

Keywords: on-sale bar; ready for patenting; commercial sale; experimental use

General: The Federal Circuit held a patent invalid under the 35 U.S.C. § 102(b) on-sale bar test of *Pfaff* because (1) the invention was ready for patenting, based on a declaration by the inventor that the invention was “reduced to practice,” and (2) the invention was the subject of a commercial sale, based on the fact that testers were invoiced for calls made during beta testing, prior to the critical date.

In re Cygnus Telecommunications Technology LLC Patent Litigation

87 U.S.P.Q.2d 1801 (Fed. Cir. 2008)

Decided August 19, 2008

I. Facts

In the late 1980s, placing a telephone call from the United States to a foreign country was typically less expensive than placing the same call from the foreign country to the United States. In 1988, James Alleman, and his company Paragon Services International, Inc., began to develop systems designed to take advantage of the cost differential. The system allowed a user in a foreign country to purchase a dedicated line that was attached to a “black box” in the United States. The foreign user would place a call on the dedicated line and then promptly terminate the call. The black box would then call the user back, using the less expensive U.S. billing rate, and the user would then dial the desired destination number, and the black box would place that call and bridge the two lines together. The effect was to allow a person overseas to initiate a call to the United States, but for the call to originate in the United States for billing purposes so as to take advantage of the lower U.S. billing rates.

Alleman subsequently developed a computer-based system to carry out these processes. Throughout the development process, Alleman worked with several individuals overseas, in particular Theo Brenner and Fadi Ghandour, as “beta-testers” who helped him troubleshoot the system. These individuals were regularly invoiced for the cost of their telephone calls. In addition, Alleman had discussions with another telecommunications company, Call Interactive, as to how they could implement and market his invention on a commercial scale.

Alleman filed a patent application for his computerized callback system on April 24, 1992. The application led to the issuance of U.S. Patent Nos. 5,883,964 (“the ‘964 patent”) and 6,035,027 (“the ‘027 patent”). Paragon’s successor-in-interest, Cygnus Telecommunications Technology, LLC, later brought infringement suits alleging infringement of both patents. The various actions were ultimately transferred and consolidated into a single multi-district proceeding before the United States District Court for the Northern District of California. On October 27, 2006, AT&T filed a motion on behalf of all defendants for summary judgment of invalidity based on prior public use and commercial sales of the subject matter of the patents. Several of the defendants also filed motions for summary judgment of noninfringement. The district court granted the invalidity and noninfringement motions and entered a final judgment on March 30, 2007. This appeal followed.

II. Issues

- A) Was Cygnus collaterally estopped from challenging the invalidity of the ‘964 and ‘027 patents because it failed to appeal the district court’s judgment against *all* defendants?
- B) Did the district court err in finding the ‘964 and ‘027 patents invalid under the on-sale bar of 35 U.S.C. § 102(b)?

- C) Did the district court err in dismissing Cygnus' trade secret misappropriation claims against AT&T?

III. Discussion

A) No. Cygnus did not include one of the defendants, Heritage Communications Corp., in this appeal. The Federal Circuit noted that a judgment of patent invalidity in one case can collaterally estop the patent owner from contesting invalidity in a subsequent case, as long as the patent owner had a "full and fair opportunity to litigate the validity of the patent" in the first case. However, the Federal Circuit stated that the defendants were seeking to extend that principle to a setting in which it has no application.

In particular, the Federal Circuit held that the defendant's collateral estoppel argument, reduced to its essentials, is that if a court enters a judgment of patent invalidity against a patentee in a multi-defendant action, and the patentee appeals that judgment against fewer than *all* of the defendants, the appellees can invoke collateral estoppel based on the final judgment in favor of the defendant not included in the appeal. As a result, the patentee's decision not to appeal against *one* defendant would mean that the patentee loses its right to an appellate decision against *all* of the defendants.

The Federal Circuit noted that the general doctrine of collateral estoppel does not apply because this appeal is not a "subsequent suit based on a different cause of action." See *Montana v. United States*, 440 U.S. 147, 153 (1979). In addition, the Federal Circuit cited *Innovad Inc. v. Microsoft Corp.*, 260 F.3d 1326 (Fed. Cir. 2001), closely analogous to the present case, which stated that "for excellent policy reasons, the doctrine of issue preclusion does not require Innovad to include all parties involved below in its appeal, which would preclude the opportunity of settlement with any party before appeal." Furthermore, the Federal Circuit argued that it would not serve the underlying purposes of the collateral estoppel doctrine.

B) No. A patent is invalid under the section 102(b) on-sale bar if, prior to the critical date, the invention was ready for patenting and was the subject of a commercial sale or offer for sale. *Pfaff v. Wells Elec., Inc.*, 525 U.S. 55, 67 (1998). An invention can be found to be 'ready for patenting' in at least the following ways: by proof that it was reduced to practice, or by proof that the inventor had prepared drawings or other descriptions of the invention that were sufficiently specific to enable a person skilled in the art to practice the invention. *Cargill, Inc. v. Canbra Foods, Ltd.*, 476 F.3d 1359, 1368 (Fed. Cir. 2007).

The district court held that the computerized callback system met the "ready for patenting" prong of the *Pfaff* test because, on February 12, 1997, Alleman submitted a declaration to the Patent and Trademark Office ("PTO") which stated "I reduced to practice the invention of the claims before June 27, 1990." On appeal, Cygnus argued that it should not be bound by Alleman's sworn statements for several reasons, including the fact that the PTO did not ultimately rely on the declaration, and that there were "internal inconsistencies" in the declaration, among others. The Federal Circuit noted that only a few of the documents Cygnus relied on for purposes of this appeal were before the district court when the summary judgment motion was being litigated. In addition, the Federal Circuit found that the documents Cygnus relied upon did not, in fact, contradict Alleman's declaration. As such, the Federal Circuit held that Cygnus was bound by Alleman's declaration, regardless of whether it was necessary for issuance of the patents. In addition, the Federal Circuit stated that "[a]ny alleged internal inconsistencies in those documents were the responsibility of Cygnus, as the applicant, and do not provide an excuse for Cygnus to disavow the clear statements by the inventor regarding the date of reduction to practice."

Cygnus also argued that the computerized callback system was not ready for patenting because it would not work on a commercial scale, as evidenced by Alleman's discussions with Call Interactive to implement and market the system on a commercial scale. The Federal Circuit stated that because the computerized system embodied the claims, sales relating to its use constitute an invalidating commercial sale, regardless of the state of development of the larger Call Interactive system. As such, the invention met *Pfaff's* "ready for patenting" prong.

With respect to Cygnus' argument that Brenner and Ghandour were merely "beta testers," the Federal Circuit stated that, in light of the undisputed evidence that they paid to use the computerized system, there was a sale of the service. The Federal Circuit also noted that there did not need to be a profit in order for there to be a sale within the meaning of section 102(b). Cygnus also argued that Brenner and Ghandour's use of the computerized system did not involve a commercial sale because their use of the system was part of Alleman's experimentation and thus was excluded from commercial use by the experimental use exception. The Federal Circuit noted that "experimental use cannot occur after a reduction to practice."

C) No. Cygnus also claimed that during negotiations with AT&T in the mid-1990s, it had given AT&T access to its computerized callback technology, including the patent applications that issued as the '964 and '027 patents. Although AT&T ultimately declined to enter into a business relationship with Cygnus, it launched its own computerized callback service in 1996. Cygnus alleges that AT&T's service used Cygnus's technology.

Under Minnesota law, the statute of limitations begins to run once a lawsuit could survive a motion to dismiss for failure to state a claim. The district court found that the allegations in Cygnus's complaint demonstrated that Cygnus was in possession of sufficient facts to state a claim for trade secret misappropriation as of August 30, 1996, when AT&T publicly announced its plan to launch a callback service, and AT&T had acknowledged receipt of Cygnus's callback patent applications, providing Cygnus with notice that AT&T had access to its trade secrets.

Cygnus argued on appeal that the statute of limitations should not have started running until 2005, when AT&T's counsel allegedly admitted during an in-court argument that AT&T used Cygnus' technology in its 1996 callback services. Cygnus claims that it had no reason to suspect misappropriation by AT&T before that time, particularly because the negotiations between the two companies had led Cygnus to believe that AT&T would pay a royalty if it decided to use Cygnus' technology. Cygnus also argues that before the 2005 admission, it had no means of knowing whether AT&T was using the precise callback technology encompassed by its patents.

The Federal Circuit affirmed the district court's ruling because Cygnus had possession of sufficient facts to allege trade secret misappropriation when it knew that AT&T had access to Cygnus's proprietary callback technology and knew of AT&T's launch of its callback services.

IV. Conclusion

A patent is invalid under the 35 U.S.C. § 102(b) on-sale bar if, prior to the critical date, the invention was ready for patenting and was the subject of a commercial sale or offer for sale. An invention is ready for patenting if (1) the invention has been reduced to practice or (2) the inventor has prepared drawings or other descriptions of the invention that are sufficiently specific to enable a person skilled in the art to practice the invention. The experimental use exception to the on-sale bar does not apply after a reduction to practice.