

Litigation Notes

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UPDATE: POST-TRIAL PROCEEDINGS IN KINETIC CONCEPTS v. SMITH & NEPHEW

We read the various post-trial motion papers filed by both sides in **Kinetic Concepts'** patent infringement case against **Smith & Nephew**. As previously discussed, Kinetic Concepts obtained a jury verdict in its favor five months ago in the U.S. District Court in San Antonio in which the jury upheld all of the asserted claims in the two patents at issue and found that Smith & Nephew infringes all of them. Subsequently, a minitrial was held in July to determine whether KCI's patents are unenforceable because of patent misuse, and at the same time Judge Ferguson heard arguments on the scope of the permanent injunction that will be issued if the verdict is not set aside.

On the merits, it is fairly clear to us that the jury verdict was wrong on both infringement and validity of the asserted patents, but the issue is whether Judge Royal Ferguson will ignore the flaws in the verdict because of his known tendency to allow jury verdicts to stand. In our analysis, the better view is that he will make some changes to the verdict, but that he will let KCI come away with something, in which case we think he will be reversed on appeal. As for the injunction, assuming he does not set the verdict aside altogether, we think he will grant an injunction but that it will be relatively narrow. We think the broad injunction KCI is seeking would interfere with Smith & Nephew's rights to design around the patents.

Judge Ferguson already cut KCI back in one respect, since on June 24, 2010, he granted Smith & Nephew's motion to dismiss certain "KCI entities" that had been listed as coplaintiffs in the case. Specifically, he dismissed all of KCI's subsidiaries from the case on the ground that they did not have "standing" to sue for infringement of the Wake Forest patents. The parent company, Kinetic Concepts, Inc., did have standing, since it acquired the exclusive right to exclude others from practicing the patented inventions, but the record showed that the subsidiaries did not acquire that right from the parent, notwithstanding the language that may have been used in the license agreement between the parent and KCI Licensing, Inc., the parent of the other subsidiaries.

Once it had the June 24 ruling in its pocket, Smith & Nephew moved for judgment as a matter of law that no lost profits could be awarded in this case. It argued that since the parent, Kinetic Concepts, Inc., was the only KCI entity remaining in the case, and since all sales were effected through the subsidiaries, the parent Kinetic Concepts, Inc. made *no* sales and therefore it had *no* lost profits. In opposition to the motion, KCI argued that Smith & Nephew had waived its right to challenge the damage verdict, since it conceded after the trial that there was sufficient evidence to support it.

We think Judge Ferguson will not accept KCI's waiver argument, since Smith & Nephew is not challenging the damage award as such, but rather it is challenging the right of the parent company to recover lost profits at all. Prior to the start of the trial, Judge Ferguson had denied a Smith & Nephew motion to dismiss the KCI entities, but he made it clear that the denial was without prejudice and that he would consider the issue in detail after the verdict if the jury ruled in KCI's favor.

The amount of lost profits awarded by the jury is relatively small, i.e., \$901,680, and Wake Forest had no lost profits, so it is easy to conclude that lost profits as a damages item is insignificant. However, we think the standing issue is likely to return when the court considers the injunction. The jury was asked to specify a reasonable royalty on infringing sales for which KCI did not prove entitlement to lost profits, and its answer was \$142,800, based on a royalty rate of 10%. In our thinking, if the parent company lacks standing to recover for lost profits, then it lacks standing to obtain an injunction as well, but the jury's 10% royalty could be adopted.

KCI recently undertook to cure the standing problem of its subsidiaries by entering into a new set of license agreements, and it has also asked Judge Ferguson to reconsider his ruling dismissing the KCI subsidiaries from the case. In our view, neither strategy is legally effective to solve its problem. We do not believe that reconsideration will be granted, since KCI has nothing new to add on the subject, and we think that KCI's new set of post-trial agreements cannot support an injunction that depends for its validity on the jury verdict based on the evidence produced *at the trial*.

If KCI cannot secure an injunction, then for practical purposes it will have lost the case, even if the jury verdict is upheld and Smith & Nephew is required to pay the \$142,800 of accrued royalty. Similarly, if a *narrow* injunction is issued, then Smith & Nephew will be able to avoid it by selling the same apparatus but crafting the instructions so as to insure that the apparatus is not used in an infringing manner.

In the present case, Judge Ferguson specifically inquired about the scope of the injunction at the July 2010 hearing, noting that wounds with "fistulas" or "pus pockets" would not be covered. Similarly, the Bagautdinov prior art involves the use of foam-based products that are used to treat "purulent wounds," and therefore, in theory, use of the Smith & Nephew foam-based apparatus to treat purulent wounds would be outside of the scope of the patents. KCI's proposed injunction does not carve out any of these exceptions, and instead they broadly cover "any foam-based NPWT dressing" and "any system combining such a dressing and any NPWT pump." KCI then proposes alternative language proscribing the use of the products "on wounds," with wounds defined to cover tissue damage to the surface of the body, but "excluding fistulae and pus pockets."

Smith & Nephew responds to KCI's proposed injunction language by remarking that the prohibition would extend substantially beyond the reach of the jury's infringement findings and would prohibit conduct and devices that are plainly permissible. Some of the language, it says, would prohibit the sale of the pumps that are used in conjunction with unpatented gauze-based systems. KCI, for its part, says that the courts are permitted to enjoin activities that do not themselves constitute infringement "if necessary to prevent infringement."

In our analysis, KCI's description of the law is incorrect, or at least misleading. A broad injunction that prohibits noninfringing conduct, we think, would be reversible error, since infringers have a right to design around the patents which they have been found to infringe. The Federal Circuit plans an en banc rehearing in the case of *TiVo v. Echostar* precisely because Echostar's legitimate design-around attempt happened to violate an overly broad injunction. In that case, a 2-1 majority (with which we strenuously disagreed) upheld a contempt citation against Echostar for attempting to design around TiVo's patent in violation of an injunction that was manifestly overbroad.

We think it would be logical for Judge Ferguson to issue an injunction that excludes purulent wounds and wounds with fistulas or “pus pockets,” assuming that he decides that the verdict should be upheld and that the patents are not unenforceable because of patent misuse, discussed below. A broader injunction than that, we think, would run the risk of a reversal on appeal.

We also think there is a meaningful chance that KCI could lose its right to enforce its asserted patents because of the doctrine of patent misuse. This doctrine is well-established in the law, having been recognized in numerous U.S. Supreme Court decisions in the Twentieth Century. It is an attempt to harmonize patent law and antitrust law by preventing a patentee from extracting more exclusion from the market than the patent provides, and therefore the doctrine prevents collection of royalties beyond the patent’s expiration date, and it prevents collection of royalties on noninfringing sales or on sales outside of the jurisdiction. It also prevents unlawful tie-ins, in which sales of the patented product are conditioned on a buyer’s purchase of another, unpatented product. The knowing enforcement of a patent known to be invalid is also a form of patent misuse. The consequences of patent misuse are that the entire patent is deemed unenforceable unless and until the misuse is “purged.” Patent misuse is an equitable doctrine and therefore it cannot be submitted to a jury.

In KCI’s case, patent misuse is charged because, pursuant to a written agreement, KCI did in fact pay royalties to Wake Forest University for sales occurring outside the U.S. in jurisdictions where Wake Forest did not have patent protection and in jurisdictions where patent protection had expired. We would be surprised if Judge Ferguson actually ruled that these royalties constituted patent misuse, but the legal basis for doing so is clearly available.

A stronger ground for patent misuse, in our view, is KCI’s enforcement of the two patents at issue, U.S. Patent Nos. 7,216,651 and 5,645,081, despite a substantial paper trail indicating internal KCI beliefs that the patents were invalid in light of a prior patent issued to Zamierowski. The Zamierowski patent is U.S. Patent No. 4,969,880, which expired on April 9, 2009. KCI acquired the patent from Zamierowski, supposedly to “hedge its bets,” and then it obtained a subsequent continuation-in-part patent, U.S. Patent No. 5,527,293, based on the same disclosure. Smith & Nephew argues, correctly, we think, that the claims in the ‘293 patent are potent indicators of what the ‘880 specification discloses, and that therefore the ‘293 claims can also be used to show that the later ‘651 and ‘081 patents are invalid.

Smith & Nephew filed an expert report by Dr. Ian Gordon which has a detailed claim-by-claim comparison of the asserted claims and their counterparts in the ‘880 and ‘293 patents. We are not going to discuss this comparison here, but suffice it to say that the claims of the ‘880 and ‘293 patents are quite close to the asserted claims in this case. Gordon concedes that Claim 1 of the ‘293 patent does not disclose the open-cell polymer foam claimed in Claim 2 of the ‘081 patent, but in his discussion of the comparison, he states that both Bagautdinov and Solovev used open-cell foam in their prior art treatment systems, that open-cell foam was virtually the only type of foam available and that therefore the use of the foam was an obvious variant.

We previously discussed the infringement and validity issues that Judge Ferguson will have to address in his forthcoming rulings on the post-trial motions in this case, cf. *Litigation Notes*, April 8, 2010, and we think that Smith & Nephew’s arguments discussed in that report are still persuasive today. In summary, KCI put on no evidence of a screen that was “sized and configured,” which is performed by the doctor or nurse but not by Smith & Nephew, and its vacuum pressure is not applied to “the skin surrounding the wound,” both of which are limitations in the ‘081 patent. Likewise, KCI put on no evidence that any person practices the method claimed in the ‘651 patent. These omissions amount to a failure of proof on infringement of every asserted claim in the case.