

PATENT

Using Arbitration to Resolve Patent Disputes: The Right Thing for the Right Case

BY DAVID A. ALLGEYER

Patent litigation can be really expensive. The 2015 Report of the Economic Survey, for example, reports an average cost of \$873,000 for patent cases with less than \$1 million at risk and \$2 million for cases with \$1 million to \$10 million at risk. Many patent disputes cannot bear that sort of expense.¹

In many areas of commercial law, parties have turned to arbitration to save time and money. The same is true for the right sorts of patent-related disputes.

Statutory Basis

Patent arbitration did not begin well, however. Some courts found patent issues were “inappropriate for arbitration proceedings and should be decided by a court of law, given the great public interest in challenging invalid patents.”² But Congress enacted 35 U.S.C. § 294 to allow parties to save time and money by arbitrating any contractual dispute relating to patent validity or infringement.

The arbitration is governed by the Federal Arbitration Act. The arbitrator must consider defenses under 35 U.S.C. § 282. These include (1) noninfringement; (2) invalidity; (3) unenforceability; (4) failure to comply with 35 U.S.C. § 112—including, for example, failure to meet written description, definiteness, and enablement requirements; and (5) failure to comply with any requirement of 35 U.S.C. § 251, which, among other things, prohibits broadening the scope of reissued patents.

Interestingly, the arbitration award binds only the parties, but the award is not enforceable until it is provided to the director of the U.S. Patent and Trademark Office.³ It is noted as part of the prosecution record of the patent.⁴

What to Arbitrate

Nothing prevents the parties from agreeing to submit any patent dispute to arbitration. But agreement is unlikely after a dispute has arisen. One party or the other is likely to see an advantage to a forum they like, want federal circuit review of a disputed claim construction, or see some other advantage to them in litigation. Thus, patent disputes arising from contractual arrangements like patent licenses, employment agreements, or development agreements are most likely to be arbitrated.

How to Ensure Arbitration

To ensure a patent dispute can be arbitrated, you will need to provide for arbitration in your contract. It is almost always better to have an arbitration provider named in your arbitration clause. While this means administrative fees, it also provides a comprehensive set of rules, case administration, resolution of questions concerning impartiality of the arbitrator, and related advantages.

To provide for American Arbitration Association (AAA) arbitration, for example, start with the AAA model commercial clause and then add a few basics. You will get this:

Any controversy or claim arising out of or relating to this contract, or the breach thereof, shall be settled by arbitration administered by the American Arbitration Association under its Commercial Arbitration Rules and the AAA Supplementary Rules for the Resolution of Patent Disputes for any patent issues submitted. Judgment on the award rendered by the arbitrator(s) may be entered in any court having jurisdiction thereof. The arbitration shall be before a [single arbitrator/ panel of three arbitrators] in [insert city].

This will get you to arbitration without fail and give you meaningful input into who the arbitrator will be. Usually you will provide for a single arbitrator to save money. But you may decide that if more than \$1 million is in controversy, for example, you will provide for a panel. You can build that into the clause.

Because arbitration is a creature of contract, you can also include just about anything else in the clause to which you and the other side agree. This can include the qualifications of the arbitrator, a deadline for the hearing, or how much discovery will or won't be allowed.⁵

But be careful. Often you are better off with a fairly general clause, the AAA's (or other provider's) rules, and an experienced arbitrator who can help fit the process to the dispute. Whatever you do, don't just copy the last arbitration clause someone in your office used. An ill-conceived clause could result in a court having to resolve disputes about the arbitration itself. At that point you will have lost some of the time and money you hoped to save by arbitrating instead of litigating.

TIPS

Best Practices for Patent Disputes

Embrace the Flexibility

Arbitration is flexible. Working with an experienced arbitrator, you can craft a procedure for the specifics of your dispute that will save time and money while providing a thoughtful and informed decision. Here are a couple of examples from recent cases.⁶

In a product licensing dispute, the key was how three claims of the licensed patent were to be construed. The licensor had broad constructions. The licensee had narrow constructions that would exclude its new, improved device. To save time and money, that was the only part of the dispute the parties initially addressed. Focused discovery was conducted, mostly about the specifics of the design of the new product. After briefing, a Markman presentation⁷ was made, and a decision was rendered construing the claims. That resolved the matter. The party whose construction was not adopted was undoubtedly unhappy with the result. But the amount spent to get to resolution was modest and in line with the amount at stake. The process fit the problem.

In another licensing matter involving a process for producing biologic material, the real dispute was not the construction of claims, but rather the specifics of the process the licensee used to make biologic material. If it infringed the claims of the involved patent, license payments were due. Thus, the focus was on exchange of information and, importantly, expert analysis of the process used as compared to the claimed process.

There were some disputes as to the scope of certain claims. But the scope of those claims was best determined in the context of all the background and evidence to be presented at the hearing instead of a separate Markman hearing. There was also the issue of how many products subject to the royalty payments were produced, if any.

The parties exchanged documents revealing respondent's processes and agreed to limit depositions to a total of 20 hours per side, which could be used for any witnesses they wanted to depose. They could come back to ask the arbitrator for more time if needed, but as I recall, they didn't. The depositions were efficient and focused.

The hearing took about four days, including testimony from knowledgeable experts on both sides. The evidence was presented to a decision-maker who was familiar with patent law and had years of experience learning about technical matters from experts and analyzing the results.

Contrast that to a jury trial that would have taken much longer to get to hearing, sprinkled with plenty of motions along the way. The hearing would have lasted twice as long. The decision would have

been made by folks who did not have the background and experience to bring to bear that the arbitrator did. Then would come the post-trial motions and appeal. Instead, the parties had a final decision in less than a year from the date filed.

Again, the losing party probably was not completely enamored with the arbitration. But any adjudicative process has to have a winner and a loser. Even the losing party would have to concede that it made a lot more sense to have a more efficient and affordable process, particularly given the amounts at stake.

Finality

Arbitration is efficient because the decision of the arbitrator is final. But this may also be a reason for concern. Arbitration awards are generally subject to being overturned or modified only if there is significant procedural unfairness or misconduct. The award is not reviewed to see if factual determinations were clearly erroneous or legal conclusions were in error.

But, if that is a concern, flexibility comes back into play. The major arbitration services allow the parties to agree to an arbitral appeal to provide review by a panel of appellate arbitrators. For AAA arbitrations, the award may be overturned for "(1) an error of law that is material and prejudicial; or (2) determinations of fact that are clearly erroneous."⁸ Other providers offer a similar standard of review.

Note, however, that the parties must agree to the optional appeal process. So you must include that in your arbitration clause if you want the option of an appeal.

The Right Case

Arbitration can be the perfect way to fit both the process and cost to the amount at stake. But you'll need to plan ahead and put the right arbitration clause in your contract to take advantage of the flexibility arbitration can offer. ☺



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Endnotes

¹AIPLA Report of the Economic Survey 2015, I-109- I-110.

²*Beckman Instruments Inc. v. Technical Devs. Corp.*, 433 F.2d 55 (7th Cir. 1965).

³35 U.S.C. §§ 135(f), 294(d), & 294(e).

⁴35 U.S.C. §§ 135(f) & 294(d).

⁵To explore the possibilities, see ClauseBuilder Tool, American Arbitration Association, available at www.clausebuilder.org (last visited Aug. 4, 2016).

⁶Arbitrators must keep arbitrations confidential, so the descriptions of the cases are necessarily cryptic and lack identifying characteristics.

⁷A pretrial hearing named for *Markman v. Westview Instruments Inc.*, 517 U.S. 370 (1996). There the Supreme Court held that the court and not the jury was to determine the meaning of keywords in a patent claim as a matter of law.

⁸Optional Appellate Arbitration Rules, American Arbitration Association, available at go.adr.org/AppellateRules (last visited Aug. 4, 2016).

Negotiating Arbitration Clauses For Patent Disputes

BY STEVEN KATZ

With costs typically ranging from \$3 million to \$5 million for a typical single patent case that has over \$10 million at stake,¹ arbitration appears to be an attractive alternative given its promise to resolve disputes at lower cost. The problem is that the complexities of patent litigation can easily drive up costs, whether in court or in arbitration.

Patent litigation often involves multiple accused products and multiple patents, each with multiple patent claims and each presenting numerous “claim construction” disputes concerning the meaning and scope of the patents. Typically, a patent defendant may raise numerous potential defenses, including those related to noninfringement, invalidity, unenforceability, contractual defenses, and equitable defenses (such as estoppel). Patent cases often involve numerous fact and expert witnesses, including technical experts and accountants, economists, and sometimes survey and market experts to address the issue of damages. If arbitration were to address all of these issues without significant constraints, then the costs would likely rival that of district court litigation.

To maximize the benefits of arbitration, care must be taken when drafting arbitration agreements.² Parties should be hesitant to accept boilerplate arbitration clauses that merely choose a set arbitration forum (e.g., the American Arbitration Association, JAMS, or the International Institute for Conflict Prevention & Resolution) and that merely state that all issues related to one or more patent disputes shall be arbitrated according to the rules of the selected forum. Such a clause may very well provide all of the downsides of arbitration with few of the benefits. This article discusses some of the issues that parties should consider addressing when crafting arbitration clauses.

Qualifications of the Arbitrator

The arbitration agreement may specify the qualifications of the arbitrator or panel of arbitrators to better ensure a reasoned and sensible resolution of a dispute. The parties may, for example, require the arbitrators to have some familiarity and expertise in the underlying technology, business, or market. That said, when deciding on the qualifications for the arbitrator, the parties should keep in mind the value of a judicial mindset and judicial temperament. A jurist who day in and day out must objectively determine which side in a dispute is right brings a different skill set to being an arbitrator than an advocate that zealously and unwaveringly represents a client's position. Thus, a retired judge with some experience and comfort in resolving patent disputes has much to offer even without the technical depth and breadth of a longtime patent practitioner. In addition, the required technical qualifications of an arbitrator should not be so

exacting that the arbitrator patent pool is too small to actually retain a desired arbitrator or arbitration panel.

The Scope of the Arbitration Award

Patent damages are typically in the form of a reasonable royalty based on a legal fiction, which makes them difficult to quantify and injects a significant element of uncertainty. The royalty is based on a “hypothetical negotiation” between the parties that did not take place and, more significantly, would in many circumstances never have taken place in the real world. Many patent plaintiffs initially propose damages theories that are based on a tenuous economic underpinning or rely on questionable factual inferences. An experienced arbitrator or arbitration panel may well be a significant improvement over a jury in resolving such an open-ended patent damages dispute. However, preparation of an open-ended damages case will be expensive, whether for trial or for arbitration, and the parties can increase predictability and reduce arbitration costs by placing parameters on the damages award in the arbitration agreement itself. For example, the parties can agree to a royalty rate or a formula for calculating damages should liability be found, thus dispensing with the damages dispute altogether. The parties may agree that damages will be based on certain forms of evidence, use particular benchmarks, or be based on a particular economic model to significantly narrow the dispute. At the very least, the parties may agree to damages caps such that the maximum exposure (or exposure per unit of revenue) is known up front. This can be particularly comforting to a potential patent defendant who may be giving up a right to appeal by agreeing to arbitration rather than trial.

The arbitration agreement may also specify whether interim or equitable relief will or will not be available, including the availability of preliminary or permanent injunctions.

Claim Construction

The most significant event in any patent litigation is claim construction—the process by which the court determines the meaning of disputed terms in the asserted patents. Two decades ago, the Supreme Court confirmed that in a patent litigation, claim construction is to be determined by the judge and not the jury.³ Nonetheless, commentators as well as some judges have questioned whether the judiciary has the expertise to properly interpret patents.⁴ That said, the parties give up significant procedural safeguards by agreeing to arbitration; therefore, the parties may wish to specify ground rules for claim construction and require a reasoned opinion from the arbitrator.

Patent Invalidation

In patent disputes, the party accused of infringement often challenges the validity of the asserted patents. An invalidity challenge may be based on prior art, meaning that the patented invention was disclosed in (or an obvious advance over) prior patents, technical publications, or actual devices. An invalidity challenge may also allege that a patent is invalid because the patent claims are indefinite or the patented invention is not adequately or sufficiently described in the patent itself. Often, a validity challenge is used by an accused infringer to rein in the scope of the patent to support a noninfringement defense. The accused infringer proposes a narrow claim construction and further argues that if the patent were construed more broadly, it would be invalid over the prior art. If this is the likely strategy, then the parties may wish to specify in the arbitration agreement that questions of infringement, validity, and claim construction should be decided together.

On the other hand, if the invalidity challenge is expected to be an independent attack on the asserted patents, then the parties may agree that invalidity based on prior art will be submitted to the U.S. Patent and Trademark Office (USPTO) through its post-grant proceedings, such as *inter partes* review proceedings (IPR) before the Patent Trial and Appeal Board. Such an agreement would greatly simplify the arbitration (and thus reduce costs and increase predictability) and leave the question of patent invalidity to the experts at the USPTO. Another option would be to stage resolution so that the question of infringement is decided first. If infringement is found, then the arbitration proceeds

with resolving the question of invalidity and, if appropriate, damages.

The foregoing are just some of the issues parties should consider when drafting an arbitration agreement. Careful, up-front thought will avoid an arbitration free-for-all and thereby provide for a relatively inexpensive dispute resolution process for patent disputes. ☉



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Endnotes

- ¹AM. INTELLECTUAL PROP. L. ASS'N, REPORT OF THE ECONOMIC SURVEY (2015).
- ²Parties are generally free to craft their own arbitration agreements for patent disputes, which are fully enforceable in federal court. *See, e.g.*, 9 U.S.C. § 9.
- ³*Markman v. Westview Instruments Inc.*, 517 U.S. 370, 372 (1996) (“the construction of a patent, including terms of art within its claim,” is “exclusively” for “the court” to determine).
- ⁴*See, e.g.*, Kimberly A. Moore, *Are District Court Judges Equipped To Resolve Patent Cases?*, 15 HARV. J. L. & TECH. 1 (2001) (now Judge Moore, sitting on the U.S. Court of Appeals for the Federal Circuit).

IRS Appeals *continued from page 31*

³⁰*See supra* n.12.

³¹National Taxpayer Advocate, Annual Report to Congress at 10 (Dec. 31, 2015).

³²IRM 33.3.6.1 (08-11-2004).

³³Marie Sapirie, *News Analysis: The Increase in Cases Designated for Litigation*, 2016 TAX NOTES 49-3 (March 14, 2016).

³⁴H.R.4128, 114th Cong. § 309 (2015), S.2333, 114th Cong. § 309 (2015).

³⁵S.2809, 114th Cong. § 3 (2015).

³⁶H.R.4128, 114th Cong. § 309 (2015); S.2333, 114th Cong. § 309 (2015); S.1578, 114th Cong. § 602 (2015).

³⁷*See* OMB Statement of Administration Policy on H.R. 5485 (June 21, 2016); Financial Services & General Government Appropriations Act, 2017, H.R. 5485, 114th Cong. (2016).

³⁸The FAST Act, Pub. L. No. 114-94, 129 Stat. 1312 (Dec. 4, 2015) (amending I.R.C. § 6306).

³⁹Lowell E. Mann, *Administrative Appellate Procedure Before the I.R.S.*, 62 A.B.A. J. 377 (March 1976).



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