

Testimony of
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Regarding Certain Abusive Practices in the ITC Related to Patent Infringement Investigations

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Chairman Smith, thank you for inviting me to this hearing today. It is my honor and privilege to appear before this subcommittee.

I am an Intellectual Property counsel for Ford Global Technologies, LLC, a wholly owned subsidiary of Ford Motor Company that handles all intellectual property matters for the company. I am here to testify regarding a problem plaguing production and manufacturing companies who employ hundreds of thousands of American workers. At Ford, we directly employ more than 65,000 Americans – and our dealers employ more than 150,000 Americans.

We believe that Section 337 of the Tariff Act is an important tool for the protection of American jobs and intellectual property. Section 337 is a US trade law, enacted in 1930. It was designed to protect U.S. manufacturers from unfair foreign competition, and empowers the U.S. International Trade Commission (ITC) to exclude products from the U.S. market. The statute is particularly useful in intellectual property enforcement cases because it sometimes is difficult to enforce a patent against foreign infringers in the U.S. courts due to jurisdictional issues. Section 337 permits direct action against the infringing products, whether or not the maker of the products is subject to the U.S. courts.

Increasingly, Section 337 is being abused by Patent Assertion Entities (PAEs) who acquire and hold patents for the purpose of litigation. PAEs don't produce goods – they don't actually use technology to create products or jobs in the United States. Their goal is to threaten other businesses with patent litigation in the hope that those other businesses will agree to pay royalties rather than face continuing legal claims.

In recent years, PAEs have targeted American manufacturers, threatening their U.S. operations, and trying to force them into cash settlements that would not be awarded by a court. This began after the U.S. Supreme Court ruled, in the 2006 *eBay* decision, that U.S. courts could issue injunctions in patent cases only if the plaintiff could show the traditional requirements for injunctive relief. Most importantly, the plaintiff is required to show that irreparable harm would occur if the injunction did not issue. A PAE that is only seeking money can't show irreparable harm: money can always be awarded later. So the Supreme Court decision meant that PAEs would have to prove their damages. But the PAE business model is to seek quick negotiating leverage, not to pursue a long patent case for damages. So after the *eBay* decision, Section 337 became more attractive to PAEs. It offers an injunction-like remedy without requiring proof that an injunction is warranted. PAEs use the threat of a Section 337 exclusion order to obtain bargaining leverage, just as prior to *eBay* PAEs used the threat of a court injunction.

By the time a manufacturer enters production, the company has spent great sums of money on design integration, tooling, and other investments to incorporate a particular technology. The technology itself may not be valuable – it may be trivial – but it is very expensive to change it after the investments have been made. PAEs can assert a minor patent against such a company and demand exorbitant sums – amounts far beyond the actual value of the technology in the market – because the manufacturer must either pay or walk away from its sunk costs.

This tactic is a patent “hold-up”. That is, the PAE demands royalties that are large not because the patent is valuable, but because the target is vulnerable. This behavior by PAEs hinders innovation instead of promoting the adoption of new technology.

Some believe that most, if not all, Section 337 cases are brought against shadowy Asian companies that are counterfeiting American goods or infringing U.S. patents. In fact, only a small percentage of Section 337 cases are brought by a U.S. company against foreign companies. Most cases are brought against a mix of U.S. and foreign companies. PAEs like to bring their cases against prominent U.S. companies, because their goal is not to exclude foreign products from the United States or to protect American manufacturers: it is to negotiate a royalty stream to earn a return on their investment. In recent years PAEs have brought Section 337 actions against such prominent U.S. companies as Apple, Ford, Google, General Motors, Hewlett Packard and Intel, among many others.

These U.S. manufacturers, and others, operate on a global basis: they sell their products globally, and they ensure their products are internationally competitive by purchasing parts and materials globally as well. Exclusion of critical parts or components from the U.S. market can lead to a calamitous shut-down of U.S. operations.

The intensity and fast pace of ITC litigation creates an atmosphere where a respondent in the ITC must divert extensive resources quickly to its defense or face a rapid, adverse and unfair result. Even if a company is confident that its imported products do not infringe a patent, the costs of litigation, the uncertainty of litigation, and the risks of an interruption of business are so great that the company may be tempted to settle.

Ford wholeheartedly supports the underlying purpose of Section 337 investigations, that is, to prevent unfair competition from foreign entities, and to protect American industry, jobs, and innovation. We have utilized the ITC to prevent importation of products that blatantly infringed our intellectual property and that unfairly competed with our parts.

Nonetheless, Ford has also been recently hauled into the ITC under circumstances that cry out for reform. In November of last year, a Swiss-based patent holding company, Beacon Navigation GmbH, brought one of the largest Section 337 cases ever *against* major American manufacturers. The case, involving GPS navigation systems, named as respondents every major producer of automobiles in the United States, including Chrysler, Ford, General Motors, Honda, BMW, Mercedes, Nissan and Toyota. These companies employ hundreds of thousands of Americans in good-paying manufacturing jobs. Rather than *protect* U.S. jobs, the case *threatened* U.S. jobs. Beacon also sued the companies in Delaware district court. The patents underlying the 337 investigation allegedly cover certain aspects of automotive navigation systems. Despite the fact that Beacon has only a handful of employees in the US, did not itself make any products, had not undertaken any research or development related to navigation systems, had purchased the patents from another party, was only interested in obtaining royalties, and had questionable licensing activities, it claimed that it qualified as a “domestic industry” under the licensing clause of the statute.

Beacon asserted that certain Ford vehicles assembled in Mexico and Canada should be excluded from the U.S. market. This despite the fact that these Ford vehicles contain a high percentage of content manufactured in the U.S. by American workers, and despite the fact that the vehicles were imported under the North American Free Trade Agreement (NAFTA). In addition, the navigation component that Beacon claimed was covered by its patents was a relatively small percentage of the total vehicle value. And so a highly complex product with thousands of parts, many of which were manufactured and assembled in the U.S. by tens of thousands of American workers, was subject to exclusion from the U.S. market by a foreign PAE.

Beacon was using the ITC to obtain exorbitant royalties far beyond a reasonable value. And they attempted to use the ITC as leverage to extract higher fees on products made in the U.S., such as Ford F-150 trucks, that contain a small component from a global supplier. Beacon even

tried to get royalties for vehicles in countries where it had no patents by using the leverage of the ITC investigation.

Only after diligent inquiry by defense counsel and by forceful direction from the ITC judge did it become apparent that Beacon could not sustain its claim of a domestic industry. It subsequently withdrew its complaint. But not before costing the respondents tens of millions of dollars in defense fees.

The Beacon case demonstrates the extent to which 337 investigations have strayed from their intended purpose. Beacon should not have been allowed to initiate a 337 investigation because it had no real trade grievance - it was only seeking money damages. Its alleged licensees do not make automotive navigation systems, and even if they did, they do not have the capacity to supply even a fraction of the industry that Beacon sought to exclude. Nonetheless, Beacon was able to proceed because they claimed domestic industry under the licensing clause in Section 337, and because there is no procedure to challenge the reasonableness of an ITC remedy at the beginning of an investigation.

Licensing is permitted in the domestic industry test to allow innovators who don't make products, like universities, to use Section 337. Innovators engage in production-based licensing, sometimes called "ex-ante" licensing. That is, innovators license their patents before a product is developed and encourage their licensees to bring new products to market. This helps create American jobs in product development and manufacturing. On the other hand, PAEs obtain and license their patents after a product has come to market, and seek to share in the value already created by others. This is referred to as revenue-based licensing, or "ex-post" licensing. While a PAE may have a claim in district court, it should have no place in the ITC, which is intended to protect U.S. industries and jobs, not to allocate existing value among claimants by awarding damages. The current domestic industry test in Section 337 does not specifically distinguish between production-based licensing and revenue-based licensing. And so, under current practice, almost any patent owner, even foreign based PAEs with virtually no presence in the U.S. and licensees with limited capacity, can bring an action against an entire U.S. industry. The ITC is thus essentially operating as an alternate patent court in many respects.

In my opinion, the federal court system, particularly the Federal Circuit Court of Appeals, is doing an excellent job in recognizing the PAE problem and fashioning judicial policy within their authority to put appropriate limits on abusive PAE practices. Congress also deemed it necessary to correct some of these practices in the recently enacted America Invents Act (AIA), which, in part, limits a PAE's ability to include unrelated defendants in a patent lawsuit.

Unfortunately, the adjustments made by the courts and Congress to limit PAEs do not apply to the ITC. PAEs can name any number of respondents in their complaints. Recent statistics

clearly show an increase in the number of respondents in 337 investigations, mainly the result of PAEs. And the ITC is not bound by Supreme Court precedent that requires a thorough equitable evaluation prior to the grant of injunctive type relief. In fact the ITC has only exercised its public interest equitable powers to deny an exclusion order a handful of times in the many hundreds of investigations it has undertaken over the last forty plus years.

While I have the utmost respect for the ITC, including the Commissioners, ALJs, Staff, General Counsel, and others, it is clear to me that the ITC is not able to remedy the problem. This is so because, by its own admission, it is not a policy-making body. The ITC is constrained by statute and, to its credit, stays strictly within its statutory authority. However, this has resulted in a mechanistic application of the law which has ultimately led to absurd situations like the Beacon case that I've related, which is one of many examples of PAE abuse in the ITC.

Some believe that the ITC has the ability to fix this problem without statutory change. There is no evidence that it will do so. To the contrary, the ITC has stated that it will not distinguish between entities that claim domestic industry based on particular licensing activities. That is, any entity that can show it has licensed a patent to another party, even if it is revenue-based "ex-post" licensing, qualifies as a "domestic industry" under current ITC law. And while recent decisions and proposed rule changes indicate that the ITC may genuinely be trying to address the problem in limited respects, these attempts will likely fall far short of eliminating PAE activity from unfairly burdening productive US manufacturers that employ hundreds of thousands of American workers.

It is therefore necessary, and I ask you here today, to remedy the problems I've described by supporting the following statutory changes to the Trade Act of 1930:

First, institute an inquiry into the equities of each 337 investigation at an early stage of the proceeding, or even before an investigation is begun. The inquiry preferably would be the first matter undertaken by an ALJ. An initial determination by an ALJ on this issue should be immediately reviewable by the Commission, and a Commission determination should be reviewable by the Federal Circuit Court of Appeals. This inquiry will allow the ITC to use its discretion in preventing abusive PAEs from initiating non-trade related investigations. The inquiry could be similar to that used by the courts before awarding injunctive relief.

Second, change the domestic industry requirements by either limiting qualification to those who engaged in production-based (ex-ante) licensing, or by eliminating the licensing aspect entirely, as licensing entities are really seeking money and the ITC cannot award damages.

These changes will preserve legitimate uses of the ITC while shunting PAEs who have an adequate remedy at law to the federal courts, thus protecting U.S. industry, jobs and technology from abusive and destructive litigation in the ITC.

Thank you Mr. Chairman and Ranking Member for holding this hearing and shining a light on a problem that is harming American manufacturers. I appreciate your efforts to bring forth legislation that will deliver a fair solution that preserves the intent of the law while fixing the abuses of PAEs.