

Expanding the Customer Suit Exception in Patent Law

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Sweeping changes in patent law over the past decade regarding patent exhaustion and declaratory judgment have greatly altered the licensing and litigation practices of non-practicing entity (“NPE”) patent owners. The Supreme Court decision in *Quanta Computer, Inc. v. LG Electronics, Inc.* that the “authorized sale” of an article that “substantially embodies” a patent exhausts a patent owner’s rights (and prevents the owner from invoking patent law to control post-sale use of the “sold” article) greatly reduced the incentive of NPE’s to license component manufactures. Certain NPEs fear that such licenses would greatly reduce the economic value of their patents since the systems that incorporate the licensed components often are sold for many multiples the price of the component and maintain substantially higher profit margins. The reluctance to license (or even negotiate licenses with) component manufacturers was enhanced by changes in the law regarding declaratory judgment. Today, any NPE who provides a component manufacturer with notice of a patent and any statement that the NPE believes that the component manufacturers product is covered by one of the NPE patents could face a declaratory judgment action or patent interference proceeding. Such a declaratory judgment action or interference could cripple their litigation strategy by staying any litigation directed against a customer of the component manufacturer. To prevent such a result, NPEs frequently file without notice patent claims against downstream customers of patent manufacturers. This NPE’s hope that this “shoot first strategy” will enable them to maximize the economic value of their patents and the negotiation leverage against the customer defendants.

It has been well-documented that there is a significant risk that traditional “reasonable royalty” damages will overstate the value of a patent. Recent Federal Circuit and other court decisions have attempted to limit the application of the “entire market” rule to the calculation of damages and apportion the royalty base of the accused products between the value of the patented technology and the value of the non-patented features. In many instances, the “apportionment” have, in effect, limited the value (royalty base) of a patent to a specific component within a larger system. In other words, the apportionment damages analysis determines that the proper royalty basis is the component that may “substantially embody” the claimed invention. The component that the NPE refuses to license on the ground of the *Quanta* decision.

The apportionment decisions do not prevent the high costs and inefficiencies associated with litigating patent cases on a piece meal basis with selected downstream customers when compared to litigating the case in a single case with the component manufacturer

who provides the component at the heart of the infringement allegations. These inefficiencies and costs associated with customer suits places tremendous costs and burdens on the component manufacturers who often contractually obligated to defend and indemnify their customers. Because they are not parties to the suit, these component manufacturers face the prospect of continuous serial litigation (and licensing demands) against their customers since most cases settle before trial and do not result in final, non-appealable judgments. Each case (and customer negotiation) results in additional, unnecessary costs to the component manufacturers. There is no vehicle to permanently resolve the matter because the NPE refuses to enter into a license with the component manufacture based on the component manufacturer's economics on the basis of (1) the Quanta decision and (2) the belief that they can obtain a "premium" from each individual customer by leveraging the potential litigation costs associated with defending against the NPE patent.

The article recommends an expansion of the "customer suit" exception to the venue rules. The "customer suit" exception is a doctrine where a subsequent suit brought by a manufacturer takes precedent over the earlier filed suit brought against a customer. The doctrine recognizes that often the manufacturer is the "true" defendant in the customer lawsuit. The courts applying the doctrine look to judicial economy to determine whether the earlier filed "customer suit" should be stayed pending resolution of the manufacturer suit. This doctrine should be expanded in multiple ways. First, the doctrine should be expanded to allow Court's to expressly determine whether the manufacturer suit is the better action for determining damages associated with the NPE's patent claims. Second, the doctrine should be expanded to provide more procedurally flexibility for component manufacturers. Such manufacturers should be allowed to bring such actions within a reasonable time period after the NPE makes its infringement contentions. Namely, when the NPE has crystallized its infringement allegations and has identified (1) its asserted claims and (2) for the asserted claims, the component as the primary basis for infringement, the manufacturer should have the right to bring a declaratory judgment action to globally price and resolve the patent claims brought by the NPE.