Obviously Obvious: Federal Circuit Reverses District Court's Decision That Online "Shopping Cart" Patents Are Nonobvious as a Matter of Law—*Soverain Software LLC v. Newegg Inc.*

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"We saw that if we paid off this patent holder, we'd have to pay off every patent holder this same amount. This is the first case we took all the way to trial. And now, nobody has to pay Soverain jack squat for these patents."[1]

Litigation is expensive, plain and simple. In a typical patent-infringement dispute, defending a case from start to finish—that is, from the complaint to the appeal—may cost a company upwards of a million dollars. Accordingly, the defendant-company will often choose to pay the patent holder a licensing fee instead of advancing its case to trial. At times, the alleged infringer may be particularly confident that it is not infringing, or that the patent is not even valid in the first place. Nevertheless, an impartial weighing of potential litigation costs against the price of licensing the patent will oftentimes produce an economically justifiable solution—pay the patent holder and simply walk away. It must just be the cost of doing business, right?

Not for Newegg, and not for its Chief Legal Officer, Lee Cheng.[2] In an age when settlement is commonplace, Newegg's approach to infringement litigation is refreshing, albeit confrontational and seemingly expensive: Newegg refuses to settle with nonpracticing entities (NPEs) that allege infringement.[3] NPEs, which are more commonly referred to as "patent trolls," are companies that accumulate patents with the intent to aggressively pursue licensing fees through litigation, with no plans of ever manufacturing or

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1. Joe Mullin, *How Newegg Crushed the "Shopping Cart" Patent and Saved Online Retail*, ARS TECHNICA (Jan 27, 2013, 4:00 PM), http://arstechnica.com/tech-policy/2013/01/how-newegg-crushed-the-shopping-cart-patent-and-saved-online-retail/.vhttp://arstechnica.com/tech-policy/2013/01/how-newegg-crushed-the-shopping-cart-patent-and-saved-online-retail/.

2. *See id.* (discussing Lee Cheng's position on settling infringement suits).

3. *See* Daniel Nazer, *Trolls and Tribulations*, ELECTRONIC FRONTIER FOUND. (Feb. 6, 2013), https://www.eff.org/deeplinks/2013/02/trolls-and-tribulations ("To its credit, Newegg has a policy of never settling with patent trolls.").

marketing the patented inventions.[4] In the past decade, NPEs have changed the landscape of patent law, generating a constant fear of litigation and discouraging the very innovation that lies at the heart of patent protection. Even President Obama, in a recent "Fireside Hangout" on Google Plus, stated that NPEs were doing nothing more than "extorting" money from others, and that further legislation is necessary to remedy the problem.[5] *Soverain Software LLC v. Newegg Inc.*[6] demonstrates how costly and truly difficult it can be for a defendant to stand its ground against an NPE.

In 2007, Soverain filed suit against a group of companies for infringement of its patents disclosing a system for e-commerce sales transactions.[7] Each of the other defendant-companies chose to pay Soverain to license the patents in exchange for avoiding litigation; however, Newegg refused. It argued that the Newegg sales system was materially different than the patented system, and that Soverain's patents were obvious in light of the prior art and thus invalid. In a way, the case was a perfect storm. On one side, the prototypical NPE holding a group of dubious patents, and on the other, an alleged infringer committed to litigating the issue, regardless of cost. The stage was set for the two companies to square off in what was coined "the mother of all patent battles," and the rest of the online-retail community had a front-row seat.[8] The case is particularly interesting for two reasons: It highlights the stark difference between the Federal Circuit and the district court's position regarding what level of evidence is necessary to establish a prima facie case of nonobviousness, and it also provides an example of when a court will disregard evidence of licensing as secondary indicia of nonobviousness, when such licenses merely reflect a party's attempt to avoid costly litigation.

THE "SHOPPING CART" PATENTS AND SOVERAIN'S GOAL TO OBTAIN ONE PERCENT OF ALL INTERNET SALES

The Soverain-Newegg dispute involved a number of patents, developed in

4. *See "Patent Trolls": How Some Say They're Hurting U.S. Economy* (CBS television broadcast Dec. 21, 2012), *available at* http://www.cbsnews.com/8301-505263_162-57560405/patent-trolls-how-some-say-theyre-hurting-u.s-economy/ ("Most everyone settles because it becomes so expensive.").

5. For access to President Obama's "Fireside Hangout" and a short discussion on NPEs, see Mike Masnick, *President Obama Admits That Patent Trolls Just Try to 'Extort' Money; Reform Needed*, TECH DIRT (Feb. 14, 2013, 2:45 PM), http://www.techdirt.com/articles/20130214/14351821988/president-obama-admits-that-patent-trolls-just-try-to-extort-money-reform-needed.shtml. For an interesting discussion on changes to the patent laws, see Richard Posner, *Do Patent and Copyright Law Restrict Competition and Creativity Excessively?*, BECKER-POSNER BLOG (Sept. 30, 2012, 10:30 PM), http://www.becker-posner-blog.com/2012/09/do-patent-and-copyright-law-restrict-competition-and-creativity-excessively-posner.html.

6. No. 2011-1009, 2013 WL 216406 (Fed. Cir. Jan. 22, 2013).

7. *See* Mullin, *supra* note 1 (discussing history of litigation).

8. *See* Mark Brohan, *The Mother of All Patent Battles*, INTERNET RETAILER (Jul. 30, 2010, 1:07 PM), http://www.internetretailer.com/commentary/2010/07/30/mother-all-patent-battles ("At stake is whether several big online retailers may be forced to fork out millions of dollars in licensing fees and court costs and even risk losing their shopping cart altogether.").

1994 by Open Market Inc., covering a system that most would describe as your typical online sales transaction. The patents disclosed a sales system with a buyer computer, a host computer, and a merchant computer, all interconnected by an electronic network. Under the patented system, the buyer accesses the merchant's website and selects a product, the product is recorded in the buyer's "shopping cart," and the information is saved on the server until he or she chooses to checkout and purchase the item. The vast majority of online retailers rely on a similar system to conduct sales transactions on the Internet.

The patented inventions were embodied in a software system called "Transact" that Open Market attempted to license to retailers in the early 1990s. After modest success, Open Market sold the patents and supporting software to Divine Inc. in 2001. Less than two years later, however, Divine filed for bankruptcy, and Soverain purchased the patents. In fact, Soverain was created specifically to acquire these "shopping cart" patents, with the ultimate goal of brandishing the patents to demand licensing fees from all major online retailers.[9] Shortly after acquiring the patents, Soverain began actively pursuing licensing fees from online retailers whose sales systems incorporated the patented technology.

Soverain's goal was to demand a one percent royalty on all Internet sales transactions generated through the use of the patented system.[10] From the outset, Soverain was extremely successful, obtaining judgments against Avon and Victoria's Secret for over $18 million, as well as a running royalty on all online sales.[11] In 2005, Amazon settled with Soverain for a reported $40 million, while The Gap also settled for an undisclosed sum.[12] And to date, Soverain has filed infringement suits against more than a dozen other companies, such as Office Depot, Kohl's, and J. Crew.[13] In 2007, Soverain shifted its focus to Newegg, an online retailer that sells electronics and information-technology products.[14]

9. *See* Mullin, *supra* note 1.

10. See Chloe Albanesius, *Newegg Crushes Patent Troll in Online 'Shopping Cart' Suit*, PCMAG.COM (Jan. 28, 2013, 4:24 PM), http://www.pcmag.com/article2/0,2817,2414778,00.asp (discussing Soverain's plan to acquire royalty payments for internet sales); *see also* Mullin, *supra* note 1 ("Soverain's plans were always bigger than Amazon and Newegg. It wanted nothing less than to extract a patent tax from the entire retail sector, using three patents it claimed covered pretty much any use of 'shopping cart' technology.").

11. *See* Dan O'Connor, *Why Newegg is Exceptional (and Just Saved You Money!)*, PAT. PROGRESS (Jan. 31, 2013) http://www.patentprogress.org/2013/01/31/why-newegg-is-exceptional-and-just-saved-you-money/ (discussing prior settlements).

12. *See* Dawn Kawamoto, *Amazon Pays $40 Million to Settle Patent Dispute*, ZDNET (Aug. 11, 2005, 9:11 PM), http://www.zdnet.com/news/amazon-pays-40-million-to-settle-patent-dispute/144171; *see also* Mullin, *supra* note 1.

13. For a chart listing all of Soverain's pending and resolved litigation, see Mullin, *supra* note 1.

14. *See* NEWEGG, http://www.newegg.com (last visited Feb. 22, 2013).

NONOBVIOUS AS A MATTER OF LAW?

Newegg refused to pay Soverain a licensing fee for the use of the patented system, and in 2007 the parties went to trial in the United States District Court for the Eastern District of Texas.[15] At issue were the three Open Market patents that Soverain had acquired: U.S. Patent Nos. 5,715,314 (the '314 patent); 5,909,492 (the '492 patent); and 7,272,639 (the '639 patent). The parties each agreed that there were three specific sets of claims at issue: the "shopping cart" claims, which were system claims 34 and 51 of the '314 patent; the "hypertext statement" claims, which were system claims 41 and 61 of the '492 patent; and the "session identifier" claims, which were method claims 60 and 79 of the '639 patent. The "shopping cart" claims involved the system of storing shopping information in individual storage areas, referred to as shopping carts, on the host server. The "hypertext statement" claims covered a system of producing an online-accessible sales summary, or receipt, with each sales transaction. And last, the "session identifier" claims disclosed a method of assigning a number to each shopping session, for purposes of keeping record of the transaction.

At trial, Newegg attempted to differentiate its system from the patented inventions, claiming that its sales system did not store sales information on its server but, instead, utilized "cookie" technology to store the ongoing sales information on the buyer's computer until checkout, which it argued was a significant distinction. Additionally, and most notably, Newegg also attacked the validity of the patents themselves, claiming that all three patents were obvious in light of the prior art and thus invalid. Specifically, Newegg alleged that an e-commerce system called the "CompuServe Mall" was available prior to the issuance of Open Market's original patents, rendering the "shopping cart" and "hypertext statement" claims of the '314 and '492 patents obvious. Additionally, Newegg relied on U.S. Patent Nos. 5,560,008 (the '008 patent) and 5,724,424 (the '424 patent), both of which disclosed a method of assigning numbers to individual customers, to argue that the "session identifier" claims of the '639 patent were also obvious.

Throughout trial, both parties offered evidence on the issue of obviousness. Newegg relied heavily on the CompuServe Mall, a system by which a buyer could access a database of retailers on a buyer computer that operated as an electronic sales catalog: The buyer would type "O" to order or select an item and "checkout" to purchase. Newegg offered testimony from CompuServe's former Chief Technology Officer, who provided a detailed description of the CompuServe system, as well as two books, published prior to the patented inventions, that explained how to utilize the CompuServe Mall. Additionally,

15. *See* Soverain Software LLC v. Newegg Inc., 836 F. Supp. 2d 462 (E.D. Tex. 2010), *rev'd in part*, No. 2011-1009, 2013 WL 216406 (Fed. Cir. Jan. 22, 2013).

Newegg's expert witness testified regarding the similarities between the CompuServe Mall and the patented system embodied in the Transact software, detailing the similarities element by element, before concluding that all of the elements and limitations found in Soverain's patents were "shown or apparent" in the prior art.[16]

In response, Soverain argued that its patents were nonobvious in light of the CompuServe Mall, offering testimony from its own expert, who explained that the patented system had a number of claims that were not present in the CompuServe Mall. Specifically, Soverain alleged that the patents incorporated Internet technology that was not available at the time of the CompuServe system. Additionally, Soverain was permitted to offer evidence that numerous companies had paid to license its "shopping cart" patents, as a means of demonstrating that the inventions were commercially successful. Relying on these licenses, Soverain's argument was rather convincing: Why would companies pay to license Soverain's software if its patents were invalid?

Despite extensive evidence on the issue of obviousness, at the close of trial Judge Davis removed the issue of obviousness from the jury, granting Soverain's Rule 50(a) motion and concluding that the patents were nonobvious as a matter of law and thus valid. Judge Davis said, "I don't think there's sufficient testimony to present an obviousness case to the jury. I think it would be very confusing to them."[17] With the issue of obviousness removed from consideration, the jury found that Newegg had indirectly infringed on the "shopping cart" and "hypertext statement claims" of the '314 and '492 patents, but that it did not infringe on the "session identifier" claims of the '639 patent. The jury awarded Soverain $2.5 million dollars in damages.

After the jury rendered its verdict, both Newegg and Soverain filed a series of post-trial motions. Newegg moved to vacate and remit the damages award, while Soverain moved for a permanent injunction or, in the alternative, an ongoing royalty payment. Both sides also filed renewed motions for judgment as a matter of law under Rule 50(b). Again, Judge Davis sided with Soverain, denying Newegg's motions and upholding the jury's verdict of infringement of the '314 and '492 patents. Additionally, the judge *set aside* the jury's finding of noninfringement of the asserted claims of the '639 patent, entering a judgment in favor of Soverain and ordering a new trial on the issue of damages. Last, he entered a judgment in favor of Soverain for both post-trial damages and an ongoing royalty of $0.15 per sales transaction for the life of the patents.

16. *See* Soverain Software LLC v. Newegg Inc., No. 2011-1009, 2013 WL 216406, at *4 (Fed. Cir. Jan. 22, 2013).

17. *See id.* at *2.

THE NONOBVIOUSNESS REQUIREMENT

To obtain a patent, an invention must exhibit patentable subject matter and must be new, useful, and nonobvious.[18] At issue in *Soverain* was the obviousness requirement, which states a patent may not be obtained "if the differences between the subject matter sought to be patented and the prior art are such that the subject matter as a whole would have been obvious at the time the invention was made to a person having ordinary skill in the art to which said subject matter pertains."[19] In order to determine nonobviousness, a patent examiner or the court will consider previous patents, patent applications, and other existing public information to determine whether, in light of that information, the claimed invention or improvement would have been obvious to an ordinary person with skill in that particular art. For example, in a patent application for a new system of delivering an existing pharmaceutical, the examiner may review prior patents covering delivery systems of other pharmaceuticals, as well as articles published in medical journals and other available literature, to determine if this new system of delivery is sufficiently nonobvious to warrant patent protection.

In *Graham v. John Deere Co.*,[20] the Supreme Court established four factors that the court should consider in determining if the party has satisfied the nonobviousness requirement: (1) the scope and content of the prior art; (2) the difference between the prior art and the claimed invention; (3) the level of ordinary skill in the field of the invention; and (4) any "objective" or "secondary" considerations.[21] With ongoing advances in technology, the courts have frequently been faced with difficult validity determinations with respect to nonobviousness. Particularly relevant in the *Soverain* case was the Federal Circuit's recent decision in *Muniauction, Inc. v. Thomson Corp.*,[22] a case involving patents disclosing a system of buying and selling bonds online. With respect to whether it was obvious to combine an existing bonds-sales system and Internet technology, the Federal Circuit concluded that the patents failed the nonobviousness requirement, stating that the application of Internet technology to an existing process was "commonplace."[23]

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18. *See* 35 U.S.C. § 101 (2006). *See generally* David L. Bohan, Note, *Computer Programs: Abstract Ideas or Patentable Subject Matter?*, 29 SUFFOLK U. L. REV. 809 (1995).

19. 35 U.S.C. § 103(a) (2006).

20. 383 U.S. 1 (1966).

21. *Id.* at 17. "Secondary" considerations could include: whether there was a long-felt need for the claimed invention; whether others had failed to invent; or whether the claimed invention enjoyed commercial success. *See id.*

22. 532 F.3d 1318 (Fed. Cir. 2008)

23. *Id.* at 1326-27; *see also* Western Union Co. v. Moneygram Payment Sys., Inc., 626 F.3d 1361, 1370 (Fed. Cir. 2010) ("In *Muniauction*, we concluded that conducting previously known methods of bidding through an Internet web browser was obvious because it amounted to no more than applying the use of the Internet to existing electronic processes at a time when doing so was commonplace.").

THE FEDERAL CIRCUIT— "QUESTIONS OF LAW MUST BE CORRECTLY DECIDED"[24]

Despite the judgment in the district court, most believed Newegg had actually scored a significant victory at trial—the $2.5 million verdict was only seven percent of what Sovereign sought in damages, and the $0.15 royalty per transaction was significantly less than the one percent of all sales that Soverain had set out to obtain. Nevertheless, Newegg appealed the decision to the United States Court of Appeals for the Federal Circuit. Citing *Graham* and *KSR International Co. v. Teleflex Inc.*,[25] the Federal Circuit characterized the obviousness determination as a question of law, before gently reminding the district court that "questions of law must be correctly decided."[26]

The Federal Circuit reversed the district court's ruling that the patents were nonobvious as matter of law. In stark contrast to the district court's finding, the Federal Circuit concluded that sufficient evidence was offered to determine that the patents were, in fact, *obvious* as a matter of law and thus invalid. Judge Newman wrote, "The district court's conclusion that a prima facie case of obviousness was not met is not explained by the court or by Soverain, and does not accord with the record."[27] The court went on to hold that the "shopping cart" and "hypertext statement" claims of the '614 and '492 patents were obvious in light of the CompuServe Mall system, and that applying the use of the Internet to the existing electronic sales process did not render the Soverain patents nonobvious. Additionally, the court vacated the district court's finding of infringement regarding the "session identifier" claims of the '639 patent, stating that the prior '008 and '424 patents rendered obvious the "session identification" claims, and that any distinction between attaching numbers to individual buyers, as opposed to individual sales transactions, was immaterial.

Last, the court rejected Soverain's argument that extensive licensing and commercial success of the patented inventions negated any finding of obviousness. In reaching its decision, the court explained that the patented system was relatively unsuccessful in the early 1990s, and that the recent licensing of the product was more likely a reflection of parties attempting to avoid costly infringement litigation, as opposed to a genuine interest in the patented system. The court concluded that licenses purchased "by those who bought litigation peace . . . do not support [a finding of] nonobviousness."[28]

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24. Soverain Software LLC v. Newegg Inc., No. 2011-1009, 2013 WL 216406, at *3 (Fed. Cir. Jan. 22, 2013).

25. 550 U.S. 398, 427 (2007) ("Where, as here, the content of the prior art, the scope of the patent claim, and the level of ordinary skill in the art are not in material dispute, and the obviousness of the claim is apparent in light of these factors, [remand is unnecessary].").

26. *See Soverain Software LLC*, 2013 WL 216406, at *3.

27. *Id.* at *7.

28. *Id.* at *12.

EMPTYING THE CART—*SOVERAIN*'S IMPACT MOVING FORWARD

The Federal Circuit's decision to reverse the district court's finding of nonobviousness as matter of law would usually be surprising. It is hard to understand how two courts, both reviewing the same evidence, could come to entirely conflicting conclusions. More specifically, the district court found there was insufficient evidence to allow the jury to even *consider* the issue of obviousness, while the Federal Circuit concluded that very same evidence was sufficient to render the patented system obvious by clear and convincing evidence.

The result, however, is less surprising when you consider that the parties litigated the case in the Eastern District of Texas. The Eastern District has, over time, developed a reputation as being a "patent friendly" court and, as such, is a common forum for NPEs seeking to enforce their patents.[29] With this decision, the Federal Circuit has seemingly pushed back against the Eastern District. Nevertheless, it is hard to predict if the Federal Circuit will continue down this path of curbing baseless patent litigation, or if defendants will actually choose to provide it with the opportunity to do so. Here, Newegg likely spent more money defending the suit than it would have paid for a license—to effect change, other defendants would have to make similar financial sacrifices. Another possible solution to limiting the NPE threat could be a fee-shifting provision that would permit the defendant to recoup attorney fees if the patent is determined to be invalid, which would serve to discourage baseless infringement actions, while also incentivizing defendants to challenge what they consider to be questionable patents.[30] Under existing patent law, a judge may award attorney fees only in exceptional cases.[31]

At a minimum, the *Soverain* case is certainly a victory for online retailers, as well as the consumers who would have been affected by the increased cost of online sales. In contrast, the decision is a significant loss for Soverain, whose attempts to utilize "shopping cart" patents to generate licensing fees have seemingly been halted. From a tactical standpoint, the case provides future defendants with a roadmap for attacking broad, technology-based patents that simply incorporate the Internet into existing methods. Last, the case serves to expose the inherent weaknesses in arguing that licensing fees should be considered secondary indicia of nonobviousness, when such licensing is likely the result of parties avoiding costly litigation, as opposed to a desire to utilize

29. *See* Sam Williams, *A Haven for Patent Pirates*, MIT TECH. REV. (Feb. 3, 2006), http://www.technologyreview.com/news/405259/a-haven-for-patent-pirates/ ("[P]laintiffs have such an easy time winning patent-infringement lawsuits against big-tech companies that defendants often choose to settle rather than fight.").

30. *See* O'Connor, *supra* note 11 ("One potential fix that would help on the margins is making it easier to recoup litigation fees when a patent is invalidated.").

31. *See* 35 U.S.C. § 285 (2006).

the patented invention. Moving forward, this distinction may prove to be an effective tool for defendants seeking an invalidity determination based on the obviousness of the patented invention, especially when the licensing fees at issue are significantly less than the cost of litigating infringement.