

**Keywords: Inequitable conduct; materiality; intent; small entity status; disclosure of litigation.**

**General: It is unresolved whether an incorrect claim of small entity status under 37 C.F.R. § 1.27(a) qualifies as information material to patentability. However, where there is no evidence that small entity status was deliberately falsely claimed, underpayment of the application fee can be remedied by payment of the deficiency, rather than eradication of the patent. If immaterial to the patentability of the application, litigation related to the application need not be disclosed.**

*Outside the Box Innovations v. Travel Caddy, Inc.*

U.S. Court of Appeals, Federal Circuit

No. 2009-1171

September 21, 2012

**I. Background**

Outside the Box Innovations, LLC, d/b/a Union Rich USA, filed a declaratory judgment patent suit against Travel Caddy, Inc. and its distributor/sales agent for Travel Caddy's patented tool carry cases, Rooster Products (d/b/a/ The Rooster Group), in the United States District Court for the Northern District of Georgia. The issues were infringement, patent validity, enforceability, and unfair competition.

The district court held that Travel Caddy's U.S. Patent No. 6,823,992 (the '992 patent) and its continuation Patent No. 6,991,104 (the '104 patent) were unenforceable in their entirety, based on inequitable conduct on the grounds that (1) Travel Caddy paid small entity fees to the PTO but was not entitled to small entity status, and (2) Travel Caddy did not disclose to the PTO the existence of the litigation on the '992 patent during prosecution of the '104 application.

Law and Facts Regarding Travel Caddy's Claim of Small Entity Status

MPEP § 509 provides for reduced patent application fees for small entities as provided by 37 C.F.R. § 1.27(a), which defines a small entity as any business concern that (1) has not, *inter alia*, licensed any rights in the invention to any entity which would not qualify for small entity status, and (2) whose employees, including affiliates, do not exceed 500 persons.

During prosecution, Travel Caddy claimed small entity status and, as a result, paid reduced PTO fees. While Travel Caddy, by itself, met the small entity definition of having fewer than 500 employees, Travel Caddy had a commercial arrangement with The Rooster Group, which had more than 500 employees when counting its affiliate.

Travel Caddy's agreement with The Rooster Group, entitled "An Agreement between Rooster Products International, Inc. and Travel Caddy Inc. dba as Travelon," includes provisions relating to supply, delivery, price, quantity, and other terms appropriate to commercial sales and distribution arrangements. The sales rights are exclusive to Rooster, provided that minimum sales volumes are met. The relevant language of the agreement cited by Union Rich as providing a patent license includes: "If Travelon is unable to meet these prices and terms then Rooster will

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pay a Royalty of 2.5% for jointly owned products; 3% for non-patented Travelon designed items; and 5% for patented and patent pending items.”

The district court found that this agreement was a patent license for purposes of 37 C.F.R. § 1.27(a)(2) and thus held the '992 and '104 patents unenforceable on the grounds that Travel Caddy paid small entity fees to the PTO but was not entitled to small entity status.

#### Law and Facts Regarding Travel Caddy's Non-Disclosure of Litigation to PTO

MPEP § 2001.05 provides that there is no duty to disclose information that is not material to the PTO. MPEP § 2001.06(c) provides:

Where the subject matter for which a patent is being sought is or has been involved in litigation, the existence of such litigation and any other material information arising therefrom must be brought to the attention of the U.S. Patent and Trademark Office. Examples of such material information include evidence of possible prior public use or sales, questions of inventorship, prior art, allegations of "fraud," "inequitable conduct," and "violation of duty of disclosure." Another example of such material information is any assertion that is made during litigation which is contradictory to assertions made to the examiner.

During prosecution of the '104 application, the parent '992 patent was in litigation, but only infringement of the '992 patent was at issue. Travel Caddy did not inform the '104 examiner of the '992 litigation.

The district court held the '992 and '104 patents unenforceable on the grounds that Travel Caddy did not disclose to the PTO the existence of litigation on the '992 patent during prosecution of the '104 application.

#### **II. Issues**

**A.)** Did the district court err in holding the '992 and '104 patents unenforceable on the ground that Travel Caddy paid small entity fees to the PTO but was not entitled to small entity status?

**B.)** Did the district court err in holding the '992 and '104 patents unenforceable on the ground that Travel Caddy did not disclose to the PTO the existence of litigation on the '992 patent during prosecution of the '104 application?

#### **III. Discussion**

**A.)** Yes, the Federal Circuit concluded that the district court erred and reversed the district court's holding.

**B.)** Yes, the Federal Circuit concluded that the district court erred and reversed the district court's holding.

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### Materiality and Intent

To establish unenforceability based on inequitable conduct in the PTO, it must be shown that information material to patentability was withheld from the PTO, or material misinformation was provided to the PTO, with the intent to deceive or mislead the patent examiner into granting the patent. Withholding of material information and intent to deceive or mislead must be established by clear and convincing evidence.

### Travel Caddy's Claim of Small Entity Status

While Union Rich argued that Travel Caddy's agreement with The Rooster Group was a patent license, Travel Caddy maintained that it was a distribution agreement with a fallback safeguard that permits Rooster to seek other sources of supply if Travel Caddy could not supply Rooster's needs at a competitive price.

The district court found that Travel Caddy's false claim of small entity status was "undoubtedly material" and found intent to deceive because Travel Caddy's patent attorney was responsible for "being familiar with such standards."

The Federal Circuit first analyzed the level of materiality required. The Federal Circuit referred to its *Therasense* decision, in which the *en banc* court held that, "as a general matter, the materiality required to establish inequitable conduct is but-for materiality." The court recognized an exception to this general rule, however, stating that: "[w]here the patentee has engaged in affirmative acts of egregious misconduct, such as the filing of an unmistakably false affidavit, the misconduct is material." In other words, a false affidavit or declaration is *per se* material. Although on its face, it appears that a false declaration of small entity status would fall within the definition of an "unmistakably false affidavit," particularly since a party that claims entitlement to small entity status does so in a sworn written declaration, the Federal Circuit determined that it need not decide the question of whether a false declaration of small entity status qualifies as *per se* material.

The Federal Circuit concluded that even if a false assertion of small entity status were *per se* material, the requirements of *Therasense* are not met here because there was no clear and convincing evidence of intent to deceive the PTO. Specifically, the Federal Circuit pointed out that there was no evidence that anyone involved in the patent prosecution knew that a patent license had been granted to a large entity and deliberately withheld that information in order to pay small entity fees. The Federal Circuit surmised that it was not unreasonable for Travel Caddy to view the Rooster agreement as a distributorship of products made by Travel Caddy, with protection to Rooster to obtain alternative supply if Travel Caddy failed to provide the product.

The Federal Circuit thus held that where there is no evidence that small entity status was deliberately falsely claimed, a finding of unenforceability is inappropriate. Instead, the Federal Circuit cited 37 C.F.R. § 1.28, which provides that good faith mistakes can be remedied by making a deficiency payment. The Federal Circuit found that where there is no specific intent to deceive, underpayment of the fee can be remedied by payment of the deficiency, not by eradication of the patent.

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### Travel Caddy's Non-Disclosure of Litigation to the PTO

Travel Caddy argued that, in not disclosing the '992 litigation during prosecution of the '104 application, there was no withholding of information material to patentability, and no intent to deceive the PTO. Specifically, Travel Caddy pointed out that the validity of the '992 patent had not been included in the Union Rich complaint nor otherwise placed at issue during the time when the '104 application was pending, and that no prior art or other information had been presented by Union Rich, even informally, during the period of overlapping pendency of the '104 application and the '992 litigation.

The district court held that Travel Caddy had the obligation to inform the '104 examiner of the '992 litigation, and that this was material information, citing MPEP § 2001.06(c):

Where the subject matter for which a patent is being sought is or has been involved in litigation, the existence of such litigation and any other material information arising therefrom must be brought to the attention of the U.S. Patent and Trademark Office. Examples of such material information include evidence of possible prior public use or sales, questions of inventorship, prior art, allegations of “fraud,” “inequitable conduct,” and “violation of duty of disclosure.” Another example of such material information is any assertion that is made during litigation which is contradictory to assertions made to the examiner.

The district court held that, although only infringement of the '992 patent had been placed at issue, “it was clear that the issue of validity would likely arise in the litigation.” The district court also inferred deceptive intent from the fact of non-disclosure based on Travel Caddy's patent attorney drafting and prosecuting both the '104 and '992 patents and being heavily involved as counsel in the '992 litigation. The district court also noted that Travel Caddy's patent attorney was an experienced patent attorney and testified as to his awareness of Rule 56 and MPEP § 2001. The district court stated that it “made this inference [of deceptive intent] because it found this inference to be the single most reasonable inference based on the evidence.”

The Federal Circuit disagreed, holding that during pendency of the '104 application, the existence of the '992 litigation was not material to patentability of the '104 application because there was no citation of prior art, nor any pleading of invalidity or unpatentability in the '992 complaint. The Federal Circuit remarked that, while a later challenge to the validity of the '992 patent was possible, it did not then exist. The Federal Circuit also mentioned that there was no suggestion of how Travel Caddy may have benefitted from the non-disclosure. Thus, the Federal Circuit concluded that the district court's ruling was in error because there was not clear and convincing evidence of withholding of information material to patentability of the claims in the '104 application during the pendency of that application.

The Federal Circuit also concluded that there was not clear and convincing evidence of intent to deceive the examiner of the '104 application. The Federal Circuit recalled the court in *Therasense*, which, it stated, sought to restore objectivity and consistency to the law of inequitable conduct, by requiring that “the accused infringer must prove that the patentee acted with the specific intent to deceive the PTO.” Specific intent to deceive the PTO requires “knowledge and deliberate action.” Here, the Federal Circuit determined that record contained no suggestion of how the withholding of the information concerning the '992 litigation could have

deceived the examiner and no suggestion of deliberate action to withhold it in order to deceive the examiner. The Federal Circuit also pointed out that the district court rejected Travel Caddy's argument that if notification of the existence of the '992 suit were indeed required during prosecution of the '104 application, any omission was due to oversight or error or negligence, not deceptive intent. The Federal Circuit stated that negligence, even gross negligence, is not sufficient to establish deceptive intent.

#### Dissent

Judge Newman dissented with the panel majority with respect to the small entity issue. Judge Newman argued that the majority did not go far enough in its reversal because the filing of the small entity statement by affidavit should not render the incorrect statement "per se material." Specifically, Judge Newman suggested that affidavits that are not the basis of or essentially material to patentability should not be "per se material." Judge Newman also suggested that a contingent patent license to a distributor should not necessarily defeat the small entity status.

#### **IV. Conclusion**

The Federal Circuit held that there was no specific intent to deceive the PTO with respect to both Travel Caddy's claim of small entity status and non-disclosure of the '992 litigation during prosecution of the '104 application and that the '992 litigation was not material to prosecution of the '104 application. As a result, the Federal Circuit reversed the district court's ruling of inequitable conduct. The Federal Circuit declined to address the materiality of an incorrect claim of small entity status.

#### **V. Practice Tips**

1. Clearly designate what are patent licenses (as opposed to sales agreements). For example, avoid including royalty provisions in non-patent license agreements.
2. In calculating numbers for small entity v. large entity status, be sure to include licensees and subsidiaries of licensees.
3. Be sure to keep updated with litigation of relevant patents and report to PTO during prosecution of related applications.