Senator David Perdue
Questions for the Record

"The Impact of Abusive Patent Litigation Practices on the American Economy"

April 9, 2015

Questions for Dr. Michael Crum

Thank you for the opportunity to explain further why Iowa State University and the broader higher education community remain concerned about the ways in which the Innovation Act, H.R. 9, would hinder the ability of universities to engage in technology transfer.

Question #1

Please discuss the experience of Iowa State University with abusive litigation practices by patent assertion entities ("PAEs"). How have PAEs affected Iowa State's research capabilities and ability to innovate?

Iowa State University has been very fortunate not to have had any direct experience with abusive litigation practices by PAEs. Since we do not make products, the university itself is not a direct target of PAEs. Rather, our primary concern is for our licensees, many of which are small, innovative, and often fledgling companies comprising university faculty, inventors, and alumni. Litigation costs can cripple these small businesses as they do not have the financial wherewithal to absorb such costs. Additionally, even the mere threat of litigation by PAEs could cause our licensees to discontinue their licensing activities, thereby impeding the movement of university technology and innovations to the marketplace.

At the same time, Iowa State University is considerably worried about any legislation that would increase the probability of our school's involvement in litigation, including the prospect of incurring substantial legal costs through presumptive fee-shifting, involuntary joinder, etc. in lawsuits we neither initiate nor control. Litigation costs can dramatically reduce the amount of financial resources we have to reinvest with our inventors so they can create yet more new technology and intellectual property and, by extension, reduce the financial resources we can dedicate to supporting our efforts to move our technologies into the marketplace for society.

I want to stress that the purpose of university technology transfer – consistent with the overall university mission of education, research, and service – is to enable the commercial sector to generate products and processes that benefit society, *not* to enable the higher education sector to generate revenue. As is true of most universities, we at Iowa State consider ourselves lucky when we generate enough licensing revenues to support our technology transfer operations. At Iowa State, approximately one-third of licensing revenues are returned to the inventor, one-third goes to the inventor's home academic unit to support its overall research efforts, and one-third is used to fund our technology transfer operations. When we do have "extra" revenues,

we try to utilize them as seed funds to stimulate even more technology development and innovation. Iowa State is regularly (several times each year) approached by entities offering to acquire our patents or evaluate our portfolio of patents for the purpose of defending these patents and generating income via infringement settlements. As a matter of course, we say "no" to these entities.

I also want to stress one more important point: performing a patent portfolio review for infringement is a legitimate, appropriate activity for any good faith patent holder and should not, by itself, be considered PAE- or troll-like behavior. Yet our concerns about the abusive litigation practices of many PAEs have prompted us to go so far as to back off on legitimate portfolio review activities to ensure that our institution is not associated with PAE/troll-like behavior. Universities need to be able to undertake such activities, however, without fear of being mischaracterized as patent trolls. Otherwise, our efforts to attract licensees and investors willing to develop products based on university research – which is very often early-stage and high-risk and thus depends on the "collateral" of strong patent protection – will be frustrated.

Question #2

In your written testimony, you address the role of academic institutions in America's "innovation system," which includes the process of technology transfer. Please describe how the technology-transfer process specifically, and university research generally, would be affected by the various reform proposals contained in the Innovation Act and the so-called I-Squared Act. If your answer describes how a particular proposal would harm the technology-transfer process, please specify how the proposal can be modified, if possible, to prevent the harm you describe.

The university community is most troubled by H.R. 9's mandatory fee-shifting and involuntary joinder provisions.

Because H.R. 9 begins with a presumption in favor of fee-shifting, I am greatly concerned that the threat of fee-shifting would undermine the ability of universities and our licensees to enforce intellectual property rights in good faith. It is important to note that this approach would be highly unusual in the American legal system. Under H.R. 9, unless the patent owner is the prevailing party (and rarely is there an unqualified prevailing party in patent cases), then the presumption of fee-shifting attaches, and the burden shifts to the patent owner to prove why it should not suffer the penalty of attorney fees. Proponents of H.R. 9 assert that this bar is so low as to be easily overcome by good faith litigants, but why statutorily shift the burden at all, particularly in light of Supreme Court cases from 2014 that expand the discretion of judges to shift fees? Consider that if a good faith plaintiff patent owner misses a filing deadline, or is bankrupted by the litigation and unable to respond, then it will have failed to rebut, and fees would be shifted as a default. Given the prominence of intellectual property rights enshrined in our Constitution, and the value those IP rights bring to the economy, singling out patent enforcement for disparate treatment in our civil litigation system will not only be detrimental to the economy as a whole, but will also be especially prejudicial to enterprises that are the most innovative.

Entities without extensive litigation budgets, such as non-profit universities, are ill-equipped to operate in the environment that would be created under H.R. 9. The presumption in favor of fee-shifting would so increase the risk of expensive litigation that universities and our licensees would in many cases be unable to assume the risk of enforcing intellectual property rights. The fact that universities would be deterred from or simply unable to enforce their patent rights surely would not go unnoticed by those who conduct a risk assessment as to whether to infringe on a university's patent.

Most university technology transfer offices are not well-financed by any measure. You can imagine the pressure those engaged in technology transfer would feel from losing just one case, which easily could result in fee shifting of an amount larger than the annual budgets of many university technology transfer offices.

The direct impact of fee-shifting on the ability of universities to enforce intellectual property is of significant concern. However, what is often not as well understood is that universities are equally, if not more, concerned about the impact such statutory provisions will have on our licensees. If a patent cannot be enforced, it is of no value. Licensees have little incentive to work with entities that are unable to protect their intellectual property. Such a loss of confidence in the willingness and/or ability of universities to protect their intellectual property rights would, consequently, undermine the ability of universities to transfer their research discoveries from campus to the private sector.

Universities are not philosophically opposed to fee-shifting. We recognize there are abuses in the patent system and there is an appropriate place for a fee-shifting regime that would deter and punish frivolous litigation instigated by patent trolls. But instead of beginning with a presumption that all plaintiffs bring litigation in bad faith and, therefore, that fee shifting should be automatic if the plaintiff loses, I would urge Congress to consider a more measured approach that balances the legitimate interest in deterring and punishing patent trolls with the need to preserve access to justice for entities lacking substantial litigation budgets. I believe this could be accomplished by codifying the recent Supreme Court decisions – *Octane Fitness* and *Highmark* – that expand judicial discretion to shift fees in meritless and/or bad faith cases brought by patent assertion entities. This kind of an approach would appropriately focus the legislation on the behaviors of bad actors in the patent system.

Similarly, universities are concerned that the mandatory joinder provisions would so increase the risk of engaging in technology transfer that it would provide a strong disincentive for universities to license innovations stemming from their research. As introduced, H.R. 9, creates the real possibility that universities could be forced into court to shoulder fees and costs in cases brought by licensees or sub-licensees, including cases to which the universities did not consent or direct. The legislation provides that entities can prevent joinder by renouncing interest in the patent(s) at issue. The federal Bayh-Dole Act imposes restrictions on alienation of such ownership rights in inventions supported by federal funding. Thus, the supposed safe harbor of "renunciation" is simply not available to many universities by operation of law.

The practical implications of the joinder provisions are that universities likely would enter into in fewer licensing agreements with entities such as small startups that cannot demonstrate the capacity to absorb fee-shifting; alternatively, universities would need to write into licensing agreements restrictions on the licensees' ability to enforce the universities' intellectual property. The former approach would result in significantly less technology transfer overall. The latter approach, by requiring renegotiated and presumably less favorable financial terms for the license, would diminish the value of licensed intellectual property.

Again, universities understand the valid interest in combatting the ability of patent trolls to create shell companies to remain judgment-proof. However, the creation of shell companies to avoid liability is not a problem unique to patent litigation and thus does not require a special solution only applicable to patent suits. In my view, Congress should consider addressing attempts to hide behind shell companies by enhancing existing civil litigation tools to pierce the corporate veil.

I submit that H.R. 9, as written, would inadvertently substitute patent troll problems for an entirely new set of problems. For example, as I suggested above, a statute that discourages or prevents universities from enforcing their patents would unintentionally create incentives to infringe those patents and would diminish hard-earned revenue and sponsored research opportunities that universities rely on to maintain their leading edge as the finest educational research institutions in the world. I urge the Senate to consider a more balanced approach that attacks abusive patent litigation practices while maintaining the strength and value of the patent right, as enshrined in our Constitution, which is critical to university technology transfer and promoting innovation.

Question #3

A number of organizations representing the pharmaceutical industry and higher education have claimed that recent decisions by the Supreme Court and changes proposed by the Judicial Conference have fundamentally altered the playing field such that Congress should take a hard second look at provisions of the Innovation Act and the I-Squared Act to determine whether they are actually necessary before proceeding with legislation. Is it your view that decisions like Octane, Nautilus, and Alice have eliminated the need for any Congressional action? If not, what specific problems have those cases solved in your view, and what do we still need to address?

Several recent developments in the federal courts and the Judicial Conference of the United States and the U.S. Patent and Trademark Office (USPTO), as well as concurrent efforts of the Federal Trade Commission and state Attorneys General to protect consumers against deceptive patent threats, have the potential to substantially diminish abusive patent litigation practices. Data indicates that these developments are having a positive impact and may help achieve many, if not most, of the goals of the legislative measures that have been under consideration over the past two years. Accordingly, my recommendation would be that any congressional action should target specific bad faith activities, such as abusive demand letters,

and avoid overbroad, one-sided approaches that would render good faith enforcement of patents unduly risky and expensive.

U.S. Supreme Court Decisions

The Supreme Court decided five patent cases in 2014, including *Octane Fitness v. ICON Health & Fitness*, and *Highmark Inc. v. Allcare Health Management Systems, Alice Corporation v. CLS Bank*, and *Nautilus v. Biosig Instruments*, that should make it easier to defeat invalid or weak patents, including the kind of patents that often are asserted in abusive litigation.

Prior to the Supreme Court's April 2014 decisions in *Octane* and *Highmark*, it was very difficult for prevailing defendants to obtain fee awards under section 285 of the patent code. The Supreme Court's April 2014 decisions in *Octane* and *Highmark*, however, significantly expanded the discretion of district courts to award attorneys' costs and fees and raised the bar to overturning such determinations on appeal. A study conducted in early 2015 that looked at post-*Octane* grants of motions for attorneys' fees determined that there has been a substantial increase in the percentage of motions granted in the wake of *Octane*.[1] A number of post-*Octane* decisions demonstrate, moreover, that because the *Octane* "'totality of circumstances' standard explicitly includes 'the need in particular circumstances to advance considerations of compensation and deterrence,'" courts are already using *Octane* as an efficient and cost-effective tool to address litigation abuses by patent trolls.[2] On the contrary, the presumptive fee-shifting provisions of H.R. 9 might well "put a greater burden on the courts, and…would result in increased attorneys' fees (because of increased motion practice) for all parties."[3]

In June 2014, the Supreme Court's decision in *Nautilus v. Biosig Instruments* made it easier for courts to invalidate vague patents for "indefiniteness" and much more challenging for patent holders to enforce the kind of vague or otherwise weak patents that are the kind of patents most often asserted in abusive litigation. And, in another June 2014 decision, *Alice Corporation v. CLS Bank*, the Supreme Court narrowed the scope of patentable inventions, giving lower courts and the USPTO the authority to invalidate a number of patents involving elementary financial or business practices – precisely the kind of non-technical patents that in the past have posed the greatest potential for litigation abuse.

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[1] In the 365 days preceding *Octane*, district courts granted seven motions for fees filed by defendants and denied forty and they grated eight motions filed by plaintiffs and denied seventeen. In the period after *Octane* and, as of January 2015, district courts granted twenty motions for fees filed by defendants and denied thirty-three and they granted ten motions for fees filed by plaintiffs and denied two. Eric C. Cohen, *Is There a Need for Patent Reform Legislation?*, White Paper (March 15, 2015).

[2] Eric C. Cohen, *Is There a Need for Patent Reform Legislation?*, White Paper (March 15, 2015).

[3] Eric C. Cohen, *Is There a Need for Patent Reform Legislation?*, White Paper (March 15, 2015). Cohen's study also questions assertions that the fee-shifting standard of H.R. 9 would create great uniformity than *Octane*, observing that "reasonable justification" and "special circumstances" would give the courts at least as much leeway as the *Octane* standard.

Judicial Conference Changes to the Federal Rules of Civil Procedure

In September 2014, the Judicial Conference of the United States proposed changes to the Federal Rules of Civil Procedure that will ensure that patent cases meet the heightened pleading standards required of all other federal cases. The Judicial Conference's changes to the heightened pleading requirements will abolish Form 18, thereby addressing concerns that patent holders can file vague lawsuits that do not clearly specify how their patent is being infringed. Plaintiffs filing patent infringement complaints will be required to meet the heightened pleading standards set out by the Supreme Court in *Ashcroft v. Iqbal* and *Bell Atlantic Corporation v. Twombly*, obviating the need for stricter statutory guidelines for patent complaints.

The Judicial Conference's proposed changes to discovery requirements in patent litigation will also ensure that production of documents is "proportional to the needs of the case," reducing the ability of patent plaintiffs to use unnecessary discovery requests to drive up costs for defendants in an effort to force unwarranted settlements. Further, the Judicial Conference's changes will direct courts to shift discovery expenses to the requesting party, if producing documents would be particularly burdensome to the producing party.

These rule changes, which will go into effect in December 2015, will make any statutory provision that would heighten pleading standards or limit the scope of discovery in patent cases unnecessary and repetitive.

The America Invents Act

The Leahy-Smith America Invents Act (AIA) was fully implemented less than two years ago and its effects are only now beginning to take hold. For example, the AIA created new procedures – *Inter Partes Review* (IPR) and *Post Grant Review* (PGR) – to allow anyone to challenge patents in a fast, relatively inexpensive proceeding before the Patent Trial and Appeal Board (PTAB). These administrative proceedings are already shaping the litigation landscape: judges in patent cases are now granting 80% of all motions to stay patent litigation if the patent is also involved in a parallel IPR or PGR proceeding.

Taken together, these major developments in the patent arena suggest proceeding with caution as we consider broad statutory changes to our strong and productive U.S. patent system.

Question #4

The fee-shifting provision of the Equal Access to Justice Act has been law since 1980 and has generated little controversy in the intervening three decades. The Innovation Act contains an identical prevailing-party standard for fee shifting. And, like the Equal Access to Justice Act, the standard in the Innovation Act only creates a presumption. It does not bind a district judge or restrict the judge's ability to exercise discretion on a case-by-case basis. Please

explain your view of the Innovation Act's fee-shifting provisions and, more generally, whether any fee-shifting provision is a desirable component of a legislative reform package.

H.R. 9 would make fee-shifting the default in any given patent lawsuit, creating a new and unusual presumption against plaintiffs. The loser of a lawsuit would need to establish, based on vague, subjective criteria, that its position was "substantially justified" in order to avoid paying both its own litigation costs and those of the defendant. Although the fee-shifting provisions in H.R. 9 are modeled on the noncontroversial 35-year-old standard in the Federal Equal Access to Justice Act (FEAJA), it should be noted that there are important practical and principled differences between these fee recovery provisions.

First, and most importantly, the FEAJA was enacted to "equalize the litigating strength between the government and private litigants of modest means, and thereby deter government overreaching."[4] To the contrary, the fee recovery provisions in H.R. 9 would favor better-funded and more experienced parties and, moreover, might have the unintended consequence of allowing such parties to use the statute's fee-shifting provisions both as a shield and a sword. Larger and wealthier non-prevailing parties would be better positioned to command the attorney time and resources necessary to show why they should not be required to pay attorneys' fees. At the same time, the fee-shifting provisions of H.R. 9 could give bad actors additional ammunition to extract nuisance value settlements: by citing the statute for the proposition that losing defendants will have to pay the plaintiffs' attorneys' fees, patent trolls could scare inexperienced, smaller, and/or poorer entities away from fighting even weak or unmeritorious claims of infringement. In short, the FEAJA was designed to equalize access to justice; H.R. 9 likely would have exactly the opposite effect.

Second, the FEAJA's fee recovery provisions are limited to individuals with a net worth that does not exceed $2 million and business interests with a net worth that does not exceed $7 million (and no more than 500 employees); charities can recover fees regardless of their net worth. H.R. 9, however, would allow all prevailing parties to recover fees, regardless of their wealth.

Third, under the FEAJA, the amount of recoverable attorneys' fees is capped at $125/hour. H.R. 9 provides no such caps or any other protections against runaway costs.

As nonprofit institutions lacking substantial litigation resources, universities are ill-equipped to operate in a fee-shifting regime such as that currently proposed in the Innovation Act. Patent litigation is extremely complex and outcomes are notoriously unpredictable. Thus many universities, faced with the potentially enormous expense of losing a case – particularly a case in which a better-resourced entity is accused of infringing a university patent – would be unable

[4] Harold J. Krent, *Fee Shifting Under the Equal Access to Justice Act—A Qualified Success*. 11 YALE L. & POL'Y REV. 458, 462 (1993) (citing H.R. REP. NO. 99-120 (1985), *reprinted in* 1985 U.S.C.C.A.N. 132; H.R. REP. NO. 96-1434 (1980), *reprinted in* 1980 U.S.C.C.A.N. 5003; H.R. REP. NO. 96-1418 (1980); S. REP. NO. 96-253 (1979)).

to assume the risk of litigation. If universities are unable to enforce their patent rights in practice, this will eviscerate the value of their patents to potential licensees and investors. This, in turn, will have the socially undesirable effect of chilling university technology transfer activity and reducing the number of research discoveries that advance to the marketplace.

I would not go so far as to say that a fee-shifting provision should not be a component of a legislative reform package. Instead, I submit that any such provision should respect the "American Rule" of civil litigation that parties bear their own attorneys' fees in the absence of a statutory or contractual exception. As I explained above in my response to Question #3, the Supreme Court's decision in *Octane* provides an elegant solution that is already proving effective – it gives the American Rule more muscle by explicitly making deterrence of litigation abuses a factor in determining entitlement to attorneys' fees. Thus I respectfully urge Congress to consider codifying the fee-shifting standard for awarding fees articulated in *Octane* and its companion case, *Highmark*, in lieu of advancing the fee-shifting provisions of H.R. 9 that upset the American Rule in an unprecedented way.