

# VirtualAgility Inc. v. Salesforce.com: Federal Circuit Reverses District Court and Requires a Stay Pending a Patent Office Review of a Covered Business Method Patent

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Last week, the **Federal Circuit** had its first occasion to opine on an America Invents Act provision allowing immediate interlocutory appeals from a district court's denial or grant of a motion to stay an infringement proceeding pending before it when a **covered business method (CBM)**<sup>1</sup> transitional proceeding has been instituted at the Patent Office. In *VirtualAgility Inc. v. Salesforce.com*<sup>2</sup> the Federal Circuit reversed the District Court for the Eastern District of Texas' decision not to stay infringement proceedings pending the conclusion of CBM review. The Federal Circuit's opinion provides some useful guidance as to the grounds for staying infringement proceedings.

As background, the America Invents Act added a new tool for parties that are accused of infringing business method patents; namely, creating a post-grant review of the validity of "covered business method patents" at the Patent Trial and Appeal Board (PTAB). As part of the CBM review statute, the AIA contemplates the existence of a co-pending CBM review and district court case. The AIA statute expressly requires the district court to consider four factors when deciding whether to grant a stay of the district court case in favor of the CBM review:

(1) whether a stay, or the denial thereof, will simplify the issues in question and streamline the trial;

(2) whether discovery is complete and whether a trial date has been set;

(3) whether a stay, or the denial thereof, would unduly prejudice the nonmoving party or present a clear tactical advantage for the moving party; and

(4) whether a stay, or the denial thereof, will reduce the burden of litigation on the parties and on the court. AIA § 18(b)(1).<sup>3</sup>

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The AIA also contemplates immediate appeals from such stay decisions and provides that a “party may take an immediate interlocutory appeal from a district court’s decision” granting or denying a motion to stay litigation pending CBM review. AIA § 18(b)(2). In discussing these provisions during the AIA debate, Senate sponsor Charles Schumer stated that it was “nearly impossible to imagine a scenario in which a district court would not issue a stay.”<sup>4</sup> Despite Senator Schumer’s statements, a denial of a stay after institution of a CBM review is exactly what occurred recently in the Eastern District of Texas case of *VirtualAgility Inc. v. Salesforce.com et al.*

In *VirtualAgility* the PTAB instituted review of all claims of the patent-at-issue, stating that the patent was more likely than not invalid on two different grounds, *i.e.*, ineligible subject matter under 35 U.S.C. § 101 and lack of novelty under 35 U.S.C. § 102. In denying a motion to stay the district court case, the district court examined the four factors as required by the statute. With regard to the simplification of issues and reduced litigation burden, the district court found that these factors overlapped. The district court then proceeded to undertake an examination of a likely outcome of the PTAB proceedings and concluded that the district court “was not persuaded that the PTAB will likely cancel all claims of the ’413 patent.” Therefore, the district court found, the simplification of issues was essentially neutral or weighed against a stay and the potential possibility of reducing the litigation burden was limited. The district court further found that the timing and trial date factor weighed in favor of a stay. However, the district court determined that the market share potentially lost by the patentee competitor during a stay would be unduly prejudicial and weighed heavily against a stay. On the basis of these findings, the district court refused a stay. An immediate Federal Circuit appeal followed.

The Federal Circuit reversed the district court in a 2-1 opinion. The 26-page opinion begins by considering the applicable standard of review, *i.e.*, abuse of discretion or *de novo* review. While the statute requires the Federal Circuit to hear the interlocutory appeal,<sup>5</sup> the applicable statute allows, but does not clearly mandate, *de novo* review, stating that the Federal Circuit “shall review the district court’s decision to ensure consistent application of established precedent, and such review **may** be *de novo*.” *Id.* § 18(b)(2) (emphasis added). We discuss that peculiar formulation later, but for now we note that the Federal Circuit declined to address and expressly left for another day when *de novo* review should be applied. Instead, the Federal Circuit stated it would reverse the district court under either standard of review.

The opinion then thoroughly analyzes each of the four factors. The analysis is necessarily fact-intensive and case-specific. There are, however, a couple instructive points that will be broadly applicable to future cases.

First, the district court should not be “reviewing” the PTAB’s determinations as part of its stay analysis and it is error to do so. In this regard the Federal Circuit stated:

Under the statutory scheme, district courts have no role in reviewing the PTAB’s determinations regarding the patentability of claims that are subject to CBM proceedings.

Indeed, a challenge to the PTAB’s “more likely than not” determination at this stage amounts to an improper collateral attack on the PTAB’s decision to institute CBM review, and allowing it would create serious practical problems. As a preliminary matter, Congress made postgrant review more difficult to obtain than reexamination by raising the standard from “a substantial new question of patentability,” 35 U.S.C. § 303(a) (2012), to “more likely than not . . . unpatentable,” *id.* § 324(a). Congress clearly did not intend district courts to hold mini-trials reviewing the PTAB’s decision on the merits of the CBM review. To do so would overwhelm

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and dramatically expand the nature of the stay determination. If the district court were required to “review” the merits of the PTAB’s decision to institute a CBM proceeding as part of its stay determination, it would undermine the purpose of the stay....The stay determination is not the time or the place to review the PTAB’s decisions to institute a CBM proceeding.

Second, the Court made it clear that stays may be ruled upon at the initial filing of a CBM petition or a ruling may be delayed until after the PTAB has acted on the petition. In this regard the Court stated:

We note at the outset that it was not error for the district court to wait until the PTAB made its decision to institute CBM review before it ruled on the motion. Indeed, while some district courts ruled on motions to stay before the PTAB granted the petition for post-grant review, see, e.g., *Intertainer, Inc. v. Hulu, LLC*, No. 13-cv-5499, 2014 WL 466034, at \*1 (C.D. Cal. Jan. 24, 2014), others have waited until post-grant review was instituted, and still others denied as premature the motion to stay without prejudice to refiling after institution of post-grant review, see, e.g., *Checkfree Corp. v. Metavante Corp.*, No. 12-cv-15, 2014 WL 466023, at \*1 (M.D. Fla. Jan. 17, 2014). We express no opinion on which is the better practice. While a motion to stay could be granted even before the PTAB rules on a post-grant review petition, no doubt the case for a stay is stronger after post-grant review has been instituted.

The Court did, however, emphasize that the date when the motion to stay is filed is the proper time to analyze the stage of the litigation, essentially rejecting the notion that activity occurring in the underlying litigation between the date the motion is filed and the date the lower court rules should affect the stay analysis.

Considering the four factors, and properly excluding the district court’s independent review of the PTAB’s rulings, Judges Moore and Chen held that the denial of a stay was an abuse of discretion. In dissent Judge Newman disagreed on the basis that a stay is not obligatory and that reversing here interfered with the district court’s discretion. Specifically, Judge Newman stated:

In today’s ruling the panel majority overrides the district court’s discretion, and effectively creates a rule that stays of district court litigation pending CBM review must always be granted. Here the district court carefully considered the four factors set out in the statute, and concluded that VirtualAgility is likely to be harmed disproportionately in both the litigation and the marketplace if the defendants are allowed to draw out this case for an extended period, all the while continuing to infringe a presumptively valid patent.... Whether or not my colleagues’ prolongation of the dispute by way of a potential multiplicity of administrative trials and appeals can be defended, the district court’s evaluation of the equities is reasonable, is consistent with the analyses by other district courts, and warrants deference.

Last week’s ruling offers some instructive guidance on motions to stay with respect to CBM proceedings. Given the unresolved issue about applicability of *de novo* review, the infinite factual scenarios that may arise with respect to application of the four factors, and the divergence of views on the Federal Circuit, automatic stays in favor of CBM proceedings may be far from certain.

We note that by sidestepping the standard of review question, the majority of the Federal Circuit panel elided the interesting and peculiar formulation of the standard under Section 18(b)(2). As we observed above, the statute provides that “the Federal Circuit *shall review* the district court’s decision *to ensure consistent application of established precedent*, and *such review may be de novo*.” AIA §18(b)(2) (emphasis added). This language can be read as limiting *de novo* review in at least two ways: the *de novo* review arguably could only extend to a review to ensure that the district court’s decision was consistent with established precedent and the Federal Circuit could choose not to exercise any *de novo* review at all.

The oddities in the formulation of the standard reflect the circumstances of Section 18(b)’s birth.<sup>6</sup> Senators Kyl and Schumer devised Section 18 and commented extensively on Section 18(b). Their remarks are enlightening as to how the Federal Circuit should approach reviews of grants or denials of stays. Illustratively, Senator Kyl noted that the stay provision had been the “subject of prolonged discussion and negotiation between various groups” and the provision “reflect[ed] a compromise that requires a district judge to consider fixed criteria when deciding whether to grant a stay, and provides either side with a right to an interlocutory appeal of the district judge’s decision. The appeal right has been modified to provide that such review “may be *de novo*,” and in every case requires the Federal Circuit to ensure consistent application of established precedent. Thus whether or not every case is reviewed *de novo*, the court of appeals cannot simply leave the stay decision to the discretion of the district court and allow different outcomes based on the predilections of different trial judges.”<sup>7</sup> So, as we read this explanation, the Federal Circuit (a) had no discretion to decline to review an interlocutory appeal from a stay decision, (b) did have discretion as to whether its review would be *de novo*<sup>8</sup> and (c) had to police district courts to ensure consistency in applying established precedent regardless of whether it exercised *de novo* review. This statement is illuminating: it suggests that focus and scope of Federal Circuit review was to ensure consistency in stay determinations, regardless of what standard of review it elected to apply.<sup>9</sup>

Even more interestingly, Senator Kyl pointed to the provisions of 28 USC Section 2254(d) requiring denial in habeas corpus writs in criminal cases as providing the basis for the “consistent application of ‘established precedent’” standard:

In order to ensure consistency in decisions whether to stay, regardless of the court in which a section 281 action is pending, paragraph (2) of subsection (c) requires consistent application of “established precedent.” This particular requirement is based on section 2245(d)(1) of title 28, which has been construed to require lower courts to *look only to a fixed body of case law when making decisions* under section 2254. Currently, district judge’s decisions whether to stay litigation when a reexamination has been ordered are not appealable and therefore have never been reconciled by the Federal Circuit. Unsurprisingly, the resulting district court case law is a dog’s breakfast of different combinations of factors and different meanings ascribed to those factors. Although the cases applying *Broadcast Innovation* cite other opinions applying other tests as sources for some of its factors, by requiring application of “established precedent,” subsection (c) *limits the relevant precedent to that applying the four factors of Broadcast Innovation in combination. By requiring courts to apply this limited and relatively consistent body of case law when determining whether to grant a stay, subsection (c) should ensure predictability and stability in stay decisions across different district courts, and limit the incentive to forum shop.* The existence of forum shopping is an embarrassment to the legal system. Federal courts should apply equal justice, and give federal law the same meaning, regardless of where they are located.<sup>10</sup>

Consequently, we believe that, contrary to the dissent’s suggestion, the AIA was not intended to grant broad latitude in deciding whether to deny or to grant a stay and that the AIA did not merely list

“several factors for the court to consider in deciding how to exercise its discretion in a particular case.” Rather, the intention was to constrain discretion of the district courts in their stay decisions to the four *Broadcast Innovation* factors and to require the Federal Circuit to take appeals to ensure that the district courts were applying those four factors consistently in accordance with established precedent, looking not to all decisions that apply *Broadcast Innovation* factors generally, but rather to those precedents that apply the factors in combination. Moreover, the authors of the Schumer-Kyl amendment that became Section 18 of the AIA were quite clear that stays were to be the norm, not the exception. As Senator Kyl remarked, “[i]t is expected that district judges will liberally grant stays of litigation once a proceeding is instituted. Petitioners are required to make a high threshold showing in order to institute a proceeding, and proceedings are required to be completed within one year to 18 months after they are instituted.... In pursuit of this congressional policy strongly favoring stays when proceedings are instituted under this section, subsection (c) incorporates the four-factor test for stays of litigation that was first announced in *Broadcast Innovation, L.L.C. v. Charter Communications*, 2006 WL 1897165, (D. Colo. 2006). *Broadcast Innovation* includes, and gives separate weight to, a fourth factor that has often been ignored by other courts: “whether a stay will reduce the burden of litigation on the parties and on the court.”<sup>11</sup> If anything, Senator Schumer was even stronger in statements that stays should be liberally, almost invariably, granted.<sup>12</sup> Interestingly, even the majority of the Federal Circuit panel did not look to these very strong expressions of Congressional intent in reviewing the four factors, nor did it examine the district court’s decision with an exacting focus on whether the district court squared closely to “established precedent,” though it did come to the conclusion that the stay should have been granted. Time will tell whether the Federal Circuit will refine and focus its review in light of the clear expression of Congressional intention or whether it will continue to reach the same end result through its own means.

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<sup>1</sup>. AIA §18(d)(1) defines a “covered business method patent” as a patent that “claims a method or corresponding apparatus for performing data processing or other operations used in the practice, administration, or management of a financial product or service, except that the term does not include patents for technological inventions.”

<sup>2</sup>. *VirtualAgility Inc. v. Salesforce.com*, slip op. 2014-1232 (Fed. Cir. July 10, 2014).

<sup>3</sup>. The origins of this four-factor test were described by Senator Schumer during the Senate debates as being a codification of the test in *Broadcast Innovation, L.L.C. v. Charter Communications*, 2006 WL 1897165 (D. Colo. Jul. 11, 2006), a pre-AIA case considering whether to stay proceedings pending the conclusion of reexamination proceedings. Senator Schumer emphasized the fourth factor—reducing the burden of litigation—as being especially important and also noted that by codifying four, and only four, factors, the Section 18(b)(1) would preclude “courts from inventing new

factors” that would prevent stays from being granted. 157 Cong. Rec. S1364 (daily ed. Mar. 8, 2011) (statement of Sen. Schumer).

<sup>4</sup>. 157 Cong. Rec. S1053 (daily ed. Mar. 1, 2011) (statement of Sen. Schumer).

<sup>5</sup>. As Senator Schumer explained, “Because this amendment provides an automatic right to an interlocutory appeal, the district court does not need to certify the appeal in writing, as it would ordinarily need to do under 28 U.S.C. § 1292(b). Also, unlike the discretion typically afforded an appellate court under 28 U.S.C. § 1292(b), under this amendment the Federal Circuit may not decline to hear an interlocutory appeal.” 157 Cong. Rec. S1364 (daily ed.

Mar. 8, 2011) (statement of Sen. Schumer).

<sup>6</sup>. What became Section 18(b) was introduced as Section 18(c) as part of a manager’s amendment, but it is the same as the final statute. 157 Cong. Rec. S1038 (daily ed. Mar. 1, 2011).

<sup>7</sup>. 157 Cong. Rec. S1379 (daily ed. Mar. 8, 2011) (statement of Sen. Kyl).

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<sup>8</sup>. Senator Schumer would read discretion in applying the *de novo* standard out of the statute almost altogether, regardless of the statutory language. Thus, Senator Schumer stated, “On appeal the Federal Circuit can and should review the district court’s decision *de novo*. It is expected that the Federal Circuit will review the district court’s decision regarding a stay *de novo*, unless there are unique circumstances militating against a *de novo* review, such as subsequent requests for an interlocutory appeal in the same case.” 157 Cong. Rec. S1053 (daily ed. Mar. 1. 2011) (statement of Sen. Schumer).

But, as we note below, this broad statement was followed by a statement reflecting that the focus should be on applying consistent precedent.

<sup>9</sup>. Senator Schumer’s remarks underscore this focus: “A *de novo* review is central to the purpose of the interlocutory appeal provision in the Schumer-Kyl amendment, which is to ensure consistent application of standards and precedents across the country and to avoid one particular court with a favorable bench becoming the preferred venue of business method patent plaintiffs.” 157 Cong. Rec. S1053 (daily ed. Mar. 1, 2011) (statement of Sen.

Schumer).

<sup>10</sup>. 157 Cong. Rec. S1379-80 (daily ed. Mar. 8, 2011) (statement of Sen. Kyl) (emphasis added).

<sup>11</sup>. 157 Cong. Rec. S1379 (daily ed. Mar. 8, 2011) (statement of Sen. Kyl) (emphasis added). Indeed, *Broadcast Innovation* itself, referenced a “liberal policy in favor of granting motions to stay proceedings pending the outcome of reexamination proceedings.” *Broadcast Innovation, L.L.C. v. Charter Communication, Inc.*, 2006 WL 1897165 \*4 (D. Colo. 2006) (quoting *Whatley v. Nike*, 54 U.S.P.Q.2d 1124, 1125 (D. Or. 2000)).

<sup>12</sup>. “The amendment employs the *Broadcast Innovation* test, rather than other multifactor tests employed by other district courts, because this test properly emphasizes a fourth factor that is often ignored by the courts: “whether a stay will reduce the burden of litigation on the parties and on the court.” Too many district courts have been content to allow litigation to grind on while a reexamination is being conducted, forcing the parties to fight in two fora at the same time. This is unacceptable, and would be contrary to the fundamental purpose of the Schumer-Kyl amendment to provide a cost-

efficient alternative to litigation. Absent some exceptional circumstance, the institution of a business-methods proceeding—which requires a high up-front

court litigation. ...Several unique features of this proceeding further make it appropriate to grant stays in all but the most unusual and rare circumstances. These proceedings will only be instituted upon a high up-front showing of likely invalidity. The proceeding is limited to certain business method patents, which, as noted above, are generally of dubious quality because unlike other types of patents, they have not been thoroughly reviewed at the PTO due to a lack of the best prior art. And the proceeding will typically be completed within 1 year. In summary, it is expected that, if a proceeding against a business method patent is instituted, the district court would institute a stay of litigation unless there were an extraordinary and extremely rare set of circumstances not contemplated in any of the existing case law related to stays pending reexamination. ... We encourage the PTO Director to promulgate regulations ...to ensure that petitioners know that in extreme circumstance where a stay is not granted, the PTO will complete its review in a compressed timeframe, such as within 6 months." 157 Cong. Rec. S1364 (daily ed. Mar. 8, 2011) (statement of Sen. Schumer).

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