

Patent Law Overhaul, a Step Backwards

By John A. Squires

On the surface, 2010 appears to be a heady time for American innovation. For the first time in 30 years, the U.S. Supreme Court will denote the patentable distinction between applied and abstract ideas. And for the first time in over 50 years, Congress appears poised to pass a comprehensive patent reform bill — something it has strived to do each year for the past seven years.

Yet on substance, the Senate Compromise bill is a step backwards from the current status quo governed by the 1952 Patent Act. It tackles none of the issues driving the need for serious reform — patent quality, predatory litigation and abuse and uneven application in differing industries — which begs the question, why this bill and why now? How ironic that the legislative framework enacted at the time of the transistor and polio vaccine better serves today's economy than a new bill drafted in the age of the Internet and bioinformatics. This is not your grandfather's patent statute-in-waiting. His remains better.

While I have long advocated for meaningful modernization of our nation's patent laws — because with the right reform comes new jobs and better market transparency, clarity and predictability — the present bill advances none of these. Reform for reform's sake is no reform.

Hope floats, still, however. The House, through the amendment process, still has a last clear chance to fix the bill and achieve meaningful reform by insisting on answers to three broad questions.

Any patent statute aiming to fill the big shoes of the 1952 Patent Act, should have broad industry sector backing. The compromise bill has not garnered any significant support over last April's bill, and, in fact, some stakeholders have gone missing.

Lack of consensus is likely not a result of any one particular affirmative bill provision, but rather what the bill fails to do *in toto*. On each hot button issue, ranging from damages, to willfulness to venue, to inequitable conduct, no transparency exists as to what standard rationale economic actors must meet in ordering their conduct. This lack of transparency hurts the major stakeholder groups — the tech sector, industries mature to patent issues and the independent inventor groups alike. However, understanding how each is disaffected may produce a bridge between them and allow substantive provisions to emerge to salvage a meaningful reform framework.

Tech Sector: Lack of transparency, up front, in damage award calculations and for willfulness determinations has caused the patents litigation process to divorce itself from the underlying real economy and commercial competitor considerations. In its place, a burgeoning cottage industry has exploded chasing lottery-ticket windfalls.

Predatory patent assertions abound and the tech sector is by far the single most targeted industry by patent aggregators (Non-Practicing Entities "NPEs" — funds that merely hold patents but sell or produce nothing). Lack of clear damages rules allow large damages awards for components that patentees did not invent and allow for little or no means whereby commercial actors can either know about or value patent rights. As a result, no means for any market-based price discovery exists, and NPEs do better economically by suing going concern businesses that offer real products or services, rather than producing anything themselves.

Worse, outdated venue provisions permit defendants to be hauled

into court not where their offices or operations exist but anywhere user-based Internet or wireless access is available. For all of tech sector's misery, all that the compromise bill offers is to enshrine the court as a 'gate-keeper' on damage theories that may be presented to juries. In a world of complex value chains and ever-shrinking components and specialization, the litigation abuse cycle cannot be broken without clarity on legal standards for patent valuation.

Independent Inventors: As to patent valuation standards, independent inventor associations rightly worry that any type of apportionment approach would erode their ability to detect and deter infringement and receive compensation for their invention at the hands of infringers. However, without any standard, and with market signals blocked by an abusive litigation process, small inventors can never be sure that they are receiving fair value if they sell their inventions early stage to NPE's. So, a lack of a clear valuation standard deprives them of an important yardstick.



Patent-Mature Industries: Stakeholders, including the branded pharmaceutical sector, rightly worry that fractioning damage awards could severely disrupt their ability to recoup the enormous costs in bringing new drugs to market. But fuzzy rules wreak havoc on their interests as well. Litigation abuse abounds over issues concerning the standard by which information relevant to patentability should have been submitted, years earlier. As a result, Monday-morning quarterbacked notions of information disclosure can render pharmaceutical patents unenforceable and worthless. Under the bill, there is an attempt to address these abuses by circumscribing the inequitable conduct defense, but an administrative process is to take its place, which has an indefinite 'new question of patentability' standard for invocation. So, the concern is the pendulum has swung too far the other way.

Nevertheless, while each industry sector begins at a different starting point, all arrive at the same crossroad issue — transparency. This recognition may provide a bridge for which a consensus solution on appropriately factored standards can be fashioned.

But there is an additional nugget of optimism for consensus building: the major industry stakeholders already have a consensus victory under their belt. Without much fanfare, in January, the National Patent Jury Instruction Committee released a consensus benchbook, co-au-

thored by many of the participants in the reform process as stakeholders on case management trial process issues concerning damages.

While commonality on an issue — lack of transparency applied to legal standards — may be a driver to achieve consensus support, where would the data and analysis come from to fashion appropriate standards?

The U.S. Federal Trade Commission, for one. Precisely because valuation questions are hard and the variables complex, beginning in late 2008, the FTC embarked on a comprehensive set of hearings to analyze the evolving intellectual property marketplace, including the economic dynamic and very litigation abuse issues across all industries surrounding patent enforcement.

The report based on the 2008-09 hearings is forthcoming. That a bill could be enacted without the benefit of that report is breathtaking. The prospect that the compromise bill could be enacted before the FTC's report is released and studied is shocking and would be a historically missed opportunity.

Finally drilling into the issues, the compromise bill provisions are a step back from the 1952 Act and decisional law that has developed since. Several provisions represent severe downgrades to where decisional law now stands interpreting the 1952 Act.

Willfulness: In 2007, the Federal Circuit recalibrated the standard for determining willful behavior to 'objective reckless.' The compromise bill threatens to give back these gains by failing to require concrete notice provision, allowing any and all facts in addition to knowledge of a patent to suffice as a trigger and including a 'close case' standard that will be overly porous as compared to current law.

Patent Quality: A higher threshold for after-patent-grant quality issues bars the path to invoke the patent agency as expert arbiters of quality issues versus the litigation process. Also, adoption of a race to the patent office system for applicants, while in line with other countries' processes, is negated by any corresponding upgrade in prior user rights. In turn, NPE's will emerge with new sources of patents with which to press predatory claims.

Venue: Current law is codified, which still does not provide a standard that the proper judicial district hearing the case bear some relationship to the acts complained of in the lawsuit

Best Mode: The best mode requirement in current law relates to the key issue of transparency, and any remedy for a compliance failure is eliminated by the current bill. Based on notions of fair dealing, the best mode requirement demands an inventor disclose their preference in implementing an invention. While complaints have force that the current law remains subjective, unless full disclosure of better performing patented inventions can be compelled, transparency suffers.

The 1952 Act, while creaky in places, provided a brilliant and lasting architecture for our patent system. This bill is no 1952 Act. However, there remains an opportunity for the House and Senate to do the hard work ahead, drive consensus, incorporate the FTC's findings and include provisions that elevate the presently anemic compromise bill. In the immortal words of former British Prime Minister Margaret Thatcher: "This is no time to go wobbly."

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Inconsistent Rules Challenge State Water Regulation

By Roderick E. Walston

In a significant decision affecting California's right to regulate water, the California Court of Appeal recently held that federal law preempts California law as applied to regulation of hydroelectric power projects. The court, in its March 30 decision in *Karuk Tribe v. California Regional Water Quality Control Board*, 2010 Cal. App. LEXIS 427, followed U.S. Supreme Court precedents holding that state laws applicable to hydropower projects are preempted. The Supreme Court precedents, however, establish incongruent and inconsistent rules governing the states' rights to regulate different kinds of water projects, thus posing a challenge to the states in managing their water resources.

In *Karuk Tribe*, an Indian tribe brought a mandamus action against



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California's Regional Water Quality Control Board to compel the Board to issue waste discharge requirements for a hydropower project — the Klamath Hydroelectric Project — that generates large amounts of electricity in Northern California. The project had been licensed by a federal agency, the Federal Energy Regulation Commission (FERC), pursuant to the Federal Power Act of 1935. Under California's Porter-Cologne Act, the Board is authorized to issue waste discharge requirements prohibiting discharges of pollutants that impair beneficial uses of water. The tribe sought to require the Board to impose waste discharge requirements limiting the hydropower project's discharge of pollutants into the Klamath River.

The Court of Appeal held that the Federal Power Act preempts California's Porter-Cologne Act as applied to federally licensed hydropower projects, and therefore the Board has no authority to issue waste discharge requirements for the Klamath project. The court relied on the U. S. Supreme Court's decisions in *First Iowa Hydro-Electric Coop. v. Federal Power Comm'n*, 328 U.S. 152 (1946), and *California v. FERC*, 495 U.S. 490 (1990), both of which held that the Federal Power Act preempts state laws applicable to federally licensed hydropower projects. The court also cited the 9th Circuit's decision in *Sayles Hydro Associates v. Maughan*, 985 F.2d 451 (9th Cir. 1993), which, following the Supreme Court decisions, had reached the same result. Notably, the Board, represented by the California Attorney General, took the position that it was powerless to adopt the waste discharge requirements in light of the Supreme Court decisions.

The Karuk Tribe argued that the appellate court should follow the California Supreme Court's decision in *California Oregon Power Co. v. Superior Court*, 45 Cal.2d 858 (1955), which had held that — notwithstanding the U. S. Supreme Court's *First Iowa* decision — the Federal Power Act provides for a "duality of control" by federal and state agencies, and therefore does not preempt California's nuisance laws as applied to hydropower projects. The appellate court held that the California Supreme Court's decision was no longer valid after the U. S. Supreme Court's later decision in *California v. FERC*, which held that federal law occupies the field and thus leaves no room for the application of state law to hydropower projects.

Although the Clean Water Act authorizes the states to apply their water quality laws to projects licensed under federal law — including federally licensed hydropower projects — the appellate court held that the Clean Water Act does not apply because the Klamath project was not applying for or attempting to renew its FERC license.

The Court of Appeal decision will become final on April 29 — 30 days after filing.

The Federal Power Act of 1935 authorizes FERC to regulate and issue licenses for hydropower projects throughout the nation. Section 27 of the Act requires the projects to comply with state laws relating to the "control, appropriation, use, or distribution" of water. Section 27 was patterned after Section 8 of the Reclamation Act of 1902, which requires federal reclamation projects also to comply with state laws relating to the "control, appropriation, use, or distribution" of water. (The Reclamation Act authorized the creation of federal dams and reservoirs that have transformed the West, such as the Central Valley Project in California, which is a major source of California's water supplies.) Thus, Section 27 of the Federal Power Act and Section 8 of the Reclamation Act are virtually identical, because both require the regulated projects to comply with the same state laws.

In the 1940s and 1950s, the U. S. Supreme Court interpreted both provisions as applicable only to state "proprietary" laws and as not authorizing state regulation of the projects. The court said that the Federal Power Act and the Reclamation Act preempt state regulatory laws, and "save" only state laws governing "proprietary" rights. In *First Iowa*, the Supreme Court reached this result in construing Section 27 of the Federal Power Act, and in *Ivanhoe Irrig. Co. v. McCracken*, 357 U.S. 275 (1958) and later cases, the Court reached the same result in construing Section 8 of the Reclamation Act. The Supreme Court thus distinguished between state regulatory laws and state proprietary laws in construing the preemptive effect of both statutes.

In *California v. United States*, 438 U.S. 645 (1978), the Supreme Court erased the distinction between state regulatory laws and state proprietary laws in construing Section 8 of the Reclamation Act. The court held that Section 8 authorizes the states to apply both their regulatory laws and proprietary laws to federal reclamation projects, and overturned its decisions in *Ivanhoe* and other cases that had held otherwise. Under Section 8, the court said, the federal projects must comply with state laws both in acquiring water rights and in distributing water. On remand, the 9th Circuit — in a decision written by then-Judge (now-Justice) Anthony M. Kennedy — upheld all conditions that California's water rights agency had placed on the federal New Melones Project. *United States v. California*, 694 F.2d 1171 (9th Cir. 1982). Under these decisions, the federal Central Valley Project in California is required to comply, and is complying, with California laws relating to the Sacramento-San Joaquin Delta, as well as other areas.

Since the Supreme Court in *California v. United States* overturned its decisions narrowly construing state authority under Section 8 of the Reclamation Act, California brought another case before the Supreme Court arguing that the court should also overturn its *First Iowa* decision, which narrowly construed state authority under Section 27 of the Federal Power Act. All of California's 49 sister states signed an amicus brief supporting California's position.

In *California v. FERC*, the Supreme Court in 1990 declined to overturn its *First Iowa* decision. The court ruled that — although the issue would be "close" if presented as a matter of "first impression" — the doctrine of *stare decisis* precluded the court from overturning the case. The court did not reach or decide the merits of Section 27's meaning. As a result of the two decisions — *California v. United States* and *California v. FERC* — the Supreme Court has interpreted virtually identical statutes as meaning two different things. The court held in the former case that the statute authorizes state regulation but that the statute precludes such regulation in the latter case. As a result of this incongruity, state regulatory laws apply to federally authorized reclamation projects but not to federally licensed hydropower projects, even though the projects may be located side by side in the same river. Since the statutes are virtually identical, both decisions cannot be correct; either the statutes allow state regulation or they do not, and either the Supreme Court should overturn its prior decisions notwithstanding *stare decisis* or it should not. Since the Supreme Court in *California v. United States* was not bound by *stare decisis* and interpreted the statute on its merits, the Supreme Court in *California v. FERC* should have done the same. *Stare decisis* should not serve as a basis for not redressing an incongruity that the court itself has created.

Disclosure: In the *Karuk Tribe* decision, the California Court of Appeal noted that I argued both *California v. United States* and *California v. FERC*, and cited my law review articles describing the cases. The decision also noted that I worked initially in the California Attorney General's office and later in the Department of the Interior, which allowed me to have "seen things from the other side." Although a lawyer usually sees his name in the counsel list at the end of the opinion, he rarely sees it in the body of the opinion. Like an umpire, a lawyer is accustomed to being involved in the story but not part of it. But having "seen things from the other side," I still have no idea why the court decided the two cases differently, why it applied *stare decisis* in one case but not the other. The court's decisions serve as a reminder that the law is shaped not just by logic and analysis but also by timing and context, and other mysterious things. Whatever these considerations, the Court of Appeal in *Karuk Tribe* properly followed the Supreme Court's precedents, as it was required to do, notwithstanding the incongruent patterns of regulation they have spawned.

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