

A MICROSOFT WIN COULD BENEFIT OTHER DEFENDANTS

by Rod Berman and Joshua Hodas

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In 2011, the U.S. Supreme Court will review the decision of the U.S. Court of Appeals for the Federal Circuit in *Microsoft Corp. v. i4i L.P.*, 589 F.3d 1246 (Fed. Cir. 2009), withdrawn and revised at 598 F.3d 831 (Fed. Cir. 2010), which affirmed a \$290 million damages award against Microsoft for patent infringement. If the Supreme Court overturns the Federal Circuit, the resulting change in the law could significantly strengthen the position of defendants in patent litigation.

In 2009, an Eastern District of Texas jury found Microsoft liable for \$200 million for infringing a patent related to markup-language document editing. Judge Leonard Davis ruled the infringement willful, adding \$40 million in enhanced damages. Interest and continuing damages have boosted this figure to more than \$290 million.

Microsoft argued that the patent was invalid under the "on-sale bar" because, more than a year before i4i applied for the patent, a prior-art system (S4) embodying the patented invention was sold. Notably, i4i did not disclose S4 to the U.S. Patent and Trademark Office (PTO) during examination of its patent application. The jury was instructed that Microsoft must prove the acts triggering the on-sale bar by clear and convincing evidence. Microsoft could not meet that burden. i4i had destroyed the source code

for S4, preventing Microsoft from comparing it to the patent claims, which was necessary to meet that standard.

Microsoft argued it would have prevailed had the jury been instructed that the on-sale bar could be proven by a preponderance of the evidence. Under that standard, notwithstanding the unavailability of the S4 code, Microsoft argued it would have overcome i4i's claim that S4 was not described by the patent's claims with admitted statements by i4i to investors that it did.

The Supreme Court granted certiorari after the Federal Circuit affirmed all relevant aspects of the trial court outcome.

Section 282 of the Patent Act provides that an issued patent is presumed valid at trial, and the burden of proving invalidity is borne by the defendant, although the level of proof for meeting this burden is not recited. This enforces judicial deference to the PTO's opinion that the applicant was entitled to a patent after its review of the prior art. For more than 25 years, the Federal Circuit has held that the burden is clear and convincing evidence. The question presented to the Supreme Court is whether this is the correct standard.

Prior to the 1982 creation of the Federal Circuit, the circuit courts of appeals held that the presumption of validity was weaker, or that the standard for proving invalidity was lower, when prior art not considered by the PTO is presented

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during litigation. See, e.g., *Baumstimler v. Rankin*, 677 F.2d 1061 (5th Cir. 1982); *Manufacturing Research Corp. v. Graybar Electric Co.*, 679 F.2d 1355 (11th Cir. 1982); *Futorian Mfg. Corp. v. Dual Manufacturing & Engineering Inc.*, 528 F.2d 941 (1st Cir. 1976).

The Federal Circuit, however, has consistently held that the clear-and-convincing standard applies in all cases, even though, in dicta, in *KSR International Co. v. Teleflex Inc.*, 550 U.S. 398, 426 (2007), the Supreme Court expressed doubt about that unwavering application: When prior art not considered by the PTO is presented, "the rationale underlying the presumption — that the Patent Office in its expertise, has approved the claim — seems much diminished."

MICROSOFT'S ARGUMENTS

Microsoft and several entities that filed amicus curiae briefs argue that there is no basis for the imposition of a clear-and-convincing standard whatsoever; Congress' only intent was that § 282 make clear that the defendant bore the burden of proving invalidity. Furthermore, when unconsidered prior art is presented at trial, the PTO has not issued any opinion on that prior art to which any deference is due, let alone one that should require clear and convincing evidence to overcome. The standard, they argue, should be a preponderance of the evidence, at least in the latter case, and the Supreme Court should make explicit its holding from the dicta in *KSR*.

The Securities Industry and Financial Markets Association and other amici add that the clear-and-convincing standard imposes a particularly

harsh burden on financial institutions. Prior to the Federal Circuit's decision in *State Street Bank and Trust Co. v. Signature Financial Group Inc.*, 149 F.3d 1368 (Fed. Cir. 1998), patent protection was not generally available for the business methods crucial to that industry. Therefore, prior to 1998, financial institutions generally protected their practices as trade secrets. Thus, there is little published prior art that such defendants can use to meet the clear-and-convincing standard.

Facebook Inc. and other amici point out that the heightened standard conflicts with the lower standard employed by the PTO during patent re-examination. A court ruling on invalidity during contemporaneous litigation cuts off any pending PTO re-examination of the patent. Since a court has discretion whether to issue a stay of the litigation pending re-examination, a court may rule a patent valid in deference to the PTO just as the PTO rules it invalid.

14I'S ARGUMENTS

i4i acknowledges that § 282 does not mention a heightened evidentiary standard, but claims that Congress intended to codify a long line of cases that held both the existence of the presumption and the heightened standard for overcoming it. i4i argues that the pre-1982 holdings of the circuit courts are inapposite, as they predate the creation of the regime for patent re-examination, which provides an opportunity to put newly discovered prior art before the PTO.

i4i puts greatest weight on Congress' failure, for 25 years, to overturn legislatively the Federal Circuit's interpretation of § 282, in spite of many

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opportunities to do so and in spite of a demonstrated willingness to overturn Federal Circuit decisions on other matters. Changing to a lower standard, i4i argues, would significantly harm the value of licensed patents.

Microsoft and other amici argue for a substantial break with existing Federal Circuit law: a ruling that the clear-and-convincing standard does not apply in any context, or at least not in the context of unconsidered prior art. They clearly hope for a broad ruling to help defend against frequent suits by nonpracticing entities, also known as patent trolls, for patent infringement. Although the Supreme Court may have some sympathy for this position, it could announce a variable-burden test depending upon the deference due the prior art in light of the PTO's examination of it or push the issue off for Congress to resolve.

It is possible, however, for the Supreme Court to reverse on the narrow facts of the case, in

particular i4i's failure to disclose its own prior art to the PTO. It could even limit the holding to cases in which there is other evidence, such as i4i's representations to investors, that the withheld prior art embodied the patented invention. The Supreme Court could then shift the burden to i4i to show that S4 did not embody the patent. Since i4i could not produce the S4 source code (of its own doing), it would be unable to overcome the presumption that S4 did, in fact, embody the invention, and that the patent is invalid.

Thus, Microsoft could win the case, but the ruling would lead to a less significant shift in the balance of power between patent plaintiffs and defendants. It would leave the clear-and-convincing standard in place in most infringement cases. It would leave to another day whether that standard is appropriate in cases involving prior art that was not considered by the PTO, but that was also unknown to the applicant.



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