

### (3) ARBITRATION OF PATENT DISPUTES IN THE UNITED STATES

Anne Louise St. Martin and J. Derek Mason<sup>1</sup>

#### 1. Introduction<sup>2</sup>

Although the United States is often regarded as a litigious country, especially with respect to patent disputes, voluntary arbitration is authorized by the Patent Act and may be pursued by both national and international parties as a remedy for patent

infringement. This may be especially of interest to Japanese companies, as a way to avoid some of the uncertainties associated with patent litigation in the United States district courts, particularly the uncertainties of a jury trial having a jury of individuals with little or no technical training.

---

1 — Anne Louise St. Martin is an Associate and J. Derek Mason is a Partner with the intellectual property law firm of Oblon, Spivak, McClelland, Maier & Neustadt, LLP., in Alexandria, Virginia, USA. The opinions expressed in this article are those of the authors and do not necessarily reflect that of Oblon Spivak. This article does not constitute legal advice to any particular person/entity and should not be treated as such by readers. Reliance on this article does not create an attorney client relationship with Oblon Spivak or any individual attorney thereof.

2 — See also: "Arbitration: A Quick and Effective Means for Patent Dispute Resolution" , 12 N.C. J.L. & Tech. 301 (2011)" by the present Authors.

Arbitration is a process of dispute resolution wherein parties submit their dispute to at least one impartial “judge” who will render a binding decision. In arbitration, the parties agree that by submitting themselves to arbitration the decision rendered by the arbitrator will be binding and is “non-appealable” absent any defense of invalidity of the arbitration clause. To avail oneself to arbitration, a party must (1) enter into a contract containing an “arbitration clause” to preemptively attest their intent to arbitrate, or (2) produce a written agreement to arbitrate which may be executed independently of the contract either before or after the dispute arises.

Entering into a contract containing a carefully crafted arbitration clause provides a level of predictability with respect to the investment and liability associated with patent license and/or research agreements, thereby providing the respective companies a better estimation of the risk factors associated therewith. Specifically, when parties enter into an agreement to arbitrate they have the opportunity to obtain assurance through the careful drafting of the arbitration clause that any dispute arising out of the contract will be decided by a technologically knowledgeable neutral arbitrator in a manner that will be relatively inexpensive. Having this assurance can provide stability of the business relationship which is further strengthened by the knowledge that the proceedings will be confidential and the awards rendered will be final and non-appealable, so that the

companies can quickly resume with their business transactions without concern for negative publicity or the uncertainty of appeals. Accordingly, using arbitration as a means to quickly and effectively settle patent disputes can not only be beneficial for both parties should a dispute arise, but can also provide pre-emptive benefits which remain even if the agreement to arbitrate is never enforced. This article explores arbitration of patent disputes in the United States and the benefits and concerns associated therewith.

## 2. Statutory Basis

### A. 9 U.S.C. §§ 1-14 (2006) The Federal Arbitration Act

The Federal Arbitration Act (“FAA”)<sup>3</sup> was enacted to codify a national policy favoring arbitration and to place arbitration agreements on equal footing with contracts.<sup>4</sup> The FAA ensures that agreements to arbitrate are “valid, irrevocable and enforceable,” provided their subject involves “commerce.”<sup>5</sup> Any such clause or agreement is valid, irrevocable, and enforceable absent any ground that exists at law or in equity for revocation of a contract.<sup>6</sup> Furthermore, as a matter of substantive federal law, an arbitration agreement is severable from the remainder of the contract.<sup>7</sup> In other words, the validity of the arbitration clause is to be determined independently of the validity of the contract with each type of challenge being decided separately. This principal is internationally recognized as the doctrine of separability. If the challenge is to the validity

3 — 9 U.S.C. §§ 1-14 (2006).

4 — *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 443 (2006).

5 — 9 U.S.C. § 2 (2006).

6 — see footnote 3, *supra*.

7 — *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 404 (1967).

of the arbitration agreement itself, for example a question pertaining to the formation of the agreement to arbitrate, the federal courts may adjudicate it. However, the statutory language of the FAA does not permit federal courts to consider challenges to the validity of the contract as a whole, including, for example, fraud in the inducement.<sup>8</sup> The issue of a contract's validity is to be considered by the arbitrator in the first instance. Accordingly, the FAA provides that if any issue that is subject to an arbitration clause is brought in a proceeding before any court of the United States, the court shall, upon application by one of the parties, stay the trial of the action until the arbitration has been conducted in accordance with the terms of the agreement.<sup>9</sup>

There is a principal applied in International Commercial Arbitration recognized as "competence-competence," which stands for the notion that the arbitrators themselves are granted authority by the parties to determine the validity of the arbitration agreement.<sup>10</sup> However, this international principal has not been generally recognized by the United States federal and state courts in its strict sense.<sup>11</sup> Instead, the United States Supreme Court has relied on § 4 of the FAA for jurisdiction to review the validity of arbitration agreements.<sup>12</sup> Specifically, § 4 states:

A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court [with jurisdiction] . . . for an order directing that such arbitration proceed in a manner provided for in such agreement . . . *upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue*, the court shall make an order directing the parties to proceed the arbitration in accordance with the terms of the agreement. . . .<sup>13</sup>

In turn, the Supreme Court has held that if the challenge is to the "making" of the arbitration agreement itself, for example, inducement of the arbitration clause, then the federal court of proper jurisdiction may adjudicate the issue.<sup>14</sup>

#### B. 35 U.S.C. § 294

The Patent Act was amended in 1982 to recognize voluntary arbitration as a course of remedy for patent disputes relating to validity or infringement.<sup>15</sup> This provision has also been extended by the courts to include interference claims<sup>16</sup> and questions of inventorship.<sup>17</sup> The Patent Act specifies that arbitration of patent disputes, awards by arbitrators, and confirmation of awards shall be governed by title 9 of the FAA, discussed above, to the extent that it is not inconsistent with § 294 of the Patent Act.<sup>18</sup> Furthermore, § 294 provides that the arbitrator in a patent dispute must consider

8 — Buckeye Check Cashing, Inc. v. Cardegna, 546 U.S. at 446 .

9 — 9 U.S.C. § 3 (2006).

10 — UNCITRAL Model law, Art. 23.

11 — William W. Park, *The Arbitrability Dicta in First Options v. Kaplan: What Sort of Kompetenz-Kompetenz Has Crossed the Atlantic?*, 12 ARB. INT'L 137 (1996); Tom Carbonneau, *A Comment Upon Professor Park's Analysis Of The Dicta In First Options v. Kaplan*, 11 INT'L ARB. REP. 18 (Nov. 1996); Lawrence W. Newman and Charles M. Davidson, *Arbitrability of Timeliness Defenses – Who Decides?*, 14 J. INT'L ARB. 137 (June 1997).

12 — Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. at 404; Buckeye Check Cashing, Inc. v. Cardegna, 546 U.S. at 445.

13 — 9 U.S.C. § 4 (2006) (emphasis added).

14 — Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. at 404; Buckeye Check Cashing, Inc. v. Cardegna, 546 U.S. at 445.

15 — 35 U.S.C. § 294 (2006); Pub. L. No. 97-247, 96 Stat. 317, 322.

16 — 35 U.S.C. § 135(d) (2006).

17 — See Milner Enters., Inc. v. Adidas AG, No. 95 C 1872, 1995 WL 708570, at \*3 (N.D. Ill. Nov. 30, 1995).

18 — 35 U.S.C. § 294 (b).

the patent defenses provided in § 282 if raised by any party to the proceeding.<sup>19</sup> These enumerated defenses involving the validity or infringement of a patent include but are not limited to; non-infringement, absence of liability for infringement, unenforceability, and/or invalidity of the patent.<sup>20</sup>

Any decision rendered by the arbitrator, referred to as an “award,” must be reported to the Director of the USPTO.<sup>21</sup> There must be separate notice given for each patent involved in the proceeding, and each notice must set forth the names and addresses of the parties as well as the name of the inventor and the patent owner, must designate the number of the patent, and must contain a copy of the award.<sup>22</sup> The award shall be unenforceable until the Director receives notice thereof.<sup>23</sup> Upon receipt of the notice, the Director is required to enter the notice in the patent’s prosecution record.<sup>24</sup>

### 3. Pros and Cons of Arbitrating Patent Disputes

There are many potential benefits associated with arbitration that may prove advantageous for both sides of a patent dispute. Likewise, there are concerns that both sides should take into consideration before entering into an arbitration agreement or otherwise submitting a patent dispute

to arbitration. However, through careful drafting of the arbitration clause parties may avoid some of the potential disadvantages and ensure protection of their interests as the arbitrator must honor the intent of the parties as established by the language of the arbitration clause.

For example, the cost of arbitration, while not insignificant, is not nearly as high as the costs that parties may incur during years of patent litigation.<sup>25</sup> The American Intellectual Property Law Association Economic Survey of 2009 reported that the median costs for Patent Infringement Litigation, wherein the amount at issue was from \$1-25 million dollars, was \$2,500,000 inclusive, with \$1,500,000 being the median costs for discovery alone.<sup>26</sup> Depending on the voracity with which the parties litigate, the costs can be significantly higher. An appeal to the Federal Circuit can add at least another \$2,000,000 to the total costs.<sup>27</sup> In contrast, the costs for arbitration are often well below one million dollars.<sup>28</sup> Depending on the body selected by the parties to run the arbitration, the filing fee for a case where the amount at issue varies from \$1,000,000 to \$5,000,000 may be as little as \$11,450.<sup>29</sup> Although the attorney fees will remain at their standard rates, the time required to prepare and submit a dispute to arbitration is much less than

19 — 35 U.S.C. § 282.

20 — 35 U.S.C. § 282; the enumerated defenses specifically include: (1) non-infringement, absence of liability for infringement, or unenforceability; (2) invalidity of the patent or any claim in suit on any ground specified in part II of title 35 U.S.C. § § 100 et seq. as a condition for patentability; (3) invalidity of the patent or any claim in suit for failure to comply with any requirements of 35 U.S.C. § § 112 or 251; (4) any other fact or act made a defense by title 35 U.S.C. 20

21 — 35 u.s.c. § 294(d).

22 — *Id.*

23 — 37 CFR 1.335 (2010) filing of notice of arbitration awards.

24 — See 35 U.S.C. § 294 (e) (2006); 37 CFR 1.335 (2010).

25 — See AIPLA Report of the Economic Survey 2009, p. 29 (2009); Cohen Pontani Lieberman & Pavane LLP, New York, “U.S. - Litigation: Cost and Duration of Patent Litigation,” *MANAGING INTELLECTUAL PROPERTY*, February 2009; American Arbitration Association ‘Commercial Arbitration Rules’ as amended June 1, 2010.

26 — See AIPLA Report of the Economic Survey 2009, p. 29 (2009).

27 — See footnote 26, *supra*.

28 — See American Arbitration Association ‘Commercial Arbitration Rules’ as amended June 1, 2010.

29 — *Id.*

that required for litigation. Moreover, “pre-trial” procedures, which can cost on average \$1,500,000 in litigation, are streamlined in arbitration; and it is in the discretion of the arbitrator to allow the parties to conduct any depositions and/or other pre-trial discovery procedures.<sup>30</sup>

In parallel to this reduction in cost, the time required to resolve a dispute through arbitration is often much shorter than the time required to resolve the same dispute through litigation.<sup>31</sup> Since the decision of the arbitrator is binding, the time for resolution of a patent dispute via arbitration can be as short as a matter of months. In contrast to litigation, which can involve multiple layers of appeal, following the issuance of an award in arbitration the parties may continue with their business activities with the assurance that the dispute is finally settled and will no longer affect or impede their business plans.

Additionally, the parties can preemptively reserve their right to select the arbitrator or specify their requirements for appointment when drafting the arbitration clause to ensure that the decision maker is knowledgeable in both the field of patent law and the technology at issue. In this manner, the parties can ensure that if a dispute arises, they will be able to select an arbitrator who is familiar with the most relevant issues of the case. This avoids some of the uncertainty associated with Markman hearings and jury decisions on validity and infringement.<sup>32</sup>

Finally, as arbitration is private, the parties do not need to be concerned that challenges to their business practices and/or the validity of their patents will be broadcast throughout the industry, to their clients, and to their competitors. Although the FAA does not expressly address the issue of confidentiality, a number of the rules which are commonly elected to govern arbitration proceedings provide for the formation of a confidentiality agreement at the start of the proceeding.<sup>33</sup> Once such an agreement is created, U.S. courts have not been hesitant to enforce them.<sup>34</sup> However, in order to guarantee that the court will enforce the confidentiality agreement, the parties should include the confidentiality agreement in the arbitration clause itself.<sup>35</sup>

However, as noted above there are also some potentially negative aspects to arbitration in the United States which have not yet been addressed by the Courts. This is not an end all, as through careful drafting of the arbitration clause parties may avoid some of the potential disadvantages and ensure protection of their interests.

Primarily, discovery in arbitration proceedings is limited by the discretion of the arbitrator who is authorized by the FAA to issue subpoenas for witness testimony and physical evidence.<sup>36</sup> As such, parties on either side may have difficulty proving their case, as they may not have access to the large sum of documents normally acquired during pre-trial

30 — 9 U.S.C. § 7, 10 (2006).

31 — The Suitability of Arbitration for Intellectual Property Disputes, 71 PTCJ 143 (2005).

32 — Donna Gitter, *Should the United States Designate Specialist Patent Trial Judges? An Empirical Analysis of H.R. 628 in Light of the English Experience and the Work of Professor Moore*, 10 Colum. Sci. & Tech. L. Rev. 169 (2009).

33 — See American Arbitration Association ‘Supplementary Rules for the Resolution of Patent Disputes’ as amended June 1, 2010.

34 — *DiRussia v. Dean Witter Reynolds, Inc.*, 121 F.3d 818, 826-28 (2d Cir. 1997).

35 — *Id.* Including the confidentiality agreement in the arbitration clause will in turn ensure that it is included in the definition of “such agreement” of § 4.

36 — 9 U.S.C. § 7, 10 (2006).

procedures in US litigation.<sup>37</sup> However, if a party wishes to maintain the right to pursue a specific type of discovery, they may specify this intent in the arbitration agreement which must be honored by the arbitrator.<sup>38</sup>

Furthermore, even if there is a confidentiality agreement, as noted above § 294 of the Patent Act requires that notice of each award rendered in an arbitration proceeding be submitted to the Director of the USPTO along with a copy of the award.<sup>39</sup> Although the USPTO does not maintain a record of said awards, having the record of any such award in the file history of a patent might be very dangerous for a patentee if the award questions the validity of the patent. Particularly, although § 294 states that the award granted shall be final and binding between the parties to the arbitration, the courts have not yet determined whether any finding of invalidity of the patent shall be binding on the patent holder for future disputes or will hold any weight in future court or in United States Patent and Trademark Office (USPTO) proceedings.<sup>40</sup> Accordingly, it may be prudent to draft an arbitration clause limiting the format of the award and the issues to be decided in order to avoid any possible *res judicata* effect of validity rulings. For example, if the arbitration clause is drafted to limit the award to determination of royalty fees and/or findings of infringement only, then there will be no findings of invalidity or unenforceability

on record to be relied upon in the future by third parties.

#### 4. How To Draft an Arbitration Clause

Parties can easily establish their desire to submit a dispute to arbitration either by written agreement prior to a dispute arising or by written agreement after the dispute arises—the most common being the former.<sup>41</sup> The American Arbitration Association Rules of Commercial Arbitration set forth specific language by which parties can make known their intention to submit to arbitration. The following Standard Arbitration Clause, for example, can be included in any contract between parties to address this intent:

Any controversy or claim arising out of or relating to this contract, or the breach thereof, including any dispute relating to patent validity or infringement, shall be settled by arbitration administered by the American Arbitration Association under its Supplementary Rules for the Resolution of Patent Disputes and judgment on the award rendered by the arbitrator(s) may be entered in any court having jurisdiction thereof. (The award shall be rendered within \_\_\_\_\_ months of the filing of the Demand.)<sup>42</sup>

This clause can be further supplemented with specific selection instructions for the number and qualification of arbitrators, confidentiality, discovery, and issues to be decided in the award, if desired.<sup>43</sup>

If the dispute has already arisen, and the parties have not previously agreed to arbitration, the parties can memorialize their

37 — See American Arbitration Association 'Commercial Arbitration Rules' as amended June 1, 2010, § 30.

38 — 9 U.S.C. § 4 (2006).

39 — See footnote 21, *supra*.

40 — 35 U.S.C. § 294 (2006). See also 9 U.S.C. § § 1-14 (2006).

41 — See footnote 33, *supra*.

42 — *Id*.

43 — 35 U.S.C. § 294(b) states in part: "...In any such arbitration proceeding, the defenses provided for under section 282 of this title shall be considered by the arbitrator if raised by any party to the proceeding." This implies that the parties can agree beforehand which issues can or cannot be raised by the parties, such as invalidity or unenforceability.



interest to submit to arbitration by signing an agreement including the following provision:

We, the undersigned parties, hereby agree to submit to arbitration administered by the American Arbitration Association under its Supplementary Rules for the Resolution of Patent Disputes the following controversy: (cite briefly). We further agree that the above controversy be submitted to (one)(three) arbitrator(s) (and that the award shall be rendered within \_\_\_\_\_ months of the Demand). We further agree that we will faithfully observe this agreement and the rules, that we will abide by and perform any award rendered by the arbitrator(s), and that a judgment of the court having jurisdiction may be entered on the award.<sup>44</sup>

If the parties so desire, these paragraphs can be further refined to specify a different governing body and rules (such as, for example, the International Chamber of Commerce (ICC) or Singapore International Arbitration Centre (SIAC)). However, in that event, the parties should refer specifically to the rules set forth by those governing bodies for any additional or different language that may be necessary to bring the dispute under the auspices of the particular governing body.

While it is simple to express the intent of the parties to submit to arbitration, the ultimate decision of whether to submit patent disputes to arbitration or litigation must be taken with great care and deliberation. The ultimate decision is both a business and legal decision wherein the variety of factors noted above must be weighed.

Furthermore, the arbitration clause must be very carefully drafted to ensure the best interests of the parties are maintained. For example, as explored in the sections above, if the parties desire to maintain confidentiality of the proceedings, to reserve a specific form of discovery, and/or to limit

the issues to be decided in the award to, for example, royalty payments with no mention of validity findings in order to avoid possible estoppel effects, they may preserve their rights to do so through a carefully drafted arbitration clause.

## 5. Conclusion

Entering into a properly crafted agreement to arbitrate provides the parties to a license agreement or other contractual business relationship the assurance that any dispute arising out of the contract will be decided by a technologically knowledgeable neutral arbitrator (or panel of arbitrators) in a manner that will be relatively inexpensive, confidential, and final. Having this assurance can provide a level of predictability with respect to the investment and liability associated with patent license agreements, thereby providing the respective companies a better estimation of the risk factors associated therewith. Moreover, entering into such an agreement with the knowledge that a dispute arising therefrom will be settled in accordance with a set of rules pre-selected by both parties serves to help ensure the stability of the business relationship. The stability is further strengthened by the knowledge that the proceedings will be confidential and the awards rendered will be final and non-appealable so that the companies can quickly resume with their business transactions without concern for negative publicity or the uncertainty of appeals. This is particularly important in instances where the parties are already (or are expecting to become) long-term business allies because it helps avoid the

---

44 — See footnote 33, *supra*.

“take no prisoners” (i.e. defeat the other side at any cost) mentality that often occurs in patent litigation and can permanently damage the business relationship. Further, this stability and the corresponding assurance that litigation will be avoided can often prompt the parties to settle the disputes through negotiation, sometimes without even

filing an arbitration demand. Accordingly, using arbitration as a means to quickly and effectively settle patent disputes can be beneficial for both parties should a dispute arise, and can also provide pre-emptive benefits which remain even if the agreement to arbitrate is never enforced.