

No. 12-1184

In The
Supreme Court of the United States

—◆—
OCTANE FITNESS, LLC,

Petitioner,

v.

ICON HEALTH & FITNESS, INC.,

Respondent.

—◆—
**On Writ Of Certiorari To The
United States Court Of Appeals
For The Federal Circuit**

—◆—
**BRIEF OF THE FOOD MARKETING
INSTITUTE AS *AMICUS CURIAE*
IN SUPPORT OF PETITIONER**

—◆—
ERIK LIEBERMAN
FOOD MARKETING INSTITUTE
2345 Crystal Drive
Suite 800
Arlington, VA 22202
(202) 452-8884

DAVID A. BALTO
Counsel of Record
MATTHEW C. LANE
LAW OFFICES OF DAVID A. BALTO
1325 G Street, NW
Suite 500
Washington, DC 20005
(202) 789-5424
david.balto@yahoo.com

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INTERESTS OF *AMICUS CURIAE*¹

The Food Marketing Institute (“FMI”) is a national trade association representing large, multi-store chains, regional firms and independent operators both in the United States and internationally. FMI conducts programs in public affairs, food safety, research, education and industry relations on behalf of its nearly 1,250 food retail and wholesale member companies in the United States and around the world. FMI’s U.S. members operate more than 25,000 retail food stores and almost 22,000 pharmacies with a combined annual sales volume of nearly \$650 billion. FMI’s retail membership is composed of large multi-store chains, regional firms and independent operators. Its international membership includes 126 companies from more than 65 countries. FMI’s nearly 330 associate members include the supplier partners of its retail and wholesale members. FMI is a not-for-profit corporation located in Arlington, Virginia and has no parent companies. No publicly-held company owns a ten percent or greater ownership interest in FMI.

¹ No counsel for a party authored this brief in whole or in part, and no such counsel or party made a monetary contribution intended to fund the preparation or submission of this brief. No person other than the *amicus curiae*, or their counsel, made a monetary contribution to its preparation or submission. The parties have filed blanket consents to the filing of *amicus curiae* briefs.

FMI is uniquely situated to provide perspective to the Court regarding the negative impacts of the Federal Circuit’s rigid two-part test for determining whether a case is “exceptional” under 35 U.S.C. § 285. The businesses that FMI represents are “end-users” of important technology that reduces costs and benefits consumers. These end users are increasingly targeted by patent trolls who assert weak patents. FMI’s members are low-margin operators who often cannot pursue high cost patent suits. These members are forced to settle at prices below the cost of litigation regardless of the probability the asserted patent is valid or infringed. FMI members do not find the likelihood of being awarded attorney’s fees under the current test high enough to incentivize them to fight even meritless claims.



INTRODUCTION AND SUMMARY OF ARGUMENT

In 2005, the Federal Circuit inartfully ripped the sham litigation test from the Noerr-Pennington doctrine and transplanted it into a fee shifting law. This Federal Circuit decision in *Brooks Mfg. v. Dutailier, Inc.*, 393 F.3d 1378 (Fed. Cir. 2005) removed the district court’s congressionally granted discretion pursuant to 35 U.S.C. § 285 to award reasonable attorney’s fees in exceptional cases. The decision also increased the effectiveness of a strategy, called patent trolling, to abuse the patent system by asserting patents regardless if they are valid or infringed, in

order to leverage the high cost of litigation against lower priced settlements. The decision has increased the burden on end users of technology, like retailers, who are targeted by this patent troll strategy because they have little resources for or experience with patent litigation, or the third party's accused technology.

Patent trolls take advantage of the high cost of patent litigation to extort settlements from end users. It is estimated that a patent trial costs between \$350,000 to \$3,000,000 to reach the end of discovery and between \$650,000 and \$5,000,000 through trial. These high costs almost always significantly exceed settlement demands. So, in order to prevail against a meritless suit, the end user must spend far more than the offered settlement. Without the opportunity to recover attorney's fees there is no incentive for a patent troll's victim to defend itself in court.

The Federal Circuit's rigid two-part exceptional case test that the case be brought in subjectively bad faith and be objectively baseless sets too high a bar for defendants to rely on for relief. Alleged infringers often find this test to be unsurmountable for at least three reasons. First, patents can be difficult to interpret and usually must go through extensive claim construction proceedings before the boundaries of the patent claims are established, often late in a case. This allows many patent owners to greatly overstate what their patents actually claim while still presenting a question for the court. Second, patents are presumed valid. Finally, it can be nearly impossible to prove bad faith without a "smoking gun." These

aspects of patent law ensure that even the most ridiculous patent infringement claims could pass the Federal Circuits test.

Alleged infringers cannot rely on patent holders to rationally drop litigation they are certain to lose. In a traditional model a plaintiff would weigh their expected outcome of litigation against the costs of litigation when deciding whether to proceed. However, patent trolls have established a strategy of developing a reputation for aggressive litigation regardless of their odds of success or expected damages. This strategy means that alleged infringers cannot rely on patent holders to act rationally during settlement negotiations and must consider their own anticipated costs of litigation when deciding whether to settle.

The patent troll strategy, which remains unchecked by § 285, has had a substantial negative impact on retailers and consumers. Retailers are increasingly receiving demand letters for their use of new technologies and each demand letter costs a significant amount to resolve regardless of its merits. These costs are passed on to consumers either through increased prices or reduced services. The threat of patent litigation has also slowed or stalled adoption of new technologies that would add value to consumers. The problem is significant enough that end users have sought the aid of Congress and Congress has responded with a significant amount of proposed legislation. This legislation includes fee shifting provisions that would provide more clarity to

district court judges than currently exists under § 285.

The countervailing interests against an overly burdensome test for an award of attorney's fees under § 285 makes the Federal Circuit's adoption of the sham litigation test troubling. With no explanation, and little fanfare, the Federal Circuit in *Brooks Mfg.* transplanted a doctrine that has a long and storied history of careful balancing of fundamental rights into an unrelated body of law. The Noerr-Pennington doctrine was founded on the rights to political activity and the First Amendment right to petition the government. The sham litigation exception was carefully crafted to only include those cases where a plaintiff abuses the doctrine's immunity by disguising their illegal activity as an exercise of First Amendment rights. The bar established in *Prof'l Real Estate Investors v. Columbia Pictures Indus.*, 508 U.S. 49 (1993) is purposefully high because the rights affected are so great. Section 285 does not impact these rights in any way. The Federal Circuit wrongfully applied *Prof'l Real Estate* without examining the context behind the decision, and in doing so, robbed the district courts of their congressionally assigned discretion.

End users desperately need the protection of § 285 in order to fight meritless suits by patent trolls. The Federal Circuit's erroneous decision in *Brooks Mfg.* robs district court judges of the discretion to provide end users the protection that they need.



ARGUMENT

I. UNSCRUPULOUS PATENT HOLDERS EXPLOIT THE PATENT SYSTEM AND CREATE SOCIAL HARMS

The American patent system has been a boon to innovation and helped establish the United States as a global technology leader. However, no system is without its flaws. When exploited, these flaws hinder innovation, increase costs, and slow the adoption of new technologies. The Federal Circuit's rigid and hard to meet two-part test for defendants to recover under § 285 has entrenched one of these flaws, increasing the viability of using otherwise low value or worthless patents to hold up innocent companies, and retailers in particular.

A. THE HIGH COST OF LITIGATION ALLOWS PATENT HOLDERS TO PROFIT FROM THE PATENT SYSTEM REGARDLESS OF WHETHER THEIR PATENT IS VALID OR INFRINGED

The Achilles heel of the American patent system is the incredibly high cost of litigation. The American Intellectual Property Law Association estimates that the cost of litigation ranges from \$350,000 to \$3,000,000 to reach the end of discovery and from \$650,000 to \$5,000,000 to try a case.² These high costs

² Comments of American Intellectual Property Law Association to the United States Patent and Trademark Office, Request
(Continued on following page)

create a market for otherwise low value or worthless patents. A patent owner is in the position to offer an attractive deal compared to the cost of a defendant winning a patent trial. FindTheBest.com provides a typical example. They were threatened with a patent of extremely questionable validity. The patent troll offered them a choice between an extremely expensive patent trial and a \$50,000 settlement offer.³ Irrationally, FindTheBest.com chose to go to trial and spent \$200,000 to invalidate the patent troll's patent.⁴ Fortunately, the patent was invalidated early in litigation on Section 101 grounds, saving FindTheBest.com from having to enter into a costly discovery process. *Lumen View Tech. LLC v. Findthebest.com, Inc.*, 13 Civ. 3599, 2013 U.S. Dist. LEXIS 166852, at **34-37 (S.D.N.Y. Nov. 22, 2013).

While the high cost of litigation discourages defendants from mounting a substantive defense, it encourages litigation by patent plaintiffs. Typically, we would expect a defendant to only consider a threat to litigate credible when the probability of success times the anticipated damages minus the plaintiff's

for Comments on a Patent Small Claims Proceeding in the United States, April 30, 2013, *available at* http://www.uspto.gov/ip/global/patents/comments/aipla_comment_letter_on_small_patent_claims_4-30-2013.pdf.

³ Joe Mullin, *FindTheBest destroys "matchmaking" patent, pushes RICO case against troll*, ARS TECHNICA, Nov. 23, 2013, <http://arstechnica.com/tech-policy/2013/11/findthebest-destroys-matchmaking-patent-pushes-rico-case-against-troll/>.

⁴ *Id.*

cost of litigation is greater than zero.⁵ If this value is below zero a defendant would not accept any settlement offers because the plaintiff's value of the suit is negative. However, if the plaintiff develops a reputation of litigating even negative value cases, then the defendant cannot rely on the plaintiff acting rationally during negotiations. A defendant faced with an irrational plaintiff will be forced to accept any settlement offer that is less than the defendant's cost of litigation plus the probability of plaintiff prevailing times the expected damages.⁶ It is worth noting that this formula produces significant values even when the probability of success or expected damages is zero. Indeed, a study has shown that cases involving frequently litigated patents are only successful ten percent of the time.⁷

This patent troll strategy creates social costs. The strategy incentivizes frivolous litigation which is a drain on practicing entities' resources.⁸ Practicing entities are also encouraged to file applications for low quality patents because of their increased value in secondary markets. These patents, which compound

⁵ Erik Hovenkamp, *Predatory Patent Litigation* 8 (Aug. 5, 2013) (unpublished manuscript) (on file with SSRN at <http://ssrn.com/abstract=2308115>).

⁶ *Id.* at 16.

⁷ John R. Allison, Mark A. Lemley, & Joshua Walker, *Patent Quality and Settlement Among Repeat Patent Litigants*, 99 *Geo. L.J.* 677, 686-87 (2011).

⁸ Hovenkamp, *supra* note 5, at 17.

the problem, would otherwise not be worth filing. Finally, the patent trolling strategy has the overall effect of decreasing innovation by expanding patent thickets.⁹ Companies that successfully innovate increase their risk of being targeted by patent trolls who can use old patents to hold that success hostage for easy payouts. End users who adopt new technology increase their risk of being sued by patent trolls capitalizing on their inability to afford patent litigation.

B. THE CURRENT FEDERAL CIRCUIT TEST MAKES § 285 VIRTUALLY UNAVAILABLE FOR DEFENDANTS

The Federal Circuit test established in *Brooks Mfg. v. Dutailier, Inc.*, 393 F.3d 1378 (Fed. Cir. 2005), for § 285 sets the bar for recovery high enough that it does not factor into an accused infringer's decision-making process when deciding whether to mount a defense. Attorney's fees were awarded in only 15 of the 2,917 cases decided in 2012.¹⁰ In a real world example, Krish Gupta of EMC Corporation testified before the Senate that a patent troll sued on a number of products and made unreasonable discovery requests about a month before discovery was set to

⁹ *Id.* at 17-18.

¹⁰ *Full Calendar Year 2012 Report*, PATSTATS.ORG, http://patstats.org/2012_full_year_w_breakdown.html.

close.¹¹ EMC Corporation had to produce these discovery documents at great expense.¹² Meanwhile, the patent troll fought against discovery requests by EMC Corporation that when delivered showed that the patent troll had already licensed the patent to an upstream manufacturer.¹³ EMC Corporation was covered under this license.¹⁴ EMC sought to recover attorney's fees and costs but were denied.¹⁵ Judgments such as these discourage defendants from fighting claims and encourage settlements out of court regardless of the strength of the claims.

Alleged infringers often find the Federal Circuit's test to be unsurmountable for several reasons. It is difficult to meet the objective prong because patents can be difficult to interpret and often must go through extensive claim construction proceedings before the boundaries of the patent claims are established. This allows many patent owners to greatly overstate what their patents actually claim while still presenting a question for the court. Also, a patent's presumption of validity must be overcome by a

¹¹ *H.R. 3309: Improving the Patent System to Promote American Innovation and Competitiveness Before the H. Comm. on the Judiciary*, 119th Cong. 1:21:23 (2013) (testimony of Krish Gupta, Senior Vice President and Deputy General Counsel, EMC Corporation) available at <http://www.ustream.tv/recorded/40296631>.

¹² *Id.*

¹³ *Id.*

¹⁴ *Id.*

¹⁵ *Id.*

defendant. These aspects of patent law generate a substantial amount of work even in clear cases, making it difficult for a district court to declare a case to be objectively baseless. Finally, it can be nearly impossible to prove bad faith or inequitable conduct without a “smoking gun” because the uncertainties of patent law will almost always give the plaintiff a good faith excuse for pursuing court action.

The Federal Circuit’s rigid test puts alleged infringers at a disadvantage by not permitting district courts to consider factors more important in deciding whether a case is extraordinary. These factors include whether the plaintiff’s expected litigation outcome is negative, whether the plaintiff pursued the case irrationally, whether the plaintiff’s goals were to generate costs for the defendant as leverage, and whether the plaintiff used the case to obtain a settlement based on the costs of defense instead of the value of the underlying patent.

II. MERITLESS SUITS BY PATENT TROLLS POSE A SIGNIFICANT THREAT TO CON- SUMER WELFARE

Meritless suits by patent trolls have a negative impact on consumer welfare without any corresponding benefit. Patent trolls “typically lack any intention to develop the underlying technology, improve upon

it, or bring it to market.”¹⁶ Instead, patent trolls simply look to profit off the adoption of technology by end users *ex post* at significant cost.

A. MERITLESS SUITS HARM END USERS SUCH AS RETAILERS WHOSE COSTS ARE INCREASED AND MUST FOREGO ADVANCES IN TECHNOLOGY THAT WOULD BENEFIT CONSUMERS

Patent trolls are increasingly targeting end users because the end users’ lack of resources, relevant technical knowledge, and legal expertise makes them easy prey for meritless suits.¹⁷ Retailers, who often operate on low margins, are particularly vulnerable to patent troll demands. “Many retailers do not . . . employ legal counsel in-house, let alone a highly specialized patent attorney.”¹⁸ These low margins mean that any extra costs, whether they are costs to

¹⁶ *Demand Letters and Consumer Protection: Examining Deceptive Practices by Patent Assertion Entities Before the S. Comm. on Commerce, Sci., & Transp. Subcomm. on Consumer Prot., Prod. Safety, and Ins.*, 113th Cong. 2 (2013) (written testimony of Jon Bruning, Att’y Gen. of the State of Neb.).

¹⁷ *Demand Letters and Consumer Protection: Examining Deceptive Practices by Patent Assertion Entities Before the S. Comm. on Commerce, Sci., & Transp. Subcomm. on Consumer Prot., Prod. Safety, and Ins.*, 113th Cong. 3 (2013) (written testimony of Lary Sinewitz, Exec. Vice President of BrandsMart USA).

¹⁸ *Id.*

settle or costs to litigate, cannot be easily absorbed and must be passed on to the consumer either through increased prices or reduced services.

Retailers are so vulnerable to patent troll suits that they can be forced into settlements without even infringing a patent. For example, BrandsMart USA received a two paragraph letter claiming infringement based on “technology that enables debit cards and gift cards to read and process information via the magnetic strip on the back of the card.”¹⁹ BrandsMart USA consulted a patent attorney and discovered they used technology different from that asserted.²⁰ The patent troll refused to drop their demand when informed of this and instead lowered their settlement offer.²¹ BrandsMart eventually paid five figures for the patent troll to go away and another five figures in legal fees for the trouble.²² This transaction occurred entirely outside of the court system because the threat of legal fees unrecoupable by § 285 was too great.

Meritless suits not only increase costs to consumers, but decrease the service provided to them as well. For example, White Castle testified before the House of Representatives that it will be limiting it’s usage of QR codes and hyperlinks, as well as passing up

¹⁹ *Id.* at 2.

²⁰ *Id.*

²¹ *Id.*

²² *Id.*

creative web designs due to patent troll threats.²³ White Castle has also stated that it is considering going away with digital menu boards “despite the potential business efficiencies they create for our operators and customers by allowing us to provide real-time up-to-date information about our latest products, promotions, and offering.”²⁴

These are the very harms Congress sought to avoid when they gave district courts the discretion to award attorney’s fees in exceptional cases that abuse the patent system. The Federal Circuit’s decision in *Brooks Mfg.* excises this congressionally granted discretion and substitutes it with its own judgment on what an exceptional case should be. As a result, companies cannot afford to risk litigation even when they are certain to prevail.

B. THE PROBLEM HAS BECOME SIGNIFICANT ENOUGH TO WARRANT CONGRESSIONAL ATTENTION

Retailers have been affected by patent trolls to such an extent that they have reached out to

²³ *The Impact of Patent Assertion Entities on Innovation and the Economy Before the H. Comm. on Energy & Commerce Subcomm. on Oversight and Investigations*, 113th Cong. 5 (2013) (written testimony of Jamie Richardson, Vice President Gov’t & S’holder Relations, White Castle System, Inc.).

²⁴ *Id.* at 5-6.

Congress for help.²⁵ Congress has responded by conducting hearings including those by the Senate Commerce, Science & Transportation Committee and the House Energy & Commerce Committee.²⁶ There have also been 11 bills introduced to the current congressional session looking to alleviate the problem of patent trolls.²⁷ Four, including the Innovation Act, deal with the problem of patent trolls by introducing new language addressing the payment of attorney's fees.

In deciding this case, the Supreme Court should defer to Congress' constitutionally assigned role and presumed competence in the law making realm. The Supreme Court should reject the Federal Circuit's rigid two-part test established in *Brooks* and return discretion to the district court judges. If more clarity is needed to interpret § 285, then the Supreme Court should call on Congress to finish the task it has already begun; to redraft fee shifting standards in patent law cases.

²⁵ For example, the Stop Bad Patents campaign (seen at stopbadpatents.com), which was sponsored by the Food Marketing Institute, National Retail Federation, and the National Restaurant Association, placed targeted ads in several states urging people to contact their Congressman and urge them to stop patent trolls.

²⁶ See *supra* notes 16, 17, 23.

²⁷ For summaries of the bills currently before Congress see Matt Levy, *Patent Progress's Guide to Patent Reform Legislation*, PATENT PROGRESS (Nov. 19, 2013), <http://www.patentprogress.org/2013/11/19/patent-progresss-guide-to-patent-reform-legislation/>.

III. THE FEDERAL CIRCUIT TEST WAS MIS-APPROPRIATED FROM THE NOERR-PENNINGTON DOCTRINE WHICH WAS CREATED TO PROTECT COMPLETELY DIFFERENT INTERESTS

The Noerr-Pennington doctrine is based substantially on the bill of rights. In *Noerr* the Supreme Court stated “[t]he right of petition is one of the freedoms protected by the Bill of Rights, and we cannot, of course, lightly impute to Congress [that the Sherman Act intended] to invade these freedoms.” *Eastern R. Presidents Conference v. Noerr Motor Freight, Inc.*, 365 U.S. 127, 138 (1961). This Court has since reiterated that the Noerr-Pennington doctrine is based on the reasoning that the Sherman Act does not punish political activity nor invade “the First Amendment right to petition.” *Prof’l Real Estate Investors v. Columbia Pictures Indus.*, 508 U.S. 49, 56 (1993). Thus, it is undisputed that the doctrine is rooted in fundamental rights and protects these rights by preventing these activities from being declared illegal.

The shifting of attorney’s fees does not impact the rights to political activity or to petition the government, nor does it declare such activity to be illegal. If it did, all fee shifting powers of the court would only be available when the litigation is shown to be a sham.²⁸ The only impact fee shifting has on First

²⁸ *E.g.*, F.R.C.P. Rule 11; F.R.C.P Rule 37; 28 U.S.C. § 1927; F.R.A.P. 38; and the inherent powers of the court.

Amendment rights is to increase the costs of those rights, and this court has held that cost is not a factor in First Amendment considerations. *Citizens United v. FEC*, 558 U.S. 310, 350 (2009). Section 285 has no relation to the concerns and interests that brought about the Noerr-Pennington doctrine.

The adoption of the ruling in *Professional Real Estate* by the Federal Circuit in *Brooks* was an improper misapplication of an unrelated law. The Noerr-Pennington doctrine and the sham litigation exception represent a careful balancing of competing fundamental interests. The fact that this balancing was difficult is apparent in Justice Steven's concurrence in judgment which states "I would not, however, use this easy case as a vehicle for announcing a rule that may govern the decision of difficult cases, some of which may involve abuse of the judicial process." *Prof'l Real Estate Investors, supra*, at 76. When fundamental rights are not at stake the balance clearly weighs in favor of the Congressional intent for district court judges to have discretion to award attorney's fees in exceptional cases.



CONCLUSION

Because of the clear disregard for legislative intent, the immediate harm to end users and consumers, and the pervasive effect the Federal Circuit's ruling will have encouraging meritless patent suits, the judgment of the Court of Appeals should be reversed.

Respectfully submitted,

ERIK LIEBERMAN
FOOD MARKETING INSTITUTE
2345 Crystal Drive
Suite 800
Arlington, VA 22202
(202) 452-8884

DAVID A. BALTO
Counsel of Record
MATTHEW C. LANE
LAW OFFICES OF DAVID A. BALTO
1325 G Street, NW
Suite 500
Washington, DC 20005
(202) 789-5424
david.balto@yahoo.com