



Testimony of

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before the

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hearing on

“Protecting Small Businesses and Promoting Innovation by
Limiting Patent Troll Abuse”

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I. Introduction

Chairman Leahy, Ranking Member Grassley, and distinguished members of the Judiciary Committee, on behalf of the American Intellectual Property Law Association (AIPLA), I would like to thank you for the opportunity to present our views on patent litigation abuse and its effect on small businesses and innovation.

My name is Q. Todd Dickinson and I am the Executive Director of AIPLA. Prior to becoming Executive Director, I was Under Secretary of Commerce for Intellectual Property and Director of the United States Patent and Trademark Office, and Vice President and Chief Intellectual Property Counsel for the General Electric Company.

Founded in 1897 as the American Patent Law Association, AIPLA is a national bar association with approximately 15,000 members who are lawyers in both private and corporate practice, judges, patent agents, academics, law students and patent and trademark office professionals. Our members practice in a wide and diverse spectrum of intellectual property fields, including patent, trademark, copyright, and unfair competition law, as well as other areas of law affecting intellectual property. They represent both owners and users of intellectual property, as well as those who litigate and prosecute before patent and trademark offices, giving AIPLA a unique and varied perspective on patent procurement, licensing and litigation practices.

This hearing provides an occasion for this Committee and the stakeholder community to look at recent complaints leveled at the practices of certain patent owners, licensees and representatives, give careful consideration to the alleged harm, and propose appropriate remedies, with an eye toward deterring undesirable practices while avoiding unintended consequences to our critically important patent system. Generally speaking, the reported practices involve the attempted enforcement of potentially invalid or overbroad patents, often aggregated and asserted against multiple alleged infringers for the purpose of threatening litigation and obtaining below-cost-of-litigation settlements. Not surprisingly, the cost of such threatened litigation is often an effective lever for extracting large settlements in lieu of litigation.

The reports of such practices have received widespread publicity and understandably provoke a “where there’s smoke, there must be fire” reaction. Such a reaction is appropriate in the sense that these reports may very well indicate aspects of the intellectual property system that require thoughtful investigation, and as an organization representing lawyers for both plaintiffs and defendants, AIPLA is extremely sensitive to any abuses of the patent system. At the same time, we also are committed to making sure that any proposed changes to the system are balanced and do not risk unintended consequences. Furthermore, the seriousness of the alleged abuses of the system, and the concurrent need for reforms of various types, cannot be fully understood without a careful examination of the magnitude and scale of the concerns, an understanding of the various types of behavior giving rise to those concerns and the need to understand them in the context of the overall patent system. Oftentimes, the solution to a perceived problem is not a “one-size-fits-all” solution, and care needs to be taken in attempting to find a “quick fix.”

a. Past Is Prologue

We wish to make clear that we neither intend to minimize the current concerns about litigation abuse, nor intend to suggest that Congress should refrain from acting where necessary to address current concerns. However, in pursuing the solution to the current problem of patent litigation abuse, we also believe that it is useful to initially consider the history leading up to the culmination of the last and recent legislative reforms in this area: the Leahy-Smith American Invents Act (AIA).

Improvements in the intellectual property system were very much the object of patent reform efforts that AIPLA joined 10 years ago after multi-year studies of the patent system by the National Academy of Sciences (NAS) and the Federal Trade Commission (FTC).¹ Those efforts included concrete reform proposals from AIPLA as early as 2004, followed by a series of town hall meetings that year which we co-sponsored with the FTC and NAS to air reform issues to stakeholders of the patent system, both in and out of government.

¹ See Committee on Intellectual Prop. Rights, National Research Council, *A Patent System for the 21st Century* (2004); and Federal Trade Comm’n, *To Promote Innovation: The Proper Balance of Competition and Patent Law and Policy* (2003).

Reflecting on those early days, it is instructive to note that several concerns expressed at the beginnings of the AIA patent reform process are similar to those that have been expressed in current discussions. For example, much of the early AIA debate was driven by proposals to address concerns about the assertion of poor quality patents against companies and the need for better tools and litigation reforms to more efficiently and cost effectively resolve such disputes. As an example, as far back as June 2005, this Committee held a hearing entitled “Patent Law Reform: Injunctions and Damages.”² Witnesses testified then about the relatively recent phenomenon of patent owners filing infringement complaints against large companies (in particular financial services and media companies) who were thought not to be “patent savvy.” They complained of demands for large settlements and that the law at the time exposed them to easily obtained permanent injunctions and to expansive damages awards from juries in certain jurisdictions recently new to large-scale patent litigation. Other issues being discussed at that time included the ease of pleading willfulness, the difficulty of transferring venue from places such as the allegedly “patent friendly” confines of the Eastern District of Texas, the difficulty of proving invalidity on the basis of obviousness, and the proliferation of inequitable conduct claims, leading to excessive discovery costs.

Not unlike the recent passage of the “Innovation Act” (H.R. 3309), the House of Representatives on September 7, 2007, passed a patent reform bill (H.R. 1908) which at the time was called “a work in progress.” In 2008, this Committee took up its own patent reform bill (S. 1145), then took the time to ask stakeholders tough questions, and worked out the difficult details of the legislative language. In the meantime, however, something interesting occurred: the courts, including the Supreme Court, began to address a number of litigation issues that were the very subject of a number of the most hotly-debated provisions of proposed legislation, in fact, addressing them in such a deliberate and almost “surgical” way that eventually each issue to drop out of the final Senate bill. In essence, the Courts were working on patent reform right alongside

² The Senate Committee on the Judiciary Subcommittee on Intellectual Property hearing on *Patent Law Reform: Injunctions and Damages*, June 14, 2005.

the Congress.³ In the process, the Senate heard from many different and distinct stakeholder groups and coalitions, the legislative language was continuously refined after no small amount of time and resources were expended to ensure that unintended consequences were considered and collateral damage scenarios were also addressed.

Following that instructive example, now as then, we believe that great care is needed to resist a legislative quick fix to reported problems, to get input from the wide variety of affected stakeholders, and take the time to get it right. More simply put, as my friend and fellow former Director of the USPTO Dave Kappos put it in his recent testimony before the House Judiciary Committee on the same topic: we should follow the axiom taken from Hippocrates: “first do no harm.”

b. Let the AIA Reforms Have an Opportunity to Prove they Work

A recurring theme that can be traced through the patent reforms of the AIA to the current debate over patent litigation abuse is the issue of patent quality. A key component of the reported abuses is the assertion of allegedly invalid or overbroad patents, the very abuse for which AIA post-grant procedures were created, in order to improve patent quality. These matters of patent quality are being addressed by the changes made to the law by the Judiciary and by Congress in the AIA, which are only now beginning to be felt.⁴ It may well be premature to conclude that they are not doing the job.

Take one major example, as a former Director of the USPTO in particular, I would support, as former Director Kappos did, giving the post-grant processes in the USPTO a chance to work. They have only been in place for less than two years, and in the case of PGR, less than one.⁵

³ See, e.g., *Lucent Technologies, Inc. v. Gateway, Inc.*, 580 F.3d 1301 (Fed. Cir. 2009); *eBay Inc. v. MercExchange, L.L.C.*, 547 U.S. 388 (2006); *In re TS Tech USA Corp.*, 551 F.3d 1315 (2008).

⁴ Regarding patent quality, no issue is of greater importance than sustainable funding of the USPTO. We will discuss this in more detail below.

⁵ With respect to Inter Partes Review (IPR) petitions, trials have been instituted in over 80% of cases, since the proceedings became available on September 16, 2012. For Post Grant Review (PGR), these proceedings are available for patents that issue under a file-inventor-to-file (FITF) system and no trials have yet been instituted since the FITF system has only been in effect since March 2013. See *Trial Proceeding Statistics* available at http://www.uspto.gov/ip/boards/bpai/stats/aia_trial_proceedings.pdf.

Early data suggests that they are performing in many ways as Congress intended, at least at the macro level, to provide an efficient, less expensive means to address potentially low quality patents. We believe that the prudent course is to give these reforms the chance to demonstrate their efficacy to deal with the concerns for which they were created before we consider making significant additional changes which may have their own unintended consequences. In support of this proposition to wait and see how they are working, we would simply point out that the AIA itself requires that USPTO study the reforms implemented by the AIA and report back to Congress by September 16, 2015. Those reports would serve as an important and more empirically-driven body of data which would allow for greater clarity and direction in making any necessary changes.

c. The Current Environment

Nonetheless, we do understand that there is something different about certain abusive behaviors currently plaguing the business community. Specifically since the passage of the AIA, there has emerged a practice by some patent rights holders of sending widespread distributions of demand letters – often to small and patent unsophisticated end users such as “mom and pop” businesses, coffee shops, retail stores, or restaurants, who have often acquired and used equipment or services often ancillary to their primary business. These letters, often threatening, allege infringement of a patent or patents, sometime without citing to them specifically, rarely suggesting how the end-user is infringing specifically other than perhaps by using a particular broadly identified technology, such as “scanner,” and demanding relatively small amounts to settle an alleged dispute or provide a license. Demand letters are nothing new and have been sent and received by both large and small companies for years. However, the law has evolved such that it has become more difficult for patent holders to assert allegations of direct infringement against service providers or product suppliers, with the result that more and more patent holders have reached out to downstream customers to assert their patents.

We would also note that this is an area where there is little empirical data on which to gauge the magnitude of the problem. Some have suggested that there are only a handful of entities engaging in abusive behavior, but the large cumulative number of demand letters creates the

impression of a more pervasive problem. Additionally, as the Vermont Attorney General has noted in his complaint against one of the most notorious of these abusers, in spite of the significant number of demand letters which were purportedly sent out, as of July 8, 2013, the date of the complaint, that company had not filed a single infringement lawsuit.⁶

In point of fact, therefore, many of these practices—sending a multiplicity of demand letters containing vague allegations and minimal information, with persistent but relatively modest settlement terms, and apparently with little preparation for actually bringing a lawsuit—may have less to do with abusing the rules and procedures in patent litigation per se than they have to do with consumer fraud and deceptive trade practices arising from the demand letter. In some respects, this problem is similar to the problem we saw in the late 1990s involving invention promotion firms preying on innocent inventors, who had little knowledge of the patent system and paid exorbitant fees to such firms in exchange for very little in return. In both cases, the targets of the abuse have been exploited with misleading information about patents and the patent system.

Law enforcement has developed measures to deal with such wrongdoers. With respect to invention promotion firms, the FTC responded to a massive fraud committed by many such firms by launching in 1997 “Project Mousetrap” to identify, prosecute and fine firms engaged in fraudulent or deceptive practices.⁷ As will be discussed further below, the FTC has already undertaken a thorough study of all of these practices, and is in a traditional and well-understood position to take action against consumer fraud and deceptive trade practices. In addition, state attorneys general have similar long-term experience and authority to deal with abusive behavior. As already stated, recently several attorneys general have pursued state law actions against certain patent owners for abusive litigation behavior.⁸ Given the nature of this more recent

⁶ See the complaint of the Attorney General of Vermont in *State of Vermont v. MPHJ Technology Investments, LLC*, at <http://www.atg.state.vt.us/assets/files/Vermont%20v%20MPHJ%20Technologies%20Complaint.pdf>.

⁷ See <http://www.ftc.gov/news-events/press-releases/1997/07/ftcstate-project-mousetrap-snares-invention-promotion-industry>

⁸ See the complaint of the Attorney General of Vermont in *State of Vermont v. MPHJ Technology Investments, LLC*, at <http://www.atg.state.vt.us/assets/files/Vermont%20v%20MPHJ%20Technologies%20Complaint.pdf>; see cease and desist letter from Nebraska Attorney General, at http://www.ago.ne.gov/resources/dyn/files/1069534z3005a836/_fn/071813+Farney+Daniels+LLP+-+Cease+%26+Desist+Letter+and+Civil+Investigative+Demand.pdf; see consent order reached by Minnesota Attorney General at <http://www.ag.state.mn.us/Consumer/PressRelease/130820StopPatentTrolling.asp>.

problem, which in many ways has triggered the broader political reaction among organized constituencies such as retailers, restaurants and real estate agents that has led us here today, we would suggest that it would be prudent to consider allowing those enforcement bodies with the appropriate experience and authority to pursue the matter.

However, state law remedies also require careful examination, first to guard against encumbering legitimate patent enforcement, and second to guard against limiting the litigation privilege and free speech right to send demand letters in the first instance.

d. AIA Reforms Were Directed to Many Complaints About Litigation

Any further proposed legislative remedy should not overlook the extensive revisions which the AIA only recently accomplished. The AIA includes a variety of reforms directed to improving the quality of pending patent applications and the enforceability of issued patents. With respect to patent quality, the legislation institutes a first-inventor-to-file system that will provide a more objective basis for establishing the priority of rights. It also provides tools to allow third parties to participate in patent examination⁹ or challenge the validity of an issued patent.¹⁰ These tools are expected to decrease abusive patent litigation practices by reducing the issuance of low quality patents and by providing a lower-cost administrative procedure for challenging issued patents. With respect to patent enforcement, the AIA reforms to prior user rights,¹¹ case removal,¹² false marking,¹³ and joinder practice,¹⁴ are all areas in which the interests of plaintiffs and defendants were in need of rebalancing. The exact balance struck by these various reform provisions is just beginning to unfold.

⁹ AIA, Pub. L. No. 112-29, § 8.

¹⁰ AIA, Pub. L. No. 112-29, § 6.

¹¹ AIA, Pub. L. No. 112-29, § 5.

¹² AIA, Pub. L. No. 112-29, § 19(c).

¹³ AIA, Pub. L. No. 112-29, § 16(b).

¹⁴ AIA, Pub. L. No. 112-29, § 19(d)(1).

e. Evidence of the Problem

One particular challenge in crafting any legislative remedy to a problem is understanding the metes and bounds of the problem at hand. Such is the case in this current discussion. The nature and the scale of abusive patent litigation continue to be strongly debated, with partisans rising from academia, the media, Congress, and the White House. In general, at least the theme of early studies was to focus on the nature of the actor rather than the act. In this case, identifying or labeling them as “trolls,” “non-practicing entities,” or “patent assertion entities” who are gaming or manipulating the intellectual property system for their private advantage and to the detriment of the economy and society. These studies often provided the analytical underpinnings framing the debate, and found their way into many other reports and news articles.

What is still under serious debate is how well the available data supports the conclusions of these studies, which are often based on confidential information and surveys. A recent study responding to the debate put it this way:

“While the rhetoric in these studies is often sharp and clear, the same cannot also be said for the disclosures of the underlying data. The studies merely provide summary data to the public and often do not differentiate among the various types of NPEs. Instead, the studies broadly classify companies as either NPEs or not NPEs (sometimes, trolls or non-trolls). Importantly, nearly all of the data upon which these studies are premised are confidential and thus are not available for peer review or for use in other studies.”¹⁵

Another reaction to the PAE debate in this area has come from the Government Accountability Office (GAO), which was tasked by Section 34 of the AIA to study the consequences of patent litigation by PAEs.¹⁶ Concerning the size of the problem, the August 22, 2013, the GAO report confirmed a 33% increase in patent litigation from 2010 to 2011, but said that most stakeholders attributed that increase to anticipated changes in the joinder rules in 2011 under the AIA. A

¹⁵ Christopher Anthony Cotropia, Jay P. Kesan & David L. Schwartz, *Patent Assertion Entities (PAEs) Under the Microscope: An Empirical Investigation of Patent Holders as Litigants*, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2346381, page 5.

¹⁶ Intellectual Property: Assessing Factors That Affect Patent Infringement Litigation Could Help Improve Patent Quality, GAO-13-465, Aug 22, 2013, available at <http://www.gao.gov/products/GAO-13-465> (visited Nov. 21, 2013).

further finding of the report, based on a representative sample of 500 patent infringement lawsuits from 2007 to 2011, shows that manufacturing companies brought most of the lawsuits, and that NPEs brought about 20% of all of the lawsuits. The report also identified other causes for increased patent litigation, such as (1) the prevalence of patents with unclear property rights, (2) the attraction of large monetary awards, and (3) corporate recognition that patents are a more valuable asset than previously thought.

Further investigation continues with the Federal Trade Commission's announcement of its Section 6(b) Study, 15 U.S.C. §46(b), of patent assertion entities, evidencing the dearth of data on this subject.¹⁷ The Federal Register notice observed that the joint FTC and Justice Department Workshop, conducted last April on this subject, lacked sufficient empirical data on PAEs.¹⁸ However, as we commented to the FTC at the time, the studies in this area become imprecise when they rely on labels for the actors to define the problem rather than focusing on the misconduct at issue.

The Federal Register notice describing the FTC study on patent assertion entities defines such entities as “firms whose business primarily involves purchasing patents and attempting to generate revenue by asserting them against persons already practicing the technology.”¹⁹ Not unlike other studies, the FTC uses a label that is excessively broad because it refers to completely legitimate activities that are available to all patent owners and that are essential to the property value of patent rights.²⁰ There is nothing new about non-practicing entities and many patents and innovations develop with companies and individuals that do not have the resources to practice the technology of their inventions.

Any investigation into this area must be directed at those patent owners that appear to be abusing the system, no matter what label is attached to them. The heart of the matter is the misconduct

¹⁷ See 78 Fed. Reg. 61352.

¹⁸ “Patent Assertion Entity Activities Workshop” (“Workshop”) jointly conducted on December 10, 2012, by the FTC and the Department of Justice (“DOJ”).

¹⁹ 78 Fed. Reg. 61352

²⁰ In a post on the George Mason Law School web site for the Center for the Protection of Intellectual Property, Professor Adam Mossoff comments on a frequently cited study on “troll” litigation. Under the definition used in that study, no less a patent holder than IBM must be considered a troll. See <http://cpip.gmu.edu/2013/11/13/the-nadir-of-patent-troll-rhetoric>.

itself. To the extent that studies are directed at patent owners engaged in perfectly lawful conduct, i.e., acquiring and enforcing intellectual property rights, those studies are flawed.

Finally, with regard to the benefit of additional data, we would also note that S. 1720 also provides for a study on secondary market oversight for patent transactions (Sec. 11. Reports). AIPLA generally supports this type of study (unless they may divert resources more appropriately used elsewhere especially in times of resource constraint), and supports this specific study and notes that it would likely yield additional valuable data that may more accurately guide the Congress in crafting such legislation.

f. Judiciary Appropriately Reacts to Abuses in Enforcement Proceedings

As was the case when Congress was developing the patent reforms that became the AIA, the judiciary has continued to address many issues plaguing the system in the course of its interpretation and application of the patent laws. In addition, many district courts themselves have recognized the need for innovations to streamline proceedings, as such developing local patent rules and e-discovery rules for cases,²¹ or focusing on potentially dispositive issues early in a case. For example, it is worth noting that all courts in the patent pilot program are required to develop patent rules. In addition, the Judicial Conference frequently reviews the Rules of Civil Procedure and amends them to conform to the realities of the day.

One particular issue being addressed that has direct relevance to patent litigation abuse is the lack of detail in complaints alleging patent infringement. The sufficiency of pleadings generally was addressed by the Supreme Court rulings in *Twombly* and *Iqbal*,²² which arguably set the bar higher for patent complaints than Form 18 of the Federal Rules of Civil Procedure. The Federal Circuit in *K-Tech Telecommunications v. Time Warner Cable* confronted the conflict of pleading

²¹ Local Rules for Eastern District of Texas, Appendix P Model Order Regarding E-Discovery In Patent Cases, available at <http://www.txed.uscourts.gov/page1.shtml?location=rules:local>.

²² *Ashcroft v. Iqbal*, 556 U.S. 662 (2009); *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007).

standards and said that, notwithstanding the *Twombly* and *Iqbal* rulings, the Forms control because the rules of procedure may not be changed by judicial interpretation.²³

With regard to proposals to direct specific procedural rules by legislation, we would note that last August, the Judicial Conference Advisory Committee on Civil Rules proposed a series of changes to the rules of civil procedure, and included a proposal to abrogate Rule 84 entirely, with all of its forms, making specific reference to Form 18 and the *Twombly* and *Iqbal* requirements.²⁴ Hopefully, this process will obviate the need for similar statutorily-mandated rules.

Also high on the list of many reformers is a change to 35 U.S.C. § 285 to make it easier for trial courts to award attorneys' fees to prevailing parties. The current statute permits an award to a prevailing party in "exceptional cases," which the Federal Circuit has interpreted in a way that makes fees very difficult to recover. The Judiciary is currently addressing this issue as well. Pending in the Supreme Court right now is a case that could change the standard used by district courts in awarding fees,²⁵ and another case that could change the standard used by the Federal Circuit in reviewing such awards.²⁶ AIPLA has filed amicus briefs in both cases arguing that district courts require more discretion to award attorneys' fees where warranted.²⁷

Probably the most tumultuous issue in patent law right now is the question of patent eligibility under 35 U.S.C. § 101. While that statutory language is fairly straightforward, identifying the various categories of inventions that are patentable subject matter, the Supreme Court years ago staked out exceptions to statutory subject matter where the patents recite a law of nature, a natural phenomenon, or an abstract idea. The Court has taken a number of cases recently involving method claims and found them ineligible as claiming an abstract idea, but in *Alice Corp. Pty, Ltd. v. CLS Bank International*, the Court is currently considering whether a system claim, i.e., one that combines a method and an apparatus, can be ineligible as an abstract idea.²⁸ This case has the potential to resolve numerous questions created by past decisions which could

²³ 714 F. 3d 1277, 1283 (Fed. Cir. 2013).

²⁴ See <http://www.uscourts.gov/uscourts/rules/preliminary-draft-proposed-amendments.pdf>.

²⁵ *Octane Fitness, LLC v. Icon Health and Fitness, Inc.*, U.S., No. 12-1184.

²⁶ *Highmark Inc. v. Allcare Health Management Sys.*, U.S., No. 12-1163.

²⁷ Also pending before the Federal Circuit is *Kilopass Technology, Inc., v. Sidense Corp.*, Fed. Cir., No. 2013-1193.

²⁸ *Alice Corp. Pty, Ltd. v. CLS Bank International*, U.S., No. 13-298.

impact the entire software industry. To the extent that confusion over the law of software patents has provided an opportunity for questionable infringement claims, the Court's decision to review *Alice* to clear up such confusion is another example of action by the Judiciary to address the validity of some patents that may be the subject of perceived patent litigation abuses.

The complexity of patent law and its scientific and technical subject matter is compounded by the complexity of the litigation procedures for enforcement that gives the patent rights its value.²⁹ All of this complexity may well provide extraordinary opportunity for misconduct, but the challenge for Congress is to see that the cure is not worse than the disease. Oftentimes, the procedures that may be applied for efficient management of one case will not necessarily be effective in another case.

Below we consider the specific provisions of S. 1720, as well as the issues raised by alternative approaches to litigation abuse.

II. Legislative Proposals

When considering changes to the patent system, it is important to take into account that the purpose of the system, according to the U.S. Constitution, is to promote innovation.³⁰ As an incentive for continuous innovation and as a driver of the U.S. economy, the patent system is working. According to a report released by the U.S. Department of Commerce in March 2012, "IP is used everywhere in the economy, and IP rights support innovation and creativity in virtually every U.S. industry."³¹ The report attributed 27.7% of U.S. jobs directly or indirectly to IP intensive industries. This is what is at stake when we discuss reforms to the system.

²⁹ Some are concerned that the cost of patent enforcement has deprived small inventors of the value of their patents. AIPLA believes it would be desirable to investigate the possibility of a small claims procedure, conducted in either the United States Court of Federal Claims; in that Court in conjunction with Federal District Courts that are participating in the existing patent pilot program; or only in the existing patent pilot program as proposed in Section 11(d) of S. 1720.

³⁰ U.S. Const., art. 1, sec. 8, cl. 8.

³¹ "Intellectual Property and the U.S. Economy: Industries in Focus," March 2012, available at http://www.uspto.gov/news/publications/IP_Report_March_2012.pdf.

To the extent that legislative reforms are necessary to curb abusive practices in patent litigation, Congress needs to ensure that, while reducing incentives for abuse, any reforms preserve the traditional rights of patent owners to protect and secure reasonable returns on their innovations,³² safeguard the interests of users before the USPTO and the courts, and maintain judicial discretion to appropriately manage litigation. The reforms should approach the process by carefully targeting specific abusive actions rather than a particular category of actors. Congress should also avoid singling out patent litigation or a particular category of litigant with inflexible statutory changes to the judicial process. Instead, it should encourage courts to more readily exercise their discretion with existing tools for case management, or, where necessary, the courts acting collectively could provide new tools that maintain the discretion and flexibility so important to trial judges.

a. S. 1720, The Patent Transparency and Improvements Act

AIPLA commends Chairman Leahy for taking a careful and targeted approach to addressing the problems in the patent litigation system in S. 1720. AIPLA believes the bill is a positive contribution to the legislative discourse and readily supports some provisions, particularly those that strengthen and clarify the reforms already implemented through the AIA. That said, as detailed below, AIPLA believes that other provisions require further study and modification before they can be supported.

S. 1720 seeks to address abusive behavior that exploits the strength of the patent system to coerce American businesses, such as retailers and hotels, into paying settlements to avoid the expense of defending a patent infringement suit, regardless of the merits of the infringement claim. It does so by imposing heightened patent ownership disclosure requirements, providing stays for suits against downstream users, and giving the Federal Trade Commission the authority to police bad faith patent demand letters, among other things.

More specifically, we offer the following comments and suggestions:

³² It should be noted that the very first patent law of 1790 allowed for assigns the full rights of original inventors or owners. Patent Act of 1790, Ch. 7, Sec. 1 Stat. 109-112 (April 10, 1790).

i. Transparency in Patent Ownership (Section 3)

S. 1720 would give defendants the ability to better assess the litigation risks that they might be facing by requiring plaintiffs at the time a case is filed to disclose certain ownership, licensee and assignee information. Additionally, the provision requires patent owners to update assignee information with the USPTO. AIPLA conceptually supports this provision. However some of its language could benefit from further consideration.

The current proposed provisions require initial disclosures of any person or entity with a financial interest in the outcome of the litigation, which we believe, require further clarifications and safeguards. The definition of financial interest should exclude obvious and expansive interests, like those of the shareholders of a company, or other internal corporate holders aside from the parent corporation. And the requirement for such initial disclosures should provide for the ability to file information under seal, since certain interests may contain commercially sensitive information that should be protected by the courts and the parties.

Additionally, the requirement to update assignment information on the ultimate parent entity with the USPTO within 3 months of the assignment may be too short an interval in practice. Congress also should to consider that assignment is complex and may involve daughter entities and parent companies, or “ultimate” parties who may have no direct involvement in the assignment changes. Where the ultimate parent corporation is readily obvious from the name of the currently listed patent owner, for example in the case of a subsidiary, we respectfully suggest some form of safe harbor should apply.

In that same light, we are also concerned that the penalty for non-compliance as proposed in S. 1720, i.e. loss of the ability to recover potential attorney’s fees or enhanced damages during a period of non-compliance, is overly harsh. Finally, this provision includes a strict penalty of requiring an award of attorneys’ fees to any prevailing accused infringer upon discovery of “any previously undisclosed ultimate parent entities in the chain of title.” AIPLA does not support the

mandatory imposition of attorneys' fees. Courts should be given the discretion to determine where an award of attorneys' fees is appropriate on a case-by-case basis.

We note that the USPTO has recently indicated they will soon publish a proposed rule on "real party in interest," which relates to these same transparency issues. We would respectfully suggest that the Committee consider deferring any specific legislation in this area, such as in Section 3, until this additional information is available to help guide the Committee in its drafting process.

ii. Customer Stays (Section 4)

As discussed above, one abusive litigation practice used by some parties is to send numerous demand letters or to threaten or initiate infringement actions against multiple retailers or other downstream end users of a patented product or process to increase settlement prospects. In pursuing such potential infringers, the assertion entity may seek to gain an advantage over parties with inadequate experience or resources to litigate the matter. S. 1720 proposes a framework to allow a "covered manufacturer" to intervene in such patent infringement litigation with its customer or end user, and gives the customer or end user the right to stay infringement actions against them pending the outcome of litigation between the "covered manufacturer" and the patent owner.

AIPLA supports encouraging the courts to more frequently allow manufacturers to intervene in litigation brought against its customers or users, as many do now. While courts have the power to grant stays now, we conceptually support this provision of S. 1720. Staying customer litigation would be consistent with the rule that infringement actions against manufacturers have priority over infringement actions against customers, despite the general rule that a first-filed suit has priority over a later-filed suit.³³ The Federal Circuit has explained that "[t]he customer suit exception is based on the manufacturer's presumed greater interest in defending its actions against charges of patent infringement; and to guard against possibility of abuse."³⁴

³³ *Gluckin & Co. v. International Playtex Corp.*, 407 F.2d 177, 179 (2d Cir. 1969).

³⁴ *Kahn v. General Motors Corp.*, 889 F. 2d 1078, 1081 (Fed. Cir. 1989).

We believe it is important to address the issue of unsuspecting end-users without real knowledge of how their products or systems operate from having to individually defend against abusive enforcement tactics with little to no resources. It is crucial that the language is carefully crafted so that only appropriate end users are covered. The proposal should not have the unintended effect of strong-arming all manufacturers and suppliers into heavy-handed contractual indemnification language or making cases even more complicated in which multiple potentially responsible parties are involved.

As such, the customer stay provision would benefit from further clarity, particularly as to when a court may deny such a request. The proposal also needs to address added complexities of multiple vendors, manufacturers, and retailers as potentially responsible parties, and how stays would work in such instances, i.e., where there is a multi-supplier market. In addition, the proposal needs to consider whether it is likely to result in larger companies requiring much smaller importers and resellers, among others, to agree to heavy-handed contractual obligations, in which they are not in any better position to handle the subject claims than the company they have been asked to defend. In other words, the reality of distribution chains should be taken into account, especially where an accused product is manufactured and originates overseas.

iii. Bad Faith Demand Letters (Section 5)

S. 1720 seeks to target demand letter abuse by giving the FTC the express authority to police the widespread sending of bad faith demand letters by treating it like a deceptive trade practice. It is difficult to use a single definition for the term “demand letter” because such letters are sent with a variety of legitimate purposes. A patent owner may send a genuine inquiry letter to find out whether a product includes his patent with no threat or intention of future litigation. They may send an offer of licensing in order to begin negotiations, which may later result in a threat of litigation for failure to accept or comply with a licensing agreement. A patent owner may also send a letter stating that the patent owner believes there is infringement and threatens to file suit to defend its rights if the infringing action is not stopped or a royalty paid. These are all essential

enforcement tools for patent owners, and they allow many patent disputes to be resolved long before court intervention is necessary.

AIPLA appreciates that providing some form of oversight to the actions of parties prior to the institution of a lawsuit may help relieve the burden on retailers and downstream users of patents. However, there are several issues that need further consideration and clarification.

The existing studies of litigation do not necessarily capture the full picture of misconduct because they fail to take into account the actions of patent owners prior to the filing of suit, which may be where most of the abusive behavior is actually taking place. In some cases, there may be patent holders who are sending thousands of demand letters to unknowing end users of allegedly patented products, using the recipient's lack of experience with the patent system to coerce them into paying settlements.

We note that patent owners sending demand letters are not immune from challenges by the potential infringers targeted by the letters. If the letters give rise to an "actual controversy" between the parties under the Declaratory Judgment Act, the recipient can file its own lawsuit to challenge the validity of the patent or obtain a declaration that it is not infringing the patent being asserted.³⁵ The U.S. Supreme Court recently lowered the burden for establishing "actual controversy." In *Medimmune v. Genentech*, the Supreme Court rejected the "reasonable apprehension of imminent suit" test applied by the Federal Circuit, in favor of a broader "totality of the circumstances" test to determine whether a case or controversy exists between the parties for the purposes of a declaratory judgment action.³⁶ This decision gave recipients of demand letters the ability to bring declaratory judgment actions where there is a mere potential for future litigation and placed the burden on the patent owner to show there is no actual controversy.

In *Medimmune*, the existence of a licensor/licensee relationship did not immunize the patent holder from a declaratory judgment action from their licensee. In the cases following, standing

³⁵ The Declaratory Judgment Act provides, "In a case of actual controversy within its jurisdiction...any court of the United States, upon the filing of an appropriate pleading, may declare the rights and other legal relations of any interested party seeking such declaration, whether or not further relief is or could be sought. Any such declaration shall have the force and effect of a final judgment or decree and shall be reviewable as such." 28 U.S.C. 2201(a).

³⁶ 549 U.S. 118 (2007).

for a declaratory judgment action was found in the following circumstances: where parties engaged in pre-suit negotiations but failed to come to an agreement even in the absence of a threat to sue;³⁷ where the party seeking a declaratory judgment believed that further negotiations with the patent owner would not result in an agreement and the patent owner made a press statement after winning an infringement case against a third party stating “its intention to continue ongoing licensing discussions with other companies;”³⁸ and where a patent owner “bragged in a trade magazine of its habit of threatening to sue (or actually suing) the customers of allegedly infringing vendors or manufacturers, presumably as a means of pressuring the parties to cease their activities or sign a license agreement” though no threat of suit was made to the party bringing the declaratory judgment action.³⁹

It should also be noted that a patent owner’s knowledge of potential infringement, but failure to act by sending a demand letter or filing an infringement action, could provide a basis barring relief if they decide to later file suit under the doctrine of laches. Laches provides a limit on liability for alleged infringers where “the neglect or delay in bringing suit to remedy an alleged wrong, which taken together with lapse of time and other circumstances, causes prejudice to the adverse party and operates as an equitable bar.”⁴⁰

The extensive use of demand letters to extract payments from downstream customers has caught the attention of state attorneys general from Vermont, Minnesota, and Nebraska, who have been looking to consumer protection and unfair competition laws to stop the abusive behavior.⁴¹

The Bad Faith Demand Letters provision in S. 1720 would give the FTC the authority to investigate persons who “engage in the widespread sending of written communications,” but it fails to define “widespread.” This term is ambiguous and would benefit from specifying how many demand letters need to be sent to trigger this provision. However, Congress should be careful not to set the bar too low, which could sweep in patent owners seeking to legitimately

³⁷ *SanDisk Corp. v. STMicroelectronics Inc.*, 480 F. 3d 1372 (Fed. Cir. 2007).

³⁸ *EchoStar Satellite LLC v. Finisar Corp.*, 515, F. Supp. 2d 447, 451-52 (Dist. Ct. D. Delaware 2007).

³⁹ *WS Packaging Group v. Global Commerce Group, LLC*, 505 F. Supp. 2d 561, 565-66 (Dis. Ct. ED Wisconsin 2007).

⁴⁰ *A.C. Aukerman Co. v. R.L. Chaides Constr. Co.*, 960 F.2d 1020, 1028-29 (Fed. Cir. 1992).

⁴¹ As noted above, Minnesota Attorney General Swanson has already used her state’s consumer protection laws to enjoin one of the most notorious “patent trolls” from doing business in Minnesota.

enforce their patents in good faith. Also, demand letters may incentivize avoiding litigation. If sending demand letters becomes too risky, some may file suit rather than send pre-litigation demand letters.

Further consideration also needs to be given to how the FTC would distinguish between regular licensing activity and abusive activity. As previously discussed, demand letters come in many forms and can serve a number of different legitimate purposes. Patent owners need to have the flexibility to use demand letters to make a general inquiry without automatically opening themselves up to a declaratory judgment action because too much information is required in demand letters to avoid FTC enforcement under this provision. A safe-harbor provision for normal business communications could serve this purpose.

In the same vein, the provision needs to be carefully drafted so it will not be considered an unlawful regulation of free speech under the First Amendment. Although commercial speech can be regulated where it is false or misleading, the factors for finding a deceptive trade practice listed in this provision may be overly broad. Also, the provisions should not undermine the ability of litigants to use the litigation privilege in notifying appropriate persons of pending litigation. To ensure that the law is applied consistently across all fifty states, federal pre-emption should also apply to any state law to prescribe standards for demand letters.

For these reasons, AIPLA conditionally supports this provision, so long as the final legislation does not include other more burdensome statutory changes to patent enforcement rules and procedures.

iv. “Scrivener’s Error” in PGR (Section 7(a))

Section 7(a) would correct a so-called “scrivener’s error” made during the legislative process of the AIA by striking “or reasonably could have raised” from the estoppel provisions of 35 U.S.C. §325. This change is essential to improving patent quality, as intended by the AIA, by encouraging parties to use this new review proceeding to address questionable patents in the

early stages of patent term when reliance, commercialization and related investment are likely at their minimum. AIPLA supports this provision.

v. Standard for Claim Construction in IPR and PGR (Section 7(b))

S. 1720 aligns the claim construction standard in IPR and PGR with the standard used by district courts. AIPLA supports the legislative proposal to change this standard. As an intended alternative to costly and often burdensome litigation, these processes should apply the same claim construction standards as used in the Federal courts, so that consistent claim construction across these post-grant validity challenges will provide greater certainty in final decisions and reduce the need for further litigation. For example, the vast majority of IPR proceedings involve co-pending litigation. The playing field should be level such that the patent owner is not subjected to a narrower claim construction standard in trying to enforce its claims in district court, but a broader standard for the petitioner to attack its patents before the Patent Trial & Appeal Board.

Failure to use this standard raises the very real prospect of an owner having a patent found to be valid by a federal district court, all the way through appellate review, only to have an administrative tribunal later come to the opposite conclusion. Such an environment creates uncertainty in patent rights and encourages gamesmanship.

vi. Protection of Intellectual Property Licenses in Bankruptcy (Section 8)

This section sets forth provisions for the protection of intellectual property licensees and transferees in the event of bankruptcy of the IP licensor or transferor. First, Section 8(a) amends 11 U.S.C. § 1520(a) to protect licensees of U.S. intellectual property rights by making clear that U.S. courts shall not recognize a bankruptcy trustee's unilateral cancellation of licenses to or transfers of intellectual property rights if the licensor goes bankrupt, whether in a U.S. or foreign bankruptcy proceeding. The intent and effect of this provision would be to protect U.S. licensees and transferees of intellectual property rights from trustees' unilateral rejection of their licenses by extending to them the right of election to retain their rights set forth in 11 U.S.C. § 365(n).

The provision would contribute to the protection of licensees and transferees of U.S. intellectual property rights.

Second, Section 8(b) amends 11 U.S.C. § 101(35A) by adding trademarks, service marks, and trade names as defined in 15 U.S.C. § 1127 (the definitional section of the Lanham Act) to the definition of “intellectual property” in Section 101(35A) of the Bankruptcy Code. In addition, Section 8(b) would make clear that, in the event that election is exercised, the bankruptcy trustee must discharge any quality control obligation of the licensor in order to protect the licensed marks from claims of abandonment or the like. AIPLA supports the changes under this section.

vii. Inventor’s Oath or Declaration (Section 10(a)(1))

The proposed amendment to 35 U.S.C. § 115(g)(1) addresses the use of an oath or declaration from a prior application in continuation or divisional applications. This would change the current law which allows use of the prior oath or declaration in a continuation-in-part (CIP) application even when the CIP claims an invention that was not described in the prior application. The proposed amendment also changes the requirements of the submitted oath or declaration from including the required statements set forth in 35 U.S.C. § 115(b), which are applicable to AIA applications, to allow the use of an oath or declaration that was properly filed by or on behalf of the inventor in either a pre-AIA or an AIA application. The change to exclude CIP applications covering new inventions is consistent with the law for pre-AIA applications, and will greatly reduce costs of further patent prosecution by rights holders. We support this provision.

viii. Double Patenting (Section 9)

This provision seeks to codify the judicial doctrine against double patenting for post-AIA patents. AIPLA agrees that there are issues to be worked through for adjusting and simplifying double patenting, but we are concerned that the proposed legislation is overly and perhaps unnecessarily dense and its subtleties difficult to appreciate even by seasoned practitioners. Incidents where this would be applicable are extremely limited and may be disproportionate to

the inevitable unintended consequences. We suggest additional consideration be given, and we are confident that stakeholders can work together resolve any issues.

ix. Time Limit for Commencing Misconduct Proceedings (Section 10(a)(7))

This provision is reportedly being advanced because some apparently believe the USPTO is unable to complete the review of misconduct allegations against registered attorneys and agents in a timely manner, thus apparently necessitating the filing of potentially unwarranted charges to avoid tolling the statute of limitations.

We strongly opposed the original provision in the AIA, which already extended the time limit for bringing disciplinary actions, and we are equally concerned about this amendment. This provision seeks to extend the threat of discipline against individuals within our membership, with the related potential for increases in malpractice insurance rates against all registered members, for unjustified reasons. Many of the provisions of the AIA, more challenging than this, impose one year deadlines on the USPTO, e.g. PGR and CBM. It remains incumbent upon the USPTO to complete their work in this highly sensitive area in the amount of time Congress allocated in the AIA.

Moreover, we are informed by the USPTO that they do not support this proposal and do not in fact need it, as in those few cases where the deadline has loomed, they have entered into tolling agreements with the specific individual under investigation, which was the solution we proposed during the debate on the AIA.

b. Other Legislative Proposals

Several additional legislative proposals have been introduced in the 113th Congress with a stated goal of targeting litigation abuses. Some of the most concerning proposals would introduce statutorily mandated requirements into the patent litigation process or make premature substantive changes to the reforms implemented by the AIA. AIPLA would ask that this Committee use caution before integrating them into S. 1720.

i. Mandating Judicial Rules and Procedures

AIPLA fears that congressionally created litigation rules, as proposed, would intrude on the established role of the Judicial Conference, be overly difficult to amend once fixed in a statute, and would overly restrict the traditional discretion of district court judges to manage their cases. While proposed with good intentions, mandating inflexible rules may have unintended consequences, including increasing costs of compliance and impeding access to the courts particularly for small businesses and independent inventors. In addition, patent litigation cases vary in complexity, including technology, number of patents and products involved, type and amount of prior art, and number of defenses. Rules for managing one case may not be appropriate for other cases, i.e., one size does not fit all. AIPLA believes that the Judicial Conference in its own discretion is in a better position to work with the district courts to institute appropriate case management rules.

Specifically, AIPLA is concerned about proposals that would remove judicial discretion and mandate specific patent litigation rules, including:

- Imposing significantly heightened pleading requirements for patent lawsuits;
- Statutorily limiting discovery in patent litigation;
- Singling out patent litigation or a particular category of litigation with amendments to the rules of joinder; and
- Directing the Judicial Conference to adopt rules and procedures detailed by Congress.

As previously noted, the Judicial Conference Advisory Committee on Civil Rules has begun the process for amending the Federal Rules of Civil Procedure to reduce costs and delays in litigation through active case management and proportionality in discovery. Given these developments, legislative action in this area may be premature or even unnecessary. As we learned through the process which led to the AIA, the courts have an effective ability to recalibrate patent law to properly address legitimate concerns, without the challenges of crafting statutorily acceptable language.

ii. Fee Shifting

Some of the current proposals would make a fee shifting determination mandatory in every case. Having such a provision would add to the cost of litigation, potentially discourage settlement because of the fee shifting incentive, and have the potential to invade the attorney-client privilege in making the determination whether to award fees.

While AIPLA supports giving the judiciary more discretion to award fees in exceptional cases, that is far different than advocating for a presumption that fee shifting is warranted. In addition, in some pending proposals, the burden would be on the losing party to show why fees are *not* warranted rather than on the prevailing party to show why fees are warranted. Moreover, in any proposal that may address fee shifting, the issue of maintaining access to the courts for smaller businesses and innovators, who need to rely on contingent fee arrangements to assert their rights, should be considered. The unintended effect of impeding legitimate rights holders' access to the courts, disincentivizing patent procurement in the first place, or possibly encouraging further lawsuits down the road (such as malpractice claims where fees are awarded) is something to avoid, if possible.

Again, the U.S. Supreme Court and Federal Circuit are currently reviewing the standard for fee shifting in patent cases under the current 35 U.S.C. § 285. As noted above, AIPLA has filed amicus briefs in those cases.

iii. Bonding

Another proposal being considered to address litigation abuse is bonding – requiring a plaintiff to post a bond sufficient to ensure payment of the accused infringer's reasonable fees and expenses, including attorney fees. As proposed, such a bond requirement would only apply to the patent owner and has the potential to tie up necessary resources of a business, a particular crucial consideration for small businesses, which might then hesitate to initiate a valid suit. Additionally, the requirement has the potential to be applied to almost any plaintiff, regardless of

the merits or strength of the particular case. Lastly, the requirement will likely increase costs and prolong litigation, as the court wades through arguments over the many listed factors to be considered. AIPLA opposes this proposal.

iv. Expansion of the Transitional Program for Covered Business Method Patents

Other proposals would expand the scope and duration of the Transitional Program for Covered Business Method Patents (CBM), which AIPLA opposes. CBM was specifically enacted in Section 18 of the AIA to allow for a specialized provisional post-grant review of validity of certain business-method patents (those related to financial services). The PGR proceeding was developed to permit for a limited time after issuance a wide-ranging challenge to patent validity, balancing the challenger's need for plenary review against the patentee's need for repose and quiet title. However, the CBM provision inserted into the AIA legislation created an exception to this premise of the PGR procedure, ostensibly because many questionable business method patents were beyond the reach of this new procedure. Nonetheless, the CBM provision was accepted as part of a compromise that allowed the legislation to go forward. It was adopted for a limited period of time, 8 years, to quickly "clean out" that small set of patents that were issued when the law and regulations in this area were in doubt. But the law of business method patents, as well as the procedures for examining applications claiming that subject matter, has substantially evolved.

The CBM provision has been proposed to be revised and extended before there has been time to determine if it is serving its purpose as originally enacted. There are numerous issues that remain to be addressed in the transitional program. For example, cases are only now beginning to make their way through the program and there has been little analysis of those cases and whether the processes are working as envisioned. Given the limited number of cases brought thus far, it is premature to extend the transitional program before it has been truly tested and evaluated, and it is unclear if it will be needed in light of, e.g., AIA's other *inter partes* review and post-grant review programs. To expand the procedure now as proposed is to put at significant risk over half of all U.S. patents, representing the most important U.S. technologies, without even having one CBM case yet tested on appeal.

v. USPTO Funding

One additional legislative proposal that AIPLA has a long history of support for, and one which I as a former Director would be remiss in not singling out again in this debate, is providing full and sustainable funding to the USPTO. AIPLA strongly believes that the single most important reform for improving the quality of patents is securing permanent full funding for the USPTO. Congress understood the importance of giving the USPTO access to all of its user fees at the time of the AIA, but 2 years after its passage USPTO funds are again being made unavailable to the Office due to sequestration.

As discussed above, some of the abuse in patent litigation is thought by some to stem from lower quality patents with unclear terms, overly broad claims, or both. In their view, these patents may be problematic because of the difficulty for entities, even those that regularly interact with the patent system, to determine what the patent actually covers, and therefore whether the product they are developing may be infringing, without the intervention of the courts. Full funding of the USPTO will give it the ability to issue the highest quality patents possible.

Regarding the specific issue of previous efforts at reform, sequestration has unfortunately delayed the efforts and improvements mandated by the AIA, and undoubtedly risks undercutting major initiatives designed to continue improving the patent system. Until full funding is restored to the USPTO, AIPLA has reservations about further burdening the patent system with another round of reforms. To that end, AIPLA would strongly support making permanent USPTO funding central to any legislative initiative.

III. Conclusion

The patent system continues to be a key economic force in the U.S., and AIPLA believes the goal of any legislative effort should be to find the right balance of all interests. It should protect the innovators that drive virtually every U.S. industry, and encourage innovation by individual businesses, both large and small. The patent system should also facilitate the enforcement of

patent rights while making any corrections to stop the abusive behavior of bad actors who take unfair advantage of the litigation system.

AIPLA appreciates the Committee's careful attention to this important but very complex issue, and we look forward to working with you to find a solution that strikes the proper balance.