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Federal Circuit Requires Complainants to 'Do the Math' in ITC Domestic Industry Analysis

May 13, 2015

Section 337

It is axiomatic that before a patent owner can take advantage of U.S. International Trade Commission (the "Commission" or "ITC") remedies against unfair imports under Section 337 (19 U.S.C. § 1337), the patent owner must show that a "domestic industry" exists with respect to the asserted patent. That showing in turn requires proof of "significant" or "substantial" domestic investment connected to the patent. In *Lelo Inc. v. International Trade Commission*, Case No. 2013-1582 (Fed. Cir. May 11, 2015) the Federal Circuit has provided important guidance regarding the record a patent owner must develop in order to demonstrate the significance of the domestic investment at issue—the court rejected the notion that showing the "qualitative" significance of a patent owner's domestic investments can overcome an absence of evidence as to the "quantitative" significance of those investments.

Satisfying the Domestic Industry Requirement's "Economic Prong"

The Federal Circuit's decision makes clear that a complainant in a Section 337 action must 'do the math' and come forward with quantitative evidence to support a claim that they have made significant domestic investments in plant or equipment, significant employment of labor or capital, or substantial investments in engineering, research and development, or licensing. Such evidence is ultimately directed to proving that the underlying statutory factors that the Commission is obligated to consider are satisfied.

Specifically, 19 U.S.C. § 1337 requires that a complainant show that they have made "significant" domestic investments in plant or equipment, 19 U.S.C. § 1337(a)(3)(A), or "significant" employment of labor or capital, 19 U.S.C. § 1337(a)(3)(B), with respect to products that are covered by its asserted intellectual property. Alternatively, a complainant can show that they have made "substantial" investments in the exploitation of its intellectual property, including through engineering, research and development, or licensing. 19 U.S.C. § 1337(a)(3)(C). Without one of these showings, the ITC may not find a violation of Section 337, and an aggrieved patent owner will be precluded from relying on Section 337 to stop the importation of articles infringing their intellectual property. This requirement exists so as to ensure that only companies supporting relevant U.S. economic activity—and not mere importers—receive the protections of the statute.

Prior to the *Lelo* decision, there was some uncertainty as to precisely what evidence was required to satisfy this economic prong of the domestic industry requirement. While many Commission decisions have found the requirement satisfied based on a wholly quantitative analysis (*e.g.*, showing large dollar, square footage, or headcount investments), other decisions of the Commission, particularly those involving complainants that are small businesses, relied

heavily on a finding that the relevant activities of the complainant, while small in terms of dollars or personnel, are nevertheless qualitatively significant to the ultimate domestic industry product. At the heart of these disparate approaches seemed to be differing views on what precisely makes an investment "significant" or "substantial" for purposes of the statute.

The *Lelo* Decision Rejects Qualitative Evidence as a Substitute for Quantitative Evidence

While not dismissing the role of qualitative considerations in the domestic industry analysis, in *Lelo* the Federal Circuit has now weighed in definitively on the side of a quantitative economic analysis. In doing so, it reversed the Commission's domestic industry finding, and largely agreed with the underlying initial determination of the Administrative Law Judge ("ALJ") who first considered the matter. In the initial determination, the ALJ found no violation of Section 337 because the evidence provided with respect to relevant U.S. economic activity was insignificant. In particular, as part of finding the evidence insufficient, the ALJ noted that the claimed domestic industry products in the case were assembled in China, with only four relevant components (out of some larger number in total) sourced from the United States. Further undermining the complainants' case, even those four domestically sourced components were found to be purchased from others, rather than being custom designed or built by the complainants. The ALJ further found that less 5% of the total costs of the domestic industry products was attributable to components manufactured in the United States.

Despite the preceding record of minimal quantitative investments, the complainants argued that their purchase of these domestically-manufactured components nevertheless satisfied the economic prong of the domestic industry requirement. In particular, they argued that these U.S. components were critical to the function of the patented domestic industry product, and that their payments to the U.S. component suppliers ultimately yielded relevant domestic investments and expenditures by those suppliers on plant, equipment, labor and capital—what one might call a "trickle-down" approach to establishing a domestic industry. The ALJ, however, rejected these arguments, because there was ultimately no evidence provided as to how the complainants' payments to component suppliers actually related to a relevant investment made in the United States by the component suppliers.

On review, the Commission, relying almost entirely on the preceding qualitative factors, reversed the ALJ's determination. In doing so, the Commission likened the U.S. component suppliers to subcontractors, and emphasized the qualitative importance of those components to the ultimate domestic industry products, characterizing them as "critical" to the function of those products. The Commission thus came to find a domestic industry present.

On appeal, the Federal Circuit rejected the Commission's reasoning, finding that the purchase of domestically-manufactured components could not satisfy the economic prong of the domestic industry requirement solely based on the qualitative contribution of those components to the domestic industry product. In reaching its conclusion, the court engaged in a textual analysis of § 1337, finding that the statute's requirement of a "significant" or "substantial" economic activity refer to actual *quantities*—be they of dollars, or square feet at manufacturing plants, or of the numbers of people who work there—and that, accordingly, the domestic industry analysis must be a quantitative one. In view of what the Federal Circuit found was "insignificant" quantitative evidence put forward by the complainants of investment and employment, the court concluded that the qualitative value of the components to the ultimate domestic industry products, no matter how critical, could not overcome the absence of quantitative proof and satisfy the domestic industry requirement.

Lelo's Potential Implications for Future Complainants

It is readily apparent that future complainants must now develop and offer into evidence the required quantitative showing, as the *Lelo* standard requires an accounting of a complainant's (or its licensees') allegedly relevant investments in the United States. Beyond specifying what evidence will ultimately be considered, the Federal Circuit's decision tacitly serves as a cautionary tale for future complainants—they must collect the right evidence, do the math in analyzing the impact of their expenditures on the relevant economic activities, and make a case that provides the Commission with a record containing hard numbers on which to base its analysis. This is consistent with the prior holdings of the ITC where, in view of the lack of an express definition for the terms "significant" and "substantial" within the statute, a determination of significance is made though "an examination of the facts in each investigation, the article of commerce, and the realities of the marketplace" rather than by reference to a specific threshold. *In Re Certain Double-Sided Floppy Disk Drives & Components Thereof*, USITC Inv. No. 337-TA-215, 227 U.S.P.Q. 982, 989 (Oct. 15, 1985). Such an examination mandates a complainant to develop the appropriate record, which is most easily accomplished by providing quantitative measures of the qualifying activities.

For example, where a complainant (like the one in the case at hand) attempts to rely on expenditures for purchased components from U.S. suppliers, it should be prepared to show not only how much it spent, but also that those expenditures have gone towards significant investments in the purchase of facilities or equipment related to that component, or that those expenditures have gone towards significant domestic employment associated with that component. This may require additional advanced preparation prior to filing the complaint (e.g. obtaining these details from the component suppliers), and may further require a complainant to obtain commitments from its suppliers to cooperate in the Commission proceeding. While this is not necessarily a significant departure from the prevailing wisdom on how to effectively develop and put forward a domestic industry case, it could easily become a trap for the unwary who think they have a "good story" to tell, but might not have the best numbers available on their side to back up that story.

At the same time, there remains an important place for the qualitative narrative in domestic industry showings. This is particularly so for small or newly established businesses, which have historically had to revert to a qualitative story advancing their key contributions where their absolute investments are small. Even when the Commission applies the *Lelo* standard and measures the sufficiency of a complainant's quantitative proof, such qualitative evidence will almost certainly remain important; but now it will be part of helping the Commission frame its quantitative deliberations, rather than a stand-alone test of sufficiency—*i.e.,* it will go into the Commission's "examination of the facts …, the article of commerce, and the realities of the marketplace." *See Double-Sided Floppy Disk Drives* 227 U.S.P.Q. at 989.

In this context, a $10,000 investment in the production of prototypes of a domestic article may or may not be significant. The difference could well end up being, among other things, whether the entity making the investment is small or large, and whether the dollar amount represents a meaningful amount of what has been invested in the product over all. If a complainant fails to develop and introduce a compelling qualitative story to frame its investments, even concrete quantitative figures can be rendered almost meaningless. Thus, while the *Lelo* decision's emphasis of quantity over quality is clear, and while it will likely impact the scope of the economic record developed in future investigations, it does not—and should not—mean the end of qualitative domestic industry arguments before the Commission.

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