

# OBVIOUS

July 23, 2007  
**IP**  
SUPPLEMENT TO LEGAL TIMES

**No, the patent upset of  
*KSR v. Teleflex* creates  
winners and losers.**

# Wise?

By Robert G. Sterne and Kenneth C. Bass III

**L**et's look at the new contours of the patent landscape, as reshaped by the Supreme Court's April 30 decision in *KSR International Co. v. Teleflex Inc.* Without a doubt, a higher standard of inventiveness will now be needed to obtain and sustain patents. It will be harder to prove that an innovation is nonobvious and thus patentable. And the legal test for obviousness will be applied more subjectively by patent examiners and federal courts.

The precise parameters of that legal test are unclear because the *KSR* Court did not articulate a new standard, limiting its opinion to criticism of the specific application of the old standard. It will take years for the full *KSR*-driven changes in the law of obviousness to roll out as the U.S. Court of Appeals for the Federal Circuit issues decisions that interpret the high court's vague directive. Patent law has entered a period of substantial uncertainty.

However, as we wait and watch for a revised, stable obviousness standard to

evolve, we can predict more immediate ripple effects from the Supreme Court's decision.

That's no wonder, for the justices' unanimous decision in *KSR* is arguably the most important patent case since *Graham v. John Deere Co.*, the Court's 1966 decision on the obviousness standard for granting patents.

Over the last quarter-century, the Federal Circuit has created an extensive body of law on obviousness that developed into the "teaching, suggestion, or motivation" standard. This TSM standard says that an invention is obvious where a person of ordinary skill in the art would arrive at the same idea by combining two or more concepts in the prior art where there is some teaching, suggestion, or motivation to combine them. Critics called the standard too strict and said that by focusing on the prior art documents, it ignored common knowledge or information not written down but well-known to people skilled in the art. After certiorari was granted in *KSR*, the Federal Circuit issued a series of decisions that corrected the latter

impression and were seen by the critics as expanding the ways in which the requisite TSM could be found. Critics carped that these decisions were tantamount to amicus briefs urging the Supreme Court not to upend TSM case law.

Nonetheless, the *KSR* Court found that the TSM standard had been too rigidly applied and was not the sole test for obviousness. The Court did not articulate a new test but admonished the Federal Circuit to be more flexible in determining obviousness.

On May 3, the U.S. Patent and Trademark Office issued interim guidelines instructing patent examiners to continue to address obviousness as they had before *KSR* while the PTO wrote new guidelines.

On May 9, the Federal Circuit issued its first post-*KSR* precedential decision, *Leapfrog Enterprises Inc. v. Fisher-Price Inc.*, in which it seemingly eschewed any rigid application of the TSM standard (and found the patent to be invalid as obvious). The panel wrote, "An obviousness determination is not the result of a rigid formula disassociated from the consideration of the facts of a case. Indeed, the common sense of those skilled in the art demonstrates why some combinations would have been obvious where others would not."

On June 18, the Federal Circuit released its second post-*KSR* decision on obviousness. In *Omegaflex v. Parker-Hanafin Corp.*, the panel reversed a summary judgment of nonobviousness, concluding that there was a material factual dispute as to whether the claimed invention was obvious in light of prior art. The panel's approach to the case is markedly different from that taken by the Federal Circuit panel in *KSR*, where the court strained to find the absence of an explicit motivation to combine by focusing on a very narrow aspect of the patent.

On June 28, the Federal Circuit issued its third post-*KSR* obviousness decision. In *Takeda Chemical Industries v. Alphapharm Pty.*, the court again noted that *KSR* left the TSM standard intact as one of the proper ways to decide obviousness, and the court upheld a detailed ruling that the particular chemical compound patent was not invalid as obvious.

But these three decisions represent good and bad news for just a few companies. *KSR* made at least 12 obvious winners and 12 obvious losers throughout the patent realm.

between their rights and liabilities and those of nonpracticing or nonmanufacturing patent owners. In the view of the established companies, these often-small nonpracticing entities, pejoratively referred to as "patent trolls," have gamed the system by asserting dubious patents to extract windfall settlements and damages from large companies with substantial revenues. Patents on so-called combination inventions (most inventions are combinations) have proved particularly troublesome, so one key objective for these established companies was to make it harder to obtain such patents on the ground of obviousness. While their efforts in Congress were unavailing, they got what they wanted at the Supreme Court.

Another clear winner are *businesses built on knockoffs*, i.e., companies that produce or distribute quick copies of other companies' hits. The ability of these free riders to legally piggyback on market innovators has been strengthened by *KSR*'s higher bar for obtaining and maintaining patent protection. Similarly benefited by the change are *low-cost producers with low R&D expenditures* that wait for entire new markets to emerge before they swoop in and grab the bulk of market share and profits through superior economic power and resources.

*KSR* is a boon to the *generic drug industry*. Through the legal mechanisms of the Hatch-Waxman Act, generics producers have already been able to challenge enormously valuable drug patents using myriad infringement defenses. But now the obviousness defense is much more likely to succeed and will undoubtedly be used in many more attacks on blockbuster drug patents.

The *open-source software community* is another substantial victor. Software patents are under attack from many quarters based most recently on the argument that the PTO in the 1990s was too lax in examining software innovations and issued many "junk" patents. After *KSR*, the perception is that it will be harder to assert existing software and business method patents in the courts and harder to get new ones granted by the PTO. (Indeed, some argue that was one of the Court's intentions.)

*Standard-setting bodies* will find their work easier because fewer inviolable patents will have to be navigated around to establish or practice a standard.

## WAY TO CHALLENGE

*Challengers of very valuable patents* in all technical areas will benefit. An axiom of patent strategy is that the more valuable the patent, the more a challenger will spend to try to defeat it. Since many of these valuable patents were obtained under the old TSM standard, some are surely now more vulnerable to challenge. The rigorous requirement of "clear and convincing evidence" that applies to claims of patent invalidity will be easier to meet on obviousness grounds.

For *existing licensees*, the Supreme Court's decision in *MedImmune Inc. v. Genentech Inc.* (Jan. 9) and subsequent Federal Circuit decisions such as *SanDisk Corp. v. STMicroelectronics Inc.* (March 26) had already made it less burdensome to contest the validity of the patent that they were licensing. The obviousness change will only encourage these "renegotiations." Because licensees have substantial economic incentive to seek

# They Win

First and foremost are the *large established companies, mostly from the computer and electronics industry*, that sought this and other changes in patent law to correct a perceived imbalance

better terms, licensors should expect a lot of action over the next several years.

The *patent infringement defense bar* must be happy about *KSR*. The obviousness defense has better “legs” now and is a more likely basis for summary judgment. The uncertainty surrounding the new standard frees defense counsel to be creative in how to prove it. Settlement will be less attractive in many suits. For the next few years, most cases will involve patents issued under the old TSM standard. And the substantial viability and widespread availability of the defense will increase the amount of work for lawyers and expert witnesses.

### MORE CHANCES

*Patent aggregators* must see opportunity as well. A relatively new business phenomenon, aggregators assemble disparate patents and patent portfolios into larger portfolios and then license or otherwise build business deals around these larger portfolios. The increased cost of and lower probability of succeeding in enforcement efforts will make selling to aggregators more attractive to patent owners seeking optimal monetization of their intellectual property. Larger portfolios are simply harder to defeat.

*Those who seek re-examinations* will get a boost, even as the creation of the PTO’s Central Reexamination Unit has already led to a substantial increase in re-exams over historical levels. The staffers who conduct these re-exams labor under no presumptions of patent validity and are free to construe claims as broadly as possible, unlike the more narrow *Markman* interpretations reached by the courts. Patents allowed under the old TSM standard may be especially susceptible to amendment or rejection of claims under the new obviousness standard based on a combination of prior art that was not considered in the original examination.

Finally, *federal trial judges* will have more discretion because of the greater latitude of the obviousness defense and the increased flexibility to tailor it to specific facts. Moreover, because the defense has significant factual components, the Federal Circuit will likely show greater deference to the rulings of the trial courts. And that, in turn, could produce a lower reversal rate in cases based on this defense, at least for the next several years.

# They Lose

*Independent inventors*, a group that has contributed so much creativity over the life of our republic, face trouble ahead because of *KSR*. Their inventions are usually insightful and clever combi-

nations of previously known elements—those “Wow, why didn’t I think of this?” ideas that may seem obvious after the fact but weren’t. Following *KSR*, patent examiners and federal judges may fall into that trap of 20/20 hindsight, even if the invention goes against established thinking, is enormously successful, or solves a long-felt need (all practical indicators of nonobviousness). Seeing this, financial backers may become more reluctant to invest in independent inventors’ efforts to commercialize their ideas.

*Startup businesses*, which produce a disproportionate amount of the innovation in this country, often rely on patents and patent applications to raise capital. The new standard will make those assets more vulnerable and less valuable. And that means fewer startups will get the money they need to succeed, which is not good for the long-term health of the American economy.

*Emerging companies*, which fall somewhere between startups and established businesses in their level of success, build up patent portfolios to increase enterprise value. Over the last decade many emerging companies went public or were purchased at high multiples over their actual revenue. In many cases, that substantial valuation rested on the entity’s intellectual property. Now the new obviousness standard will decrease the value of patent portfolios, which will make these kinds of business deals harder to achieve at all and likely to proceed at lower valuations when they do occur. Emerging companies overall will seem like less attractive investment vehicles. Thus fewer emerging companies will be funded in the future, which will harm U.S. competitiveness.

*Universities* too rely on their patent portfolios to generate capital—in their case, to fund research and development programs. Private enterprise leans on academia to do much of the basic scientific research that eventually leads to new products and services. But the ability of universities to recoup their investment in and fund future R&D will decrease under the *KSR* standard.

Besides universities, there are *private enterprises that specialize in doing R&D* and then licensing their designs to other entities for manufacture or use. That business model could be significantly undermined if *KSR* drives down licensing royalty rates (without, needless to say, lowering costs). In today’s “world is flat” economy, business will follow higher profits overseas. In other words, the United States could lose engineering and scientific expertise and high-knowledge jobs to lower-cost countries. Once these are lost, history shows, it is very hard to recover them.

*Professional inventors* have contributed to the U.S. standard of living since the dawn of the Industrial Revolution. Thomas Edison and Nikola Tesla made seminal inventions that sparked the electric industry. Edmund Armstrong and Lee de Forest powered radio with their ideas. Today, Dean Kaman and Gary Michelson have made breakthroughs in medical technology. These professional inventors often bankroll their work by plowing invention profits back into the next round of innovation. But what happens if the changed law of obviousness lowers the return on their investment?

### TOO LITTLE RETURN

*Venture capitalists and other investors* in technical innovation enterprises—i.e., companies that exist to technically innovate—

have learned through decades of experience that they must receive high rates of returns on their successful investments to offset the losses on their not-so-successful investments. *KSR* could undermine the patents of technical innovation enterprises and thus their business model, thereby reducing the rate of return for investors.

In some cases, a drop in the average rate of return will drive investors to demand higher stakes in the businesses. This, in turn, will make it less attractive for risk takers to start such enterprises. But even where they might be able to hold a larger stake, investors will still be discouraged by the lower rates of return. The ultimate payoff for investors comes when the company goes public (a much less attractive option these days due to Sarbanes-Oxley burdens) or is sold. But the established companies that wait to scoop up the winning shops in the invention sweepstakes are not going to pay as much for lower rates of return either. And that reluctance will make venture capitalists' initial decision to invest less viable.

*R&D funding* more generally will likely drop if the rate of return on technical innovation decreases. Investing in the possibility of invention is already a gamble; these efforts must show higher rates of return to lure capital away from less risky opportunities. And what supports higher rates of return? Valid patents unlikely to be overturned on the ground of obviousness, of course.

#### AT THE OFFICE

With the imprecise new standard on obviousness, *patent seekers* can look forward to a lot more confusion and delay. Post-*KSR*, it has become much harder to predict whether a particular patent application will be granted—at least until the new standard is clarified.

In the meantime, prudence still dictates that an application be filed. But no one knows yet how to draft that application to overcome an obviousness rejection. The bases for claiming nonobviousness will have to be established through more involved and extensive prosecution. The number of applications receiving final rejections will likely increase, leading to more appeals to the Board of Patent Appeals and Interferences. All of this will make it more difficult, more time-consuming, and more costly to obtain a patent.

*Patent examiners* are not going to find their jobs any easier either. The PTO's avowed goal is to reduce its current backlog of more than 1 million applications and to shorten the length of the examination period (it can take up to nine years for an application to receive a first office action). It has been said that many examiners applauded the *KSR* decision because they thought it would streamline their work to some degree. Under the old TSM regime, they had to allow an application unless they could explicitly point to the prior art combination that rendered it obvious; under the new regime, they thought they could reject on the ground of obviousness and force the applicant to show why the rejection was improper.

But the PTO quashed that approach in its May 3 memo by telling the examining corps that it still had to set forth explicitly the basis for the prior art combination. That means the

amount of time and effort that an examiner must spend per application has not decreased. And unless businesses decide to file fewer patent applications, which they may do over the next few years, the backlog of pending applications seems unlikely to go down any time soon.

A nascent *market for patent assets*—complete with brokers, agents, auctions, and private equity—has emerged in the last five years, giving patent assets greater liquidity. While the value of patents remains in the eye of the beholder, this market has produced some pricing discipline. Already observers of this market have noted that the value of patents has dropped on the uncertainty created by *KSR*, which is good news for neither patent owners nor patent brokers.

Before taking a case, *contingency lawyers* make calculated decisions about the likelihood of success for the litigation versus the time and other costs required to pursue the case to completion. The uncertainty engendered by the undermining of the TSM standard, coupled with other recent changes in the law, will make contingency cases more expensive to pursue and more problematic to win. Fewer patent disputes will be attractive to contingency lawyers.

Time will tell which of these winners and losers will be most affected by the Supreme Court's decision to stir the pot on obviousness. But it is worth noting that, despite predictions of radical change, *KSR* is noticeably cautious and middle-of-the-road.

Perhaps the justices were worried about unintended consequences, having been warned by the many amici supporting *Teleflex*. Perhaps they observed the Federal Circuit's movement in its TSM "amicus decisions." Perhaps they noticed the moderation in the solicitor general's position from cert petition to merits brief. Perhaps they came to realize during the opinion-drafting stage that a new test for obviousness was harder to formulate than they had originally thought. Or perhaps the effort to reach a 9-0 result required them to kick the reformulation of the TSM test back to the lower courts.

The Board of Patent Appeals and Interferences has a key role in formulating the obviousness standard. Its published decisions since *KSR* indicate that the board understands well the impact of its decisions on patent examiners and the Federal Circuit.

But the ball is mainly back in the Federal Circuit. Its precedential decisions on how to prove obviousness will set the new standard. It is critical that these decisions create a coherent body of law and not a patchwork quilt of three-judge rulings devoid of overarching methodology. Too much business and too much innovation is riding on the clarity and predictability of our legal standards for invention.

---

*The authors served as co-counsel to Teleflex at the Supreme Court. Student associate Matthew J. Dowd provided research for this article. The article reflects the views of the authors and should not be attributed to their firm or its clients. Robert G. Sterne is director and Kenneth C. Bass III is of counsel at Sterne, Kessler, Goldstein & Fox, a D.C.-based intellectual property law firm. They can be reached at [rsterne@skgf.com](mailto:rsterne@skgf.com) and [kbass@skgf.com](mailto:kbass@skgf.com).*