No. 05-130

In The Supreme Court of the United States

EBAY INC. and HALF.COM, INC.,

Petitioners,

v.

MERCEXCHANGE LLC,

Respondent.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Federal Circuit

BRIEF *AMICUS CURIAE* OF COMPUTER & COMMUNICATIONS INDUSTRY ASSOCIATION IN SUPPORT OF PETITIONERS

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Computer & Communications Industry Association (CCIA) submits this brief as *amicus curiae* and respectfully requests that the Petition for a Writ of Certiorari be granted. Petitioners and Respondent have consented to the filing of this brief, and the letters of consent are being filed herewith.

INTEREST OF AMICUS

The Computer & Communications Industry Association is a non-profit trade association dedicated to open markets, open systems, and open networks. CCIA members participate in many sectors of the computer, information technology, and telecommunications industries and range in size from small entrepreneurial firms to the largest in the industry.[1] CCIA members use the patent system regularly, and depend upon it to fulfill its constitutional purpose of promoting innovation. CCIA is increasingly concerned that the patent system has expanded without adequate accountability and oversight.

CCIA supports the petition for certiorari. This brief addresses how the Federal Circuit's standard for injunctive relief reflects and reinforces other problematic Federal Circuit decisions.

[1] Counsel for a party did not author this brief in whole or in part. No person or entity other than CCIA, its members, or its counsel made a monetary contribution to the preparation or submission of this brief.

Neither CCIA nor its members have a direct financial interest in the outcome of this litigation. However, allowing the Federal Circuit's decision to stand would subject CCIA members to increased patent litigation, burden information technology and software, and undermine the legitimacy of the patent system as a whole.

SUMMARY OF ARGUMENT

The issue presented in this case is whether the standard for injunctive relief in patent cases as articulated in 35 U.S.C. § 283 is consistent with general principles of equity or there should be a *sui generis* standard of automatic injunctive relief as articulated below by the U.S. Court of Appeals for the Federal Circuit.

The Federal Circuit's standard of automatic injunctive relief is fundamentally hostile towards complex products, especially today's extremely complex, systems-based digital information technology. The value of a deeply embedded patented function or component may be miniscule in relation to the value of the finished product and the costs of bringing it to market. Under such conditions, the extraordinary leverage accorded by automatic injunctive relief enables the patentee to extract settlements that approach the costs of shutting down an entire product line, far in excess of what a reasonable royalty is likely to be.

The undue leverage afforded by automatic injunctive relief belongs to a larger set of interrelated problems that are having a profound, often negative effect on intellectual property practice in the information technology sector. These problems are manifestations of the Federal Circuit's doctrinal championing of patent rights without due consideration

for the economic characteristics of different innovation environments and the inevitable dangers that a rigid jurisprudence poses to large segments of the economy.

Following its unique bureaucratic imperative, the Federal Circuit has become, in the words of Judge Posner, "a booster of its specialty."[2] While championing the expansion in scope and scale of the patent system, the Federal Circuit has instituted a narrowed stewardship which, along with the institutional biases that result from a fee-funded U.S. Patent and Trademark Office (PTO), has resulted in a system that operates in a dangerously self-serving manner.

The Federal Circuit's expansionist jurisprudence has unbalanced and distorted the U.S. patent system, especially as it affects information technology, software, and business services. In effect, it has transformed patent law from a rigorous technical specialty into a general law of novelty that reaches into every sector and all aspects of human activity. The Federal Circuit has made patents easier to get, easier to assert, more potent, more versatile, and widely available. In addition, the PTO's own bureaucratic incentives have led it to grant patents in increasing number and, arguably, decreasing quality.

Together, these phenomena promote an inflationary spiral of patents in the information technology industry, fed by a perceived need and demand to assemble ever-larger patent portfolios. These effects produce anti-competitive

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[2] Declan McCullagh, *Left Gets Nod from Right on Copyright Law*, C|Net News, Nov. 20, 2002, *available at* http://news.com.com/2100-1023-966595.html.

behavior, foster more litigation, and undermine innovation.

It is against this backdrop of extraordinary growth and distortion that the Federal Circuit has endorsed a manifestly inappropriate standard for injunctive relief. Accordingly, review should be granted.

ARGUMENT

I. The Automatic Injunction Rule Exacerbates Existing Problems In The Patent System.

A recent study by the Federal Trade Commission (FTC) confirmed what many technologists have long believed: the U.S. patent system contains deep flaws that prevent it from efficiently performing its constitutional purpose of promoting the progress of science and the arts, particularly with respect to complex technologies. *See generally* Federal Trade Commission, *To Promote Innovation: The Proper Balance of Competition and Patent Law and Policy* (2003) (FTC Report). Some of the problems flow from structural biases at the Patent and Trademark Office. Others are rooted in a pattern of questionable Federal Circuit decisions that has made patents overly attractive – easy to get, easy to assert, potent, versatile, and available for all areas of activity – thereby increasing demand and putting pressure on a system that already resolves many questions in favor of patent applicants and holders. The automatic injunction rule fashioned by the Federal Circuit in the decision below significantly amplifies these other problems by placing a dangerously powerful weapon in the hands of a patentee who, but for the

Federal Circuit's and the PTO's expansive policies, might not hold the patent to begin with.

Through ritual invocation of the patent incentive while ignoring scholarly literature and empirical economic evidence, the Federal Circuit has proved not only a booster of patents but a guardian of a lawyer's patent system, narrowly focused on the individual case but blind to the effects of patents on particular fields and indifferent to aggregate economic impact. This unsupervised expansion has triggered a staggeringly expensive arms race. In sum, "we converted the weapon that a patent represents from something like a handgun or a pocket knife into a bazooka, and then started handing out the bazookas to pretty much anyone who asked [] for one, despite the legal tests of novelty and non-obviousness." Adam B. Jaffe & Josh Lerner, *Innovation and Its Discontents* 35 (2004).

A. The Federal Circuit Has Made Patents More Potent.

By requiring injunctive relief, the Federal Circuit has made patents extraordinarily potent. Under general principles of equity, injunctive relief may well make sense in many circumstances, particularly where there is a close correlation between patents and products. However, the Federal Circuit's automatic rule removes the opportunity to examine the full range of factors that courts of equity normally consider. It demands ignorance of the economic realities of the situation, while depriving defendants of their interests in equity and district courts of their equitable powers.

In information technology, an infringing function may represent only an infinitesimal fraction of the value of a marketed product or service that embodies a complex technology. In determining damages, a court can evaluate the importance of the infringing function relative to the product as a whole. However, if injunctions are automatic, a patent on a single function can suddenly freeze an entire product line. The loss of the product line may well be catastrophic for the manufacturer, who faces the burden of extracting infringing functionality once a product has been designed, tested, debugged, packaged, and put on the market. In this context, economies of scale and scope, which have brought the benefits of information technology to millions at low cost, become a vulnerability. A single obscurely embedded patent can hold hostage an enormous sunk investment in manufacturing, distribution, and marketing of a rich, expensive product. Under such circumstances, the mere threat of an injunction carries enormous weight, tilting the negotiating table against the manufacturer in proportion to its investment.

There is no practical reason to depart from traditional principles of equity to constrain judicial consideration of injunctive relief. The power and leverage to radically disrupt innovation and commerce in complex technologies is an unneeded add-on to the patent incentive. This form of extortionate leverage does not exist as a practical matter in discrete technologies, and judges should not be forced to require it in complex technologies.

Even if the patent system were perfect in all possible respects, the Federal Circuit failed to justify its deviation from normal principles of equity. But the patent system is far from perfect. Other problematic decisions by the Federal Circuit and the institutional biases of the PTO

multiply the damage caused by the lower court's automatic injunction rule.

B. The Federal Circuit Has Made Patents Easier To Get.

Prior to the Patent Act of 1952, the Supreme Court articulated a very high standard for patentability: an invention must evidence a "flash of creative genius" to merit a patent. *Cuno Eng'g Corp. v. Automatic Devices Corp.*, 314 U.S. 84, 91 (1941). Drafted by two patent attorneys assigned to serve as staffers, *see* Giles S. Rich, *Congressional Intent – Or, Who Wrote the Patent Act of 1952* in *Patent Procurement and Exploitation* 61, 68 (1963), the Act contained the present language on the "person having ordinary skill in the art" (PHOSITA) standard, which effectively buried the subjective determination within a superficially objective standard while putting the burden of showing obviousness on the examiner. *See* 35 U.S.C. § 103. Although the Act was presented on the floor of the Senate as a mere codification of existing law, Section 103(a) appeared to overrule the Court's standard. *Compare* Rich, *supra*, at 76 n.21 *with Graham v. John Deere Co. of Kansas City*, 383 U.S. 1, 15 (1966) ("Patentability shall not be negatived by the manner in which the invention was made") (quoting § 103(a)). The Court interpreted this new standard in its 1966 *Graham* trilogy. *See Graham*, *supra*; *Calmar, Inc. v. Cook Chemical Co.*, 383 U.S. 1 (1966); *United States v. Adams*, 383 U.S. 39 (1966).

The Federal Circuit has since further lowered the standard by holding that combinations of known art are not rendered obvious unless there exists a specifically

documented suggestion or motivation to combine them. *See Arkie Lures, Inc. v. Gene Larew Tackle, Inc.*, 119 F.3d 953, 957 (Fed. Cir. 1997); *In re Lee*, 277 F.3d 1338, 1345 (Fed. Cir. 2002) (rejecting "common knowledge and common sense" in favor of requiring documentation). While purporting to reduce subjectivity, the requirement of documentation effectively sidesteps the PHOSITA test and reduces nonobviousness into a mere elaboration of the novelty requirement. Combinations of known art are enormously important in information technology where new elements are rare and most innovation routinely combines known elements in new configurations and designs. Many Internet patents are in effect combinations of the Internet and known business practices. *See, e.g.*, U.S. Patent No. 5,794,207 (issued Aug. 11, 1998) (reverse auctions on the Internet). The FTC has recommended that this special permissive treatment of combinations be eliminated. *See* FTC Report, Exec. Summ. at 11-12 (Recommendation 3b).[3]

The Federal Circuit has also liberalized the standard for nonobviousness in the application of the secondary factors enumerated in *Graham*, 383 U.S. at 16. The FTC report recommends a reformulation of the commercial success factor to ensure that commercial success is attributable to the patent in question rather than other circumstances or product features. *See* FTC Report, Exec. Summ. at 11 (Recommendation 3b).

[3] This issue is presented in the petition before the Court in *KSR International v. Teleflex, Inc.*, 04-1350.

C. The Federal Circuit Has Made Patents Easier To Assert.

In addition to making patents easier to get, the Federal Circuit has made patents easier to assert by cloaking them in an artificially enhanced presumption of validity, so that challengers must show by "clear and convincing" evidence that the patent should not have been granted. *Connell v. Sears Roebuck & Co*., 722 F.2d 1542, 1549 (Fed. Cir. 1983).

The strength of this presumption is not justified because of the ex parte nature of the examination, the limited time available to the examiner, and the fact that the burden is on the examiner to show that the applicant is not entitled to a patent. *See* FTC Report, Exec. Summ. at 8-10 (Recommendation 2) (proposing adoption of "preponderance of the evidence" standard); *id.*, ch. 5, at 26. The unjustified presumption compounds the problem of declining patent quality, as is evidenced most clearly in the information technology sector. *See* Stephen A. Merrill et al., National Research Council, *A Patent System for the 21st Century* 44-48 (2004). Thus, an artificially elevated presumption of validity provides patent holders undue leverage and gives speculators an incentive to acquire and assert questionable patents.

D. The Federal Circuit Has Made Patents More Versatile And Broadly Available.

The controversial extension of patents to pure software and then to business methods is the product of Federal Circuit decisions that conspicuously sidestep Supreme Court precedent. *See Gottschalk v. Benson*, 409 U.S. 63 (1972); *Parker v. Flook*, 437 U.S. 584 (1978);

Diamond v. Diehr, 450 U.S. 175 (1981). By virtually abolishing subject matter limitations on the patent system in a series of cases culminating in *State Street Bank & Trust Co. v. Signature Financial Group Inc.*, 149 F.3d 1368 (Fed. Cir. 1998) and *AT&T Corp. v. Excel Communications, Inc.*, 172 F.3d 1362 (Fed. Cir. 1999), the Federal Circuit has single-handedly transformed patent law from an exceptionalist regime tailored to technology to a generalist regime for all areas of human activity. *See* John R. Thomas, *The Patenting of the Liberal Professions*, 40 B.C.L. Rev. 1139, 1163-64 (1999).

Yet the extension of system in these new directions – on the one hand into the many elements of software and, on other hand, into non-technical business processes – has overwhelmed the administration of the patent system. Because software functions at so many different levels of granularity ranging from code-level algorithms to program features to business methods (most of which are implemented in software), it creates opportunities for claiming patents at multiple overlapping levels of abstraction.

Nearly forty years ago, a Presidential Commission warned against software patents because "all inventions should meet the statutory provisions for novelty, utility and unobviousness and [software] cannot readily be examined for adherence to these criteria." President's Commission on the Patent System, *To Promote the Progress of Useful Arts in an Age of Exploding Technology* § IV (1966). The poor quality of the business method patents granted in the wake of *State Street* spurred the PTO to launch a special initiative that included a second level of review. *See* Notice of Roundtable on Computer-Implemented Business Method Patent Issues, 65 Fed. Reg. 38,811, 38,112 (June 22, 2000). According to the PTO

director, this initiative cut the allowance rate in target class 705 ("Electronic Commerce") from 75% to 25%. *See* David Streitfeld, *Note: This Headline is Patented*, L.A. Times, Feb. 7, 2003, at A1. Despite this remarkable impact, indicating both the effectiveness of the program and the dire need for quality control, and an FTC recommendation that the practice be expanded to other economically important areas, second-level review has not been introduced outside of class 705. *See* FTC Report, Exec. Summ. at 14 (Recommendation 5c).

The expansion of the patent into software and business methods has engendered the most common and visible complaints about patent quality and the negative effects of patenting. The FTC sector-by-sector analysis shows that patent quality and the role of the patent system in innovation is perceived most negatively in the software and Internet sector. *Id.*, ch. 3, at 44. Accordingly, the FTC recommends considering "possible harm to competition – along with other possible benefits and costs – before extending the scope of patentable subject matter." *Id.*, Exec. Summ. at 14 (Recommendation 6). The negative U.S. experience with patents in these areas has crystallized consensus in Europe against business method patents, and contributed to the failure of a directive on "computer-implemented inventions" that would have validated European Patent Office standards on software patents.[4] The difficulties experienced in the software and

[4] *See "Should Patents be Granted for Computer Software or Ways of Doing Business?" The Government's Conclusion*, United Kingdom Patent Office, March 2001, *available at* http://www.patent.gov.uk/about/consultations/conclusions.htm; European Parliament News, Software patents: the 'historic vote' in the European Parliament brings the battle to an end, July 9, 2005, *available at* http://www.europarl.eu.int/news/

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Internet sector contrast dramatically with the views of the pharmaceutical industry, which views patents as essential to protecting products. *See* FTC Report, ch. 3, at 14, 50-56.

E. The PTO's Bureaucratic Interests Undermine Patent Quality.

The constellation of automatic injunctive relief and other Federal Circuit decisions coincides with the shift to fee-funding for the PTO in 1990. Fee-based funding gives the agency an incentive to increase the overall number of patent applications, grants, and maintenance fees in order to maximize its budget. This led to a new mission for the PTO's patent business, "to help customers get patents" and an explicitly expansionist performance goal: "Help protect, promote and expand intellectual property rights systems throughout the United States and abroad." *See* U.S. Patent and Trademark Office, *Corporate Plan 2000*, at 17; U.S. Patent and Trademark Office, *Corporate Plan 2001*, at 23.

For example, the agency's internal incentive system rewards examiners for dispositions, thereby discouraging them from contesting claims (which only delays final dispositions). *See* Robert P. Merges, *As Many As Six Impossible Patents Before Breakfast: Property Rights for Business Concepts and Patent System Reform*, 14 Berkeley Tech. L.J. 577, 607 (1999). The result has been a significant diminishment in patent quality, as reflected in an allowance rate possibly as high as 97 percent, when continuations are taken into account. *See* Cecil D. Quillen,

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public/focus_page/057-1002-255-9-37-909-20050819FCS01001-12-09-2005-2005/default_en.htm.

Jr. & Ogden H. Webster, *Continuing Patent Applications and Performance of the U.S. Patent and Trademark Office*, 11 Fed. Cir. B.J. 1, 3 (2001). Under the Federal Circuit rule, however, the threat of automatic injunction will discourage firms from disputing these low quality patents.

II. By Exacerbating The Patent System's Problems, The Automatic Injunction Rule Encourages Litigation And Impedes Innovation.

Given the inherently rich functionality of information technology, these phenomena – the automatic injunction rule, the Federal Circuit's other expansive patent jurisprudence, and the customer orientation of the PTO – have triggered a patent arms race. Facing prodigious potential infringement, companies in the information technology sector hedge their bets by filing for hundreds of patents, expecting that "mutually assured destruction" will deter others from asserting patents against them. FTC Report, ch. 3, at 35-36.

This deterrent value is increasingly formalized in cross-licenses and non-assertion agreements that provide insurance against litigation. These cross-licenses also create insurance against competition, however, by permitting companies with large portfolios to extract "balancing payments" from smaller competitors. To sustain cross-licensing, companies engage in "portfolio racing" to ensure a steady stream of patents into their portfolios. Hence, the demand for patents keeps rising, perpetuating the arms race.

The density of patents in this innovation environment means that inadvertent infringement becomes unavoidable. This phenomenon reinforces the inflationary cycle.

As Cisco observed before the FTC, "[t]he only practical response to this problem of unintentional and sometimes unavoidable patent infringement is to file hundreds of patents each year ourselves so that we can have something to bring to the table in cross-licensing negotiations." *See Competition and Intellectual Property Law and Policy in the Knowledge-Based Economy: Hearings Before the Federal Trade Commission*, Feb. 28, 2002 (statement of Robert Barr, Vice President, Worldwide Patent Counsel, Cisco Systems, Inc.) *available at* http://www.ftc.gov/opp/intellect/barrrobert.doc.

While portfolio accumulation is a rational strategy against present and potential competitors, it provides little protection against patent speculation by non-producers. Easily asserted patents, endowed with automatic injunctive relief, become potent weapons in the hands of non-producing patent firms, sometimes referred to as "trolls." These trolls profit solely from holding up producers, and therefore have no need for cross-licenses and no fear of mutually assured destruction. *See* FTC Hearings, *supra*; FTC Report, ch. 3, at 38. The trolls, therefore, are free to pursue aggressive litigation strategies based on questionable patents, which often yield settlements far in excess of the patents' true inventive contribution.

In sum, the Federal Circuit's standard for injunctive relief does not operate in a vacuum. In information technology, it provides an inordinately powerful weapon in a landscape of uncertainty. A litany of interrelated phenomena – low quality, portfolio racing, high transactions costs, widespread inadvertent infringement, opacity of patent information – make producers in this sector exceptionally vulnerable to claims of patent infringement. Automatic injunctive relief magnifies their exposure, making those

producers that contribute the most value to the marketplace the most vulnerable to catastrophe.

CONCLUSION

Efforts by Congress to correct the Federal Circuit's misinterpretation of 35 U.S.C. § 283 have been stalled by firms that benefit from the automatic injunction rule. Given the Federal Circuit's near exclusive jurisdiction over patent appeals, this Court remains the only forum where the automatic injunction rule, which magnifies the many flaws in the patent system, can be considered and reversed. Accordingly, CCIA respectfully requests the Court to grant the petition.

Respectfully submitted,

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