in studies of statistical correlation between patent protection and the ultimate economic goal of increasing growth.

A rare statistical study of copyright protection has just been published. Relying on data from 1870 to 2006, the authors conclude: “Despite the logic of the theory that increasing copyright protection will increase the number of copyrighted works, the data do not support it.”¹⁸

In sum, the empirical literature on the public benefits of patent and copyright is at best inconclusive.¹⁹ This brings us full circle back to the theoretical impasse that preceded it. Small wonder, then, that so many policy makers in the United States have taken the fall-back position, the mistaken focus on the means itself – on maximizing IP protection in the erroneous belief that progress will be maximized as a natural result.

Patent economics: the residue

¹⁸ RSR Ku, J Sun, Y Fan, ‘Does Copyright Law Promote Creativity? An Empirical Analysis of Copyright’s Bounty’ (2009) 62 Vanderbilt Law Review 1669.

¹⁹ Regardless of findings, all the empirical work confronts methodological difficulties. Here are two. First, the variables used are controversial. The uses of patent counts, citations, or renewal rates as measures of technological progress have all been criticized, as has the use of research and development expenditure data. Simply counting patents, or copyright registrations for that matter, does not take into account differences in their importance and social value. And more R&D spending does not necessarily lead to more or better inventions.

There is a second methodological difficulty – the intractable problem of disentangling patent or R&D data from other sources of economic growth, sources including trade secrets, improved technical education, or increased production, to name a few. A noted American legal scholar put the general methodological problem this way: “If a state of affairs is the product of n variables, and you have knowledge of or control over less than n variables, if you think you know what’s going to happen when you vary ‘your’ variables, you’re a booby.” A Leff, ‘Economic Analysis of Law’ (1974) 60 Virginia Law Review 451 (comparing the first edition of Richard Posner’s *Economic Analysis of Law* to Cervantes’ *Don Quixote*). “Booby” denotes a stupid person.

Where does that leave IP economics? Some alternatives to the mainstream approach have emerged, alternatives ranging from conservative incrementalism to radical repeal. Landes and Posner sit at the conservative end of the spectrum, where they argue that we should try to optimize the system and do the best we can with what we have. Economists Michele Boldrin and David Levine have been the latest to lay claim to the radical end, where they argue that IP rights are not necessary because free competition produces adequate profits to attract the invention necessary to promote economic progress. Of course these positions as well as those between them are not new.²⁰

A moment's tarry at the Landes and Posner position is worthwhile, in my view, because it is likely to become the mainstream position, once the shock of incentive theory's demise has subsided. Landes and Posner take up the view espoused in Machlup's 1958 Report to Congress, the view that while the patent regime *per se* cannot be rationalized, changes can be evaluated for their effectiveness.²¹ For this, Machlup developed a nine-step analysis and provided an example. The example is an increase in the patent term. As the author pointed out, the analysis requires quantitative and qualitative assumptions at every step and, even then, it cannot take into account the opportunity cost of more investment in research and development. In short, even though the more confined analysis of changes in rules or standards benefits from having a defined baseline of current invention levels that is lacking in an analysis of the patent regime *per se*, other problems of experimental design and measurement remain. Machlup concluded that the analysis of whether an increase in the patent term increases economic growth depends on "a complex set of probabilities, the magnitudes of which depend [on] . . . many unknown variables."²²

²⁰ Cf. Peritz (n 11 above).

²¹ Machlup (n 11 above) 64-67, discussed in Peritz (n 11 & 16 above).

²² *Ibid.*

Following Plant and Machlup, Landes and Posner reject incentive theory. In its place they adopt a series of more specific goals emphasizing reductions in, for example, transaction costs, rent seeking, and congestion externalities.²³ In their chapter on patent law, the authors proceed from the general point that patent protection “makes economic sense because it curbs certain inefficiencies unavoidably created by trade secrecy.”²⁴ In their view, those inefficiencies derive from a number of sources, including the following: First, from the very nature of trade secrecy, which keeps information out of the market. Second, from the higher costs of trade secret licensing. But these assertions turn out to be controversial. As to the first, Landes and Posner themselves develop an elegant analysis of the relationship between patent and trade secret that belies the impact on information. In the chapter on trade secrets, they assert patents are preferable only to the extent an invention is self-disclosing or likely to be invented independently.²⁵ That is, patents tend to disclose information that has lowest public value. As to the higher cost of trade secret licensing, the authors identify a number of higher costs associated with patents that seem to offset the advantage in licensing costs. Most telling, patent disclosure may lower the time to invent around or, perhaps worse, enable infringement that triggers expensive litigation with a substantial risk of finding patent invalidity.²⁶

Landes and Posner take the substantive patent regime as a given and seek to optimize its implementation, an enterprise that seems likely to become the mainstream approach even though it is rife with the indeterminacy that devastates incentive theory. In my view, sound economics calls for change in patent policy more severe than fine-tuning.

²³ Congestion externalities reflect a questionable reintroduction of tragedy-of-the-commons logic to public goods. The issue is of questionable importance for two reasons. First, because use of information (or invention, as Arrow called it) does not deplete its supply or quality; in that sense, there cannot be over-use. Second, because privatization presents an analogous problem, if there is one at all, in the form of the anti-commons – often called patent thickets. In sum, congestion is either a two-sided problem that does not resolve the question of propertization or it is no problem at all.

²⁴ Landes and Posner (n 3 above) 294.

²⁵ *Ibid.* 355-56.

²⁶ *Ibid.* 357.

Surprisingly, there might be a place in patent policy for a more limited conception of incentive theory, a conception that takes account of its limitations as well as the primacy of the free competition baseline. In this view, incentive theory becomes a sharp instrument of focused industrial policy, one applied to target particular goals. Patent rules might be changed to channel specific inventive activity toward green technology, cancer research, equality-inducing business methods, or other specific goals. Such targeting would introduce a qualitative dimension to economic progress. These judgments would place bets on particular social welfare consequences, political economic judgments that do not purport to serve the quantitative goal of economic growth. Thus, neither large scale nor narrow gauge cost-benefit analysis would ensue. The question would be whether the added incentive would increase the targeted inventive activity beyond the current rate. But targeted incentives would be bets and would raise difficulties of evaluation discussed above. Still, as Arrow recognized in his landmark paper, governments both here and abroad have long made these sorts of bets.

In addition to the risks of unsuccessful research and development, such judgments bring the danger of unintended consequences. One current example is the unintended anti-competitive impact of the Hatch-Waxman Act, the 1984 amendment to the Food & Drug Act that was intended to increase the incentive to produce patented drugs by extending the patent term and at the same time increase competition by opening the door to early market entry by generics manufacturers who claimed their generics did not infringe valid patents. In actual experience, such generic filings are quickly answered with patent infringement cases filed by branded manufacturers. These cases have often produced settlements that include reverse payments of large sums from plaintiff branded pharmaceutical companies to defendant generics manufacturers in exchange for promises to keep their generic drugs off the market. Courts have approved the settlements and rejected antitrust claims of agreements in restraint of competition, finding them not only consistent with the general law that encourages settlements but also within the exclusionary rights of the contested patents. In consequence, consumers pay billions of dollars in higher prices and follow-on inventors are given the perverse incentive to invest

resources that position them to litigate and settle rather than develop and commercialize generic drugs.²⁷

Certainly, patents can serve as a more focused instrument for targeted industrial policy. But even there, risks of failure and unintended consequences call for careful analysis to overcome the presumption that free competition better serves the goal of promoting progress.²⁸ While the dynamic efficiency effects of both free competition and patent rights are indeterminate, distributional effects provide a tie-breaker. Patents that actually have economic value produce monopoly prices and, with them, welfare losses in both static and dynamic terms. Not only consumers but subsequent inventors are worse off. In this light, a rule or policy that would strengthen patent rights should first be shown to promote greater progress than would otherwise occur.

C. Patent Jurisprudence: Ends, Means, Emergent Emphasis on Competition

The frailties of patent economics leave policy makers in a quandary. On the one hand, there is no economic justification for patent protection as the primary means for promoting economic growth. Indeed, the residual economics points to free competition as the presumptive means. On the other hand, the constitutional instruction remains: Congress and the judiciary must formulate patent policy to promote progress. How can policy makers advance the constitutional purpose of patent protection in light of the economics?

²⁷ See, e.g., Peritz, 'Three Statutory Regimes at Impasse: "Reverse Payments" in "Pay-for-Delay" Settlement Agreements between Brand-Name and Generic Drug Companies' in J Drexler, W Grimes, RJR Peritz, and E Swaine (eds) *More Common Ground for International Competition Law?* (forthcoming 2010); CS Hemphill, 'Paying for Delay' (2006) 81 *New York University Law Review* 1553 ; C Shapiro, 'Antitrust Limits to Patent Settlements' (2003) 34 *RAND Journal of Economics* 31; M O'Rourke & JF Brodley, 'An Incentives Approach to Patent Settlements' (2003) 87 *Minnesota Law Review* 1767.

²⁸ In some circumstances, including the FDA example, there is no free competition to presume; there, the question becomes one of betting that one targeted incentive is better than its alternatives.

This section takes up patent jurisprudence, whose constitutional quandary is reflected in a pair of tensions in means and ends. The tension in means has been expressed in dominant and emergent strains of the jurisprudence. While the dominant strain continues to treat patents as the primary engine for promoting progress, an emergent alternative has recognized competition as the primary engine or, at the very least, an instrumentality that deserves more recognition for its value in promoting progress. These strains parallel the tension in means earlier seen in Arrow's Trade-Off. At the same time, a second tension, this one in ends, lies entirely within the dominant approach. It is a tension between the goals of more public knowledge or more material benefits. After unravelling these tensions, the section closes by organizing the jurisprudence according to what can be called the patent life cycle. Patents are shown to move through a life cycle in three stages, each one characterized by its own mix of means and ends, and all of them driven by a fundamental commitment to competition.

The dominant approach: an internal tension in ends

The Supreme Court has long declared that patent policy is founded on an incentive theory: "Since the primary aim of the patent laws is to promote the progress of science and useful arts, an arrangement which diminishes the incentive is said to be against the public interest."²⁹ Last year the Federal Circuit Court of Appeals characterized an amendment to the Patent Act as a "legislative effort to reinforce the value of the patent statute as an innovation incentive."³⁰ Although these pronouncements might seem to be synonymous statements of patent policy, they are not. There is a subtle but significant difference between them.³¹ While the Supreme Court addressed the general enterprise of promoting progress, the Federal Circuit focused on innovation, which reflects only one aspect of progress. Innovation is not invention but rather its commercialization. The

²⁹ *Transparent-Wrap Mach. Corp. v Stokes & Smith Co.*, 329 U.S. 637, 646 (1947) (Douglas, J.)

³⁰ *Cardiac Pacemakers, Inc. v St. Jude Medical, Inc.*, 576 F.3d 1348, 1371 (Fed. Cir. 2009).

³¹ There is a second subtle difference as well: note that the Supreme Court writes that "an arrangement which diminishes the incentive *is said to be* against the public interest." The Court is careful to avoid the implication that it adopted this view. This is consistent with the skepticism expressed in the text accompanying the next footnote.

distinction between invention and innovation is important in two respects. First, because attracting investment to innovation can draw investment away from invention. Second, because a focus on innovation defines the primary form of progress as material advancement of day-to-day life through commercial development of extant invention.

Indeed, the Federal Circuit's focus on material advancement diverges from numerous statements by the Supreme Court that "[t]he primary purpose of our patent system . . . is directed to disclosure of advances in knowledge which will be beneficial to society; it is . . . an incentive to disclosure."³² In other words, patents make public new knowledge which would otherwise be hidden under the blanket of trade secrecy. The public value of new knowledge goes beyond the Enlightenment virtue of edification. It has use value for follow-on inventors: Disclosure reduces the costs of competition by invention. Moreover, it accelerates the learning curve. In short, the public benefit of disclosure is the free competition that results from free riding on the patented efforts of prior inventors.³³

This divergence is embedded in the Constitution's language of promoting the "Progress of *Science* and *useful Arts*." A twenty-first century restatement of the constitutional

³² "The primary purpose of our patent system is not reward of the individual but the advancement of the arts and sciences. Its inducement is directed to disclosure of advances in knowledge which will be beneficial to society; it is not a certificate of merit, but an incentive to disclosure." *Sinclair & Carroll Co. v. Interchemical Corp.*, 325 U.S. 327, 330 (1945). "The basic quid pro quo contemplated by the Constitution and the Congress for granting a patent monopoly is the benefit derived by the public from an invention with substantial utility." *Brenner v. Manson*, 383 U.S. 519, 534 (1966). ". . . the public may have the full benefit thereof, after the expiration of the patent term." *Bonito Boats, Inc. v. Thunder Craft Boats, Inc.*, 489 U.S. 141, 147 (1989).

Yet the Supreme Court has long expressed some skepticism about the incentive value of IP rights. For example, in the *Marconi Wireless* case of 1943, the Chief Justice remarked: "For all I know the basic assumption of our patent law may be false, and inventors and their financial backers do not need the incentive of a limited monopoly to stimulate invention. But whatever revamping our patent laws may need, it is the business of Congress to do the revamping." *Marconi Wireless T. Co. of America v. U.S.*, 320 U.S. 1, 63-4 (1943).

Economic analysis of disclosure: Patent right and disclosure obligation is the right strategy for those inventions not adequately protected as trade secrets. In this light, patented inventions are those most likely to be disclosed anyway and so public really gains very little if anything. Note tension between this account and traditional norms and incentives to disclose in scientific community, tensions increased with increased proprietization and thus incentive to withhold disclosure until patent application filed. Note also patent doctrine's disincentives to read patents, especially intentional infringement liability for multiple damages.

³³ Of course the incentive problem re-emerges. Should patent rights be shaped to encourage publication of new knowledge or encourage internalization of pecuniary benefits?

language calls for promoting the progress of *knowledge* and *industrial technology*. Yet courts have seldom been asked to adjudicate the relationship between advancing knowledge and advancing the material conditions of every day life. Here are two examples of court decisions whose outcomes turn on the choice of primary public benefit.

The first example involves a dispute between two researchers who filed patent applications for the same pharmaceutical compound. The first to file was a biochemist for a Japanese company but the first to invent was a professor at Cornell Medical School. As a general rule, patents in the United States are awarded to the first to invent. The time of invention dates back to the moment of conception. In the U.S. patent system, the first to conceive the idea is supposed to win. It matters not who files first.

The professor should have won. But he lost. Why? The court refused to apply the standard U.S. rule because it determined the professor did not proceed with “reasonable diligence” from the time he conceived the new idea to the time he reduced it to a practical invention. In the court’s view, there was unreasonable delay in his waiting for outside research funding and for his chosen graduate student to enter the program. Confronted by a conflict between “the interest in rewarding and encouraging invention [and] the public’s interest in the earliest possible disclosure,”³⁴ the court chose “earlier disclosure over earlier invention” because it saw “early public disclosure [as] the “linchpin of the patent system.””³⁵ The outcome appears very European or very Japanese insofar as the first to file was awarded the patent. But the rationale reflects a uniquely American issue

³⁴ *Griffith v Kanamaru*, 816 F.2d 624 (Fed. Cir. 1987). More specifically, the date of invention generally relates back to the date of conception. The first inventor is the first to conceive the idea. But here, there was the unacceptable delay between the professor’s conceiving the idea and his reducing it to practice. And so the reduction date was treated as the date of invention. As for the commercial researcher, there was no evidence to support either a date of conception or a date of reduction – both of them irrelevant in the Japanese as well as EU patent regimes. And so the patent filing date was used as the date of invention. The filing date preceded the professor’s reduction date, each of them proxies for the date of invention.

³⁵ *Horwath v Lee*, 564 F.2d 948, 950 (Crt Customs & Patent App. 1977).

characterized as a conflict between the goals of advancing knowledge and advancing industrial technology.³⁶

The second example of patent jurisprudence that seeks to adjudicate this conflict of ends is even more dramatic. It is more dramatic because it involves the entire relationship between the patent and trade secret regimes, between the federal requirement of patent disclosure and the state trade secret requirement of secrecy. In the United States, the Constitution expresses a general principle of harmonization in what is called the Supremacy Clause. When a state law conflicts with federal law, the federal law prevails; the state law is unconstitutional and thus unenforceable.

In practical terms, the Supreme Court had to find a way to harmonize two regimes that had co-existed for more than 100 years; throwing out the trade secret laws of 50 states was unacceptable.³⁷ What to do? The Court characterized patent and trade secret protection as harmonious because they both encourage technological advancement. In this view, they share the same goal. As for the conflict in disclosure, the Court reduced its importance to triviality by asserting without foundation that an inventor would always choose stronger patent over weaker trade secret protection. But in some circumstances trade secrecy can provide stronger protection. Indeed, market studies have found that many inventors prefer trade secret protection for reasons IP economics, including the work of Landes and Posner, has made clear.³⁸

³⁶ Before going to my second example of the conflict between encouraging invention and encouraging its disclosure, between advancing technology and advancing knowledge, I want to take a quick look at the court's treatment of reasonable diligence. The professor's seeking necessary outside funding and waiting the return of his graduate student does not seem unreasonable per se. Still, the court refused these typical academic reasons, stating that only personal reasons such as family illness, personal finances, or vacation time would excuse delay, even though arguments were made that outside funding was a university research policy to validate projects through outside competitions for funds. In that sense, there was no delay but rather another kind of evaluation or even competition that was going on. Without explanation, the court seemed much more approving of the commercial research environment.

³⁷ *Kewanee Oil Co. v. Bicon Corp.*, 416 U.S. 470 (1974).

³⁸ See discussion accompanying (n 58 below) for the economic analysis of Landes and Posner on strategic choices between trade secrecy and patent protection.

And so the orthodox patent jurisprudence has sought to mediate a tension within the constitutional incentive logic of promoting progress, the tension in ends between advancing knowledge and improving the material conditions of life. The mediation has affected adjudication of questions both narrow and broad – our two examples, the narrow question of whom to deem the inventor of a particular product and the broad question of how to characterize the relationship between the patent and trade secret regimes. In each case, the choice of end affected the outcome, changed the circumstances of inventive enterprise, and defined the conditions of competitive activity – first in prosecuting patent applications and second in making strategic choices between patent or trade secret protection.

The emergent approach: three recent patent cases and their countenance

While the dominant approach has grappled with a conflict in ends, the constitutional logic for promoting progress has produced a second tension as well. Recent Supreme Court jurisprudence has shown signs of an approach different from the orthodoxy, an emergent approach that raises questions about patent protection as the presumptive means for promoting progress, questions that parallel those raised in IP economics. This emergent approach is more properly termed a re-emergent strain of IP jurisprudence insofar as the recent decisions summon the policy stated in Justice O'Connor's opinion some thirty years ago for a unanimous Court, the statement that there is a "baseline of free competition upon which the patent system's incentive to creative effort depends." In short, "free exploitation of ideas will be the rule, to which the protection of a federal patent is the exception."³⁹

This line between patent monopoly and free competition is drawn by the statutory requirements for patentability, most notably the requirement that a patented invention be

³⁹ *Bonito Boats, Inc. v Thunder Craft Boats, Inc.*, 489 U.S. 141, 145-7 (1989). Note that Justice O'Connor poses the baseline imagery within the orthodox view of incentive theory. But, as the first section demonstrates, the baseline metaphor itself has an economic logic that does not depend on the orthodoxy.

nonobvious in light of prior art.⁴⁰ Beginning in the 1980s, the nonobviousness requirement was increasingly trivialized. For example, in 1999, the Federal Circuit Court ordered that the U.S. Patent Office issue a patent to an applicant who decorated large black plastic garbage bags with orange pumpkin faces. The Federal Circuit declared that this combination of garbage bags and Halloween decoration, each element itself obvious, was a nonobvious combination that merited a patent.⁴¹ In 2003, the Federal Trade Commission issued a widely praised Report criticizing patent protection's descent into triviality.⁴²

Then, in 2007, the Supreme Court published the *KSR* decision, which elevated the nonobviousness requirement for the largest category of patents, those like the Halloween garbage bag that involve combinations of prior art. The decision instructed the Patent Office to reject applications for combination that show only "ordinary creativity."⁴³ The Patent Office has since rejected on the ground of obviousness a number of applications for combination patents, and the courts have regularly upheld those rejections.

The Court in *KSR* took issue with the Federal Circuit's "transform[ation of a] general principle into a rigid rule that limits the obviousness inquiry." The patent principle holds that a combination is obvious to "a person of ordinary skill in the relevant field" when the prior art "demonstrate[es] a teaching, suggestion, or motivation to combine known elements" into that combination.⁴⁴ The Federal Circuit rigidified the principle "by overemphasis on the importance of published articles and the explicit content of issued patents." This approach failed to take account of "common knowledge and common

⁴⁰ Patent Act § 103(a).

⁴¹ *In re Dembiczak*, 175 F.3d 994 (Fed. Cir. 1999).

⁴² See Federal Trade Commission, "To Promote Innovation: The Proper Balance of Competition and Patent Law and Policy" (Oct. 2003) <<http://www.ftc.gov/os/2003/10/innovationrpt.pdf>> accessed 4 December 2007; see also, JH Barton, 'Non-Obviousness' (2003) 43 *IDEA: The Journal of Law and Technology* 475; Working Group on the New Economy, American Antitrust Institute, *Antitrust and the New Economy: Comments to the Antitrust Modernization Commission, Washington, D.C.* (July 2005). <http://govinfo.library.unt.edu/amc/public_studies_fr28902/new_economy_pdf/050715_AAI-New_Economy.pdf> accessed on 31 May 2010.

⁴³ *KSR Int'l. Co. v. Teleflex Inc.*, 127 S.Ct. 1727, 1743 (2007).

⁴⁴ 127 S.Ct. at 1741, 1742.

sense,” which consider a larger body of public knowledge, including “design need and market pressure,” knowledge which seldom finds its way into the literature of prior art. Justice Kennedy observed that a “person of ordinary skill is also a person of ordinary creativity, not an automaton.”⁴⁵ This observation brings to the fore the difficulty of separating ordinary creativity from the non-obvious type because “inventions in most, if not all, instances rely upon building blocks long since uncovered, and claimed discoveries almost of necessity will be combinations of what, in some sense, is already known.”⁴⁶

The practical question, then, is what to do about the great bulk of inventions that lie in the bandwidth between the obviously ordinary and the obviously non-obvious. In expanding the range of references for determining prior art, the Court in *KSR* raised the level of non-obviousness required for patentability. Now, a combination may be found obvious even without a reference in the prior art to “teaching, suggestion or motivation to combine known elements.”

It should be noted that the very process of determining non-obviousness in the course of patent application is in effect a contest in ideas, a competition between prior art and the prosecuted invention. The standard is whether the invention embodies an advance in ideas that is not obvious in the light of prior art. *KSR* raises the level of difficulty for the new arrival to win this competition in ideas.⁴⁷

Given that the heightened standard will exclude a class of combination inventions that met the old standard for non-obviousness but fail the new one, what are the likely effects? Some of the newly obvious combinations, especially those involving processes, can be hidden from public view and, thus, their owners can seek trade secret protection. In this

⁴⁵ *Ibid* 1743 (citing *DyStar Textilfarben GmbH & Co. Deutschland KG v C.I.I. Patrick Co.*, 464 F.3d 1356, 1367 (Fed. Cir. 2006)) (internal quotation marks omitted).

⁴⁶ *Ibid* 1741.

⁴⁷ The statutory requirement of usefulness assures that the invention is not a disembodied idea. 35 USC § 101. For further discussion of this point, see Peritz, “Patents and Progress” (n 11 above).

instance, public information about such combinations will be lost until the secrets are discovered. Owners of newly obvious combinations which are self-disclosing on sale or use will proceed in reliance on licensing provisions, first-mover advantages, or simply the benefits of the new combination when they outweigh the competitive costs of imitation by others. The resulting mix of secret and public combinations is an empirical question.

Moreover, there is a strategic question that sheds some light on the matter. As Landes and Posner have observed, the choice between patent and trade secret protection depends on their relative value.⁴⁸ On the cost side, patents are more expensive to obtain. And patent disclosure provides the very information rivals need to invent around more cheaply or simply infringe when that makes strategic sense. On the benefit side, a patent becomes more valuable than trade secret protection as the risk of disclosure, reverse engineering, or independent invention increases. As a general matter, the inventor is more likely to seek patent protection for inventions that are more likely to become public knowledge or otherwise legally available to rivals. Inventions whose secrecy is more readily maintained are less likely to be patented.⁴⁹

In sum, *KSR*'s heightened standard for non-obviousness increases the play of competition, either immediately by direct imitation or eventually by investigation, independent discovery, or reverse engineering. The Court has denied patent protection for inventions that reflect only "ordinary creativity" and, in consequence, expanded access to inventions that were protected under the old rule.⁵⁰ The result is that competitors now

⁴⁸ Landes and Posner (n 3 above) 354-71. Note as well that patents are less expensive to maintain and license.

⁴⁹ In this light, the loss of public knowledge from patent publication should not be overestimated. Nor should a decline in public knowledge resulting from the heightened standard of patentability.

⁵⁰ The extent of access to competitors under the new approach deserves further comment insofar as it depends on the character of prior art embodied in the combined elements. If no elements are protected by patents still in force, then access to the new combination is entirely free and competition is simply extended. If, however, any element is still protected, then use of the new combination requires a license from each patent holder. But no patent license is required to practice the combination. The net effect in either case is free access to the combination and, with it, lower bargaining and licensing costs. In all circumstances, however, the intervention of trade secret protection must be taken into account, with consequences as described in the discussion accompanying this footnote.

have free access to make, use, and sell inventions that would have been protected by combination patents under the lower level of creativity.

In a second recent patent decision, a unanimous Supreme Court in *eBay* tightened the requirement for obtaining an injunction against a patent infringer. A more stringent requirement means that infringing competitors are not so easily restrained from making, using, or selling patented inventions; instead, the remedy of compulsory licenses opens competition to patent infringers who would otherwise have been excluded from the market.⁵¹

The unified Court in *eBay* once again rejected an instance of the Federal Circuit's rigid jurisprudence of expansive patent rights, this time its "general rule that courts will issue permanent injunctions against patent infringement absent exceptional circumstances." In rejecting this general rule, the Court held that issuance of permanent injunctions summons "familiar principles [of equity that] apply with equal force to disputes arising under the Patent Act."⁵² Justice Thomas' opinion for the Court provides a clear and unembellished basis for a more flexible approach:

As this Court has long recognized, "a major departure from the long tradition of equity practice should not be lightly implied." Nothing in the Patent Act indicates that Congress intended such a departure. To the contrary, the Patent Act expressly provides that injunctions "may" issue "in accordance with the principles of equity."⁵³

While the opinion for the Court does not venture beyond the statutory text and equity doctrine to make plain the outcome, two concurring opinions offer differing policy

⁵¹ *eBay Inc. v MercExchange, L.L.C.*, 126 S.Ct. 1837 (2006). Of course the infringing user must be a reasonable royalty as determined by the court. This can be understood as shifting from the patent holder to the court the power to determine royalties. In consequence, the patent holder cannot hold up would-be competitors in what is typically a one-sided monopoly bargaining scenario that does not promise the efficient solution generally attributed to settlements and bargain contracts more generally, per the Coase Theorem.

⁵² 126 S.Ct. at 1839 (both quotations in the paragraph).

⁵³ *Ibid* (citations omitted).

analysis for support. Both address an issue raised in the opinion by Justice Thomas, particularly in a passage that rejected the Federal Circuit's reasoning for its general rule for issuing permanent injunctions. The Federal Circuit had concluded that the Patent Act's explicit definition of a patent as "having the attributes of personal property," particularly "the right to exclude others from making, using, offering for sale, or selling the invention . . . alone justifies its general rule." Justice Thomas quoted specific statutory language that provides for the judicial discretion associated with traditional equity practice, observing that "the creation of a right is distinct from the provision of remedies for violations of that right."⁵⁴ The two concurring opinions assert sharply different rationales for treating the distinction between the exclusionary nature of property rights and the exclusionary remedy of injunction.

Chief Justice Roberts understood the relationship between right and remedy reflected in the statutory provisions to be reflected in a "long tradition of equity practice" to grant injunctions "upon a finding of infringement in the vast majority of patent cases" on account of "the difficulty of protecting a right to *exclude* through monetary damages that allow an infringer to *use* the invention against the patentee's wishes."⁵⁵ In sum, Justice Roberts was instructing federal judges not to stray from that "long tradition" of recognizing patents as fundamentally property rights to exclude, rights to empower individual choice about how to practice the invention, or whether to practice it at all.

Justice Kennedy in his concurring opinion gave a diametrically opposed rationale for the Court's declaration that the statutory definition of patent as property right does not necessarily define the remedy for its violation. At the outset, Justice Kennedy rejected the Chief Justice's view that the difficulty of fully protecting patent rights with monetary damages underlies a "long tradition" that calls for judges to conserve the property rights in patents. In sharp contrast, Kennedy's opinion looks forward rather than back. It invests the equitable nature of injunctive relief with a progressive ability to adjust to change:

⁵⁴ *Ibid* 1840 (citing 35 U.S.C. §§ 261, 154(a)(1)).

⁵⁵ *Ibid* (joined by Justices Ruth Bader Ginsberg and Antonin Scalia) (emphasis in original).

“[I]n many instances the nature of the patent being enforced and the economic function of the patent holder present considerations quite unlike earlier cases.” Two examples are given: first, “industries in which firms use patents not as a basis for producing and selling goods but, instead, primarily for obtaining licensing fees;” second, “patents over business methods,” which raise significant questions of “vagueness and suspect validity.”⁵⁶ Both examples reflect concerns that patent rights to exclude can be questionable barriers to the market entry needed for competition to flourish.

It is no accident that Justice Kennedy’s source for both examples is the Federal Trade Commission report entitled “To Promote Innovation: The Proper Balance of Competition and Patent Law and Policy.” A balance between access and exclusion is required because experience and economics tell us that both competition and patent rights can promote innovation as well as the invention that precedes it. In this light, injunctive relief for patent infringement should not be granted, particularly to patent trolls or business patent holders, when it results in less progress than competition or compulsory licensing.⁵⁷ Justice Kennedy cautions against the dangers of excessive patent protection and, with it, inadequate regard for competition as a powerful means to promote progress through innovation.

In the third recent case, the competition logic driving Justice Kennedy’s concurrence emerges even more emphatically in Justice Stephen Breyer’s dissent from the *Metabolite* decision. Justice Breyer’s opinion questions the wisdom of dismissing the writ earlier granted in a case that addresses the fundamental patent imperative to “[e]xclude from . . . patent protection . . . laws of nature, natural phenomena, and abstract ideas.”⁵⁸

⁵⁶ *Ibid* 1842 (Justice Kennedy joined by Justices Stevens, Souter & Breyer) (for all quotations in the paragraph).

⁵⁷ *Ibid* (FTC Report).

⁵⁸ *Lab. Corp. of Am. Holdings v Metabolite Labs., Inc.*, 126 S.Ct. 2921, 2922 (2006) (Justice Breyer, joined by Justices John Paul Stevens & David Souter, dissenting from opinion to dismiss writ of certiorari as improvidently granted).

What is so important about this issue? In Justice Breyer’s view, granting a “monopoly over a basic scientific relationship” upsets a careful balance embodied in patent rights: “[S]ometimes too much patent protection can impede rather than ‘promote the Progress of Science and useful Arts,’ the constitutional objective of patent and copyright protection.”⁵⁹

Justice Breyer was concerned about public access to “the basic tools of scientific and technological work” and, as such, to “part of the storehouse of knowledge and manifestations of laws of nature as free to all men and reserved exclusively to none.” The rationale for free access lies in the public policy to promote progress by encouraging “development and the further spread of useful knowledge itself.”⁶⁰

What exactly is this careful balance embodied in patent rights? Justice Breyer incorporates it by reference to Justice O’Connor’s *Bonito Boats* opinion for a unanimous Court:

The Patent Clause itself reflects a balance between the need to encourage innovation and the avoidance of monopolies which stifle competition without any concomitant advance in the “Progress of Science and useful Arts.” . . . [T]he stringent . . . novelty and nonobviousness requirements express a congressional determination that the purposes behind the Patent Clause are best served by free competition and exploitation of either that which is already available to the public or that which may be readily discerned from publicly available material.⁶¹

Justice Breyer was reminding readers that the patent regime begins, as Justice O’Connor put it, with “the baseline of free competition . . . [from] which the protection of a federal patent is the exception.”⁶² And so Justice Breyer concluded his opinion in *Metabolite* with references to competition policy – not only the *Bonito Boats* decision but also the

⁵⁹ *Ibid* 2925 (citations omitted).

⁶⁰ *Ibid* 2923 (citations and internal quotation marks omitted).

⁶¹ *Bonito Boats, Inc. v Thunder Craft Boats, Inc.*, 489 U.S. 141, 146, 150 (1989); *Metabolite*, 126 S.Ct. at 2926 (citing 489 U.S. at 146).

⁶² 489 U.S. at 156, 151.

FTC Report and former FTC Commissioner Robert Pitofsky's article on antitrust and intellectual property rights.⁶³

Each of these patent cases expresses an aspect of an emergent jurisprudence: first, granting rights to exclude competitors only with respect non-obvious inventions; second, determining the propriety of exclusionary remedies by equitable principles rather than by the property logic of patent ownership; and finally, maintaining public access to "laws of nature, natural phenomena, and abstract ideas." Every one of these propositions limits the exclusionary power of patent protection. Each one widens public access to inventions or to the knowledge embodied in those inventions. The result is increased weight attributed to the patent regime's internal policy of free competition as an engine to promote progress.

These recent calls to competition are not exceptional.⁶⁴ Patent monopoly has long been disfavored in the United States. As Thomas Jefferson put it over 200 years ago, the patent system must draw "a line between the things which are worth to the public the embarrassment of an exclusive patent, and those which are not."⁶⁵ Indeed, the Supreme Court is currently considering a closely-watched case that presents questions posed by Justices O'Connor, Kennedy, and Breyer, questions about the scale and scope of patentable subject matter and thus the reach of exclusionary rights in information technology.⁶⁶

The patent life cycle: three stages of competition

⁶³ 126 S.Ct. at 2929.

⁶⁴ For a recent trade dress decision that echoes Justice O'Connor's call to a baseline of competition, see *Wal-Mart v Samara*, 529 U.S. 205, 213-14 (2000). The opinion was written by Justice Antonin Scalia, usually the Court champion of property rights and freedom of contract.

⁶⁵ 13 Writings of Thomas Jefferson (Memorial ed 1904) 335, cited in, e.g., *Bonito Boats*, 489 U.S. 141, 148 (1989). This passage and others suggest the possibility that for the 18th century founding fathers, property rights had a natural incentive effect. In this view, there was no fundamental distinction between property as natural rights and as incentives.

⁶⁶ *In re Bilski*, 545 F3d 943 (Fed. Cir. 2008), cert. granted sub nom *Bilski v Doll*, 129 S.Ct. 2735 (2009).

The twin tensions reflected in the patent jurisprudence, the tensions in means and ends, resolve differently in the course of what can be called the patent life cycle. Patents move through three stages, each one comprising a technological and a legal component. Schumpeter, F.M. Scherer, and other economists have characterized technological change as the well-known steps of invention, innovation, and imitation or diffusion.⁶⁷ The legal component of the patent life cycle runs through the stages of patent prosecution, patent term, and patent expiry.

During the patent prosecution stage, the claimant must persuade the patent examiner that there is an invention and that it merits protection.⁶⁸ The applicant is free to engage in innovation and further invention during prosecution. The process is confidential.⁶⁹ Diffusion of knowledge is delayed until the application and file folder are published by the Patent Office – when the a patent is issued though even sooner in many cases.⁷⁰ Patent prosecution can be understood as a competition in ideas pitting the invention against the body of prior art in a contest refereed by a patent examiner according to a strict set of rules and guidelines. If the invention is useful and proper subject matter, if it

⁶⁷ "Invention to [Schumpeter] was the act of conceiving a new product or process and solving the purely technical problems associated with its application. Innovation involved the entrepreneurial functions required to carry a new technical possibility into economic practice for the first time – identifying the market, raising the necessary funds, building a new organization, cultivating the market, etc. Imitation or diffusion is the stage at which a new product or process comes into widespread use as one producer after another follows the innovating firm's lead." F Scherer, *Industrial Market Structure and Market Performance* (1970) 350. The three steps are not mutually exclusive. Indeed, they are best understood as overlapping and intertwined. Cf. Peritz, 'Freedom to Experiment: Toward a Concept of Inventor Welfare' (2008) 90 *Journal of the Patent & Trademark Office Society* 245.

⁶⁸ Though the statute states that patent "will be granted unless . . .", in practical terms the vast majority of applications are rejected and thus the burden falls on the applicant.

⁶⁹ In some circumstances, provisional rights to damages are available for third party use during the prosecution stage, but only after the patent has been issued. Patent Act § 154(d).

⁷⁰ "Publication of patent applications is required by the American Inventors Protection Act of 1999 for most plant and utility patent applications filed on or after November 29, 2000. On filing of a plant or utility application on or after November 29, 2000, an applicant may request that the application not be published, but only if the invention has not been and will not be the subject of an application filed in a foreign country that requires publication 18 months after filing (or earlier claimed priority date) or under the Patent Cooperation Treaty. Publication occurs after the expiration of an 18-month period following the earliest effective filing date or priority date claimed by an application. Following publication, the application for patent is no longer held in confidence by the Office and any member of the public may request access to the entire file history of the application. <<http://www.uspto.gov/web/offices/pac/doc/general/#pub>> accessed 1 June 2010. Patent Act § 122.

is clearly described and, finally, if it is not anticipated by the prior art, if it is not obvious, then it embodies new knowledge whose embodiment is worthy of patent protection.⁷¹ The competition in this phase of the life cycle produces the private right to exclude and what can be called the patent's public knowledge benefit.

The knowledge benefit's crucial importance to the prosecution stage can be seen in the strict requirement that the description of the invention in the patent application be clear and complete, and that it enable those reasonably skilled in the art to make and use it. The applicant must also include any additional knowledge concerning a "best mode" of making and using the invention. The description and enablement requirements provide two kinds of public knowledge benefit. First, the description requirement separates the idea from its embodiment, the public benefit from the private property by assuring that the applicant has reduced the idea to practice. Without a strict description requirement, there would be the danger of patenting the idea, of turning the public benefit into private property. Second, as the Supreme Court stated long ago, "If the description be so vague and uncertain that no one can tell, except by independent experiments, how to construct the patented device, the patent is void."⁷² In other words, the information must be sufficient to enable subsequent inventors to learn from the description. With less stringent requirements of description and enablement, the patent prosecution phase would produce the worst of all possible outcomes: private commercial rights to an idea and public knowledge without use value. The domain of ideas would shrivel while monopoly in commercial markets would expand.

The life cycle's second stage begins when the patent is issued. During the patent term, the owner holds a right to exclude others from using the invention for any purpose including

⁷¹ Of course, in addition to nonobviousness, requirements of utility, novelty, and proper subject matter must be met.

⁷² The Incandescent Lamp Patent, 159 US 465 (1895). The patenting of computer software raises important questions about the knowledge benefit. The description element is satisfied by language of general means that does not require publication of source code. The result is patents that are too broad and information that is too vague to be useful. My approach would not permit the current approach to software patents.

innovation and further invention.⁷³ This right to exclude is seen as the condition underlying the patent holder's power to license the technology and in consequence take advantage of downstream efficiencies of development, production, and distribution. Licensing the technology or otherwise using the invention is of course subject to general legal requirements and restrictions. A private right to the commercial benefits of the invention promises a public benefit – the material benefit of improved conditions of every day life. In this stage of the life cycle, two kinds of competition are anticipated. First, the patent holder is encouraged to commercialize the invention and offer it on the market. Nonetheless, a material benefit from commercial competition is not guaranteed because the patent holder has no obligation to work the patent and even if she does, consumers might not buy it. Second, competitors have access to the new knowledge and often the invention itself, and can make practical use of it by improving or inventing around it. However, this competition by experimental use is severely restrained in the United States.⁷⁴

The third stage of the patent life cycle begins with the grant's expiry. The patent's limited term creates a further material benefit when, after 20 years in the case of a utility patent, the invention itself falls into the public domain. This reversion to public use⁷⁵ triggers a general privilege to use the invention and, in so doing, invites commercial competition by imitation that promises to lower prices and, thus, to disseminate more widely the invention's material benefits. Moreover, to the extent invention follows imitation, there is further competition in both ideas and commerce.

Each stage of the patent life cycle reflects a different sort of competition, each one conditioned by the regime's rules and policies, which express resolutions of the tensions in means and ends. As discussion of the *Griffith* and *Kewanee Oil* decisions has shown,

⁷³ In the United States, there is virtually an absolute ban on unlicensed experimental use. Pritz, (n 68 above).

⁷⁴ *Ibid.*

⁷⁵ The public's future interest is a reversion to the transferor in the constitutional sense that patents are not common law property rights but rather statutory grants for a term of years that reserve a reversionary interest in the public.

resolving the tension in ends by (not) privileging the knowledge benefit over the material benefit can have dramatic consequences. In similar fashion, taking competition as the presumptive starting point for adjudication of patent rights can also have powerful effects. For instance, in making it more difficult to obtain an injunction remedy for patent infringement, the Supreme Court in *eBay* weakened the patent holder's property right to exclude and thereby opened the market to increased competition in the second stage of the patent life cycle. Similarly, when the *KSR* decision raised the standard of nonobviousness for combination patents in the patent prosecution phase to change the conditions of competition in ideas, it effectively cut back the scope of exclusionary rights and increased commercial competition in the second stage. And when Justice Breyer in his *Metabolite* dissent explicitly called for protection of the public knowledge benefit by limiting the subject matter of patent rights, the intended effect was to change the prosecution stage's conditions for competition in ideas and thereby extend the reach of public access to subject matter that would otherwise fall under the private control of patent holders.

These recent cases present not only a common dynamic of tensions, but a common resolution. They reflect an underlying commitment to competition policy expressed in the patent regime. Their approach resonates with the political economy described in Justice O'Connor's *Bonito Boats* opinion for a unanimous Court. That is not to say this sample of opinions provides enough data to infer a new orthodoxy in patent jurisprudence, one that recognizes the illogic of an IP economics founded on incentive theory. Indeed, Justice O'Connor's opinion itself presents the baseline of free competition as the necessary condition for an incentive theory of patents. But the sample is enough to say there is an emergent strain of patent jurisprudence that reveals a preference for competition policy, an emergent strain of patent jurisprudence that converges with a residual IP economics of competition, an economics that does not depend on an unfounded incentive theory as the logic for privileging exclusionary rights to promote economic progress.

D. Patents as a Competition Regime: Some Consequences

This section concludes the chapter by suggesting some additional changes that would result from extending the patent regime's emergent jurisprudence and the residual economics of competition.

The recent Supreme Court decisions discussed offer examples of what Complexity theorists call the 'butterfly effect' – a small change in initial conditions that produces a radical change in system behavior. It takes its name from the familiar image of a butterfly in New York City's Central Park, a butterfly whose fluttering wings alter the course of an entire weather system in the Amazon rain forest.⁷⁶ A presumptive shift in patent jurisprudence to competition policy is a small change, a change well within the traditional view that both exclusionary rights and free competition drive economic progress. The same can be said for privileging the public knowledge benefit over the material benefits anticipated from the patent regime. These changes in initial conditions are incremental, not radical. They are small but, as recent decisions demonstrate, they can effect sharp and surprising turns in patent policy.⁷⁷

Further changes, large and small, could come of this shift in initial conditions, a procedural shift in patent jurisprudence to the presumption that free competition promotes progress, a shift supported by the residual economics. Each stage of the patent life cycle would understood as reflecting a baseline of competition, a primary

⁷⁶ This effect can be called radical incrementalism, meaning that small differences in the initial condition of a dynamic system may produce large variations in its long term behavior. The concept of sensitive dependence on initial conditions was developed by French mathematician R Thom, *Structural Stability and Morphogenesis: An Essay on the General Theory of Models* (1972) and was popularized later as Catastrophe Theory in EC Zeeman, *Catastrophe Theory*, (Apr. 1976) *Scientific American* 65. It was a precursor to Chaos Theory and Complexity Theory. On Complexity Theory and dynamic efficiency, see Peritz, 'Dynamic Efficiency' in A Cuccinota, R Pardolesi, & R Van den Bergh (eds) (2002) 108 fn 30 and accompanying text.

⁷⁷ The shift in IP economics, however, would not be perceived as small. This effect is an extreme form of the tipping phenomenon derived from mathematician René Thom's Catastrophe Theory: a sudden and irreversible change in direction from a preceding course that appeared steady and reversible. Examples include stock market volatility, fight and flight reactions to danger, and the last straw.

commitment to the public knowledge benefit,⁷⁸ a narrowly targeted version of incentive theory, and in sum a patent policy that serves the constitutional purpose of promoting progress. Here are a three further instances of such changes, the last one extended into a specific example derived from the E.U. *Microsoft* case..

The first involves the experimental use defense to patent infringement. Almost twenty-five years ago, the Federal Circuit transformed unauthorized experimental use of another's patented invention into patent infringement. The rationale lay in a questionable extension of the already questionable logic of incentive theory. The court determined that a patent holder's power over the invention should extend beyond commercial profit to control of its every use. Why? The court began by attributing a "business interest" to everyone from garage tinkerers to research scientists, a business interest that was itself seen as endangering the incentive value of patents. An unlicensed researcher could overcome this powerful presumption of a business interest only when the purpose was literally the "idle curiosity" of a "dilettante affair."⁷⁹ Since the doctrine's announcement, not one published decision has reported a successful experimental use defense to patent infringement.

The demise of the traditional privilege to engage in unauthorized experimental use of a patented invention is another instance of the propertization trend that has been expanding IP protection in the United States. It is a particularly harmful instance because experimental use is perhaps the most important form of competition during the patent term. If unauthorized experimentation were seen instead as presumptively competitive conduct, then the patent holder would be required to prove actual commercial injury and public harm, all of which results not from imagined intentions but from actual

⁷⁸ Of course a primary commitment to the public knowledge benefit would call for reconsideration of the *Kewanee Oil* decision. For discussion, see Peritz, 'Patents and Competition: Toward a Knowledge Theory of Progress' in LM Genovesi (ed) *Intellectual Property Rights and Market Power* (2009) (selected papers from ATRIP annual conference, Parma, Italy, September 2006).

⁷⁹ *Roche Prods. v Bolar Pharma, Co.*, 733 F.2d 858 (Fed. Cir. 1984) (citing as most persuasive precedent *Pitcairn v U.S.*, 547 F2d 1106 (Ct. Cl. 1976)). This expanded view of patent rights is a natural result of viewing them through the prism of property logic.

commercial conduct, from making, using, and selling. In short, a viable experimental use defense would not harm patent holders' legitimate interests in exclusive rights to commercial profit during the patent term.

Moreover, the current stranglehold on unlicensed experiment disserves the public interest in three ways. First, it in effect extends the twenty-year patent monopoly by the time necessary for rivals to engage in research and development of products for offer on the market.⁸⁰ Second, the current regime empowers patent holders to control too much of follow-on research, a power inconsistent with the unlimited availability of improvement patents to all who meet the statutory requirements. Patent's open door policy for follow-on research is in sharp contrast to the Copyright Act's treatment of derivative works, whose protection is available only to the holder of the underlying copyright.⁸¹ Third, the patent holder's control over research also channels and restrains the production of new knowledge intended to replenish the public domain. More widespread competition and cooperation in research during the patent term would produce public benefits by lowering the costs, expanding the field of improvement patents, opening the production of new knowledge, limiting the patent term to its statutory boundary, and, if relevant, serving the national interest by bringing the United States in line with most of the rest of the world, to which unlicensed research activities likely immigrate to escape the harsh U.S. regime.

My second example involves purified forms of naturally occurring substances. Product patents have been granted for them regularly since an early 20th century decision, which affirmed a grant for the purified hormone Adrenalin on the ground that it was "a new thing commercially and therapeutically."⁸² While this rationale emerged from a focus on commercial markets, the actual effects were much broader because of the standard scope of protection afforded product patents in the United States: The product patent practically encompassed the very idea of purified Adrenalin insofar as it included not only the

⁸⁰ Cf. *Brulotte v Thys Co.*, 379 U.S. 29, 32 (1964) (licensing agreement extending beyond patent term per se violation of federal patent law); *Pitney Bowes, Inc. v Mestre*, 701 F.2d 1365 (11th Cir. 1983) (same).

⁸¹ The current treatment of derivative works also reflects overprotection, in this author's view.

⁸² *Parke-Davis v Mulford*, 189 F.2d 95 (S.D.N.Y. 1911).

product but its equivalents for all uses not only known at the time but also discovered later.⁸³

An approach beginning with the presumption of competition as patent's baseline would begin by confining the scope of protection to what was actually invented – the new process of purification and the method of using purified Adrenalin. Beyond the specific process and method of use, open competition would prevail. The product and with it the idea of purified Adrenalin would be freely available in the public domain.⁸⁴

In a very recent decision that has attracted attention, a federal court in New York City ruled that isolated and purified DNA was not patentable because it lacked “markedly different characteristics” from native DNA.⁸⁵ The plaintiffs referred to the *Adrenalin* case in arguing, “Isolated DNA molecules should be treated no differently than other chemical compounds for patent eligibility.” But the court rejected the reference by distinguishing DNA from other chemical compounds in the body: While Adrenalin and other compounds necessarily convey information, DNA encodes an entirely different kind of information, not about its own molecular structure involving its own biological function but rather about its biological function of directing the synthesis of other molecules in the body. This distinction was dispositive because, in the court's view, the isolated and purified DNA carried precisely the same information as the native DNA and thus lacked “markedly different characteristics.”

⁸³ Only patents for improved or new production processes or methods of use were possible. The result would be blocking patents.

⁸⁴ With a targeted incentive theory, the question might be whether it would be good industrial policy to support the exclusionary regime of a product patent for Adrenalin and a suitably defined category of naturally occurring substances in order to channel research and development in a direction that is currently neglected under what would otherwise be a regime of open access required by free competition. Since the question would call for a judgment about industrial policy, it would be for Congress to legislate some combination of general standards and specific rules for the Patent Office, which would promulgate guidelines for its examiners, who would provide technological expertise, as they do now, according to guidelines in the prosecution stage of the patent life cycle.

⁸⁵ *Association for Molecular Pathology v U.S. Patent and Trademark Office*, S.D.N.Y., No. 09 Civ. 4515, March 29, 2010.

The court recognized the importance of the case in stating, “The widespread use of gene sequence information as the foundation for biomedical research means that resolution of these issues will have far-reaching implications, not only for gene-based health care and the health of millions of women facing the specter of breast cancer, but also for the future course of biomedical research.” In short, competition and cooperation in gene research would not be controlled by patent holders. Despite the court’s special treatment of DNA, the same could be said for generally denying product patents for purified forms of all naturally occurring substances.

The last example involves the description and enablement requirement already discussed in the jurisprudence section – here, the requirement as it applies to computer software. Ten years ago the Federal Circuit Court declared that a general functional description satisfies the requirement⁸⁶ for software patents. The practical consequence of these cases is lack of adequate description and enablement. The description is insufficient to assure that the claimant actually “has possession” of the invention rather than simply a general idea about its function. Moreover, enabling a skilled programmer to make or use the software would require flow charts, source code, and the detailed descriptions that annotate modules, descriptions that computer programmers customarily include as documentation for others who subsequently need to understand, change, or fix the source code. Both protocols⁸⁷ and programmer comments are embedded in source code listings, while protocols also appear in software documentation. Why is a general functional description enough for the Federal Circuit Court and, thus, for the Patent Office though it does not meet industry standards? Because, according to the court, conversion of functional description into source code is “a mere clerical function to a skilled programmer.”⁸⁸

⁸⁶ Patent Act § 112. The court acknowledged that more might be required in special cases.

⁸⁷ A protocol is a standard procedure and format that two computers or other devices must understand, accept and use in order to communicate with one another. Examples include network log on procedures and html format.

⁸⁸ *Northern Telecom, Inc. v Datapoint Corp.*, 908 F.2d 931, 942 (Fed. Cir. 1990) (citing *In re Sherwood*, 613 F.2d 809, 817 n. 6 (C.C.P.A. 1980)). There may be exceptional cases where more is required. *Ibid*.

The court's rationale rings hollow for anyone who has actually designed or written operating system or complex applications software. Indeed, no judge sitting on the Federal Circuit could have taken the stated view after having any actual experience in the field. The author of this chapter spent some years designing and writing such software, and the experience evidences the reality that conversion of systems design specifications to source code is often challenging work that involves much more than mere clerical function. Nonetheless, the Federal Circuit in its nescience requires only a general description of the software process.

While general information about software function has some limited value, its satisfaction of the patent disclosure requirement creates two problems. First, general claims and descriptions produce software patents that are too broad and, as a result, foreclose too much competition as functional equivalents. This problem includes treatment of business method inventions, which are typically embodied in software. Second, there is insufficient information flow for subsequent inventors. The combination is deadly: broad patent rights and little public information about them. This situation is exacerbated by the acknowledged difficulty in locating and identifying prior art in the category of computer software.

If the patent regime is intended to encourage learning from prior art and thereby foster competition by invention, the level and quality of information must be improved. The current requirement of a general process description requires only a low level of information and, in consequence, erects a barrier to further invention, a barrier that benefits the patent holder by keeping rivals out, rather than an information flow that benefits society by enabling others to improve and surpass the invention.

Moreover, a surprising anomaly arises: Despite the patent requirement of disclosure, specific code modules in patented software can be protected as trade secrets. The patent requirement of disclosure and anomaly of trade secrecy in its midst can co-exist because

of the Federal Circuit's general description requirement. Recognizing the public knowledge benefit of competition in ideas during the prosecution stage of the patent life cycle would call for a more demanding description and enablement standard for computer software. The change would call for disclosure of the source code and system documentation that industry practices recognize as needed to enable subsequent work on the software.

Moreover, in the broader ambit of innovation policy, a proper patent requirement to disclose would obviate the need for antitrust litigation to resolve some issues of interoperability and disclosure through compulsory licensing of patented software. The E.U. *Microsoft* antitrust case provides a handy example because it involved computer software for which Microsoft asserted patent and trade secret protection as defenses to antitrust liability for refusals to disclose information rivals needed for the continued interoperability of their software with Microsoft WINDOWS for PCs. How would the analysis of IP claims proceed if antitrust were no longer seen as the sole source of a conflicting competition policy? And if patent policy were no longer seen as driven exclusively by property rights to exclude competitors? Instead, let's look at policies of exclusion and access not in opposition to one another, not in antithetical domains of patent and antitrust, but rather in a joint venture to set the conditions for relationships of competition and cooperation.⁸⁹

In the actual *Microsoft* case, the Court of First Instance (CFI) affirmed the Commission judgment that Microsoft abused its dominant position in the market for PC operating

⁸⁹ Wesley Hohfeld made the fundamental point that property rights can be best understood as relations between persons rather than between a person and a thing. W Hohfeld, 'Some Fundamental Legal Conceptions as Applied in Judicial Reasoning' (1923) 23 Yale Law Journal 16; JW Singer, 'The Legal Rights Debate in Analytical Jurisprudence from Bentham to Hohfeld' (1982) Wisconsin Law Review 975. The chapter takes up this well-known relational conception of property rights and extends it to competition and cooperation. The extension is indebted to the voluminous literature about the interplay between competition and cooperation – whether literature relating directly to innovation and efficiencies or more broadly throughout the social and management sciences. Much of the literature is informed by game theory, from the simple prisoners' dilemma to complex multi-layered iterative games. For a brief introduction to a game theory approach to parallel commercial conduct, see Peritz, 'Doctrinal cross-dressing in derivative aftermarkets: Kodak, Xerox and the copycat game' (2006) 51 Antitrust Bulletin 287 and sources cited therein.

systems by leveraging WINDOWS' dominance into the market for work group server operating systems. The CFI concluded that Microsoft wrongfully applied this leverage in refusing to disclose to rivals in the server market information they needed for continued interoperation with work group PCs running WINDOWS.⁹⁰ The information included interface protocols and an "Active Directory," [Directory] which organized the protocols in an arguably original way that allowed Microsoft's server software to interoperate smoothly and efficiently with WINDOWS. Microsoft claimed that patent and trade secret protection allowed them to deny access to this information.⁹¹

The CFI began its analysis by resolving what it treated as a conflict between competition policy and intellectual property rights. The conflict was resolved as follows: First, the Court simply assumed that Microsoft had patent and trade secret protection of the protocols and the Directory, despite some hesitation over the strength of the claims. Second, the Court affirmed the Commission's determination that, under exceptional circumstances, competition policy can trump patent and trade rights. The exceptional circumstances turned on the question of access to an indispensable asset controlled by a dominant firm, here WINDOWS protocols controlled by Microsoft. The protocols were deemed an essential facility for competition in the market for server operating system software. The CFI concluded that in the special circumstances competition policy trumped Microsoft's exclusionary rights in the absence of objective justification. It followed that the proper remedy was a decree compelling Microsoft to disclose the information to their competitors.

⁹⁰ The case also involved distribution of WINDOWS MEDIA PLAYER. As Professor Steven Anderman put it, four threads run through the CFI analysis: "(1) The significance of the findings of 'indispensability' of the interface protocols to interoperability in the 'second market.' (2) The significance of the finding that there was a 'risk' of elimination of competition in the second market. (3) The 'exceptional circumstances' in which competition law will find that a refusal to license an IPR will be an infringement of Art. 82. (4) The finding of an absence of objective justification." Anderman, 'Pro-Consumer Efficiencies in Antitrust Law and Practice' (26 October 2007) LUISS University, Rome.

⁹¹ Case T-201/04 *Microsoft v Commission* [2007] ECR II-3601 (interoperability protocols for some front-end server software); see also, *Lochwood v American Airlines, Inc.*, 107 F.3d 1565 (Fed. Cir. 1997).

The effect was a sharp change in the competitive and cooperative relationships between Microsoft and its rivals. Until the decision, both competition and cooperation were restrained by Microsoft's asserted property rights to refuse disclosure of interoperability information, an exclusionary right asserted under the aegis of trade secret and patent ownership. As is often the case, competition on the merits was not possible without some cooperation between participants. The CFI decision applied the competition policy of then-Section 82 to compel Microsoft to cooperate with rivals in order to allow competition on the merits of the server software rather than on the advantage derived from Microsoft's ownership of exclusive access to an essential component in PC networks comprising numerous components.

So much for E.U. competition policy and exclusionary rights. In the U.S., the outcome would have been in doubt. First, the Supreme Court has in effect gutted essential facility doctrine as a basis for antitrust liability. Second, turning on its head the E.U. view, patent rights trump U.S. antitrust policy. And third, as a general matter, U.S. courts are indisposed toward granting compulsory licenses, seeing them as insults to the institution of private property. In sum, U.S. antitrust is a weak voice for expressing competition policy.⁹²

Now comes the emergent view of the U.S. patent domain as a distinct competition regime and, in consequence, a more rigorous requirement of description and enablement. How would this play out on the bare-bone facts of the E.U. *Microsoft* antitrust case?⁹³

As already discussed, the current description and enablement requirement for computer software calls only for a general description of the process. And so Microsoft is not currently required to specify the protocols or the Directory. In short, the information

⁹² See, e.g., Peritz, 'The Microsoft Chronicles' in Luca Rubini (ed) *Microsoft on Trial: Legal and Economic Analysis of a Transatlantic Antitrust Case*, (forthcoming 2010); 'Microsoft e il flusso di informazioni' (2007) 9 Mercato, Concorrenza, Regole 523 (Ital. trans by Andrea Giannaccari).

⁹³ For an expansive introduction to patent, copyright, trade secret, and trademark as competition regimes, see Peritz (2006) (n 4 above).

would likely be secret. But if the requirement were reformulated in consonance with the emergent view, then both the protocols and the Directory would be disclosed – the protocols as necessary to enable skilled practitioners to use the software and the Directory as reflecting the protocols’ best mode of use.⁹⁴

A more demanding description and enablement would have two effects. First, it would improve the information flow during the patent term, the public knowledge benefit expected from the prosecution stage’s competition in ideas. Second, it would define more clearly and more narrowly the metes and bounds of the patent monopoly. In relational terms, it would expand the patent holder’s obligation to cooperate with rivals and other interested parties, a third party obligation enforced during the prosecution stage of the patent life cycle. As a result, it would change the conditions of competition during the patent term by having given rivals the information needed to compete on the merits. In sum, the relational changes would track those of the CFI decision in the E.U. *Microsoft* decision.

But the relational changes would not be identical. First, the patent resolution would require no litigation for disclosure. Second, it would involve no licensing, no judicial oversight, and thus no licensing fee, no bargaining or other transaction costs. Third, however, the use value of the information would depend on the scope of experimental use permitted. In the United States, the use under current law is for all practical purposes forbidden. But with a viable experimental use doctrine properly understood as competition during the patent term, experimentation short of commercial use would be permitted. Finally, unlike the compulsory license in the E.U. case, patent disclosure of the Directory as the best mode of organizing the protocols would not necessarily permit its commercial use. Certainly second comers could use the protocols commercially because they lack invention; but if the Directory is a nonobvious invention, patent rights would block its commercial use. Here, the patent regime’s compelled cooperation between

⁹⁴ For a demanding approach to the description requirement, see *The Gentry Gallery v The Berkline Corp.*, 134 F.3d 1473 (Fed. Cir. 1998). For criticism, see *Moba v Diamond Automation, Inc.*, 325 F.3d 1300, 1323 (Fed. Cir. 2003) (Rader, J., dissenting).

Microsoft and its rivals should not include commercial use of the Directory, if determined a nonobvious invention, because commercial competition on the merits is possible without access. Indeed competition in the development of more efficient or otherwise superior protocol organization in other directories holds the promise of technological progress.

This final example has shown how the patent regime can be understood as an instrument of economic progress that shapes relationships of competition and cooperation. The analysis begins with the presumption that free competition promotes economic progress. Any policy or adjudication that would expand the scale or scope of patent rights requires evidence of its progressive value. What justifies this shift from the current patent regime's presumption that exclusionary rights promote progress? It begins with recognition of a policy stalemate that derives from the indeterminacy of incentive theory as the basis for preferring either patent protection or free competition as the superior engine of progress. This stalemate is broken by free competition's superior distributional effects, superior because competition generates more allocatively efficient outcomes and, with them, conditions more conducive to future inventive activity. At the same time, recent Supreme Court jurisprudence reflects an emergent strain of patent doctrine that recognizes an internal competition policy – what an earlier decision by a unanimous Court called “a baseline of free competition.” More broadly, adopting a baseline of competition would change the current U.S. view of IP and antitrust as antithetical regimes, as a binary opposition between monopoly and competition, between exclusion and access. What would emerge is a more progressive and more functional view of IP and antitrust as two intertwined regimes comprising policies of both exclusion and access, two sets of rules and policies that set the conditions for relationships of competition and cooperation to promote the progress of knowledge and industrial technology.

Conclusion

This chapter has sketched the orthodox view of the patent regime as founded on exclusionary rights to promote progress, its jurisprudence, and its dependence on a failed incentive theory, as well as an emergent view expressed in the jurisprudence and in a residual economics that converge to support the reconceptualization of patent protection as a competition regime. The emergent jurisprudence echoes an opinion by Justice Sandra Day O'Connor written some twenty years ago for a unanimous Supreme Court, an opinion that described the foundation of patent policy as a "baseline of free competition."

While the chapter adopts the baseline of free competition, it otherwise diverges from Justice O'Connor's opinion insofar as the chapter's ensuing analysis reflects the failure of incentive theory as the economic logic for patent protection, a failure that is not acknowledged in the opinion or in today's mainstream jurisprudence. Still there is a residual economic logic that is surprisingly straightforward despite its absence in the mainstream literature: While the dynamic efficiency effects of both free competition and patent rights are indeterminate, their distributional effects point toward free competition. Why? Because patents that actually have economic value produce monopoly prices and, with them, welfare losses in both static and dynamic terms. In consequence not only consumers but subsequent inventors are better off under a regime of free competition because it gives inventors open access to new information. The result is improved conditions for subsequent invention. In this light, a rule or policy that would strengthen patent rights should first be shown to promote greater progress than would otherwise occur. Yet patent protection can serve the public interest as a sharp instrument for targeted industrial policy though it fails as a magic potion for promoting economic progress. But even with patents as sharp tools of industrial policy, risks of failure and unintended consequences call for careful analysis to overcome the presumption that free competition better serves the public interest.

THE COALITION FOR 21ST CENTURY PATENT REFORM
Protecting Innovation to Enhance American Competitiveness
www.patentsmatter.com

Submission of Views

by

Kevin H. Rhodes

Member of the Steering Committee

Coalition for 21st Century Patent Reform

and

Chief IP Counsel of 3M Company

to the

**Subcommittee on Intellectual Property, Competition
and the Internet**

Committee on the Judiciary

United States House of Representatives

on

**“The International Trade Commission and Patent
Disputes”**

July 16, 2012

Chairman Goodlatte, Ranking Member Watt and Members of the Subcommittee:

I am pleased to have this opportunity to submit for the record these views of the Coalition for 21st Century Patent Reform (21C) on the role and functioning of the International Trade Commission (ITC) in investigating and remedying unfair methods of competition and unfair acts in the importation of articles that infringe U.S. patents.¹

I am a member of the 21C Steering Committee. I am also the Chief Intellectual Property Counsel of 3M Company and the President and Chief Intellectual Property Counsel of 3M Innovative Properties Company, but I am submitting these views on behalf of 21C. Our coalition has nearly 50 members from 18 diverse industry sectors and includes many of the nation's leading manufacturers. In addition to 3M, the coalition's steering committee includes Caterpillar, General Electric, Johnson & Johnson, Eli Lilly and Procter & Gamble. The coalition has members in a variety of industry sectors, including: aerospace and defense, chemical, computers, diversified financials, diversified technology, energy, food production, forest & paper products, health care, household & personal products, industrial equipment, medical equipment & devices, network & communications, payroll services, pharmaceutical, biotechnology, semiconductors & electronic components, and transportation equipment. 21C was an active participant in the legislative process that led to the enactment of the Leahy-Smith America Invents Act, and 21C remains active and engaged with Congress, the Administration, including the United States Patent and Trademark Office, and the federal courts on issues of patent law and policy.

¹ The ITC's authority to undertake such investigations and to issue Exclusion Orders arises from Section 337 of the Tariff Act of 1930, 19 U.S.C. § 1337 (hereinafter "Section 337").

My submission for the record will address two different types of complainants which seek ITC Exclusion Orders under Section 337 to prohibit the importation into, and the sale within, the United States of imported articles that infringe a valid and enforceable U.S. patent, and for which there exists a so-called “domestic industry.” For each type of complainant, I will discuss the perceived concerns that have arisen regarding its use of ITC Section 337 proceedings to resolve patent infringement disputes and the changes to ITC law and practice that have been proposed to address those concerns.

First, I will discuss some concerns that have been raised regarding the ITC’s issuance of Exclusion Orders in Section 337 investigations of alleged patent infringement brought by a subset of non-practicing entities (NPEs) that acquire patents for the sole purpose of obtaining settlement payments by asserting them against alleged infringers. These NPEs (frequently referred to as “patent assertion entities or “PAEs”)² cannot establish a “domestic industry” through manufacture of the patented articles in the United States and have no intention of establishing such an industry by manufacturing or marketing any articles covered by their patents. Rather, PAEs seek to show a “domestic industry” through investments in “licensing” their patents, with such licensing investments including litigation fees and costs associated with enforcing the patents against alleged infringers. Even though they seek to license their patents, not to exclude others from practicing them, PAEs are said to be turning to the ITC to seek Exclusion Orders solely to obtain negotiating leverage to extract larger royalties from accused infringers, because they are less likely to obtain similar

² See Fed. Trade Comm’n, *The Evolving IP Marketplace: Aligning Patent Notice and Remedies with Competition* 8 n.5 (2011) (available at <http://www.ftc.gov/os/2011/03/110307patentreport.pdf>).

leverage in the form of injunctions from U.S. district courts following the U.S. Supreme Court decision in *eBay, Inc. v. MercExchange, L.L.C.*, 547 U.S. 388 (2006).

Second, I will touch briefly on the issue of ITC Exclusion Orders in Section 337 investigations initiated by the owners of “standard-essential patents” (SEPs), when the patent owner has agreed to license its SEP on fair, reasonable and non-discriminatory (“FRAND”) terms.³ When the owner of a SEP and a firm interested in practicing that SEP are unable to agree upon what constitutes FRAND licensing terms, the patent owner may attempt to obtain more favorable terms by seeking an ITC Exclusion Order against imported products alleged to practice the SEP. The question that has been posed is whether the seeking of an ITC Exclusion Order by such patent owners is inconsistent with their FRAND licensing commitments and thus should be disallowed or curtailed.

I. NPEs and PAEs in ITC Section 337 Investigations

Under Section 337, a domestic industry relating to articles protected by the patent for which an Exclusion Order is sought is considered to exist if there is, in the United States and with respect to those patented articles:

- (A) significant investment in plant and equipment;
- (B) significant employment of labor or capital; or
- (C) substantial investment in its exploitation, including engineering, research and development, or licensing.⁴

³ Such licensing commitments are also commonly referred to as “reasonable and non-discriminatory” (RAND) terms. In this statement, I use the acronym FRAND generally to refer to FRAND and RAND commitments.

⁴ 19 U.S.C. § 1337(a)(3).

At the outset, it is important to remember that not all NPEs fall into the category of PAEs. There are many NPEs – *e.g.*, universities and small engineering firms – that expend considerable resources on the research and development of new products that they seek to commercialize indirectly through the sale and/or licensing of patents covering those products. These NPEs clearly have a “domestic industry” that satisfies most or all of the three indicia set forth in Section 337. In that sense, these NPEs have many of the same attributes as firms that manufacture patented products, which likewise must make investments in such things as plant and equipment, labor or capital, and engineering, research and development before they begin to manufacture the patented product.

I believe there is widespread consensus – as there should be – that such NPEs need access to the ITC and the remedies available under Section 337 to exclude the importation of infringing products. Just as with patent owners who actually manufacture patented products, for these NPEs the availability of the ITC, with its *in rem* jurisdiction over the imported infringing articles themselves, is absolutely essential to prevent the importation of infringing products by manufacturers who are beyond the reach of U.S. district court infringement actions or who may be located in countries where it is not feasible to obtain or to enforce effectively a patent in that country.

The stated goal of those seeking to amend the ITC’s authority is to address the perceived problem of PAEs, that subset of NPEs who seek to use the ITC not to exclude infringing imports, but rather to extract larger royalties from companies that are manufacturing products under the threat of an Exclusion Order to block the importation of necessary components. 21C does not question whether there are PAEs that seek to misuse

Section 337 remedies in this manner, but before changes to ITC jurisdiction or practice are made to address such misuse, proponents of those changes should show (1) that the ITC is incapable of distinguishing between PAEs who are misusing the ITC and those NPEs who should be entitled to Exclusion Orders, and fashioning its remedies accordingly; and (2) that the proposed changes are narrowly tailored to avoid unintended negative consequences for NPEs who should be entitled to Exclusion Orders. 21C does not believe that the case has been made for (1), or that the proposed “fixes” are narrow enough to satisfy (2).

**A. Has the Case Been Made That the ITC Cannot,
Or Is Not, Applying Section 337 To Prevent Misuse by PAEs?**

ITC statistics are being used to support the claim that PAEs seeking Exclusion Orders are a problem, but it is unclear whether those statistics really make the case. It is undoubtedly true that the number of ITC Section 337 investigations, and the number of respondents in those investigations, have increased over the past several years, with sizeable increases in 2011.⁵ It also seems to be true that the prevalence of complainants relying on licensing alone to establish a domestic industry has increased. Yet without an accepted consensus on the definition of an NPE, let alone a PAE, and without an examination of the specific types of licensing activities being cited as supportive of a domestic industry, claims that these statistics show PAEs have flooded the ITC with requests for Section 337 investigations, where the true goal is not an Exclusion Order but rather leverage in licensing negotiations, are far from clear. And 21C is not aware that anyone has claimed that a PAE actually has obtained an ITC Exclusion Order in such circumstances.

⁵ See http://www.usitc.gov/press_room/337_stats.htm.

Nor has the case been made that the ITC lacks the ability to prevent future attempts by PAEs to obtain unwarranted Exclusion Orders. In an ITC investigation where the complainant is a PAE, presumably the PAE would try to meet the domestic industry requirement through its investments in “licensing,”⁶ as it would be unlikely that a PAE could show that any other of the statutory bases for a domestic industry exists. Yet both the ITC and the Federal Circuit have held that patent infringement litigation expenses alone, *i.e.*, patent infringement litigation activities that are not related to engineering, research and development, or licensing, do not create a domestic industry under the term “licensing” in Section 337(a)(3)(C).⁷ As the Federal Circuit explained, “[w]e agree with the Commission that 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.”⁸

Although it is true that the ITC and the Federal Circuit have not foreclosed any possibility that litigation expenses could be recognized as creating a domestic industry, there is no basis to suggest that the ITC is incapable of effectively distinguishing between genuine licensing investments and sham activities designed solely to create a basis for being in the

⁶ Section 337 requires that an investment in licensing relate to “exploitation” of the asserted patent. *In re Semiconductor Chips with Minimized Chip Package Size and Products Containing Same*, Inv. No. 337-TA-432, Order No. 13 at 11-13 (unreviewed) (Jan. 24, 2001) (“Semiconductor Chips”). *Accord In re Certain Coaxial Cable Connectors and Components Thereof and Products Containing Same*, Inv. No. 337-TA-650, Comm’n Op. at 44-51 (Apr. 14, 2010) (“Coaxial Cable Connectors”), *aff’d*, *John Mezzalingua Assocs., Inc. (d/b/a PPC, Inc.) v. Int’l Trade Comm’n*, 660 F.3d 1322 (Fed. Cir. 2011).

⁷ *Coaxial Cable Connectors* at 44-51 (“The owner of the property right must be actively engaged in steps leading to the exploitation of the intellectual property, including application engineering, design work, or other such activities. S. Rep. No. 100-71 at 130”); *John Mezzalingua*, 660 F.3d at 1328.

⁸ *John Mezzalingua*, 660 F.3d at 1328.

ITC. The ITC assesses whether licensing or litigation expenses establish a domestic industry on a case-by-case basis, based on the nexus between litigation expenses and efforts to license the asserted patent and whether there has been “substantial investment in the exploitation of the patent.”⁹ This is a factually-specific inquiry which may vary depending on the nature of the industry and the resources of the complainant.¹⁰

Given that all types of U.S. patent owners, including small and large companies, universities, and individual inventors, routinely license and litigate their patents, it is entirely appropriate that the ITC determine whether licensing or litigation expenses establish a domestic industry on a case-by-case basis, rather than adopting *per se* rules that risk the unintended consequence of cutting off the ITC as a forum where patent owners who have licensed their inventions can seek to prevent infringing imports from destroying their investments. Moreover, Section 337 requires the ITC to consider the effect of any Exclusion Order it is contemplating issuing upon the public health and welfare, competitive conditions in the United States economy, the production of like or directly competitive

⁹ *Coaxial Cable Connectors* at 43-44 (“Depending on the circumstances, [licensing activities] may include, among other things, drafting and sending cease and desist letters, filing and conducting a patent infringement litigation, conducting settlement negotiations, and negotiating, drafting and executing a license. The mere fact, however, that a license is executed does not mean that a complainant can necessarily capture all expenditures to establish a substantial investment in the exploitation of the patent. A complainant must clearly link each activity to licensing efforts concerning the asserted patent.”).

¹⁰ See *In re Stringed Instruments*, Inv. No. 337-TA-586, Comm’n Op. at 25-26 (May 16, 2008) (“There is no minimum monetary expenditure that a complainant must demonstrate to qualify as a domestic industry under the ‘substantial investment’ requirement of [19 U.S.C. § 1337(a)(3)(C)] [S]howing the existence of a domestic industry will depend on the industry in question, and the complainant’s relative size. . . . [T]here is no need to define or quantify the industry itself in absolute mathematical terms.”); see also *In re Certain Multimedia Display and Navigation Devices*, Inv. No. 337-TA-694 (July 22, 2011).

articles in the United States, and United States consumers.¹¹ These public interest factors provide the ITC with considerable discretion to decide whether to deny or limit an Exclusion Order in an investigation initiated by a PAE. Again, we are not aware of any evidence that the ITC is incapable of appropriately considering and applying the public interest factors in its issuance of Exclusion Orders when they are being sought by PAEs.

In sum, 21C believes the ITC has ample authority and discretion under Section 337 to issue and tailor Exclusion Orders to ensure that they preclude the importation of an infringing product only when such importation would destroy or substantially injure an industry in the United States or prevent its establishment. On balance, 21C believes the ITC has used this authority and discretion appropriately and the case has not been made that sweeping changes to Section 337, changes that would impact all patent owners and risk unintended consequences, are needed because the ITC has allowed PAEs to abuse Section 337 investigations for negotiating leverage.

B. Do the *eBay* Factors Belong in ITC Investigations?

Some proponents of changes to ITC law and practice intended to prevent PAEs from seeking Exclusion Orders solely to obtain negotiating leverage have proposed that the issuance of Exclusion Orders be made subject to the same traditional four-factor equitable test that the Supreme Court held should be applied in deciding whether to issue a permanent injunction against patent infringement. *See eBay, Inc. v. MercExchange, L.L.C.*, 547 U.S. 388 (2006). In *eBay*, the Court listed four factors that a patent owner must demonstrate to obtain a permanent injunction:

¹¹ 19 U.S.C. § 1337(d)(1).

- (1) it has suffered an irreparable injury;
- (2) remedies available at law, such as monetary damages, are inadequate to compensate for that injury;
- (3) considering the balance of hardships between the plaintiff and defendant, a remedy in equity is warranted; and
- (4) the public interest would not be disserved by a permanent injunction.¹²

Unlike these equitable factors listed in *eBay*, the ITC's decision whether to issue an Exclusion Order is based on the statutory criteria set forth in Section 337. Accordingly, the ITC has held that the *eBay* test does not apply when deciding whether to issue an Exclusion Order because Section 337 "represents a legislative modification of the traditional test in equity . . . [and] it is unnecessary to show irreparable harm to the patentee in the case of infringement by importation."¹³ The Federal Circuit has affirmed that the ITC's remedies are governed by statute and not by equitable principles.¹⁴

In our view, the *eBay* factors are simply inapplicable to the determination of whether an Exclusion Order should be issued in a Section 337 proceeding. These factors arise from the traditional test in equity, where the issue is whether remedies at law, such as monetary damages, are adequate to compensate the plaintiff. When applied in patent infringement actions in U.S. district courts, the judge is deciding whether a permanent injunction should

¹² *eBay*, 547 U.S. at 391.

¹³ *In re Certain Baseband Processor Chips and Chipsets*, Inv. No. 337-TA-543 at 62-3 n.230 (Int'l Trade Comm'n 2007).

¹⁴ *Spanion, Inc. v. Int'l Trade Comm'n*, 629 F.3d 1331, 1359 (Fed. Cir. 2010).

issue in addition to whatever damages have been awarded to compensate for the infringement. In contrast, the only remedies available in an ITC Section 337 investigation are in essence injunctive relief – Exclusion and Cease and Desist Orders. Damages are not available and thus there is no determination of whether damages alone are an adequate remedy, as when a district court applies the *eBay* test. Thus, applying the *eBay* factors in Section 337 proceedings would mean that whenever the ITC determines that a complainant has not made an adequate showing that they are met, the patent owner would be left with no ITC remedy whatsoever to prevent the continued importation of products that were found to infringe a valid and enforceable U.S. patent.

A short discussion of each of the four *eBay* factors will show how inapposite they are to the question of whether the ITC should issue an Exclusion Order to prevent the continued importation of products found to infringe a valid and enforceable U.S. patent. The first three factors are simply inapplicable when taken out of their context in equity and grafted into Section 337's statutory framework, and the fourth factor is already part of the ITCs determination.

With respect to the first *eBay* factor – whether the patent owner has suffered an irreparable injury – Congress did consider the applicability of this question when it amended Section 337 to remove the requirement that the importation of a patented product “destroy or substantially injure an industry” in the Omnibus Trade and Competitiveness Act of 1988.¹⁵ As the House Report explained, “the Committee believes that requiring proof of

¹⁵ Pub. L. No. 100-418, § 1342, 102 Stat. 1107, 1212-16 (codified at 19 U.S.C. § 1337 (1988)).

injury, beyond that shown by proof of the infringement of a valid intellectual property right, should not be necessary.²¹⁶

That reasoning remains equally true today. The question of whether an injury is irreparable boils down to whether or not it can be repaired with money damages. In district court patent infringement actions, a prevailing patent owner has a statutory right to recover damages “adequate to compensate for the infringement but in no event less than a reasonable royalty for the use made of the invention by the infringer, together with interest and costs as fixed by the court.”²¹⁷ The traditional four-factor test in equity that the Supreme Court applied to patent infringement actions in *eBay* determines whether the patent owner also is entitled to a permanent injunction. In other words, the *eBay* factors were never intended to determine whether the patent owner would obtain any remedy when infringement has been proven. Thus, the question of whether the patent owner’s injury is “irreparable” – *i.e.*, repairable with a damages award – makes little, if any, sense in the ITC, where the patent owner either gets an Exclusion Order or goes home empty-handed.

For the same reasons, the second *eBay* factor – whether remedies available at law, such as monetary damages, are inadequate to compensate for the injury – is equally inapplicable to ITC proceedings. The ITC cannot award money damages, which moots the question.

The third *eBay* factor – whether, considering the balance of hardships between the plaintiff and defendant, a remedy in equity is warranted – also becomes inapt when it is

¹⁶ H.R. Rep. No. 100-40 at 156 (1987).

¹⁷ 35 U.S.C. § 284.

taken out of its context for determining whether relief in the form of both money damages and a permanent injunction is an equitable remedy. There can be no meaningful balancing of hardships between the owner of a patent found to be valid, enforceable and infringed who would receive no relief whatsoever without an Exclusion Order, versus an infringer who would merely be denied the ability to benefit from importing only those products found to infringe into the United States before the U.S. patent expires, while retaining the ability to make and sell them anywhere else in the world.

It is not a satisfactory answer to argue that U.S. patent owners could mitigate any hardship from failing to obtain an Exclusion Order by seeking relief in U.S. district court. As discussed already, foreign defendants may not be subject to personal jurisdiction in the United States. Nor is it persuasive to argue that U.S. patent holders should file infringement actions against offshore manufacturers in the countries where the infringing products are made. Not only would it be exorbitantly expensive to seek patent protection in every country where products that infringe a U.S. patent could be made, but effective patent coverage, and especially effective enforcement of those patents that can be obtained, is simply not possible in many jurisdictions where infringing products originate.

Finally, regarding *eBay's* public interest factor, the ITC already must consider four public interest factors when determining whether to issue an Exclusion Order: (1) the public health and welfare, (2) competitive conditions in the U.S. economy, (3) the production of like or directly competitive articles in the U.S., and (4) U.S. consumers.¹⁸ As the ITC has observed, these public interest factors “are not meant to be given mere lip service,” but

¹⁸ 19 U.S.C. § 1337 (d)(1).

rather “public health and welfare and the assurance of competitive conditions in the United States economy must be the overriding considerations in the administration of this statute.”¹⁹

In sum, 21C does not support the proposal that the ITC be required to consider the *eBay* factors in determining whether to issue Exclusion Orders. Such an approach would take the factors out of their proper context in determining whether it is equitable to issue an injunction in addition to an award of money damages in a patent infringement case. The result would be greater uncertainty for all U.S. patent owners, especially those who are not manufacturers, such as universities, research-oriented engineering firms and independent inventors, as to the availability of Exclusion Orders to prevent imported infringing products from flooding the U.S. marketplace.

Moreover, the proposal to introduce the *eBay* factors into Section 337 would impose added burdens and complexity on all patent owners seeking to use the ITC. It is not just PAEs, or even NPEs, who would be forced to prove that the *eBay* factors justify issuance of an Exclusion Order to prevent infringing importation. These additional burdens may fall hardest on small and medium enterprises struggling to create a business in the United States in the face of infringing imports. Particularly when the evidence is arguable for claims that the ITC is being abused by PAEs, making this sweeping limitation to the ITC’s authority, in all investigations sought by all patent owners, is neither warranted nor wise.

¹⁹ *In re Certain Inclined Field Acceleration Tubes and Components Thereof*, Inv. No. 337-TA-67, USITC Pub. 1119, Comm’n Op., at 22 (Dec. 1980) (quoting S. Rep. 93-1298, at 197 (1974), reprinted in 1974 U.S.C.C.A.N. 7186, 7330).

C. Proposed Changes to the Definition of “Domestic Industry.”

Another proposal which has been discussed as a possible approach for limiting the ability of PAEs to obtain TTC Exclusion Orders is to restrict those “licensing” investments eligible to support a domestic industry. As we understand it, the proposal would clarify that a domestic industry may be established through licensing only when that licensing takes place prior to the alleged infringing activity and promotes the adoption of the patented invention.

21C cannot support the proposal in that form. It would generate uncertainty and risk for U.S. patent owners, particularly research-oriented American universities and engineering firms, that their investments in licensing, even if substantial, would be disregarded for purposes of establishing a domestic industry if the infringement began before a license was offered, negotiated and executed. Indeed, limiting access to Section 337 to those licensors who entered into licenses prior to infringement would almost certainly lead to perverse results, including a “race to import” an infringing product before the infringer would engage in licensing negotiations with the U.S. patent owner.

The limitation that licensing only qualifies to support a domestic industry if it “promotes the adoption of the patented technology” adds further uncertainty. One can envision extended collateral disputes over whether this limitation is satisfied by the patent owner’s licensing activities. Given the unresolved debates over the definition of what exactly constitutes an NPE, and a PAE, it is not difficult to imagine similar debates over whether the licensing activities of such firms actually promote the adoption of the patented technology or instead represent a tax on innovation and technology adoption.

That is not to say, however, that 21C is unwilling to consider supporting changes to the definition of “licensing” in Section 337 to address perceived abuses of the ITC by PAEs. In fact, 21C has been discussing such concerns and possible solutions with those stakeholders who have raised them. 21C believes that, with further investigation and discussions, it may be possible to reach consensus on a very precise and narrow solution that would tighten the definition of “licensing” for purposes of establishing a domestic industry while avoiding the very real specter of adverse unintended consequences. The risk of unintended impact is perhaps most acute when patent laws are amended at the behest of some industry segments and in the face of opposition from others, so 21C remains committed to working toward the goal of consensus. But at a time when U.S. economic recovery is in such a precarious state, we urge caution with respect to efforts to limit the ITC’s powers in Section 337 investigations that might benefit foreign manufacturing over domestic.

II. SEPs in ITC Section 337 Investigations

I turn now to the second category of ITC complainants which has drawn an increasing amount of attention lately; namely, the owners of SEPs. Firms, especially in the information technology and telecommunications industries, face the problem that hundreds of patented inventions need to work together in devices operating together within a system. To solve the inevitable “interoperability” problem that would arise if all the firms were to practice their competing technologies, the firms may engage in voluntary, consensus standard setting conducted by standards-setting organizations (SSOs). These voluntary

bodies adopt standards to ensure that devices operating within a system will work together and communicate with each other in standardized, predictable ways.

When an adopted standard incorporates patented technology owned by a participant in the standard-setting process, it creates the potential for the SEP owner to engage in what has been referred to as “patent hold-up.” The SEP owner may use the leverage it acquired when the SSO based the standard on its patented technology to negotiate much higher royalty rates than would have been possible before the standard was set. The SEP owner may have the ability to demand and obtain royalty payments based not on the true market value of its patents, but on the costs and delays of switching away from the standardized technology. As the Federal Trade Commission (FTC) has explained, “once a standard is adopted, implementers begin to make investments tied to the implementation of the standard. Because it may not be feasible to deviate from the standard unless all or most other participants in the industry agree to do so in compatible ways, and because all of these participants may face substantial switching costs in abandoning initial designs and substituting a different technology, an entire industry may become locked in to a standard.”²⁰ To preclude such opportunistic conduct, SSO members often agree to license their SEPs on FRAND terms as a *quid pro quo* for the inclusion of their patents in a standard.

The FTC, U.S. Department of Justice (DOJ) and other commentators have questioned whether the ITC should be precluded from granting Exclusion Orders with respect to SEPs that patent owners have committed to license on FRAND terms. They

²⁰ See Third Party United States Federal Trade Commission’s Statement on the Public Interest, *In re Certain Gaming and Entertainment Consoles, Related Software, and Components Thereof*, Inv. No. 337-TA-752 at 2 (Int’l Trade Comm’n June 6, 2012).

have raised the prospect that a patentee could make a FRAND commitment as a member of the SSO, and then seek an Exclusion Order for infringement of the FRAND-encumbered SEP as a way of securing royalties that may be inconsistent with that FRAND commitment and the value of the patented technology. Neither the FTC nor the DOJ, however, has gone so far as to assert that Exclusion Orders should not be available categorically to SEP owners.²¹

In our view, the right approach to this issue is a nuanced one. There should be no blanket rule that Exclusion Orders are, or are not, available to SEP owners. That is because for legal purposes, a FRAND commitment is a contractual obligation. When a patent owner voluntarily makes a FRAND commitment, it is entering into an agreement with the SSO to which implementers of the standard are third-party beneficiaries. Like any contract, the scope and meaning of a FRAND commitment is determined by its language, as interpreted in view of the intention and understanding of the parties who formed the contract. The meaning may depend on the written agreements, policies, and procedures of the SSO at the time the FRAND commitment was made, as not all SSOs structure FRAND obligations in the same manner. Likewise, what licensing terms are “fair” or “reasonable” will be factually specific, based on evidence such as industry practice, terms agreed to by other licensees and the negotiations between the parties.

²¹ *See, e.g.*, Hearing of the United States Senate Committee on the Judiciary, “Oversight of the Impact on Competition of Exclusion Orders to Enforce Standard-Essential Patents” (July 11, 2012) (Statement of Joseph F. Wayland, Acting Assistant Attorney General, Antitrust Division, U.S. Dep’t of Justice) (available at <http://www.judiciary.senate.gov/pdf/12-7-11WaylandTestimony.pdf>); (Statement of Edith Ramirez, Commissioner of the Fed. Trade Comm’n) (available at <http://www.judiciary.senate.gov/pdf/12-7-11RamirezTestimony.pdf>).

Accordingly, a FRAND commitment must be construed on a case-by-case basis to give effect to the parties' intent. That intent may or may not be consistent with the SEP owner's request for an ITC Exclusion Order. For example, suppose that the SEP owner offered to grant a license on FRAND terms and has attempted in good faith to negotiate such terms with the infringer, but the infringer has rejected the offer. In that case, a blanket rule eliminating an ITC Exclusion Order as a remedy would punish the patentee for giving the FRAND commitment, reward the infringer for its intransigence and discourage participation in SSOs and the making of FRAND commitments. Indeed, if the infringer is located overseas, beyond the reach of U.S. district courts, an Exclusion Order may be the only remedy available to the SEP owner who faces an obstinate infringer.

On the other hand, suppose that the evidence shows the alleged infringer would be licensed if the SEP owner had complied with its FRAND commitment. In that case, the ITC would be entitled to conclude the public interest would be damaged by entering an Exclusion Order. The public would hardly be served if a SEP owner were able to make a FRAND commitment in order for its patented technology to be included in a standard; then in breach of the FRAND commitment, refuse to license its SEP on FRAND terms to a respondent willing to accept such terms, but not the terms the SEP owner now demands; and then obtain an ITC Exclusion Order against the standard-practicing products of the respondent.

The ITC should be allowed to take into account these nuanced fact patterns on a case-by-case basis. The ITC already has the statutory authority it needs to do so. For example, the Commission has been considering whether a respondent may raise a FRAND-

based affirmative defense under Section 337.²² In any event, the ITC could cite the public interest factors it must consider under Section 337 in determining that an Exclusion Order should not issue, or should be limited somehow, when the investigation involves a SEP subject to a FRAND obligation.

In sum, the ITC is no less capable than are the district courts of considering the impact of FRAND obligations when SEP owners request exclusionary relief. Rather than adopting bright-line rules on this issue, the ITC is best positioned to consider the facts of particular cases and to determine, under its mandate to consider the public interest factors set out in Section 337, whether an Exclusion Order is an appropriate remedy. To exclude such patent owners from the ITC risks leaving them with no remedy against a manufacturer of imported infringing products who refuses to negotiate a license on FRAND terms.

* * *

I thank the Subcommittee for the opportunity to submit for the record 21C's views on the ITC's role in investigating patent disputes. As always, 21C remains committed to working with all stakeholders on these and other issues of patent law and policy. I will be pleased to submit written answers to any questions my statement may raise and to supply any additional information for the record that may be requested.

²² See *In re Certain Wireless Communication Devices, Portable Music and Data Processing Devices, Computers and Components Thereof*, Inv. No. 337-TA-745, Comm'n Decision to Review in Part, 77 Fed. Reg. 38826 (June 29, 2012).

**Letter from Catherine A. Novelli, Vice President,
Worldwide Government Affairs, Apple Inc.**

July 18, 2012

The Honorable Lamar Smith
Chairman, Committee on the Judiciary
United States House of Representatives
Washington, DC

The Honorable John Conyers, Jr.
Ranking Member, Committee on the Judiciary
United States House of Representatives
Washington, DC

The Honorable Bob Goodlatte
Chairman, Subcommittee on Intellectual Property, Competition, and the Internet
United States House of Representatives
Washington, DC

The Honorable Melvin Watt
Ranking Member, Subcommittee on Intellectual Property, Competition, and the Internet
United States House of Representatives
Washington, DC

Dear Chairmen Smith and Goodlatte and Ranking Members Conyers and Watt:

Thank you for holding the recent hearing on patent disputes before the International Trade Commission. Attached is a letter sent by Apple General Counsel Bruce Sewell to Chairman Leahy and Ranking Member Grassley of the Senate Judiciary Committee after that committee's hearing to examine the anti-competitive use of standard-essential patents. I bring it to your attention to give you a greater understanding of Apple's perspective and experience with these issues. Abuse of standard-essential patents and the International Trade Commission process is a critical matter, and I appreciate the Committee's attention to it.

Sincerely,



Catherine A. Novelli
Vice President, Worldwide Government Affairs
Apple Inc.

cc: Representative Darrell Issa
Representative Zoe Lofgren

July 18, 2012

The Honorable Patrick J. Leahy
Chairman, Committee on the Judiciary
United States Senate
Washington, DC

The Honorable Chuck Grassley
Ranking Member, Committee on the Judiciary
United States Senate
Washington, DC

VIA: HAND DELIVERY

Dear Chairman Leahy and Ranking Member Grassley:

I write with regard to last week's hearing on the problems created by attempts to use allegedly "standard essential" patents that are subject to commitments to license on "fair, reasonable, and non-discriminatory" ("FRAND") terms to seek exclusionary remedies—including in the International Trade Commission ("ITC"). Such remedies would result in removal of products from the United States market, and some FRAND patent owners have used the prospect of exclusion to "hold up" competitors. The Department of Justice and Federal Trade Commission voiced significant concerns about these patent hold-up practices. We thank the Committee for its bipartisan effort to review these important issues. Apple has experienced these abuses first-hand, and I write to share some observations on these issues.

The DOJ and FTC expressed hope that this problem may be resolved by the ITC and Article III courts, and signs of progress exist. For example, Judge Richard Posner's recent decision rejecting the effort of Motorola (Google's subsidiary) to enjoin the sale of the iPhone and iPad in the Northern District of Illinois articulated several important limits on FRAND patents—including, crucially, that they cannot be used as a basis for injunctions. The ITC may reach the same conclusion through proper application of the public interest factors that it must consider in every case. 19 U.S.C. § 1337(d)(1).

Yet concerns remain. The ITC's Office of Unfair Import Investigations, for example, took the position just last week that the ITC should assert jurisdiction over cases involving FRAND patents—and issue exclusion orders based on such patents. If the ITC adopts this position, Congress may need to act to ensure that FRAND patents are not used as weapons to harm competition and consumers.

Two Types Of Technology: Standardized And Product-Differentiating

All agree that standards are critical to the modern economy. Standards facilitate interoperability of devices, and create a common foundation for robust competition among devices that share certain core functionality.

On this common platform, mobile device manufacturers compete vigorously to develop features that differentiate their products from competitors. The differentiating features can take the form of product design (such as the physical shape of the device), the user interface, the processing capabilities, or other aspects. It is competition among *nonstandardized*, product-differentiating technologies that drives the current marketplace and benefits consumers. And it is this competition that is threatened by the abusive use of FRAND patents.

The capabilities of an iPhone are categorically different from a conventional phone, and result from Apple's ability to bring its traditional innovation in computing to the mobile device market. Using an iPhone to take photos, manage a home-finance spreadsheet, play video games, or run countless other applications has nothing to do with standardized phone protocols. Apple spent billions in research and development to create the iPhone, and third-party software developers have spent billions more to develop applications that run on the iPhone. The price of an iPhone (and the cost of applications that can be purchased from third parties) reflects the value of these nonstandardized technologies—as well as the value of the aesthetic design of the iPhone, which also reflects immense study and development by Apple, and which also is entirely unrelated to standards.

The heart of the problem is that a handful of FRAND patent holders are using their standard essential patents as leverage to extort either (i) a share of the monetary value of nonstandardized, product-differentiating technology or (ii) the right to use, themselves, proprietary nonstandardized technology owned by other companies. To enhance their bargaining position, the FRAND patent holders have sought injunctions or other exclusionary remedies—to threaten companies like Apple that have been leaders in developing product-differentiating technology, and to force them to either pay exorbitant royalties or license their product-differentiating technology.

FRAND Compensation

The royalty for a FRAND patent should be based on the value of the component that contains the standardized functionality. *See* Federal Trade Commission, *The Evolving IP Marketplace* at 212 (“The practical difficulty of identifying a royalty rate that accurately reflects the invention’s contribution to a much larger, complex product often counsels toward choosing the smallest priceable component that incorporates the inventive feature.”) (Mar. 2011); *Cornell Univ. v. Hewlett-Packard Co.*, 609 F. Supp. 2d. 279, 288 (N.D.N.Y. 2009) (selecting a processor as the royalty base where it was the smallest priceable unit).

For wireless standards like the third-generation (or “3G”) standards created by the European Telecommunications Standards Institute, any standardized functionality in a mobile device is substantially located in a computer chip called a “baseband processor.” The price of a baseband processor is typically less than \$20, and often less than \$10. Thus, to obtain the computer chip that enables a device to communicate using 3G standardized protocols, a device manufacturer must pay less than \$20 per device. That same inexpensive chip could be used in a “plain vanilla” mobile phone, or a cutting-edge device like an iPhone. The standardized functionality is exactly the same. Given the enormous volume of the mobile device market, a FRAND patent holder can collect significant total royalties, even if the per-unit royalties are properly constrained.

The use of FRAND patents to try to collect a share of the value of nonstandardized technology—or to extract coerced license rights to such technology—is neither fair, reasonable, nor non-discriminatory. It is inherently unfair and unreasonable to use a patent directed to one thing (standardized functionality centered in a commodity baseband chip) to collect money or cross-license rights on another thing (product-differentiating, nonstandardized technology). It is also discriminatory, because the result would be for makers of cutting-edge devices to pay more for precisely the same standardized technology used in simple phones.

That is why it is wrong to charge FRAND royalties on the end price of a device like the iPhone, whose value arises more from product-differentiating technology than standardized technology, and whose price reflects this. A FRAND royalty on an iPhone should be no higher than a FRAND royalty on any other 3G phone. It is akin to a toll on a highway: the toll is identical for a jalopy and a new sports car—the sports car does not pay more just because it is faster, more stylish, and has a better sound system.

Nor is it FRAND to seek royalties based on the mere fact that a particular technology was standardized; a FRAND royalty should be limited to the true technical value of a patented technology, not an artificially inflated value based on the fact that it has been included in a mandatory industry standard. As Judge Posner recently put it, “once a patent becomes essential to a standard, the [patentee’s] bargaining power surges because a prospective licensee has no alternative to licensing the patent; he is at the patentee’s mercy.” *Apple, Inc. v. Motorola, Inc.*, No. 1:11-cv-08540, ECF No. 1038, slip. op. at 18 (N.D. Ill. June 22, 2012).

At its core, FRAND is a pro-competitive concept intended to prevent patentees from abusing this artificial, standard-derived market power, and is meant to limit FRAND patent holders to the intrinsic, pre-standardization value of the standardized technology. The essence of the FRAND bargain is that patent holders receive the benefits of standardization (including a large market of potential licensees, and in some cases first-mover advantages arising from the ability to quickly implement their own patented technology) in return for restricting themselves to royalties based on the true value of the standardized technology.

Resolution of FRAND Disputes

Apple believes in resolving license disputes through negotiation, to the greatest extent practicable, and has successfully executed licenses with many FRAND patent holders. But when certain companies have demanded non-FRAND compensation for FRAND patents, Apple has put them to their burden. A FRAND patent holder should be prepared to demonstrate that its demand is truly fair, reasonable, and non-discriminatory. FRAND should not be subject to the patent holder’s subjective, often self-serving, interpretation.

To take Motorola as an example, Apple has negotiated for years to try to persuade Motorola to comply with FRAND. Motorola has demanded a royalty of 2.25% of the price of each Apple wireless device—which translates into more than \$13 per unit—for rights to its allegedly standard essential patents. This is more than the price of the baseband processor chip. Motorola’s demand is not based on the value of standardized technology—rather, Motorola

seeks to expropriate the value of the non-standardized technology in Apple's products. For example, Motorola's demand would result in significantly different royalties for different iPad models, which sell for different prices depending on the amount of memory included in the device. But the amount of memory—and its cost—is wholly unrelated to wireless standards.

That Motorola has steadfastly refused to comply with FRAND makes *Motorola* an unwilling licensor on FRAND terms. Apple is not alone in reaching this conclusion: in an ITC case between Motorola and Microsoft, the judge rejected Motorola's "standard terms," finding that "the royalty rate offered by Motorola of 2.25%, both as to its amount and the products covered, could not possibly have been accepted by Microsoft." *Certain Gaming and Related Consoles, Related Software, and Components Thereof*, Inv. No. 337-TA-752, Initial Determination (Public Version) at 300 (Apr. 23, 2012).

Such disputes can be finally resolved in federal district courts, which have the jurisdiction and expertise to adjudicate patent royalty issues.¹ To the extent the FRAND patent holders' positions are correct, they will win an award of damages in the amount they seek, plus interest. To the extent Apple (or others who refuse non-FRAND demands) is correct, that position will be vindicated by the judge or jury. Given the increasing scrutiny of district courts into the relationship between a damages demand and the actual functionality at issue², Apple is confident that its position will prevail. But for now, the critical point is that FRAND disputes are monetary disputes and should be decided on monetary terms—whether by negotiation or, if the parties reach an impasse, in district court.

Yet some FRAND patent holders have sought to distort the dispute-resolution process, by hanging the sword of an injunction or exclusionary order over the proceedings. This is a "hold up" technique: the goal is to force prospective licensees to agree to pay exorbitant royalties and/or cross-license nonstandardized, product-differentiating technology—or have their products taken off this market. This hold-up power is, as discussed below, fundamentally incompatible with FRAND.

¹ Apple recognizes that in the exceptional and rare circumstance where a foreign company is not subject to personal jurisdiction in any United States district court, the ITC might be an appropriate forum for adjudication of a FRAND dispute. The Department of Justice raised this scenario at last week's hearing.

² See, e.g., *Lucent Techs., Inc. v. Gateway, Inc.*, 580 F.3d 1301 (Fed. Cir. 2009), in which the Federal Circuit overturned the jury's damages award on the grounds that the "entire market value rule" had been improperly applied because the patented feature was only a small part of "an enormously complex software program [Outlook] comprising hundreds, if not thousands or even more, features." *Id.* at 1332. *Lucent* and other recent cases make clear that patent holders will no longer be able to collect royalties against the entire market value of a device unless an asserted patent truly drives demand for that entire market value. In the case of advanced wireless devices like the iPhone, it is beyond question that standardized communications protocols do not drive demand for their entire market value; if so, then basic phones would sell for the same price as iPhones, because both equally use those standardized protocols.

The Hold-Up Effect Of Exclusionary Remedies

Permitting injunctions or exclusion orders for FRAND patents would empower makers of FRAND declarations to engage in the very type of anticompetitive patent hold-up that they disavowed in return for having their purportedly essential technologies standardized. The Federal Trade Commission has clearly articulated the severity of the threat that an exclusion order based on a FRAND-committed patent would pose to competitive conditions and U.S. consumers:

[A] royalty negotiation that occurs under threat of an exclusion order may be weighted heavily in favor of the patentee in a way that is in tension with the RAND commitment. High switching costs combined with the threat of an exclusion order could allow a patentee to obtain unreasonable licensing terms despite its RAND commitment, not because its invention is valuable, but because implementers are locked in to practicing the standard. The resulting imbalance between the value of patented technology and the rewards for innovation may be especially acute where the exclusion order is based on a patent covering a small component of a complex multicomponent product. In these ways, the threat of an exclusion order may allow the holder of a RAND-encumbered [standard-essential patent] to realize royalty rates that reflect patent hold-up, rather than the value of the patent relative to alternatives, which could raise prices to consumers while undermining the standard setting process.

Certain Wireless Communication Devices, Portable Music and Data Processing Devices, Computers and Components Thereof, Inv. No. 337-TA-745, Third Party United States Federal Trade Commission's Statement on the Public Interest ("FTC Public Interest Statement") at 3-4 (June 6, 2012).³ Judge Posner echoed the FTC's view when he flatly rejected the possibility of an injunction for patents subject to FRAND commitments, explaining that the FTC's logic "embraces any claim to enjoin the sale of an infringing product." *Apple*, slip op. at 19.

The threat to competition associated with permitting exclusion orders based on FRAND-committed patents is particularly acute where, as in the wireless-communications industry, devices comply with many different standards, each of which is subject to many parties' claims to hold standard-essential patents. If exclusion orders or injunctions were available, *each and*

³ See also other public interest submissions made in Investigation No. 337-TA-745, including Comment on the Public Interest by AT&T, June 8, 2012, Doc. ID 482441; Comment in Response to the Request for Statements on the Public Interest by Cisco Systems, Inc., June 7, 2012, Doc. ID 482396; Comments on the Public Interest by Microsoft Corporation, June 6, 2012, Doc. ID 482241; Comments on the Public Interest by Nokia Corporation, June 6, 2012, Doc. ID 482247; Comments on the Public Interest by Business Software Alliance, June 6, 2012, Doc. ID 482232; Comments on the Public Interest by Hewlett-Packard Company, June 6, 2012, Doc. ID 482215; Comments Retail Industry Leaders Association, June 6, 2012, Doc. ID 482212; see also *Certain Gaming and Related Consoles, Related Software, and Components Thereof*, Inv. No. 337-TA-752, Statement Regarding the Public Interest by Non-Party Intel Corporation, June 8, 2012, Doc. ID 482466.

every party claiming to hold a standard-essential patent would be empowered to seek exclusion of standard-compliant products from the market—and to use that power to hold up suppliers of new and innovative products for exorbitant royalties or other license terms. Indeed, absent obtaining licenses in advance from every declared-essential patent holder for every standard covering its products—which would take years, if it could ever be accomplished—device manufacturers could no longer invest in, develop, and bring to market new and innovative products without fear that any of the declared-essential patent holders could seek to enjoin product sales. To put this into perspective, companies have declared thousands of patents as essential to the 3G “UMTS” standard alone, and UMTS is only one of dozens of standards practiced by advanced wireless communications devices.⁴ The use of FRAND patents to seek exclusion orders or injunctions has great potential to stifle competition from new market entrants.

This anticompetitive effect would be all the more serious because declared standard-essential patent holders would have strong incentives to “hold out” and refuse to agree to FRAND royalties, to take advantage of increased leverage from the sunk costs that potential licensees put into not only developing their devices, but also obtaining licenses from others—and patent holders could demand ever more exorbitant royalties as the price for removing the possibility of an exclusion order halting sales of the devices in which costs have been sunk. Not only would these incentives further distort the negotiation process, but they could lead to even more delay before the device manufacturer could bring new and innovative products to market without threat of an exclusionary remedy.

The bottom line is that if exclusion orders or injunctions were available for patents subject to RAND commitments, device makers would operate under a constant threat of being excluded from the market. The end result would be great harm to the competitive conditions of the U.S. economy. Product supply would be put at risk—either because of exclusion orders, or because companies decide practicing the standard is simply not worth the cost and voluntarily withdraw from the market or never introduce their products in the first place; product prices would increase sharply; the reduced supply would diminish the availability of like or directly

⁴ See, e.g., *Certain Wireless Communication Devices, Portable Music and Data Processing Devices, Computers and Components Thereof*, Inv. No. 337-TA-745, Public Interest Statement by Nokia Corporation at 4 (“For the UMTS standard, companies have disclosed thousands of patents as potentially essential to practice the standard. UMTS is only one of many, many standards that cover various components in modern high-technology devices such as computers and smartphones.”); Tim Simcoe, *Can Standard Setting Organizations Address Patent Holdup? Comments for the Federal Trade Commission*, August 5, 2011, available at <http://www.ftc.gov/os/comments/patentstandardsworkshop/00040-80169.pdf> (“ETSI requires explicit disclosure and sometimes gets thousands of declared essential patents for a single project.”); Fairfield Resources International, Inc. *Review of Patents Declared Essential to LTE and SAE (4G Wireless Standards) Through June 30, 2009*, January 6, 2010, available at <http://www.frlicense.com/LTE%20Final%20Report.pdf> (“The lists of patents and patent applications declared as essential to LTE or SAE [two fourth generation cellular technology standards] compiled by ETSI contains more than 1100 distinct entries declared as of June 30, 2009.”).

competitive articles; and U.S. consumers would experience a substantial reduction in innovation and product quality, to their detriment.

The Problems With The “License Offer As The Ticket To An Injunction” Theory

Even parties like Motorola and its parent Google recognize that FRAND imposes *some* form of constraint on their ability to use FRAND patents to seek injunctions; all agree that FRAND patents are not like other patents. But such companies seek to make that constraint as minimal as possible—notably, by advocating what might be called the “license offer as the ticket to an injunction” theory. Under this theory, if the FRAND patent holder makes what it deems to be a FRAND-compliant offer, and the prospective licensee declines, then the patent holder is freed to seek an injunction in district court or an exclusion order at the ITC. This theory is wrong, for several reasons.

First, it places all the leverage into the hands of the patent holder. After the patent holder makes the self-interested judgment that it has made a FRAND offer, it frees itself to seek exclusionary remedies. This distorted and unfair approach ignores the far more equitable alternative of an independent decision-maker—such as a court—setting a FRAND royalty, without injunction demands hanging over the proceedings.

Second, as the FTC noted in its recent ITC submission, “a royalty negotiation that occurs under threat of an exclusion order may be weighted heavily in favor of the patentee in a way that is in tension with the RAND commitment.” *Certain Wireless Communication Devices, Portable Music and Data Processing Devices, Computers and Components Thereof*, Inv. No. 337-TA-745, FTC Public Interest Statement at 3. The United States District Court for the Western District of Washington recently reached a similar conclusion in a case between Microsoft and Motorola, stating, “[A] negotiation where [the licensor] must either come to an agreement or cease its sales throughout the country. . . fundamentally places that party at a disadvantage.” *Microsoft Corp. v. Motorola, Inc.*, No. 10-cv-1823, ECF No. 318, slip op. at 24 (W.D. Wash. May 14, 2012). Simply put, with the threat of an injunction or exclusion order hanging over the defendant’s head, the dynamic between the parties is fundamentally distorted—creating an unfair incentive to settle the litigation on non-FRAND terms.

Third, the patentee does not need exclusionary remedies to recover FRAND compensation. FRAND means money, and in particular royalties—which the district court can award, with interest, if the patent holder demonstrates it is entitled to them. By committing to FRAND, the patent holder has necessarily admitted that money is adequate compensation—which cuts sharply against the availability of an injunction. As Judge Posner concluded, “a [FRAND] royalty would provide all of the relief to which [the patentee] would be entitled if it proved infringement . . . and thus it is not entitled to an injunction.” *Apple*, slip. op. at 21.

Nor, as Motorola has argued, is the threat of exclusionary relief necessary to ensure that potential licensees bargain in good faith. As Judge Posner explained in rejecting that contention, absent the threat of exclusionary relief, both the FRAND patentee and potential licensees have strong incentives to reach agreement and avoid the costs of patent litigation, and a potential licensee that rejects a license offer later found to be RAND “[runs] the risk of being ordered by a court to

pay an equal or even higher royalty rate.” *Apple*, slip. op. at 20. It is the distortion from the threats of exclusionary relief that imperils fair and fruitful negotiations.

Fourth, the “normal rules” for patents simply do not apply to FRAND-committed patents, and thus arguments about the normal remedies available to patent holders are unavailing. Even parties like Motorola seem to recognize this, by suggesting a FRAND license offer as the ticket to an injunction. No such license offer needs to be made for “normal” patents—owners of nonstandardized, non-FRAND committed patents are free to *never* license their patents. The “offer as the ticket to an injunction” theory actually proves too much—it is an implicit concession that unrestricted licensing lies at the heart of the FRAND bargain, and this simple fact compels the conclusion that exclusionary remedies are inappropriate.

Fifth, the notion that standard-setting organizations like ETSI have accepted injunctions for FRAND patents is incorrect. Quite the contrary: on June 8, 2012, Dr. Michael Walker, former Chairman of the Board of ETSI, testified on Apple’s behalf at the hearing in the International Trade Commission case that Samsung brought against Apple. Dr. Walker testified that even though the ETSI IPR Policy does not explicitly address injunctions, that Policy is “all about seeking a license, not preventing use of IPR, which an injunction is at the end of the day.” *Certain Electronic Devices, Including Wireless Communications Devices, Portable Music and Data Processing Devices, and Tablet Computers*, Investigation No. 337-TA-794, Hearing Transcript at 1350. Samsung did not call any witness to rebut Dr. Walker.

“De Facto Standards”

Google’s letter submission to the Committee refers to certain “de facto” standards. This is, Apple submits, an attempt to deflect the Committee’s attention from the real problem—and, perhaps, an attempt to unduly obtain rights to nonstandardized technologies developed outside of the standard-setting process.

Standard-setting is an industry-wide process to develop common technologies through collective action and agreements. Mechanisms like FRAND are required to safeguard against anticompetitive abuses that could arise from such industry-wide efforts.

In contrast, if a single company develops a proprietary technology, this unilateral action does not implicate the same considerations as the joint process of standard-setting. That a proprietary technology becomes quite popular does not transform it into a “standard” subject to the same legal constraints as true standards.

Apple’s Commitment To FRAND

Finally, let me discuss Apple’s license terms for its own strong and growing portfolio of FRAND patents. Apple is willing to license its FRAND patents for wireless communications standards on license terms that rely on the price of baseband processor chips as the royalty base, at a rate that reflects Apple’s share of the total declared-essential patents for those standards—provided that its licensee reciprocally agrees to the same approach. Simply put, Apple is “walking the walk” on FRAND, and is not asking that any company do anything that Apple itself is unwilling

to do. Apple believes in FRAND, recognizes its critical role in preserving the integrity of the standard-setting process and promoting fair competition, and is committed to complying with it.

* * *

Let me close by repeating Apple's hope that the courts and the ITC take decisive action to cure the problems of FRAND abuse. But, this is a critical issue that warrants close scrutiny by Congress, and if the courts and the ITC fail to address these issues, it will be necessary for the Congress to take action to ensure that standard-setting results in competition and innovation rather than hold-up and coercion.

Sincerely,



Bruce Sewell
Senior Vice President and General Counsel
Apple Inc.

CC: The Honorable Herb Kohl
The Honorable Dianne Feinstein
The Honorable Chuck Schumer
The Honorable Orrin G. Hatch
The Honorable Jon Kyl
The Honorable Jeff Sessions
The Honorable Patrick J. Leahy
The Honorable Chuck Grassley
The Honorable Amy Klobuchar
The Honorable Al Franken
The Honorable Christopher A. Coons
The Honorable Richard Blumenthal
The Honorable Lindsey Graham
The Honorable John Cornyn
The Honorable Michael S. Lee
The Honorable Tom Coburn