

ASPATORE THOUGHT LEADERSHIP

Patent Law 2009

*Top Lawyers on Trends and Key Strategies
for the Upcoming Year*



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First Printing, 2009

10 9 8 7 6 5 4 3 2 1

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Maximizing Your Patent Strategy in a Changing World

David W. Beehler

Partner

Robins, Kaplan, Miller & Ciresi LLP



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Patent Exhaustion

While this year was not as dramatic as 2007, we still had some significant developments in the patent arena. Certainly one of the most anticipated cases was the United States Supreme Court's decision in *Quanta Computer Inc. v. LG Electronics Inc.*, 128 S. Ct. 2109; 170 L. Ed. 2d 996 (U.S. 2008), with its impact on the patent exhaustion doctrine. For matters decided so far in 2008, this case has the most potential to affect the area of patent law—specifically strategies of licensing versus enforcement.

As a general concept, patent exhaustion limits a patent holder to one recovery for an infringement. So whether you recover by suing someone and obtaining a judgment, or by obtaining a license, future enforcement for that particular infringing conduct would be lost or “exhausted.” This “exhaustion” concept is front and center in situations involving licensing a supplier of a component in determining whether a patent holder can later enforce its patent against that supplier's downstream customers.

The *Quanta* case that came out this year concerned patents licensed to Intel for certain technology associated with microprocessors. The dispute seemed simple enough—did that license extend not only to Intel but also to Intel's customers, given that the license expressly said that no license to third parties to combine Intel's products with other items had been granted? Despite that express language, the Court held that the license did extend to Intel's customers. Specifically, the Court found that licensing a component part will lead to patent exhaustion when that component “substantially embodies” the patent. So whatever money the patent holder received from the initial licensing to the component manufacturer is all the patent holder will receive—even if the downstream customer is utilizing the technology of the patent in its product.

So why should that decision potentially cause big changes in strategy? As an initial matter, the case changes any reliance patent holders might have been placing on language in their license agreements showing an intent to not exhaust patent rights. Such language on its own does not seem to really matter anymore. Instead, the question is now whether the licensee has the authority to sell the product to third parties, and whether there are conditions and limitations that limit the grant of the license. You can

imagine the difficulty in trying to convince a component supplier to somehow give up their authority to sell their licensed component downstream.

If patent holders risk being cut off from further enforcement against ultimate sellers or users by licensing the component manufacturers, you can and should expect a change in a patent holder's behavior. Perhaps the court expected that change in behavior to be a reduction in patent litigation. But the opposite reaction may have been created, and it is for that reason many do not see the opinion as a positive development. Instead of licensing, one could expect some patent holders to shift enforcement efforts to the ultimate sellers, customers, and end users, rather than component suppliers, or indeed to sue all of them simultaneously, rather than license *seriatim*.

Even if that trend does not happen, one can certainly imagine how lawyers will now fight over what it means for a component to substantially embody an invention, especially when the court did not give us much guidance or some bright-line test of what that means. Usually one speaks to a precise determination of whether a product or process is an embodiment of the claimed invention. The smallest detail can take it out of being such an embodiment. The test of whether something "substantially" embodies an invention will need further clarification. Moreover, we are starting to see the *Quanta* case used affirmatively against patent holders through allegations that attempt to license patents that have been exhausted and constitutes patent misuse or an illegal suppression of competition.

An additional nuance to the case could well lead to a different type of litigation other than strict patent lawsuits. In the license, Intel agreed it would give written notice to its customers that the license Intel had was not a license for combinations of Intel's components with components of others. Commenting on that requirement, the court said that its opinion did not affect any contract rights the patent holder might have. So that suggests that a patent holder could be more likely to bring suit for breach of contract against a licensee if the patent rights downstream get frustrated.

The opinion increases the importance of really understanding the business objectives my clients want with their patent portfolios. Drilling down to understand the economics of all potential infringers—instead of the one I

might have wanted to sue previously for other strategic reasons—becomes more necessary in order to properly advise my clients on whether to license, sue one, or sue a lot, to best meet my client’s objectives.

Impact

Strategies for clients will seldom be the same because the facts, economics, and the nature of the patent claims always differ. That said, the *Quanta* case gives me pause before I would recommend negotiations or enforcement against any one company—whether that is a component manufacturer or ultimate seller. As I suggested earlier, a patentee really needs to understand the entire stream of revenue from the various manufacturers, suppliers, sellers, and users before entering into a decision as to whom to negotiate with or sue, because not doing so risks leaving a lot of money on the table. Settling with a component manufacturer and then being cut off from further enforcement efforts downstream, where the revenue and damage calculations would have no doubt been potentially much higher, is not a surprise any patentee wants to experience.

Yet I do not expect that aspect of the case to change the nature of my individual practice over the next six months. As a firm that works with clients to understand those revenue streams so that we can decide whether to share the risks of licensing and enforcement through creative retainers, we have been trying to conduct that type of diligence for many years. Since we are partnering in that risk, we have an enhanced and direct interest in making sure our clients come out of their cases with what they are entitled to, so we stress the importance of knowing as much as we can up front. The real difference now comes in deliberating with your client as to the order of whom you try to enforce the patents against first. Where a client might have been more inclined to pick off the component manufacturers initially, before proceeding against the ultimate seller, they might be more motivated now, depending upon the economics, to engage in simultaneous licensing, enforcement against all of the infringers or just going after the ultimate seller and having that seller pull the component manufacturer into the lawsuit.

These changes, together with decisions like *KSR International Co., v. Teleflex Inc.*, 127 S. Ct. 1727; 167 L. Ed. 2d 705 (U.S. 2007); *Microsoft Corp. v. AT&T*

Corp., 127 S. Ct. 1746; 167 L. Ed. 2d 737 (U.S. 2007); *In re Seagate Tech. L.L.C.*, 497 F.3d 1360 (Fed. Cir. 2007); *SanDisk Corp. v. Stmicroelectronics Inc.*, 480 F.3d 1372 (Fed. Cir. 2007), and *MedImmune Inc. v. Genentech Inc.*, 549 U.S. 118; 127 S. Ct. 764; 166 L. Ed. 2d 604 (U.S. 2007), have made me restructure my licensing documents differently than I have in the past. For licensing, the factors I now look to, other than a paid-up royalty, include taking an equity interest in the potential licensee's business or obtaining a consent judgment during licensing to preclude subsequent patent challenges. There is also a laundry list of adverse consequences one can argue that should be included to try and keep the licensee from bringing a patent challenge or that adversely affects the licensee if the licensee does indeed bring a patent challenge. Those might include a stipulation for attorneys' fees, alternative dispute resolution, a forum selection clause, a termination of the license or a "claw back of licensed technology" if a challenge is brought.

Of course, changes in how laws are interpreted should and do result in changes in a lawyer's negotiation and settlement strategy. But articulating that change is difficult since I have never had only one negotiation or settlement strategy. Strategies are always dependant upon the nature of the client's business and the specific objectives it wants to achieve. And, unlike some of the firms we have recently seen trying to get into patent litigation that seem to be more bent on achieving quick settlements based upon the cost of litigation rather than the strength of the patents, we have always been of the view that we will not get involved in a case just to try to settle it. When we get involved, we have to feel it is a strong portfolio from infringement and strong enough economically to justify our efforts to go to trial, go to appeal, and try it again if we have to.

In that respect, the recent changes in patent law have not changed our strategy of negotiation. But for those matters where we are asked by our clients to first reach out for potential licensing, these recent changes in the patent law bring three basic issues to the forefront.

One of the differences is what I have previously discussed—namely the order of whom you try to enforce the patents against, and whether to engage in simultaneous licensing against all of the infringers. The second issue is the current preference for a paid-up royalty discussion rather than a

running royalty. In short, given current case law, patentees want to resolve disputes once and be fully paid up for it rather than risk diminution of future value based upon later decisions involving validity or infringement of their patents.

The third change is that most patent holders now seek non-disclosure agreements prior to licensing, as a result of decisions like *SanDisk Corp.* Previously, by invoking certain magic language, I could initiate licensing discussions, put infringers on notice for accrual of damages purposes or set up enhanced damages, without risking being sued for a declaratory judgment action. Now we step through the initial dance even more carefully in inviting folks to the table, but asking for some form of nondisclosure agreements in which the parties agree that the talks will not be used in evidence or used to invoke declaratory judgment jurisdiction. My experience has been that with reasonable people, this system works. Patent litigation is enormously expensive and it might well be the case that a putative infringer would rather discuss resolution and licensing than trigger a declaratory judgment action with a mandatory counterclaim of infringement. What should never be forgotten is that with many companies, there is a substantial philosophical and practical difference between initiating a lawsuit for infringement themselves, as opposed to counterclaiming for infringement having been dragged into litigation. In short, the first decision, whether to sue initially, is always discretionary. The second decision, having already been sued, is compulsory.

I do not see these three types of changes being affected during 2009. The strategies are now embedded into current thinking and there are no pending cases that I am aware of that would modify them.

From a standpoint of requesting financial or asset information during negotiations, there is now more of a tendency to seek out projections and potential uses of the technology at issue since the parties understand that a paid-up royalty is the most likely result. In fact, one of the matters I was more recently involved in actually utilized depositions outside of discovery to obtain the certainty needed to reach a licensing deal on a paid-up royalty amount. Others have demanded that warrants from financial officers be signed in order to assure the accuracy of the numbers.

I have previously discussed the changes in strategy based upon the order of whom you try to enforce the patents against. That change can also affect the actual retainer agreement I have with my clients. I have been involved for instance in matters where I am teamed with the client in a licensing strategy with the idea of transforming the retainer into a shared risk retainer, dependant upon who licenses and who does not in terms of component manufacturers as opposed to downstream sellers or users. As you might imagine, with a patent portfolio that covers component manufacturers as well as retailers and users, there might well be different patents or technologies that could be asserted at any given level. That represents a bit of a different approach from the past, where my focus would have been on a particular infringer or group of like infringers.

Looking Ahead

For 2009, patentees face two significant hurdles not previously faced. Re-examination abuse has been there previously, but it is becoming even more prevalent. I am aware of putative infringers putting entire patent portfolios into reexamination in an effort to keep from having to litigate. And once in the patent office, it becomes very difficult to force an expedited timetable for resolution. Whether this can be helped through legislation is an unknown, as there are competing forces present there that cannot assure any certainty within any specific timeframe. The best we can do as trial lawyers is to try the cases against the closest prior art, and trust the examiners will see it the same way on re-examination.

The second major hurdle patentees and potential patentees face is the outcome of *In re Bilski*, 264 Fed. Appx. 896 (C.A. Fed. 2008), and whether claims as to mental process or business method patents will remain intact. Creative patent prosecutors should be in hot demand as to how they will claim new inventions differently in order to overcome the anticipated changes from *Bilski*, but the trial lawyers will be left trying to figure out if there is any way to save the existing claims already out there dependant upon whatever standard the Federal Circuit and ultimately the Supreme Court sets.

The third hurdle litigants, most often accused infringers, face is the rising costs associated with defending patent litigation—including electronic

storage and production, the costs of expert witnesses, and as always, the increasing expense of trial and appeal. Having the steel to face down patentees and plaintiff's firms who try to settle a patent case based upon the cost of litigation alone will be a necessary attribute of in-house counsel and management.

The most fruitful area of potential new offerings for clients this coming year is in the patent prosecution field, an area from which my firm stays clear in order to avoid potential conflicts in handling enforcement matters. We will continue, as we have in the past, to address the client's most immediate concerns of cost through creative risk sharing arrangements and electronic discovery advice.

Here, though, is reality. The Court of Appeals for the Federal Circuit Court was created in order to achieve "certainty" for the public as to patents and patent coverage. But in order to achieve that "certainty," it costs the parties millions of dollars to get a ruling at that appellate level. And that "certainty" can be overcome by subsequent decisions in the patent office. Add to that the fact that the patent law itself continues to evolve. And for the most part it appears to be evolving in ways that seem to be a contraction of individual inventor's or patent holders' rights. So the last few years has required clients to more than ever really look for experienced trial lawyers who not only possess great knowledge of existing patent law, but who also have an ability to predict changes in the law and structure their case accordingly, so as to best keep the verdicts intact regardless of the change that might occur.

Think about just a few ways that the patent law has, at least theoretically, been impacted in the last two years by cases like *KSR*, *AT&T*, *In re Seagate*, *SanDisk*, and *MedImmune*. Those cases have changed how you prove or disprove an obviousness case, whether and when you can claim damages for certain activities outside the United States, the standard for willful infringement, when a licensee can sue a licensor, and indeed whether you can send out a letter to try to engage in licensing discussions without getting sued for a declaratory judgment.

We still are judging the true practical impact of those cases. But I think it is beyond question that as a whole, those transformations have really encouraged patent strategies to a paid-up royalty payment and away from

running royalty transactions, where we used to be most concerned about audit rights and whether next generation modifications would be included in the royalty calculations. Now it is more often the case that the license will be a onetime payment with the discussion on trying to measure the effect that the license grant has downstream.

I do not see that transformation changing anytime soon. The Federal Circuit decided a case in early September of this year, which gives yet one more reason why paid-up royalty is the dominant strategy right now. The case was called *In re Swanson*, 2008 U.S. App. LEXIS 18928, and is a rather difficult case to justify to potential clients who are non-lawyers, because the result is really dictated by pure procedural grounds concerning differing burdens of proof rather than by equities or common sense. In that case, the Patent Office first rejected, and then allowed the patent to issue, despite knowing about this particular piece of prior art. Then there was litigation and the alleged infringer claimed the patent was invalid but lost. In fact, the Federal Circuit affirmed that litigation decision of no invalidity. But then the infringer went back to the Patent Office, after the litigation, with this same piece of prior art and asked for a re-examination and this time won a finding of invalidity on the same piece of art. The Federal Circuit, having previously upheld validity from the litigated case, now affirmed the finding of invalidity from the Patent Office because the standard of proof in a trial court is different than it is before the Patent Office. It is one more reason for a patent holder to try to get paid in a lump sum.

But the more surprising aspect is that with all of the predictions and seminars and client advice given out analyzing and interpreting *KSR*, *SanDisk*, and *MedImmune*, the jury is still out on their true lasting impact. For example, I have not seen any explosion of declaratory judgment actions being filed just because the standard changed, making it easier to do so. And while there have been a lot of suggestions as to what licensing agreements might contain to discourage a licensee from seeking an invalidity challenge, I have not seen that type of language actually agreed to in any substantial form. While I do believe many trial courts feel *KSR* changed the law dramatically, I think there are many of us who feel it was not as dramatic or far-reaching as first described. In fact Judge Rader decided a case earlier this year, *Eisai Co. Ltd. v. Dr. Reddy's Labs.*, 533 F.3d 1353 (Fed. Cir. 2008), where he seems to suggest that *KSR* may not have

much of an impact at all in certain areas of patents—like the chemical arts—because potential solutions to problems in that field are by their nature “less likely to be genuinely predictable.”

Are these potential or actual changes positive or negative? From my viewpoint, I try to use as a touchstone whether any particular decision is more or less likely to drive innovation. Restrictions on patent holders’ substantive rights, which might create more freedom to operate for infringers or change the leverage of negotiation against patent holders, in my view, generally discourages innovation, and that is something I am not in favor of overall. I was involved for a decade in some very specific patent litigation involving the oil industry, and I saw during that time an incredible degradation in research and development in that industry. I witnessed an outright hostility from both the private and public sectors toward rewarding patent holders, even though the jury and judiciary had upheld the patents. So I am concerned that there is a trend toward further restricting patent rights.

As far as *KSR*, the real change that these cases have brought to my practice is in two areas. First, during my due diligence in deciding whether to take on a case, I am undoubtedly more skeptical and cognizant of patents that might be seen as mere “combination of previously existing elements” patents. I know that I will need to articulate it at some point, so I probably spend more time in the front end trying to evaluate whether the innovation was predictable and whether the prior art would have motivated someone skilled in the art to make the combination. And I certainly spend more time in discovery concentrating on motivations to combine or not combine, in anticipation of that hypothetical witness getting on the stand without any supporting documentation and trying to now say there was such a motivation at the time of the invention.

One of the most important pending cases right now before the U.S. Court of Appeals for the Federal Circuit and expected to be decided anytime is *In re Bilski*. Depending upon what the Federal Circuit says, many of us wonder whether the Supreme Court will take yet another patent case up on its docket because of its importance.

The case concerns the scope of patentable inventions under 35 U.S.C. §101 and specifically whether claims covering an abstract idea or mental process are patent-eligible subject matter, and whether a method or process claim has to result in a physical transformation of an article or be tied to a machine to be patentable. In fact, the court has specifically invited briefs on those issues and whether previous decisions on business method patents need to be revisited.

Why is that a big deal? Because process or business method claims are typical choices for inventors of innovative software or Internet-based inventions. If the court substantially changes or restricts the scope of patentable subject matter on such claims, there will be a lot of gnashing of teeth as to how to claim these types of inventions, and a lot of motion practice on pending cases to dismiss such claims.

There has been a host of *amicus* briefs submitted on the various issues, and they generally break down into two camps—those arguing that patentable subject matter should be strict and predictable, and those saying that you should not prejudge innovation through artificial or old-school lenses. Given the case law over the last few years, it is difficult for me to believe that the Federal Circuit would have taken this case *en banc* if it did not intend to substantially restrict these types of claims, but I would certainly like to be surprised for a change. But, of course, one has to be mindful of whether the Supreme Court would grant *certiorari* if the Federal Circuit does not substantially restrict these types of claims. There is ample reason to believe the court would review it in that event.

I am often asked what changes I intend to make in my practice for any given year. As always, I sincerely hope I do not have to make more than a few changes in any one year to my legal strategies, because that would mean I have not anticipated anything. Hopefully, any changes we might employ are incremental and represent more of a fine-tuning to the way we do things here.

With that disclaimer, here is my “Top 5” list of changed strategic nuances for 2009:

1. *Step away from those business method/mental process claims and no one gets hurt.* The uncertainty created by the pending case, *In re Bilski*, in the Federal Circuit and its potential for *certiorari* in the Supreme Court, cautions against proceeding too quickly with business method/mental process type infringement claims.

2. *Everything's obvious after you show me how to do it.* Keep the teachings of KSR firmly in mind, but do not overreact to it. Defendants still prefer anticipation cases for a reason—and the reason still is if it has not been made before, you have a distinct advantage in front of the jury on why it is not obvious. As the argument goes, every reference that fails to anticipate is a failure.

3. *Rocket dockets are an endangered species.* The traditional rocket dockets across the country, for one reason or another, have slowed to a traditional pace. Seeking venue there because of some perceived advantage of “rocket” pace is not to be assumed as a given.

4. *Can we not all just get along—in the same courtroom?* It may make the management of a case more difficult, but if there are issues with patent exhaustion in settling or licensing, we need to consider suits that name all of the putative infringers simultaneously.

5. *It is not over until the patent examiner has conducted her last re-examination.* Remember that as a patent holder, you need to win every time in every forum on validity. The putative infringer only needs to win once. Expect the cost of enforcement to include trial, appeal, retrial, and re-examination.

In sum, the developing case law does not seem to be encouraging innovation, and sadly, none of the changes seem to be making patent litigation more efficient or cheaper. In a troubled economy, that makes it even more important for those companies and individuals involved in enforcing or defending patent matters to hire lawyers who they can trust to understand and drive their best business objectives with even more creativity and efficiency.

David W. Beebler is a partner, elected member of the executive board, and chair of the Professional Responsibility Committee of Robins, Kaplan, Miller and Ciresi LLP. He concentrates his practice in patent enforcement, licensing and antitrust litigation, representing both corporations and individual inventors from both enforcement and defense perspectives. For example, Mr. Beebler has represented General Electric Co. in various matters in patent litigation ranging from magnetic resonance imaging to polymers. He also represented Eolas Technologies Inc. and the Regents of the University of California, in patent litigation against Microsoft Corporation concerning web browser technology and an individual inventor in litigation involving antivirus technology against McAfee Inc. For ten years, Mr. Beebler represented Unocal Corporation with respect to its patents on reformulated gasoline technology. Those matters included infringement verdicts against ARCO, Chevron, Exxon, Mobil, Shell, and Texaco, the defense of antitrust claims brought by the Federal Trade Commission, and the defense of patent infringement and judicial interference claims brought by Talbert Fuel Systems Patents Company. Following the acquisition of Unocal Corporation by Chevron, Mr. Beebler represented ExxonMobil Chemical Company in assisting them on licensing polymer patents. Mr. Beebler also represents clients outside patent litigation but in commercial business disputes, including, for example, General Electric Co., Blue Cross Blue Shield of Minnesota, Delta Dental of Minnesota, infoUSA Inc., and Best Buy Co. Inc.

Mr. Beebler is a member of the state bars of Minnesota, Kansas, and Missouri and is admitted to the U.S. Court of Appeals for the Eighth, Ninth, and Federal Circuit as well as the United States Supreme Court. He received his J.D. from the University of Minnesota Law School in 1985 and is a co-author of "Trial" in the treatise Patent Litigation compiled by Lawrence Pretty.

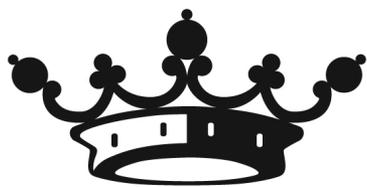
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