

**The Domestic Industry Requirement in Proceedings
Before the U.S. International Trade Commission
Under Section 337 of the Tariff Act of 1930**

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In an investigation by the International Trade Commission (“ITC” or “Commission”) under Section 337 of the Tariff Act of 1930 based on a statutory intellectual property (“IP”) right, a complainant must demonstrate that “an industry in the United States, relating to the articles protected by the [IP], . . . exists or is in the process of being established.” 19 U.S.C. § 1337(a)(2). The domestic industry requirement has two so-called “prongs:” the technical prong and economic prong. *Certain Microsphere Adhesives, Process for Making Same, and Products Containing Same, Including Self-stick Repositionable Notes*, Inv. No. 337-TA-366, USITC Pub. 2949 (Jan. 1995). Thus, the complainant in a patent-based 337 investigation must show “that an industry exists or is being established (economic prong) and that the industry practices at least one claim of the patent at issue (technical prong).” See, *Certain Display Controllers and Products Containing Same*, Inv. Nos. 337-TA-491/481, Commission Opinion at 52 (Feb. 4, 2005).

Because the statute speaks of “articles protected by” the respective IP right, the Commission generally has defined the domestic industry in statutory IP-based investigations as the domestic operations of the IP owner and its licensees devoted to exploitation of the IP right. *Certain Feathered Fur Coats and Pelts, and Process for the Manufacture Thereof*, Inv. No. 337-TA-260, USITC Pub. No. 2085 (May 1988) at 14, citing *Schaper Mfg. Co. v. US. Int’l Trade Comm.*, 219 U.S.P.Q. 665, 667 (1983). The Commission does not adhere to any rigid formula in determining the scope of the domestic industry, but rather examines each case in light of the particular realities of the market place. *Certain Double-Sided Floppy Disk Drives and Components Thereof*, Inv. No. 337-TA-215, Commission Op. (1985); *Certain Modular Structural Systems*, Inv. No. 337-TA-164, Commission Op. at 12 (1984).

In patent-based investigations, the technical prong concerns whether the complainant practices at least one claim of the asserted patents. Importantly, the complainant need not use an asserted claim to satisfy this requirement. *Certain Microsphere Adhesives, Process for Making Same, and Products Containing Same, Including Self-stick Repositionable Notes*, Inv. No. 337-TA-366, USITC Pub No. 2949 at 7-15 (January 1996). Specifically, “[t]he Commission has held that a complainant may satisfy the domestic industry requirement of section 337 by showing that the domestic industry exploits the patent in issue, and that a complainant is not required to establish that it practices asserted claims.” *Certain Digital Satellite System Receivers and Components Thereof*, USITC Inv. No. 337-TA-392, Initial And Recommended Determinations at 11 (October 1997), citing *Certain Microsphere Adhesives, Process for Making Same, and Products Containing Same, Including Self-stick Repositionable Notes*, Inv. No. 337-TA-366, Commission Op. at 24 (Jan. 16, 1996).

With respect to the economic prong of the domestic industry requirement, a complainant in a Section 337 action may show that a domestic industry exists or is in the process of being established under any of the three statutory grounds set forth in Section 337(a)(3), which provides:

(3) an industry in the United States shall be considered to exist if there is in the United States, with respect to the articles protected by the patent, copyright, trademark, or mask work concerned -

- (A) significant investment in plant and equipment;
- (B) significant employment of labor or capital; or
- (C) substantial investment in its exploitation, including engineering, research and development, or licensing.

19 U.S.C. § 1337(a)(3). Given that these criteria are in the disjunctive, satisfaction of any one of them will be sufficient to meet the domestic industry requirement. *Certain Integrated Circuit Chipsets and Products Containing Same*, Inv. No. 337-TA-428, Order No. 10 at 3, Initial Determination (Unreviewed) (May 4, 2000), citing *Certain Variable Speed Wind Turbines and Components Thereof*, Inv. No. 337-TA-376, Commission Op. at 15, USITC Pub. 3003 (Nov. 1996).

In 1988, by amending Section 337 and including for the first time the factor “substantial investment in its exploitation, including engineering, research and development, or licensing,” Congress intended to expand the definition of domestic industry to include certain non-manufacturing activities. *Certain Dynamic Sequential Gradient Compression Devices and Component Parts Thereof*, Inv. No. 337-TA-335, Initial Determination on Temporary Relief at 59 (May 15, 1992). The legislative history to these amendments provides that Congress intended to:

modify the domestic industry requirements by allowing complaints to be filed by persons who have made a substantial investment in facilities or activities relating to the exploitation of a patents, copyrights, trademarks, or mask work, including research and development, licensing, sales, and marketing. This adjustment will assure continued access to the ITC by entities, including universities, who have a substantial stake in the United States. This change would also avoid unfortunate results which have occurred on some recent cases, such as Gremlins, where - because of pertinent legislative history explaining the current law - the ITC has denied relief notwithstanding the existence of a large service industry exploiting the intellectual property rights within the United States. Finally, such a change will enabled universities and small businesses who do not have the capital to actually make the good in the United States to still have access to the ITC forum for the protection of their rights.

Certain Digital Processors and Digital Processing Systems, Components Thereof and Products Containing Same, Inv. No. 337-TA-559, Initial Determination at 89 (May 11, 2007) citing 132 Cong. Rec. H. 1782, 99th Cong., 2nd Sess, (Apr. 10, 1986). Congress included Section 337(a)(3)(C) to allow businesses ranging from “large Hollywood movie studios, to research and development programs at universities, to small start-up companies that are too small to manufacture any products for themselves” to access the ITC. *Certain Digital Processors* at 97.

The Senate Finance Committee Report on the Senate’s version of the Omnibus Trade and Competitiveness Act of 1988 commenting on domestic industry criteria (A) (B) and (C) of subsection (a) (3) of section 337, *supra*, stated:

The first two factors [(A) and (B)] in this definition have been relied on in prior Commission decisions finding that an industry exists in the United States. The third factor (C), however, goes beyond the ITC's recent decisions in this area. This definition does not require actual production of the article in the United States if it can be demonstrated that substantial investment and activities of the type enumerated are taking place in the United States. Marketing and sales in the United States alone would not, however, be sufficient to meet this test. The definition could, however, encompass universities and other intellectual property owners who engage in extensive licensing of their rights to manufacturers.

S. Rep. No. 71, 100th Cong., 1st Sess., at 129 (1987) (Senate Report); *see also* H.R. Rep. No. 40, 100th Cong., 1st Sess., at 157-58 (1987) (House Report).

Generally speaking, the domestic industry requirement is easy to satisfy, even for foreign companies with a relatively small footprint in the United States. A wide range of factors have been considered by the Commission and the Judges to establish the existence of a domestic industry.¹ For example, under certain circumstances, general expenditures have been considered in analyzing domestic economic activities where such expenditures can be allocated based either on sales of the products at issue versus sales of other products or based on the number of employees devoted to research and development or manufacture of the products at issue versus all other products. *See Certain Glass Tempering Systems*, Inv. No. 337-TA-171, Initial Determination at 34 (unreviewed); *Certain Laminated Floor Panels*, Inv. No. 337-TA-545, Order No. 17 (unreviewed ID) at 4 (March 2, 2006); *Certain Microlithographic Machines with Control Systems Having Programmable Operator Interfaces Incorporating General Purpose Computers, and Components Thereof II*, Inv. 337-TA-468 (“[I]t is well-settled that a complainant need only show that its investments are for activities that relate to the articles of commerce covered by the patents at issue.”).

If a patented element is an essential element of a final product, the industry may also be defined in terms of the completed product. *Certain Diltiazem Hydrochloride and Diltiazem Preparations*, Inv. 337-TA-349, Initial Determination at 138-141; *Certain Personal Computers and Components Thereof*, Inv. No. 337-TA-140, Commission Op. (1984); *Certain Double-sided Floppy Disk Drives and Components Thereof*, Inv. No. 337-TA-215 (patented head assembly a necessary part of floppy disk drive, and domestic industry properly defined by complainant's activities related to floppy disk drives, not just the head assembly). For example, in an investigation covering integrated circuits, an Administrative Law Judge found “that complainant had made substantial pre-manufacturing investment in research and development relating to the

¹ To establish that a domestic industry is in the process of being established, the IP owner must be “actively engaged in steps leading to the exploitation of the [IP].” *Certain Wire Electrical Discharge Machining Apparatus and Components Thereof*, Inv. No. 337-TA-290, Commission Opinion at 14 (May 15, 1990), citing S. Rep. No. 71, 100th Cong., 1st Sess. at 130 (1987). Congress intended that in determining whether a domestic industry is “in the process of being established,” pursuant to 19 U.S.C. § 1337(a)(2), the Commission should determine “whether the steps indicate a significant likelihood that the industry requirement will be met in the near future.” *Id.* “How far along complainant must be before it will be in the process of establishing a domestic industry” is a question of fact. *Certain Scanning Multiple-Beam Equalization Systems for Chest Radiography and Components Thereof*, Inv. No. 337-TA-326, Order No. 23 at 2 (August 20, 1991).

chipsets, including collaboration between the complainant's engineers and prospective customers in the initial design of the chipsets needed by the customers, and the efforts of complainant's engineers to debug those new designs." *Certain Integrated Circuits, Processes for Making Same, and Products Containing Same*, Inv. No. 337-TA-450, USITC Pub. No. 3624 at 152 (August 2003).

Where a subcontractor makes a substantial quantity of the complainant's products in the United States, that production can be sufficient to meet the domestic industry requirement of Section 337. *Certain Portable On-Car Disc Brake Lathes*, Inv. 337-TA-361, USITC Pub. No. 2889 (May, 1995); *Certain Static Random Access Memories and Components Thereof, and Products Containing Same*, Inv. No. 337-TA-325, Initial Determination, Order No. 9 at 5-6 (May 14, 1991) (unreviewed); *Certain Methods of Making Carbonated Candy Products*, Inv. No. 337-TA-292, Initial Determination at 142 (Dec. 8, 1989) (unreviewed in relevant part); *Certain Feathered Fur Coats and Pelts and Process for the Manufacture Thereof*, Inv. 337-TA-260, Initial Determination at 16-17 (Sept. 24, 1987) (unreviewed); *Certain Bag Closure Clips*, Inv. No. 337-TA-170, Initial Determination at 39 (1984) (unreviewed).²

The importance of the activities performed in the U.S. to the commercial viability of the products at issue also has been considered. *See e.g., Certain Diltiazem Hydrochloride and Diltiazem Preparations*, Inv. 337-TA-349, Initial Determination at 139-41; *Certain Salinomycin Biomass and Preparations Containing Same*, Inv. No. 337-TA-370, Initial Determination at 126, USITC Pub. 2978 (July 1996) (unreviewed). For example, in *Certain Variable Speed Wind Turbines and Components Thereof*, Inv. 337-TA-376, the domestic industry (after the Complainant went bankrupt) was defined by the Complainant's repair and service activities, although the turbines had been made in the U.S. prior to the bankruptcy filing. Similarly, in appropriate circumstances, the Administrative Law Judges have taken into account the importance of the domestic activities to complainant's business, including whether the activities enhanced complainant's ability to meet special market needs. *See e.g., Certain Plastic Encapsulated Integrated Circuits*, Inv. No. 337-TA-315, Initial Determination at 82-93, USITC Pub. 2574 (November 1992) (unreviewed in relevant part); *Certain Dynamic Random Access Memories, Components Thereof and Products Containing Same*, Inv. No. 337-TA-242, Commission Action and Order at 68-69, USITC Pub. 2034 (November 1987)). In other cases, the Judges have examined the relative value added to the finished article as a result of the activities performed in the United States. *See e.g., Certain In-Line Roller Skates with Ventilated Boots and In-Line Roller Skates with Axle Aperture Plugs and Component Parts Thereof*, Inv. No. 337-TA-348, Notice of Commission Determination to Review and Remand an Initial Determination Granting a Motion for Partial Summary Determination on the Issue of Domestic Industry, Order at 2 (August 31, 1993).

In at least two investigations, one of the Judges analyzed the domestic industry requirement through a comparison of the domestic versus worldwide activities of the complainant. In both cases, however, the Commission declined to pronounce as to whether such

² Investments in the general technology that is the field of the patent, rather than articles protected by the patent, do not count. *See Certain Dynamic Sequential Gradient Compression Devices and Component Parts Thereof*, Inv. No. 337-TA-335, Initial Determination at 62 (unreviewed).

an analysis was appropriate. *See, Certain Microlithographic Machines and Components Thereof*, Inv. No. 337-TA-468, Initial Determination at 343 (April 1, 2003) (Commission did not adopt ID's position on comparative analysis); *Certain Personal Computers, Server Computers, and Components Thereof*, Inv. No. 337-TA-509, Order No. 36 (March 7, 2005) (unreviewed initial determination) (comparative analysis not reached by Commission). Similarly, Judges have looked to the nature of the activities performed in the U.S., including the relationship between those activities and the asserted patent, in analyzing whether a domestic industry exists. *See e.g., Certain Plastic Encapsulated Integrated Circuits*, Inv. No. 337-TA-315, Initial Determination at 82-93, USITC Pub. 2574 (November 1992) (unreviewed in relevant part); *Certain Concealed Cabinet Hinges and Mounting Plates*, Inv. No. 337-TA-289, Commission Opinion at 23 (January 8, 1990)).

In pharmaceutical cases where the formulation was made abroad, the complainant's activities in the U.S. to gain FDA approval, to develop different dosages or means of delivery, or to formulate bulk material into finished product, all have been deemed sufficient. *See, e.g., Certain Salinomycin Biomass and Preparations Containing Same*, Inv. 337-TA-370, USITC Pub. No. 2978 (July, 1996) at 120-128. For example, in *Diltiazem*, the Commission held that complainant had made substantial investment in the United States by development of diltiazem HCl in dosage form, as well as testing that was necessary to satisfy the requirements of the U.S. Food and Drug Administration. *Diltiazem Hydrochloride and Diltiazem Preparations*, Inv. No. 337-TA-348, USITC Pub. No. 2902, Commission Opinion at 134, 144-45 (June 1995).

Mere ownership of a patent, of course, is insufficient to meet the domestic industry requirement. *Certain Digital Processors* at 93, citing S. Rep. No. 71 at 130, H.R. Rep. No. 40. Licensing activities alone, however, can suffice to establish a domestic industry. *See, e.g., Certain Digital Satellite System (DSS) Receivers and Components Thereof*, Inv. 337-TA-392; *Certain Semiconductor Chips with Minimized Chip Package Size and Products Containing Same*, Inv. 337-TA-432, Order No. 13 (granting summary determination finding domestic industry based solely on licensing) (unreviewed); *see also Certain Video Graphics Display Controllers and Products Containing Same*, Inv. No. 337-TA-412, Initial Determination at 13 (May 14, 1999); *Certain Integrated Circuit Telecommunication Chips and Products Containing Same Including Dialing Apparatus*, Inv. No. 337-TA-337, USITC Pub. No. 2670, Initial Determination at 98 (March 3, 1993); *Certain Zero-Mercury-Added Alkaline Batteries, Parts Thereof and Products Containing Same*, Inv. No. 337-TA-493, Initial Determination at 142 (June 2, 2004); *Certain Semiconductor Chips*, Order No. 13 at 6 (January 24, 2001); *Certain Digital Satellite System DSS Receivers and Components Thereof*, Inv. No. 337-TA-392, Initial and Recommended Determinations at 11 (December 4, 1997).

Licensing expenses must be allocated to the patent at issue when it is licensed as part of a large portfolio of patents. *See Certain Set-Top Boxes and Components Thereof*, Inv. No. 337-TA-454, Initial Determination at 296-98, USITC Pub. 3564 (Nov. 2002) (unreviewed in relevant part). There must be a nexus between the licensee's activities upon which the complainant relies and the asserted patents. *Certain Digital Processors* at 85, citing *Certain Microlithographic Machines* at 346. Generally, the complainant must derive revenue, such as lump sum or royalty payments, from its licensing activities. *Certain Digital Processors*, at 93-95 ("Commission decisions also reflect the fact that a complainant's receipt of royalties is an important factor in

determining whether the domestic industry requirement is satisfied ...[t]here is no Commission precedent for the establishment of a domestic industry based on licensing in which a complainant did not receive any revenue from alleged licensing activities. In fact, in previous investigations in which a complainant successfully relied solely on licensing activities to satisfy section 337(a)(3), the complainant had licenses yielding royalty payments.”).

The Commission recently has been presented with the so-called “patent troll” issue in the context of the domestic industry requirement in Section 337. Specifically, in *Certain Combination Motor and Transmission Systems and Devices Used Therein and Products Containing Same*, Inv. No. 337-TA 561, the complainant’s licensing efforts may have been commenced largely for purposes of the litigation, as they apparently were in the form of a series of form letters, emails, and a few phone calls that were not followed up, most of which post-dated the filing of the complaint. The one license that was obtained was executed the week before the hearing in the investigation began and may have had little binding effect on the licensee. The complainant also relied on research and development activities relate to another product, that was actually assembled for sale, to show research and development in the patentable article. The research and development effectively ceased in 2000 and the majority of the alleged research and development expenditures appeared to have been related to administrative costs not directed to the patent at issue. The inventor on the asserted patent testified that he “built no prototypes of [the patentable device]. . . until after the patent issued.” Initial Determination at 154. The complainant apparently had one full-time employee, working as a “Director of Engineering.” *Id.*

The Administrative Law Judge found that the complainant had established that it satisfied the economic prong of the domestic industry requirement. Most of the basis for the Judge’s decision is confidential, but he concluded that, given the close relationship between the complainant’s related devices and the device covered by the asserted patented, the complainant “established the requisite economic prong of the domestic industry requirement directed to the patented article through its investment in the overall research and development activity.” *Id.*, Initial Determination at 157. While the Commission upheld the Judge’s finding of no violation of Section 337, it expressly declined to address the domestic industry issue. Notice of Determination to Review Initial Determination in Part, 72 Federal Register 25776 (May 7, 2007).

More recently, the Commission has decided to directly address the domestic industry requirement in *Certain Stringed Musical Instruments and Components Thereof*, Inv. No. 337-TA-586. That investigation was brought by complainant, Geoffrey McCabe, the sole inventor on six patents, including two patents asserted at trial in the investigation directed to the tuning of stringed musical instruments, particularly tremolos for electric guitars. McCabe originally brought the ITC action *pro se*, but retained counsel prior to the hearing. McCabe did not manufacture, sell, or license a commercial product alleged to be covered by any of his patents. Thus, prior to filing the complaint, McCabe had not derived any income from any product alleged to be covered by his patents.

McCabe asserts that he nevertheless expended “substantial investment” in exploiting his patents by engaging in research and development, engineering, and licensing of his patents consistent with the market realities of his industry. McCabe contends that he has engaged in an extensive amount of research and development and expended a significant amount of time to

arrive at a novel guitar tuning device, efforts that resulted in issuance of six patents in the United States. In all, McCabe alleged that he had invested a total of at least \$12,500 in this project, and a significant amount of personal time and travel expenses that are difficult to quantify, which he claims represents a significant investment by an individual.³

In particular, McCabe alleges that he invested in research and development to create final designs and prototypes of his products from which Kahler International, Inc. ("Kahler"), a domestic manufacturer of guitar components, created Computer Aided Design (CAD) drawings sufficient to prepare the patented products for manufacturing. *Id.*, Initial Determination at 12-15. Kahler allegedly took the first steps of manufacturing McCabe's devices by creating a tremolo "Model 7170" prototype utilizing McCabe's design, which was displayed for sale in Kahler's catalogue during the 2006 National Association of Music Merchants (NAMM) show. *Id.* Kahler apparently offered to manufacture the tremolo Model 7170 contingent upon resolving all legal rights to the design with one of the respondents in the Section 337 investigation.⁴

In addition, for many years prior to filing the complaint, McCabe apparently unsuccessfully attempted to license his patents to the named respondents in the ITC investigation and to others. *Stringed Instruments*, Initial Determination at 15-19. Subsequent to the filing of the complaint, McCabe negotiated and entered into licensing agreements with two of the respondent companies, though the record suggests that the royalties called for in the agreements may have been contingent and/or may not have been substantial. *See* Order No. 9 (May 7, 2007) (Hoshino Settlement Agreement) and Order No. 11 (July 10, 2007) (Vigier Settlement Agreement).

In December, 2007, the Administrative Law Judge issued an Initial Determination finding no violation of Section 337 because McCabe failed to establish that a domestic industry exists practicing the two asserted patents. The Judge found that McCabe failed to establish a domestic industry based on the requirement that the complainant show a substantial investment in research and development or licensing activities under Section 337(a)(3)(C). Initial Determination at 25. He held that "[s]hort collaborations and prototypes do not qualify as a 'substantial investment' in research and development." *Id.* According to the Judge, the two license agreements at issue do "not lead to the creation of a 'licensing' industry." *Id.* The Judge concluded "[q]uite simply, McCabe's activities are not 'substantial investment[s], in research and development or licensing' as intended by Congress." *Id.*

³ The ID states that McCabe spent \$8,500 on his prototypes. *Stringed Instruments*, Initial Determination at 23. However, McCabe asserts that he spent about \$12,500. McCabe Response to Commission Notice to Review at 22. The two patents at issue are both based on a parent application filed by McCabe in October 1990. Apparently, all of these prototyping expenses occurred prior to 1991, more than 15 years before filing of the complaint in late 2006.

⁴ McCabe claimed that he could license his designs for immediate production in the United States by Kahler but for the competition of infringing imports by, and legal challenges of, Respondent Floyd Rose Marketing, Inc. ("Rose"). In particular, McCabe characterizes a letter of August 11, 2006, from Kahler as an offer to manufacture McCabe's designs "contingent on resolving the dispute in this [ITC] investigation." McCabe Response to Commission Notice to Review at 24. In that letter, Kahler stated, "I can not manufacture your designs including the model 7170 series until you can fully indemnify me personally and my company and prove you have the funds to fight [Respondent Rose's] law firm's lawsuits and/or countersuits." *Id.*

In February 2008, the Commission determined to review the ID and requested briefing regarding three broad categories of questions:

(1) What type of level of research and development is necessary to satisfy the economic prong of the domestic industry requirement under Section 337 (a)(3)(C)? Should it differ depending upon the size of the relevant marketplace or whether the patent holder is an individual versus some other entity? What is the appropriate industry market in which we should examine the economic prong of the domestic industry requirement:

the market for certain guitars, all guitars, certain musical instruments, or all musical instruments or some other industry market? How do these criteria apply in this case? How is your argument supported by the record in this case? Does research and development prior to the issuance of a patent count towards the domestic industry requirement?

(2) What type and level of licensing activity is necessary to satisfy the economic prong of the domestic industry requirement under Section 337 (a)(3)(C)? Is the relevant time period for licensing activity before or after the filing of the complaint, or both? How do these criteria apply in this case? How is your argument supported by the record in this case? For the purposes of this question, consider whether licensing negotiations would qualify if they did not result in an actual license during a relevant period of time.

(3) Is the relevant industry in this case “in the process of being established” pursuant to Section 337(a)(2)? Was this issue properly raised before the ALJ and in the petition for review? How is your argument supported by the record in this case? How do the criteria for an industry in the process of being established differ from the criteria for an industry that already exists?

Stringed Instruments, Notice of Commission Determination to Review Initial Determination (February 7, 2008).

On April 24, 2008, the Commission determined not to review the Judge’s Initial Determination. As of this printing, the Commission has not issued its opinion. Both McCabe and the Office of Unfair Import Investigations petitioned for reconsideration. It will be interesting to see how the Commission decides the domestic industry issues presented by Mr. McCabe. On the one hand, “the domestic industry requirement [is intended to] serve as a gatekeeper to prevent excessive use of the ITC under Section 337.” *See Id.*, Initial Determination at 25 n. 107 (citing Representative Kastenmeier’s comments from the Congressional Record, 132 Cong. Rec. H9965 (Oct. 14, 1996)). Therefore, should an expenditure of approximately \$12,500 for research and development and the creation of prototypes over the course of 17 years, together with the filing of a complaint with the Commission and two settlement/license agreements after filing of the complaint, be sufficient to establish a domestic industry? On the other hand, Congress amended Section 337 to “enabled universities and small businesses who do not have the capital to actually make the good in the

United States to still have access to the ITC forum for the protection of their rights.” Thus, should the domestic industry requirement prevent an inventor or one who holds the rights to an invention from filing a complaint with the ITC in an effort to protect the IP rights when the inventor unsuccessfully tried to license the patents and apparently has a willing U.S.-based manufacturer that wants the inventor’s IP rights clarified before commencing production?